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THE DEPARTMENT'S TECHNICAL POLICY CIRCULARS ARE REPRODUCED IN THIS BULLETIN

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Accident Compensation Levy Liability
- Withholding Payments

It has come to our attention that there is confusion in the area of AC Levy liability in relation to Withholding Payments and who is actually liable to account for the levy.

Although Withholding Payments are a convenient way to make tax deductions at source on a variety of classes of income, they are not a reliable guide to what are "earnings as an employee" or "earnings as self-employed" for Accident Compensation Levy purposes, and should be disregarded in making such a decision.

In order to establish this it is necessary to consider whether the income (or in some cases the recipient), falls within the definition in the Accident Compensation Act.

Tests to be applied are:

1 Consider whether there is an employer/employee relationship between the payer and the payee OR if the payee falls within one of the classes which are deemed to be employment by Section 2 of the Accident Compensation Act. (Refer to ACC booklet "Levies on Employers & Self Employed").

Some questions which can help determine whether there is an employer/employee relationship are:

Who has control over the manner in which the work is performed, e.g.:

- quality of work, hours of work, place of work;
- who performs the work?

Can the worker reach his/her work place at any time, or only when the work place is opened and thus at the discretion of the management?

Does the work performed constitute an integral part of the business, e.g., What happens if the worker is sick?

What hours and times does the worker work?

Does the work allocated have to be done by that worker or can it be delegated to family members or others?

To what extent is the worker carrying on his/her own separate and independent business, e.g., is he/she responsible for any loss?

When each of the above areas have been assessed an overall picture will emerge so that a reasoned decision can be made. If an employer/employee relationship exists, or the recipient is a deemed employee the person making the withholding payment is required to pay Employer Accident Compensation Levy.

2 If the recipient is NOT an employee or deemed to be an employee, consider whether the earnings come within the scope of "earnings as a self-employed person".

A self-employed person is one who is carrying on a business in New Zealand (whether or not that business is also carried on outside New Zealand). Business includes any profession, trade, manufacture, or undertaking carried on for pecuniary profit.

If the person receiving the withholding payments is self-employed, then he/she would be required to pay self-employed Accident Compensation Levy.

The Accrual Tax Accounting Regime and Export Tax Credit Incentives

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1 An enquiry has been received regarding the impact of the accrual tax accounting regime on export tax credit incentives such as the export-market development and tourist-promotion incentive.

2 The accrual tax accounting regime has two significant components: section 64B - M (along with the amended section 106(1)(a) and 106(1)(h) and section 104A). Sections 64B - M have the effect of deeming expenditure relating to financial arrangements to be incurred as it accrues (and brings to account income from financial arrangements on a similar basis), but section 104A does not affect the time at which the expenditure is incurred. Section 104A defers the general tax effect of expenditure from the time at which it is incurred to the time to which the expenditure relates by adding back to assessable income any "unexpired portion" of relevant expenditure. In the context of the export incentives, "outgoings" means expenditure incurred.

Thus -

(a) Where a tax credit is based on gross income -

(i) It will be affected by sections 64B - M so far as it deals with income from financial arrangements; but

(ii) It will not be affected by section 104A:

(b) Where a tax credit is based on outgoings or expenditure incurred -

(i) It will be affected by section 64B - M so far as it relates to expenditure in relation to financial arrangements; but

(ii) It will not be affected by section 104A:

(c) Where a tax credit is based on amounts receivable or payable -

(i) It will not be affected by section 64B - M; and

(ii) It will not be affected by section 104A.

3 Section 156A: Export Performance Incentive for Qualifying Goods

The amount of this tax credit is a function of the consideration receivable in respect of certain qualifying export goods, reduced by amounts payable for relevant freight and insurance. It is not affected by the accrual tax accounting regime. This section applied up to 31 March 1987 or the corresponding balance date.

4 Section 156B: Export Performance Incentive for Qualifying Services

This section allows as a tax credit a percentage of the "net foreign currency earnings", which are actually remitted to New Zealand through the banking system in respect of those services, or which are paid in New Zealand from funds held in New Zealand.

In the calculation of the "net foreign currency earnings", the deduction for outgoings will be affected by sections 64B - M where the outgoings relate to financial arrangements. The tax credit is not otherwise affected by the accrual tax accounting regime. This section applied up to 31 March 1987 or the corresponding balance date.

5 Section 156D: Export Performance Incentive for Qualifying Overseas Projects

The amount of this tax credit is determined in a manner similar to section 156B, but in relation to qualifying projects. The comments in paragraph 4 apply to this tax credit.

Section 156D(4) gives the Commissioner the discretion to apportion the tax credit to the appropriate income years over the life of the project if it spans balance dates. The Commissioner's policy is to make the apportionment on the basis of the "net foreign currency earnings" in each particular year of the project.

The application of sections 64B - M may accelerate or defer recognition of income or expenditure in relation to financial arrangements, thereby decreasing or increasing the "net foreign currency earnings" in any income year. The accruals regime will not otherwise affect the timing of tax credits. This section applied up to 31 March 1987 or the corresponding balance date.

6 Section 156E: Export Performance Incentive for Qualifying Tourist Services

The amount of this tax credit is a function of the amount of the gross foreign currency earnings of the taxpayer in relation to qualifying tourist services, reduced by the amount of all expenditure incurred by the taxpayer outside New Zealand in relation to those services. Thus where the taxpayer incurs expenditure in relation to financial arrangements and qualifying tourist services, the amount of the reduction will to that extent be subject to the accrual tax accounting regime. Otherwise the tax credit is not affected by the accrual tax accounting regime. This section applied up to 31 March 1987 or the corresponding balance date.

7 Section 156F: Export-Market Development and Tourist-Promotion Incentive

The amount of this tax credit is a function of the amount of otherwise deductible prescribed outgoings incurred by the taxpayer. To the extent that the outgoings relate to financial arrangements, the tax credit will be affected by section 64B - M. The tax credit is not otherwise affected by the accrual tax accounting regime. This section applies up to 31 March 1990 or the corresponding balance date.

8 Section 156G: Export-Market Development Activities for Self-Employed Taxpayers

The amount of this tax credit is a function of the time spent by the taxpayer engaged in export market activities and the minimum customary charge-out rate for principals in firms in the taxpayer's field. The tax credit is therefore not affected by the accrual tax accounting regime. This section applies up to 31 March 1990 or the corresponding balance date.

Average Market Values of Specified Livestock

By Orders in Council the average market values for specified livestock have been announced for the income year commencing on 1 April 1987 in accordance with the provisions of section 86D of the Income Tax Act 1976.

Listed below, under the various classes of specified livestock, are the values to be used for the standard value scheme and the herd scheme for the income year.

The standard values have been determined in accordance with section 86G(8), as amended by section 8 of the Income Tax Amendment Act 1988 (No. 2). Subsection (8) provides for the standard value to be the lesser of -

(i) The average market value (AMV) for the year (1988), or

(ii) The sum of the following formula:

$$\frac{\text{Value}}{2} \times \frac{70}{100}$$

Value equals AMV for 1987 plus AMV for 1988.

For example:

Red deer - rising two-year and older hinds

(i) = $729.00 - 1988 AMV

(ii) = $787.50 - calculated as follows:

$$\begin{array}{lr} \text{1988 AMV} & \$729.00 \\ \text{1987 AMV} + & \underline{\$1,521.00} \\ \text{Value} = & \$2,250.00 \end{array} \qquad \frac{\$2,250}{2} \times \frac{70}{100} = \$787.50$$

Therefore the standard value for 1988 is $729.00.

The 1987 average market values were published in Public Information Bulletin Number 163.

Average Market Values of Specified Livestock

Type of Livestock	Classes of Livestock	Standard Value	Herd Value (Average Market Values)
		$ ¢	$ ¢
Sheep	Ewe hoggets	12.74	19.20
	Ram and wether hoggets	12.74	19.20
	Two-tooth ewes	17.43	27.50
	Mixed-age ewes (rising three-year and four-year old ewes)	10.71	17.40
	Rising five-year and older ewes	8.15	13.50
	Mixed-age wethers	9.45	15.40
	Breeding rams	91.21	136.40
Cattle	Beef breeds and beef crosses:		
	Rising one-year heifers	135.10	191.00
	Rising two-year and older heifers (maiden/first calving)	191.80	275.00
	Mixed-age cows (second and subsequent calving)	191.10	293.00
	Rising one-year steers and bulls	182.70	258.00
	Rising two-year and older steers and bulls	348.95	498.00
	Breeding bulls	491.75	723.00

Type of Livestock	Classes of Livestock	Standard Value	Herd Value (Average Market Values)
	<u>Friesian and Related Breeds</u>:		
	Rising one-year heifers	134.05	213.00
	Rising two-year and older heifers (maiden/first calving)	244.30	357.00
	Mixed-age cows (second and subsequent calving)	240.80	350.00
	Rising one-year steers and bulls	116.55	180.00
		$ ¢	$ ¢
	Rising two-year and older steers and bulls	348.95	498.00
	Breeding bulls	329.35	470.00
	Jersey and other dairy breeds:		
	Rising one-year heifers	117.95	186.00
	Rising two-year and older heifers (maiden/first calving)	201.25	312.00
	Mixed-age cows (second and subsequent calving)	176.05	259.00
	Rising one-year steers and bulls	105.70	166.00
	Rising two-year and older steers and bulls	247.80	367.00
	Breeding bulls	283.85	429.00
Deer	Red Deer		
	Rising one-year hinds	652.75	739.00
	Rising two-year and older hinds (maiden/first fawning)	729.00	729.00
	Mixed-age hinds (second and subsequent fawning hinds)	745.85	865.00
	Rising one-year stags	149.80	197.00
	Rising two-year and older stags (non-breeding)	222.60	326.00
	Breeding stags	1,137.15	1,213.00
	Wapiti, Elk, and related crossbreeds		
	Rising one-year hinds	751.10	794.00
	Rising two-year and older hinds (maiden/first fawning)	783.00	783.00
	Mixed-age hinds (second and subsequent fawning hinds)	886.55	929.00
	Rising one-year stags	166.60	227.00
	Rising two-year and older stags (non-breeding)	260.05	381.00
	Breeding stags	975.10	1,034.00

Type of Livestock	Classes of Livestock	Standard Value	Herd Value (Average Market Values)
	Other Breeds		
	Rising one-year hinds	390.60	540.00
	Rising two-year and older hinds (maiden/first fawning)	458.50	533.00
	Mixed-age hinds (second and subsequent fawning hinds)	447.65	632.00
	Rising one-year stags	95.20	174.00
	Rising two-year and older stags (non-breeding)	95.90	134.00
	Breeding stags	517.30	610.00
		$ ¢	$ ¢
Goats	Angora and Angora Crosses - Mohair Producing Including Purebred and G1 to G3:		
	Rising one-year does	38.00	38.00
	Mixed-age does	81.00	81.00
	Rising one-year bucks (non-breeding)/wethers	10.50	13.00
	Bucks (non-breeding)/wethers over one year	12.25	16.00
	Breeding bucks	182.00	182.00
	Other fibre and meat producing goats - including Cashmere or Cashgora producing and G4		
	Rising one-year does	23.00	23.00
	Mixed-age does	29.00	29.00
	Rising one-year bucks (non-breeding)and/wethers	2.45	6.00
	Bucks (non-breeding/ wethers over one year	7.70	13.00
	Breeding bucks	51.00	51.00
	Milking (dairy) goats		
	Rising one-year does	26.00	26.00
	Does over one year	35.00	35.00
	Breeding bucks	52.50	75.00
	Other dairy goats	7.70	13.00
Pigs	Breeding sows less than one year of age	67.20	110.00
	Breeding sows over one year of age	114.45	184.00
	Breeing boars	153.65	246.00
	Weaners less than 10 weeks of age excluding sucklings	33.95	53.00

Growing pigs 10 to 17 weeks of age (porkers/baconers)	67.20	105.00
Growing pigs over 17 weeks of age (baconers)	104.30	159.00

Bloodstock Cost Determination

In PIB No. 166, pages 6 and 7, we set out the method of determining the cost price of home bred bloodstock.

It has been brought to our attention that there has been some confusion on how the cost of unborn foals are to be treated at balance date.

Since the costs to be used to determine the cost of a home bred foal arise in the year of servicing and are in the nature of "work-in-progress", they should be capitalised as the cost of the unborn foal. The servicing costs can be written off only if the servicing is unsuccessful or the breeding mare fails to deliver a live foal.

Chainsaw Reimbursing Allowances

The Department has recently approved increases in the exemption from tax of allowances paid to workers who are required to purchase and pay for the operation of chainsaws in deriving income from employment or services.

The maximum rates, which are effective from 11 May 1988, are as follows:

- one chainsaw used (all cc ratings) $28.00 per day.
- two chainsaws (all cc ratings) used concurrently - the exemption is 75 percent of the total for two chainsaws, i.e., $28 x 2 x 75 percent = $42.00 per day.
- where an additional chainsaw is a compulsory spare only - 10 percent of the daily exemption for the spare, i.e., $28.00 + $2.80 = $30.80 per day.

Cost of Domestic Establishment

Preamble

The "cost of domestic establishment" is an adjustment made by the owners of hotels, taverns, private hospitals and similar businesses to reflect the use by the owner and family of accommodation goods and services charged to the business.

Background

Section 106(i)(j) of the Income Tax Act 1976 debars a deduction for expenditure which is of a private or domestic nature. It is clear that some owners of these businesses are still using figures set many years ago when making adjustments in their returns of income for the cost of domestic establishment. These figures are now entirely inappropriate for adjusting for the private and/or domestic use of the accommodation and goods and services expenditure.

Ruling

As from the income year which commenced on 1 April 1988 all owners of such businesses should, if they are not already doing so, make adjustments to their assessable incomes on a factual basis that more realistically reflects the private use of accommodation goods and services charged to the hotel or tavern or other business.

"Cyclone Bola" Disaster Relief Payments - Income Tax Implications

Recently the Commissioner issued a press release which outlined the treatment for income tax and GST purposes of relief payments made to "Cyclone Bola" victims. The purpose of this item is to expand on the ruling given.

The relief payments come from two sources; namely

- Government Grants
- The Mayoral and other Relief funds

Income Tax Position

Payments which are made to compensate for loss of income including losses of crops or livestock, constitute assessable income in the year received. Such payments will be treated as income either under section 65 2(a) and/or section 79 (in the case of trading stock) of the Income Tax Act 1976.

Compensation paid in respect of the loss of farm sundries which have been claimed as a deduction would also be assessable. Farm sundries would include materials or items purchased to meet ordinary and continuous farming requirements such as fertiliser, winter stock feed and stock drenches. Payments to compensate for the loss of farm sundries are assessable in terms of section 79(1)(b) of the Act.

Payments made to compensate for damage to capital assets, such as erosion of farm land and damage to vines or fruit trees, permanent pastures, fences and other structural improvements on the land, e.g., tracks, stopbanks, dams, culverts, etc, (and including buildings) would not be assessable.

Where the payment is to compensate for loss, destruction or irreparable damage to a depreciable asset (other than permanent buildings), the provisions of section 117(7) of the Act apply. For depreciation purposes the asset is deemed to have been sold in the income year in which the loss, destruction or irreparable damage occurred at a price equal to the amount of the compensation payment received. Payments made in respect of damage, not being irreparable damage, to a depreciable asset (other than a permanent building), are to be treated in accordance with the provisions of section 117(8) of the Act.

The question has been raised as to whether the payments made by Government come within the provisions of section 169 of the Act. For section 169 to apply the payments must be made in respect of expenditure that the taxpayer has or is to incur. The Government payments to "Cyclone Bola" victims are being made on an indemnity basis and there is no restriction on how the payments may be used by the recipients. This being the case, the provisions of section 169 would not apply.

See also the decision in the case, MacLean v CIR (1985) 7 NZTC 5035.

GST Position

Payments to registered persons, whether from Government or any other source, that relate to an asset used in the taxable activity or to lost income of the taxable activity come within the definition of 'consideration' contained in section 2 of the Goods and Services Tax Act 1985. Any payments received must therefore be included by the registered person as taxable supplies made.

It should be noted that it is not necessary for the person/organisation making the payment to receive goods or services in return for the payment. It is merely necessary that the payment relates to the supply of goods or services. Thus any payment to a registered person in respect of the carrying on of the taxable activity will be subject to GST.

However, any payment received that relates to assets not used principally in the carrying on of a registered person's taxable activity (or received by a person not registered for GST purposes), would not be subject to GST.

Three further issues have arisen in connection with the application of income tax provisions to farmers and other agricultural business taxpayers affected by the cyclone.

Ruling

1 When Government Compensation Grants Derived as Income

Compensation grants under the Cyclone Bola Farming Assistance Programme are generally paid out in three equal monthly payments. However, where the total grant payable amounts to less than $30,000, payments are made at the rate of $10,000 a month (or such smaller amount as remains) until the grant is fully paid out.

The compensation payments are direct credited to the farmer's bank account by the Ministry of Agriculture and Fisheries.

The taxable portions of each compensation payment are to be treated as assessable income in the income year in which the particular payment is direct credited to the farmer's bank account, e.g., compensation payments credited to an account in the months of May, June and July 1988 in respect of a farmer with a 30 June balance date. In such a case the May and June payments are assessable income in the farmer's return for the year ended 30 June 1988, while the July payment will be assessable in the farmer's 1989 income year.

2 Early Farm Income Equalisation Scheme Refunds

The Commissioner has exercised his discretion under section 179 (2B) of the Income Tax Act 1976 and will allow farm income equalisation refunds within six months of a deposit having been made provided -

(i) The refunds are in respect of cyclone affected taxpayers who have been in receipt of compensation payments from the Government's Cyclone Bola Assistance Programme, and

(ii) The refund is to be used in meeting costs of restoration of the taxpayer's cyclone damaged farming operations.

3 **<u>Deductibility of "Restoration" Expenditure</u>**

Broadly speaking, expenditure incurred in repairing storm or flood damaged assets qualifies as repairs and maintenance and is deductible in the year incurred. However, where virtual reconstruction or replacement of an entire asset is undertaken the expenditure may go beyond mere repairs and become capital in nature.

Although capital in nature, certain storm restoration expenditure will still qualify for a partial deduction under the farm developmental expenditure deduction provisions, contained in section 127 of the Income Tax Act 1976. Under the terms of the phase out of that deduction, qualifying expenditure will be deductible in the year incurred to the following extent -

- 90 percent where incurred in the income year ended 31 March 1988 (or equivalent balance date),
- 75 percent where incurred in the income year ending 31 March 1989,
- 55 percent where incurred in the income year ending 31 March 1990, and
- 30 percent where incurred in the income year ending 31 March 1991.

The undeducted balance of this expenditure is subject to the depreciation type allowance provided by section 128A and the Thirteenth Schedule.

While the dividing line between capital expenditure and repairs and maintenance (revenue expenditure) in relation to farming may often seem indistinct, the following are some examples of the income tax treatment of various items of storm restoration expenditure.

<u>Fences</u>

(i) Construction of a new "first time" fence - developmental expenditure section 127.

(ii) Repairing or replacing a section of fence (washed/slipped away or buried by silt) with a similar type of fence along the same fence line - repairs and maintenance deductible as a normal revenue expense.

(iii) Replacing a section of fence but along a new line because that particular section of the previous fence line is unable to be used (slipped away, river changed course) - revenue expenditure deductible.

(iv) Replacement of a run-down fence with a similar type of fence using similar materials and the same fence line - revenue expenditure deductible.

(v) Total replacement of a fence using an entirely new fence line, or extending an existing fence line - developmental expenditure section 127.

(vi) Replacement of a fence with an improved type using the same fence line, e.g., a 2 wire electric "subdivision" fence replaced by a 6 wire post and batten fence or a sheep fence replaced by a deer fence - developmental expenditure section 127.

Farm Access Road and Tracks

(i) Repairing or removing slips from existing roads and tracks - revenue expenditure.

(ii) Upgrading or improving the surfacing of existing roads or tracks, e.g., metal instead of dirt - developmental expenditure section 127.

(iii) Putting in a new access road or track - section 127.

(iv) Repairing a bridge or culvert damaged by flooding - revenue.

(v) Replacing a bridge or culvert destroyed by flood - section 127.

Stopbanks and Drains

(i) Repairing holes in stopbanks - revenue.

(ii) Extending stopbanks or increasing their height - section 127.

(iii) Completely replacing stop banks or building new stopbanks - section 127.

(iv) Clearing out existing drains and channels - revenue.

(v) Digging new drains - section 127.

Pastures

(i) Cultivating and resowing to re-estabish damaged pastures - revenue.

Fruit Trees and Vines

(i) Clearing vineyards and orchards of silt, flood debris, etc., - revenue.

(ii) Replacement plantings of destroyed fruit trees and vines - capital expenditure depreciable at 10 percent DV per year under section 128A and the 13th Schedule.

Disclosure of Inter-Related Arrangements
Under Section 64H of the Income Tax Act 1976

1 Background

Section 64H(1) of the Income Tax Act 1976 requires every person who is a party to an "inter-related arrangement" to disclose certain details about the arrangement to the Commissioner. An inter-related arrangement is a financial arrangement that consists of two or more arrangements, whether or not those arrangements are themselves financial arrangements.

This disclosure is to be made in the "prescribed form" with the person's annual return, and is required in each year of the term of the arrangement. The following information is to be provided:

(a) the existence of each of the component arrangements making up the inter-related arrangement;

(b) the parties thereto;

(c) the assessable income or deductible expenditure arising from the inter-related arrangement;

(d) such other information as the Commissioner may require.

The aim of this disclosure is to provide the Commissioner with information about complex financial arrangements having possible tax avoidance implications. This information will aid in identifying and selecting such arrangements for further investigation.

2 Exemption

2.1 The meaning of inter-related arrangement is wide and will therefore include many common arrangements involving little or no tax avoidance content.

Under section 64H(2) the Commissioner may exempt a person or class of persons from the disclosure requirement in respect of a particular financial arrangement or class of financial arrangements, where the making of the arrangement is a commercially acceptable practice. The aim of such an exemption is to greatly reduce the number of disclosures required, and to focus on those arrangements which are more likely to involve material tax avoidance.

Under section 64H(3) the Commissioner may at any time cancel an exemption made under subsection (2).

2.2 **Exemption dated 24 March 1988 (Appendix A)**

This has application for the five income years ending 31 March 1986 to 1990 inclusive, and exempts all persons to the extent that they are a party to any of the four types of inter-related arrangements listed in the schedule.

The overriding requirement for each of the four exemptions is that the making of the inter-related arrangement must be a generally accepted commercial practice. It is considered that this would exclude all tax avoidance schemes.

The four types of exempted inter-related arrangements are explained below.

2.2.1 **Any inter-related arrangement the value of which does not exceed $10 million at any time in the income year.**

The value of an inter-related arrangement is determined according to the definition provided in paragraph 4(g) of the Exemption. Where a foreign currency is involved the amount should be converted to NZ$ in line with Determination G6: Foreign Currency Rates.

2.2.2 Any inter-related arrangement that consists only of:

(a) one or more financial arrangements, none of which is an exempt security arrangement; and

(b) one or more exempt security arrangements;

and which would not be an inter-related arrangement but for the existence of the exempt security arrangement or exempt security arrangements.

This category is designed to exempt all collateral or security type arrangement where the existence of the collateral/security is the sole reason that the arrangement is an inter-related arrangement.

Note however the definition of exempt security arrangement. This excludes from exemption any arrangement where the security includes:

(i) a share which is differential as to voting rights and distributions (e.g. redeemable preference shares); or

(ii) a back-to-back type arrangement involving any offshore element.

Note also that while the two arrangements (i.e. the exempt security arrangement and the financial arrangement which is being secured) are required to be financial arrangements, this does not mean that the underlying security must also be a financial arrangement. The underlying security may instead be an excepted financial arrangement, such as an ordinary share or a contract of insurance, or it may be a tangible asset. The financial arrangement in these cases is the holder's right to the underlying security upon default of the issuer, not the underlying security itself.

2.2.3 Any inter-related arrangement that has no material purpose and effect other than to achieve the exchange of a sum of money in one currency for an equivalent sum of money in another currency, such exchange not being subject to any agreement to reverse the exchange at some future date.

This is aimed at forward and futures foreign exchange contracts, and spot exchange transactions involving more than one currency. A transfer at a market-based spot or forward exchange rate, derived in general accordance with Determination G6, will be considered to be an exchange for "an equivalent sum of money". The reference to reversing the exchange makes it clear that the exemption does not extend to swaps.

2.2.4 Any inter-related arrangement, in relation to a person:

(a) that comprises only obligations (conditional or otherwise) to be fulfilled outside New Zealand; and

(b) none of the parties to which is an associated person of the person.

This exempts arms-length arrangements which are conducted entirely offshore.

2.3 Insurance

It has been submitted that the definitions of inter-related arrangement and financial arrangement are sufficiently wide to extend to multi-legged insurance arrangements such as reinsurance and coinsurance. A contract of insurance is an excepted financial arrangement.

It is considered that arrangements of pure coinsurance and reinsurance are contracts of insurance, and that they are therefore excepted financial arrangements. As such they are not subject to the disclosure requirement. This view might not apply however where any such arrangement has additional non-insurance elements which enable the arrangement to be more readily considered a financial arrangement.

3 IR4A Disclosure Return (Appendix B)

3.1 This is the prescribed form for the purposes of section 64H(1), relating to the 1988 and previous tax years. The 1988 income return forms for companies, trusts, and non-exempt superannuation schemes (respectively IR's 4, 6 and 44) contain a declaration and guidance note pointing out the potential requirement to file the IR4A. Note however, that as the guidance note was written prior to finalisation of the Exemption, it does not include reference to the fourth exemption category (offshore arrangements). The form was distributed to District Offices during late April 1988.

As this is the first year that the IR4A is to be used, the form is initially to be distributed to selected taxpayers with a covering letter. Other taxpayers may obtain the form on request from Inland Revenue. In future the form is to be available only by request from IRD district offices, rather than by general distribution, as it is expected that the disclosure will only be required of a relatively small number of taxpayers.

3.2 Back Years

The disclosure requirement dates back to the income year commenced 1 April 1985 and therefore affects the income years ended 31 March 1986 and 1987, as well as 1988. As the prescribed form has only recently been produced it was previously not possible for taxpayers to comply with their disclosure obligations. The availability of the IR4A Disclosure Return means that this situation no longer exists and it is now necessary for disclosure to be made for the 1986 and 1987 years, where applicable, as well as for the 1988 year.

Disclosure Returns for the 1986 and 1987 years should be filed with the 1988 Disclosure Return, i.e., with the 1988 return of income. For each of these years a separate Part A should be completed, with at least the person's name and the signed declaration, plus any details that differ from the 1988 return. The front page of each back year return should be suitably amended to show the year to which it relates. Photocopies of the form may be used, or further copies obtained from Inland Revenue.

3.3 Taxpayer Problems with Compliance

It is possible that some taxpayers may have difficulty in complying with the disclosure requirement, for example in respect of group companies or the 1986/1987 back years. In any such case the problem should be brought to the attention of the Accruals Unit, IRD Head Office.

Exemption from the Requirements of Section 64H(1) of the Income Tax Act 1976 - Appendix A

This exemption was signed by John Simcock, Commissioner of Inland Revenue, on 24 March 1988.

1 Explanation

Section 64H(1) of the Income Tax Act 1976 requires the disclosure of all financial arrangements that are inter-related arrangements.

This exemption removes the disclosure requirement in respect of certain commonly encountered inter-related arrangements.

2 **Reference**

This exemption is made pursuant to section 64H(2) of the Income Tax Act 1976.

3 **Scope of Exemption**

This exemption shall apply to the income year commencing on the 1st day of April 1985 and the four next succeeding income years.

4 **Interpretation**

In this exemption, unless the context otherwise requires -

(a) Expressions used have the same meaning as in the Income Tax Act 1976;

(b) Every reference to an income year shall, where a person furnishes a return of income under section 15 of the Income Tax Act 1976 for an accounting year ending with a day other than the 31st day of March, be deemed to be a reference to the accounting year corresponding with that income year;

(c) A person (the "directing person") controls another person where the directing person or any person controlled by the directing person is able by any means whatsoever (including by exercise of legal or equitable right or by exercise of economic influence) to secure that the affairs of the other person are conducted in accordance with the wishes of the directing person, whether or not that ability is exercised and, without limiting the generality of the foregoing, the directing person controls another person where the other person is -

(i) A company and more than 50 percent of the -

(A) Voting power; or

(B) Nominal capital; or

(C) Paid up capital; or

(D) Rights that persons have to acquire capital -

in the company are held by or for the benefit of the directing person or any person that is controlled by the directing person;

(ii) The directing person, or any person controlled by the directing person, acting in a fiduciary capacity in relation to assets or rights of any person;

(iii) Acting in a fiduciary capacity in relation to assets or rights of the directing person or any person controlled by the directing person -

whether or not the directing person or the other person are resident in New Zealand; and "controlled", and "controls" have corresponding meanings;

(d) "Associated persons" means associated persons as determined by section 8 of the Income Tax Act 1976, and also includes any two persons -

(i) That are controlled by the same person or persons; or

(ii) Where one of the persons controls the other person;

and "persons associated with each other" has a corresponding meaning:

(e) "Exempt security arrangement" means a security arrangement other than a security arrangement that includes -

(i) A share in a company which does not rank equally with ordinary shares in the company in terms of voting rights and rights to distributions ; or

(ii) An arrangement pursuant to which -

(A) A person has entered into two or more financial arrangements with another person or persons (being persons associated with each other in any case where more than one other person is involved); and

(B) Those financial arrangements are dependent upon one another; and

(C) Any obligation is to be performed outside New Zealand;

(f) "Inter-related arrangement" means a financial arrangement that consists of two or more arrangements, whether or not those arrangements are themselves financial arrangements;

(g) "Value", in relation to any arrangement, means -

(i) In relation to any variable principal debt instrument, other than an inter-related arrangement, the amount of money owing to the holder pursuant to the arrangement;

(ii) In relation to any fixed principal debt instrument, other than an inter-related arrangement or an instrument involving a notional principal, the greater of the acquisition price of the arrangement or the nominal or face value of the arrangement;

(iii) In relation to any security arrangement, the greater of -

(A) The amount of the maximum liability of the surety under the security arrangement;

(B) The sum of the values of the financial arrangements wholly or partially secured by the security arrangement;

(iv) In relation to any financial arrangements involving a notional principal (for example, certain types of interest rate or currency swaps, forward rate agreements, certain futures contracts) the amount of the notional principal;

(v) In relation to any arrangement which is not a financial arrangement, the total amount of consideration required to be provided under the arrangement by the person having the greatest liability under the arrangement;

(vi) In relation to any inter-related arrangement, the sum of the values of the arrangements (other than exempt security arrangements) that constitute the inter-related arrangement;

Provided that where, under an inter-related arrangement, consideration is required to be passed between persons more than once and as a consequence an amount would, but for this proviso, be required to be taken into account more than once in calculating the value of an inter-related arrangement, that amount shall not be taken into account more than once in calculating the value of the financial arrangement;

Provided also that where the value can be ascertained pursuant to more than one of the foregoing subparagraphs, the value shall be ascertained pursuant to the subparagrah that provides the greatest value.

5 <u>Exemption</u>

Any person who in an income year is party to an inter-related arrangement shall be exempt from the requirements of section 64H(1) of the Income Tax Act 1976 in respect of the inter-related arrangement and the income year where -

(a) The making of the inter-related arrangement is a generally accepted commercial practice; and

(b) The inter-related arrangement is of a kind specified in the Schedule hereto.

Schedule

1 Any inter-related arrangement the value of which does not exceed $10 million at any time in the income year.

2 Any inter-related arrangement that consists only of -

(a) One or more financial arrangements, none of which is an exempt security arrangement; and

(b) One or more exempt security arrangements -

and which would not be an inter-related arrangement but for the existence of the exempt security arrangement or exempt security arrangements.

3 Any inter-related arrangement that has no material purpose and effect other than to achieve the exchange of a sum of money in one currency for an equivalent sum of money in another currency, such exchange not being subject to any agreement to reverse the exchange at some future date.

4 Any inter-related arrangement, in relation to a person -

(a) That comprises only obligations (conditional or otherwise) to be fulfilled outside New Zealand; and

(b) None of the parties to which is an associated person of the person.

Disclosure - Return IR4A

Provide with this return (by way of separate schedule) the following information in relation to each inter-related arrangement to which you were a party during the income year and for which no reporting exemption has been made:

1 A short description of the nature of the inter-related arrangement (e.g., currency swap, back-to-back loan).

2 In relation to each of the parties to the inter-related arrangement:

- Full name;
- Residential or registered address;
- Whether you are an associated person of the party, and if so, a full explanation of the relationship that gives rise to the association.

3 A complete description of the inter-related arrangement, including separate identification of each of the component arrangements.

4 The purpose of the inter-related arrangement and each of the component arrangements.

5 The amount of your assessable income or deductible expenditure in the income year in respect of the inter-related arrangement, and a complete explanation of how the amount has been calculated.

6 How the inter-related arrangement is reflected in your annual financial report for the year, and how this treatment reconciles to your corresponding annual return of income to the Commissioner of Inland Revenue.

7 The names and residential, postal (if in New Zealand) or registered addresses of each of your external advisors in relation to the inter-related arrangement.

Fiji Tax Free Zones and the International Tax Regime

Fiji has recently enacted legislation to encourage foreign investment and to rejuvenate the commercial and industrial sectors in that country.

The main taxation incentive offered by Fiji to qualifying operations in the form of an exemption from corporate income tax for a period of 13 years.

The following analysis addresses the question of the impact of the proposed international tax regime on the operations of Fijian subsidiaries of New Zealand resident companies which are taking advantage of the tax incentive described above. The analysis relies on the details of the regime which have been decided on to date and announced by the Consultative Committee on International Tax Reform and Imputation in Part 1 of its report on international tax reform.

Taxation of New Zealand Shareholders

If the Fijian operations of New Zealand companies are conducted through Fijian subsidiaries the Controlled Foreign Company (CFC) regime being developed by the Consultative Committee will remove the deferral benefit and the benefit of the Fijian incentives. As the Fijian subsidiary would be a CFC the New Zealand shareholders would be taxed on a branch-equivalent basis. Using that method the CFC's income would be calculated according to New Zealand tax rules and attributed to the New Zealand shareholders, thus negating the effect of the Fijian tax exemption.

The CFC regime applies from 1 April 1988 with respect to interests in CFC's acquired after 17 December 1987 where the CFC is not resident in one of the following seven "high tax" countries: United States, Australia, Canada, United Kingdom, Japan, West Germany and France. Therefore, in relation to CFC's resident in Fiji the new regime will apply from 1 April 1988 where interests in such CFC's were acquired after 17 December 1987.

Fourth Schedule - Excess Superannuation Contributions

Background

Head Office has become aware that enquiries are being made about claiming excess superannuation contributions under Clause 8 of the Fourth Schedule to the Income Tax Act 1976.

Facts

Claims under Clause 8 of the Fourth Schedule are limited to those that are for the purpose of, and as condition of a taxpayer's employment.

Such claims do not include expenditure incurred under Clauses' 1 - 7 of the Schedule, or expenditure to which section 106 of the Act refers.

Decision

A claim for excess superannuation contributions under Clause 8 of the Fourth Schedule does not succeed as superannuation contributions are specifically mentioned in section 106(1)(m).

Fringe Benefit Tax - Change to the Prescribed Rate of Interest

The "prescribed rate of interest" used in calculating the taxable value of a low interest loan fringe benefit has been decreased from 18 percent to 17 percent.

This change will take effect for and from the quarter commencing 1 July 1988 and should therefore be taken into account by employers when preparing the September quarters return - due 20 July 1988 and subsequent returns.

GST and the Accounting Basis and Return Period Criteria for Group Representative Members in Terms of Section 55 of the Goods and Services Tax Act 1985

This item is to confirm the guidelines for establishing the eligibility of persons operating under section 55 to use the payments basis of accounting, and return period allocation.

(i) Groups whose members have a combined turnover of taxable supplies less than $250,000 in any twelve month period are entitled to use the payments basis of accounting and category "C" return period.

(ii) Where the group members have a combined turnover of taxable supplies exceeding $250,000 but less than $500,000 in any twelve month period, they are entitled to use the payments basis of accounting but they will not qualify to use the category "C" return period.

(iii) Groups which have a combined turnover of taxable supplies exceeding $500,000 in any twelve month period may not adopt the payments basis of accounting without the express approval of the Commissioner, or use the category "C" return period.

(iv) Where the group members have a combined turnover of taxable supplies exceeding $24 million in any twelve month period the group is required to adopt a one month, category "D", return period.

(v) Non-Profit Bodies are able to adopt a Payments Basis regardless of their size of turnover, but must still comply with the criteria pertaining to the adoption of category "C".

(vi) The representative member of any group is required to notify the Department where circumstances alter and the eligibility of the group to use either the payments basis of accounting or the category "C" return period is affected. The Department is to be notified within 21 days of the group exceeding the criteria mentioned above.

GST - Advance Payments to Kiwifruit Growers

The Department has considered the GST treatment under the following circumstances:

1 Once the goods (kiwifruit) have been accepted for export and stored for a length of time they may lose their quality and therefore are no longer of export standard and are sold on the domestic market.

2 Once the goods (kiwifruit) have been accepted for export and are put into storage they may lose their quality due to a malfunction occurring with the cool store and the goods are consequently destroyed.

In both of the above cases the goods would no longer come within the zero-rating provisions of section 11(1)(a)(i) of the Goods and Services Tax Act 1985 and therefore the grower's GST return for the period concerned would need to be re-assessed.

If an indemnity payment is received on an insurance policy then that payment will be subject to GST.

GST and the Calculation of Employers Accident Compensation Levy

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In consultation with the Accident Compensation Corporation the Department has reviewed the policy on the calculation of employers accident compensation levies where a person:

1 Is deemed an employee under the Accident Compensation Act 1982, and,

2 Is also a registered person under the Goods and Services Tax Act 1985, and,

3 Receives payments which are subject to Withholding Tax.

The Accident Compensation Corporation has ruled that the definition of earnings as employees in the Accident Compensation Act 1982 does not include the GST payable on those earnings. Employers who have paid levies on GST inflated earnings may have an adjustment made to that levy where they are able to provide evidence of the amount of GST included in the earnings. Credits that result from the adjustments can be held and applied against 1988 levies where appropriate.

GST - Consumer Credit and Contingency Debt Insurance Contracts

Background

In PIB 164, issued in August 1987, the Department stated both Consumer Credit (CCI) and Contingency Debt (CDI) policies were exempt supplies in terms of section 3(1)(h) of the Goods and Services Tax Act 1985. Since announcing this policy the Department has been requested to review this decision.

Ruling

The result of the review has determined that CCI policies are not financial services as defined in section 3 of the Goods and Services Tax Act 1985, as previously ruled by the Department. The services therefore, are not exempt supplies in terms of section 14 of the Act. CDI policies continue to be exempt supplies in terms of section 14 of the Act.

Premiums in respect of consumer credit policies are consideration for a supply of services on which GST is payable. However, any portion of a premium which is paid for life cover included in such a contract continues to be exempt as consideration for a financial service. In this respect it will be necessary to show there is an intelligible basis of apportionment to distinguish the proportion of the premium which is attributable to the life cover.

As this ruling reverses the Department's previously stated interpretation of the relevant sections of the Goods and Services Tax Act it will apply with effect from 1 June 1988.

GST on Directors' Fees

Background

The Department has been asked to review the guidelines issued in PIB 164 as they relate to the GST treatment of directors' fees.

Decision

The result of that review has established that the proviso to section 6(3)(b) of the Goods and Services Tax Act 1985 can only apply to a sole trader, e.g., an accountant or solicitor (being a registered person) who, in carrying on his/her taxable activity, is appointed a director of a company.

The reason for this is that, in terms of the Companies Act 1955, a director can only be a natural person.

Directors' fees paid to a member of a partnership or to a shareholder, director or employee of another company will therefore not be subject to GST.

GST on Rebates Paid by Co-Operatives

Background

The Department has been asked to confirm the GST treatment to be given to rebates paid by co-operatives to their members.

Decision

Each case will need to be examined to determine whether the rebate is the distribution of tax paid profits (no GST liability) or an alteration to the consideration (GST liability).

Where the rebate is a distribution of tax paid profits, it falls within section 3(1)(ka) of the Goods and Services Tax Act 1985 and is therefore an exempt supply in terms of section 14 of the Act.

However, where the rebate is an alteration to the consideration the appropriate adjustment should be made to output or input tax. Examples of rebates that have a GST liability are end of year rebates to dairy farmers for their butter fat sales or organisations that give their members an annual discount for purchases made during the year.

The income tax treatment is covered by section 199 of the Income Tax Act 1976.

GST and Premiums of Loss of Earnings Indemnity Policies

Background

The Department has been asked to confirm the GST treatment to be given to the premiums payable on loss of earnings indemnity insurance policies.

Ruling

Such premiums have always been subject to GST at the standard rate. The 1987 amendments to the Goods and Services Tax Act 1985 provided for a change in the GST treatment given to payouts made in respect of the loss of earnings policies. The amendments did not alter the GST treatment given to premiums payable on those policies.

GST on the Sale of Taxi Licences

Background

The Department has been asked to confirm the GST treatment given to the sale of a taxi licence, where the taxi cab etc, is not sold with the licence.

Decision

The taxi licence is the sale of an asset which is not capable of independent operation. Accordingly it is a normal supply, subject to GST at the standard rate. Zero-rating in terms of section 11(1)(c) of the Goods and Services Tax Act 1985 is not applicable.

GST - Tax Invoice Requirements

It has come to Head Office's attention that unconditional agreements for the sale and purchase of land and buildings are being treated as tax invoices for the purposes of claiming input tax credits.

Section 24 of the GST Act sets out the criteria that must be shown on a document for it to constitute a tax invoice. If this information is recorded on the agreement for sale and purchase then it will constitute a tax invoice and an input tax credit can be claimed. If not, then the recipient of the supply is unable to claim an input tax credit on the basis of the agreement for sale and purchase held. In order to claim an input tax credit the recipient of the supply must obtain some other document that constitutes a tax invoice from the supplier.

It would appear that this misunderstanding arose because of a previous item (GST - Time of Supply of Real Estate) in which it was stated that an unconditional agreement for sale and purchase constitutes an invoice for determining the time of supply in terms of section 9 of the GST Act 1985. Care should therefore be exercised by registered persons to ensure that any document issued by the supplier that constitutes an invoice for the purposes of determining the time of supply also satisfies the tax invoice requirements to enable an input tax credit to be claimed.

Obsolete Forms - GST 103 Application for Alternative Taxable Period - GST 104 Application to Furnish GST Returns on a Payments Basis

The above forms are now obsolete. Both forms are incorporated on the reverse of the Application for Registration, GST 1. Elections when registering for GST are to be made on that form.

Subsequent requests for an alternative taxable period will now be required in writing stating the taxable period requested and, in the case of two monthly and six monthly periods, the reason(s) for the request.

Any application for a change in accounting basis will also be required to be in writing. The GST 106 is available for this type of election.

High Court Decision - CIR v Drew - M 282/86 - Whether or not the Income is Exempt under Section 61(37)

Facts

This was a case stated on appeal by the Department from the Taxation Review Authority (TRA). The issues before the High Court were as follows:

(a) Did the Authority err in determining that the Appellant was incorrect in including the amount of $9,721 as assessable income of the Respondent;

(b) Were the payments received by the Respondent in terms of a "scholarship or bursary" pursuant to Section 61(37) of the Income Tax Act 1976:

(c) Were the payments paid to him in respect of his attendance at an educational institution pursuant to Section 61(37) of the Income Tax Act 1976;

(d) Were the payments in the nature of a "maintenance" or "allowance" pursuant to Section 61(37) of the Income Tax Act 1976.

Decision

Ellis J answered these questions in favour of the Department.

TRA Decision - Case H109 (1986) 8 NZTC 723 OR Case 39 (1986) 10 TRN2273
Shareholders' Bonuses - Whether Expenditure Incurred

Facts

The objector, a private company, claimed a dedution for "Proprietors' Salaries-Provision for Bonuses" for the year March 1983. At this date the bonuses had not been paid but were shown as a current liability in the company's balance sheet. The issue for determination was whether the objector had definitely been commited to the expenditure in the relevant year, and had incurred the expenditure though no payment had taken place.

Decision

Judge D F G Sheppard found for the objector.

Comment

This case is being appealed to the High Court by the Department. The Department will not allow expenditure which is merely threatened or impending. The taxpayer needs to be definitely committed to it.

TRA Decision - Case K15 (1988) 10 NZTC 196 or Case 233 (1987)
11 TRNZ 207 - Section 73 of the Income Tax Act 1976

Facts

This case before the TRA centred around allowances paid to employees of the objector being exempt from income tax under section 73 of the Income Tax Act 1976.

The objector contended that the wording of the section, together with the evidence of a survey results produced a sufficient case for the grant of exemption under section 73(3) and (4).

The Commissioner referred to the onus of proof being on the objector. It was also submitted the allowance could not be considered exempt from tax as it was payable to all employees, regardless of whether they each incurred "additional transport costs".

Decision

Judge J D Bathgate confirmed that the Commissioner had not acted incorrectly in refusing to exempt from tax such allowances paid to employees under the awards.

Comment

In the words of Judge Bathgate "It is necessary to refer first to section 73(3) to ascertain what payments may be exempt, before considering section 73(4) to discover the amount of exemptions after the averaging provisions of the latter subsection are applied. Section 73(4) does not grant an exemption to income paid in the way of an allowance, that exemption is only provided for in section 73(3) or section 73(2). To grant an exemption to employees under section 73(4)(b) in cases where those persons would not be entitled to the exemption under section 73(3) would not be applying section 73(4) for the purposes of section 73(3). It would not be carrying out the provisions of section 73(3) or for the purposes of section 73(3). All that is permitted or intended is the averaging of the amounts of allowances exempt under 73(3)."

Press Release 9 May 1988
- Land Tax Liability Unchanged Until Law Passed

"1988 Land Tax returns due to be furnished today, 9 May, should be prepared on the basis of the existing law", the Deputy Commissioner of Inland Revenue, Mr Robin Adair, said today. Although the Taxation Reform Bill (No. 4) introduced into Parliament last week contains provisions to exempt residential property and certain historic buildings from Land Tax, the liability for returns remains unchanged until the new law is passed. "We will tell people affected by the proposed changes what they need to do when the Taxation Reform Bill becomes law", said Mr Adair.

Press Release

The Commissioner of Inland Revenue, Mr John Simcock, today announced his intention to retire.

Mr Simcock was first appointed to the Department in 1952, and has had a wide range of experience since then in both District and Head Office positions. He was appointed Commissioner in early 1982.

Mr Simcock said that the past few years had been among the most rewarding of his career, but certainly the most demanding. During this period the Department grew in size from 3,000 staff to over 5,000 as a result of taking on significant new responsibilities, such as Fringe Benefit Tax, Goods and Services Tax and Family Support Tax Credits. He said that it was very satisfying to have overseen the implementation of some of the most far reaching tax reform in the history of New Zealand.

Though he could have continued in his present capacity for some time yet, his health in the last two or three years had not been perfect, he said, and he wanted to have both the time and health in which to enjoy retirement. "There seems now to be a natural break in the Government's implementation of new tax policy. There is also the coincidental introduction of the State Sector Act which marks a milestone in the Public Service environment", he said.

All in all, Mr Simcock said, it seemed a logical and natural time to step down.

Valuation of Timber Stocks - Timber Merchants

Background

PIB No. 82, issued in 1974, states that for timber merchants who elect to value their stock of timber at cost price, a deduction not exceeding 20 percent may be deducted from cost. The special basis for arriving at the value of their stocks for timber was not extended to other taxpayers in the timber/building industry, although it is thought that some may have claimed on a similar basis.

Review of Deduction

The industry formula has been reviewed. The result of the review is that there is no justification for the deduction from cost price in terms of section 85 of the Income Tax Act 1976 on an industry wide basis. As from the income year ending 31 March 1989, (or equivalent balance date), the deduction will no longer be allowed. The basis to be adopted by taxpayers is that of the normal provisions being either cost price, market selling value or replacement price. Under section 85(5) a written application may be submitted to value below these options to take account of obsolescence and special circumstances on an individual case basis. The application must be approved by the Department.

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