



Public Information Bulletin

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LEGISLATION 1987

TAXATION REFORM BILL 1987

- The Income Tax Amendment Act (No. 3) 1987
 - The Goods and Services Tax Amendment Act (No. 2) 1987
 - The Estate and Gift Duties Amendment Act 1987
-

TAXATION REFORM BILL 1987

The Taxation Reform Bill 1987 was introduced to Parliament on 19 November 1987. It was passed by Parliament on 9 December. Immediately following passage it was split into three separate Acts being:

- . The Income Tax Amendment Act (No. 3) 1987
- . The Goods and Services Tax Amendment Act (No. 2) 1987
- . The Estate and Gift Duties Amendment Act 1987

This explanatory document is divided into three parts:

- Part I explains the amendments to the Income Tax Act 1976.
- Part II explains the amendments to the Goods and Services Tax Act 1985.
- Part III explains the amendments to the Estate and Gift Duties Act 1968.

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NOTE: IT = INCOME TAX AMENDMENT ACT (NO. 3) 1987
GST = GOODS AND SERVICES TAX AMENDMENT ACT (NO. 2) 1987
EGD = ESTATE AND GIFT DUTIES AMENDMENT ACT 1987

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PART I INCOME TAX AMENDMENT ACT (NO. 3) 1987

Section 1 - Short Title

This section provides for this Act to be read together and be deemed part of the Income Tax Act 1976.

Section 2 - Dates by which Annual Returns to be Furnished

This section amends section 17 of the principal Act to bring forward the date by which provisional taxpayers must furnish their annual returns of income. The new dates are as follows:

- (a) If the taxpayer's balance date is in the period 1 October to 7 May, the return must be furnished not later than 7 July.
- (b) If the taxpayer's balance date is in the period 8 May to 30 September, the return must be furnished not later than 2 months after that balance date.

These changes were necessary to align the return furnishing dates with the date for payment of the first instalment of provisional tax which is also 7 July.

Subsection (2) provides for the new return furnishing dates to apply in respect of returns for the 1987/88 income year and all subsequent income years.

Section 3 - Income and Expenditure where Financial Arrangement Redeemed or Disposed of

This section inserts two new subsections (7A) and (7B) into section 64F of the principal Act.

Section 64F(7A) provides that where an amount to be paid under a financial arrangement is forgiven under a testamentary disposition executed before 1 October 1987 the forgiveness is not to be dealt with under the accrual tax accounting regime.

Under the accrual tax accounting regime, if a debt owing is forgiven the amount forgiven may be assessable income to the debtor. This will be the case where the amount forgiven exceeds the cost of the borrowing, which is generally the case with debt used for estate planning purposes and forgiven in wills.

As a result of submissions to the effect that law practitioners are unable to take the necessary steps to ensure that wills are redrafted to avoid the consequences of debt forgiveness under the accrual tax accounting regime, the Government decided to ensure

that the accrual tax accounting regime would not affect the forgiveness of debt in testamentary dispositions executed before 1 October 1987.

A testamentary disposition is an instruction given by a person regarding the disposition of his or her assets at death. As the testamentary disposition must be executed to satisfy section 64F(7A), it must be in writing: a will or a codicil to a will.

The instrument making the gift on the death of the testator must be executed before 1 October 1987: where there is a will executed before 1 October 1987 it is not possible to satisfy section 64F(7A) by executing a codicil to the will on or after 1 October 1987 to forgive the debt in the event of the testator's death.

Section 64F(7B) provides that where an amount owing under a debt (including accrued interest) is forgiven by a natural person in consideration of natural love and affection, the amount owing shall be deemed to have been paid when it is forgiven.

Example 1:

Daughter owes Father \$200,000. Debt at call with interest payable on demand. The advance was made on 15 June 1988 and no interest has yet been demanded.

On 17 April 1989 Father forgives the debt. The debt is therefore deemed to be repaid at that time. There being no interest, the deemed repayment will not affect the income tax position of either party.

Example 2:

Daughter owes Father \$200,000. Advance was made on 5 June 1988, repayable on 5 June 1998, interest of 19% per annum payable annually in arrears.

On 5 December 1988 Father forgives the debt including all accrued interest. The debt and all accrued but unpaid interest is deemed to be paid on 5 December 1988.

Base price adjustment: Father

a	-	(b	+	c)
\$219,000	-	(\$200,000	+	0)
=	\$19,000	(income)		

Base price adjustment: Daughter

a	-	(b	+	c)
\$219,000	-	(\$200,000	+	0)
=	\$19,000	(expenditure deemed to be incurred, which may be deductible depending upon the use to which the borrowed money was put)		

A forgiveness in a will may be made in consideration of natural love and affection, and if so it is to be treated according to section 64F(7B). Where a forgiveness is conditional it does not occur until the conditions are fulfilled, so that the amount forgiven is not deemed to be paid until the conditions are fulfilled.

Section 4 - Rural Debt Restructuring

This section inserts into the principal Act a new section 64FA, which is intended to ensure that where in the course of the rural debt restructuring an amount owing under a variable principal debt instrument and borrowed before 2 July 1986 is forgiven before 31 December 1988, the forgiveness will not be affected by the accrual tax accounting regime.

Where the balance owing under the variable principal debt instrument is reduced on or after 2 July 1986, the amount for which the concession is available is also reduced. Where the debt under the variable principal debt instrument at 2 July 1986 is replaced with other debt and the other debt is later forgiven before 31 December 1988, the other debt also qualifies for the concession.

Who qualifies for the concession?

The concession under the new section 64FA is available only to:

- (a) Farmers engaged in livestock farming, horticulture or cropping; and
- (b) Agricultural contractors.

For the purposes of section 64FA "livestock farming" is defined in section 64FA(1) as follows:

"Livestock farming" means the business of animal husbandry; and includes poultry-keeping, bee-keeping, and the breeding of horses (other than bloodstock):"

An agricultural contractor is a person who undertakes contract work in the agricultural sector. Examples are fencers, top-dressing firms, contract shearers and transport operators engaged chiefly in work for the agricultural sector. It includes contractors engaging in work that may be done for persons outside the agricultural sector, but which the contractor undertakes chiefly for persons in the agricultural sector.

What debt qualifies for the concession?

The concession is available only for debt incurred in the course of business as a farmer engaged in livestock farming, horticulture or cropping or in the course of business as an agricultural contractor.

The concession is available only in relation to -

- (a) Variable principal debt instruments, and then only in relation to the amount owing that was incurred before 2 July 1986 and, at the time of the forgiveness of debt, has not since been repaid (section 64FA(2) refers); and
- (b) Debts that replace amounts that were owing under a variable principal debt instrument at the beginning of 2 July 1986, and then only in relation to the amount of the replaced debt that, at the time of the replacement, has not been repaid (section 64FA(3) refers).

To achieve this end the legislation applies the concession to the "specified principal" of the debt. "Specified principal" is defined in section 64FA(1).

When dealing with an amount owing under a variable principal debt instrument at 2 July 1986, the specified principal is the least amount owing under the variable principal debt instrument at the beginning of every day from and including 2 July 1986 to the day on which the forgiveness occurs. It is not necessary to consider movements in the balance owing during the course of a day.

When dealing with a debt that replaces an amount owing under a variable principal debt instrument at the beginning of 2 July 1986, the specified principal is the least amount owing under the variable principal debt instrument at the beginning of every day from and including 2 July 1986 to the day on which the amount owing under the variable principal debt instrument is replaced.

In what circumstances is the concession available?

The concession is available where the debt is forgiven -

- (a) Before 31 December 1988; and

- (b) In the course of a rearrangement of the debtor's liabilities due to financial difficulties of the debtor that render doubtful the capacity of the debtor to carry on in the business of livestock farming, horticulture, cropping or agricultural contracting.

The concession is intended to be available for any rural debt restructuring before 31 December 1988. It is intended as an assistance to farmers and agricultural contractors in such severe financial difficulty that they may have to leave their businesses.

Section 5 - Deduction in respect of Livestock Revaluation

Death of Farmers in Period 12 December 1985 to end of 1986 Income Year

This section amends section 86E(2) of the principal Act, which gives a "write-off" to farmers ceasing farming after 12 December 1985 and before the end of the 1986 income year. The "write-off" given to such farmers is similar in principle to that allowed to continuing farmers in the 1987 income year when specified livestock were required to be revalued to new standard values.

The amendment ensures that the estates of farmers who died in the period between 12 December 1985 and the end of the 1986 income year receive the same concession as farmers who retired in that period. The write-off which will now be available to the estate of a farmer who died between 12 December 1985 and the end of that income year will be 70 percent of the difference between:

- (a) the total of -
 - (i) the sale proceeds of any of the specified livestock which were on hand at the beginning of the 1986 income year and sold during that income year before the date of death; and
 - (ii) the probate value of any of the specified livestock which were on hand at the beginning of the 1986 income year and still on hand at the date of death; and
- (b) the value of specified livestock on hand at the beginning of the 1986 income year as taken into account for income tax purposes.

Prior to this Amendment the "write-off" did not apply to (a)(i) above.

It should be noted that this provision only applies where the farmer at date of death was still in the business of farming. In other words, the write-off does not apply where the farmer disposed of the farming business prior to 12 December 1985 and died subsequently but prior to the end of the 1986 income year. Similarly, the write-off does not apply to a farmer who retired or died prior to 12 December 1985.

Section 6 - Deferral of Income derived from Livestock in 1987 Year

This section gives effect to a decision by the Government to allow a deferral of revaluation income not covered by the existing legislation. In essence it allows a spread of revaluation income arising from the retention of natural increases in specified livestock during the 1987 income year.

To calculate the income which qualifies for the deferral, an adjustment has to be made for purchases of livestock in the 1987 income year which increase the total value of livestock on hand. A deduction is received for such purchases so revaluation income is increased.

The amount of livestock income which may be deferred ("deferrable livestock valuation income") is arrived at by using the following formula:

$$a - (b - c) - d$$

Where -

a is:

- (i) the total value of all specified livestock (other than livestock deemed to be high-priced livestock by sections 86G(6) or 86G(7) of the Income Tax Act) to be taken into account for tax purposes at the end of the 1987 income year; less
- (ii) the total value of all specified livestock (other than livestock deemed to be high-priced livestock by section 86G(6) of the Income Tax Act) to be taken into account for tax purposes at the end of the 1986 income year.

b is the total amount spent in the 1987 income year on purchasing or capturing non high-priced livestock that were, at the beginning of the income year, herd class livestock. For this calculation herd class livestock are taken as any livestock, regardless of ownership or valuation, of the types shown in column 3 of the Twelfth Schedule to the Income Tax Act.

c is the total amount received from the sale in the 1987 income year of non high-priced livestock that were, at the beginning of the income year, herd class livestock.

If c is greater than b then subsection (2) of section 6 deems b - c to be nil. This is done because such an amount would represent net cash income. The deferral applies to unrealised revaluation income only.

d is:

- (i) the amount of the livestock revaluation income "write-off" given by section 86E(3) of the Income Tax Act; and
- (ii) the amount of livestock revaluation income able to be spread over 5 years by section 86F of the Income Tax Act. (This is the amount of "livestock revaluation income" defined in 86F(1)); and
- (iii) the amount of any loss available for tax purposes in the 1987 income year. This includes any past losses carried forward under the provisions of section 188 or 188A of the Income Tax Act.

The income which qualifies for the deferral may be spread over the 1987 income year and the two income years immediately succeeding that year. However, it need not be spread equally over the three years. In other words, the income may be allocated in whole or in part to any of the three years.

It should be noted that under the provisions of this amendment every taxpayer is required to elect, by notice in writing, the amount to be allocated to each of the income years. The election only becomes binding after 31 March 1988. It can, therefore, be amended, if desired, before this date.

Subsection (4) requires that the notice of election be submitted by 31 March 1988.

Example showing Calculation of the Deferral

In the example sheep numbers are being built up until the 1988 income year. The herd scheme is used to value qualifying animals, i.e., mature sheep.

Sheep Account

Year Ended 31 March 1987

<u>Class of Livestock</u>	<u>No</u>	<u>Value (\$)</u>	<u>Total Value (\$)</u>
<u>Purchases</u>			
Two Tooth Ewes	50	20	1,000
Breeding Ram (High-Priced)	1	500	500
			<hr/>
			1,500
<u>Opening Livestock</u>			
Ewe Hoggets	200	4 (old std value)	800
Two Tooth Ewes	300	4 (old std value)	1,200
Mixed Age Ewes	650	4 (old std value)	2,600
Breeding Rams	10	4 (old std value)	40
			<hr/>
			4,640
			<hr/>
(Total Deduction - purchase plus opening stock)			(6,140)
<u>Sales</u>			
Lambs	800	15	12,000
Old Ewes	100	6	600
			<hr/>
			12,600
<u>Closing Livestock</u>			
Ewe Hoggets	200	12 (std new value)	2,400
Two Tooth Ewes	200	22 (herd value)	4,400
Mixed Age Ewes	800	13 (herd value)	10,400
Breeding Rams	9	124 (herd value)	1,116
			<hr/>
			18,316
Breeding Ram (high priced)	1	375 (DHP value)	375
			<hr/>
			18,691
			<hr/>

(Total Additions - Sales plus closing stock) 31,291

Gross Profit (before write-off and spread) 25,151

Assume section 86E "write-off" is \$8,500
and section 86F spreadable income is \$2,500

Livestock Income Calculation

Gross Profit from sheep \$25,151
less revaluation income "write-off" \$8,500
less spreadable revaluation income
spread to future years
(4/5 of \$2,500) \$2,000

1987 Gross Livestock Income from
sheep \$14,651

Section 86FA Deferral

Deferrable livestock valuation income calculation

a = \$18,316 - 4,640 = \$13,676 (Revaluation)

b = \$1,000 (Purchase of Two
Tooth Ewes)

c = \$600 (Sale of Old Ewes)

d = \$8,500 + \$2,500 = \$11,000 (Write-off and
spread)

so: a - (b - c) - d

= \$13,676 - (1,000 - 600) - 11,000

= \$2,276

If the deferrable income is spread between the 1988 and 1989
income years, 1987 taxable livestock income will be:

\$14,651 - 2,276 = \$12,375

Section 7 - Farmers Expenditure on Tree Planting

This section clarifies section 134 of the principal Act, which gives a deduction for the cost of maintaining and planting of trees on farm land. The amendment excludes from section 134, tree planted primarily and principally for the production of fruit. Such trees may be depreciated under the provisions of section 128A.

Section 8 - Accounting for Goods and Services Tax

This section amends section 140B of the principal Act. It ensures that the entire refund of Sales Tax under section 83(2) of the Goods and Services Tax Act is included as assessable for income tax purposes.

As the registered person has been allowed an Income Tax deduction for the Sales Tax paid, it is logical that the refund of that tax should be assessable, thereby giving the net effect of a claim for the true final cost of those goods on hand as at 30 September 1986.

This adjustment should be made in returns for the income year which commenced on 1 April 1986, i.e., the 1987 income year.

Section 9 - Pay-Period Taxpayers

This section amends section 356(1) of the principal Act. It increases the pay-period taxpayer's income limit from \$11,500 to \$20,000.

This change, which applies from the income year commenced 1 April 1987, means a taxpayer will not be required to furnish a return if that taxpayer's income does not exceed \$20,000 and that taxpayer:

- (a) did not derive income as a shearer or shearing shed hand; and
- (b) does not receive, or has a spouse who receives, family support; and
- (c) does not derive income from National Superannuation as well as income from other sources exceeding \$6,500; and
- (d) is not an absentee; and
- (e) is not a person who is deemed not to be pay-period taxpayer by the Commissioner; and
- (f) did not operate a special tax code; and
- (g) did not use an incorrect tax code.

A pay-period taxpayer's tax liability is determined by the PAYE which has been deducted from that income. The PAYE becomes, in effect, a final tax.

Section 10 - Interpretation and Section 11 Determination of Assessable Income

Family Support and Livestock Valuation Income

These sections give effect to the changes in the determination of Family Support for farmers. There are three main changes in the amendment.

Firstly - the amendment removes totally from income used for determining eligibility for Family Support, the amount of "livestock revaluation income" able to be spread over five years by section 86F of the Income Tax Act. Previous to this amendment this income had to be taken into account in full in the 1987 income year for family support purposes.

Secondly - the livestock valuation income which may be deferred and spread over three years by section 86FA, as introduced by this Amendment Act, is to be taken into account in full as income for family support purposes in the 1987 income year. This is done because this income represents an increase in the total value of trading stock on hand.

Thirdly - from the 1988 income year onwards, where livestock is valued under the herd scheme basis of valuation, stock will be required to be valued at the trading stock scheme standard values for determining assessable income for Family Support. This is to ensure that for family support purposes the assessable income factor is calculated on the same basis as farmers using the trading stock scheme.

Example showing Calculations of Income for Family Support Purposes

1987 Calculation of Family Support Income (using figures from example in section 6)

Livestock income to be included in Family Support income is:

\$12,375	+	2,276	-	500	=	\$14,151
(taxable livestock income)		(86FA deferral)		(portion of 86F spread allocated to 1987)		

Sheep Account

Year Ended 31 March 1988

<u>Class of Livestock</u>	<u>No</u>	<u>Value (\$)</u>	<u>Total Value (\$)</u>
<u>Purchases</u>			
Two Tooth Ewes	100	22	2,200
<u>Opening Livestock</u>			
Ewe Hoggets	200	12 (std value)	2,400
Two Tooth Ewes	200	24 (1988 HV)	4,800
Mixed Age Ewes	800	15 (1988 HV)	12,000
Breeding Rams	9	130 (1988 HV)	1,170
Breeding Rams (high-priced)	1	375 (DHP value)	375
			<hr/>
			20,745
			<hr/>
(Total Deduction - purchase plus opening stock)			(22,945)
<u>Sales</u>			
Lambs	900	17	15,300
Old Ewes	150	8	1,200
			<hr/>
			16,500
<u>Closing Livestock</u>			
Ewe Hoggets	100	13 (std value)	1,300
Two Tooth Ewes	200	24 (1988 HV)	4,800
Mixed Age Ewes	900	15 (1988 HV)	13,500
Breeding Rams	9	130 (1988 HV)	1,170
Breeding Ram (high-priced)	1	250 (DHP value)	250
			<hr/>
			21,020
			<hr/>
(Total Additions - sales plus closing stock)			37,520
			<hr/>
Gross Profit			14,575
			<hr/>

1988 Gross livestock income from Sheep

$$= 14,575 + 1,138 + 500 = \$16,213$$

(1/2 of deferral) (1/5 of spread)

1988 Calculation of Family Support Income

Livestock income to be included in Family Support income and will be:

$$\$16,213 - 1,138 - 500 + 536 = \$15,111$$

(taxable livestock income) (1988 portion of deferral - already accounted for) (1988 portion of spread - not to be included) (extra income that would be generated by using std values - see below)

Non High-Priced 1988 Herd Class Livestock

<u>Class</u>	<u>No</u>	<u>Herd Value</u>	<u>Std Value</u>	<u>Difference</u>	<u>Total Value</u>
Opening Livestock					
Two Tooth Ewes	200	24	16	8	1,600
Mixed Age Ewes	800	15	9	6	4,800
Breeding Rams	9	130	87	43	387

					6,787
Closing Livestock					
Two Tooth Ewes	200	24	17	7	1,400
Mixed Age Ewes	900	15	10	5	4,500
Breeding Rams	9	130	91	43	351

					6,251

					536

If standard values were used, the deduction of opening livestock would be reduced by \$6,787. Income arising from valuation of closing livestock would be reduced by \$6,251. The overall change to income for family support purposes would be an increase of \$536.

Section 12 - **Provisional Taxpayers**

This section amends section 377 of the principal Act. It increases from \$1,000 to \$3,000 the amount that any person, whose only other income is from source deduction payments, may earn from interest, dividends and rents in any income year before being required to pay provisional tax.

This section also consequentially amends section 17 (due date for furnishing returns) to allow such taxpayers to furnish IR 5 returns of income.

Both changes will apply from the income year commencing 1 April 1988. This will mean that such taxpayers will not be required to pay 1989 provisional tax, and will become IR 5 taxpayers for the 1988/89 income year.

PART II GOODS AND SERVICES TAX AMENDMENT ACT (NO. 2) 1987

Sections 1, 2 and 3

The Goods and Services Tax Amendment Act (No. 2) 1987 makes two amendments in respect of the treatment of indemnity payments made or received under a contract of insurance that indemnifies a person for loss of earnings.

The amendments relate to:

- (a) Section 5(13) of the Goods and Services Tax Act 1985 which provides that any indemnity payment under a contract of insurance is a taxable supply when it is received by a registered person and relates to a loss incurred in the course of making taxable supplies. Where the supply of the contract of insurance is not a taxable supply this provision does not apply (the proviso to this subsection); and
- (b) Section 20(3)(d) of the Goods and Services Tax Act 1985 which provides that in calculating the tax payable in any taxable period, a registered person is entitled to claim one-eleventh of any payment made under a contract of insurance to indemnify any other person as an input tax credit. There are a number of provisions that limit the application of section 20(3)(d).

Background

In relation to contracts of insurance that provided indemnity cover for loss of earnings, there was a loss of revenue where the indemnity payment was paid to a third party. This arose for example when an employer paid a levy to the Accident Compensation Corporation (ACC) to cover employees for loss of earnings. The levy was subject to GST which meant the employer may have been entitled to an input tax credit whilst the ACC accounted for output tax. When an employee made a claim for loss of earnings, section 20(3)(d) of the Goods and Services Tax Act 1985 allowed the ACC to claim an input credit in relation to that payment. However, as that indemnity payment was made to the employee who was not a registered person, there was no requirement for the employee to account for output tax on that payment.

Whilst this revenue loss did not occur in all cases where a person was indemnified for loss of earnings, the amendment applies to all indemnity payments made or received to indemnify a person for loss of earnings. This is because there would have been increased compliance costs if registered persons were required to distinguish between payments made to third parties and others.

Amendments

To overcome this loss of revenue the amendment adds a further subparagraph to the proviso to section 20(3)(d) of the Goods and Services Tax Act 1985 to deny an input credit where an indemnity payment is made to indemnify a person for loss of earnings.

As a consequence of the above amendment denying an input tax credit, section 5(13) has also been amended to exclude such indemnity payments from being a taxable supply when received. The amendment to section 5(13) of the Goods and Services Tax Act adds a further subparagraph to the proviso to exclude from a taxable supply those indemnity payments received which indemnify a registered person for loss of earnings.

This amendment applies to all contracts of insurance that provide an indemnity cover for loss of earnings such as earnings related compensation payable under the Accident Compensation Act 1982 and accident policies issued by Insurance Companies that indemnify a person for loss of earnings.

For the purpose of this amendment, "earnings" has the same meaning as the Accident Compensation Act 1982. Section 52 of the Accident Compensation Act includes in the meaning of "earnings":

- (i) all wages, salary, allowances, commissions, etc., paid or payable to a person in respect of employment as an employee; and
- (ii) in relation to a self-employed person, the assessable income of that person derived from the carrying on of a business.

The above is a guideline and it is suggested that either the Accident Compensation Act 1982 or Technical Rulings Chapter 9 Part II is used as a reference as to what is included in and excluded from the meaning of "earnings". Please note that Chapter 9 Part II is based on the 1972 Act but the provisions are similar to those in the 1982 Act.

It should also be noted that the supply of a contract of insurance to provide cover for loss of earnings is still a taxable supply, i.e., the levies imposed by the ACC are a taxable supply.

This amendment applies to all such indemnity payments made or received on or after 23 September 1987. This is the date that the Minister of Revenue announced that there would be an amendment in respect of indemnity payments for loss of earnings.

Section 1 - **Short Title**

Subsection (1) provides for this Act to be read together and be deemed part of the Goods and Services Tax Act 1985.

Subsection (2) deems this Act to have come into force on 23 September 1987 and applies to all supplies made on or after that date.

Section 2 - **Meaning of the term "Supply"**

Subsection (1) repeals the previous proviso and substitutes a new proviso to exclude the following indemnity payments from the meaning of taxable supply when received by a registered person in the course of making taxable supplies:

- (a) Received under a contract of insurance, where the contract of insurance is not a taxable supply (this is the same proviso that was repealed); or
- (b) Received under a contract of insurance that indemnifies that person for loss of earnings.

Subsection (2) repeals section 5(5) of the Goods and Services Amendment Act 1986 which introduced the proviso. This is a consequential amendment.

Section 3 - **Calculation of Tax Payable**

Section 3 adds to the proviso subparagraph (v) that limits section 20(3)(d) of the Goods and Services Tax Act 1985 from applying in respect of indemnity payments made to indemnify a person for loss of earnings.

PART III ESTATE AND GIFT DUTIES AMENDMENT ACT 1987

Section 1 - Short Title

This section provides for this Act to be read together and deemed part of the Estate and Gift Duties Act 1968.

This Amendment Act is consequential to the enactment of the accrual tax accounting regime in the Income Tax Amendment Act 1987. An effect of the accrual tax accounting regime is to render assessable the amount of any debt forgiven to the extent that the amount forgiven exceeds the cost (including interest and discount) of the debt. This can occur in the case of -

- (a) Gifts by way of forgiveness inter vivos:
- (b) Gifts by way of forgiveness of debt in a will.

Section 2 - Estate Duty

This section inserts into the principal Act a new section 35BA. Section 35BA applies where -

- (a) The estate of a deceased person includes a financial arrangement; and
- (b) The debt is wholly or partially forgiven in the will of the deceased or by way of a "donatio mortis causa".

A "donatio mortis causa" is a testamentary disposition made in contemplation of one's impending death. Although it may not comply with the requirements of the Wills Act 1837 (UK), such a testamentary disposition may well be binding.

Section 35BA provides that where and to the extent that, under the accrual tax accounting regime, a gift by way of forgiveness of debt in a testamentary disposition (under a will or donatio mortis causa) reduces the deduction allowable to, or increases the assessable income of, the recipient of the gift, that part of the debt shall not be included in the dutiable estate of the testator.

This means that, to the extent that the forgiveness is brought to account for income tax purposes under sections 64B to 64M of the Income Tax Act 1976, the debt -

- (a) Is not a part of the final balance of the testator's estate; and
- (b) Is not subject to estate duty.

Section 3 - Gift Duty

This section inserts into the principal Act a new section 75B. Section 75B provides that where and to the extent that, under the accrual tax accounting regime, a gift by way of forgiveness of debt reduces the deduction allowable to, or increases the assessable income of, the recipient of the gift, the forgiveness shall not constitute a gift.

This means that the forgiveness, to the extent that it is brought to account for income tax purposes under section 64B to 64M of the Income Tax Act 1976, -

- (a) Is not subject to gift duty; and
- (b) Is not required to be reported in a gift statement; and
- (c) Is not to be included in "b" in the calculation of the amount of gift duty payable (according to section 62 of the principal Act) on any other gift; and
- (d) Is not subject to the estate duty avoidance provisions of the principal Act (sections 10 and 11).

Application

Both section 35BA and section 75B apply on and after 1 October 1987. They are intended to deal with types of arrangements used in estate planning and, as forgiveness of debt under such arrangements was exempt from the application of the accrual tax accounting regime until 1 October 1987 (section 64F(7) of the Income Tax Act refers), it was not necessary to give sections 35BA and 75B any earlier application.

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