

(a) Where it is a positive amount, be deemed to be income derived by the holder or the issuer as the case may be:

(b) Where it is a negative amount, be deemed to be expenditure incurred by the holder or issuer as the case may be:

Provided that expenditure incurred by the holder, in the year in which the financial arrangement is varied, using this method shall not exceed total income derived by the holder in previous income years.

(2) In income years after the income year in which the financial arrangement is varied, income deemed to be derived or expenditure deemed to be incurred shall be calculated using the terms of the financial arrangement as varied and the provisions of the Act.

#### 7. Examples—(1) Example A (A straight line method)

A New Zealand taxpayer issues (borrows) \$8,800 on 10 July 1991 for 3 years with interest at 10% pa payable half-yearly in arrears. The loan is made by issuing \$10,000 of notes at a discount. There are no fees.

The issuer is a New Zealand taxpayer eligible to use the straight line method (Determination G24), and chooses to do so. The issuer has a balance date of 31 March.

The total finance charges are:

+ 10,000 principal payable
+ 3,000 interest payable
– 8,800 principal received
+ 4,200

Since the principal outstanding is fixed throughout, and all time units are of the same length, Method A of Determination G24: Straight Line Method was used to calculate expenditure incurred.

Accordingly, an amount of  $4,200/6 = 700$  would be expenditure incurred in each half year period.

On 10 July 1993, in consideration of the issuer's circumstances, the holder agrees to forgive the 5th and 6th interest payments but not the principal amount due. The treatment of the loan in the 1994 and following years is set out below.

If the actual cashflows had been known at the outset, namely:

10 July 1991	+ 8,800	principal received
10 January 1992	– 500	interest
10 July 1992	– 500	interest
10 January 1993	– 500	interest
10 July 1993	– 500	interest
10 July 1994	– 10,000	principal paid
	– 3,200	expenditure incurred

then Method B of Determination G24: Straight Line Method would have applied because the length of the periods between payments are unequal. Under that method the Total Finance Charges of 3,200 would be spread over the term of the loan in proportion to the principal outstanding and length of each period. Using the formula in Method B of Determination G24 expenditure of 533.33 would have been incurred for each period.

Then using Determination G1A: Apportionment of Income and Expenditure on a Daily Basis, (on a 365 day basis) the position of the lender before and after the variation would be as follows:

Year Ending 31 March	Expenditure Incurred Original (1)	Changed (2)	Actual Expenditure Incurred
1992	1,016	774	1,016
1993	1,400 (3)	1,067	1,400
1994	1,400	1,067	492 (4)
1995	384	292	292
Totals	4,200	3,200	3,200

(1) Expenditure calculated using Method A of Determination G24: Straight Line Method.

(2) Expenditure calculated using Method B of Determination G24: Straight Line Method.

(3) The number of actual days was used to arrive at the 1992 figure (a broken period plus a leap year), whilst the annual payments were used for the 1993 and 1994 years.

(4) Expenditure calculated using this determination where:

$$\begin{aligned} a &= 0 \\ b &= 774 + 1,067 + 1,067 = 2,908 \\ c &= 0 \\ d &= 1,016 + 1,400 = 2,416 \end{aligned}$$

so  $a - b - c + d = -492$  which being a negative amount is deemed to be expenditure incurred in the year.

In the 1995 income year the expenditure incurred would be calculated using the base price adjustment in section 64F where:

$$\begin{aligned} a &= \text{all consideration paid} = 12,000 \\ b &= \text{acquisition price} = 8,800 \\ c &= \text{expenditure incurred in previous years} = 2,908 \end{aligned}$$

so  $a - (b + c) = 292$ , which because it is a positive amount is deemed to be expenditure incurred in terms of section 64F (4) (b) (i).

#### (2) Example B (a zero coupon loan)

On 15 April 1991 a 5 year zero coupon bond with a face value of \$1,000,000 is issued for \$500,000. The lender is a New Zealand taxpayer who balances on 31 March, and uses the yield to maturity method of accounting for financial arrangements.

By mutual agreement the debt is varied on 15 April 1993: the borrower repays \$250,000, and the face value of the bond is reduced to \$600,000.

The original yield to maturity is 14.870% pa, so that the income of the lender (the holder) would be as follows:

Year Ending 15 April	Opening Principal Outstanding	Accrual Income (1)	Closing Principal Outstanding
1992	500,000	74,350	574,350
1993	574,350	85,406	659,756
1994	659,756	98,106	757,862
1995	757,862	112,694	870,556
1996	870,556	129,444	0
		500,000	

(1) Calculated using the yield to maturity method and a rate of 14.870%.

If the changed cash flows had been known at 15 April 1991, namely:

15 April 1991	500,000 by lender
15 April 1993	250,000 by borrower
15 April 1996	600,000 by borrower

the yield to maturity would have been 14.235% pa and the income would have been as follows:

Year Ending	Opening Principal	Accrual Income	Closing Principal
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