LOOKING AHEAD

¶2 Looking Ahead

Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill was introduced into Parliament on 6 April 2017 and had its first reading on 24 May 2017. The Bill lapsed on 22 August 2017 and was reinstated by the new government on 8 November 2017. It is due to be reported back from Select Committee on 29 March 2018. The Bill proposes amendments to the Income Tax Act 2007, Tax Administration Act 1994, KiwiSaver Act 2006, Student Loan Scheme Act 2011, Goods and Services Tax Act 1985, Child Support Act 1991, Accident Compensation Act 2001 and Income Tax Act 2004. The Bill proposes measures relating to the collection of employment and investment income information, reforms to the taxation of employee share schemes and numerous other policy and remedial changes to tax legislation. Some of the measures proposed in the Bill include the following:

Employment income information

The Bill proposes a number of changes to modernise New Zealand's tax administration system and to use business/payroll systems to reduce the compliance and administrative costs associated with the provision of PAYE information. These include:

- consolidation of the record-keeping requirements of employers — see ¶3-131
- the introduction of a new subpart 3C in the Tax Administration Act 1994 to provide for the payday provision of employment income information — see ¶3-022
- clarifying the circumstances in which the "no notification" deduction rate applies and restructuring the provisions relating to the use of tax codes — see ¶3-025, ¶3-030, ¶3-034 and ¶3-044
- amendments to retain the late filing and non-electronic filing penalties as monthly penalties — see ¶3-022, ¶14-040 and ¶14-045
- consequential changes to employer reporting of employee share scheme benefit information to ensure compliance with the new payday reporting obligations — see ¶3-469
- repeal of the subsidy for listed PAYE intermediaries — see ¶3-490.

Investment income information

The Bill also proposes several amendments relating to the provision of investment income information. The key changes include:

- obtaining more frequent and detailed information for interest, dividends and Māori authority distributions and requiring investment income information to be filed electronically — see ¶15-215, ¶24-335 and ¶26-457
- bringing forward the due date when portfolio investment entities (PIEs) are required to provide information to Inland Revenue — see ¶29-150

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- requiring an investor in a multi-rate PIE to notify the PIE of their IRD number within six weeks — see ¶29-145 and ¶29-150
- increasing the "non-declaration" rate from 33% to 45% for taxpayers that do not provide their IRD number to payers of interest income — see ¶15-020
- extending the non-electronic filing penalty to investment income information — see ¶14-045
- improving the administration of RWT exempt-status (certificates of exemption) — see ¶15-110 and ¶15-115
- removing some requirements to provide end-of-year withholding tax certificates — see ¶15-200, and
- making it easier to correct errors in the following tax year when the payee has not deducted enough withholding tax — see ¶15-180 and ¶26-455.

Employee share schemes

The Bill proposes new core rules for determining the amount and time of derivation of income and incurring of expenditure under an employee share scheme. The Bill also proposes a simplified set of rules for certain widely-offered employee share schemes (commonly referred to as "exempt schemes"). See ¶3-470.

Other changes

The Bill also proposes a number of other changes, including:

- amendments to the setting of a new due date for default assessments — see ¶14-060
- reducing the time before UOMI begins on GST refunds from 15 to 10 working days — see ¶14-200
- allowing employers to tax holiday pay or salary or wages paid in advance as if the lump sum was paid over the period to which it relates, instead of under the existing extra pay method — see ¶3-256
- clarifying the rate or threshold to apply to a PAYE income payment when there is a change in the rate or threshold is the rate applying on the date the payment is made — see ¶3-020, ¶8-055, ¶29-240 and ¶29-420
- introducing an electronic filing requirement for GST-registered persons over a taxable supplies threshold — see ¶2-019 and ¶14-045
- clarifying that the amount of a dividend includes any withholding tax paid or withheld in relation to that dividend — see ¶16-630
- amendments to the dividend rules so that certain transfers of shares received by New Zealand shareholders as a result of a company split (demerger) by a listed Australian company will not be treated as a dividend — see ¶16-732
- providing the Commissioner with the discretion to issue IRD numbers in cases where there is no New Zealand bank account — see ¶7-018
- changes to the petroleum mining regime — see ¶28-122, and
- introducing a general rule to distinguish between a trustee's personal or body corporate capacity and their separate trustee capacity — see ¶25-025.

Taxation (Neutralising Base Erosion and Profit Shifting) Bill

The Taxation (Neutralising Base Erosion and Profit Shifting) Bill was introduced into Parliament on 6 December 2017 and received its first reading on 12 December 2017. It is due to be reported back from Select Committee on 12 June 2018. The Bill proposes amendments to the Income Tax Act 2007 and the Tax Administration Act 1994. The Bill follows extensive work done by the Organisation for Economic Co-operation and Development (OECD) on the issue of base erosion and profit shifting (BEPS) strategies being used by multinationals and the release of several consultative documents by the government. The measures proposed in the Bill are intended to prevent multinationals from using these strategies to shift profits out of New Zealand, and include the following proposed changes:

- new rules requiring related-party loans between a non-resident lender and a New Zealand resident borrower to be priced using a restricted transfer pricing approach (interest limitation rules) — see ¶26-610
- amendments to the thin capitalisation rules to require a company's total assets to be determined net of a company's non-debt liabilities, reducing the ability for companies owned by a group of non-residents to use related-party debt, restricting when a company can use the net current value of an asset, introducing an anti-avoidance rule for when a taxpayer substantially repays a loan before the end of the year, and clarifying how the owner-linked debt rules apply when the borrower is a trust — see ¶26-620
- new rules to deal with hybrid mismatch arrangements that exploit differences between countries' tax rules to achieve an advantageous tax position — see ¶26-650
- introducing a permanent establishment anti-avoidance rule to deal with artificial arrangements aimed at avoiding having a taxable presence in New Zealand — see ¶26-300
- consequential amendments to the source rules in ss YD 4 and YD 5 to take account of the permanent establishment changes — see ¶5-144
- amendments to strengthen the transfer pricing rules so they align with the OECD's transfer pricing guidelines and Australia's transfer pricing rules — see ¶26-608
- deeming an item of income to have a New Zealand source under our domestic legislation if New Zealand has a right to tax that item of income under a DTA — see ¶26-400
- allowing Inland Revenue to request offshore information that is held by large multinational groups — see ¶1-590
- introducing a new civil penalty for members of large multinational groups who fail to comply with a request for information — see ¶14-055, and
- allowing Inland Revenue to collect tax owed by a member of a large multinational group from any wholly-owned local group member — see ¶26-410.

Tax Working Group established

A Tax Working Group has been established to consider the structure, fairness and balance of New Zealand's tax system. The Group will also look at how the tax system can promote the long-term sustainability and productivity of the economy. The Group will be chaired by Sir Michael Cullen. It is intended that the Group will issue an interim report to the Ministers of Finance and Revenue by September 2018, with a final report issued no later than February 2019. See ¶1-025.

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Draft public rulings released

The following draft public rulings were released by Inland Revenue in 2017 and have yet to be finalised:

- PUB00297, "Income tax — Australian source income earned by Australian limited partnership and foreign tax credits", "Income tax — distributions made by Australian limited partnership and foreign tax credits", "Income tax — distributions made by Australian unit trust to Australian limited partnership and foreign tax credits", "Income tax — franked dividend received by Australian limited partnership and foreign tax credits", and "Income tax — tax paid by an Australian limited partnership as a 'head company' and foreign tax credits", which are a reissue of BR Pub 14/01–BR Pub 14/05. See ¶23-182.

Draft interpretation statements released

The following draft interpretation statements were released by Inland Revenue in 2017 and have yet to be finalised:

- PUB00295, "Income tax: Donee organisations — meaning of wholly or mainly applying funds to specified purposes within New Zealand", which concludes that an organisation must apply 75% or more of its funds to specified purposes within New Zealand to be a donee organisation. See ¶11-055.
- PUB00261, "Taxation of trusts — income tax", which provides an updated summary of the tax law as it applies to trusts. See ¶25-025.

Draft questions we've been asked released

The following draft Questions We've Been Asked were released by Inland Revenue in 2017 and have yet to be finalised:

- PUB00277aa, "Goods and services tax — GST treatment of fees payable to manager of a unit trust" , which considers whether services supplied by the manager of a unit trust under a contract with investors in the unit trust are exempt supplies. See ¶32-044.
- PUB00277bb, "Goods and services tax — GST treatment of outsourced services in relation to a unit trust", which considers whether administrative services (registry or accounting functions) or investment management services acquired by the manager of a unit trust to satisfy its obligations under the contract with investors are exempt supplies. See ¶32-044.
- PUB00286, "Can a fit-out of an existing building be 'improvements' for the purposes of s CB 11?", which concludes fit-out can be improvements. See ¶7-095.
- PUB00306, "Can a registered person issue a combined tax invoice and credit note?", which concludes only when they are for different supplies. See ¶32-190.
- PUB00318, "Binding Rulings — Effect of the Commissioner changing her mind in relation to the application of s BG 1", which considers whether the Commissioner can take a different view on the application of s BG 1 to an ongoing arrangement when a binding ruling that applies in relation to s BG 1 expires and concludes that she can. See ¶33-137.
- PUB00319, "When is an arrangement considered to be 'materially different' from the arrangement identified in a private or product ruling?", which concludes it is when the difference is capable of affecting the tax outcome. See ¶1-525.

- PUB00296, "When is income from a cash dividend paid on ordinary shares derived?", which concludes it is at the earlier of when it is paid or credited for the benefit of a shareholder and discusses timing differences between cash-basis and accrual-basis taxpayers. See ¶5-057.

Draft standard practice statements released

The following draft standard practice statements were released by Inland Revenue in 2017 and have yet to be finalised:

- ED0198, "Loss offset elections between group companies", which sets out certain practices the Commissioner will accept for offsetting losses between group companies. It will replace SPS 05/12. See ¶18-060.
- ED0199, "Elections to change a balance date", which sets out Inland Revenue's practice for considering applications for the Commissioner's consent to change a balance date for income tax purposes. It will replace SPS 08/04. See ¶2-055.

Recent consultation

The following issues papers and discussion documents released for consultation during 2017 outline proposals expected to be progressed in the coming year:

Black hole and feasibility expenditure

The Government discussion document, "Black hole and feasibility expenditure" was released on 25 May 2017. The discussion document discusses and seeks submissions on the Government's proposals for a new treatment of feasibility expenditure and other expenditure that results in an economic cost to a taxpayer, but for which neither immediate deductions nor depreciation deductions are available ("black hole" expenditure). See ¶10-440.

Taxation of employee share schemes: start-up companies

On 30 May 2017, the issues paper, "Taxation of employee share schemes: start-up companies", was released. The issues paper sets out proposed deferral rules aimed specifically at start-up companies with employee share schemes (ESS). The issues paper expands on a proposal raised in a May 2016 officials' issues paper, examining in closer detail a proposal for the taxation of ESS offered by start-up companies. The proposal would provide the ability to defer the taxation point for employees of start-up companies (with a corresponding deferral of the company's deduction).

Making tax simpler — better administration of individuals' income tax

The discussion document, "Making tax simpler — Better administration of individuals' income tax", was released on 19 June 2017. The Government is seeking feedback on proposals that would reduce the number of people who have to provide information to Inland Revenue, and give many people their tax refunds or tax bills automatically. See ¶1-025.

Making tax simpler — better administration of social policy

In July 2017, the Government released the consultation document "Making tax simpler — Better administration of social policy", which explores some proposals for improving the way social policy entitlements and obligations are administered by Inland Revenue. See ¶1-025.

PAYE error correction and adjustment

On 9 August 2017, the tax officials' issues paper, "PAYE error correction and adjustment" was released. The paper presents options on how PAYE errors may be corrected and adjustments made, in the context of more frequent filing of PAYE information (as proposed in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill). See ¶3-022.

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make binding rulings, assessments, determinations relating to financial arrangements and determinations for other purposes. The Tax Administration Act also authorises the Governor-General to issue directions to the Commissioner of Inland Revenue, but only in relation to the administration of the Inland Revenue Acts. These directions are made by Order in Council. The Governor-General is not authorised to give directions concerning the tax affairs of individual taxpayers or the interpretation of tax law.

The Tax Administration Act and the Income Tax Act require taxpayers to self-assess their income tax liabilities. However, it is the Commissioner who administers the tax system and issues assessments on default or after investigations.

Regulations for various purposes under the Income Tax Act may be made by the Governor-General. Any regulations and orders made under earlier Acts continue to have effect as though they were made under the Income Tax Act, unless they are specifically revoked. Regulations have been made to deal with matters such as general administration and machinery provisions (eg the Taxation Review Authorities Regulations 1998, which outline the disputes resolution procedures). Numerous orders have been made under specific sections of the Act relating to very specialised matters.

¶1-020 The tax statutes

A brief history of taxation

The origins of income tax can be traced to the Napoleonic Wars. To finance the conduct of the wars, a duty known as income tax was imposed in the United Kingdom, as a temporary measure, from 1799 to 1802 and 1803 to 1816. It was reintroduced as a temporary measure in 1842, but this time the duty was never removed. Income tax was first imposed in New Zealand by the Land and Income Assessment Act 1891. That Act, with subsequent amendments, was consolidated in 1900. Further consolidating Acts were passed in 1908, 1916, 1923 and 1954. Various other types of tax were imposed by those Acts. The importance of income tax increased, however, and the proportion of revenue collected by that tax rose, particularly compared with that from land tax, until it was the dominant source of Government revenue. In 1976 Parliament split the Land and Income Tax Act 1954 into two Acts. These were the Income Tax Act 1976 and the Land Tax Act 1976 (the latter being abolished from 31 March 1992 by the Land Tax Abolition Act 1990). In December 1994 Parliament enacted the Income Tax Act 1994, the Tax Administration Act 1994 and the Taxation Review Authorities Act 1994, marking the first phase in a four-step process to rewrite the Income Tax Act 1976. In July 1996 the Taxation (Core Provisions) Act 1996 rewrote Pts A and B of the Income Tax Act 1994. In May 2004 the Income Tax Act 2004 received Royal assent. Briefly, this Act rewrote Pts A–E and Y of the Income Tax Act 1994. In November 2007, the Income Tax Act 2007 was enacted, containing the rest of the rewritten Parts and Schedules and re-enacting the Parts enacted under the 2004 Act. It applies from the 2008/09 income year.

The significance of taxation

Income tax is important for two reasons. First, it is the Government's principal source of revenue. In the "Annual Report 2017" document produced by Inland Revenue, published October 2017, the breakdown of revenue collected in the 2016/17 year by the three key tax types is shown as:

- income tax — 72% of revenue
- GST — 26.7% of revenue, and
- other indirect taxes, including excise taxes on tobacco, alcohol and petrol — 1.3% of revenue.

This revenue is applied to finance many of the benefits offered by New Zealand's welfare system. Secondly, it is a measure that influences most people's standard of living. Most adults pay income tax but any who did not do so would be financially better off. Many taxpayers see income tax as an appropriation of their earnings. Many businesses, particularly the large-scale ones, see income tax as a business cost that must be kept to a minimum. Consequently, taxpayers are usually conscious of the possible tax implications when they come to arrange their financial affairs, and this outlook on the part of taxpayers accounts for many features of the income tax system. It has required the creation of a large bureaucratic organisation to administer and enforce the system, with the administrators being given wide powers to inquire into people's financial affairs. It has also led to the pattern of constant amendment required not only to plug gaps but also to expand the tax base.

¶1-025 Tax policy work programme

In a speech on 13 March 2015 to the International Fiscal Association conference in Queenstown, the then Revenue Minister, the Hon Todd McClay, announced the Government's tax policy work programme for the next 18 months. The programme was updated in November 2016, as announced by the then Revenue Minister, the Hon Michael Woodhouse, in his opening address to the Chartered Accountants of Australia and New Zealand annual conference, and was intended to run through to the end of 2017. The programme was further updated in August 2017 with new projects from Inland Revenue's 2017 regulatory stewardship strategy. (See below for a discussion of the new Labour-led Government's tax priorities for the first 100 days of its term.)

The tax policy work programme aims to support the Government's priorities for growth and productivity, and delivering better public services. There are three main areas of focus for the tax policy work programme:

- making further improvements to the tax and social policy rules within the Government's broad-base, low-rate tax framework — ensuring that the tax system is well maintained, kept up to date and continually improved
- continuation of the Government's reform of our international tax rules and addressing base erosion and profit shifting — so New Zealand is an attractive place to do business and invest in while strengthening our tax rules to ensure that overseas companies pay their fair share of tax in New Zealand, and
- sharpen the focus on tax policy development work to support Inland Revenue's business transformation programme and the Government's goal of better public services for New Zealanders.

Details of the current tax policy work programme are as follows:

BUSINESS TRANSFORMATION AND BETTER PUBLIC SERVICES	
Business transformation	
Better administration of GST and PAYE	Policy options to reduce compliance and administrative costs consistent with longer term business transformation thinking.
Review of the Tax Administration Act 1994	Developing a framework for tax administration with an emphasis on the key roles of the Commissioner, taxpayers and tax agents, as well as the rules around information collection and tax secrecy which underpin their interactions.
Individual taxation	Improving the tax system for individuals, including comprehensive pre-population of income information, collection of information, more efficient debt collection processes and the degree of interaction with the tax system.

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Review of donee status applications	Dealing with applications by organisations for donee status under schedule 32.
Treaty of Waitangi settlements	Tax implications of Treaty settlements are addressed as required.
Feasibility and black hole expenditure (new)	Reviewing the rules on deductions for the costs related to undertaking feasibility studies and other possible black hole expenditures.
GST on imported low-value goods (new)	Working with New Zealand Customs Service to support the development of a regime to collect GST on low-value imported goods.
Employee share schemes — deferral regime for start-up companies (new)	Design of a deferral regime, whereby start-up companies may defer the payment of tax on employee share schemes to a future point in time when the valuation and liquidity problems are not as pronounced.
Social policy	
Financial Assistance for Live Organ Donors Bill 2015	Inland Revenue was consulted by the Ministry of Health on aspects that affect the Tax Acts, for example: child support, Working for Families, student loans, KiwiSaver, information sharing, and whether income replacement for donors proposed under the Bill should be treated as income for tax purposes.
Encouraging student loan repayments and addressing debt of overseas-based borrowers in the PEN group	Overseas-based student loan borrowers known as the "Penalty (PEN) Group" have overdue amounts growing faster than the rate at which borrowers in this group are becoming compliant. This is due to the compounding effect of late payment penalties (under the 1992 Act) and late payment interest. Ministers are interested in any further measures that could be developed to address the overdue debt of this group and the wider student loan borrower population.
Student loans — interest exemption	Budget 2016 announced the International Connections for New Zealander's package, which extends student loan interest write-offs to borrowers studying overseas who are recipients of Government funded scholarships.
KiwiSaver (new)	A range of reforms reflecting recently announced changes to New Zealand Superannuation and the Retirement Commissioner's recent recommendations.

An indicative timetable for consultation on matters included in the tax policy work programme was also released. Items currently remaining on the timetable are as follows:

ENHANCEMENTS TO TAX POLICY WITHIN BROAD-BASE, LOW-RATE TAX SETTINGS	
Financial arrangement issues	March–April 2017
Trust beneficiaries as settlors (limited consultation)	April–May 2017
Deductibility of holding costs for revenue account property	May–July 2017
Income protection insurance	July–September 2017

▶ *Note:* New Government's 100-day priorities for the tax system

Following the change in Government in late 2017, the new Revenue Minister, the Hon Stuart Nash, outlined the Government's 100 day priorities for the tax system in a speech to the Chartered Accountants Australia and New Zealand Annual Tax Conference 2017 on 16 November 2017 as follows:

- repeal the previous government's tax cuts and redirect that to families in need and to what is considered more targeted assistance
- legislate to pass the Families Package, including the Winter Energy Payment, Best Start and increases to Paid Parental Leave
- establish a Tax Working Group, led by the Ministers of Finance and Revenue.

Tax Working Group

On 23 November 2017, Sir Michael Cullen was announced as the Chair of the Tax Working Group and the terms of reference of the group were released. The members appointed to the group were announced on 20 December 2017. The Working Group is to report to the Government by February 2019 on:

- whether the tax system operates fairly in relation to taxpayers, income, assets and wealth
- whether the tax system promotes the right balance between supporting the productive economy and the speculative economy
- whether there are changes to the tax system that would make it more fair, balanced and efficient, and
- whether there are other changes that would support the integrity of the income tax system, having regard to the interaction of the systems for taxing companies, trusts and individuals.

The Working Group is to consider in particular:

- the economic environment that will apply over the next 5–10 years, taking into account demographic change, and the impact of changes in technology and employment practices, and how these are driving different business models
- whether a system of taxing capital gains or land (not applying to the family home or the land under it), or other housing tax measures, would improve the tax system
- whether a progressive company tax (with a lower rate for small companies) would improve the tax system and the business environment, and
- what role the taxation system can play in delivering positive environmental and ecological outcomes, especially over the longer term.

The following are outside the scope of the Working Group's review:

- increasing any income tax rate or the rate of GST
- inheritance tax
- any other changes that would apply to the taxation of the family home or the land under it, and
- the adequacy of the personal tax system and its interaction with the transfer system (this will be considered as part of a separate review of Working for Families).

The Working Group intends to issue an interim report to the Ministers of Finance and Revenue no later than September 2018, with the final report issued no later than February 2019. Further information is available through the Tax Working Group's website — taxworkinggroup.govt.nz.

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Families package

On 4 December 2017, the planned increases to paid parental leave were enacted as part of the Parental Leave and Employment Protection Amendment Act 2017 (see ¶12-145).

On 20 December 2017, the Families Package (Income Tax and Benefits) Act 2017 was enacted. The new Act repealed the previous government's tax cuts and replaced them with increased changes to Working for Families tax credits (see ¶12-135, ¶12-150 and ¶12-160), the Best Start payment (see ¶12-165), the Winter Energy payment and the reinstatement of the independent earner tax credit (see ¶11-080).

Consultation on simplifying and modernising tax administration

On 31 March 2015, Revenue Minister Hon Todd McClay officially launched the Government's public consultation on options for simplifying and modernising New Zealand's tax administration. Two consultation documents were released: "Making tax simpler — A government green paper on tax administration", which outlined the overall direction of the tax administration modernisation programme, and "Making tax simpler — Better digital services", which outlined proposals for greater use of electronic and online processes.

On 11 November 2015, the Revenue Minister released two further consultation documents. The first, "Making tax simpler — Towards a new Tax Administration Act", looked at the current tax administration system in the Tax Administration Act and considered how it might be simplified, and also looks at the role of the Commissioner of Inland Revenue, information collection, tax secrecy, the role of taxpayers and tax agents, and future issues. The second document, "Making tax simpler — Better administration of PAYE and GST", considered proposals to design digital services for PAYE and GST that would, as much as possible, integrate tax requirements into the tasks that people would already be doing as part of running their business or organisation. Also released was a summary of public feedback received from the first round of public consultation — "Making tax simpler — Green Paper and Better digital services — Summary of Feedback".

On 13 April 2016, an issues paper, "Making tax simpler — Better business tax", was released. The issues paper contained proposals to simplify tax for businesses, including reforming the provisional tax regime.

A further consultation document, "Making Tax Simpler — Investment income information", was released on 7 July 2016. The discussion document set out proposed changes to the way that investment income information is provided to Inland Revenue by organisations such as banks, companies that pay dividends, Maori authorities, and portfolio investment entities. The main proposal requires payers of investment income to provide taxpayer specific withholding information to Inland Revenue on a monthly basis. A summary of the feedback received in submissions on this document was released in March 2017.

Legislation to implement many of these proposals was introduced in April 2017 as part of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill.

The seventh discussion document in the series, "Making Tax Simpler — Proposals for modernising the Tax Administration Act", was released in December 2016. This document firmed up the government's proposals from the November 2015 document, "Towards a new Tax Administration Act", following submissions on that document. It detailed the Government's legislative proposals for a wider application of the Commissioner's care and management function, and more relevant information-sharing and confidentiality rules.

The eighth discussion document in the series, "Making Tax Simpler — Better administration of individuals' income tax", was released in June 2017. The document focuses on proposals that would make individuals' income tax obligations simpler and more certain. The intention is to improve the way Inland Revenue uses the information it collects to help individuals get their tax obligations right both during and at the end of the tax year.

In July 2017, the ninth discussion document in the series was released, "Making Tax Simpler — Better administration of social policy". The document focuses on proposals for Working for Families, child support and student loans to ensure customers receive their correct entitlements or fully meet their obligations by making rules and processes easier to understand, to provide greater certainty around payments, and to make payments more accurate and improve the access to and timing of payments.

LEGISLATIVE FRAMEWORK

¶1-030 Structure of the Tax Acts

The Income Tax Act 2007 is organised in a structure of Parts and Subparts and follows the structure, drafting style and features of the Interpretation Act 1999. The following is a brief analysis of the Act:

- Part A sets out the Act's purpose and principles for interpretation.
- Part B contains the core provisions.
- Part C defines income.
- Part D defines the extent to which deductions are allowed, and sets out how specific rules on deductions interact with the general rules on deductions.
- Part E deals with the timing and quantification of income recognition and deductions.
- Part F recharacterises certain transactions.
- Part G contains the provisions relating to tax avoidance and non-market transactions.
- Part H provides for the tax treatment of certain specific entities.
- Part I contains provisions relating to tax losses.
- Part L sets out the entitlement to tax credits.
- Part M deals with the tax credits which are paid in cash.
- Part O contains the rules relating to memorandum accounts.
- Part R contains the general collection rules relating to the payment and withholding of tax.
- Part Y contains the definitions used in the Act and related matters.
- Part Z contains the amendments, repeals, savings and transitional provisions.

Structure of the Tax Administration Act

The Tax Administration Act 1994 contains most of the provisions relating to administrative and procedural aspects of income tax law. Formerly, these provisions were found in the Income Tax Act 1976 and the Inland Revenue Department Act 1974 (except those provisions relating to the Taxation Review Authority). Among other things, the Tax Administration Act imposes reporting and disclosure obligations on taxpayers. It also sets out the offences and penalties imposed on taxpayers for breach of their tax obligations together with the procedure for disputes resolution. Its structure may be analysed as follows:

- Part 1 — purpose and construction
- Part 2 — the roles of the Commissioner and Inland Revenue
- Part 2A — taxpayer's principal tax obligations
- Part 2B — PAYE intermediaries, provisional tax and resident passive income
- Part 3 — information, record-keeping and returns

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- Part 3A — income statements
- Part 3B — credits of tax
- Part 4 — secrecy
- Part 4A — disputes procedures
- Part 5 — determinations
- Part 5A — binding rulings
- Part 6 — assessments
- Part 7 — interest
- Part 8 — objections (relating to pre-1 October 1996 assessments)
- Part 8A — challenges (to notices of disputable decisions issued after 1 October 1996)
- Part 9 — penalties
- Part 10 — recoveries
- Part 10A — tax recovery agreements
- Part 10B — transfers of excess tax
- Part 11 — remission, relief, and refunds
- Part 11B — foreign account information-sharing agreements
- Part 12 — offences and penalties (repealed)
- Part 13 — miscellaneous, and
- Part 14 — transitional provisions and savings.

Taxation Review Authorities Act and Regulations

The law relating to Taxation Review Authorities, whose function is to decide on challenges to assessments of taxes and to other decisions or determinations, is found in the Taxation Review Authorities Act 1994 and the Taxation Review Authorities Regulations 1998.

¶1-040 Fixing the tax rates [TAA s 92A]

Income tax rates are fixed annually. This is because of the constitutional convention that income tax should be imposed only on a yearly basis and that the Crown's ability to collect revenue be subject to Parliament's consent. The rates are fixed by an Act referred to as the annual taxing Act. In practice, such an Act simply adopts the tax rates set out in sch 1 to the Income Tax Act 2007. To remove the necessity of passing a separate Act each year for the sole purpose of fixing the tax rates, the rates may be set as part of a wider amending Act.

The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 set the rates for the 2015/16 year. The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 set the rates for the 2016/17 year. The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, introduced into Parliament on 6 April 2017, sets the rates for the 2017/18 year.

If an annual taxing Act is not passed, there is a savings provision in s 92A of the Tax Administration Act 1994 which enables the assessment for a tax year at the basic rates set out in sch 1 to the Income Tax Act. Such an assessment is not invalidated by the fact that it may have been made before the passing of an Act setting rates for the year concerned. Even without that provision, revenue would continue to flow to the Crown if Parliament did not sit or did not pass an annual taxing Act. This is because the PAYE tax deduction system under the principal Act would continue to operate.

¶1-050 The core provisions of the Income Tax Act [IT07 Pt B]

The core provisions set out the key principles on which the rest of the income tax legislation is based. The provisions, found in Pt B of the Income Tax Act 2007, are intended to:

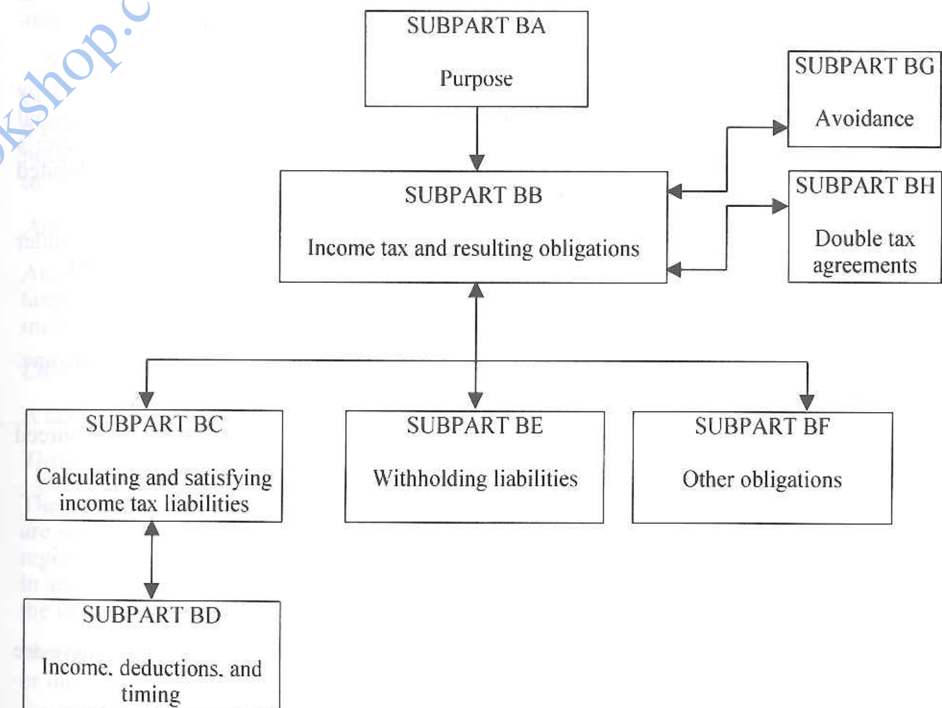
- impose tax liability
- specify the steps that a taxpayer must follow to arrive at the taxpayer's tax liability
- provide a basis for applying the other Parts of the Income Tax Act, and
- set up the scheme of the Income Tax Act and the main links between its Parts.

Terminology

The Act follows a global or gross approach to the calculation of taxable income. Some of the key terms used in the core provisions include income, exempt income, excluded income, assessable income, deduction and allocation (or attribution). These components make up the taxpayer's annual gross income and annual total deduction for the tax year.

¶1-055 Structure of the core provisions [IT07 Pt B]

The core provisions are structured as follows:



Subpart BB — income tax and resulting obligations

Section BB 1 is the central charging provision. Income tax is imposed on taxable income at the rates set out in sch 1 to the Act. "Taxable income" means taxable income for a tax year calculated under s BC 5. See s YA 1 "taxable income".

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Section BB 2 sets out a person's main tax obligations. A person's income tax liability must be calculated and satisfied in accordance with subpart BC (unless that person is a portfolio investment entity (PIE), in which case subpart HM must be applied (see ¶29-100)). An obligation to pay provisional tax and to satisfy any withholding liabilities as well as other obligations are also imposed.

Section BB 3 provides that the Commissioner may counteract a tax advantage from a tax avoidance arrangement.

Subpart BC — calculating and satisfying of income tax liabilities

Section BC 1 sets out the process to be followed by different types of taxpayers in order for them to satisfy their tax liabilities. The section provides that:

- the tax liability of a non-filing taxpayer is the total tax withheld from the taxpayer's annual gross income
- the tax liability of a filing taxpayer is calculated under ss BC 2–BC 6, and
- the calculation of the tax liability of a filing taxpayer with schedular income is modified by s BC 7 (briefly, filing taxpayers with schedular income are life insurers, non-resident mining operators, multi-rate PIEs, group investment funds, non-resident general insurers, non-resident shippers, non-resident film renters and taxpayers with non-resident passive income subject to final non-resident withholding tax).

Once a taxpayer's tax liability has been calculated, that liability may be satisfied first by offsetting any available tax credits and then through the payment of terminal tax. Special ordering rules determine the way in which excess credits may be set off against a taxpayer's liability. This is to allow maximum credits for foreign taxes and other amounts that are limited to the level of domestic income tax liability. See ¶2-110.

If credits remain after set-off in the stipulated order, the Commissioner may be required, under s LA 5, to make a refund of the remaining credits by applying ss LA 6–LA 8. See ¶1-400.

Subpart BD — income, deductions, and timing

Subpart BD defines the central elements that determine a taxpayer's annual gross income. Briefly, the central elements are:

- income (including exempt income, excluded income, non-residents' foreign-sourced income and assessable income)
- deductions, and
- timing (the allocation of income and deductions to particular income years).

Income

Amounts received that are income are listed in Pt C of the Income Tax Act 2007. There are five general income categories:

- income from business or trade-like activities — subpart CB
- income from holding property (divided into non-equity — subpart CC, and equity — subpart CD)
- income from employment — subpart CE

- pensions and government entitlements (such as benefits, compensation and government grants) — subpart CF, and
- recoveries (such as depreciation and bad debts recovered, remitted amounts, expenditure or loss recovered) — subpart CG.

These are followed by subparts dealing with adjustments (eg the matching rules, change in accounting practice) and specific income types (PIEs, life insurance, superannuation funds, controlled foreign companies, foreign investment funds and petroleum and mineral miners) and entity-specific rules for certain taxpayers (eg group companies and Crown research institutes).

Assessable income, exempt income, excluded income and non-residents' foreign-sourced income

Assessable income is generally income that is derived by a taxpayer and that is subject to income tax in the tax year or a later tax year. The following types of income are specifically excluded from assessable income:

- "exempt income" under subpart CW or CZ
- "excluded income" under subpart CX or CZ, provided the amount is not the taxpayer's non-residents' foreign-sourced income (see below), and
- "non-residents' foreign-sourced income".

In broad terms, non-residents' foreign-sourced income is made up of amounts derived by a non-resident, which are not treated as being derived from New Zealand, and the amounts are not income of a trustee under s HC 25 (see ¶25-035). This exclusion is intended to give effect to the basic source and residence rules set out in ¶1-110 and ¶1-120.

Annual gross income

Annual gross income is the amount of assessable income allocated to the income year. A taxpayer's tax liability for the income year is calculated on the taxpayer's annual gross income.

Deductions

A taxpayer is allowed a deduction for an amount under Pt D; see further at ¶1-220–¶1-221.

Timing rules

The rules for allocating amounts of income and deductions to their respective income years are set out in ss BD 3 and BD 4. The sections are intended to clarify whether a specific timing regime applies or not. If a specific timing regime applies, income or expenditure is allocated in accordance with that regime. For income, the relevant Parts are C and E–I. For deductions, the relevant Parts are D–I.

If no such regime applies, income or expenditure is allocated to the year in which it is derived or incurred.

Subpart BE — withholding liabilities

The various withholding liabilities imposed under the Act are set out in s BE 1. These include amounts withheld from PAYE payments, amounts withheld from payments of resident passive income, amounts withheld from payments of non-resident passive income, fringe benefit tax, employer superannuation contribution tax and retirement scheme contribution tax.

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Subpart BF — other obligations

A number of additional obligations are imposed under the Act, such as the requirement to pay qualifying company election tax, income tax on taxable distributions from non-complying trusts, further income tax and residential land withholding tax. See s BF 1.

Subpart BG — avoidance

The prohibition against tax avoidance is split into two essential components — the voiding of tax avoidance arrangements and the Commissioner's ability to counteract such arrangements. See s BG 1.

Subpart BH — double tax agreements

The overriding effect of double tax agreements is set out in s BH 1, which stipulates the purposes for which a double tax agreement may be entered into. Of particular note is s BH 1(6). This subsection provides that any reference to profits in a double tax agreement (DTA) shall be read as reference to net income, calculated as if the activity or business in question were the only activity or business. With effect from 30 March 2017, it has also been made explicit that the general anti-avoidance rule in s BG 1 can apply in the context of a DTA.

¶1-060 Obligations under the Tax Administration Act 1994 [TAA ss 15B, 33, 37, 92]

Additional compliance obligations are imposed on taxpayers under the Tax Administration Act 1994. In particular:

- All those who are liable for tax are required by s 33 to furnish a return of income for the preceding tax year. See ¶1-360, ¶1-380 and ¶2-010. A taxpayer is also required to make an assessment of the taxpayer's taxable income, income tax liability, net loss, terminal tax or refund due for the tax year. The taxpayer's return must contain notice of this assessment.
- The dates by which annual returns must be furnished are set out in s 37.
- A taxpayer must deduct or withhold the correct amounts of tax when required by law to do so.
- A taxpayer must disclose to the Commissioner all information that the law requires disclosure of.
- A taxpayer must cooperate with the Commissioner in the exercise of their powers under the tax laws.
- If the taxpayer is a natural person, they must correctly respond to any income statement issued to them.

A taxpayer's tax obligations must be carried out to a reasonable standard of care. Failure to reach that standard will result in severe penalties on any tax shortfall. See further at ¶14-100 et seq.

INTERPRETATION OF TAX LEGISLATION

¶1-065 Interpreting tax legislation [IT07 s AA 2; INT s 5]

The approach taken by the courts when interpreting revenue statutes has changed over time. Initially, there was a strictly literal approach, based on the precise words of the particular section and nothing more. This has been succeeded by a more expansive view incorporating a more purposive approach whereby a particular provision is viewed by the court in the context of the overall structure and objectives of the legislation.

The leading cases on interpretation of tax statutes are *Mangin v C of IR* 70 ATC 6001; [1971] NZLR 591 and *C of IR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175.

Example 1:

In a Privy Council case involving s 108 of the 1954 Act (the precursor to s 99 of the Income Tax Act 1976 and s BG 1 of the Income Tax Act 2007), Lord Donovan described the following rules for the interpretation of tax legislation:

> First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As *Turner* J says in his (albeit dissenting) judgment in *Marx v Commissioner of Inland Revenue* [1970] NZLR [182] at p 208, moral precepts are not applicable to the interpretation of revenue statutes. Secondly, "one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used" (Per *Rowlatt* J in *Cape Brandy Syndicate v Inland Revenue Commissioners* [1921] 1 KB 64, 71, approved by Viscount *Simons* LC in *R v Canadian Eagle Oil Co Ltd* [1946] AC 119; [1945] 2 All ER 499). Thirdly, the object of the construction of a statute being to ascertain the will of the Legislature it may be presumed that neither injustice nor absurdity was intended. If, therefore, a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted. Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction.

See *Mangin v C of IR* 70 ATC 6001 at 6,003; [1971] NZLR 591 at 594.

Example 2:

In a case concerning the meaning of the phrase "a group of companies" as defined in s 191(3) of the Income Tax Act 1976 (now s IC 6), the Court of Appeal held that the arguments advanced by the Commissioner did not provide a sufficient basis for departing from the plain meaning of the words. After reviewing the principles of statutory interpretation, the Court of Appeal found it fundamental to all statutory interpretation that words be given their ordinary meaning. Where words can have more than one meaning and the object of the legislation is clear, then the words must be given "such fair, large and liberal construction" as will best ensure the attainment of the object of the Act. Where the words are unclear, or are reasonably capable of more than one meaning, the court prefers an interpretation that does not lead to injustice or absurdity, and one that accords with the evident purpose. 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. See *C of IR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175.

The Interpretation Act 1999 confirms the modern purposive approach to statutory interpretation adopted by the courts. Section 5 states that:

- the meaning of an enactment must be ascertained from its text and in light of its purpose
- the matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment, and
- examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

In addition, s AA 2 of the Income Tax Act 2007 provides guidance on the use of the diagrams, flowcharts, readers' notes and list of defined terms when interpreting the provisions of the Income Tax Act.

The Supreme Court of New Zealand confirmed the purposive approach to interpretation of tax legislation in *Ben Nevis Forestry Ventures Ltd v C of IR*; *Accent Management Ltd v C of IR* (2009) 24 NZTC 23,188. In the same case the Court also introduced the idea of interpreting a tax provision in light of Parliamentary contemplation and the policy behind the provision when it was enacted. It is up to the courts to apply a principled approach which gives effect to the statutory language when confronted with conflicting provisions. See [102] and [103] of the judgment.

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The Supreme Court in *Penny and Hooper v C of IR* (2011) NZTC ¶20-073 has firmly entrenched the "parliamentary contemplation" test in New Zealand tax law and the judiciary's approach to tax avoidance analysis. See [47] of the judgment.

See ¶33-105 for a discussion of interpretation of tax legislation in regard to tax avoidance.

ACC and tax legislation compared

The High Court has held that accident compensation legislation should be interpreted differently from tax statutes. After considering analogies with cases decided under comparable definitions in income tax legislation, the Court found that tax statutes are concerned with taking money from citizens, whereas the accident compensation legislation was concerned with compensating people. See *Accident Rehabilitation and Compensation Insurance Corporation v Lewis* (1994) 16 NZTC 11,234.

¶1-070 Case law [IT07 ss BD 3(3), BD 4(3)]

The interpretation of any Act of Parliament often gives rise to a dispute. A dispute regarding the operation of tax law is resolved through the statutory challenge procedures set out in the Tax Administration Act 1994. See Chapter 4. A large number of tax cases have been decided over the years. Those cases give a good indication of how a section applies in relation to a particular problem. For example, there are many cases on the general permission and general limitations sections found in ss DA 1–DA 3 of the Income Tax Act 2007 and the general anti-avoidance sections. Even though it is hoped that the interpretation of tax legislation has been simplified through the rewriting of the Income Tax Act, case law remains an essential tool to its interpretation. In fact, ss BD 3(3) and BD 4(3) specifically require persons to have regard to case law when determining the time income is derived or when expenditure or loss is incurred.

PERSONS LIABLE FOR INCOME TAX

¶1-080 Tax year [IT07 s YA 1 ("income year", "tax year")]

Income tax is imposed on the taxable income of a taxpayer for each tax year. A tax year runs from 1 April to the following 31 March. The tax years are numbered according to the years in which that 31 March falls. For example, the 2013/14 tax year is the tax year ending on 31 March 2014. Although the tax year is from 1 April to 31 March, some taxpayers who have an accounting balance date other than 31 March may treat the year ending on their balance date as their tax year for the purpose of determining their business income. This period is referred to as an income year: see ¶2-055.

¶1-090 Imposition of income tax [IT07 s BB 1]

Section BB 1 is the charging provision that imposes income tax on a person's taxable income. This taxable income for any tax year is determined by offsetting any available net losses against the person's net income. A person's net income is determined by reference to annual gross income less annual total deduction. In other words, individual sources of income can only be identified at the gross level of the tax calculation. See ¶2-105. The way in which s BB 1 applies may be illustrated by reference to a person who derived income from two sources: salary and New Zealand superannuation.

Example:

A person took the view that tax at the appropriate rate should be imposed on each item of income separately. This method produced a lower tax burden than if the tax payable had been calculated on the sum total of all items of income. The Taxation Review Authority rejected the person's method. Income tax is imposed on the year's income as an accumulated sum and not on each item of income separately. See *Case* D45 (1980) 4 NZTC 60,763.

See also *Tax Information Bulletin* ¶89-115 Vol 8, No 9, November 1996 at 27. However, certain categories of income, called schedular income, are subject to separate income tax calculations to ensure conformity with the gross/global concept underlying the legislation. See ¶2-105.

¶1-100 Who pays tax? [IT07 ss BB 2, YA 1 ("taxpayer"); INT s 30]

Every person is liable for income tax. A "person" is defined in the Interpretation Act 1999 to include a corporation sole, a body corporate, and an unincorporated body. The term "taxpayer" is used to mean a "person" who is, or may be, liable to perform or comply with an obligation imposed by the Income Tax Act 2007. Consequently, an individual (ie a natural person), a company (including any body corporate, not only those incorporated under the Companies Act 1993), a local or public authority and a trust (the actual liability being imposed on the trustee or trustees) are all taxpayers, liable to pay income tax on income derived by them. See *Guy v C of IR* (2003) 21 NZTC 18,269 and *Keighley v C of IR* (2004) 21 NZTC 18,461.

In *C of IR v Rupe* (2003) 21 NZTC 18,129, the District Court rejected the taxpayer's argument that he was not subject to New Zealand tax by virtue of the Treaty of Waitangi, the New Zealand Bill of Rights and his status as a Christian. This decision was affirmed by the High Court in *Rupe v C of IR* (2004) 21 NZTC 18,519.

¶1-110 The source doctrine [IT07 s YD 4]

A New Zealand resident (see ¶1-120) is liable for tax on all assessable income, whether derived from New Zealand or overseas. A non-resident is liable for New Zealand income tax only on income that is derived from New Zealand. The effect of these two qualifications is that only New Zealand residents and New Zealand-sourced income are liable for New Zealand income tax. For this reason, there is a carefully drafted and complex definition of "New Zealand" for tax purposes. The effect of the extended definition is to enlarge New Zealand's tax jurisdiction to cover many of the mineral exploration activities carried out off the New Zealand coast. See ¶5-139 and ¶5-144.

¶1-120 Residence — Individual [IT07 s YD 1]

In New Zealand, a person's liability to income tax depends on the person's residence status. The concept of residence for tax purposes is based mainly on the "permanent place of abode" test or on a quantitative test. Whether a taxpayer is a New Zealand resident is important for a number of tax-related matters, including:

- the international tax regime
- dividend imputation
- non-resident withholding tax
- foreign superannuation schemes
- double tax treaties
- tax rates, and
- foreign losses.

Individuals

The rules for determining an individual's residence for tax purposes are:

- *The permanent place of abode test:* a person is deemed to be a New Zealand resident if that person has a permanent place of abode here, whether or not that person also has a permanent place of abode overseas.

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- *The government service rule:* any person who is personally absent from New Zealand in the service of the New Zealand Government in any capacity is deemed to be resident in New Zealand during that absence.

  Example:

  A public servant continues to be liable to New Zealand income tax on any salary paid to him or her while posted overseas. Similarly, any interest or dividends received by a public servant is subject to tax in the usual manner.

  Although these people are liable to New Zealand tax as well as overseas tax, New Zealand gives credit for the overseas tax against the New Zealand tax. This does not apply if the relevant double tax agreement provides otherwise.

- *The 183-day test:* a person who is present in New Zealand for more than 183 days in aggregate in any 12-month period is deemed to be a resident from the first day of presence. (This will be the case even if the person concerned does not have a permanent place of abode in New Zealand.)
- *The 325-day test:* to cease New Zealand residency, a person must be absent from New Zealand for a period or periods exceeding in aggregate 325 days in any 12-month period. Non-residence commences from the first day of absence.

Note that from 30 June 2014, the retrospective application of the day count rules no longer applies for GST purposes. To be resident, a person must be present in New Zealand for more than 183 days in total, over a 12-month period. For GST purposes, the person will be treated as being tax resident from the first day after the 183-day period has been exceeded. Similarly, to be considered non-resident, a person must be outside New Zealand for more than 325 days in a 12-month period and, for GST purposes, the resident will be regarded as non-resident from the first day after the 325-day period has been exceeded.

The permanent place of abode test takes precedence over all the other provisions. Consequently, an individual whose permanent place of abode is in New Zealand remains a tax resident despite an absence from New Zealand of more than 325 days in a 12-month period. Equally, a person who is present in New Zealand for less than 183 days in a 12-month period is still resident if they have a permanent place of abode here.

▶ ***Note:*** The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, introduced into Parliament on 6 April 2017, proposes an amendment to the residence rules in s YD 1 to clarify that the natural person residency test will continue to apply to trustees following the introduction of a new provision relating to trustee capacity (see ¶25-010). The amendment is intended to apply from the date of enactment of the Bill.

Permanent place of abode

The concept of "permanent place of abode" for the purposes of s YD 1 is not defined in the Income Tax Act 2007 (the Act). The Act does, however, envisage the possibility of an individual having a permanent place of abode in more than one country, as s YD 1 requires the person to have a permanent place of abode in New Zealand, "even if they also have a permanent place of abode elsewhere".

Background to current position

In March 2014, the Commissioner released an interpretation statement, IS 14/01: "Tax Residence", explaining the residence rules (see *Tax Information Bulletin* ¶263-103 Vol 26, No 3, April 2014, p 6). IS 14/01 replaced earlier items on tax residence and applied from 1 April 2014. An accompanying statement set out the Commissioner's transitional operational position for situations where a taxpayer's residence status may have changed under IS 14/01 from that under previous statements by the Commissioner (see *Tax Information Bulletin* ¶263-102 Vol 26, No 3, April 2014, p 3).

However, the validity of the Commissioner's approach in IS 14/01 was cast into doubt following the Court of Appeal decision in *C of IR v Diamond* (2015) 27 NZTC ¶22-035, discussed below. As a consequence of the court's decision, the Commissioner released a further interpretation statement, IS 16/03, which updated and replaced IS 14/01. This statement is also discussed below.

Diamond decision

In *Case* 10/2013 (2013) 26 NZTC ¶2-009, the Taxation Review Authority (TRA) held that a taxpayer who had a rental property available to him was resident in New Zealand, even though he had never lived in the property. The decision was successfully appealed by the taxpayer in *Diamond v C of IR* (2014) 26 NZTC ¶21-093. The Commissioner then appealed to the Court of Appeal in *C of IR v Diamond* (2015) 27 NZTC ¶22-035. The Court of Appeal dismissed the Commissioner's appeal and upheld Clifford J's conclusion in the High Court that the mere fact that an individual has a dwelling available to him or her in New Zealand will not, by itself, mean the person has a permanent place of abode in New Zealand and is resident in New Zealand for tax purposes. The Court of Appeal's judgment restricts the application of former TRA case law on the residence of individuals and provides guidance on how the statutory residence test is to be applied.

The Court held:

- The relevant property (the Waikato Esplanade property) had never been Mr Diamond's home and it was never intended by him to be his home. He had never lived in that property and had only ever used it as an investment. A place in which Mr Diamond had never lived could not constitute a dwelling with which he had enduring and permanent ties.
- Although Mr Diamond had other ongoing personal connections with New Zealand, the only address advanced by the Commissioner as a permanent place of abode for Mr Diamond was the Waikato Esplanade property. These connections must be focused on the alleged permanent place of abode to have significance for s OE 1 (now s YD 1 of the Act). If that property did not carry any of the characteristics of a permanent place of abode, other connections would not alter that conclusion.
- The TRA's decision in *Case* Q55 was not authority for the Commissioner's proposition that the mere availability of a dwelling was sufficient to ground an assessment of factual connections to the property, even if it had not been used by the taxpayer as a dwelling previously.

Statutory interpretation

- The plain meaning of the words "permanent place of abode in New Zealand", coupled with the statutory context, demonstrated that the phrase meant something more than mere availability of a place to stay and implied actual usage of the property by the taxpayer for residential purposes.
- The consequence of having tax residence in New Zealand was that all the taxpayer's worldwide income was taxable in New Zealand, subject to any applicable double taxation arrangements. This could result in serious implications for the taxpayer and suggested that an interpretation beyond the ordinary and natural meaning of the term "permanent place of abode" ought not to be adopted unless plainly indicated by the statutory language or the context.

Correct interpretation of s OE 1 (now s YD 1)

- Whether an individual has a permanent place of abode is a question of fact.
- What is required is an overall assessment as to whether the taxpayer has a permanent place of abode in New Zealand. This will be highly contextual and will naturally turn on the circumstances of each case.

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There are exclusions from the financial arrangements rules for a financial arrangement where:

- all parties enter into the financial arrangement after 19 May 1999, under a binding contract entered into before 20 May 1999, or
- all its parties enter into the financial arrangement after 19 May 1999, under a binding contract entered into before 20 May 1999 and the financial arrangement is transferred under a relationship agreement after 19 May 1999.

If the financial arrangements rules do not apply, the financial arrangement continues to be subject to the old financial arrangements rules in ss EZ 33–EZ 52.

If the old financial arrangements rules apply, a person can elect to apply the financial arrangements rules by calculating a transitional adjustment under s EZ 51.

A person who is a party to a financial arrangement that is subject to the financial arrangements rules must calculate and allocate income or expenditure under the arrangement for an income year under those rules.

¶6-030 Exclusions from financial arrangements rules [IT07 ss EW 9, EW 11]

The financial arrangements rules do not apply to:

- the calculation of resident passive income
- the calculation of non-resident passive income (other than non-resident financial arrangement income or income derived under a notional loan under s FG 3), and
- use of money interest paid to or by the Commissioner.

Thus, the financial arrangements rules do not apply to some interest regimes, eg the calculation of resident passive income and non-resident passive income, ensuring interest under both regimes is ascertained on a cash basis rather than an accrual basis. Note that, with effect from 30 March 2017, there are exceptions for non-resident financial arrangement income and for a notional loan to the New Zealand branch of a foreign bank (see ¶26-440).

The financial arrangements rules generally apply to a non-resident only to the extent that the non-resident is a party to a financial arrangement for a business carried on by the non-resident through a fixed establishment in New Zealand. Effectively, this means that the rules apply to a non-resident who operates a branch business in New Zealand and who borrows or invests in financial arrangements for that business. Under the controlled foreign company regime outlined in ¶26-038, the financial arrangements rules would have application to the shareholder of a non-resident company.

The financial arrangements rules may also apply to a non-resident trustee of a non-complying trust. This extension of the financial arrangements rules envisages a trust with a settlor resident in New Zealand, which derives foreign-sourced income from investments made by the non-resident trustee. The extension ensures that the settlor's tax liability is calculated as if trustee income was subject to New Zealand tax rules.

¶6-045 Financial arrangements defined [IT07 ss ED 4, EW 3, EW 4, EW 7, EW 8, YA 1 ("arrangement")]

A financial arrangement is an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person:

- at a future time, or
- on the occurrence or non-occurrence of a future event, irrespective of whether the event occurs because notice is, or is not, given.

The concept of an arrangement is very broad. It encompasses an agreement, contract, plan, or understanding, whether it is enforceable or not, including all steps and transactions by which it is carried into effect. However, there are limits to the breadth of the concept. For example, not every stated prediction of probable future conduct is an arrangement in the form of an understanding. For there to be an understanding, there must be a statement of intent that is unequivocal and unqualified. See *GPO Holdings Ltd v C of IR* (1996) 17 NZTC 12,429.

Without limiting the generality of the definition, the concept of a financial arrangement includes:

- a debt, including a debt that arises by law
- a debt instrument
- the deferral of the payment of some or all of the consideration for an absolute assignment of some or all of a person's rights under another financial arrangement or under an excepted financial arrangement, and
- the deferral of the payment of some or all of the 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.

A financial arrangement also includes an excepted financial arrangement (see ¶6-065) that ceases to have that classification. An excepted financial arrangement can cease to be so classified where:

- the excepted financial arrangement is one of the following kinds that the person stops using for a private or domestic purpose:
  - a cash basis person who is a borrower under a foreign currency loan
  - an option to acquire or dispose of property that is not a financial arrangement
  - an agreement for the sale and purchase of property or services or a specified option that must be settled within 365 days and is for a value that is less than $1m for real property or $400,000 for other property or services
- the excepted financial arrangement is one of the following kind that the person elects to treat as a financial arrangement and the expenditure under the agreements satisfies the general permission and is not denied by a general limitation as a deduction of the person:
  - an agreement for the sale and purchase of property or services if prepayments under all such agreements do not exceed $50,000
  - a short-term agreement for the sale and purchase of property or services
  - a short-term option
  - travellers' cheques
  - a variable principal debt instrument if the value of all such instruments do not exceed $50,000
- the excepted financial arrangement is an interest-free loan in New Zealand currency, repayable on demand, that the person elects to treat as a financial arrangement.

For the first category, the excepted financial arrangement becomes a financial arrangement on the day on which the person stops using it for a private or domestic purpose. Upon becoming a financial arrangement, a spreading method must be applied and a base price adjustment calculated upon disposal or maturity of the financial arrangement.

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No guidance is given for determining when the excepted financial arrangement ceases to be used for a private or domestic purpose. This is a question of fact.

Example 1:

Mr KP is a motor vehicle dealer who raises a USD loan to purchase a Humvee vehicle and uses it for private motoring. Six months later, Mr KP decides to sell the vehicle through his business. The USD loan becomes a financial arrangement probably at the point at which Mr KP starts to display the vehicle for sale.

The second category is provided for in s EW 8(1)(a). That section was amended in 2013, with effect from 27 September 2012, to apply only to a person carrying on a business of acquiring short-term agreements for sale and purchase to collect amounts owing at the time of acquisition. The person could then choose to treat all such acquired agreements as financial arrangements. However, the amendment was later repealed in 2014 and the original provision was restored. An additional amendment added the requirement for the expenditure to satisfy the general permission and not be denied a deduction by a general limitation, with effect from 17 July 2013. A savings provision preserves an election made under s EW 8 as amended in 2013, provided a tax position was taken in a return received by the Commissioner, or a determination or binding ruling made by the Commissioner, before 14 April 2014 and the person chose to continue to take that tax position after that date.

Note, however, that at the time s EW 8 was amended in 2013, an additional amendment inserted s ED 4 and that section remains. That section provides that when a taxpayer has one of the five excepted financial arrangements listed above that is denominated in a foreign currency, they may choose to value any debts outstanding under the excepted financial arrangement at the same spot exchange rate they use in preparing financial statements. This rule is optional, but once a taxpayer elects into the rule for an excepted financial arrangement, they must continue to apply the rule to all of their excepted financial arrangements that are of the same type. A taxpayer's decision to elect into the rule will be reflected in the tax position they take in their return of income for the year. No prior notice of election is required.

An election under s EW 8 is made by preparing the tax return for the year of election on the basis that the excepted financial arrangements are financial arrangements. That involves the application of a spreading method to the financial arrangements. A category-by-category approach may be adopted or a class approach for short-term agreements. The election does not need to be made for all categories or classes that are potentially subject to an election.

An election may be revoked. The revocation is achieved by giving the Commissioner notice of the revocation within the time allowed for the filing of the tax return for the year in which the notice of revocation is given. The revocation applies prospectively, extending to excepted financial arrangements entered into after the year of election. Financial arrangement treatment would continue to apply to those financial arrangements held at the end of the year of revocation, until such time as they are sold or they mature.

Consideration

The definition of a financial arrangement refers to a receipt of money "in consideration for" money to be provided in the future. The notion of consideration for these purposes is not defined. Some reference can be made to the general principles on the meaning of the concept.

Consideration is a feature of every contract. To be a contract, the agreement in question must be supported by consideration. Under the law of contract, consideration, as traditionally conceived, involves either some detriment to the promisee or some benefit to the promisor. An alternative definition adopted by the House of Lords is that consideration is the price for which the promise of the other is bought. See *Dunlop v Selfridge* [1915] AC 847.

These propositions were outlined by the High Court in *Cooper v C of IR* (1995) 17 NZTC 12,216. This case concerned the construction of a loan agreement that provided that the borrowers would be discharged from all liabilities under the loan, if the lender became insolvent. In due course, the lender became insolvent and was wound up. The Court held that the borrowers had been discharged from making all remaining loan payments without consideration. The Court made no reference to the alternative possibility that consideration had been provided when the loan was entered into. At that time, the lender agreed to discharge the borrowers upon the lender's insolvency, and it was not explained why it was necessary that the borrowers should give additional consideration to obtain the discharge when insolvency eventuated.

There is an element of reciprocity in the concept of consideration. No such element was found to be present for GST purposes where a corporate body for a time share resort merely collected contributions from its members and passed them on. See *Taupo Ika Nui Body Corporate v C of IR* (1997) 18 NZTC 13,147.

It is not every benefit or advantage that accompanies or follows a disposition that can be regarded as consideration. There must be an element of bargain that ties the benefit to the disposition. The benefit must be given in return for the disposition and be enforceable by the disponor. See the gift duty case of *Baigent v C of IR* (1979) 4 NZTC 61,628 (CA).

The concept of consideration for stamp duty purposes was held, in one case, to be what the vendor of an asset receives to transfer the asset to the purchaser. This was in the context of a case that concerned the dutiable value of an agreement for the sale and purchase of shares, the agreement also providing that the target company would pay a pre-settlement dividend to its shareholder as vendor. A majority of the High Court of Australia held that the amount of the dividend should be taken into account in computing the consideration. Receipt of the dividend was part of the payments that induced the vendor to transfer the shares it held in the target company. The minority of the Court thought that the consideration for the dividend was provided upon the original subscription for share capital in the target company. When the shares were subscribed for, the subscription was in consideration of the company's promise to apply its assets in various ways, such as by paying dividends. See *Chief Commr of State Revenue (NSW) v Dick Smith Electronics Holdings Pty Ltd* 2005 ATC 4052.

The Commissioner discussed the concept of consideration in the course of addressing the question of whether school fees and activity fees paid to a state school attract GST. See BR Pub 14/06, *Tax Information Bulletin* ¶269-102, ¶269-103 Vol 26, No 9, October 2014 at 3.

What is not a financial arrangement

Under s EW 4, some transactions are not a financial arrangement.

An absolute assignment of some or all of a person's rights under a financial arrangement or excepted financial arrangement is not a financial arrangement. This is provided that there is no deferral of payment of any of the consideration for the assignment.

A legal defeasance that releases a person from some or all obligations under a financial arrangement or an excepted financial arrangement is not a financial arrangement. This is provided that there is no deferral of payment of any of the consideration for the defeasance. The notion of a legal defeasance encompasses the release from the primary obligation owed under a financial arrangement that is formally acknowledged or established by legal judgment.

These exclusions may be regarded as confirmatory in nature, because the absence of deferral indicates that the assignment or defeasance would not have been within the scope of the definition of a financial arrangement.

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Farm-out arrangement

A farm-out arrangement is an excepted financial arrangement. A farm-out arrangement is one that involves the provision of services or finance for petroleum or mineral exploration activities in return for a share in the activity or any success generated from the project.

Group investment fund interest

An interest in a group investment fund is an excepted financial arrangement.

A group investment fund is a fund established under the Public Trust Act 2001, the Trustee Companies Act 1967 or the Public Trust Office Act 1957. A group investment fund is treated as an equity investment arrangement for income tax purposes. It is appropriate that the financial arrangements rules do not apply.

Hire purchase of livestock or bloodstock

A hire purchase agreement for livestock or bloodstock is an excepted financial arrangement. For this purpose, a hire purchase agreement is one of the following:

- an agreement for the hire of goods, with an option to purchase
- an agreement for the purchase of goods by instalment payments where possession is given before the purchase price is paid in full
- an agreement to sell goods at retail under which property in the goods passes to the buyer subject to a security granted by the buyer for payment of the price, and
- a sale and loan agreement, where a loan has been advanced to enable the purchase of goods at retail and security over the goods is given.

There are a number of exclusions. An agreement that was not made at retail is not a hire purchase agreement; similarly, an agreement that provides for title to pass at the time it is made or before or upon delivery of the goods. However, if the agreement is one of the first two kinds of agreement listed above, it continues to be classified as a hire purchase agreement.

A lay-by sale is not a hire purchase agreement. A feature of a lay-by sale agreement is that the buyer does not receive possession or title to the goods until the price has been paid in full.

There is a specific regime relating to the taxation of hire purchase agreements. See further at ¶6-740.

Insurance contract

An insurance contract is an excepted financial arrangement to the extent to which it is not life financial reinsurance.

An insurance contract can include a cover note and the renewal of an insurance contract. The courts have noted that the aim of insurance is to shift risk from one person (the insured) to another (the insurer). There must be an element of uncertainty as to the risk, which may or may not happen, or an event that is certain to happen but at a time that cannot be predicted, and the insured must have an insurable interest in the subject matter. In common with any contract, each party must provide consideration, which, in this instance, will usually be a premium taken in the form of money. The consideration supplied by the insurer is the promise to provide a benefit in exchange for the premium. The insured must have a legal right to the benefit where the claim falls within the terms of the agreement, and the benefit must have some value. See *C of IR v Motorcorp Holdings Ltd* (2005) 22 NZTC 19,126 (CA).

In *Sovereign Assurance Company Ltd v C of IR* (2012) 25 NZTC ¶20-138, the High Court considered whether commission arrangements under reinsurance contracts were a contract of insurance and therefore an excepted financial arrangement and concluded they were not. The Court held that a payment or payments in the nature of a premium was a necessary element of a contract of insurance. In addition, the commission arrangements lacked other usual attributes of a contract of insurance and, as a matter of commercial reality, there was no significant transfer of risk to the reinsurers.

Lease that is not a finance lease

A lease that is not a finance lease is an excepted financial arrangement.

For the financial arrangements rules, a lease is generally:

- an agreement under which a lessor transfers to a lessee a personal property lease asset in consideration for a personal property lease payment
- a sublease
- a licence to use intangible property
- a hire or bailment
- two or more consecutive or successive leases treated by the Commissioner as one lease
- an arrangement of the above kinds relating to real property, livestock or bloodstock, or
- from 1 April 2015, an occupation right agreement as defined in the Retirement Villages Act 2003.

The notion of what constitutes a lease does not include a hire purchase agreement or an assignment of a hire purchase agreement.

A personal property lease asset is personal property that is subject to a lease, while a personal property lease payment is consideration in money or money's worth for such an asset.

For a discussion of finance leases, see ¶6-700.

Loan in New Zealand currency

An excepted financial arrangement for a lender is a loan made in New Zealand currency that is interest free and repayable on demand. Note, however, that a person may elect to treat this excepted financial arrangement as a financial arrangement under s EW 8 (see ¶6-045).

A loan of this kind is relatively common in estate-planning arrangements and similar family dealings. In the absence of interest payable to the lender, there would appear to be little merit in including loans of this kind within the scope of the financial arrangements rules. For the borrower, the loan is subject to the financial arrangements rules, possibly to monitor whether any release of the debt occurs to give rise to income under a base price adjustment calculation.

Partnership or joint venture

An excepted financial arrangement includes an interest in a partnership or a joint venture.

Look-through interest for look-through company

A look-through interest for a look-through company is an excepted financial arrangement.

Share-lending arrangement

An excepted financial arrangement includes a share-lending arrangement.

This is to ensure that the financial arrangements rules do not subject to tax any movement in the market value of the shares over the term of a "qualifying" share-lending arrangement.

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The financial arrangements rules contain a specific provision effectively deeming the ownership of shares under a share-lending arrangement to have always remained with the share supplier for the purposes of the financial arrangements rules. See s EW 52. For a discussion of the tax treatment of distributions under a share-lending arrangement, see ¶17-116.

Share or an option over shares

An excepted financial arrangement includes a share or an option to acquire or dispose of shares.

This does not apply if the shares in question are withdrawable shares. Essentially, a withdrawable share is one issued by a building society specifying at the outset the rate of dividend payable on the share. However, if the share was acquired, or the option entered into, before 19 May 1999, there may be an exclusion under the old financial arrangements rules.

The notion of what is a share for tax purposes is outlined in ¶16-555. The concept encompasses:

- any interest in the capital of a company
- a profit-related (floating rate) debenture (s FA 2)
- a stapled debt security to which s FA 2B(2) applies
- a unit in a unit trust
- an investor's interest in a group investment fund where:
  - the fund is not a designated group investment fund
  - the interest does not result from an investment from a designated source, and
  - the interest results from an investment made after 22 June 1983.

Prior to 1 April 2015, a debenture in substitution for shares under s FA 2 was also treated as a share. However, from 1 April 2015, a substituting debenture is debt for tax purposes. Any income derived or expenditure incurred under such a debenture is therefore taken into account under the financial arrangements rules from that date. A transitional provision (s EZ 77) applies for substituting debentures already in existence. See ¶16-555.

Specified preference share

A specified preference share is an excepted financial arrangement. This was a special kind of share that was issued under a contract entered into before 23 October 1986. They were treated as debt for tax purposes.

Superannuation

A membership of a superannuation scheme is generally an excepted financial arrangement.

A superannuation scheme is a trust established mainly for the purposes of providing retirement benefits to natural persons or paying benefits to superannuation funds.

Warranty

A warranty for goods or services is an excepted financial arrangement.

The Court of Appeal held that a warranty and a sale and purchase agreement for a motor car were one financial arrangement that constituted an excepted financial arrangement. See *C of IR v Mitsubishi Motors New Zealand Ltd* (1994) 16 NZTC 11,099 (CA). This category, presumably to avoid doubt, prevents the warranty provisions of a contract, or the statutory warranties incorporated in the contract, from becoming a financial arrangement in their own right.

Transitional residents

An excepted financial arrangement includes an arrangement of a transitional resident, provided the other parties to the arrangement are non-residents and the arrangement is not for the purposes of a business carried on in New Zealand by a party to the arrangement.

Loan in a foreign currency for a private or domestic purpose

A loan in a foreign currency that is used for a private or domestic purpose, is an excepted financial arrangement for a borrower who is a cash basis person.

The courts have said that an outgoing is of a private nature if it is exclusively referable to living as an individual member of society and that domestic expenses are those relating to the household or family unit. See *Hunter v C of IR* (1990) 12 NZTC 7,169 (CA).

The loan will change its classification to a financial arrangement if the loan ceases to be used for a private or domestic purpose (see ¶6-045).

It is possible that a foreign currency loan raised for an income-producing purpose may start to be used for a private or domestic purpose. In that event, a base price adjustment is calculated immediately before the loan becomes an excepted financial arrangement.

Option over property for private or domestic purpose

An option to acquire or dispose of property, where the person becomes a party to the option for a private or domestic purpose, is an excepted financial arrangement. However, if the property in question is an interest in a financial arrangement, the option cannot be classified as an excepted financial arrangement.

In the event that the option is no longer for a private or domestic purpose, the option ceases to be an excepted financial arrangement and becomes a financial arrangement (see ¶6-045). The converse situation of an option granted for an income-producing purpose that begins to be used for a private or domestic purpose requires a base price adjustment calculation when the option becomes an excepted financial arrangement.

Private or domestic agreement for the sale and purchase of property or services

An agreement for the sale and purchase of property or services or a specified option is an excepted financial arrangement if all of the following apply:

- the agreement is entered into by the person, or the option was granted to or by the person for a private or domestic purpose
- the subject matter of the agreement or the option is for a purchase price that is less than:
  - $1,000,000 for real property
  - $400,000 for other property, or
  - $400,000 for services, and
- settlement of the property or performance of the services is required no later than 365 days:
  - after the date of the agreement, in the case of an agreement for property or services, or
  - after the date of the specified option, should an agreement result from exercise of the option.

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A specified option is an option to acquire or dispose of property or services, and includes any agreement for sale and purchase entered into upon exercise of the option. The notion of property includes all forms of property, with the exception of a financial arrangement and foreign exchange.

This category of excepted financial arrangement ceases to have that status if the agreement for the sale and purchase of property or services stops being used for a private or domestic purpose (see ¶6-045). A base price adjustment calculation may be required in the converse situation of an agreement originally for an income-producing purpose that starts to be used for a private or domestic purpose.

Agreement for the sale and purchase of property or services

An agreement for the sale and purchase of property or services is an excepted financial arrangement if all sales or purchases are prepaid and the total value of such prepayments under all such agreements throughout the income year does not exceed $50,000. No guidance is given on what constitutes prepayments. Under a contract of general insurance, for example, the year's premium is usually paid at the beginning of the year of insurance. Usual terms of trade of that kind are not readily regarded as giving rise to a prepayment.

This category of excepted financial arrangement does not apply if the person elects to treat the agreements as financial arrangements under s EW 8.

Short-term agreement for the sale and purchase of property or services

An excepted financial arrangement includes a short-term agreement for sale and purchase. The requirements for classification as a short-term agreement for sale and purchase are that the agreement is for the sale and purchase of property or services and provides for one of the following alternatives:

- settlement must take place or the services must be performed within 93 days of the date of the agreement
- if the date of the agreement is unknown, settlement must take place or the services must be performed within 93 days of the earlier of:
  - □ the date of first payment by the buyer, and
  - □ the date on which the first right in the property is transferred or the services are performed, or
- settlement must take place or the services must be performed within 93 days of an invoice date if the agreement is continuous and the seller renders periodic invoices.

This category of excepted financial arrangement can be expected to be applicable to business-to-business dealings. The usual terms of trade for such sales is that payment by the buyer is due no later than the 20th of the month following the month of sale. That timetable is well within the 93-day limit.

A short-term agreement for sale and purchase will not be an excepted financial arrangement if the person elects to treat all such agreements as financial arrangements under s EW 8. See further at ¶6-045.

Short-term option

An excepted financial arrangement includes a short-term option. A short-term option is an option to acquire or dispose of property or services if one of the following alternatives applies:

- settlement must take place or the services must be performed within 93 days of the date of the option agreement, or
- if the date of the option agreement is unknown, settlement must take place or the services must be performed within 93 days of the earlier of:
  - □ the date of first payment by the buyer, and
  - □ the date on which the first right in the property is transferred or the services are performed.

A party to a short-term option may elect to treat the agreement as a financial arrangement under s EW 8. See further at ¶6-045.

Travellers' cheques

Travellers' cheques are an excepted financial arrangement. A person may elect to treat the travellers' cheques as a financial arrangement under s EW 8. See further at ¶6-045.

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Variable principal debt instrument

An excepted financial arrangement includes a variable principal debt instrument if all instruments of that kind held by the person at all times during the income year do not exceed $50,000. A variable principal debt instrument is one that contemplates further advances on demand or on call. It is also an instrument that contemplates that foreign currency advances must be repaid on demand. A bank overdraft is perhaps the most common example of a variable principal debt instrument.

A person may elect that a variable principal debt instrument be classified as a financial arrangement under s EW 8. See further at ¶6-045.

¶6-075 Relationship between a financial arrangement and an excepted financial arrangement [IT07 s EW 6]

It is particularly common for a transaction, upon closer examination, to involve a number of associated transactions. A purchase of consumer goods by electronic funds transfer or by credit card, for example, may result in an agreement between the merchant and the consumer and the finance institutions of the merchant and the consumer. A proliferation of transactions from a purchase of goods or services may result in some that are financial arrangements and others that are excepted financial arrangements. Some guidance on their separation may be desirable to ensure that different statutory regimes operate according to their tenor.

A first proposition is that an excepted financial arrangement can be part of a financial arrangement. The kind of excepted financial arrangement determines the amounts taken into account under the financial arrangements rules.

Solely attributable amounts excluded

For certain categories of excepted financial arrangements that are a part of a financial arrangement, any amount solely attributable to the excepted financial arrangement is not taken into account under the financial arrangements rules. The following excepted financial arrangements fall within this exclusion:

- an annuity
- a bet
- an emissions unit

- non-Kyoto greenhouse gas unit
- a research and development agreement
- an employment contract
- a farm-out arrangement
- a group investment fund interest
- a hire purchase agreement for livestock or bloodstock
- an insurance contract
- a lease that is not a finance lease
- a New Zealand currency loan that is interest-free, repayable on demand for the lender
- an interest in a partnership or joint venture
- a look-through interest for a look-through company
- a share-lending arrangement
- a share or an option over shares
- a specified preference share
- membership of a superannuation scheme, and
- a warranty.

Solely attributable amounts included

For other categories of excepted financial arrangement that are a part of a financial arrangement, any amount solely attributable to the excepted financial arrangement is an amount taken into account under the financial arrangements rules. The categories of excepted financial arrangement that become subject to this treatment are:

- certain arrangements to which a transitional resident is a party
- a private or domestic purpose loan in a foreign currency for a borrower who is a cash basis person
- an option over property for a private or domestic purpose
- a private or domestic agreement for the sale and purchase of property or services or specified option
- an agreement for the sale and purchase of property or services where sales and purchases prepaid
- a short-term agreement for the sale and purchase of property or services
- a short-term option
- travellers' cheques, and
- a variable principal debt instrument.

Reason for different treatments

The Commissioner explained the reason for the different treatment according to the kind of excepted financial arrangements, stating that the solely attributable rule was amended so that it does not apply to arrangements that are excepted financial arrangements for compliance cost reasons only. In other words, these excepted financial arrangements are outside financial arrangements rules on their own but, when used within a wider financial arrangement, they are subject to the financial arrangements rules.

The Commissioner also stated that income or expenditure is solely attributable to an excepted financial arrangement if it could have been expected to arise, or be incurred, without the support of a wider financial arrangement.

The solely attributable phrase should not be interpreted strictly. A gain or loss remains solely attributable to an excepted financial arrangement, even if a non-excepted financial arrangement, such as a loan, is a necessary precondition for the gain or loss to be derived or incurred. As an example, the Commissioner referred to the situation of a loan raised to purchase shares. The share subscription and all benefits flowing from it, such as dividends, are solely attributable to the shares as an excepted financial arrangement and so are not taken into account under the financial arrangements rules. See *Tax Information Bulletin* ¶116-103 Vol 11, No 6, July 1999 at 10.

It may not always be easy to understand how an excepted financial arrangement is "part of" a financial arrangement. The Commissioner appears to accept the example of where monies are lent to subscribe for shares. It appears to be accepted that the entire transaction is one financial arrangement with the test of amounts solely attributable to an excepted financial arrangement applied to exclude any dividends from being accounted for under the financial arrangements rules. There is some scope to debate the cogency of this example. There is a basis for doubting whether the transaction of loan and share acquisition form one financial arrangement despite their close association. The two contracts may be freestanding without financial interdependence.

It is probable that in some situations it may be necessary to draw a distinction between an excepted financial arrangement that is "part of" a financial arrangement and one that is "subject to" a financial arrangement. An example could be the sale of shares under an agreement for sale and purchase that is not itself to be classified as an excepted financial arrangement. It may be appropriate to regard the shares as subject to the agreement for sale and purchase as a financial arrangement but not as part of that financial arrangement. That view would be on the basis that the contract of shareholding continues between the issuing company and its shareholder irrespective of any arrangements the shareholder may make for disposal of that contract as a form of property.

Excepted financial arrangements that form part of a financial arrangement are discussed by P Speakman in "The FA rules: problems and practical issues", CCH, *New Zealand Tax Planning Report*, No 1, May 2007, p 1.

SPREADING METHODS

¶6-102 Spreading method required for financial arrangements [IT07 ss EW 12, EW 13]

A party to a financial arrangement must use a spreading method to calculate income and expenditure under the financial arrangement for each income year over the term of the financial arrangement. This is unless the person is not required to apply a spreading method.

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A spreading method is not required to be applied:

- by a cash basis person, unless an election to the contrary is made
- by a trustee of a trust fund for personal injury compensation, if the trustee meets the criteria for classification as a cash basis person
- in the income year in which a base price adjustment calculation is required upon disposal or maturity of the financial arrangement.

¶6-120 Cash basis person [IT07 ss EW 54–EW 63]

A cash basis person is not required to apply a spreading method to a financial arrangement, unless an election to do so is made. The absence of the spreading requirement applies to the cash basis person as both a lender and a borrower. A cash basis person is still required to undertake a base price adjustment when the financial arrangement matures or is disposed of.

Example:

Mr TP invests in a zero-coupon loan with a face value of $150,000, maturing in two years, for an outlay of $120,000. Under the financial arrangements rules, the $30,000 return on the investment should be spread over the two-year term of the loan. However, if Mr TP is a cash basis person, he will only return the income when it is received upon repayment of the loan. The return is recognised upon calculation of the base price adjustment when the loan is repaid.

A cash basis adjustment may be required when a person becomes a cash basis person or ceases to be one.

Required thresholds

A cash basis person is a person whose financial arrangements do not exceed prescribed values set out in s EW 57(1)–(3). Any taxpayer can be a cash basis person, not just natural persons.

There are two aspects to the criteria for classification as a cash basis person. Firstly, the person must satisfy one of the following prescribed values thresholds:

- income and expenditure under all financial arrangements for the income year does not exceed $100,000, or
- the value of all financial arrangements on every day of the income year does not exceed $1m, with that value being determined on the basis of:
  - face value for a fixed principal financial arrangement
  - the amount owing for a variable principal debt instrument, and
  - the value determined under the old financial arrangements rules if they apply to the financial arrangement.

These thresholds apply to all financial arrangements to which the person is a party during the income year. The financial arrangements will include any financial arrangements that are subject to the old financial arrangements rules.

Secondly, in addition to satisfying one of the above prescribed values thresholds, there is a deferral threshold requirement that the difference between the accrual and cash treatments cannot exceed $40,000 for the income year.

The deferral threshold requirement is determined by applying a formula to each of the person's financial arrangements. The total of the outcomes of the formula cannot exceed $40,000. The formula is applied as follows:

(accrual income – cash basis income) + (cash basis expenditure – accrual expenditure)

where:

accrual income is the amount that would have been income if the person had chosen to apply the yield to maturity method, the straight-line method or an approved method

cash basis income is the amount that would have been income determined on a cash basis

cash basis expenditure is the amount that would have been expenditure incurred on a cash basis, and

accrual expenditure is the amount that would have been expenditure incurred if the person had chosen to apply the yield to maturity method, the straight-line method or an approved method.

The following supporting principles are applied when determining if both the prescribed values thresholds and deferral threshold are met:

- where the trustee of a bare trust is party to a financial arrangement, the value of the arrangement and any income or expenditure arising is attributed to the beneficiary of the trust to the extent of the beneficiary's share in the beneficial interest of the arrangement
- where a person is a beneficiary of a trust, other than a bare trust, whose trustee is a party to a financial arrangement, the value of the arrangement and any income that is trustee or beneficiary income under the trust rules is excluded from the calculations, and
- where a person is party to a financial arrangement as a trustee, the following are excluded from the calculations:
  - the value of the arrangement, if it produces trustee or beneficiary income under the trust rules
  - income that is trustee or beneficiary income under the trust rules
  - the value of the arrangement, if expenditure is incurred under it, and
  - expenditure incurred under the arrangement.

A testamentary trustee will be a cash basis person if the deceased was a cash basis person and the thresholds discussed above were met at the time of death. However, treatment of the trustee as a cash basis person cannot extend beyond the period encompassing the year of death and the following four income years (s EW 60).

The Commissioner 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 if the class has been structured and promoted to defer an income tax liability, or the parties to a financial arrangement are associated and the person's calculation of income and expenditure is different to the associated party.

Election to apply a spreading method

A cash basis person may elect to apply a spreading method to all financial arrangements to which the person is a party (s EW 61). To make the election, the person calculates a cash basis adjustment. No election may be made for a financial arrangement that is subject to a base price adjustment calculation.

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The Commissioner will be able to grant an exemption from electronic filing if the investment income payer would experience unreasonable compliance costs or other hardship as a result of the requirement to file digitally. In considering whether to exercise her discretion, the Commissioner must have regard to:

- the capability of the investment income payer
- the nature and availability of suitable digital services, and
- the compliance costs involved with complying.

The Commissioner will publish guidelines on how the exemption will apply.

The amendments are intended to come into force on 1 April 2020. However, payers will be able to apply the new rules from 1 April 2019 if they choose.

¶15-220 Disclosure obligations where no deduction required from interest payments [TAA ss 28, 52]

Special disclosure requirements must be met by certain payers of interest. If interest is paid to a person who does not hold a valid certificate of exemption and no resident withholding tax deduction has been made from that interest because the payment was not made in the course or furtherance of a taxable activity or because the payment fell short of $5,000 (see ¶15-080) and the interest has been allowed as a deduction, the following information must be provided:

- the full name and last known address of the recipient
- the total interest paid to the recipient in that income year
- the tax file number of the recipient, and
- any other information required by the Commissioner.

The disclosure is made in the payer's tax return.

The recipient of this interest must supply to the payer his or her tax file number within 10 working days of receiving a notice from the payer.

▶ *Note:* As part of the changes proposed by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill (see ¶15-215), the above requirements for information from payers with no withholding obligations will remain, but will be moved into new subpart 3E of the Tax Administration Act 1994 as part of the codification of the requirements (see proposed s 25N).

¶15-230 Disclosure obligations where no deductions required in relation to financial arrangement transaction [TAA ss 27(2), 53]

Special disclosure provisions apply, in certain circumstances, to persons holding an RWT exemption certificate, in respect of financial arrangements and/or redemption payments for which no resident withholding tax (RWT) was deducted from the interest or the redemption payment because the exempt person was not aware that it constituted resident passive income. If interest which is liable to RWT is paid or payable on a financial arrangement, these disclosure provisions apply where the exempt person either:

- acquires such an arrangement from, or disposes of such an arrangement to, another person, or
- makes a redemption payment in respect of such an arrangement to another person

and that other person is not at the time of acquisition, disposal or redemption, the holder of a valid RWT exemption certificate or the issuer of the financial arrangement.

Information to be provided

Exempt persons to whom these circumstances apply are required to provide the following information with their annual return of income for the year in which the transaction took place:

- the full name and last known address of the non-exempt person
- the date of the acquisition, disposition or redemption
- the consideration paid or received by the exempt person exclusive of any fees
- the tax file number (if any) of the non-exempt person, and
- any other information required by the Commissioner.

This information may generally be provided in the form of summary totals in relation to all such acquisitions, dispositions and redemptions. If no return is required to be made, the information must be furnished in a form prescribed by the Commissioner and within two months of the end of the tax year.

A non-exempt person who enters into a financial arrangement as detailed above must provide the exempt person with the tax file number of the non-exempt person within 10 days of being notified by the exempt person to do so.

▶ *Note:* As part of the changes proposed by the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill (see ¶15-215), the above requirements for information on financial arrangements will remain, but will be moved into new subpart 3E of the Tax Administration Act 1994 as part of the codification of the requirements (see proposed s 25O).

RECORD-KEEPING AND OFFENCES

¶15-240 Record-keeping requirements for RWT [TAA s 26]

Any person required to pay resident withholding tax (RWT) in relation to resident passive income must keep records. At the end of each year, the record keeper must also record, in relation to any recipient of interest or dividends treated as interest, the total amount of interest and dividends paid and details of all other financial arrangements under which interest has been paid. Records must also be kept by any person who must make disclosure of interest payments under s 52 of the Tax Administration Act 1994 (see ¶15-220), even though that person is not required to make RWT deductions. This also applies to any person who must provide information relating to recipients under s 54 (see ¶15-210).

Records must be kept for at least seven years after the end of the year in which the payments are made unless the Commissioner permits them to be disposed of, or the records are required by law to be delivered to another person, or the records are those of a company which has been liquidated or dissolved. The Commissioner can notify a person to retain the records for a further three years before the expiry of the seven-year period if the Commissioner is undertaking, or is going to undertake, an audit of the person or any person to whom the records relate. The records must be kept in English, unless the Commissioner gives permission to the contrary.

¶15-250 Assessment of RWT by the Commissioner [TAA ss 99, 111]

The Commissioner has the power to make an assessment of resident withholding tax. An assessment may be amended, although the right to do this is generally limited to within four years of the income year in which the tax return is provided. An assessment is deemed to be correct except upon challenge proceedings.

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¶16-590 Further dividends [IT07 s CD 11, GB 1(3), GB 23(7), GB 25(2)]

A dividend also includes:

- an amount derived in substitution for a dividend under a dividend stripping arrangement — see ¶33-175
- excessive remuneration for services rendered by a person who is a relative of a director or shareholder of a company, other than a close company — see s GB 23(7), and
- excessive remuneration, including lump sum retirement payments, made to a shareholder or director (or a relative of a shareholder or director) of a close company to the extent of the excessive component — see further at ¶16-070 and s GB 25.

DIVIDEND CALCULATION RULES

¶16-600 General rule for calculation of dividend amount [IT07 ss CD 38, CD 39(9), CD 40–CD 42, FC 1(1)(d), FC 2(1)]

The general rule for the calculation of the amount of a dividend is the following formula:

value from company – value from person

where:

> **value from company** is the market value of the money or money's worth that the company provides to the person, and
>
> **value from person** is the market value of the money or money's worth, if any, that the person provides as consideration for the transfer, excluding any amount attributable merely to the holding or giving up of rights as a shareholder in the company.

Subpart FC also provides that the company is to be treated as having disposed of the property at its market value when the transaction involves a distribution in kind that is a dividend. In addition, the shareholder is treated as having acquired the property at that market value.

Reversal of the dividend

There may be reversal of a dividend in four situations.

First, there is scope to adjust values if a dividend has arisen because of a difference in the market value of property provided by or to the company and the consideration paid for it. To reverse the dividend treatment of the transaction, the following requirements laid down in s CD 42 must be satisfied:

- the consideration paid must have been an amount the company considered was the market value, having taken reasonable steps at the time of the transaction to ascertain a market value
- the recipient of the dividend must have subsequently paid to the company:
  - sufficient additional consideration to reflect the actual market value of the property at the time of the transaction, or
  - a refund of any excess consideration paid by the company, and
- any necessary adjustments must have been made to the accounts of the company and the recipient for the additional consideration or refund.

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Secondly, a dividend is eliminated if the company recovers the dividend from the shareholder. That outcome is possible, for example, if the dividend resulted in the company not being able to satisfy the solvency requirement. Appropriate amendments of assessments and refunds of tax may be made by the Commissioner and debits and credits recorded in the imputation credit accounts of the company and the shareholder. See s CD 40.

Thirdly, if the release of a debt owed to the company created a dividend and the released amount is later repaid, the dividend is reversed and the tax paid is refunded. The same treatment applies to the dividend arising from the expenditure of a close company that is not allowed as a deduction where the expenditure is subsequently repaid to the company. See s CD 41.

Fourthly, there is provision for the reversal of a dividend treatment in relation to a shareholder current account that is retrospectively treated as employment income. The current account may be treated as having been repaid as from the beginning of the company's income year or date of advance where (s CD 39(9)):

- the shareholder to whom the loan was made is paid an amount of salary, wages, an extra pay, dividends or interest
- the amount so paid constitutes income of the shareholder
- the amount so paid is applied in repayment of the loan, and
- the amount so paid is not subject to resident withholding tax (RWT), non-resident withholding tax or PAYE tax deduction or is a fully-imputed dividend.

The intention is to allow for a fully-imputed dividend to be backdated to expunge, or at least reduce, an overdrawn current account balance. It has therefore been clarified that the rule in relation to a fully-imputed dividend applies irrespective of any RWT obligation that may arise because of the relevant shareholder's RWT rate. This avoids or limits the deemed dividend arising and reduces compliance costs.

¶16-620 Calculating amount of dividend when property made available [IT07 s CD 39]

A dividend may take the form of the company making property available to a shareholder or some other person. A loan at no interest or at a low rate of interest is an obvious example, as is the provision of residential accommodation for the use of the company's shareholders.

Example 1:

TZ Ltd makes a beach house available to shareholder B for three weeks at a rental of $12 per week. The market rental is $200 per week. Calculation of the dividend is:

$$(\$200 - \$12) \times 3 = \$564.$$

The amount of the dividend from TZ Ltd is $564.

The general principle is that the fringe benefit tax rules apply to determine the amount of the dividend. These rules contain detailed provisions, for example, for calculation of the benefit arising from the provision of a motor vehicle and the sale of goods and services at a discount. In all cases, the amount of the dividend is calculated for each quarter during which the company's property is made available.

Loan

If the property made available is a loan, the dividend for the quarter may be calculated under one of two approaches:

- the excess, if any, of interest calculated for the quarter on the daily balance of the loan at the benchmark rate over the actual amount of interest accruing on the loan for the quarter, or
- at the company's election, the excess of the benchmark interest rate amount over the amount of income accruing to the company for the quarter under the yield to maturity method.

The benchmark rate varies according to the nature of the parties to the loan and the currency in which the loan is expressed. The following three categories apply:

- the benchmark rate is the prescribed interest rate applicable under the fringe benefit tax regime where all amounts payable to the company are expressed in New Zealand dollars and the borrower is not a company (or, if it is a company, the lender company notifies the Commissioner that the prescribed interest rate is to apply to the loan and the quarter), or
- a rate set by the Commissioner becomes the benchmark rate where:
  - all amounts payable to the company are expressed in a single foreign currency
  - the Commissioner has set a benchmark rate for that currency and the quarter, and
  - the borrower is not a company (or if it is a company, the lender company notifies the Commissioner that the Commissioner's rate is to apply to the loan and the quarter)
- in all other cases, the benchmark rate is the market interest rate determined at the end of the quarter for a loan made on the same terms between persons acting at arm's length.

Example 2:

KS Ltd makes an advance to its shareholder, AP Ltd, on terms providing for interest at 5%. The bankers to KS Ltd were charging interest at 12% to borrowers with the same credit rating as members of the AP Ltd group. The dividend will be calculated by applying, to the daily balance of the loan, the following rate of interest:

	%
Market rate	12
Less interest rate payable	5
	7

Averaging approach

Where the loan is a variable principal debt instrument (broadly an overdraft facility), and the borrower is a company, averaging loan balances may be adopted. The method of ascertaining the daily loan balance is used as the basis for calculating the amount of the dividend. In addition, the lender may elect that the daily balance of the loan shall be one of the following:

- the average of the outstanding balances of the loan at the end of each month of the lender's tax year, or

- the average of:
  - the outstanding balance of the loan at the later of the beginning of the tax year or upon the making of the first advance, and
  - the outstanding balance of the loan at the earlier of the end of the tax year or just before the loan is finally repaid.

In a significant qualification, the averaging approach is not available if it provides a dividend amount that differs by more than 30% from the amount of dividend that would arise if actual loan balances were used. When this restriction does not prevent adoption of the averaging approach, the lender must make the appropriate election in its return of income for the tax year in which the dividend transaction occurs.

Example 3:

AB Ltd makes a series of advances to assist its parent company in completion of a development project, although all of the advances are repaid within six months. The outstanding balances at the end of each month were $18,000, $23,000, $31,500, $42,750, $49,900 and $55,000. The averaging approach produces an average daily balance of $36,691 ($220,150 ÷ 6) and that may be adopted by AB Ltd if it does not produce a dividend amount that varies by more than 30% from the dividend amount calculated by use of actual daily loan balances.

The second of the averaging approaches permits adoption of the average of the loan balances at the beginning and end of the tax year, with provision made for the situation where the loan is advanced or repaid within a tax year.

Example 4:

As an alternative to an average of monthly balances in Example 3, AB Ltd could have adopted an average daily balance of $36,500, being an average of the opening and closing balances of $18,000 and $55,000 respectively. Again, adoption of the averaging approach is subject to the qualification that it is not available when it produces a dividend amount that varies by more than 30% from the dividend ascertained by use of actual daily loan balances.

Timing of dividend

A dividend arising from the making available of property is treated as paid by the company and derived by the person:

- six months after the end of the company's income year, or
- if the company gives notice to the shareholder on an earlier date of the amount of the quarter's dividend, on that earlier date.

Example 5:

TE Ltd provides a loan of $10,000 to a shareholder, Don, on 1 April 20X1. The interest rate is 5% calculated on the daily balance of the loan, payable annually on 1 April.

Don makes no repayments of principal during the 20X1/X2 income year. The first interest payment, due on 1 April 20X2, is therefore $500. Assuming that the prescribed rate of interest for the year is 10%, a dividend of $125 will arise in each quarter of the 20X1/X2 income year.

TE Ltd has a 31 March balance date so that the dividends generated by the provision of the low-interest loan in the 20X1/X2 income year are deemed to be paid by TE Ltd and derived by Don on 30 September 20X2.

See *Tax Information Bulletin* ¶79-105 Vol 7, No 9, February 1996 at 2.

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¶16-630 Dividend calculation adjustments [IT07 ss CD 15–CD 19]

Tax credits

Subject to certain exceptions, a dividend includes the amount of any imputation credits attached to the dividend. This treatment is a necessary step in the application of the imputation concept (¶16-550).

▶ *Note:* The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, introduced into Parliament on 6 April 2017, proposes an amendment to clarify that the amount of a dividend includes any RWT or NRWT withheld from or paid in relation to the dividend. The amendment is intended to apply from the date of enactment of the Bill.

Unit trust exclusion

An exclusion covers the situation where unit trust managers, in the ordinary course of their management activities for a unit trust:

- acquire units from unit holders under the terms of issue, and
- derive a dividend from the redemption or other cancellation of units in the unit trust.

The dividend for the unit trust manager does not include imputation credits attached to the dividend to the extent to which the dividend, exclusive of the credits, recovers the price paid by the unit trust manager to acquire the units.

A unit trust manager for these rules includes any one of the following:

- a person nominated by the unit trust manager
- a trustee or a manager of a group investment fund that derives category A income, or
- a person nominated by the trustee or the manager of the group investment fund.

The exclusion of credits from the dividend also applies for other parts of the Act to ensure that the credits are not counted as passive income.

Share-lending exclusion

Also excluded from being a dividend is the amount of any imputation credits attached to a dividend derived by a share user under a share-lending arrangement where the credits were attached by way of a credit transfer notice. However, those credits are included as dividend income of the share supplier under the share-lending arrangement. See s CD 17.

Reduction for overseas tax paid

If a shareholder has directly paid tax overseas on a foreign company's income, as if the foreign company were a partnership and the shareholder were a partner, s CD 18 allows the amount of any dividend received by the shareholder from the foreign company to be reduced by the amount of the overseas tax. This reduction ensures that shareholders in such entities are not taxed twice on the same income. See ¶26-010.

Foreign tax credits

Section CD 19 recognises that a double tax agreement may provide a New Zealand resident shareholder with a tax credit in a foreign country. In that event, the amount of the dividend is increased by the tax credit.

A refund of foreign income tax is also treated as a dividend when:

- the foreign company was entitled to deduct the tax from the dividend, and
- the New Zealand shareholder is not personally liable to pay the tax.

DIVIDEND EXCLUSIONS

¶16-680 Exclusions from dividends [IT07 ss CD 22–CD 37]

A number of transactions are expressly excluded from giving rise to dividends. These include:

- a non-taxable bonus issue (¶16-685)
- a return of capital upon cancellation of the company's shares covering:
  - □ an amount returned upon the total redemption or cancellation of a share, or upon an off-market purchase of a share by the company, provided the transaction is not in substitution for dividends (¶16-705)
  - □ realised and unrealised capital gains returned upon the liquidation of the company (¶16-720)
  - □ an on-market purchase of the company shares (¶16-710)
  - □ bonus shares issued during the period 1 April 1982 to 30 September 1988 if the bonus shares were capitalised out of share premiums arising other than upon the issue of shares, or the return of capital is upon the liquidation of the company
  - □ a non-taxable bonus issue made before 1 July 1994 if issued out of capital gains and the return is upon the liquidation of the company or the bonus shares were issued out of share premiums arising other than upon the issue of shares by a company in exchange for shares in another company
  - □ a non-taxable bonus issue made after 1 July 1994 if the bonus shares were issued out of capital gains and the return is upon the liquidation of the company
- a fringe benefit subject to fringe benefit tax and, from 1 April 2017, a benefit provided to an employee that would be a fringe benefit if an election had not been made under s CX 17(4B) (¶16-695)
- a treasury stock repurchase that is not part of a pro rata cancellation (¶16-700)
- certain transfers of value between associated companies (¶16-725)
- transfers of certain excepted financial arrangements within wholly-owned groups (¶16-730)
- rights issues and premiums paid under bookbuild arrangements (¶16-715)
- vesting of property by a foreign unit trust (¶16-690)
- certain amounts derived by an amalgamated company on a resident's restricted amalgamation (¶16-740)
- the provision of residential property by a flat-owning company (¶16-745)
- a payment by a company to repurchase a share under a profit distribution plan (¶16-571)
- employment income in the form of board and lodging (¶16-695)

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- a Maori authority distribution (¶24-311)
- a further distribution by a co-operative company or a statutory producer board based on an earlier notional distribution (¶16-750)
- an amount paid by a company that is a foreign superannuation scheme if it is derived by a person as a foreign superannuation withdrawal or a pension (¶16-733), and
- a distribution from a foreign investment fund (FIF) for which the comparative value method, the deemed rate of return method, the cost method or the fair dividend rate method has been applied. When the fair dividend rate method has been applied, the dividend exclusion does not apply if the person held a direct income interest of 10% or more in the FIF at the beginning of the relevant income year and the FIF satisfied the exclusion for Australian resident FIFs under s EX 35(b) and its income tax liability was not reduced under s EX 35(c) (¶16-735).

¶16-685 Dividend exclusions — non-taxable bonus issues

[IT07 ss CD 29, YA 1 ("non-taxable bonus issue")]

A non-taxable bonus issue is not a dividend.

A non-taxable bonus issue is a bonus issue that is not a taxable bonus issue (¶16-570). Essentially this means that there is neither a cash alternative nor an election by the company for taxable bonus issue treatment.

¶16-690 Dividend exclusions — vesting of property by a foreign unit trust

[IT07 s CD 30]

The vesting of a beneficial interest in the assets of a foreign unit trust that is a dividend (see further at ¶16-573) does not lead to a further dividend when the legal interest in the property vests in the unitholder.

¶16-695 Dividend exclusions — fringe benefits and accommodation

[IT07 s CD 32]

A dividend does not arise for the provision of a fringe benefit that attracts fringe benefit tax (FBT).

From 1 April 2017, a dividend also does not arise if a motor vehicle benefit is provided to a shareholder-employee of a close company and that benefit would be a fringe benefit subject to FBT except that an election has been made by the close company under s CX 17(4B) to apply subpart DE instead of the FBT rules.

Another exclusion from dividend classification applies to accommodation or an accommodation allowance that is employment income in the hands of the employee.

¶16-700 Dividend exclusions — treasury stock purchases

[IT07 ss CD 25, CW 58, YA 1 ("cancellation", "on-market cancellation", "pro rata cancellation")]

Treasury stock is a purchase by a company of its own shares where the company determines not to cancel the shares. A company may apply this treatment to no more than 5% of its shares (with a different regime for a co-operative company).

A treasury stock repurchase is not a dividend provided that the repurchase is not part of a pro rata cancellation or a transaction that is similar in substance to a pro rata cancellation. The notion of a pro rata cancellation is the cancellation of all of the shares of a class or a uniform cancellation of part of the class.

Although the purchase may not be a dividend, there may be available subscribed capital implications if the company cancels or continues to hold the shares purchased. A reduction to the available subscribed capital of the company may be deemed to occur if the shares are cancelled before the first anniversary of acquisition or if the company has not, by the first anniversary, transferred shares of the same class in an arm's length transfer (a transfer to a non-associate or one occurring independently on a recognised exchange). In those circumstances, with effect from the cancellation or first anniversary, the company's available subscribed capital is reduced by the lesser of the amount paid to the shareholder on acquisition of the shares and the available subscribed capital per share calculated under the ordering rule. In the case of the first anniversary causing the reduction, the available subscribed capital is calculated as if the share (and any other shares to which s CD 25(4) applies) were cancelled on that anniversary date. If the shares are cancelled or not transferred in an arm's length transfer before the first anniversary, the repurchase is treated as if it were an on-market cancellation, and a debit arises in the company's imputation credit account. However, the amount included in the formula for calculating the debit is limited to the excess of the amount received by the shareholder over the amount of the reduction to the available subscribed capital discussed above. The debit arises on the date of acquisition by the company (although that retrospective debit does not create an exposure to imputation penalty tax or late payment penalty if it wouldn't have arisen if the debit had arisen on the date of cancellation or first anniversary). The concept of available subscribed capital is covered at ¶16-760.

The income derived by a company on disposing of shares acquired as a treasury stock purchase is exempt income.

There is a discussion by the Commissioner of the rules on treasury stock at the time of their introduction in *Tax Information Bulletin* ¶66-103 Vol 6, No 6, December 1994 at 7.

¶16-705 Dividend exclusions — off-market share cancellations

[IT07 ss CD 22, YA 1 ("cancellation", "off-market cancellation", "on-market cancellation", "pro rata cancellation")]

An amount paid by a company to a shareholder upon the cancellation of his or her shares may not be a dividend if specified criteria are satisfied as to the circumstances of the cancellation. Those circumstances may encompass:

- a pro rata cancellation, where the main requirements are that there is satisfaction of the bright line test relating to the size of the cancellation and that the transaction is not in lieu of the payment of dividends
- a 15% interest reduction applying, for example to a buy-out of a minority shareholder
- the cancellation of a non-participating redeemable share
- the non pro rata cancellation of a share in an unlisted trust.

If the requirements applicable to these transactions are satisfied, the measure of the amount that is not a dividend has reference to the company's available subscribed capital. It is explained at ¶16-760 that available subscribed capital encompasses consideration received by the company for the issue of its shares, less previous share cancellations that were not dividends.

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It may also be necessary to apply the slice rule or the ordering rule. The slice rule is applicable to the cancellation of units by an unlisted trust or unlisted group investment fund, and it enables the available subscribed capital component of the redemption proceeds to be excluded from being a dividend even though the cancellation may be on a small scale. See further at ¶16-770.

Section CD 22 does not apply to shares issued under a profit distribution plan (¶16-571) and repurchased by the company. The section also does not apply to the cancellation of shares on liquidation of a company.

Pro rata cancellation

A pro rata cancellation is the cancellation of all shares in a class or a uniform cancellation of part of the shares of the class. A pro rata cancellation typically occurs in relation to a company that cancels its shares pursuant to an arrangement under Pt 15 of the Companies Act 1993. That procedure is normally followed to ensure that the arrangement will result in a uniform cancellation of shares. The arrangement, if approved by the required majority, will bind any dissenters.

An amount paid by the company to shareholders upon a pro rata cancellation is not a dividend when:

- the cancellation results in:
  - a 15% capital reduction for the company, or
  - a 10% capital reduction for the company and the Commissioner has given a notice that the payment is not in lieu of a dividend, and
- no part of the payment is in lieu of the payment of a dividend, having regard to:
  - the nature and amount of dividends paid by the company before or after the cancellation
  - the issue of shares in the company after the cancellation
  - the expressed purpose or purposes of the cancellation, and
  - any other relevant factor.

15% capital reduction

A 15% capital reduction is the circumstance where the aggregate amount paid by the company on account of the cancellation, or on account of any other pro rata cancellation occurring at the same time, is at least 15% of the market value of all participating shares in the company at the time the company first gave notice to shareholders of the cancellation. A 10% capital reduction is similarly defined to mean the circumstance that the amount paid on cancellation is at least 10% of the market value of all participating shares at the time of first notification to shareholders of the cancellation. The 15% and 10% thresholds are applied to the amount actually distributed on the share cancellation and not the potential maximum distribution if all shareholders accepted the company's offer.

The difference between the two capital reductions is that a 15% capital reduction does not require any notice from the Commissioner that the pro rata cancellation is not considered to be in lieu of a dividend. This more relaxed treatment may reflect the notion that the larger reduction of market capitalisation suggests it is less likely that the cancellation is a substitute for dividends. A 15% reduction of market capitalisation represents approximately three times typical dividend yields.

Not in lieu of dividends

The requirement that the cancellation is not in lieu of dividends is obviously significant. On that topic, the Commissioner has indicated that a cancellation may be accepted as not in substitution for dividends where it is prompted by any of the following factors:

- an overall corporate reorganisation or restructuring of ownership
- the company having surplus capital irrespective of a high dividend policy with which it wishes to alter its debt:equity ratio, to align it more closely with comparable companies
- lowering of funding costs by replacing equity with cheaper debt funding
- the reduction of the company's cash balance for improved balance sheet performance
- the capital reduction being part of an overall downsizing of the company or corporate group, and
- the reduction of administrative costs.

See *Tax Information Bulletin* ¶118-105 Vol 11, No 8, September 1999 at 5.

If the cancellation complies with the requirements for exclusion, the amount paid on cancellation is not a dividend to the extent it is less than or equal to the available subscribed capital per share calculated under the ordering rule (¶16-770).

A dividend did not arise when Tenon Ltd paid $1.25 per share cancelled to cancel one out of two shares on issue (to total approximately $349m) following the sale of its entire forest estate. See *Tax Information Bulletin* ¶163-106 Vol 16, No 3, April 2004 at 15.

15% interest reduction

A dividend may not result where the cancellation is not part of a pro rata cancellation, but it results in the shareholder suffering a 15% interest reduction. A 15% interest reduction is a share cancellation under which the total direct voting interests of the shareholder and counted associates or, where a market value circumstance exists the total direct market value interests of the shareholder and counted associates, are 85% or less of such interests as they were immediately before the cancellation. For this purpose, a counted associate is the shareholder's spouse, civil union partner, de facto partner or minor child, the trustee of a trust under which the spouse, civil union partner, de facto partner or minor child has benefited or is eligible to benefit, or a non-relative associate of the shareholder. This category of share cancellation may be thought to be directed at the cancellation of the shares of a minority shareholder. The transaction must not be in lieu of the payment of a dividend.

Non-participating redeemable shares

An amount paid upon the redemption of a non-participating redeemable share is not a dividend if the cancellation is not in lieu of the payment of a dividend. A non-participating redeemable share is one where all of the following apply:

- the share is able to be redeemed prior to liquidation
- the share is:
  - a redeemable share under New Zealand or foreign company law, or
  - issued by a co-operative company, or

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- subject to ss FA 2 and FZ 1, or s FA 2B(2) (stapled debt securities), or
- a unit in a unit trust that is not a widely-held trust

- the share is either a fixed rate share or a share for which the amount payable on cancellation is no more than the available subscribed capital per share calculated under the slice rule (¶16-770), and
- the only shareholder decision-making right the share carries is a protective right, unless the share was issued by a co-operative company.

Unlisted trusts

An amount paid by an unlisted trust on the redemption or cancellation of units may not be a dividend to the extent to which it is less than or equal to the available subscribed capital per share calculated under the ordering rule. The cancellation must not be part of a pro rata cancellation and the payment must not be in lieu of a dividend. However, if an unlisted trust has issued units subject to the slice rule, the amount paid on cancellation may still be excluded from being a dividend if the redemption proceeds are not in lieu of the payment of dividends. On this occasion the measure of the exclusion from dividends is calculated under the slice rule. It is explained at ¶16-770 that the slice rule effectively refers to the amount paid for issue of a unit in the unit trust. The component of the redemption proceeds that are a dividend may have imputation credits attached.

An unlisted trust is a unit trust or group investment fund whose units or interests are not quoted on the official list of a recognised exchange.

It is recognised that an investor in a non-resident unlisted widely-held trust may not be able to obtain sufficient information to apply the ordering rule. In that event, the units are treated as having been issued subject to the slice rule. The available subscribed capital of the trust becomes the amount paid for the issue of each unit or the unit holder's entitlement if issue of the units was a taxable bonus issue. A widely-held trust is one with at least 100 unit holders or investors or, if fewer, one that can be regarded as a widely-held investment vehicle for direct investment by the public or investment vehicles comprising unit trusts, group investment funds or superannuation funds.

¶16-710 Dividend exclusions — on-market share repurchases

[IT07 ss CD 24, YA 1 ("on-market cancellation")]

An amount paid by a company in purchasing its shares in an on-market cancellation is not a dividend. An on-market cancellation is an acquisition of shares in the company where all of the following apply:

- the transaction occurs on a recognised exchange through a broker or other agent independent of the company
- there is no prior arrangement between the shareholder and the company for the company to acquire the shares, and
- the acquisition is not a treasury stock acquisition, because the shares are cancelled on acquisition.

It also includes an on-market acquisition of the company's shares by an associated person under an arrangement for the associate to acquire the shares in lieu of the company.

Under this exclusion, the entire amount of a share market repurchase is not a dividend. However, any excess of the amount paid over the available subscribed capital per share calculated under the ordering rule may, nonetheless, be treated as a dividend and not as a return of capital for certain other purposes. This is when the dividend recovery provisions (s CD 40) apply, on calculation of the company's available subscribed capital (s CD 43) and when considering whether dividend stripping is present (s GA 1(4)). An on-market repurchase may give rise to a debit to the company's imputation credit account when available subscribed capital is exhausted.

¶16-715 Dividend exclusions — rights issues and premiums paid under bookbuild arrangements

[IT07 s CD 29B]

Companies can offer their shareholders rights to buy new shares, generally at a discount. Following concerns that the legislation was unclear whether such transactions were excluded from being a dividend, a retrospective amendment was made to clarify that the discounted amount is not a taxable dividend for those shareholders who exercise the right and that the right itself is also not a taxable dividend.

In addition, it was also clarified that in general premiums paid under bookbuilds are not dividends for tax purposes. A bookbuild can take place following a rights issue. A bookbuild involves the rights of non-participating shareholders (who chose not to participate or were not entitled to participate) being offered to other investors who pay a premium for them. The original shareholder is paid all or part of this premium for giving up their rights. The premium in that case will not be a dividend. Note, however, that in some cases the premium may be paid to the company and this may give rise to available subscribed capital. In those circumstances, the exclusion will not apply.

¶16-720 Dividend exclusions — distributions on liquidation

[IT07 ss CD 26, CD 44, YA 1 ("available capital distribution amount", "available subscribed capital", "dividend", "liquidation")]

Upon a company going into liquidation, a liquidator is appointed to realise the company's assets, repay creditors and distribute any surplus to shareholders in extinguishment of their shares. The provisions of s CD 26 specify the extent to which the liquidator's distribution is a dividend. For this purpose, the notion of a liquidation encompasses both a conventional liquidation and the more informal removal of the company from the register of companies. To the extent that the liquidator's distribution comprises dividends, the liquidator is able to attach imputation credits to the dividends.

The liquidation rules also apply to companies that migrate from New Zealand by treating them, for tax purposes, as if they were in liquidation. See s CD 26(1)(b) and ¶16-870.

A distribution to shareholders by a company in liquidation is not a dividend to the extent of:

- the available subscribed capital per share calculated under the ordering rule, and
- the available capital distribution amount calculated under s CD 44.

This exclusion effectively excludes from dividend classification returns of available subscribed capital and approved capital gains distributed by a company in liquidation. However, a capital gain amount distributed to an associated non-resident company on liquidation is a dividend for non-resident withholding tax purposes: see para (c) of the definition of "dividend" in s YA 1.

For a statutory producer board in liquidation, any return of a levy specifically charged for capital development is also not a dividend.

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Calculation of the available capital distribution amount

The available capital distribution amount is calculated in relation to a share. This reflects the liquidator's approach of paying an amount per share, calculated according to the company's reserves, in satisfaction of cancellation of the company's shares. In relation to a share in the course of a company's liquidation, the available capital distribution amount is calculated under the following formula:

(receipt – asc per share) × (capital gains + (capital property distributed – cost) – capital losses) ÷ (total receipts – total asc)

where:

receipt is the amount received by the shareholder on liquidation for the share

asc per share is the available subscribed capital per share calculated under the ordering rule for the share at the time of liquidation

capital gains is the total capital gains available for distribution but excluding any gain occurring upon distribution of the company's property in liquidation

capital property distributed is the total market value of the company's capital property distributed on liquidation

cost is the cost of the company's capital property distributed on liquidation

capital losses is total capital losses as from the beginning of the 1992/93 income year, but excluding any loss arising from distribution of the company's property on liquidation

total receipts is the total of all amounts received by shareholders on liquidation, and

total asc is the total available subscribed capital at the time of liquidation.

The available capital distribution amount is deemed to be nil if either multiplier in the formula is negative. A nil available capital distribution amount also arises if the company is not resident in New Zealand and insufficient information can be obtained to apply the formula.

Capital gain amount

Section CD 44(7) defines a capital gain amount in detail. The starting point is that a capital gain amount comprises gains (the excess over cost) from property that is not revenue account property.

Prior to 30 March 2017, a company that disposed of property under an arrangement with an associated person did not derive a capital gain amount, nor did it incur a capital loss amount: s CD 44(10B). This is sometimes known as the "tainted capital gains" rule. There was an exception for a disposal made on the liquidation of a close company to an associated person who was not a company: s CD 44(10C).

The effect of the qualification was to confer non-dividend treatment on the gain that a close company in liquidation made when a capital asset was sold to associated natural person shareholders.

With effect from 30 March 2017, amendments made to s CD 44(10B) and (10C) have narrowed the scope of this "tainted capital gains" rule. For distributions made on or after 30 March 2017, the rule only applies to asset disposals between companies that have at least 85% common ownership at the time of disposal, with the original owners still retaining at least 85% interest in the asset at the time of liquidation. Where, by the time of the liquidation distribution, the asset is owned by a company that does not have the required common ownership or by a non-corporate, the gain or loss is not tainted and is non-taxable. The narrowed rule applies to liquidations of a company from 30 March 2017. This means the new formula applies to capital gain or loss amounts made prior to that date as long as the liquidation occurs after.

The receipt of a capital gain in the liquidation of another company continues to have status as a capital gain amount. The capital gain amount can be distributed in the liquidation of the recipient company without classification as a dividend. See s CD 44(7)(c). The same treatment applies to a capital gain amount retained by an amalgamating company that passes only to the amalgamated company in the amalgamation: s CD 44(8).

A gift that was not income is treated as a capital gain amount: s CD 44(7)(b).

A capital gain amount can include capital gains that have been applied to pay a non-taxable bonus issue after 30 September 1988. This is provided the bonus shares are still on issue at liquidation. See s CD 44(5).

However, a company's capital gain amounts derived after 31 March 1988 and before the 1992/93 tax year are reduced by the amount of capital losses suffered in the tax year in which the capital gain was made or in a later tax year before the 1992/93 tax year: s CD 44(6).

A capital gain amount includes an amount attributable to a revaluation of livestock held under the herd scheme: s CD 44(7)(d).

The difference between the consideration for disposal or acquisition of livestock and the value of that livestock under s EC 4C is regarded as a capital gain or loss by corporate parties to the transaction: s CD 44(7)(db).

A capital gain amount also includes any item coming within the transitional provisions of s CZ 9. These include amounts recognised as capital gains under the rules in force before 1 April 1988 and livestock, wine, brandy and whisky revaluations under provisions in force during the period including the 1985/86–1991/92 tax years. See s CD 44(7)(e).

The calculation of a capital gain amount does not include reinvested dividends that do not become part of the available subscribed capital of the company that issued the shares: s CD 44(13).

Example:

TP Ltd was incorporated in 2005. TP goes into liquidation and the surplus available for distribution is $3,300,000, comprising:

	$
Cash	2,050,000
Building (market value)	1,250,000
	3,300,000

Equity includes:

- $1,000,000 share capital from the issue of 500,000 shares at $2 per share (fully paid), and
- $600,000 realised capital gain upon the sale of a business to an arm's length purchaser.

The building owned by the company cost $850,000 and has a current market value of $1,250,000.

Therefore, the distribution per share is:

$3,300,000 ÷ 500,000 = $6.60

The available subscribed capital per share calculated under the ordering rule is:

$$\frac{1{,}000{,}000}{500{,}000} = \$2.00$$

The available capital distribution amount formula for each shareholder becomes:

$$(6.60 - 2.00) \times \frac{600{,}000 + (1{,}250{,}000 - 850{,}000)}{3{,}300{,}000 - 1{,}000{,}000}$$

$$= 4.60 \times \frac{1{,}000{,}000}{2{,}300{,}000}$$

$$= \$2.00 \text{ per share.}$$

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¶16-725 Dividend exclusions — property supplied intra-group

[IT07 s CD 27]

There are two exclusions from dividends for a transfer of value between associated companies. The exclusions apply when:

- a company (the first company) makes a transfer of value to another company (associated company), and
- the transfer of value would be a dividend because the associated company is associated with a shareholder in the first company.

Small transfer of value

A transfer of value by the first company to the associated company is not a dividend when:

- the transfer is the making available of property for less than market value (other than loans), and
- total dividends by this means in the income year of the first company do not exceed $10,000.

Downward transfer of value

A transfer of value by the first company to the associated company is not a dividend when:

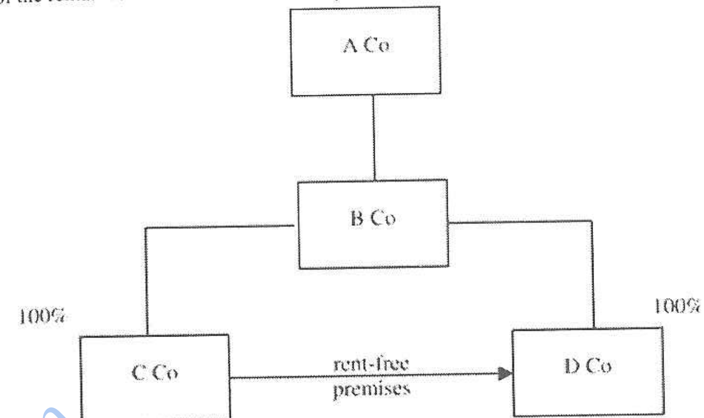
- the first company:
  - □ holds a direct voting interest in the associated company, or
  - □ is associated with another company (the parent company) that has a direct voting interest in the associated company and that could have received the transfer of value without the benefit being assessable income or non-resident passive income, and
- the associated company does not hold a direct voting interest in the first company, and
- there is no person apart from the parent company that holds both:
  - □ a voting interest or a market value interest in the first company, and
  - □ a voting interest or a market value interest in the associated company of more than 10%.

The third requirement of a common interest exceeding 10% is generally to be ascertained only by having regard to a shareholder's direct voting or market value interests. The principles to apply are:

- direct interests only are taken into account to ascertain shareholders' or the associated company's, other than the parent company's, interests in the first company
- the direct voting and market value interests of the first company and the associated company are taken into account to ascertain whether a shareholder, other than the parent company, holds a voting or market value interest of more than 10% in the associated company.

Example:

Under the following corporate structure, C Co allows D Co to occupy a building rent-free, even though the market value of the rental would be at least $100,000 per annum.



Potentially, the benefit provided by C Co, as the first company, to D Co, as the associated company, is a dividend because both companies are associated. The exclusion from a dividend can be considered:

- although C Co does not have a voting interest in D Co, it is associated with B Co as the parent company which does have a voting interest in D Co
- B Co could have received the rent-free use of the building without the benefit being assessable income (because dividends between wholly-owned companies are exempt income)
- only B Co has a voting interest in C Co, as the first company, and a voting interest of more than 10% in D Co, as the associated company.

The benefit provided by C Co is excluded from being a dividend.

Source: New Zealand Society of Accountants July 1995 *Tax Workshop*, prepared and presented by KPMG Peat Marwick and reproduced with permission from the NZSA.

The exclusion does not apply to a transfer of value that is treated as a dividend under s FA 3 (recovery of cost of shares that are revenue account property): see ¶16-785.

¶16-730 Dividend exclusions — share transfers within wholly-owned group

[IT07 ss CD 28, ED 2(4)]

A transfer of an excepted financial arrangement held on revenue account to another member of a wholly-owned group of companies is not a dividend. Nor does the transfer generate a realised loss that can be taken into account for tax purposes.

¶16-732 Dividend exclusions — company splits (demergers) by listed Australian company

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill, introduced into Parliament on 6 April 2017, proposes amendments to the dividend rules so that certain transfers of shares received by New Zealand shareholders as a result of a company split (demerger) by a listed Australian company will not be treated as a dividend. Proposed new s CD 29C will provide that the transfer by an Australian Stock Exchange (ASX) listed company of shares in a subsidiary company is not a dividend. Proposed new s ED 2B will set out the conditions needed for s CD 29C to apply and the tax consequences for taxpayers who hold the ASX-listed company's shares as revenue account property. The new section will also provide for the adjustment of available subscribed capital amounts.

The amendments are intended to apply from 1 April 2016 for the 2016/17 and later income years.

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¶16-733 Dividend exclusions — payments by foreign superannuation scheme [IT07 s CD 36B]

From 1 April 2014, a new set of rules applies for the taxation of New Zealand residents on interests in, and income from, foreign superannuation schemes, provided they are not FIF superannuation interests (see ¶5-317). As part of the changes made, a new s CD 36B has been inserted to provide that an amount paid by a company that is a foreign superannuation scheme is not a dividend if the person derives the amount as a foreign superannuation withdrawal or a pension.

¶16-735 Dividend exclusions — foreign investment fund income [IT07 s CD 36]

There is an exclusion from dividends for a distribution received from an attributing interest in a corporate foreign investment fund where foreign investment fund (FIF) income or loss is calculated under the comparative value method, the deemed rate of return method, the cost method or the fair dividend method. When the fair dividend rate method has been applied, the dividend exclusion does not apply if the person held a direct income interest of 10% or more in the FIF at the beginning of the relevant income year and the FIF satisfied the exclusion for Australian resident FIFs under s EX 35(b) and its income tax liability was not reduced under s EX 35(c).

The exclusion does not apply to:

- portfolio investment entities (PIEs)
- entities eligible to be PIEs, and
- life insurance companies

if the FIF is a foreign PIE equivalent.

¶16-740 Dividend exclusions — resident's restricted amalgamations [IT07 s CD 35]

There is an exclusion from dividends for an amount derived by an amalgamated company (the continuing company) under a resident's restricted amalgamation that arises from:

- the acquisition of property from the amalgamating company (the extinguished company), or
- the amalgamated company being relieved of an obligation owed to the amalgamating company.

The effect of this exclusion is to prevent dividend treatment applying to the property of the amalgamating company that passes to the amalgamated company under a resident's restricted amalgamation. There is no additional provision that addresses the position of shareholders and the possible benefits they may receive under an amalgamation.

¶16-745 Dividend exclusions — flat-owning companies [IT07 s CD 31]

A dividend does not arise from the provision of residential property by a flat-owning company. A flat-owning company is a company whose constitution provides an entitlement to shareholders to use specific residential property in New Zealand and whose only significant assets are such residential properties and accompanying funds.

¶16-750 Dividend exclusions — producer boards and co-operative companies [IT07 ss CD 2, CD 33, CD 34B, DV 11]

A statutory producer board or a co-operative company may choose to treat a notional distribution as a dividend by attaching imputation credits to the notional distribution (see ¶16-575). A subsequent distribution that corresponds to the notional distribution is not a dividend if the later distribution is based on produce transactions with the entity (or alternatively on member levies in the case of a statutory producer board).

A co-operative company can elect not to treat certain distributions to members as dividends. To be eligible to make such an election, the company and the member need to satisfy certain New Zealand residency requirements and the distribution must be based on the member's transactions with the company involving trading stock other than intangible property.

The distributions need not be in strict proportion to the member's transactions with the co-operative — a variation of up to 20% is permitted.

The company is entitled to a deduction for the amount that is not a dividend and that same amount is income of the member for tax purposes.

¶16-760 Available subscribed capital [IT07 ss CD 43, OZ 13]

The concept of available subscribed capital is relevant when a company cancels its shares and pays consideration to compensate the shareholder for the cancellation. The available subscribed capital becomes the measure of the payment that may be excluded from dividend classification. Whether there is exclusion will depend on the circumstances of the cancellation and application of the requirements for exclusion.

Essentially, available subscribed capital represents a reserve that the company may be able to return to shareholders without dividend classification. This reflects the capital nature of the transaction when the capital was first contributed to the company by its shareholders.

There are four components to a company's available subscribed capital. These comprise:

- the company's paid-up share capital on 1 July 1994, if the company was in existence on that date
- amounts received by the company after 30 June 1994, as consideration for the issue of the company's shares of the same class
- consideration the company has previously paid after 30 June 1994, on cancellation of its shares and that did not give rise to a dividend
- consideration the company paid before the calculation time on the cancellation or buyback of shares while it was a look-through company (¶16-010).

The first two components are added together to give the maximum possible available subscribed capital. That figure is reduced by the third and fourth components incorporating previous reductions of available subscribed capital that were not dividends.

Paid-up share capital

A company's available subscribed capital comprises any share capital that the company may have had on 1 July 1994, plus consideration received by the company after 30 June 1994 for the issues of its shares but reduced by amounts paid after that date upon share cancellations that are not dividends. The available subscribed capital is calculated on a class basis if the company has more than one class of share on issue.

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The share capital that the company may have had on 1 July 1994 incorporates:

- paid-up capital on 1 July 1994 but excluding bonus issues made after 30 September 1988, unless the bonus issue was:
  - □ a taxable bonus issue, or
  - □ paid up by the application of qualifying share premium, being share premium that had been credited to the company's share premium account and that did not result from a share issue in the course of the takeover of another company, and
- qualifying share premium received before 1 July 1994 that has not been applied before that date to pay up shares.

The Commissioner has addressed the available subscribed capital implications of a deemed merging of share classes that may have occurred upon a re-registration of a company. The Commissioner's view was that any merging of classes did not result in a loss of available subscribed capital. The new class of share created by the deemed merger of former classes of share effectively was to be ascribed with the available subscribed capital of those former classes. See *Tax Information Bulletin* ¶107-114 Vol 10, No 7, July 1998 at 8. Effectively, paid-up capital as at 1 July 1994 can be regarded as becoming part of the available subscribed capital of the new class of share created by the merger.

Paid-up capital as at 1 July 1994 includes the par value received upon issue of the shares even though the company may have subsequently treated the par value as reduced by capital losses suffered by the company. See *Tax Information Bulletin* ¶187-103 Vol 18, No 7, August 2006 at 6.

A company with altered shares may have decided to make allowance for the effect of deemed registration by altering rights attaching to a share class. In that event the value of the consideration received for the shares is calculated when the altered shares join the new class of share. The consequences are that, upon the company altering shareholder rights to rectify the effect of deemed registration, the available subscribed capital of the rectified share class is reached by dividing the available subscribed capital of the new class by the number of shares in the class immediately before rectification.

Consideration for the issue of shares

Detailed provision is made to specify what consideration received for issue of shares after 30 June 1994 may be treated as additions to the company's available subscribed capital.

The starting point is what the board of the company determined is the consideration for the share issue. The duties of the board include determining the consideration received for issue of the company's shares.

Available subscribed capital encompasses:

- the money or money's worth alternative under a bonus issue in lieu
- the amount offered by the company to repurchase a share issued under a profit distribution plan
- the amount of the dividend under a taxable bonus issue elected by the company
- the amount of the debt released or converted when shares are issued in satisfaction of a debt claim against the company.

Available subscribed capital does not include:

- a non-taxable bonus issue
- a taxable bonus issue between wholly-owned companies that is exempt income to the extent that the dividend is not fully credited
- a taxable bonus issue from a foreign company that is an item of exempt income to the extent not fully credited.

With effect from 30 March 2017, it has been clarified that imputation credits attached to a taxable bonus issue are not included in the available subscribed capital. This also allows for equal treatment between taxable bonus issues and ordinary cash dividends that are reinvested.

To calculate the extent of crediting of a dividend, the following formula applies:

$$\text{dividend excluding credits} \times \text{actual ratio} \div \text{maximum ratio}$$

where:

dividend excluding credits is the amount of the dividend exclusive of imputation credits and dividend withholding payment credits

actual ratio is the total of the imputation ratio and the dividend withholding payment ratio of the dividend, and

maximum ratio is the maximum permitted imputation ratio under the imputation and dividend withholding payment rules.

Debt forgiven within an economic group

Debt forgiven within a wholly-owned group of companies, or within lesser degrees of ownership, may be treated as having been paid for the purposes of the financial arrangements rules. That would preclude the recognition of base price adjustment income on account of unpaid debt. The debt forgiveness may consequentially result in an increase in the available subscribed capital amount of the debtor company. In the wholly-owned group context, the increase to the available subscribed capital occurs where all of the following apply:

- the creditor and debtor are in the same wholly-owned group of companies with the debtor resident in New Zealand or directly owned by New Zealand resident companies
- the creditor is a non-resident company
- the debt has not previously been held outside of the wholly-owned group, and
- the available subscribed capital calculation is being made for the debtor company or a company that directly owns the debtor company.

Outside the context of a wholly-owned group of companies the increase in available subscribed capital occurs where the creditor holds direct voting interests or market value interests in the debtor company and there is partial deemed payment of the debt commensurate with those interests. The increase in available subscribed capital for the debtor company is the amount of debt that is deemed to have been paid for the purposes of the financial arrangements rules. The debt release is effectively treated as a capital injection into the debtor company. The amount included in the available subscribed capital cannot exceed the creditor's voting interests or market value interests in the debtor company. The addition to available subscribed capital is consequentially treated as an addition to the cost base of the shares of the creditor in the debtor: s DV 19B.

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The Commissioner has addressed the available subscribed capital implications of the establishment of energy companies as successors to electric power boards and municipal electricity departments. The conclusion reached was that available subscribed capital could be recognised in relation to the shares issued by the energy companies. The companies had received consideration for the issue of shares in the form of the business undertakings transferred to them by the power boards and electricity departments. See *Tax Information Bulletin* ¶112-109 Vol 11, No 2, February 1999 at 18.

Returns of available subscribed capital

The general proposition is that available subscribed capital is reduced by all amounts paid by the company after 30 June 1994 on the cancellation of shares and that were not a dividend. Some specific items supplement the general proposition.

No reduction to available subscribed capital is made for any distribution recovered by the company from shareholders.

There is a reduction to available subscribed capital where shares in an amalgamated company are held by an amalgamating company but cancelled in the course of the amalgamation. The amount of the reduction to available subscribed capital of the amalgamated company is increased by an amount calculated using the following formula:

$$\text{cancelled shares} \times \text{asc per share}$$

where:

cancelled shares is the number of cancelled shares, and

asc per share is the available subscribed capital per share of the cancelled shares.

An on-market acquisition of the company's shares by an associate is also addressed. There is no reduction to the company's available subscribed capital where the share acquisition by the associate is treated as an on-market cancellation giving rise to a debit to the company's imputation credit account.

¶16-770 Ordering rule and slice rule [IT07 s CD 25]

The ordering rule and the slice rule apply to ascertain the amount of available subscribed capital that may be attributed to a share. The attribution is relevant to the amount of a return of available subscribed capital that is not a dividend. The ordering rule and the slice rule are applicable to unlisted unit trusts and group investment funds. The ordering rule is also applied to the available subscribed capital reduction for treasury stock and to calculate the debit to a company's imputation credit account that may arise following an on-market share repurchase and cancellation.

Ordering rule

The ordering rule for the calculation of the available subscribed capital per share is applied to all cancelled shares of the same class as the share cancelled. The ordering rule is incorporated in the following formula:

$$\text{available subscribed capital of class} \div \text{shares being cancelled of class}$$

where:

available subscribed capital of class is the available subscribed capital of all shares of the same class at the time of calculation, and

shares being cancelled of class is the number of shares of the class being cancelled.

The ordering rule effectively allocates subscribed capital on a "first come, first served" basis. The available subscribed capital of the company is treated as having been distributed to those eligible to receive it, rather than to those shareholders who may have contributed it. In addition to applying to a conventional company, the ordering rule applies to listed trusts and group investment funds.

Example 1:

VM Ltd issued a total of 20 million shares in consideration of the receipt of $1 per share. Following the sale of the company's principal investment for a profit of $8m, VM Ltd proposes a pro rata share cancellation. VM Ltd proposes to cancel 5 million shares upon payment of $1.60 per share cancelled. The ordering rule would be applied as follows:

$$\frac{20{,}000{,}000}{5{,}000{,}000} = \$4.00 \text{ per share.}$$

If the shareholder cannot obtain sufficient information to make the calculation, the available subscribed capital per share is zero. This applies when the company in question is not resident in New Zealand.

Slice rule

The slice rule for the calculation of the available subscribed capital per share is applied to shares of the same class on issue at the time of calculation. The formula for the calculation is as follows:

$$\text{available subscribed capital of class} \div \text{shares of class}$$

where:

available subscribed capital of class is the available subscribed capital of all shares of the same class at the time of calculation, and

shares of class is the number of shares of the class on issue at that time.

The effect of the formula is to allocate available subscribed capital evenly over shares of the class.

Example 2:

WP Ltd had issued a total of 5 million shares for a consideration of $1 per share. Successful trading has resulted in the addition to equity of $2.5m in retained earnings. WP Ltd contemplates a return of capital. The available subscribed capital of WP Ltd calculated under the slice rule would be:

$$\frac{5{,}000{,}000}{5{,}000{,}000} = \$1.00 \text{ per share.}$$

The slice rule comes to have application to an unlisted trust or unlisted group investment fund that issues units on the basis that the slice rule applies on their redemption (or, as an alternative formulation, that the ordering rule does not apply). When units in the trust are redeemed, there is no dividend to the extent of their redemption proceeds that equal the available subscribed capital per share as calculated under the formula.

¶16-780 No double tax on share cancellation [IT07 s CD 53]

An amount derived by a shareholder on the cancellation of a company's shares may be a dividend. This may be because the cancellation does not satisfy the bright line tests or the company is in liquidation. If the shares are held on revenue account, the cancellation is treated as a disposal that may or may not produce assessable income. It is necessary to allocate taxation between the two potential categories of income.

When ascertaining whether the cancellation produces assessable income, a deduction from the cancellation proceeds is made for any component that is a dividend. Effectively, priority is given to taxation as dividends. In making the deduction for the amount already taxed as a dividend, the dividend amount is to be treated as excluding any attached imputation credits. In addition, no deduction is made for a dividend to the extent it is exempt income from equity (under ss CW 9 and CW 10).

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¶16-785 Cancellation of shares held on revenue account [IT07 s FA 4]

A shareholder holding shares on revenue account may be required to undertake adjustments when some of the shareholding is cancelled under an off-market share repurchase by the company whose shares are repurchased. These adjustments concern the impact of the cancellation on the remaining shares in the company that the investor continues to hold.

The first adjustment applies if all of the cancellation proceeds are a dividend under an off-market cancellation. The cancellation is likely to be a dividend because the cancellation failed the bright line or in lieu of dividends test. The adjustment required is that the cost of the shares cancelled must be apportioned on some fair basis and added to the cost of the remaining shares. In addition, the cancellation is treated as not giving rise to a disposal for the purposes of the revenue account provisions.

A second adjustment may be required if there is an off-market cancellation that takes place at below the market value of the shares at the time of first notification to shareholders of the cancellation. In this situation, the adjustment again is to the cost base of the remaining shares. The cost of the shares cancelled must be added to the cost of the remaining shares in accordance with the following formula:

share cost – (cost pre-cancellation × amount from cancellation ÷ market value)

where:

share cost is the cost of the cancelled share to shareholders

cost pre-cancellation is the aggregate cost of all the shareholder's shares of the same class before cancellation

amount from cancellation is the consideration derived by the shareholder from cancellation of the share, and

market value is the market value of all the shareholder's shares in the same class before the cancellation.

The effect of this formula is to link the allowable deduction for the cost of shares sold to the percentage of the shareholder's interest that is sold. For example, if a shareholder is disposing of 5% of the value of its interest in a class, a deduction should be permitted for 5% of the cost of shares that the shareholder holds in that class.

Example:

A Co bought 100 shares for $1 each in B Co and holds them on revenue account. B Co buys back 25 shares at $0.50 per share. The market value of each share is $2.50. The distribution is not a dividend but is sourced from available subscribed capital as a 15% interest reduction.

A Co calculates the loss or gain on sale as follows:

Cost per share	$1.00
Amount excluded from cost	
$1 – ($100 × $0.50) / $250	$0.80
Adjusted cost of share disposed	$0.20

A Co is disposing of $12.50/$250 of its interest, or 5% of the market value of the interest. The aggregate allowable cost deducted is $5 (0.20 × 25), or 5% of the total cost of all the shares.

Alternatively, this may be seen as A Co disposing of shares at 20% of their value and being able to claim only 20% of their cost.

The gain on sale is therefore $7.50 (sale price ($0.50) – cost ($0.20) = $0.30 per share × 25). The cost price of the remaining shares increases to $1.26 per share ($95/75 shares), or $95 in total.

See *Tax Information Bulletin* ¶66-103 Vol 6, No 6, December 1994 at 14.

INTERCOMPANY DIVIDENDS

¶16-800 Dividends between companies [IT07 ss CW 9, CW 10, YA 1 ("foreign company")]

The general proposition is that dividends are a class of assessable income in the hands of the shareholder who derives the dividends. There are some modifications if the shareholder is also a company.

Wholly-owned group companies

Dividends paid between members of a wholly-owned group of companies are exempt income: s CW 10. Broadly, this covers companies with 100% common voting interests and, where relevant, market value interests. Companies do not have to have the same tax balance date or satisfy the Commissioner that no timing advantage will occur.

For the exemption to apply the dividend must also be:

- derived by a company resident in New Zealand, and
- derived from a company that is neither a foreign company nor a company that can derive only exempt income

and must not be:

- derived by a local authority from any council-controlled organisation, energy company or port company or subsidiary of a port company
- derived by a friendly society from a company registered as an insurer under the Accident Insurance Act 1998 that is under the friendly society's control, or
- derived by a trustee in trust for any sickness, accident or death benefit fund from a company registered as an insurer under the Accident Insurance Act 1998 that is under the control of that trustee.

Dividend from foreign company

Dividends derived from a foreign company by a New Zealand company are also exempt income: s CW 9. There are a number of exclusions to this general rule, including:

- dividends from a direct income interest in certain foreign investment funds (FIFs) (comprising 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, and certain grey list companies)
- dividends from fixed-rate foreign equity
- dividends from deductible foreign equity
- dividends derived by a portfolio investment entity
- in certain circumstances, dividends derived by a person from a direct income interest of 10% or more in an Australian resident FIF.

A foreign company is defined in s YA 1 as:

- a company that is not resident in New Zealand, or
- a company that is treated under a double tax agreement as not being resident in New Zealand.

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LIQUIDATION

¶16-850 Liquidation of a company

[C93 sch 7; IT07 s RA 23; TAA ss 44, 167–170]

The liquidation of a company raises a number of aspects.

Authorisation

The person appointed as liquidator must consent to act before the liquidation is commenced. See *C of IR v Edmonton Group Ltd* (2004) 21 NZTC 18,679.

The liquidator as the person responsible for operation of a company in liquidation would need to make all necessary returns of income incorporating the company's trading activities. The Commissioner has the power at any time to demand that a return of income be filed in relation to a company in liquidation. The demand may be for a specified period or in respect of a particular transaction. See s 44 of the Tax Administration Act 1994 (TAA).

In some instances, possible application of the capital limitation to prevent the deduction of expenses may be an issue. This is because of the capital complexion, in part at least, of the liquidation process. The process may involve realisation of the company's capital structure. Nonetheless, expenses fairly referable to continued operation of the company's trading operations can be expected to be allowed as a deduction.

Distributions on liquidation are discussed at ¶16-720.

Tax losses

The fact of liquidation may be regarded as having no impact on the ability of the company to carry forward a loss balance from a prior income year. Liquidation does not impact on the voting interests carried by shares of the company. Liquidation merely affects management of the company upon the control of operations passing from the company's directors to the liquidator.

The position was reviewed in Australia in *FC of T v Linter Textiles Australia Ltd (in liq)* 2005 ATC 4255. This case related to a situation involving both a loss company and its shareholder being placed in liquidation. The Court concluded that the loss company was not able to continue to carry-forward its losses because of the effect of liquidation of its shareholder company. (The law in Australia was later changed to reverse the *Linter* decision.)

One of the tests for the loss company being able to carry forward its losses was that the voting power in that company continued to be controlled, or capable of being controlled, by the same natural persons (disregarding any interposed companies). Upon liquidation of the shareholder company, the natural persons who formerly controlled the shareholder company ceased to do so. Those natural persons had ceased to be capable, for example, of carrying an ordinary resolution at a general meeting of shareholders of the loss company. The ability to exercise the rights attaching to the shares passed to the liquidator of the parent company as the person who assumed control of the assets of that company. Control of the shares of the shareholder company, also in liquidation, passed to the liquidator of that company.

In reaching this conclusion, the courts confirmed that the fact of liquidation did not impact on the voting rights carried by shares in the loss company that were held by the shareholder company. Those shares did not, for example, become subject to a trust in favour of the creditors and shareholders of the loss company. The shareholder of the loss company continued to be the beneficial owner of the shares in that company.

This supports the view that the commencement of the liquidation of a loss company would not prevent the continued carry-forward of its losses. The shareholder rights carried by those shares are not changed by the liquidation of the company itself. The liquidation merely operates to change who may control the affairs of the company.

The liquidation of a company has the effect of remitting any debts owed by the company. If those debts have formed part of a tax loss that has been used against the income of another company in the same group of companies, the Commissioner is entitled to reassess the profit company to disallow the grouping of tax losses. The remitted debt ceases to be a deduction able to be taken into account to arrive at the tax loss. See *Hotdip Galvanisers (Christchurch) Ltd v C of IR* (1999) 19 NZTC 15,337 (CA).

Preferences

When a company is liquidated, the Commissioner ranks as an unsecured creditor for tax derived on income prior to the date of liquidation. Consequently, a liquidator would be unwise to pay the demands for tax immediately, merely to avoid late payment penalties, since doing so would amount to undue preference being given to one particular creditor over another.

Combined tax and earner-related payments deductions (excluding any late payment or shortfall penalties) made under the PAYE rules are held in trust for the Crown. This is also the case for deductions of employer superannuation contribution tax and non-resident withholding tax.

Should the company become insolvent, any such tax deductions so held remain separate property and do not form part of the estate in liquidation (or upon the appointment of a receiver). They are deemed to become a debt due and payable to the Commissioner on the 20th of the month following the month in which the relevant payment to the employee is made.

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Jennings Roadfreight decision

The High Court in *Jennings Roadfreight Ltd (in liq) v C of IR* (2012) 25 NZTC ¶20-135 concluded that if an amount of PAYE has not been paid to the Commissioner when liquidation of a company commences, the deemed trust imposed under s 167 of the TAA in favour of Inland Revenue ceases and the Commissioner then becomes a creditor in the liquidation. However, on appeal, the Court of Appeal overturned the High Court decision and held that where s 167(1) applies the trust remains in existence upon liquidation and therefore the Commissioner was entitled to payment of the PAYE owing, as opposed to being subject to the sch 7 ranking (discussed below). If the PAYE has not been dealt with properly and falls within s 167(2), the sch 7 ranking will apply. See *C of IR v Jennings Roadfreight Ltd (in liq)* (2013) 26 NZTC ¶21-035 (CA). In effect, the decision would have meant that any credit balance in a bank account of a company on liquidation up to the value of PAYE deducted would be held on trust for the Commissioner and will not form part of the company's estate on liquidation. However, the Supreme Court allowed the appeal by Jennings and confirmed that upon the liquidation of Jennings the unpaid (and overdue) PAYE was dealt with under s 167(2) and was therefore subject to the sch 7 ranking. Section 167(2) applies on liquidation when one of two conditions is met: (i) where the employer has failed to deal with the amount withheld or deducted in the manner required by s 167(1), and (ii) where the employer has failed to deal with the amount in accordance with the PAYE rules. Section 167(2) was a specific qualification to the broader provisions of s 167(1), which applied even if there was no insolvency. This means that, in the event of liquidation, s 167(2) and the priorities set out in that subsection apply to all amounts of PAYE withheld that fell due before liquidation but were not paid to the Commissioner before liquidation. Section 167(1) does not apply to such amounts, unless (possibly) unpaid PAYE deducted has been segregated by the employer in a separate account. Amounts of PAYE that fall due for payment after liquidation will, however, remain subject to s 167(1). See *Jennings Roadfreight Ltd (in liq) v C of IR (No 2)* (2014) 26 NZTC ¶21-108 (SC).

Schedule 7 ranking

In a liquidation or on the appointment of a receiver, unpaid tax deductions have the ranking provided for in sch 7 of the Companies Act 1993. This means that the order of priority is as follows:

- costs and expenses of liquidation
- the following preferential payments:
  - the salary and wages owing to any employee for services rendered to the company in the four-month period prior to the commencement of the liquidation (limited to $22,160 per employee) (this category of debt extends to commissions and piecework payments owing)
  - untransferred payroll donations of an employee and held by the employer or a PAYE intermediary during the four months before commencement of the liquidation (limited to $22,160 per employee)
  - the holiday pay payable to an employee upon the termination of employment before or because of the commencement of the liquidation (limited to $22,160 per employee)
  - any redundancy owed to an employee that has accrued before or by reason of the commencement of the liquidation (limited to $22,160 per employee)
  - any reimbursement or payment provided for, or ordered by, the Employment Relations Authority, the Employment Court or the Court of Appeal for wages or other remuneration lost during the four-month period before the commencement of the liquidation as a result of a personal grievance (excluding wages or benefits lost for humiliation, loss of dignity and injury to feelings) (limited to $22,160 per employee)
  - any deduction made by the company to satisfy some obligation of the employee (eg union fees, superannuation contributions) (limited to $22,160 per employee)
  - child support amounts payable to the Commissioner (limited to $22,160)
  - KiwiSaver contributions payable to the Commissioner
  - 10% of the value of a debt secured by a lien in respect of services performed before the liquidation commenced (to a maximum of $2,000)
  - any other debts required by some other statute to be paid in priority to all other debts in the event of a liquidation
- all sums, for which the buyer is a creditor under the Layby Sales Act 1971, paid by a buyer to a seller on account of the purchase of goods, or to which a buyer is entitled to receive from the seller under the Layby Sales Act
- any costs incurred by a person in organising and conducting a creditors' meeting
- tax payable by the company in terms of the following:
  - goods and services tax
  - PAYE (to the extent that it was not properly dealt with prior to the liquidation — see discussion of *Jennings Roadfreight* decision above)
  - non-resident withholding tax
  - resident withholding tax, and
  - excise duty

- debts owed to holders of security interests held over all or part of the company's accounts receivable and inventory, other than purchase money security interests and security interests that have been the subject of a factoring transaction. (A "purchase money security interest" is generally any security interest which secures the purchase price of goods, including the equivalent of a Romalpa clause; or a security interest which prohibits or restricts the property from being disposed of in the ordinary course of the business.)
- unsecured creditors (eg the Commissioner, for unpaid income tax, civil penalties and use of money interest), and
- deferred creditors.

There is a limitation on the debts which enjoy priority to the effect that the debts for salary, holiday pay, payroll donations and employee obligations may not, in each case, exceed $20,340 per employee. Subject to that qualification, the specified debts rank equally among themselves and, if the assets are insufficient to meet them, they abate in equal proportions.

For the purposes of sch 7:

- remuneration in respect of a period of holiday or of absence from work through sickness or other good cause is treated as wages in respect of services rendered to the company during that period
- the expression "holiday pay", in relation to a person, means all sums payable to that person by the company under subpart 1 of Pt 2 of the Holidays Act 2003, and includes all sums payable to that person by the company as holiday pay (whether by or under any other enactment or any award, agreement or contract of service), and
- an "employee" is any person of any age who is employed to do any work for hire or reward under a contract of service, including a home worker but excluding a person who was, at any time in the 12 months before the commencement of the liquidation:
  - a director of the company, or
  - a nominee, or a relative of or a trustee for a director of the company.

Commissioner's priority and the Personal Property Securities Act 1999

Under the Personal Property Securities Act 1999, the preferential tax debts (GST, PAYE, RWT and NRWT) rank behind the claim of anyone who has:

- a purchase money security interest, ie any security interest that secures the purchase price of goods, including the equivalent of a Romalpa clause, or
- a security interest that stops the property from being disposed of in the ordinary course of business.

When a security interest does not prohibit or restrict the property from being disposed of in the ordinary course of business, preferential tax debts will have priority.

The case *Burns and Agnew v C of IR* (2011) 25 NZTC ¶20-070 concerned a dispute between a secured creditor and the Commissioner (as a preferential creditor) in respect of certain funds received by the liquidators of Takapuna Procurement Ltd. The liquidators applied to the High Court for directions as to the application of those funds and this required the Court to undertake an analysis of the concept of an "account receivable" to determine whether such funds could be applied to satisfy preferential claims under sch 7 of the Companies Act 1993 ahead of the claim(s) of secured creditors.

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¶16-870 Corporate migration — tax treatment

[IT07 ss CD 26, CD 43(16), FL 1, FL 2, OB 62]

Specific tax rules ensure that companies that migrate from New Zealand pay tax on all their worldwide income earned while resident in New Zealand. Prior to the Companies Act 1993, companies could not be removed from the New Zealand register of companies without being liquidated. Under the current Companies Act, companies can transfer their place of incorporation outside New Zealand and become non-resident without being liquidated. Therefore, before the introduction of specific tax rules, this meant New Zealand companies could migrate from New Zealand without necessarily paying New Zealand tax on all the income earned while resident in New Zealand, eg in respect of unrealised property gains. In fact, some companies found it more tax effective to migrate from New Zealand than to be liquidated. To counter this, an emigrating company, under the corporate migration rules, is treated for tax purposes as if, immediately before emigrating, it realises all its assets, is liquidated and the proceeds are fully distributed to its shareholders. This deemed distribution is treated as a dividend under the usual rules.

The corporate migration rules apply to companies migrating on or after 21 March 2005. Some limited exceptions exist for companies that had already commenced the migration process prior to this date.

An emigrating company is a New Zealand resident company that ceases to be a New Zealand resident for tax purposes. See further at ¶16-010 for residency of companies.

An emigrating company is treated for tax purposes as if, immediately before it became non-resident, it had paid a cash dividend to its shareholders of an amount equal to the amount that would have been available for distribution if the company had disposed of its property at market value and gone into liquidation. See ss FL 1 and FL 2.

Imputation credits can be attached to the distribution deemed to be made under s FL 2. The company is entitled to retrospectively claim imputation credits for any tax paid in respect of income arising before migration or as a result of the deemed disposition of property under s FL 2. Such tax is deemed to have been paid immediately prior to the migration for imputation purposes. See s OB 62.

That portion of the deemed distribution that is treated as being paid to New Zealand resident shareholders is resident passive income and therefore subject to the RWT rules. For a discussion of the RWT rules and how they apply to dividends, see ¶15-030. Likewise, that portion of the deemed distribution that is treated as being paid to non-resident shareholders is non-resident passive income and therefore subject to the NRWT rules. See ¶26-450. Payments of RWT and NRWT must be made by the emigrating company within three months of migration. Any related information must be provided to the Commissioner within the same period.

The amount of any dividend deemed to have been paid on migration is added to the company's available subscribed capital. This is to prevent shareholders from being double taxed, in the event that an emigrating company subsequently pays an actual dividend from the same source as the deemed distribution.

Emigrating companies are deemed to reacquire their property at the same market value at which it was deemed to be disposed of for New Zealand tax purposes. This establishes a cost base for assets remaining in New Zealand. Depreciable property deemed to be reacquired

following migration remains eligible for the 20% New Zealand-new asset loading; that is, the reacquisition is ignored for the purposes of s EE 31. However, the 20% loading is not available for assets acquired after 20 May 2010.

For the Commissioner's view on the operational implications of the rules and examples, see *Tax Information Bulletin* ¶185-120 Vol 18, No 5, June 2006 at 97.

Special rules can apply to tax the interests of New Zealand shareholders in emigrating companies. See ¶26-142.

TAX RECOVERY

¶16-880 Recovery of income tax from directors and shareholders after asset stripping

[IT07 s HD 15]

The Commissioner is authorised by s HD 15 to recover income tax from the directors and shareholders of a company who have entered into an arrangement or transaction to deplete the company's assets, so that it is unable to fully meet its tax liabilities. See *Spencer v C of IR* (2004) 21 NZTC 18,818. The section focuses on asset stripping by contributors to avoid payment of an otherwise lawful demand for income tax rather than being a general tax recovery provision. See *Case* X11 (2005) 22 NZTC 12,175.

The Commissioner's ability to recover unpaid tax extends to civil penalties and use of money interest for which the company is liable.

The tax recovery provisions apply to an arrangement entered into by the company that has the effect of leaving the company unable to satisfy its tax liability if it is reasonable to conclude that a purpose (which does not need to be the dominant purpose) of this arrangement was to have this effect, ie to avoid a tax liability. The recovery provisions do not apply to arrangements to which the Commissioner is a party, arrangements that have been previously assessed (and for which tax has been duly paid), or arrangements entered into when the company is under statutory management pursuant to the Reserve Bank of New Zealand Act 1989 or the Corporations (Investigation and Management) Act 1989.

Example 1:

TP Co sells its only asset, making a profit of $1,000. The company's tax liability of $280 is not paid. The $1,000 is distributed by way of dividend to the four shareholders of TP Co. Tax of $280 on the dividend income is paid by the four shareholders. TP Co cannot pay its tax liability of $280. However, because its liability is equal to the amount already paid by the shareholders, s HD 15 will not apply to this arrangement.

See *Tax Information Bulletin* ¶37-146 Vol 3, No 7, April 1992 at 45.

Liable persons

Certain persons (as agents of the company) are potentially responsible for the company's liability. These are all persons who were directors at the time the arrangement was entered into, shareholders who were controlling shareholders at the time the arrangement was entered into or persons (non-controlling shareholders) who had a voting or market value interest in the company at that time where it was reasonable to conclude, having regard to the materiality of any benefit derived by the person, that the person was a party to the arrangement. Allocation of liability between directors and shareholders is not prescribed, although it would seem the Commissioner is able to choose those persons who will be made liable under s HD 15. A taxpayer has the right to challenge a demand made by the Commissioner under these provisions.

Directors

A director is defined for s HD 15 as a person occupying the legal office of director. Where a corporate entity does not have directorships, any trustee, manager or other person who acts in the same or similar fashion as a director would be treated as a director of that entity. The

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- Subpart OK — Maori Authority Credit Accounts (MACAs) (which deals with income tax paid by a Maori authority that may be credited to a member of the authority). See ¶24-314.
- Subpart OP — which deals with the various memorandum accounts of consolidated groups. See ¶17-250 and ¶20-070.

This chapter focuses principally on imputation. For discussion on the other memorandum accounts, see the paragraphs noted above.

¶17-020 Summary of principal features of imputation regime

The principal features of the imputation system are as follows:

- New Zealand resident companies must maintain an imputation credit account (ICA). See ¶17-025.
- The tax year for imputation purposes is always 1 April to 31 March, irrespective of the company's balance date.
- Credits to the ICA include New Zealand provisional and terminal tax paid for the 1989 and later years and imputation credits on dividends received. See ¶17-040.
- Debits to the ICA include imputation credits attached to dividends paid and tax refunds. See ¶17-045.
- A New Zealand resident company can allocate tax credits to dividends paid to its shareholders by drawing from the pool of credits in the ICA.
- The first dividend in the tax year ordinarily sets the benchmark level for credit allocations in that year unless the statutory declaration procedures have been exercised (non-compliance incurs penalties). See ¶17-070.
- A company making a dividend payment is not obliged to allocate a credit (however, should the company do so, 28:72 from the 2011/12 income year of the "net" dividend is the maximum ratio that may be allocated). See ¶17-060.
- If an over-allocation of credits leaves the ICA in debit at 31 March for any year, the company must pay to Inland Revenue the amount of the shortfall plus 10%. See ¶17-100.
- Special anti-streaming rules apply to prevent the direction of credits to some shareholders and not others. See ¶17-120.
- Any change in shareholding or in shareholders' interests of over 34% could bring about the cancellation of credits in the ICA. See ¶17-055.
- All ICA companies must file an annual imputation return, a company dividend statement and a shareholder dividend statement. See ¶17-080–¶17-090.
- The imputation regime is linked to the consolidation rules.
- There is no provision for the grouping of imputation credits by companies in the same group (except where the company is a consolidated group: see ¶20-070) — imputation credits may be transferred by the payment of a dividend (companies included in the same group may pass on imputation credits by the actual payment of an intercorporate dividend and allocate tax credits under the normal rules for imputation).
- With effect for the 2017/18 and later income years, companies that are commonly owned, but not wholly owned, may transfer imputation credits as part of loss grouping. See ¶17-107.
- An individual's tax liability is reduced by any imputation credits (with any excess credits carried forward to the next income year: see ¶2-110).

- Special rules prevent unit trust managers and trustees and managers of group investment funds that derive category A income from using imputation attached to dividends received upon the redemption of units where the dividend merely reflects the cost to those persons of purchasing the units.
- Non-residents are subject to non-resident withholding tax (NRWT) only if they hold a less than 10% voting interest in the company or the rate of NRWT applicable to the dividend is 15% or more. The monetary effect of the NRWT liability may be negated under the foreign investor tax credit (FITC) regime: see ¶26-500.
- A company has the option of declaring bonus issues (taxable or non-taxable). Taxable bonus issues may convey imputation to shareholders (non-taxable bonus issues, however, are not taxed in the shareholder's hands and therefore do not carry any credits). See ¶16-570 and ¶16-685.
- A producer board, because it does not have a normal company shareholding structure, is treated as a company for tax purposes to enable the board to pass on credits to its members. See ¶24-150.
- Primary sector producer and marketing co-operatives which are incorporated as companies may allocate imputation credits to dividends paid. See ¶24-160.
- An Australian-resident company may elect to maintain an ICA. See ¶17-210.
- Certain companies may form an imputation group. See ¶17-240–¶17-250.
- Special rules apply where overpaid tax is applied to other tax liabilities. See ¶17-040 and ¶17-045.

IMPUTATION CREDIT ACCOUNT

¶17-025 Companies required to maintain an imputation credit account (ICA)

[IT07 ss OA 2(2), (3), OB 1]

Under the imputation system a company may allocate or "impute" the tax it pays on its income to its shareholders on the dividends it pays. The gross dividends are included as income of the shareholders, but their individual tax liabilities are satisfied in part by the amount of any tax credit so allocated to the dividends.

An ICA is a memorandum account (outside the books of account and not relating to income or expenditure) which records a company's tax payments and the allocation to shareholders of the benefit of those accounts. Consequently, every New Zealand resident company is required to maintain an imputation credit account (ICA) because the balance in the ICA determines the amount of credits the company may allocate to its shareholders (ie to its dividend payments) and the ICA keeps a record of the tax credits which are available for allocation to dividend payments.

The New Zealand imputation system was extended to Australian-resident companies from 1 April 2003. See ¶17-200–¶17-250.

¶17-030 Companies not permitted to maintain an imputation credit account (ICA)

[IT07 s OB 1(2)]

Certain companies are not permitted to maintain an imputation credit account (ICA). These companies are as follows:

- A company acting only in the capacity of trustee. When a company acts as a trustee, the trustee/beneficiary rules apply. However, there is an exception to this in that a company that is a group investment fund deriving category A income must operate an ICA. Companies that act partly in the capacity of trustees and partly in other activities allocate debits and credits to the ICA only in respect of their non-trustee activities.

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Incremental late penalty ($23,339.89 × 1%)	21/08/X3	233.40		
		23,573.29		
				23,898.12
Interest @ 8.40% for 1 day ($23,573.29 × 1/365 × 8.40%)	21/08/X3		5.43	
				23,903.55
Balance of further income tax, interest and penalties	**21/08/X3**			23,903.55

Remission of late payment penalty and interest on further income tax

In certain circumstances the Commissioner must remit any interest payable by the company and the late payment penalty payable on the further income tax. See ¶14-180 and s 181C of the TAA.

Remissions of imputation penalty tax

In accordance with s 180 of the TAA the Commissioner may remit imputation penalty tax in the following circumstances:

- the liability for imputation penalty tax arose by virtue of a debit to the company's ICA in relation to imputation credits determined to have been the subject of an arrangement to obtain a tax advantage (under the anti-avoidance provisions in ss GB 35 and GB 36) and, subsequently, it is established that the imputation credits were not the subject of any such arrangement
- the liability for the imputation penalty tax arose by virtue of a tax refund having been sent, but not received by the company before the end of the tax year, or
- the liability for the imputation penalty tax arose by virtue of a debit arising under any provision of s OB 33 (application of overpaid income tax or FDP) or s OP 31 (application of overpaid income tax of consolidated imputation group), and OZ 3 (application of overpaid income tax for pre-imputation income year), and the taxpayer did not become aware of the debit in time to remove the debit balance before the end of the year.

In the event that remission occurs under one of these heads, the Commissioner is also required to remit any ancillary late payment penalties imposed under s 139B of the TAA.

Remission or cancellation of imputation penalty tax, late payment and late filing penalties, and interest

In addition to the specific remission provisions referred to above, the general remission and cancellation provisions in ss 183A–183H of the TAA may also apply. See ¶14-180.

Challenges to assessments of further income tax

The Commissioner may issue an assessment for the amount of further income tax payable. Assessments of further income tax are treated in similar fashion to assessments of ordinary income tax. See s 101(3) of the TAA. This means that assessments are deemed to be correct unless proceedings challenging the assessment are made (see ¶4-220) and assessments may be varied by the Commissioner in accordance with s 113 of the TAA.

If the Commissioner issues an assessment of further income tax that increases the amount payable, he is required to set a new due date for payment of that further income tax. There will be no penalty on the newly assessed tax if it is paid by the new due date. Furthermore, any use of money interest applying from the date of the notice until the due date specified in the notice will be cancelled.

¶17-105 Limit on refund and transfer of tax for imputation purposes

[IT07 ss RM 13–RM 17, RM 33]

Under s RM 2 the Commissioner is required to make a refund of tax when the Commissioner is satisfied that the tax has been paid in excess of the amount properly payable. See ¶2-145. For an imputation credit account (ICA) company, tax paid in excess may not include any further income tax paid under ss OB 65 and OB 66. See s RM 17.

In s RM 13 the amount of a refund to be paid to an ICA company or any transfer of tax within a wholly-owned group of companies is limited to the amount of the credit balance in the ICA of the company at the later of:

- the last day of the tax year just ended (unless the company has an extension of time for filing its annual ICA return), or
- the last day of the period for which the company is required by the Commissioner to file a return under s 70(1) of the Tax Administration Act 1994 (TAA), or
- the last day of a period for which the company filed an annual ICA return for a specified period under s 70(3) of the TAA.

With respect to a company with an extension of time for filing its imputation return that has not filed its return for the most recent tax year at the date the refund is due, but has filed its return for the preceding tax year, he refund or the amount transferred within a wholly-owned group of companies is limited to the credit balance of the company's ICA on the last day of that preceding tax year, not the most recently ending tax year. See s RM 13(3).

▶ ***Note:*** With effect from 1 April 2018, for the 2018/19 and later income years, a new accounting income method (AIM) of calculating provisional tax will be available (see ¶22-090). As a consequence, an amendment is also made to s RM 13 from that date to provide that the section will not apply to the refund of provisional tax paid under AIM.

Company ceasing to be an ICA company — s RM 14

A restriction is imposed on a refund of income tax entitled to be paid or transferred where a company has ceased to be an ICA company.

A company that is entitled to:

- have a refund of income tax when the company was an ICA company, or
- make a transfer when the company was an ICA company

can have a refund or make a transfer for an amount which cannot exceed the final credit balance of the ICA at the time the company stops being an ICA company.

This restriction also applies to an ICA company that is part of a wholly-owned group of companies that becomes entitled to make a transfer of an amount of overpaid provisional tax under s RC 32.

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The provision will still apply if any of the purposes of the arrangement falls within the above. The purpose of the arrangement to have another company pay a dividend to the shareholder, beneficiary, or associated person of the shareholder or beneficiary does not need to be the dominant purpose.

Example:

Company A is a New Zealand resident company. Company A has incurred tax losses since its incorporation. The shareholders in Company A are all New Zealand residents. Company B is also a New Zealand resident company. Company B is a tax-paying company with imputation credits available to be attached to any dividends paid. The shareholders in Company B include New Zealand residents and non-residents. Company A and Company B enter into an arrangement for Company B to pay a dividend to Company A's shareholders, using the imputation credits which are unable to be used by Company B's non-resident shareholders.

This arrangement would fall within s GB 37. The dividend paid by Company B will be treated as being paid by Company A. Company A will be treated as having a debit arising to its ICA for the imputation credits attached to the dividend paid. Company A will therefore have a debit balance in its ICA and unless this balance is cleared by the end of the tax year, Company A will be liable for imputation penalty tax. Also, the shareholders in Company A who receive the dividend under the arrangement will not be entitled to claim the imputation credits attached as credits against their income. These credits are also excluded from the shareholders' return (ie they are not income to the shareholders).

Shares for the purposes of these provisions can include a debenture complying with s FA 2.

¶17-116 Taxing distributions from share-lending transactions

[IT07 ss GB 49, LE 1(2), LE 7, OB 22, OB 49, OB 50, OB 64, YA 1 ("returning share transfer", "share-lending arrangement"); TAA s 30C]

Share-lending transactions occur when one party lends shares to another for a fee. Generally, such arrangements will constitute the sale and buy-back of the share with regular tax impost. However, specific share-lending rules allow "qualifying" share-lending transactions to be taxed on the basis of economic substance (ie treated as a loan) rather than legal form (sale of shares). Anti-avoidance provisions are applicable to non-qualifying share-lending transactions.

A qualifying share-lending arrangement involves a "returning share transfer" which is an arrangement where the following apply:

- where an original share listed on an official list of a recognised exchange is transferred from a share supplier to a share user
- where it is agreed that the share user (or associate) will pay a replacement payment to the share supplier (or associate) if a dividend is payable on the original share
- where it is agreed that the original share or an identical share may be transferred from the share user to the share supplier (or associate), and
- where it is not a warrant or an instalment receipt.

Where the arrangement satisfies the criteria for a returning share transfer the arrangement will fall within the definition of a share-lending arrangement and there will be no tax on disposal.

A share-lending arrangement is a returning share transfer entered into on or after 1 July 2006 where:

- the term of the returning share transfer is one year or less
- the terms are ordinary commercial terms such as would be agreed between arm's length parties
- any RWT under s RE 17 for a replacement payment is paid

- the original shares (or identical shares) are returned to the share supplier during the agreed term (or such extended term as approved by the Commissioner), and
- the share user issues a credit transfer notice in respect to any dividends paid on the original share or establishes and maintains an ICA if a dividend is payable on the original share.

The imputation credit account rules recognise that under a share-lending arrangement the imputation credits remain with the economic owner of the shares (the share supplier). This is achieved by transferring the imputation credits to the share supplier and denying the share user a tax credit under s LE 1(2).

A share user can either maintain an ICA in order to attach imputation credits to replacement payments or if the share user has received the underlying dividend they can issue a credit transfer notice. The form of a credit transfer notice is specified in s 30C of the Tax Administration Act 1994. Any imputation credit transferred under a credit transfer notice is excluded from the taxable income of the share user and instead becomes income of the share supplier. See s CD 17 and ¶16-630.

Where no direct transfer of imputation credits is possible because, say, the original shares have been sold, the share user is obliged to pay RWT at the rate of 33%, refer to s RE 17 and sch 1, pt D, cl 5. This share-lending RWT gives rise to imputation credits attached to the replacement payment. See ¶15-067.

Imputation credits received by a share supplier on a replacement payment are subject to the same treatment as normal imputation credits, regardless of whether they are allocated under s OB 64, arise from the share user paying RWT or from a credit transfer notice being issued. In the first two cases the credit arises on the date the replacement payment is paid and in the latter case, on the date the notice is issued. See ¶17-040.

Debits to a share user's ICA will arise when imputation credits are attached by the share user to a replacement payment, a credit transfer notice is issued or where the share user receives imputation credits in respect of a returning share transfer that is not a share-lending arrangement. See ¶17-045.

Returning share transfer not a share-lending arrangement

Where a returning share transfer does not qualify as a share-lending arrangement, the rules still operate to ensure that any imputation credits received by the share user in respect of the shares remain with the economic owner of the shares (the share supplier). This is achieved by requiring the share user to enter a debit in their ICA for the amount of any imputation credits received in respect of dividends paid to the share user (or an associate). In addition, the share user is not entitled to a credit of tax for the imputation credits and the transfer of the shares itself is treated as a disposal for tax purposes.

An anti-avoidance provision ensures that taxpayers do not attempt to structure transactions that fall outside the returning share transfer definition. See s GB 49.

For further discussion and examples of the operation of the share-lending rules see *Tax Information Bulletin* ¶185-120 Vol 18, No 5, June 2006 at 86.

¶17-120 Arrangements to obtain tax advantage

[IT07 ss GB 35, GB 36, LE 1(5), OB 13, OB 25, OB 44, OB 54, OB 71, OB 72, OB 72B, YA 1 ("tax advantage"); TAA s 90AF]

Anti-avoidance provisions are contained in ss GB 35 and GB 36 of the Income Tax Act 2007 (IT07) and s 90AF of the Tax Administration Act 1994 (TAA). These provisions apply to arrangements to obtain a tax advantage in relation to imputation credits.

For the purposes of this section a "tax advantage" is, among other things, the obtaining of a credit of tax by shareholders, or a credit to an imputation credit account (ICA) or Maori authority credit account.

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¶17-215 Credits and debits to the Australian imputation credit account (ICA)

[IT07 ss OB 27–OB 29, OB 57–OB 59]

An Australian imputation credit account (ICA) company must record debits and credits which are additional to those of a New Zealand ICA company.

Credits

The following credits arise in the ICA of an Australian ICA company:

- non-resident withholding tax (NRWT) withheld from non-resident passive income (see ¶26-440–¶26-450)
- non-resident contractors withholding tax (see ¶26-480)
- income tax payments for schedular income derived under s CR 3 (income of non-resident general insurer) or CV 16 (income of non-resident shippers).

These credits arise on the date the type of tax in question was withheld or paid.

Only one credit entry is allowed for each of the above types of tax payment made. See s OB 4(5). If a payment is recorded as a credit in the ICA in accordance with ss OB 4–OB 26 (see ¶17-040), another credit will not be allowed under ss OB 27–OB 29.

Debits

An Australian ICA company must record as a debit in its ICA, any refund of:

- overpaid NRWT which has been credited to the ICA
- tax overpaid on schedular payments to non-resident contractors which has previously been credited to the ICA
- income tax overpaid for schedular income derived under derived under ss CR 3 and CV 16 (non-resident insurers and shippers), which has previously been credited to the ICA.

These debits arise on the date on which the refund is paid.

¶17-220 Australian ICA company — converting further income tax to loss

[IT07 s OB 69]

In certain circumstances, an Australian imputation credit account (ICA) company may elect to convert a payment of further income tax into a tax loss. The tax loss may be used by a company in the same wholly-owned group as the Australian ICA company.

The conversion of further income tax paid can be made when, at the time of payment of the further income tax, there is no possibility that the company will have a New Zealand income tax liability against which the payment may be credited. The amount of the tax loss available is calculated by dividing the amount of further income tax paid (to the extent it is not required to meet a liability of the company) by the company tax rate.

Example:

Ozzie Ltd is an Australian ICA company and also part of a wholly-owned group of companies with Kiwi Ltd. Ozzie Ltd has a debit balance of $700 in its ICA at 31 March 20X3. Ozzie Ltd pays further income tax of $700 on 20 June 20X3. At that time, there is no possibility Ozzie Ltd will have a future income tax liability against which the payment of further income tax may be credited. Ozzie Ltd elects to convert the further income tax payment into a loss. The amount of tax loss available for offset by Kiwi Ltd in the 20X3/X4 income year is $2,500 ($700/0.28).

The reason for allowing the loss conversion is to stop the refund of the further income tax payment to another group company (assuming the group company has sufficient imputation credits in its ICA). This could happen if the further income tax payment was simply transferred to the other group company.

¶17-225 Compliance requirements for an Australian ICA company

[TAA ss 69(2), 139A, 142(1)(d)]

The following is a summary of the additional compliance requirements that are placed on an Australian imputation credit account (ICA) company.

Imputation return — s 69(2)

An Australian ICA company which does not have to file a return of income for the tax year must file the annual imputation return by 31 July following the end of the tax year. For example, an Australian ICA company that is not required to file a tax return for the year ended 31 March 2018 must file its 2017/18 imputation return by 31 July 2018.

If the Australian ICA company is required to file a tax return for the tax year, the imputation return must be filed by the time the tax return is required to be filed. This is the same rule that applies for a New Zealand ICA company. See ¶17-080.

Late filing penalty — ss 139A(4) and 142(1)(d)

A late filing penalty of $250 is payable by an Australian ICA company which does not file its imputation return on time. The due date for payment of this penalty is the date specified by the Commissioner or the date by which the Australian ICA company is required to furnish the imputation return, whichever is the later. Note that the date specified by the Commissioner cannot be less than 30 days after the day on which the Commissioner has notified the company that the penalty is payable.

¶17-235 Imputation — dividends paid in Australian currency

[IT07 s OB 60(6), (7); TAA ss 29(1B), 67(1)(eb)]

For the purposes of the imputation rules, a formula is provided to calculate the New Zealand dollar equivalent of the amount of a dividend that is paid in Australian currency. The formula is:

$$a \times b$$

where:

a is the amount of the dividend expressed in Australian dollars, and

b is the close of trading spot exchange rate for the Australian dollar for the date on which the dividend is declared (if that date is no more than three months before the date the dividend is paid), or the date on which the dividend is paid (if the date of payment is more than three months after the date the dividend is declared).

Shareholder dividend statement — s 29(1B)

When paying a dividend, an Australian ICA company must use the term "New Zealand imputation credit" on the shareholder dividend statement. See also ¶17-090.

Company dividend statement — s 67(1)(eb)

For any payment of a dividend in Australian currency by an Australian imputation credit account company, the company dividend statement (see ¶17-085) must show the exchange rate between the New Zealand dollar and the Australian dollar that was used to calculate the imputation ratio.

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