LEARNING OBJECTIVES

After studying the material for this week you should be able to:

- Describe the concept of income;
- Distinguish between the meaning of income, net income, taxable income and exempt income;
- Analyse the distinction between capital and income receipts;
- Categorise items deemed to be income;
- Differentiate between the taxation of “allowances” and schedular payments;
- Identify common types of income for taxpayers;
- Apply tests to determine “what is a business?”
- Explain when income is “derived”;
- Explain the relationship between fringe benefit tax and the income base;
- Identify fundamental methods of income transfers.
Supplementary Readings

1. Supplementary Readings in this Study Guide:


Additional Readings

2. Additional Reading Reference:

(a) Alley, C., Chan, C., et al. (2009). New Zealand Taxation (Chapters 2, 3, 4 (pp.149-161 only) 5, 6 and para. 8.4.2). Wellington: Thomson Brookers. [Referred to as NZT].


Introduction to “Income”

1. The concept of income.

2. What is income?
   - definition of income, net income, taxable income and exempt income.

3. Income vs capital receipts.

4. Items deemed to be taxable income.

5. Allowances & Schedular payments.

6. Common types of income for taxpayers.
   - Individuals whose income is taxed at source – non-filing taxpayers
   - An IR3 taxpayer – self employed person
   - What is a “Business”? 

7. When income is derived.

8. Why fringe benefit tax protects the income base.

9. Introduction to fundamental methods of transferring income to other taxpayers.

Note: Dividends will be considered briefly in Topic 10: Company Tax & Dividend Imputation.
Part B
Core provisions

SUBPART BA
Purpose

SUBPART BG
Avoidance

SUBPART BB
Income tax and resulting obligations

SUBPART BH
Double tax agreements

SUBPART BC
Calculating and satisfying income tax liabilities

SUBPART BE
Withholding liabilities

SUBPART BF
Other obligations

SUBPART BD
Income, deductions, and timing
**Personal Income Tax**

*(Form of presentation for filing of Taxation Returns e.g. IR3). Also refer to NZT Chap. 12, Table 12.9, pp 465.*

<table>
<thead>
<tr>
<th><strong>ANNUAL GROSS INCOME</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment income</td>
</tr>
<tr>
<td>Business income</td>
</tr>
<tr>
<td>Interest/dividends</td>
</tr>
<tr>
<td>Beneficiary income</td>
</tr>
<tr>
<td>Rent</td>
</tr>
<tr>
<td>Overseas income</td>
</tr>
</tbody>
</table>

\[ \text{Less: Annual Total Deductions} \]

\[ \rightarrow \text{Net Income (net loss)} \]

\[ \text{Less: Available net losses} \]

\[ \rightarrow \text{Taxable Income} \]

\[ \rightarrow \text{TOTAL TAX LIABILITY} \]

\[ \rightarrow \text{Taxable income: 0-}$9,500@13.75\text{¢} \]

Add: $9,501 – $14,000 @ 16.75\text{¢}  
Add: $14,001 – $38,000 @ 21\text{¢}  
Add: $38,001 – $40,000 @ 27\text{¢}  
Add: $40,001 – $60,000 @ 33\text{¢}  
Add: $60,001 – $70,000 @ 36\text{¢}  
Add: $70,001 + @ 39\text{¢}  

Unadjusted income tax liability

\[ \text{Less: Imputation credits} \]

\[ \text{Less: PAYE} \]

Tax Paid by Trustees  
Resident Withholding Tax  
Overseas Tax Credit

\[ \rightarrow \text{Residual Income Tax (RIT)} \]

\[ \text{Less: Provisional Tax Paid} \]

\[ \rightarrow \text{Tax Payable (i.e. Terminal Tax)} \]
INTRODUCTION TO “INCOME”

Refer to NZT Chapters 2, 3, 4 (part), 5 & 6

1. The Concept and Characteristics of Income

Refer to NZT 2.1.3 to 2.1.9

2. What is Income? (according to the Income Tax Act 2007)

Refer to NZT 2.1.2

2.1 Income

The determination of just what constitutes income is one of the major difficulties in studying income tax. While the Income Tax Act 2007 (ITA) under Part C, Sec CA 1(1) gives “exhaustive lists” of what is income and Sec CA 1(2) states that “income under ordinary concepts” applies it does not define the term “income”. Hence defining “income” relies on case law and the interpretation of the courts.

Although income is difficult to pin down, you can see how parts of the Act fit together. For instance the main purpose of the ITA is:

**Section AA 1:** “…to define, and impose tax, on net income…..”

This is narrowed to:

**Section BB 1:** “Income tax is imposed on taxable income …….”

On page 15 of these Notes is a flowchart depicting the calculation of taxable income as governed by the ITA 2007. The link between net income and taxable income is the deduction of any losses (Sec BC 5).

However an understanding of the core concept of **annual gross income** helps.

**Section BC 2:** “A person’s annual gross income for a tax year is the total of their assessable income that is allocated to the corresponding income year”.

Thus what is **assessable income**?
**Section BD 1:** It is income under Part C after excluding exempt income, excluded income and non-residents’ foreign sourced income.

Clearly this lack of definition in the Act does not assist the taxpayer to determine just what they are liable to pay income tax on. The onus is on the taxpayer to prove that what the person receives is something other than income.

Summarising: Assessable income becomes **annual gross income**. This amount less the taxpayer’s **annual total deductions** (Topic 4) equals net income or taxable income once any losses are deducted.

The following flowchart will help you understand what steps to take when calculating **assessable income**.
The general rule for allocating income is:

Sec BD 3(2) “An amount of income is allocated to the income year in which the amount is derived, unless a provision in any of Parts C or E to I provides for allocation on another basis”.

2.2 Exempt Income

Subpart CW of Part C of the ITA 2007 sets out certain sources of income which are exempt from tax. Some of these include:

(a) Non-resident’s exempt income;
(b) Income of most local and public authorities;
(c) Non-profit bodies and charities;
(d) Certain pensions, benefits and other compensations;
(e) Certain allowances and fees;
(f) Salary of the Governor-General;
(g) Alimony or maintenance;
(h) Income of a superannuation fund derived before 1st day of April 1988;
(i) Prize money in respect of horse or greyhound racing;
(j) Certain employee allowances;
(k) Certain dividends.

Also refer to NZT 2.2 for a further list of items of income and details of the exemptions.

3. Income vs Capital Items

See NZT 2.4 & 2.7.

4. Items of Income

4.1 For most taxpayers their liability for income tax is covered explicitly by Sec BB 1. The primary sources of income are from:

(a) Business or trade like activities – this includes dealing with land acquired for resale (on revenue account) whether for business and personal reasons. The exclusion is if it is on capital account [NZT Chap. 3 & parts of 4. Students can generally ignore the details of Land transactions (Sec CB 5-14), but need a working knowledge of para 4.1 (Introduction) and 4.2 (Personal Property Sales). See Reading “The taxman cometh” by A. Morrall on Personal Property Sales.

(b) Ownership of property i.e.
   (i) Land - rentals [Sec CC 1(2)];
   (ii) Return of equity ie Dividends [Sec CD 1. See NZT 6.2.4, for a fuller explanation refer to NZT 14.3];
(iii) Financial arrangements e.g. interest annuities [Secs CC 3-CC 8];

(c) Employment or contractor activity [Sec CE 1-CE 10. See NZT Chap. 5];

(d) Government income from living allowances, compensation, and
government grants i.e. payments of national superannuation or
state pension, income-tested benefits and specified war pensions.
[Sec CF (1) and (2)];

Miscellaneous:
(e) (i) Income derived or deemed to be derived under the accruals
regime [Subpart EW];
(ii) Income derived from any other sources whatsoever [Sec CA
(1)].
(iii) Matching rules ie prepayments, trading stock etc. [Sec CH
(1), (2) and (5)]

5. Allowances & Schedular Payments

5.1 Employee Allowances [NZT 5.2.1]

Sec CE 1 brings within income any “salary, wage, allowance ...”

An “allowance” usually means an extra monetary payment received in
respect of, or in relation to, a person’s employment. NZT refers to and
discusses the tax treatment between an “allowance” and “any
expenditure on account of an employee”. [See NZT 5.4]

Note: Non-cash allowances are generally taxed under Fringe Benefit Tax
and therefore their value is not assessable income to the recipient.

5.2 Employee or independent contractor - Schedular Payments [See NZT
5.2.2 & 5.3]

These are a form of employment income but, there is no true
master/servant relationship existing between the payer and the recipient.

Just as PAYE is deducted from salaries and wages at source, so tax is
deducted at source from schedular payments.

The rate of tax varies according to the type of payment. The rates are set
out in Schedule 4 of the ITA2007
6. **Common types of Income of Taxpayers**

6.1 **Individuals whose income is taxed at source – Non-filing tax payers** [See NZT 12.3.1]

As from the 2000 income year taxpayers who previously filed an ‘IR5’, are not required to furnish any tax returns if the taxes on their incomes have been correctly deducted at source and whose residual income tax for the prior year is less than $2,500 in an income year, i.e. ‘natural’ persons who are not provisional taxpayers.

The most common forms of income for these taxpayers are:

(a) Salary or wages; or
(b) Superannuation;
(c) Some investment income.

6.2 **An IR3 taxpayer is in general**

(a) A self-employed person [see NZT 5.3]; or

(b) A person who has received income during the income year, and has residual income tax in excess of $2,500 for that year. (This includes anyone who has received investment income from interest, dividends and net rents during the income year).

The most common forms of income for these taxpayers are:

(1) Business income and/or salary or wages or superannuation;
(2) Interest;
(3) Dividends;
(4) Net rents.

6.3 **A Business taxpayer**

Refer to NZT Chap. 3

What is a “Business”?

6.3.1 **General**

For income tax purposes it is essential that the concept of business is clearly identified. The reasons for this are two-fold:

(a) **Secs BC 2-BC 6**: income tax is imposed on taxable income and under Sec CB 1 “An amount that a person derives from a business is income of the person”.

(b) **Sec DA 1(2)** requires that in seeking a deduction the taxpayer will need to establish that the expenditure is for carrying on a business (Refer to Topic 6).
6.3.2 Method for Calculating Business Income

The *accruals/earnings* method applies to most taxpayers carrying on a business. In following this method business taxpayer should compute income on the basis of ordinary commercial principles.

6.3.3 Business Tests

Refer to **NZT 3.2**

The Act defines the term “business” as including “any profession, trade, manufacture or undertaking carried on for profit” (*Sec YA 1*).

The test for determining the existence of a business is whether the taxpayer is carrying on a particular venture with the intention of making a profit.

(a) **Meaning of “Intention”**

“Intention” is not to be judged purely subjectively, but is determined by taking into account not only words of the taxpayer, but also his actions. For instance, a taxpayer may have expressed intentions of making a profit from the business, but when looked at realistically, there seems no real prospect of attaining that goal.

The nature of the activities carried on is important. Matters which may be considered in ascertaining the taxpayer’s intentions are listed in **NZT 3.2.1**:

(b) **“Pecuniary Profit”** *Note: ITA (2004) and previous Acts only.*

Pecuniary profit in income tax terms reflects the underlying notion of income expressed in money or money’s worth as ascertained on ordinary commercial principles. In assessing the “pecuniary profit” prospect of an activity certain items, relating to tax benefits, have to be taken into account, e.g. incentives granted in respect of capital development expenditures.

The definition of a business in ITA 2007 no longer includes the word pecuniary, and the above is included for information only.

[See **NZT 3.2.8**]

(c) **Nature of Activities**
Real activities carried on for profit must be present before there can be a business. A business cannot exist only in the mind of the taxpayer.

(d) **Intention to Make a Profit** [See NZT 3.2.1]

It is insufficient for taxpayers to state their intentions to make a profit in a letter. They have to prove their intentions. Consequently they have to provide corroborative evidence which can establish the validity of an alleged profitable intention.

The element of pecuniary profit underlies the concept of a business. Hence it is inappropriate to regard a law enforcement agency such as the Ministry of Transport as a business.

(e) **Commencement/Termination of a Business** [See NZT 3.3]

Case law has established that a business does not commence until ordinary income earning activities have started.

On the other hand, a business may be considered to have terminated where the income producing activities are carried out with a view to their sale.

4.4 **Business Records**

The Act requires a business taxpayer to keep adequate records which reflect the operations of the business and profit achieved (*Sec 22, Tax Administration Act 1994*).

Such taxpayers who keep incomplete records can be prosecuted by the Commissioner, and further penalties imposed. These measures are fairly severe and are there to act as a deterrent.

7. **When Income is “Derived”** (See BD 3)

The determination as to which year income is derived is significantly important. For instance:

1. Where the tax rates differ between one year and the next (for example for the years ended 31 March 2008 and 2009) it is clearly advantageous to recognise as much income as possible in the lower tax rate year. Note that this was relevant in the last year for company tax payers as the company tax rate changed from 33% to 30% from the beginning of the 2008-09 income year, so companies would want to defer income recognition.
(2) It is also advantageous to delay recognising income on which tax must be paid for as long as possible.

Remember $1 in hand now is worth more than $1 in hand in 12 months’ time!

For this reason the IRD has tried to lay down clear “rules” which govern when income must be recognised as such for tax purposes.

In many cases no difficulty arises. For example wages and salaries, dividends and rent are recognised in the year in which they are received. However, in other cases, the year in which the cash is received is not necessarily the year in which income is derived for tax purposes:

(1) Unless a business operates a cash based accounting system (such as a cake or fruit retailer) business income is generally assessable on an accrual basis, (i.e. income is recognised in the year in which it is earned, in the same way as accounting income).

(2) Income is deemed to be derived (and therefore assessable as income), although not actually received by a “natural”/individual (vs corporate) taxpayer, when under Sec BD 3(4) it has been

(a) Credited in their account, or

(b) In some other way, dealt with in their interest or on their behalf.

8. Fringe Benefit Tax and Protection of the Income Base

Refer to Topic 3, Readings: Tax free Fringe Benefits (Richardson, et al).

9. Income Transference - Some Fundamental Methods

It is important to realise that there is nothing to stop a taxpayer engaging in minimising one’s tax by undertaking business affairs in a manner dictated by sound commercial reasons or practice. There is no requirement that taxpayers must structure their affairs in order to pay the maximum possible amount of tax. Legitimate use of opportunities to reduce tax provided by the Act is regarded as “good business sense”. What is forbidden is the entering into artificial arrangements which are oriented - directly or indirectly - towards the avoidance of tax.

The imposition of tax and the rates to be applied are dependent on:

(a) Whether the recipient is a company, an individual, a trust, a partnership, or any other entity; and

(b) The type of income received.
The students shall examine these structures in greater detail in Topics 9 & 10.

To each structure there are associated tax advantages and disadvantages. Whatever method of ownership is planned taxation advantages must not be considered in isolation. A prudent commercial approach is necessary. A company may be chosen in order to limit liability of the owners even though a partnership structure could result in a lower tax bill.

For this course it is necessary that the student is aware of the difference between tax evasion, tax avoidance, and tax mitigation.

Tax evasion occurs where the tax liability is concealed or ignored. It is illegal.

Tax avoidance refers to arrangements which seek to minimise the tax liability within the provisions of the legislation. But, when the arrangements are so artificial and lacking in commerciality, they can be overturned in Courts.

Tax mitigation refers to arrangements that are legitimate and effective. An essential feature of tax mitigation is that the taxpayer bears the burden of the arrangement by way of expenditure incurred, or a reduction in income in circumstances where the ITA 2007 permits the reduction of the tax liability which would otherwise arise.

New Zealand’s taxation law is now more sophisticated such that the wealth of minimisation techniques, which were previously available, have been curbed considerably.
Filing taxpayer – calculation of taxable income

SUBPART BD

BD 1 Assessable income

BD 2 Deductions

BD 3 Allocation of assessable income

BD 4 Allocation of deductions

sum → BC 2 Annual gross income

sum → BC 3 Annual total deductions

PART 1 Tax losses

net loss if negative

BC 4 equals

net income if positive or zero

BC 5

Net income

less

Available tax loss

equals

Taxable income

BC 6 Income tax liability
Work Preparation

Read and study the material required for this week.

Review the following questions.

1. You have just received a notice in the mail that you have been awarded a prize for outstanding achievement in taxation law at your university, and you are offered a choice of prizes.

Discuss the tax implications of the following available prizes:

(a) a cash prize of $1,000;
(b) a leather brief case (retail value $1,200) embossed with your name and the name of the award for which the prize was granted;
(c) payments of $100 a month for the next year of study.

2. (a) Peters has a mortgage with ABC Bank. The interest rate is 14%pa, though this can be reduced to four percent per annum if Peters foregoes interest on funds invested with the bank. If the mortgage is $100,000 and Peters invests an equivalent amount with the bank, what income, if any, does Peters derive?

(b) Banks works in the public service. To date Banks has paid $20 per week to have Bank’s children accommodated in the employer’s child care centre. Together with some of Bank’s fellow employees, Banks foregoes $20 weekly pay rise on the condition that the employer provides free child care for the children. What, if any, are the tax implications?

3. John Kurarangi operates a successful plumbing business in Masterton. You have been his tax agent and have prepared his income tax returns for the last nine years. John informs you that due to the building boom it has been a very busy year. He is concerned that he may not have paid enough tax during the year and will have a large tax bill to pay on April 2010.

John came in to see you on 15 May 2009 to drop off his business information. He brought in a CD with the MYOB program on it for you to print out his general ledger. He also gave you a list of his
accounts receivables as at 31 March 2009 and other sundry information required to enable you to complete his 2009 tax return by 1 June 2009.

John’s balance date is 31 March.

Below is a part printout of his general ledger from his cash manager accounting package from his business bank account.

<table>
<thead>
<tr>
<th>Cash receipts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening bank balance at 1/4/08</td>
<td>$5,700 O/D</td>
</tr>
<tr>
<td>Sales</td>
<td>160,000</td>
</tr>
<tr>
<td>Insurance refund – overpaid business premium</td>
<td>500</td>
</tr>
<tr>
<td>Personal loan from Uncle Bruce</td>
<td>10,000</td>
</tr>
<tr>
<td>GST on receipts</td>
<td>18,000</td>
</tr>
<tr>
<td>GST refund</td>
<td>2,500</td>
</tr>
</tbody>
</table>

Accounts receivables as at 31 March 2009 totalled $11,250. The previous year they amounted to $5,625. These figures are GST exclusive.

In the information which John provided you have found a dividend statement, from Telecom Ltd, dated 1 October 2008 with a gross dividend income of $480. In addition, there was a BNZ bank RWT certificate which shows a gross interest of $250 for the year ended 31 March 2009.

**Required:**

What is the amount of income that is derived by John for the 2009 tax year? Show all workings.


5. See NZT Chapter 6, Review Question 2

6. See article “Real Estate Agency told to pay couple $1m”.

Discuss the tax implications (if any) of the real estate transactions and the court settlement.

All acronyms are listed as defined terms in section YA 1. Some acronyms are in common usage (for example, GST, PAYE and FBT). Others have a more specialist flavour (for example, NRWT, RWT, CFC, FIF, LAQC, UFTC, ASC and BETA).

The remaining acronyms mostly relate to the memorandum accounts (ASCA, CTRA, FDPA and MACA), where use of an acronym is logical and its use limited in practice. In the case of CTR, ESCT and FDP there is a new or changed acronym.

Table 2 – Acronyms and their meaning

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Meaning</th>
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<tbody>
<tr>
<td>ASC</td>
<td>available subscribed capital</td>
</tr>
<tr>
<td>ASCA</td>
<td>available subscribed capital account</td>
</tr>
<tr>
<td>BETA</td>
<td>branch equivalent tax account</td>
</tr>
<tr>
<td>CFC</td>
<td>controlled foreign company</td>
</tr>
<tr>
<td>CTR</td>
<td>conduit tax relief</td>
</tr>
<tr>
<td>CTRA</td>
<td>conduit tax relief account</td>
</tr>
<tr>
<td>ESCT</td>
<td>employer’s superannuation contribution tax</td>
</tr>
<tr>
<td>FBT</td>
<td>fringe benefit tax</td>
</tr>
<tr>
<td>FDP</td>
<td>foreign dividend payment</td>
</tr>
<tr>
<td>FDPA</td>
<td>foreign dividend payment account</td>
</tr>
<tr>
<td>FIF</td>
<td>foreign investment fund</td>
</tr>
<tr>
<td>GST</td>
<td>goods and services tax</td>
</tr>
<tr>
<td>ICA</td>
<td>imputation credit account</td>
</tr>
<tr>
<td>LAQC</td>
<td>loss-attributing qualifying company</td>
</tr>
<tr>
<td>MACA</td>
<td>Māori authority credit account</td>
</tr>
<tr>
<td>NRWT</td>
<td>non-resident withholding tax</td>
</tr>
<tr>
<td>PAYE</td>
<td>pay-as-you-earn</td>
</tr>
<tr>
<td>PCA</td>
<td>policyholder credit account</td>
</tr>
<tr>
<td>RWT</td>
<td>resident withholding tax</td>
</tr>
<tr>
<td>UFTC</td>
<td>underlying foreign tax credit</td>
</tr>
</tbody>
</table>

Terminating provisions

Terminating provisions are placed in a separate "Z" subpart at the end of each Part. This continues the practice used in the 2004 Act, but the contents of each subpart have been reviewed and spent provisions or provisions having little future relevance have been omitted. The omission of any of these provisions does not remove their application to relevant past situations. Provisions in the 2004 Act that are omitted from the 2007 Act can be identified by referring to Schedule 52, part A.

COMMENTARY ON PARTS OF THE ACT

Part A

The broad purpose of the Income Tax Act 2007 is to define and impose tax on net income, to impose obligations concerning tax and to set out rules for the calculation and satisfaction of those obligations (section AA 1).

Section AA 2 reinforces the legislative principles of the Interpretation Act 1999 by highlighting how readers' aids to interpretation are to be used.

Section AA 3(1) has been omitted, as defining "this Act" to include the Tax Administration Act 1994 is no longer necessary. The drafting approach taken in the rewritten Act is to state clearly when the Tax Administration Act is being referred to.

Section AA 3(2) identifies the relationship of the Income Tax Act with the Interpretation Act, with particular reference to the defined term "person" in the Interpretation Act.

The Income Tax Act now provides that it applies to the Crown (section AA 4) to provide a better relationship with Part 4 of the Interpretation Act. Explicitly or not, the Income Tax Act has always applied to the Crown, as shown, for example, by the exemption given for government agencies in section CW 38 (Public authorities).

Part B

The scheme and purpose of Part B remains the same as in the 2004 Act – to impose income tax and other tax obligations and to set out how those obligations must be satisfied. As the core provisions are intended as an enduring framework, it is not expected that these rules will be altered in the future, unless fundamental changes are made to the policy underlying the scheme, its purpose and structure.

Overall, little substantive change has been made to the core provisions. However, some structural changes have been made to improve the relationship of the core provisions to Part I (Treatment of tax (asses)), Part L (Tax credits and other credits), and Part R (General collection rules).

Changes to the following core provisions have been made in rewriting Parts F to N of the 2004 Act:

- section BB 2(3) has been moved to section RA 4 (Provisional tax obligations);
- section BC 4(4) has been moved to subpart IA (sections LA 2 and LA 3);
- sections BC 8 and BC 10 have been moved to subpart LA (sections LA 4, LA 5 and LA 7);
- section BC 6(2) to (4) has been omitted as the restructuring of the tax credit rules means these particular rules are no longer necessary;
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* A clear linkage has been made between section RB 3 and section BC 7 (relating to schedular income); and
* Section BC 9 has been renumbered as section BC 8 in the 2007 Act, and explicit linkages developed between that provision in subpart LA (sections LA 2 to LA 5, LA 9, and LA 10).

While Part B was rewritten in the 2004 Act, it is useful to restate the scheme and purpose of Part B at this time. This enables readers to see the relationship of the various Parts of the Act to the core provisions and Part B in particular.

Subpart BA

The overall purpose of the core provisions is to establish:
* a statutory scheme for the calculation and satisfaction of taxation obligations; and
* the structural relationships of the core provisions.

Subpart BB

Subpart BB sets out the obligations that the 2007 Act requires a person to satisfy. Any of these obligations may be modified by the general anti-avoidance rule (section BG 1) and New Zealand's obligations under its double tax agreements (section BH 1).

The main obligations listed in section BB 2 are:
* the calculation and satisfaction of the income tax liability for each tax year (section BB 2(1) and subpart BC);
* the calculation and payment of provisional tax for a tax year (section BB 2(3) and the provisional tax rules);
* the calculation and satisfaction of withholding liabilities (section BB 2(4) and subpart BE); and
* the calculation and satisfaction of a variety of other taxes and payments (section BB 2(5) and subpart BF).

There is no intended change in outcome associated with the minor drafting improvements to sections BB 2(5) and BF 1. A new term "ancillary tax" has been introduced as a consequence of rewriting the definition of "income tax", to draw attention to the types of tax obligations imposed under the core provisions through the previous definition of "income tax".

Sections BB 3, BG 1 and BH 1 continue to provide an override for:
* the general anti-avoidance rule in sections BG 1 and GA 1; and
* bilateral relief under a double tax agreement entered into by New Zealand.

Subpart BC

Subpart BC is linked to sections BB 1 and BB 2 through its subject matter. Subpart BC sets out the detailed process that must be followed to meet the obligation to calculate and pay income tax for a tax year.

The concept of "schedular income" in section BC 7 takes on greater importance as some provisions in Part B (Taxation of certain entities) provide for a scheme-based approach to the calculation of an entity’s income tax liability, rather than using the core provisions’ global gross approach. An example is the rules relating to portfolio tax rate entities.

Unless a person is a non-filing taxpayer, this process contains a series of steps involving the calculation of net income, taxable income and the income tax liability for a tax year. A non-filing taxpayer’s income tax liability for a tax year is, in general, determined by amounts of tax withheld at source.

To apply subpart BC (the calculation of the income tax liability for a tax year), a person must know the core concepts of annual gross income and annual total deduction.

These core concepts are defined in sections BC 2 and BC 3 respectively. The concept of “corresponding income year” ensures that the core provisions align the calculation of the income tax liability for a tax year to the tax balance date of the taxpayer. The tax balance date may be either the standard date (31 March) or an early or late balance date.

“Annual gross income for a tax year” is a global concept. Section BC 2 defines it as the “aggregate of all assessable income from all sources that is derived in or allocated to the corresponding income year”. The concepts of “assessable income” and “allocation” are explained further in subpart BD.

“Annual total deduction for a tax year” is also a global concept, and section BC 3 defines it as the “aggregate of all deductions that are incurred in or allocated to the corresponding income year”. The concepts of “deduction and allocation” are explained further in subpart BD.

Section BC 4 now reflects the wide range of uses to which a net loss may be put.

Sections BC 6 to BC 10 of the 2004 Act provide a framework for determining the income tax liability of a person and how the Act uses tax credits to satisfy this liability. As this framework has been more closely integrated with the detailed tax credit rules in Parts L and M, these core provisions have been simplified and harmonised with Part L. As a result, sections BC 6 to BC 8 and subpart LA now cover the same subject matter as sections BC 6 to BC 10 of the 2004 Act.

The rewrite of Parts F to N of the 2004 Act highlights the importance of the concepts of “schedular income” and “schedular income tax liability” in section BC 7 as part of
the framework of the core provisions. These two terms provide a framework for:

* classes of income with unique tax rates or a final liability – for example, non-resident withholding income subject to final withholding; and

* an entity-based calculation of the entity’s income tax liability for a tax year – for example, portfolio tax rate entities in subpart HL (Portfolio Investment Entities).

The intention is that the more specific rules will state how the schedular rule relates to section BC 7. For example, section RB 3 (schedular income tax liability for filing taxpayers for non-resident passive income) states that, for the purpose of section BC 7, the schedular income tax liability for a person with schedular non-resident passive income subject to final withholding is determined under section RB 3 and not under the rules in sections BC 1 to BC 6.

The flowcharts in the core provisions have also been updated to highlight the interaction of Part L with the core provisions in section BC 8.

Subpart BD

Subpart BD has an important role to supplement the operation of subpart BC, as it explains the core concepts of assessable income, deduction, and allocation. It also defines the extent of New Zealand’s income tax base.

Assessable income

The concept of “assessable income” is a calculated amount, and is defined in section BD 1. Assessable income is a person’s income that remains after excluding any part of that income that comprises exempt income, excluded income or non-residents’ foreign-sourced income. An amount of assessable income may be spread or allocated across more than one tax year.

To use this concept, the reader also needs to know the meaning of “income”, “exempt income”, “excluded income” and “non-residents’ foreign-sourced income.”

Income

The concept of “income” is described in section BD 1. This definition is supported by all of the provisions in Part C through the explicit linkage in section BD 1(1). That section identifies that Part C is a code in relation to its role of determining whether an amount arising from a transaction or event is income.

Gains and profits that are not treated as income under Part C are not subject to income tax. Examples of this category are capital profits and windfall gains.

The only exclusions from income are found in subsections BD 1(2) (exempt income), (3) (excluded income) and (4) (non-residents’ foreign-sourced income). These subsections represent a series of exclusions from what is income under section BD 1(1).

After applying these restrictions, the amount (or apportioned amount) that arises from a transaction is termed “assessable income”. Assessable income under section BD 1(5) represents the amount of income that is included in the determination of a person’s income tax liability for a tax year, subject to any allocation of that income between different tax years. This amount may be allocated across more than one tax year.

Exempt income

The category of exempt income (section BD 1(2)) is reserved for amounts of income that Parliament determines should not be subject to income tax. An example of exempt income is found in section CW 41 (Charities: non-business income).

Excluded income

Falling within the concept of “excluded income” (section BD 1(3)) are amounts of income that are not included in income because they are generally subject to tax in another way.

For example, life insurance premiums derived by a life insurer (and reinsurers) are treated as excluded income (section CX 39). The exclusion arises because the life insurance rules in subpart EY separate the income (underwriting) and savings elements of those premiums and include the underwriting elements in income.

Non-residents’ foreign-sourced income

This category of income establishes the role that the source of income and a person’s residence play in determining whether an amount of income is subject to taxation in New Zealand (section BD 1(4)). It also enables New Zealand to identify what deductions a non-resident may or may not be entitled to.

Source and residence

The concepts of “source and residence” are fundamental to determining the scope of New Zealand’s income tax base. This is achieved through the operation of section BD 1.

Section BD 1(1) defines the subject matter by reference to the amounts listed as income in Part C. As explained later in this article, the concept of income under Part C does not depend on the concepts of time, residence, or source.

Section BD 1(5) provides that the concept of “assessable income” does not include income derived by a non-resident that is not treated as being derived from New Zealand at the time that person is non-resident. The overall effect of section BD 1(1) gives the following outcomes:

* Income that a resident of New Zealand derives from anywhere in the world is treated as assessable income, provided that income is neither exempt nor excluded income (section BD 1(2) or (3)).

* Income that a non-resident derives from New Zealand is treated as assessable income, provided that income is neither exempt nor excluded income (section BD 1(2) or (3)).
* Income that a non-resident derives from sources outside New Zealand falls within non-residents’ foreign-sourced income and is not assessable income (section BD 1(4)).

Allocation of income (timing)
Section BD 3 explains the basis on which the legislation allocates income to a particular income year. In this context, the term “income year” was chosen because allocation applies to both the standard (31 March) and non-standard tax balance dates.

The general rule is that the Act allocates income to an income year on the basis of when it was derived or credited to the account of a person, or dealt with in their interest or on their behalf. Common law principles are also to be taken into account when considering the sometimes divergent tax accounting results that arise between business and cash-basis taxpayers (section BD 3(3)).

It is important to note that the allocation made is of the income, not just the assessable income. Therefore, the method of allocating an amount of income applies also to any part of that income that is exempt income, excluded income, non-residents’ foreign-sourced income and assessable income. Allocation of the income on a consistent basis for all categories of income is necessary because of the nexus tests under the general permission which link deductibility with assessable income (section DA 1).

For example, an amount of income derived by a non-resident may be apportioned between non-residents’ foreign-sourced income and assessable income. The allocation of both the non-residents’ foreign-sourced income and assessable income across income years will be proportionate to how the income is apportioned.

Assuming that deductions in deriving income are allowed under the general permission, this allocation of income can be expected to influence the amount of deduction allowed in each tax year.

The general rule may be overridden by any rule that allocates the income on another basis.

Deductions
Sections BD 2 and BD 4 explain the core concept of deduction and the timing of a deduction.

The concept of “deduction” in section BD 2 is a key link or signpost between the core provisions in subpart BC and the operative rules found in subpart DA (previously located in section BD 2 of the 2004 Act). This relocation reflects the intention that all deductions should be located in one Part.

Section BD 2 identifies that Part D is a code for determining whether an amount arising from a transaction or event is a deduction. This means that a person may not have a deduction unless it is listed in Part D – see, for example, section HF 1(2) (Profits of mutual associations in respect of transactions with members) of the 2004 Act.

Allocation of deduction (timing)
A deduction is always allocated to an income year (section BD 4). Again, the term “income year” is used to signal the application of the allocation provisions to persons with non-standard tax balance dates.

The general rule is that a deduction is allocated to an income year on the basis of when it was incurred. Again, common law principles must be taken into account when considering any possible divergent treatment that exists in tax accounting between business and cash-basis taxpayers.

This general rule of allocation may be overridden by any rule that allocates the deduction on another basis.

Other obligations
Provisional tax
Section BB 2(3) imposes the obligation to pay provisional tax. It also points to the details of the provisional tax rules in subpart BC which set out the process for calculating and paying provisional tax.

Withholding obligations
Sections BB 2(4) and BE 1 continue to provide the obligation to comply with various tax payment systems such as PAYE, RWT, NRWT, FBT, ESTC and FDP.

Section BE 1 also provides a link to the detailed provisions that a person needs to know in order to comply with these obligations.

Ancillary tax obligations
An ancillary tax is defined in section YA 1, as being any of ESCT, PBT, FDP, FDP penalty tax, further FDP, further income tax, imputation penalty tax, NRWT, PAYE, penalty tax for a Miromar authority payable under section 140DB of the Tax Administration Act 1994, provisional tax, qualifying company election tax, RWT and withdrawal tax.

Parts C, D, and E (rewritten in the 2004 Act)
The importance of Parts C, D and E as a group is that together they provide the details that enable taxpayers to calculate their income tax liability for a tax year, as required by the core provisions. (For a full commentary on these Parts, see the commentary to the Income Tax Act 2004 in the June 2004 issue of the Tax Information Bulletin).

As a number of insertions have been made into Parts C, D and E since enactment of the 2004 Act, the new Act has required the restructuring of these three Parts.

Income and deduction provisions located in Parts F to N of the 2004 Act have been rewritten as new income provisions in Part C and deduction provisions in Part D. This drafting approach reflects the underlying policy that Part C is an exhaustive list of what is “income” and Part D is a complete list of what is “allowed as a deduction".
Examples include:

- the income and deduction rules for finance leases and consolidated groups of companies;
- section HF 1, which provides that all income derived by a mutual association is income of the association, overriding the principle of mutuality; section HF 1(1) in the 2004 Act has been rewritten as section CB 33, and this provision is signposted in section HE 1;
- sections CV 16, CV 17 and DW 3 in the 2007 Act (relating to non-resident shippers and film renters) are the new location for the operative aspects of sections FC 18 to FC 21 of the 2004 Act;
- section CB 2 (which relates to amounts received on disposal of business assets that include trading stock);
- sections CC 11 to CC 13 (which relate to finance leases and hire purchase agreements);
- section CD 11 (which relates to various avoidance arrangements);
- section DB 10 (which relates to profit-related or substituting debentures); and
- sections DB 57 to DB 59, and DC 5 (which relate to various avoidance arrangements).

The insertion has been made either in an existing rule or as a new section that has an overriding effect on the related rule. No change in outcome is intended.

This has meant that sections CW 44, CX 45, CY 1 and DV 1 of the 2004 Act have been omitted as no longer necessary.

Part C

The functions of Part C are:

- to provide an exhaustive list of what is income for income tax purposes;
- to identify the taxpayer to whom the income belongs;
- to provide a catchall provision in section CA 1(2) to pick up any amounts outside these other categories that would be income under ordinary concepts; and
- to define amounts that would be income but may, nevertheless, be exempted or excluded from being included in the calculation of the person’s income tax liability.

If an amount arising from a transaction is not income under Part C, that amount does not fall within the scope. An example would be a capital gain arising from the sale of a private residence that does not fall within the land sales rules in subpart CB. This is illustrated in the diagram outlining the process of calculating and satisfying income tax liabilities set out in subpart BC.

A key principle is that, under Part C, income is a global or gross concept that does not depend on the concepts of time, source or residence. However, a specific provision in Part C may take into account the concepts of source or residence as a parameter in determining whether an amount is income. An example in the 2007 Act where residence is relevant to the determination of income is section CQ 2(1)(d) (Attributed CPC income).

An amount of exempt or excluded income may be subject to another form of tax obligation imposed under section BB 2. Generally, the provision signals the linkage to the obligation. For example, section CW 9(2) states that the FDP rules apply to this exempt dividend. This gives a clear signal that, despite the exempt nature of the dividend, a tax obligation remains in relation to the exempt dividend.

Part D

The purpose of Part D is to provide a legislative code of when an amount is a deduction. Subpart DA sets out some general rules for deductibility of expenditure or loss.

The legislation has a general deductibility rule, the general permission, which is set out in section DA 1. The rules in sections DA 2 Act are general limitations to the general permission.

Section DA 3 sets out the legislative relationship between the specific rules and the general rules. Section DA 4 is a special provision that clarifies at an early stage the relationship between a deduction for an amount of depreciation loss and the capital limitation.

As a consequence of rewriting Parts F to N of the 2004 Act, a number of new deduction provisions provide for rules that were previously set out in a Part other than Part D. For example, in the 2004 Act, sections HF 1(3) and (4) provided a deduction for mutual association rebates. This provision has been rewritten as section DV 19 and signposted in section HE 1, both in the 2007 Act.

Part E

In the absence of specific timing rules, the core provisions timing rules (sections BD 3 and BD 4) provide for timing to be determined on the basis of when income is “derived” or expenditure is “incurred”. Sections BD 3 and BD 4 state that the meaning of “derived” and “incurred” will continue to be determined by case law.

Part E is the location for sets of rules that have a predominant focus on matching or allocation. These rules apply where the policy is to provide a timing result that differs from the result arising from the time at which income is “derived” or expenditure or loss is “incurred”.

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(note a clearer copy can be obtained from:
http://io.knowledge-basket.co.nz/iodnews/039-01.html?qt=The+taxman+cometh)
Real estate agency told to pay couple $1m

By MATT CALMAN - The Dominion Post Last updated 05:00 07/03/2009

An Auckland couple caught up in a dubious real estate deal have been awarded nearly $1 million by the Supreme Court.

Yesterday's decision ended a five-year fight for compensation for Mark and Deborah Stevens over the 2004 sale of their cliff-top North Shore home. Premium Real Estate sold the property to Makenui Valley Trust for $2.575 million and brokered its sale five months later for $3.55 million to Hong Kong buyers.

The company failed to disclose a conflict of interest between its agent, Pam Riley, and the initial buyer, trustee Brett Larsen who had previously worked together. Ms Riley was also aware he often bought and sold properties quickly to make a profit.

In the Supreme Court decision yesterday, Chief Justice Sian Elias reaffirmed that the company breached both its fiduciary duty and the Fair Trading Act and ordered it to pay $994,883 in damages, including the $67,000 agent's commission.

The Stevens’ lawyer, Willy Akel, said it was a major case and one of a handful he had taken to the Supreme Court. "It's a relief to the clients. They're very happy and delighted that it's all over. It was a matter of fairness it was a matter of principle to them."

Mr Akel said the ruling sent a strong message to real estate agents that they owed "undivided loyalty" to all their clients and should avoid conflicts of interest.

"They run the risk of having to pay a very big price. And this is a big price. They knew he [the buyer] was a speculator in the market."

Dame Sian cited earlier court decisions that said "misleading and incomplete information" gave the impression Mr Larsen was buying the house as a home, rather than to resell it for profit.

Real Estate Institute president Mike Elford said the institute needed to "take stock" of the decision so it could pass the findings on to the industry. "We need to look at it and, if there's lessons to be learned, we need to convey that to our membership."