Week1
Lecture 1
What is a tax
A **compulsory** contribution to the support of government, levied on persons, property, income, commodities, transactions, etc., now at fixed rates, mostly proportional to the amount on which the contribution is levied

Why do we tax
- Finance public expenditures
- Promote certain economic goals/objectives e.g. redistribution
- Promote social and political objectives
- Modify behaviour e.g reduce smoking / drinking

Do we need to tax?
Yes, alternatives do not support sustainable growth and shifts problems to the future

Alternatives
- Commandeer e.g. wartime (government takes money etc.)
- Create money
- Borrow
- Charge (charge for government services)

How do we classify taxes?

	Direct	Indirect
Subject matter	Income, wealth, property	Transactions and events
Example	Income tax, capital gains tax, local rates	GST, customs duties
Who has the relationship with IRD?	Person intended to be taxed	Person who collects tax
Example	You make a provisional tax payment	Shopkeeper charges you and collects GST on your purchases

How can we judge revenue taxes? Adam Smith's "Four Canons of Taxation" (1776)
Qualities of a tax
- Equity; fairness for different tax payers
- Certainty; know what the law is
- Admin convenience; not too burdensome to comply with
- Economic efficiency; shouldn't discourage economic activity (e.g income tax so high people stop working)

Lecture 2
NZ public finance and taxation, and the Tax Working Group Report 2019

Some features of NZ tax system
-major source of revenue is personal tax (40%) [considered high comparatively] GST(30%) [considered high comparatively] and company tax (15%)
-No comprehensive capital gains tax
-No (national) land tax, wealth tax or capital transfer taxes
-No need for most New Zealanders to do an income tax return
-Income tax rates are inclusive except for the ACC earner's levy

Tax to GDP

Country	Tax: GDP
Denmark	46.3%
OECD average	33.8%
New Zealand	32.3%
Ireland	22.7%
Mexico	16.5%
GDP is a measure of the value added created through the production of goods and services in a country during a certain period Correlation between trust in government and tax levels	

Tax rate

Taxable Income	Tax rate (excluding ACC earners' levy)
Up to $14,000	10.5%
$14,001 - $48,000	17.5%
$48,001 - $70,000	30%
$70,001 and over	33%
$180,001	39% (wef 1 April 2021)
No notification	45%

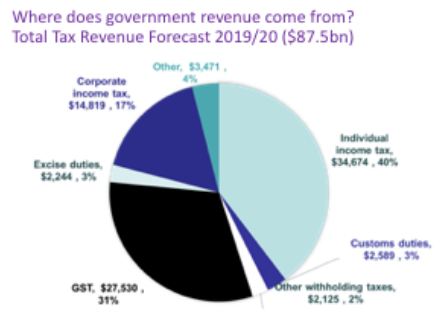
>Company tax rate: 28% (flat rate)
>GST: 15% (flat rate)

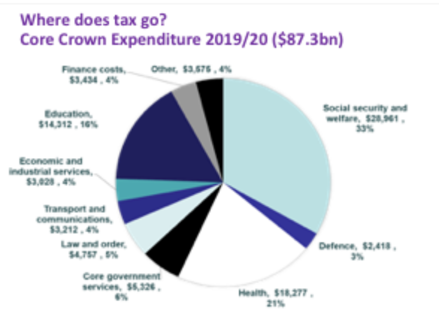
Comparison - Australia

Taxable Income	Tax rate
Up to $18,200	0
$18,201-$45,000	19%
$37,001-$120,000	32.5%
$120,001-$180,000	37%
-$180,001	45%

>Company Tax Rate: 27.5% or 30% (Flat Rate)
>GST: 10% (Flat Rate); exemptions
>Medicare levy: 2%
>Comprehensive CGT

Government revenue and expenditure





Why we tax
•Reclaim the money government has already spent
•Ratify the value of the country’s currency; can only pay in nz$ creates purpose/demand for NZ currency
•Reorganise the economy
•Redistribute income and wealth
•Reprice goods and services
•Raise representation; if you don’t like your taxes you have to be involved in government (democracy)

Purpose of tax
•Source of revenue for government
•Means of redistribution
•Influences behaviour
•Improve living standards
•develops sustainability

Concepts of wellbeing (waiora)
Living Standards Framework
- •Financial and physical capital
- •Human capital
- •Social capital
- •Natural capital

Te Ao Māori
- •Manaakitanga (care and respect)
- •Kaitiakatanga (stewardship)
- •Whanaungatanga (relationships)

Principles of tax design
•Efficiency
•Equity and fairness
•Revenue integrity
•Fiscal adequacy
•Compliance and administration costs
•Coherence
•Predictability
•Certainty

Key features of NZ tax system
•Broad base, low rate e.g. GST
•Reliance on income tax and GST
•No general capital gains tax
•Some capital gains are taxed as income
•Income tax not progressive (but Working for Families)

Capital/income distinction
•Factory vs product
•Tree/ vs fruit
•Property vs rent

The income-capital fairness issue
•Amy earns the median wage
•Over 10 years Amy pays $70,000 income tax
•Zak bought a rental property 10 years ago
•Deductions cancel out income tax liability
•Zak sells the property and makes a gain of $120,000
•He pays no income tax
•[Both pay GST on their consumption]

Recommendation (REJECTED)
•General Capital Gains tax
•Gains taxed at marginal income tax rates
•No inflation adjustment
•Capital losses deductible (generally)
•Exemption of family home and personal property
•Minority add specific receipts only e.g rental properties

The externality issue
•Cost or benefit that falls on an unrelated third party - if you pay a low cost its likely you're not paying the full cost
•Negative e.g. factory pollutes neighbouring community
•Positive e.g. wetlands on a farm may provide flood protection for a neighbouring community

Recommendation
•Use taxes to price negative externalities
•Expand and increase Waste Disposal Levy
•Strengthen Emission Trading Scheme
•Encourage congestion charging
•Long term – environmental taxes significant part of the tax system

Issue of economic double taxation
•Alpha Industries Ltd (AIL) earns profits of $1m and pays tax of $280,000
•AIL distributes $720,000 to its shareholders
•Bella, a shareholder of AIL, receives $1,000 dividend
•Bella pays $330 tax
•Economists call this double taxation
Recommendation
•NZ uses an imputation system; The dividend carries a tax credit to take account of double taxation
•TWG: Keep dividend imputation

Retirement Savings

How do you encourage people to save for their retirement?
•Contributions – investments – pay out

T-T-T – no incentive when all parts of process taxed
E-E-E – too expensive when all parts of process not taxed
•E-T-t – common
•T-T-E – NZ no incentive to save (contributions, investment taxed)

Recommendation

•T/t – T/t – E
•Reduce tax on employer's contributions for lower paid employees
•Reduce average rate on investments

Low paid employees

•NZ unusually taxes first $ of income
•$0-14,000 taxed at 10.5%
•Recommendation: increase threshold to e.g. $20,000 or $22,500

Further work needed

•Charities
•GST
•Corrective (behaviour modifying) taxes

Future challenges

•Demographic changes
•Limited retirement savings in New Zealand
•Australia A$2.9 trillion in managed funds (June 2019) v NZ $60 billion
•Sustainability of NZ Superannuation
•KiwiSaver
•Covid-19 debt
•Demographic changes
•Limited retirement savings in New Zealand
•Australia A$2.9 trillion in managed funds (June 2019) v NZ $60 billion
•Sustainability of NZ Superannuation
•KiwiSaver
•Covid-19 debt

More challenges

-sustainability of income tax regime
-alignment of tax rate (companies, trusts and individuals)
-large proportion of personal income tax is paid by a small proportion of the population
-high reliance on company tax
-consumption and income well taxed - but not for capital/wealth

Week 2
Lecture 1
Introduction to the Income Tax Act 2007

Income tax design: some basic ideas

•One tax or more: Schedular vs global

-Schedular: separate 'taxes' are imposed on different categories of income e.g. on rental income and salary (promotes secrecy)
-Global (NZ): a single tax is imposed on all income, whatever its nature
-Composite: global + schedular

•Which base for income tax?: Source vs residency

-Source (where the income arises)

-only tax where income occurs (GLOBAL) Example: Z a UK-resident singer performs in NZ – their fee is taxable in NZ: s BD 1(4)-(5)
-Countries invariably tax income sourced in that jurisdiction

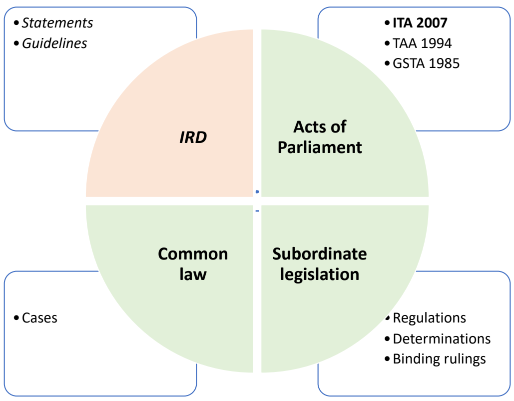
-Residency (where you live)

-Most countries tax the worldwide incomes of their residents
-Example: Z a UK-resident singer performs in NZ – their fee is taxable in UK (and NZ)* (Unusually, Hong Kong only taxes the HK-sourced income of its residents)
-This is known as juridical double taxation (i.e. the same item of income being taxed in two jurisdictions

-Citizenship – where you are a citizen
– USA only (and Eritrea to an extent)

•Individual vs couple/household
•Progressive vs flat rates

Source of tax law in New Zealand



>ITA is large however it cannot encompass everything so we require subordinate legislation to support the ITA

What are the main purposes of the ITA? ITA 2007 s AA 1

•Define, and impose tax on, net income
•Impose obligations about income tax
•Set out rules for calculating income tax and for satisfying the obligations imposed

Structure of ITA 2007 – key parts

•B Core provisions

•C Income
•D Deductions
•L Tax credits and other credits
•R General collection rules
•Y Definitions and related matters

Individual residency s YD 1
If you are in NZ but not a tax resident you will be subject to income tax because of source
If you are an NZ Tax resident you're subject to tax around the world

You are a NZ tax resident if you meet any one of these conditions
•have a permanent place of abode (PPA) in NZ (even if you also have one elsewhere) [subjective]
OR
•are present in NZ for more than 183 days in any 12 month period [subjective not bound by intention]
>a person absent from NZ and not meeting either conditions would still be considered a resident if they are in the service of the government

What is a PPA? (Not defined in the ITA 2007)
CIR v Diamond [2015] NZCA 613
A place where a taxpayer habitually resides, from time to time, even if they spend periods of time overseas
•depends on nature and quality of use by taxpayer on a habitual basis
•a dwelling house where the taxpayer has actually lived (mere availability is insufficient)

To determine PPA (Diamond: PPA)
Requires consideration of
•**continuity** of the taxpayer's presence in NZ and the dwelling
•**duration** of that presence
•**durability** of the taxpayer's association with a particular place
•**closeness** of the individual's connection with the dwelling before and after the taxpayer's absence from NZ

Van Uden v CIR [2018] NZCA 48
•VU sea captain
•8 months pa at sea
•House owned by trust
•VU – not a beneficiary of the trust however he still benefitted from it (ownership not factor)
•Place he **habitually** came back to
•VU had a PPA in NZ

Company residency s YD 2
If any one of 4 apply you're a resident:

>basis of director is made on majority resident (e.g zoom meeting with majority in Singapore considered off shore)
>Centre of management (high level company wide strategy)

Income sourced in NZ: s YD 4

•Fully sourced in NZ – fully taxed
•Partly sourced in NZ – apportioned
•Relief – under ITA or a DTA

How does NZ tax income based on residency and source?

Source

•Rate of tax depends upon the type of income
•May be taxed by source withholding as final tax
•Some income may also be exempt from NZ tax

Residency

•Worldwide income taxable
•Relief for tax paid offshore on foreign-sourced income

Relief from juridical double taxation

•DTAs (bilateral treaties between countries to allocate taxing rights) prevent double taxation and prevent avoidance/evasion
•NZ has DTAs with 40 jurisdictions

Imposition of income tax: s BB 1 (charging provision)

Income tax is imposed on taxable income, at the rate or rates of tax fixed by an annual taxing Act, and is payable to the Crown

Main obligations: s BB 2

•Income tax liability
•Non-filing taxpayer
•Provisional tax
•Withholding liabilities
•Other obligations

Annual nature of income tax

•Losses from past years
•Calculation of this year's tax liability
•Losses to future years

Calculating and satisfying income tax liabilities: subpart BC

- Annual gross income[1] **less** annual total deductions[2] = net income/loss[3]
- Net income **less** any tax loss = taxable income[4]
- Taxable income x rates = income tax liability[5]
- See flowchart

[1] s BC 2
[2] s BC 3
[3] s BC 4
[4] s BC 5
[5] s BC 6

Example

	$
Annual gross income	10,000
Less annual total deductions	(3000)
Net income	7000
Less available tax loss	(1000)
Taxable income	6000

Global approach

•No general requirement to determine net amounts from different sources e.g. rents, business, dividends, interest*
•A resident's income from all sources is taxed together using the same tax rate scale
* Despite the format of the income tax return form

Gross income

•Does the taxpayer derive gross income?
•Gross income is a transaction which gives rise to a receipt
•Not an issue of net gain or loss

Assessable income

Income/non-income distinction
Not all receipts are taxable (Non-income) e.g.
- •Capital or windfalls;
- •Exempted; or
- •Excluded

Only assessable income is subject to income tax

Determining tax liability

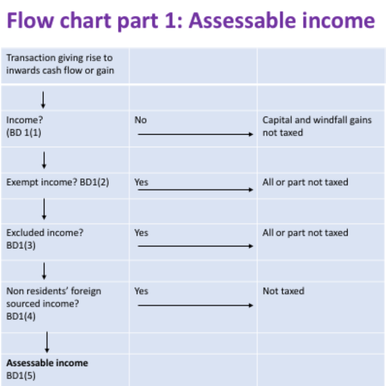
1.Calculate assessable income
2.Allocate assessable income to an income year (this is annual gross income)
3.Determine deductible expenditure or loss
4.Allocate deductions to specific income years (total is annual total deduction)
Annual gross income less annual total deduction = net income or net loss for the income year

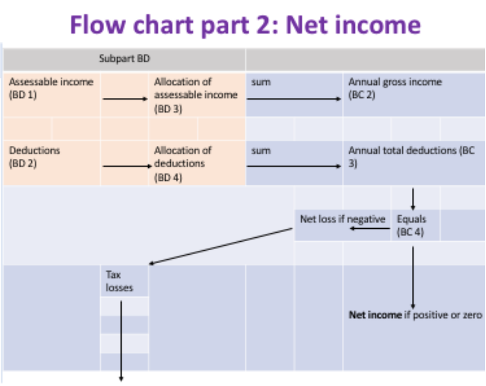
What happens to net losses?

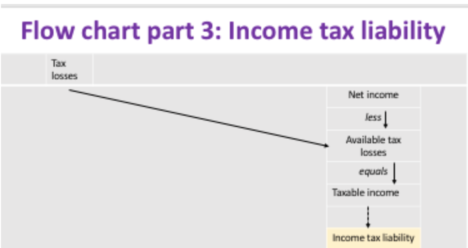
•A net loss can be carried forward and offset against future taxable income OR
•For companies, offset against another group company's taxable income
Taxable income = net income less available losses (carried forward from an earlier income year)

Lecture 2
Introduction to the Income Tax Act 2007

Flow chart part 1: Assessable income, Net Income, Income tax liability







Paying income tax
•Detailed rules say how taxpayers must pay income tax
•Deferring tax payments gives taxpayers a financial advantage … therefore significant penalties for getting it wrong

When is tax withheld at source?

Type of income	Type of withholding
Salary/wages	Pay As You Earn (PAYE)
"Schedular" payments (certain business or contractor income)	PAYE
Interest and dividends paid to residents	Resident Withholding Tax (RWT)
Interest, dividends and royalties paid to non-residents	Non-Resident Withholding Tax (NRWT)

Imputation credits
•To avoid economic double taxation
•Companies pass imputation credits to shareholders when they pay dividends

Provisional tax
•A way of paying income tax
•Applies if your residual income tax (RIT) exceeds $5,000
•RIT: tax payable on your taxable income less PAYE and any other income tax credits (not WFF credits)
•Usually, 3 equal payments to cover expected annual tax bill

Payment options
•Standard (default)
•Estimation
•Ratio
•AIM

Standard option
Assumes your income will increase year to year
Provisional tax = Last year's RIT + 5%
Three equal instalments paid on:
•28 August
•15 January
•7 May
If you file GST returns six monthly – two payments on:
•28 October
•7 May

Estimation option
Assumes income is falling
•Calculate expected taxable income
•Calculate tax
•Deduct PAYE etc
•This is your RIT
•(You can readjust payments)

•Same payment dates as standard option

Ratio option
Suits variable incomes – aligns to GST
•GST ratio % = RIT from last tax return x 100/1
total GST taxable supplies
from same tax year
•IRD advises ratio – you apply to GST taxable supplies

Penalties
•late payment penalties on all overdue payments, i.e.
•1% one day late
•4% seven days late

Accounting Income Method (AIM) – the way of the future?
•Available to small businesses (<$5m turnover)
•Approved software calculates (MYOB, Reckon or Xero)

Shortfall penalty (estimation option)

Applies to the underpaid amount

Reason for default	Shortfall penalty
Not taking reasonable care	20%
Unacceptable tax position	20%
Gross carelessness	40%
Abusive tax position	100%
Evasion	150%

Use-of-money-interest (UOMI)
UOMI
•mostly applies to large provisional taxpayers
•provides additional incentives to estimate/pay provisional tax accurately on the required dates

How does UOMI work?
•Underpayments and overpayments subject to an interest charge or paid interest income (wef 8 May 2020)
•7.00% for underpayments
•0.00% for overpayments
>COVID-19 relief may apply

Who is subject to UOMI?
-Taxpayers whose RIT(residual income tax) is above $60,000
-Taxpayers who obtained an exemption from RWT on interest/dividends
-Taxpayers with unpaid tax owing
-Individuals who estimated their provisional tax

What is the tax liability? Part A, sch 1
Tax liability = taxable income x rates

Process
•Tax liability is met by offsetting any tax credits (PAYE, RWT etc) and prior payments of tax (provisional tax)
•Credits must be applied in order (s LA 4) …

Why does the order of credits matter?

Type of credit	Example	Order of credit	Consequences of excess credits
Non-refundable	Credit for foreign tax paid	First	Lost
Convertible	Imputation credit (dividends)	Second	Carried forward to next tax year
Other	PAYE, RWT	Third	Cash refund

Terminal tax

•Terminal tax is the tax payable for the tax year – it may be a refund or additional payable (esp. provisional tax)
•Terminal tax is due for payment either 7 February or 7 April the following year
•UOMI applies to terminal tax

Rates of income tax

Individuals	Rate	Cumulative tax
$0 to $14,000	10.5%	$1,470
$14,001 to $48,000	17.5%	$7,420
$48,001 to $70,000	30.0%	$14,020
$70,001 and above	33.0%	
$180,000+	39% from 1 April 2021	
Companies	28.0%	
Trust (trustee income)	33.0%	

Example: background facts

•Sally earns a salary as a teacher
•She owns a rental property for which she has allowable deductions of $11,200
•She also receives interest and dividend income
•Sally paid provisional tax of $3,000 ($1000 x 3)
Note:
Sally receives some amounts net of tax
Her deductions for rental income may not exceed her rental income – any excess must be carried forward to be set off against future rental income (ringfencing)
You may need to make assumptions e.g. capital/windfalls – always tell us what you have assumed

	Deposit ($)	Tax deducted ($)	Type of tax
Net salary from school	55,007	14,020	PAYE
		973	ACC Earner's levy (**not** part of income tax)
Gross rents	31,200	0	
Net interest from ANZ bank	3,350	1,650	RWT deducted by bank
Net dividends from NZ Co	4,652	1,944	Imputation credit attached
		348	RWT deducted by company
TOTAL	**94,209**		

Income tax calculation: year ended 31/3/21

Salary	70,000	Add back 14,020 and 973 to net salary
Gross rents	31,200	No tax deducted
Interest ANZ	5,000	Add back 1,650 to net interest
Dividends	6,944	Add back 1,944 and 348 to net dividend
Annual gross income	**113,144**	
Less annual total deductions	(11,200)	Deductible against rents
Annual net income	101,944	
Tax due on 101,944	**24,562**	
Less convertible credits on dividends	(1,944)	
	22,618	
Less withheld tax on salary, interest and dividends	(16,018)	**Not** ACC levy
Residual income tax	6,600	
Less provisional tax paid	(3,000)	
Terminal tax due	**3,600**	

Provisional tax for year ending 31/3/21 – standard option

RIT from 2020	6,600
Plus 5% uplift	330
2020 provisional tax	6,930
Payments	
28 August 2020	2,310
15 January 2021	2,310
7 February 2021	3,600 (Terminal tax due)
7 May 2021	2,310

Tax rebates and tax credits

•Examples: charitable donations; Working for Families credits
•Deducted from tax payable – not assessable income

Working For Families Credits

•Special form of tax credit
•Fully refundable even if they are more than income tax liability – i.e. can lead to negative tax
•Compare with charitable donation credit which is limited to the amount of tax payable for the year

Two components of WFF
Family tax credit Payable to parents of dependent children up to 18 years old

In-Work Tax Credit

•Payable to principal caregiver of child who works a certain number of hours per week
•Not available to beneficiaries
•Subject to minimum family tax credit rules.

Both credits abate (reduce) as family income rises above thresholds

WFF
Parental tax credit paid for 8 weeks when a baby is born

Abatement problem
•Assume extra $10 week earned
•Income tax to pay $1.75 plus reduction in WFF credits $2.00
•Effective marginal tax rate 37.5% - can be much higher

Other problems
•As WFF can be payable at medium income levels, many families resentful at having to comply with administrative requirements in order to get a tax reduction
•Disincentive effects are quite significant for some income bands

Anti-avoidance measure
•Eligibility for WFF credits based on an adjusted income figure not taxable income
•Certain losses are not taken into account
•Many types of exempt and excluded income are taken into account as well as attributed child and trustee income

Weekly Test
Which of the following statements is most accurate? Countries typically tax on a basis of
Source and residency

Which of the following statements is correct in relation to New Zealand tax residency?
The test for tax residency has subjective and objective elements

In Diamond's case, which of the following was the most important consideration?
He habitually returned to the same property

In van Uden's case, which of the following was the most important consideration?
He habitually returned to the same property

Which of the following makes a company tax resident in New Zealand?
Incorporation in NZ

Which of the following is NOT a withholding tax?
Provisional tax

Which method of paying provisional tax is identified by the phrases "safe harbour" and "5% increase"
Standard

Under Income Tax Act 2007 s LA(4) which type of tax credit must applied first?
a non-refundable tax credit

Identify the missing word from the following sentence: "The second provisional tax payment is due on 15th ——————"
January

Tutorial
Is the sole purpose of taxation to raise revenue?
•Source of revenue for government
•Means of redistribution
•Influence behaviours
•Improve living standards
•Develop sustainability

Outline two tax criteria included by the Tax Working Group which Adam Smith did not include in his Four Canons of Taxation?
•Equity

- Efficiency
- Certainty and predictability
- Compliance and administration costs
- Revenue integrity
- Fiscal adequacy
- Coherence

Why do some commentators argue that not taxing capital gains is unfair?

- Amy earns median wage. Over 10 years she pays $70k in income tax
- Zak purchased a rental property 10 years ago. Deductions cancel out income tax liability (rental only covers mortgage interest, rates, insurance and maintenance). Now sells property for $120k more than paid for it. Pays no tax on this gain

Explain how taxes can combat environmental externalities? Also provide an example of another way in which taxes can promote sustainability?

Externalities are social and environmental costs that are not charged to you
Eg A carpet maker discharges waste dye into the local river killing wildlife
The carpet maker does this because it is free to do
If the government charged $5 per litre of discharged dye the carpet maker would have an incentive to lower the amount of discharged dye polluting the river or the government would have money to remediate the river

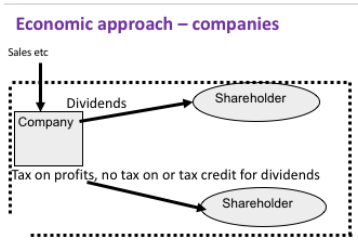
Examples of other ways in which taxes can promote sustainability:

- A levy per kg on land fill
- Traffic congestion charges per vehicle per day in the inner city
- Fringe benefit tax rates that vary on CO_2 emissions of the car
- A tax on CO_2 emissions

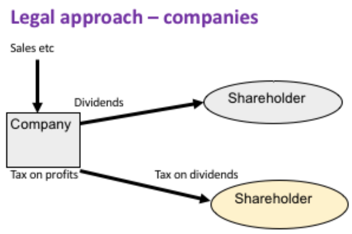
Week 3
Lecture 1

What is income?
•Not a precise concept
•Discipline-specific i.e. economics and law have different conceptions (see Holmes's income pyramid)
•Parliament (incompletely) says what income is – courts develop definitions, fill in gaps

Economic approach
Haig-Simons: total of all items consumed during a period and the **change in value of all assets owned** (realised or not)
•Any form of economic benefit
•Carter Commission (1966): 'a buck is a buck'
•Supports adoption of capital gains tax (inheritance, capital sold)
>Seperation of entity is made on basis of legal convenience, should not tax both (tax company, tax credit follows to shareholder)



Legal approach
•Capital/revenue distinction – tree/fruit
•In NZ, narrower concept than accounting definition
•Emphasis on transactions (realisation)
•(Taxing unrealised amounts follows economics)
•Does not supports adoption of capital gains tax (inheritance, capital sold)
>Company is legal entity so taxed, Shareholder also legal entity so taxed

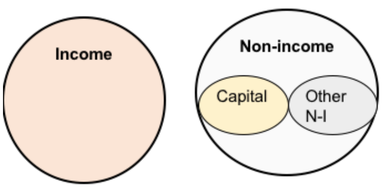


Cross over Legal and Economic approach
Crossover between law and economics can occur with earnings, interest, royalties

Accounting approach
•Increases in economic benefits
•during the accounting period
•in the form of inflows or enhancements of assets or decreases of liabilities that
•result in increases in equity,
•other than those relating to contributions from equity participants
>Note transactional emphasis

Move away from pure legal approach in income tax
•Dividend imputation
•Capital gains
•Financial instruments

Receipts: income and non-income



Assessable income

Income any amounts falling within Part C; s BD 1(1)
Assessable income all income other than:
•Exempt income
•Excluded income (e.g. employee fringe benefits)
•Non-resident's foreign-sourced income (foreign-sourced income derived by a person when they were a non-resident): s BD 1(5)

What income is taxable?

•Only assessable income is taxable
•To benefit from exclusions/exemptions, the amount must be income in the first place
•Why is there no exemption from income tax for capital gains in the ITA?

Income: ITA 2007, Part C

•Any amount falling within any section in Part C is deemed to be income of a taxpayer: s CA 1(1)
•Any income specifically exempt from tax is listed in subpart CW

What are the main types of assessable income?

Income from
•carrying on a business
•exploitation of capital (rents, interest, royalties, dividends)
•employment
•property sales (land (inmovable and movable), shares)
•welfare benefits, pensions, ACC

Income under ordinary concepts (common law principles): s CA 1(2)

•A catch-all provision to capture amounts not specifically covered
•An amount is income if it is defined under ordinary concepts

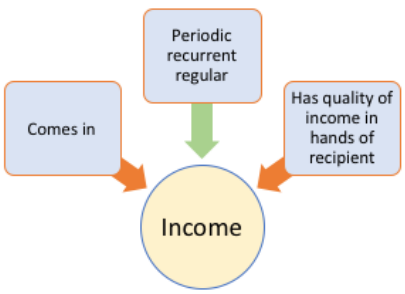
Code*-plus

ITA codifies assessable income but retains residual common law concepts (but modified by practical and business viewpoint)
* A systematic and comprehensive written statement of law

Old cases

•Cases on income under ordinary concepts (IOC)
•Most relate to ITA prior to core provisions introduced in 1994
•Some decisions discuss concepts of net income (net gains) rather than gross income receipts

IOC: characteristics – but holistic approach



e.g pay check is regular and recurrent (income) bonus is measured based on quality in hand of recipient (income)

e.g beggar donation (not income - charity) busker donation (income as is earned by performance) on basis of quality

Income comes in

•Must be money or convertible into money e.g. not rent-free TV which cannot be sold etc
•Increases in value of assets not income (unless trading stock)
•Reduction of private expenses not income

Periodicity; recurrence or regularity

•Once-off payment look like capital – income recurrent e.g. wages, interest (income flow)
•But payer/payee relationship relevant e.g. a gift to an employee
•Inheritances or windfalls not income – normally

Quality in the hands of recipient

•If I sell my car, receipt is not income – but what if I am a car dealer?
•If I am a preacher who relies on gifts for a living, are those gifts income?
•If I am a solicitor and a deceased client leaves me a legacy because they hold me in high esteem, is the gift income?

Lecture 2

Income comes in

Dawson v CIR (1978)

•D invested in debentures of a company
•Had use of a TV for period of debenture
•Could not sell etc i.e. not convertible into money
•CIR: TV equivalent of interest
•HC: D had not substituted TV for interest
•Benefit not monetary and couldn't be converted into money
•Use of the TV was not interest
Would an economist agree? No you receive utility hence you should be able to be taxed for it
OUTCOME: not taxable - you didn't receive monetary gain (could not be converted into cash)

Lambe v IRC (1934) (UK)

•L was owed interest
•Debtor did not/could not pay
•IRC not convinced L would never be paid
•Court: income is what comes in … what goes into your pocket … interest due (but not paid) was not income

•Would a legal purist agree with this decision?
•Would a business person agree with this decision?

OUTCOME: has to receive something to be considered income

Quality of income in the hands of recipient

G v CIR (1961)

•Graham, a preacher relied on gifts or contributions
•No legal obligation on donors to donate
•CIR: gifts were income in G's hands (quality) and received periodically
•HC: G was carrying on a profession
•He could expect the gifts as reward for his work
•G was carrying on a business for profit
•But some gifts were personal, based on affection, esteem or respect were "capital"

Scott v FCT (1966) (Aus)
•Deceased client left legacy to S in her will
•Gift made because of esteem in which she held S – not related to his activities as a legal adviser
•Gift not income

Could the one-off nature have been relevant?

<u>Koha-IRD Guidance</u>
You don't need to pay income tax on your koha if:

•it's given by choice
•Donor gets no benefit or advantage in return
•it's not made so that it is income for you.

<u>Capital/revenue distinction is difficult to draw</u>
IRC v British Salmson Aero Engineers Ltd [1938] 2 KB 482 at 492 per Lord Greene:

"in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons

AG Healing & Co Ltd v CIR (1964)
•Under his will, director of AGHL left option to AGHL to buy property
•Option value below market value
•AGHL bought and immediately sold the land
•CIR taxed the 'gain'
•HC: AGHL simply converting its gift into cash - not taxable
(original gift free from income tax)

Birkdale Service Station Ltd v CIR (2001)
•Deregulation of petrol distribution industry
•Wholesalers wished to tie-in stations to selling their product only – reality stations had to commit to one of five wholesalers
•Mobil paid BSS lump sum – tie-in for five years
•BSS – compensation for giving up right to deal with any wholesaler (but see reality)
•HC: payments revenue (income) in nature

Court of Appeal:
•What is the nature of the receipt in the hands of the recipient?
•Three factors:
•Proper accounting treatment – revenue account
•Freedom to contract was illusory (consumer don't specify what type of petrol (no range offered)
•Short period of trade tie-in (would be repeated; if significant determinant (if longer outcome may change))
•Receipt revenue in nature (but compare with Kenlock 2)
>Does not permanently sterilise income

CIR v Fraser (1996)
•F, TV presenter
•Agreed with advertiser to appear on TV only in adverts for BNZ
•Received 'inducement payment' and restraint of trade' payments
•CA: not payment for future services, rather compensation for giving up TV presentation
•See also Henwood v CIR (1995)

<u>But also see ITA 2007, s CE 9 Restrictive covenants – shores up tax base</u>

CIR v Thomas Borthwick & Sons Asia Ltd (1992)
•Taxpayer received $2.25m for variation of existing long-term contract
•Payment determined with reference to profits forgone
•Was it a capital lump sum payment or income?
•CA: payment not taxable as it represented compensation for part of the taxpayer's business structure (capital) that was extinguished

<u>Capital/revenue deductions</u>
•ITA 2007 s DA 1 General permission
•ITA 2007 s DA 2(1) Capital limitation

Hallstroms Pty Ltd v FCT (1946) Aus
•HPL started making fridges in anticipation of rival's patent expiring
•Rival sought extension of patent – HPL opposed
•Could HPL deduct legal fees?
•Revenue: must relate to the day-to-day operations of the Co
•HCA: Dixon J (dissenting) distinguished between income-earning process (revenue) and income-earning structure (capital)
•Legal costs related to structure
•Dixon followed in future cases

Example: income under ordinary concepts
Hemi owns a house in Tawa. His next door neighbour Jane wants to build a new garage. Because Jane's proposed garage will interrupt Hemi's view, Jane must get Hemi's permission before he can build the garage.
When Hemi says no, Jane offers Hemi $5,000 to agree.

Would Hemi be liable to income tax (under s CA 1(2)) if he takes the $5,000 from Jane?
>No payment is one off for permanently sterilise view using precedence of CIR v Thomas Borthwick & Sons Asia Ltd (1992) where a payment made was not considered income as company extinguished part of factory - Hemi would be extinguishing part of his capital by interrupting his view

<u>Conclusion</u>
•We cannot just apply legal rule - also look to practical and business point of view
•Every case depends on its own facts but we can draw on precedent
•An apple tree is the income earning structure (capital)
•Picking apples is the income earning process
•Capital/revenue distinction relevant to receipts and deduction

<u>TUTORIAL</u>

Question 1: Individual Residency
Ali Said, a New Zealand citizen, is an aid worker, who has worked in refugee camps around the world for the past 10 years. Ali spends fewer than 30 days a year in New Zealand but, through a trust, co-owns a house in Nelson with his ex-partner, Zelda. When he is overseas, Ali leaves a car and camping equipment at the house. When he is back in New Zealand, he usually packs the car and travels around the country, pitching his tent at campsites in national parks. While he never

stays with Zelda, because he does not have a post box, his New Zealand mail is sent to the Nelson address, which he picks up when he visits.
Required:
Explain whether Ali is a New Zealand tax resident.

If Ali is found to be a tax resident in New Zealand he must pay tax in the country he earn his income in and his total income is also taxed in new Zealand. Therefore it is important to know when Ali tax residency status ends or begins because this helps him to avoid double taxation. Many countries have agreements that allow you to avoid double taxation (relieve double taxation by refunding the tax from the country that you are not currently in) however If there is no agreement, Ali may end up paying a large amount of tax, making it crucial to determine the countries that you are and are not a tax resident of.

A person is considered a tax resident if they've been in New Zealand for more than 183 days in any 12-month period or have a permanent place of abode in New Zealand. This is a place where the taxpayer habitually resides; You do not need to own the house for it to be considered a PPA.
They must primarily live there. Availability is not enough to be considered a permanent place of abode. Living means to sleep, eat and spend your time there.

First we will analyse Ali's presence in New Zealand. Ali spends fewer than 30 days a year in New Zealand - hence Ali does not meet the condition of residing within New Zealand for more than 183 days.
Secondly we analysis Ali's abode condition. Through a trust, he co-owns a house in Nelson with his ex-partner, however He never stays with Zelda, He pitches his tent at campsites in national parks, and Ali has been in the same scenario for 10 years. Ali does get his New Zealand mail sent to the Nelson address, which he picks up when he visits.
Ali does own a house in New Zealand, but the fact that he does not reside there as he camps instead means it does not fulfil the requirement of being a permanent place of abode - It doesn't provide him with the same extent of permanence that a normal home would for a typical tax resident. Ali has been in this scenario for 10 years, his actions would have consistently exempted him from being a New Zealand tax resident for the entirety of the past decade. While he does receive mail at the house this does not indicate that he spends any greater amount of time at the residence apart from picking up his mail which has no post box to go to.

Ali is not a tax resident of New Zealand. He is not in the country for long enough, nor does he have a permanent place of abode here. Therefore he avoids double taxation.

ISSUE
Is Ali a tax resident of NZ?

LAW
Income Tax Act section YD1
•*'counting the days' test*
• *subjective Personal Place of Abode test*

APPLICATON
Cases:
CIR v Diamond (2015)
CIR v van Uden (2019)

Conclusion
No, doesn't meet tax residency requirement

Question 2: Corporate Residency
Leisure Holdings Ltd ("LHL") is a Singapore-incorporated company. LHL owns several hotels and holiday parks in New Zealand. LHL employs 500 people in New Zealand and 90% of its income has a New Zealand source. Four of LHL's five directors live in New Zealand but directors' meetings are normally held in Singapore. In 2020, because of the Covid pandemic, directors' and shareholders' meetings were held by Zoom. At the shareholders' meeting (three were in Sydney and two in Auckland), it was decided that LHL needed a new strategy and five new directors were appointed, and the current directors removed.

Required
Explain whether LHL is a New Zealand tax resident.

Due to LHL's legal existence being separate from its shareholders, it is therefore a company and required to meet one of the four bases of residency to be a NZ resident. Only one residency base is necessary in becoming a NZ tax resident. Thus, making it relatively easy to become a resident, and more difficult to lose such residency. These four bases include:
a) It is incorporated in NZ
b) Its head office is in NZ
c) Its centre of management is in NZ or,
d) Its directors, in their capacity as directors, exercise control of the company in New Zealand, even if the directors' decision-making occurs outside of New Zealand.

The first base is to identify if the company is incorporated in NZ. Due to LHL being incorporated in Singapore it is therefore not incorporated in NZ and thus not incorporated under NZ's Companies Act 1993.

To deduce the location of their main office, the head office test can be used to identify factors which influences their head office location. these include:
- The Location of senior staff
- Where major strategic and policy decisions occur
- Where specialised functions are carried out
- Where staff consider the head office to be located.

Due to 4 out of 5 directors living and operating LHL in NZ, it is therefore likely that their head office is located in NZ following the first, second and third point within the head office test. Moreover, to manage a multitude of employees and the operations of the hotels and holiday parks, a head office is anticipated to be in NZ.
Conversely, it can also be argued that the head office is located in Singapore due to directors' meetings being held there regularly. These directors' meetings could signify the location where strategic decisions are made. Although this is dependent on the meeting's purpose. If it is just for the purpose of formalising decisions that have already been made, this directors meeting location has little significance, and vice versa. So, if important decisions are made in these directors' meetings, it is likely the head office is located internationally.
Due to the minimal information regarding LHL's main office location, and due to the head office test tending towards having its head office in NZ, I will continue on the assumption that the head office is located in NZ and thus LHL is a tax resident.

Centre of management is defined in section YD 2(1)(c) of the income tax act 2007 which provides that a company is a New Zealand resident if its centre of management is in New Zealand.
As previously exclaimed, their centre of management is heavily dependent on their directors' meetings and the nature of the decisions made within those meetings.

Thus, if senior management, in this case the directors, manage LHL as a whole company from New Zealand, the centre of management is in NZ. On the other hand, as previously exclaimed, if the decisions are developed and executed internationally, in this case Singapore it is likely that it is the centre of management. This further extends to other levels of management outside of the directors, and their location in which they are exercising their management.
Thus, due to the Hotels and holiday parks being in New Zealand, they are likely to have a majority of senior management within the country in order to run it, and to create and implement strategic procedures.
To obtain further information about the location where shareholders meetings are usually held (pre-pandemic) would allow a more conclusive place in which the centre of management is located. Furthermore, more conclusive information regarding where upper management situates and makes such decisions is needed, following case N28 (1991), which more information regarding administration was required to identify that the company was not a NZ resident.
Therefore, I have assumed that senior management decisions also occur within New Zealand, thus, its centre of management leading to LHL further complying with NZ tax residency bases.

Finally, the directors control test, which is defined in section YD 2(1)(d) stating “that a company is a New Zealand resident if its directors, in their capacity as directors, exercise control of the company in New Zealand.”
Under the directors control test, and due to most of the directors (pre-shareholders meeting) living in NZ, it was highly probable that decisions regarding the business operations, strategic development etc were done within NZ. This meant they were still exercising their independent minds and effectively controlling the company from NZ. Due to this consistently happening, LHL will be a New Zealand resident under the director control test.
If LHL directors usually exercise their duties from overseas, and only sometimes within NZ for example. through their zoom meeting, this doesn’t mean they are applicable to being a NZ tax resident. If this is consistently applied, and decisions are continuously made from foreign countries by directors, then LHL is exercising control within that country.
Within the context, I have deduced that the directors control base for LHL further falls within NZ residency, assuming that directors’ exercise their control frequently within NZ. Overall, within the given context, and logically making assumptions LHL’s is a NZ tax resident.

When five new directors were appointed by LHL shareholders, its company residency may change, although it is likely not to, so long as one of the new directors is a NZ resident as this is a requirement within the companies act 1993.
As long as these directors appointed are still exercising their duties in NZ consistently, or their centre of management or head office are in NZ, hence, meeting at least one of the bases, they will remain a NZ tax resident.
Otherwise, if their directors exercise their strategic development/strategies from outside of NZ, and their centre of management and head office are outside of NZ too, then they will no longer be tax residents. This will continue to happen even if these newly appointed directors are stuck in NZ due to Covid-19. To ensure that LHL isn’t not subjected to double tax, they will have to comply with DTA’s between NZ and Singapore.

ISSUE
Is LHL a tax resident of NZ?

LAW
Income Tax Act section YD1
Resident if:
•Incorporated here, or

•Head office is here, or
•Centre of management is here, or
•Directors control company from here

APPLICATON
This is a factual enquiry
Cases:
•TRA Case N28 (1991)
•NZFP Finance NV v CIR (1995)

Conclusion
Yes, unless directors exercise their strategic development/strategies from outside of NZ, or their centre of management and head office are outside of NZ

Question 3: Income Tax Calculation
Hemi is self-employed as a painter and decorator. In the winter months when it is difficult to do external painting, he takes a temporary job in a local factory. Hemi owns a flat which he rents out. For the income year ended 31 March 2021, a total of $93,463 was deposited into his bank account from the following sources:

	Net deposit $	*Tax deducted before deposit* $	
Gross receipts from painting and decorating	55,000	0	
Wages from factory	10,368	1,857	PAYE deducted by employer
		255	ACC Earners' Levy
Rents from rental property	21,060	0	
Interest from Kiwibank	2,475	525	Deducted by bank
Dividends from Spark NZ Ltd	1,860	777	Imputation credits
		140	RWT deducted
Dividend from Aust Co (NZ$)	1,700	300	Aust tax deducted
Winnings from a Lotto tickets	1,000		
Total deposits	93,463		

Hemi gives you the following additional information:
(1) He is entitled to allowable deductions against his painting and decorating of $15,000 and $20,000 against his rental income.
(2) All of the $55,000 Hemi banked from his painting and decorating business was received by way of electronic bank deposits. He also received $3,000 in cash from his customers which he did not bank but kept at home for a trip he was planning to take.
(3) Hemi paid provisional tax for the 2021 income year of $6,000 in three instalments of $2,000.

Required:

(a) Calculate Hemi's income tax liability for the income year ended 31 March 2021 and the amount of his terminal tax or tax refund from that income year using the rate scale below. (Hint: Determine his assessable income first.)
(b) Calculate Hemi's provisional tax for the 2022 income tax year using the standard option.

Individual Tax Rate Scale		
Taxable Income	*%*	*Cumulative ($)*
$0 to $14,000	10.5	1,470.00
$14,001 to $48,000	17.5	7,420.00
$48,001 to $70,000	30.0	14,020.00
$70,001	33.0	

Assessable income
•Annual gross income less annual total deductions (exempt income) = net income/loss
•Net income less any tax loss = taxable income
•Taxable income x rates = income tax liability

Assessable income
>lottery winnings fall under exempt incomes. Therefore we subtract this $1,000 from the gross amount.
>$3000 cash injection which if declared would fall into the tax, allotted under painting income

Deduction
>$15,000 deduction allotted for the painting income, further, there is a $20,000 for the rental property income. To allow for this we total the deductions allowed and we subtract this from the gross annual income

Tax Deducted previously
>To balance out the calculations we must add back any relevant tax already deducted as to find the realised gross income.

Resulting in

Painting (Add on the cash amount)	58,000	
Gross Rents	21,060	
Wages	12,480	
Interest	3,000	
Dividends (Combined)	4,777	
Annual gross income		99,317
Less annual total deductions		(35,000)
Annual net income		64,317
Tax Due		12,315.10
Less convertible credits on dividends		(777)
Less withheld tax on wages, interest, and dividends		(2,822)
Residual Income tax		8,716.10
Less provisional tax paid		(6,000)
Terminal Tax Due		2716.10

Tax = 7420 + 4894.8 ((64317-48001) *0.3)
Tax= 12314.8

Credits
The order of credits used doesn't necessarily make a difference to the current period as using them would benefit the current period. However, if the individual didn't have enough tax due to use all of their credits the order therefore becomes important as there is a preference to use them not only to mitigate tax due but rather use the credits too.
This being because you want the ability to use them, as you can get a refund of unneeded Resident Withholding Tax (RWT), or carry forward unused Imputation Credits but use or lose the credit for tax paid for overseas.

Provisional Tax for 2022
With the standard calculation option we use the previous years Residual Income Tax (RIT) and add +5% to it.
The standard option assumes and allows for an increase of income p.a.
(8716.10*1.05) = $9151.91
This $9151.91 would be the provisional tax for the next years period, split into 3 payments @28th August @15th January @7th May.

Week 4
Lecture 1
Business and other income

3 Step test

-Income comes in

Examples of non-income based on this criteria

-Increases in value of assets not are income as it is not going into the individual's pocket (unless stocks are being traded for gains)

-Reduction of private expenses not income (e.g. walking instead of bussing) as it doesn't increase an individual's assets.

-Periodicity; recurrence or regularity

-Quality of income in the hands of recipient; exchange? Does it allow me to carry on my occupation? Is it a gift?

The determinant of tax is the distinction between Capital and revenue
Tree or fruit; What is being replaced - Income or capital
What is the expenditure for? What is the legal award for? Is lost income a way of calculating reduced capital?

ITA PART C; INCOME

Type	Sections	Week
Business generally	**CB 1 – CB 2**	**4**
Property obtained by theft	**CB 32**	**4**
Selected types of income	**CC 1 – CZ 34**	**4**
Income from employment	CE 1	5
Schemes for profit	CB 3	6
Personal property	CB 4 and CB 5	6
Land	CB 6A – CB 23B	7

Why does the concept of business matter?

•Amounts received from business are income – unless they are capital in nature: s CB1(1)
•Some deductions are only available to businesses: s DA 1(1)(b)
[Many business cases relate to claims for deductions]

Definition of business: s YA1

A business includes:

A profession, trade, manufacturer or undertaking carried on for profit

S DD 11 (entertainment expenditure):

Any recurring income earning activity

Business under ITA 2007

"Business"

•Business activity
•Intention to make a profit (in the long run)

Intention to make a profit: Grieve v CIR (1984)

•Taxpayer's statements
•Nature of the activity; has anyone made a profit in this kind of activity

•Period engaged in; how long have I been pursing the activity
•Scale of operations; possible to have varying scale, this considers feasibility of business due to scale
•Volume of transactions
•Commitment (time, money, effort)
•Pattern of activity; activity person in this kind of activity engage in
•Financial results

<u>Grieve</u>
Richardson J on "Business"
•Exercise of an activity in an organised and coherent way, directed to an end result
•Test is not solely subjective
•Taxpayer must show they carried on their activity with the intention to make a profit
•Actual likelihood of making a profit, one factor in ascertaining the genuineness of the taxpayer's intention

<u>Business activity + profit intention</u>
•Business activity without a profit intention OR
•Profit intention without business activity
NOT a business

Business activity but no intention
Case T2 (1997) 18 NZTC 8,007 (TRA)
•Husband and wife carried on farming partnership
•He grew cannabis without her knowledge
•Were the proceeds from drug dealing part of the partnership?
•Outside scope of the partnership
•Wife had no intention to profit from the illegal activities
•Not taxable on half the proceeds

Intention but no business activity
Slater v CIR [1996] 1 NZLR 759
•Manufacturers had plans for profitable business
•Things didn't go as planned – no actual manufacture in 2 of 3 years
•Do doubt that they had appropriate intention
•No relevant business activity in 2 of 3 years

<u>California Copper Syndicate Ltd v Harris (1904) (UK)</u>
… where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit (e.g purchase and sell house - not income)

… But … enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business… (e.g purchase land, subdivide, build house and sell - income)

… the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts
… Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business carrying out a scheme for profit-making?

COT v Miramar Land Co Ltd (1906)

•Purpose of MLC to acquire land and dispose of it
•Planned to sub-divide and sell off small plots
•Received good offer for whole land
•COT taxed the profit as income
•HC agreed with MLC that such a single transaction was not carrying on a business
•CA: MLC was formed to buy/sell the land – that was its business – therefore profit was income

Not all receipts are business income

Full time work and presumption against business: CIR v Stockwell [1993] 2 NZLR 40 (Cooke P)

"When a taxpayer has a full-time occupation and devotes some of his spare time to stock exchange speculation, one should be slow, I think, to find that he has gone as far as to embark on a business."

Often not considered a business if its pursued part time

Start and end of business

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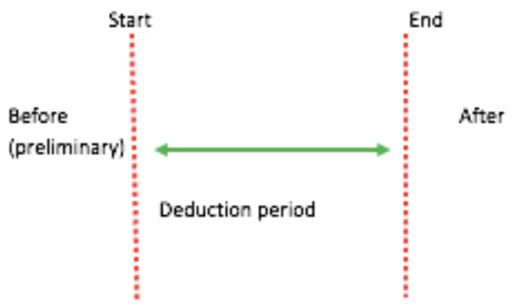


When does a business start?

Birmingham District Cattle By-Products Company Ltd v CIR (UK)

•Taxpayer incorporated on 20 June 1913, factory built in July, contracts entered into but production did not start until October 1913
•Court held taxpayer's business commenced in October 1913 and activities prior to that date were merely preparatory

Calkin v CIR [1984] 1 NZLR 440 per Richardson J:

•Commitment to engage in business not enough
•Profit-making structure must be established
•Ordinary current business operations started
•Whether a business has started depends on the facts (differs between industries)

When does a business end?

Amalgamated Zinc (de Bavay's) Ltd v COT (1935) (Aus)

•AZL stopped zinc processing in 1924
•Continued to hold properties and investments
•AZL liable for occupational diseases from zinc processing
•AZL sought to deduct payments to the fund in 1932 and 1933

•HCA: AZL had ceased to carry on zinc processing business (now property investment -cannot claim for zinc related cost) – no deduction

Hobby v business (IRD guide)

Hobby	Business
Something you do in your spare time for pleasure or recreation	Something commercial, where you aim to make a profit
▪ occasionally sell your stuff to friends, at local markets, or on sites like Trade Me and eBay	▪ charge others for the goods/services you provide? supply goods/services on a regular basis? ▪ intend to make a profit from providing goods/services? ▪ plan, organise and carry out your activities in a businesslike manner, eg keep receipts and records, or have a separate bank account for your business activities?

Businesses and hobbies
•Attraction of setting off losses against other income
•Follow Grieve's case (nature of activity + profit-making intention)
•Hobbies may become businesses
•Private expenditure must be excluded

<u>Lecture 2</u>
<u>Business and other income</u>

<u>An amount that a person derives from a business: ITA s CB 1</u>
Business activity + intention to make profit
>Grieve's case
-coherent plan
-not hobby for pleasure
-can be one off (e.g property developer spend years developing)

<u>Other income includes …</u>
•Disposal of a business
•Stolen property
•Recoveries
•Exploitation of land
•Exploitation of intellectual property

<u>Section CB 2: Second part of business generally</u>

Type	Section
Amounts derived from business	CB 1
Amounts received on disposal of business assets that include trading stock	**CB 2**

Stock on sale of a business
•Doughty v CoT [1926] all receipts from sale of a business were treated as capital [but particular wording of the 1916 Act] – not from carrying on a business

Is that right?
•The income earning structure (e.g. factory) is surely capital in nature?
•Trading stock is revenue in nature
•Temptation to overvalue business (not taxed) undervalue stock (taxed)

Disposal of business assets that include trading stock: s CB 2
•Receipts from the disposal of trading stock in the normal course of business is income: s CB 1 [derived]
•Receipts from the disposal of trading stock outside the normal course of business is income e.g. at the cessation of business: s CB 2 [disposed of]
•s CB 2 (amount received on disposal of business assets that include trading stock) overrides CB 1 (amount derived from business; derives means you have a right to it - accrual accounting)
•s EB 24(2): apportionment at market values

Is stolen property income?
•A Taxpayer v CIR (1997) (CA)
•AT stole funds from employer and invested them
•Made major losses in market crash
•CIR said stolen money was income of AT
•CA: no beneficial interest in the money (no tax) – held them as a constructive trust for employer (employer can always claim back)

•Would an economist agree with the decision?
•Would public opinion?
>law updated now taxable

Property obtained by theft:
ITA 2007 s CB 32
If Z obtains possession or control of property without claim of right*, Z's income includes the market value of the property
•a belief that an act is lawful (even if the belief is based on ignorance or mistake)
•Restitution is deductible under s DB 44(2)

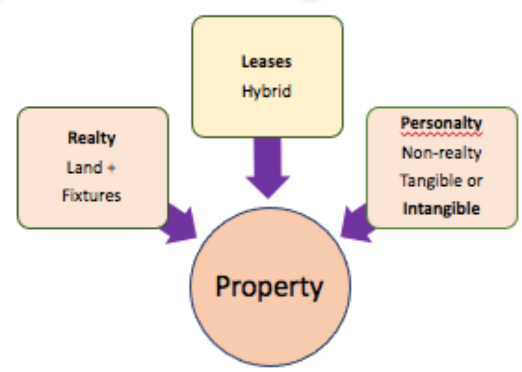
Other items of income under subpart CB

Type of income	Section
Recoveries e.g. bad debt repayment	CG 1 – CG 9
Sale of timber and timber rights	CB 24
Sale of land with timber on it	CB 25
Sale of minerals from land	CB 29
Sale of patents or patent rights	CB 30
Is a patent capital under the common law?	

>patent is authority from government to be a monopoly

Recoveries: subpart CG

Property under the common law



Land use: ITA 2007 ss CC 1 – CC 2

Type	Section
Income from land e.g. rents	CC 1
Consideration relating to grant, renewal, extension, or transfer of leasehold estate or licence	CC 1B
Consideration for agreement to surrender leasehold estate or terminate licence	CC 1C
Non-compliance with covenant for repair	CC 2

Lease inducements

•Payment of a lump sum to a prospective tenant to enter into lease
•Inducement treated as capital by tenant (did not effect carrying on of business)– see CIR v Wattie & Lawrence (1999)
• payment considered cost of doing business by landlord and deducted
•Tax mismatch
•Increased rent a deductible expense
•From 1 April 2013, inducement received by a tenant from a landlord is income (unless for residential premises) : s CC 1B (amended 1 April 2015)

Passive income and benefits

Type of income	ITA 2007 references
Dividends (covered in TAXN 301)	Subpart CD
Interest	s CC 3 – CC 8
Royalties	s CC 9
ACC payments, benefits, pensions etc	s CF 1

1. Pensions paid by registered superannuation schemes are exempt under CW 53 and HC 20 – taxed as a **complying trust**
2. s CW 33 exemption of allowances and benefits is misleading

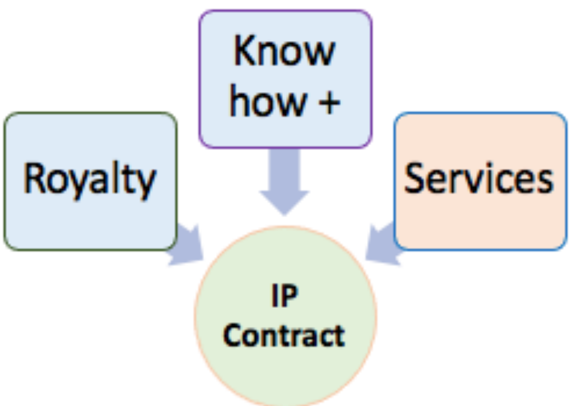
Key types of IP

	Copyright	Patent	Trade mark
What is it?	Artistic, literary, musical etc works	Novel invention	Commercial sign
How does IP arise?	Creation	Registration	Registration
How long does it last?	50 years (NZ) 70 years (Aus, EU, US)	20 years	Renewable
NZ legislation	Copyright Act 1994	Patents Act 2013	Trade Marks Act 2002

Royalties (for the use of intellectual property)

•A royalty is income: s CC 9(1)
•Royalties are typically paid for the use of IP
•Includes 'know how' payments (but not services)
•A royalty can be a lump sum: s CC 9(3) (taxable)

Complex agreement



>e.g manufacture computer - royalty for using computer design, know + how (technical knowledge) is covered by royalties but services are not

Tutorial 3

Question 1: Income under ordinary concepts

Peter Waiwhero is a highly respected kaumātua (elder) who is learned in tikanga Māori (customs). In the 2021 income year Peter receives the following:

(a) Grocery vouchers worth $750 from a kura (school) where he coaches teachers each month;
(b) An inheritance of $10,000 from a distant family member who admired Peter's knowledge of tikanga;
(c) $500 to reimburse him for costs incurred in flying to oversee the protocols at a tangihanga (funeral).

Required:
Explain whether the items identified in (a), (b) and (c) are income in Peter's hands in terms of section CA 1(2) of the Income Tax Act 2007. (You should refer to case law in your answer.)

Income act 2007
(1) An amount is income of a person if it is their income under a provision in Part C (Income).

Assessable income
(5) An amount of income of a person is assessable income in the calculation of their annual gross income if it is not income of any of the following kinds:
a) their exempt income:
(b) their excluded income:
(c) their non-residents' foreign-sourced income.

Income has three characteristics:
•Income is something that comes in
•Periodicity, recurrence, regularity
•Quality in the hand of the recipient
These characteriscis are important as they provide a framework and a basis for assessing circumstances and understanding what is and isn't taxable

Income is something that comes in; Payment/acquirement of assets must come into the pocket of the individual or business and Income must be money or convertible into money
As established in Dawson v CIR (1978) (Free T.V use not income)

Periodicity, recurrence or regularity, Income is periodic, and regularly comes in.
One-off payments are more capital in nature while income is recurrent including wages, interest & rent. Therefore Inheritances, windfalls and gifts are not usually income as they are irregular payments.
However, the relationship between the payer and payee is significant as a gift from an employer to an employee could be seen as income.

Has the quality of income in the hands of the recipient, a gift is often to be considered an exchange where no value is expected in return nor was value invested to earn this transaction.

Koha is money, but it can also be goods or services. It's given without any expectation on the part of the person receiving it. You will need to work out if you pay income tax on your koha on a case by case basis.

Grocery vouchers worth $750 from a kura (school) where he coaches teachers each month;
Income comes in; The vouchers are a placeholder for money which goes into Peter's 'pocket'. The vouchers are convertible into money as they can be used in it's place.
Periodicity; This is a regular occurrence as he receives the sum monthly. Would be seen as a contractor/employee of the school

Quality in the hands of the recipient; The vouchers are payment for the services as they are payment for the use of Peter's coaching skill
As this payment meets the three ordinary criteria for income, the $750 vouchers are income and taxable.

An inheritance of $10,000 from a distant family member who admired Peter's knowledge of tikanga;
Income comes in; The payment is money going into Peter's 'pocket'
Periodicity; Not a regular occurrence, No employer, employee relationship
Quality in the hands of the recipient; It is a genuine gift from a family member who admired Peter, It was not a payment for services
Because this is a genuine gift from a family member, the inheritance payment does not meet the three ordinary criteria for income. There for it is not classified as income and is not taxable (Graham v CIR (1961) - pastor gifted for esteem and Scott v FCT (1966) - lawyer received gift payment for esteem)

$500 to reimburse him for costs incurred in flying to oversee the protocols at a tangihanga (funeral);
Income comes in; This payment is money into Peter's 'pocket'
Periodicity; Not a regular or recurrent payment
Quality in the hands of the recipient; This payment is not a payment for services provided but rather a reimbursement for costs incurred
As this payment does not meet the three ordinary criteria for income, it is not classified as income and is not taxable.

Travel allowances:
These are paid to employees for travel between their home and work. These are usually taxed via PAYE but will be tax-free for employees (ie not classified as income):
-working outside their normal hours, eg overtime, shift or weekend work
-carrying work-related tools and equipment, eg the employee usually takes the bus to work but must
-use a taxi or their own vehicle to transport work-related gear
-travelling to do something you need done for your business
-who have a temporary change in workplace
-with no adequate public transport system serving their workplace.

Assuming Peter was employed or contracted to oversee the funeral (by a family, marae or funeral agency), this reimbursement for travel falls under the IRD guidelines of travelling to do something for the buisness

Question 2: Income under ordinary concepts
Zak Black, an employee of Omega Inc, is a designer of online games.
(a) Anna Ma, an investor in Omega, is so impressed by Zak's work that she awards him an all-expenses-paid trip to Las Vegas. The trip is worth at least $10,000. However, due to the Covid pandemic, Zak is unable to take the trip and the award expires.
(b) At the beginning of every year, Omega provides a new laptop to its designers. They must use the laptop for work but at the end of the year they can do what they want with it. The new laptop has a value of $2,500 and a year-old, second-hand laptop is worth $1,000.

Required
Explain whether the items identified in (a) and (b) are income in Zak's hands in terms of section CA 1(2) of the Income Tax Act 2007. If they are taxable, explain the taxable value of the items. (You should refer to case law in your answer.)

Income under ordinary concepts (common law principles): s CA 1(2)
- A catch-all provision to capture amounts not specifically covered
- An amount is income if it is defined under ordinary concepts

Income has three characteristics:
•Income is something that comes in
•Periodicity, recurrence, regularity
•Quality in the hand of the recipient
These characteriscis are important as they provide a framework and a basis for assessing circumstances and understanding what is and isn't taxable

ITEM A
Comes in; A trip, but it is not convertible to money
Periodicity; one time transaction
Quality of income; award/gift
>NOT taxable as it does not meet 3 criteria of income supported by precedence of (Graham v CIR (1961) - pastor gifted for esteem and Scott v FCT (1966) - lawyer received gift payment for esteem, Dawson v CIR (1978) - tv not income)

ITEM B
Comes in; No, cannot be sold in the working year
Periodicity; Received beginning of every year
Quality of the income; For working purposes, but Zak can deal with it as he wish at the end of the year
Reid v CIR (1986) - teach given grant for training course - not income as nature was of bursary
>Under ITA (CX 21) 2007, fringe benefit is an exempt income - Not an income, not taxable in the first year
>However in the second year when Zak is allowed to sell it, it is no longer a fringe benefit but a income receipt— $1000 Income and Taxable

Question 3: Income from business

Bella Lanumoli is a talented seamstress who has made dresses for friends and family for years. People often say to Bella that she should give up her work as a librarian and become a full-time dressmaker.
In 2019, when Bella makes a dress for her daughter Molly's year 13 ball, several friends ask her to makes dresses for their daughters. She makes the dresses and earns $3,000 for a cost of $2,000.
In 2020, Bella actively advertises her services at Molly's old school and receives orders for enough ball gowns to allow her to go part-time at her library job. She invests in an industrial sewing machine, and engages an accountant to advise on the best way to structure a business. In this year, Bella earns $40,000 and incurs costs of $5,000.
In 2021, Bella is working full time on her dressmaking. She has set up a website to take orders, and has employed an assistant. She earns $80,000 and incurs costs of $30,000.
Arguing that she is in business, Bella seeks to deduct her expenses in each of the three income years.

Required:
Explain whether the amounts Bella received in each of the three tax years are income from carrying on a business in terms of section CB 1(1) of the Income Tax Act 2007. (You should refer to case law in your answer.)

CB 1 Amounts derived from business
(1) An amount that a person derives from a business is income of the person

YA 1 Definitions
Business includes any profession, trade or undertaking carried on for profit

Nature of Activities
Includes these factors:
•Subject-matter : types of activity and nature and activity of subject involved
•Size of undertaking: small scale does not prelude it from business
•Extent of activity: has to be continuing activity or effort.

Intention of taxpayer (precedence Grieve v CIR [1984] 1 NZLR 101 CA)
consideration:
•nature of the activity
•period over which it is engaged in
•scale of operations and volume of transactions
•commitment (time, money and effort)
•pattern of activity
•financial results
•Similarity to ordinary behaviour in that line of activity

Hobby
Something you do in spare time for pleasure or recreation
Occasionally sell stuff to friends, at local markets or on sites like Trade Me and eBay

Business
Something commercial, where you aim to make profit
•Charge others for the goods/services provide. Supply goods/services on a regular basis
•Intend to make profit from providing goods
•Plan, organise and carry out your activities in a businesslike manner, eg keep receipts and records, or has a separate bank for business activities

Nature of Activities

	2019	2020	2021
Subject-matter	Limited supplies for limited request	Buy more supplies to fulfill more orders, not for private use	Large amount of supplies needed, much more than private use
Size of undertaking	Not even small scale business, only for friends. Very little commitment	Small scale business, higher commitment	Bigger scale business, higher volume of transaction
Extent of activity	Not habitual or regular repetition	Continuing activity, more regular	Continuing activity, habitually and systematically carried on
Business activity	✖	✓	✓

Intention of Taxpayer

	2019	2020	2021
Nature of the activity	hobby	Small scale business	Big scale business
Period over which it is engaged in	Short, occasional, as friends requested	Part time dress maker	Full time dress maker
Scale of operations and volume of transactions	Very small, in a small circle	Medium scale, enough for her to part time as librarian	Huge scale
Commitment (time, money and effort)	Little commitment, (still a full time librarian)	High commitment – advertisement, industrial sewing machine, engage with accountant	Very high commitment – set up website, employed an assistant
Pattern of activity	Occasional, not frequent	Regular, may be doing it almost daily	More regular and frequent, daily basis
Financial results	Immaterial profit, earn $3000 cost $2000	Higher profit, earn $40 000, cost $5000	Substantial profit, earn $80 000 cost $30 000
Intention to make profits	✖	✓	✓

>2019 NOT income from business, Nature of activities – hobby, No Intention to make profit
>2020 income from business, Nature of activities – small scale business, Has intention to make profit
>2021 income fro business, Nature of activities – bigger scale business, Has intention to make profit
> precedence Commissioner of Taxes v Miramar Land Company Ltd (1906) 26 NZLR 723 CA (subdivision but sold entire site)

Week 5

Lecture 1

Income from employment subpart CE

Employment income: subpart CE

Matter	Sections
Employment income	**CE 1 – CE 4**
Definitions	CE 5 – CE 7
Attributed income	CE 8
Restrictive covenants and exit inducements	CE 9 – CE 10
Income protection insurance	CE 11
Tax credits for personal service rehabilitation payments	CE 12

Amounts from employment are income: s CE 1

Key question: does an employment relationship exist (contract of service)?
If not, work is done under a contract for services, and sCE 1 does not apply
-distinction between employment (contract of service) and independent work done by a independent contractor (contract for services)

•Salary etc paid in terms of s CE 1 (contract of service) is subject to PAYE: ss RD 3, RD 5
>Employment is not a taxable activity under GST Act 1985 s 6. - when you work for employer you don't have to charge GST (contradictory of GST theory). For independent contractors they have to charge customer GST (issue present when GST funds are used for operation and contractor cannot meet tax obligation)

Categories of employee remuneration

Description	Section
Cash payments	CE 1
Value of employer-provided accommodation	CE 1B
BUT NOT	
Exempt reimbursing allowances	CW 16B et seq
Employer-provided fringe benefits	FBT

>accomodation value considered income
> reimbursements not considered income - settlement of debt

Main employee tax codes

•M (M SL) main job (with student loan)
•ME (ME SL) NZ tax resident; income $24,000 - $48,000; qualifies for independent earner tax credit
•CAE casual agricultural employees
•EDW election day workers
•NSW non-resident seasonal workers

Income tax rates

Taxable income	Tax rate
<$14,000	10.5%
$14,000 - $48,000	17.5%
$48,000 - $70,000	30%
$70,000-[$180,000]	33%
[$180,000+	39%]
No tax code provided	45% flat rate

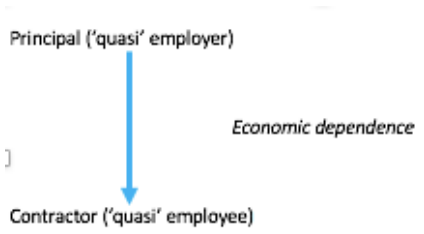
Secondary tax codes apply at flat rate on second sources of income

Tax code	Total income	Tax rate
SB	<$14,000	10.5%
S	$14,001-$48,000	17.5%
SH	$48,001-$70,000	30%
ST	$70,001-$180,000	33%
SA [from 1 April 2021]	$180,000 -	39%

Example

•Ana earns $80,000 from her only job as an employee of Alpha Ltd. Her annual PAYE is $17,320
•Bella earns $80,000 from two jobs, as an employee of Beta Ltd ($45,000) and as an employee of Gamma Ltd ($35,000) - taxed at flat rate. Her annual PAYE is $18,445
Bella can apply for a tailored tax code or IRD will automatically correct at end of tax year

Economic reality



> if we have independent contractor but work for one person, you're dependent - from IRD you should tax that person

Issue

•Employees have PAYE withholding – should quasi-employees have withholdings?
•Chas is salesperson for Wonder Glazing. He is not technically an employee but only provides services to Wonder Glazing

Solution: withholdings from 'schedular' payments (ITA 2007 sch 4)

•'Employers' must deduct 'withholding tax' from payments to certain contractors: s RD 8
•Rate depends on nature of activity Sch 4
•Exemptions are possible
•Tax at a flat rate of 20% is about the same as the graduated tax on $70,000
•A person earning above $85,150 would be subject to provisional tax

Labour-hire firm contractors

Labour-hire firm: an entity which has as one of its main activities the business of arranging for a person to perform work or services directly for clients of the entity

Alpha People Services is an employee recruitment firm. Alpha also find contractors to work for its clients

•Alpha is a labour-hire firm
•Alpha's contractors earn schedular income
•Alpha withholds tax at 20%(this could be too high or too low depending on nature of occupation - may face both provisional tax and tax withold)

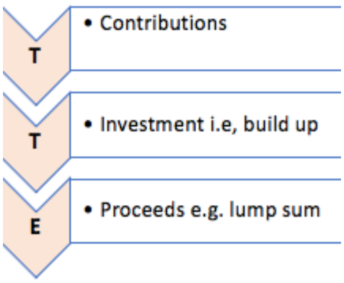
Issue

•If 'quasi employees' form companies, high earners could reduce average tax to 28%
•Diana is a communications specialist. She is offered work by the Ministry of Truth. Rather become an employee, she forms a Company that provides services to MoT only

Solution: personal service companies* 'taxed as individuals': ss GB 27-GB 29

•Applies to business income from personal services predominately to one customer
•Income cannot be trapped in company or trust but must be attributed to the person providing the services
•Can still deduct costs incurred in production of income – not subject to employment limitation
•An "associated entity" of a "working person"

Taxation of KiwiSaver



Member contributions

•Based on pre-tax pay
•Payment from post-tax income

Employer contributions

•Based on pre-tax pay
•Not taxable in the hands of the employee
•Employer superannuation contribution tax (ESCT) deducted from employer contributions
•ESCT rates: 10.5% – 33% (follow income tax rates and so 39% from 1 April 2021)

Investment income

Type of fund	Tax rate
Widely-held superannuation fund	28%
Portfolio investment entity (PIE)	Individual prescribed investment rate (PIR) 10.5% - 28%* (39% from 1 April 2021) *Based on last 2 years income

>28% too high for low income earners, for high income earners its too low

Proceeds
•Tax-free

Fringe Benefit Tax (FBT)
•Special tax on employers to "gross up" value of a benefit so value of benefit provided is effectively a post-tax amount
•Designed to make an employer indifferent between paying additional cash salary and supplying a fringe benefit
•Compare with Haig-Simons conception of income
•Employer-provided accommodation not a fringe benefit – specifically taxable as if a cash payment to employee

Main benefits subject to FBT: subpart CX

Type of benefit	Section
Motor vehicles	CX 6
Low-interest loans	CX10
Subsidised transport supplied by transport operators to employees	CX 9
Certain life insurance premiums paid by employers	CX 12, 13, 14, 15, 16
Other ("unclassified benefit") e.g. free and discounted goods and services	

FBT
•Any benefit subject to FBT is "excluded" from the assessable income of the employee: exempt under ss CX 3, 4 and 5
•But value of certain fringe benefits taken into account for determining WFF credits
•FBT usually paid quarterly with annual reconciliation return
•Separate from income tax
•But rates of FBT determined by reference to individual (personal) income tax rates - if higher paid FBT is higher
•FBT usually a deductible expense for employers for income tax purposes

Week 5
Lecture 2
Income from employment subpart CE etc

Employee v independent Contractor

	Employee	Independent contractor
For whose benefit business carried on?	Employer	Self
Minimum code applies?	YES	NO
Collective bargaining through trade union	YES	NO
Commerce Act applies?	NO	YES
Charge GST?	NO	YES (if supplies exceed $60K)
Deduct expenses?	NO s DA 2(4)	YES
PAYE deducted?	YES	NO (but WT may apply)

> employees set hours etc. independent contractor seperate entity
>minimum code: employee protection (e.g cannot fire without reasonable cause)

Bryson v Three Foot Six LTD 2004 NZSC 34

- Bryson model maker employed as contractor
- Overtime relationship changed; weta exercised more control
- Bryson dismissed without reason, Bryson claims he is employee
- court must determine the real nature of the relationship
- intention of the parties is relevant but not decisive
- Statements by the parties, including contractual statements, are not decisive
- How is the work actually done
- The real nature of the relationship can be ascertained by analysing the tests that have been historically applied
- Industry practice may also be relevant
- Bryson was found to be an employee

(decision led to 'hobbit law' ERA 2000 s5)

Employment test (factors to be considered)

-Fundamental, economic or business reality or multiple
-Intention; if always called employment then likely remains as employee, contract statement around GST, invoices
-Organisation or integration; how much access do you have to company - contractor distinction from employee
-Control v independence; control of independence (if you control other party (ability to reject) likely to be employee)

Amounts derived from employment

Description	Section
Cash payments etc	CE 1
Value of employer-provided accommodation	CE 1B
But **not** ...	

Exempt amounts

Description	Section
Exempt reimbursing allowances	CW 16B et seq
Employer contributions to employee superannuation schemes	CX 13
Employer-provided fringe benefits	FBT

Employment incomes: s CE 1

-Salary or wages etc
-Expenditure on account of an employee
-Value of accomodation (ss CE 1B-CE1E)
-Benefit received under a share purchase agreement
-Director's fees
-Compensation for loss of employment or service
-Any other benefits in money

Expenditure on account of an employee

•s CE (1)(b): charging provision; http://www.legislation.govt.nz/act/public/2007/0097/latest/DLM1512779.html?search=qs_act_income+tax_resel_25_h&p=1
•s CE (5): definition (and exclusions); http://www.legislation.govt.nz/act/public/2007/0097/latest/DLM1512790.html?search=qs_act_income+tax_resel_25_h&p=1
•s CW 17: general exemption; http://www.legislation.govt.nz/act/public/2007/0097/latest/DLM1513183.html?search=qs_act_income+tax_resel_25_h&p=1
•ss CW 16B et seq: specific exemptions; http://www.legislation.govt.nz/act/public/2007/0097/latest/DLM6439779.html?search=qs_act_income+tax_resel_25_h&p=1

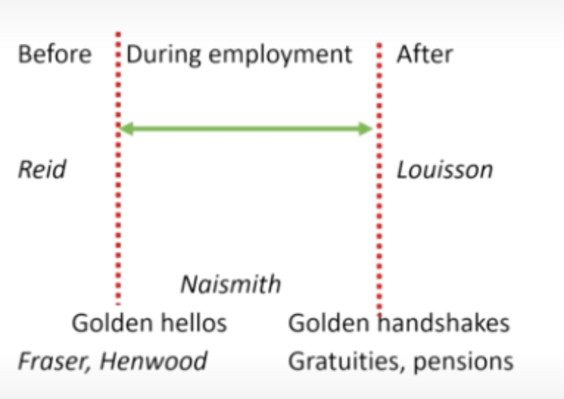
Example

Facts	Taxable?	Provision
Ana's employer pays her private electricity bill	Yes	ss CE 1(b); CE 5(1)
Bella's buys stationery for her employer who reimburses her	No	ss CE 5(3)(c)
Chas uses his home phone for work purposes – his employer reimburses him	No	ss CW 17(1)
Dodi's employer pays for his hotel when he is away from home on a work conference	No	s CW 16D(1)

Is a payment in respect of an employment relationship?

-A payment by an employer to an employee is usually taxable under s CE 1
-But not all payments.. [applying common law principles]

Payment to employees



Is a payment in respect of an employment relationship?

Louisson v CIR (1943)
•Employer offered to assist employees who resigned from their jobs to join the army
•Assistance topped-up army pay to level of previous salary
•CA: top up was not assessable
•On enlistment, L was no longer an employee
•Payment was in the nature of a gift, rather than salary

Naismith v CIR (1981)
•Northland Harbour Board employees volunteered to participate in salvage operation outside normal work hours [in Whangārei]
•Shared in the proceeds of the salvage
•HC: receipt sufficiently close to employment(regardless that it fell outside regular duties) to be income (could have been a windfall)

Reid v CIR (1986)
•R was a teacher trainee
•Wellington Education Board paid R "studentship" to study at University
•R required to complete course and work for WEB for 3 years afterwards
•CIR required PAYE deductions
•CA: income under ordinary concepts
•But not taxable under equivalent of s CE 1 (bursary) as employment income
•[ITA 1976 included an exemption for bursaries]

These undertakings are for future service and if and when performed that service is remunerated by the educational authority which employs the teacher. The giving of those undertakings and their currency during the period of teacher training cannot, in my view, convert the character of the relationship between student and education authority into one of employment or service
>no considered employment relationship as R was not qualified nor employed

Lump sums: general rule payments in conjunction with employment
Income includes a lump sum paid to an employee once an employment relationship starts: s CE 1(a)

Inducements to enter employment contracts
•Under common law principles, they could be capital
•Tax status not wholly clear under ITA
•IRD regards these as taxable under s CE 10
•Might be taxable under s CE 1(1)(g)

Consideration for restrictive covenants (payment to not use something)

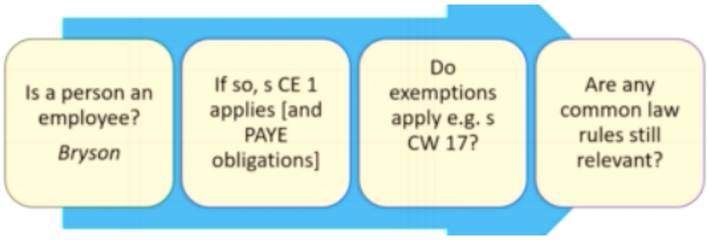
•Lump sums paid in compensation for restrictive covenants are capital under common law principles: Fraser, Henwood
•But explicitly taxable: s CE 9
•Also applies to independent contractors unless it relates to the sale of a business

Termination payments, compensation for loss of office
Explicitly taxable as payments for "loss of vocation"; "loss of position"; "leaving a position" or "loss of status": s CE 10

Awards from Employment Court etc
•S CE 10 also covers awards by the Employment Court for loss of earnings, unjustified dismissal
•CIR practice: awards for "humiliation, loss of dignity or injury to feelings" under ERA 2000, s 123 or the Human Rights Act 1993 are tax-free "capital" [non-income] receipts
>if for loss of income for period - (taxable)

Symmetry of tax treatment
•If recipients taxable under ss CE 9 or CE 10
•Payer can deduct cost: s DC 9

Employment overview



Tutorial 4
QUESTION ONE

Weka Workshop Limited is a New Zealand-based film company. Weka buys a large 3-D printer from Tanuki Corporation, a Japanese manufacturer.

Weka agrees to pay Tanuki NZD5 million. In exchange, Tanuki will provide the following:
(a) The components for the printer.
(b) Up to 20 hours of instruction by Zoom on how to assemble the printer.
(c) The right to use the software that runs the printer for 5 years.
(d) Up to 50 hours of remote training and support in relation to the software.

Required

Explain which of the elements of the contract are taxable as a royalty. (You should not consider international tax issues.)

•Royalties are the reward for allowing someone to use your property when that property is intellectual property (and also land)
•Intellectual property examples are copyrights, patents, trademarks
•Section CC9(2) list
•Can be hard to tell apart services taxed as business income by CB1 from a royalty taxed by CC1(1)

CC 9 Royalties
Income
(1) A royalty derived by a person is income of the person.
(2) Royalty includes a payment of any kind derived as consideration for—
•(a) the use of, or right to use, a copyright, patent, plant variety rights, trademark, design or model, plan, secret formula or process, or other similar property or right:
•(b) the use of, or right to use, a mine or quarry:
•(c) the extraction, removal, or other exploitation of standing timber or a natural resource:
•d) the right to extract, remove, or otherwise exploit standing timber or a natural resource:
•(e) the use of, or right to use, a film, a videotape, or a tape in connection with radio broadcasting:
•(f) the supply of scientific, technical, industrial, or commercial knowledge or information:
•(g) the total or partial forbearance of the use of, or the grant of a right to use, property or a right referred to in any of paragraphs (a) to (e):
•(h) the supply of assistance that enables the application or use of anything in any of paragraphs (a) to (f):
•(i) the total or partial forbearance of the supply of knowledge or information or assistance referred to in paragraph (f) or (h).

(A)The components for the printer.
• The property itself is not classified as royalties.

(B) Up to 20 hours of instruction by Zoom on how to assemble the printer.
•The assembly of the printer does not require an unpublished technical knowledge, information or experience.
•It is a technical fee.
Therefore, this is not subject to royalties.

(C) The right to use the software that runs the printer for 5 years.
•The use of, or right to use, a copyright, patent, plant variety rights, trademark, design or model, plan, secret formula or process, or other similar property or right: (refer to (a))
•This payment constitutes royalties.

(D) Up to 50 hours of remote training and support in relation to the software.
•The supply of assistance that enables the application or use of anything in any of paragraphs (a) to (f): (refer to (h))
This falls under the definition of royalties

QUESTION TWO

Bella Grey is an experienced project manager who works in the public sector. Bella is approached by Alpha People Solutions Ltd, a recruitment agency, on behalf of the Ministry of Media. The Ministry is looking for a person to manage a two-year project for an annual payment of $150,000. The work is full time. Bella is the successful applicant. She is offered the following options:
(a) A fixed term employment contract with the Ministry.
(b) A direct contract with the Ministry as an independent contractor.
(c) Providing services to the Ministry, through Alpha, under a labour-hire arrangement.
(d) Setting up a one-person company to provide the services to Ministry.

Option 1
If Bella were to take up a fixed term employment contract with the Ministry, she would be would become an employee of the Ministry.
An employee agreement would be established, between Bella and the Ministry and a contract would be formed as she is going to be providing a service to them.
With this in place, Bella would be subject to PAYE (pay as you earn). This means that Bella will have to declare her tax to the Ministry. Her employer will deduct the tax automatically from her pay.
Bella will not be subject to pay GST as under the GST Act 1985 s 6.
She will be taxed under the tax code M as this will be her primary income

Income tax rate	Income	Tax
Income up to $14,000.00, taxed at 10.5%	14,000.00	1,470.00
Income over $14,000.00 and up to $48,000.00, taxed at 17.5%	34,000.00	5,950.00
Income over $48,000.00 and up to $70,000.00, taxed at 30%	22,000.00	6,600.00
Remaining income over $70,000.00, taxed at 33%	80,000.00	26,400.00
	150,000.00	40,420.00

Option 2
If Bella has a direct contract, or contract for services, with the Ministry, she will perform her management for the project for the two years she is required.
She would be self employed and invoice her income to the Ministry for her services.
Bella is not subject to PAYE.
The Ministry would pay Bella schedular payments that would be subject to provisional tax after the following year that she is contracted with them. This is because Bella's residual income for this year would be over the threshold.

Option 3
Labour hire firm: an agency that arranges for an individual to conduct work or services directly for the entity's clients as one of its key activities.
Bella would be in a contract for services to Alpha.
Alpha provides their services for the Ministry.
From this, Bella would invoice Alpha for her services of the management of the project for the Ministry and then Alpha would ask the Ministry to pay them so they can pay Bella.
Bella would receive schedular payments for this and she would also pay withholding tax payments RD 8 and Schedule 4 Part J that would be subject to provisional tax as Bella earns more than $80,150 from her annual income.
She would also charge for GST in her invoices under the GST Act 1985.

Option 4
If Bella were to set up a one-person company to provide services to the Ministry, then Bella would be taxed at the end of the financial year at 28%.
The main issue with this however is that Bella would be taxed less than what she would be taxed at as an individual.
Under the Income Tax Act 2007 ss GB 27-29, personal service companies that only earn income for providing services from one party, that do so for more than 80% of the time, then she will be taxed at the individual rate rather than the company rate of 28%.

Conclusion
Option 1: An employee agreement/contract will be established between Bella and the Ministry. She will also be subject to pay tax through PAYE.

Option 2: Bella will have a contract for services with the Ministry for the two years. She will invoice the Ministry for her services for schedular payments as she doesn't do PAYE.
Option 3: Bella would be under an employee contract with Alpha to provide her services to and Alpha would provide the services for the Ministry. Alpha invoices the Ministry so they can pay Bella. GST would be charged for Bella's Services.
If Bella set up a one-person company, she would be taxed at the individual tax rate not the 28% if she spends more than 80% of her time working for the Ministry.

QUESTION THREE

KiwiSaver schemes are taxed on a T-T-E basis.

Required

Explain what T-T-E means here. Also comment on whether this arrangement is more or less likely to encourage people to join a KiwiSaver scheme than a E-T-T or T-E-T arrangement

Contributions: The individual, and/or their employers, make contributions to the Kiwi Saver scheme. In New Zealand, an employer must contribute at least 3% of their employees' gross earnings on top of their regular pay. The individual can choose what percentage of their income they would like to contribute.

Investments: Contributions are then invested by the individuals chosen Kiwi Saver scheme.

Payout: Individuals receive a payout from their Kiwi Saver funds when they become eligible to do so (retirement age, deposit for a first home or in cases of signficant hardship).

T-T-E
This arrangement refers to how each step in the saving scheme (contributions – investments – payout) is currently taxed by the government.
T = fully taxed | t = partially taxed | E = fully exempt from tax | e = partially exempt from tax

•Contributions (T) are fully taxed based on your pre-tax income; however, the payment comes out of your post-tax income. Employer superannuation contribution tax (ESCT) is deducted from employer contributions (not in the hands of the employee). The ESCT rates follow the income tax rates (10.5% - 33%, increasing the 39% from the 1st of April).
•Investment (T) build up/funds are also taxed. Most Kiwi Saver funds are what is known as widely held superannuation funds and these are taxed at a flat rate of 28%. The problem with this is that for low-income earners, this tax rate is too high and for high-income earners, it is too low. This results in individuals being either undertaxed or overtaxed which isn't equitable.
•Proceeds (E) are tax free in New Zealand which is unusual. In many countries around the world, their saving schemes make contributions exempt from tax to encourage people to join and contribute, however, New Zealand used behavioral economics, instead, registering everyone for Kiwi Saver and making people opt out if they wish to do so. Therefore, in New Zealand, the tax benefit is saved for the payout.

E-T-T
•This arrangement is common in overseas countries such as Australia.
•The idea behind this arrangement is that by allowing contributions to be exempt from tax, it will encourage people to join and contribute to the saving scheme. The investments and proceeds are then taxed.

•The further away the tax benefit is, the less likely it is to be an incentive in the scheme.
•This isn't a relevant arrangement for New Zealand as we encouraged people to save by using behavioral economics instead (saving the tax exemption for the proceeds).

T-E-T
•Placing exemption of tax within the scheme, as with this arrangement, is not common as it makes the benefit too 'cloudy' to see.
•Individuals wouldn't really see the benefit of the tax exemption on investments as it wouldn't directly affect their bank accounts.
•There must be tax visibility – there is no point in losing out on tax income, if the government isn't receiving the full benefit of encouraging the public to save.

Firstly, we can rule out the T-E-T arrangement as it doesn't carry the same benefits as the other two arrangements.
There are arguments for both the T-T-E & E-T-T arrangements. E-T-T may encourage people to join the Kiwi Saver scheme as the tax incentive encourages contribution (the benefit happens immediately) and this is why countries such as Australia have adopted this scheme. However, encouraging people to join isn't a big problem for New Zealand as we used a behavioral economics system. Therefore, I lean towards the T-T-E arrangement (what we have currently) as it enables the government to make tax revenue during the scheme but ultimately the payouts are made in full. There are certain improvements that could be implemented, such as reducing the tax on employer's contributions for lower paid employees and taxing investments on the individual's income tax rather than having a flat rate – in the interest of equality.

Week 6
Lecture 1
Schemes for making profit and personal property sales etc: ss CD 3, 4 and 5

Capital/revenue distinction
-Arthur and Betty bought their dairy farm in 1975 for $75,000 - the sale of milk are taxed as income
-In 2020, they sell the farm for $3m - the gain is capital and not taxable
-In 2000 they buy a disused milk processing plant and build up the business to make a profit on disposal
-They sell the business in 2020 - any gains may be taxable as income (ss CB 3, CB 4 and CB 6)

Sub-part CB income from business of trade like activities

Sub-part CB Income from business of trade like activities

Section	Basic provision	Capital/income distinction?
CB 1	Income from business	Yes
CB 2	Trading stock/business	Yes
CB 3	Profit-making undertaking or scheme	Yes but should it be?
CB 4	Personal property acquired for purpose of disposal	No
CB 5	Business of dealing in personal property	No

Intention, purpose and motive (not tested)
Action determined by:
-Intention; What do you have in mind to do e.g I have in mind to buy this car, then sell it
-Purpose; The reason why you do something e.g I'm buying this car so that I can sell it
-Motive; What drives me to do something e.g if I buy then sell this car, I can make a profit

Intention within an overall purpose - not intention
I may have an intention different from my overall purpose
E.g
-I have an overall purpose to buy a house
-the seller insist I buy the furniture too
-Because it is not to my taste, I intend to sell the furniture as soon as I get the house

Possible tax liability from sales of personal property
-Income under ordinary concepts s CA 1(2)
-Amount derived from business s CB 1
-Scheme for profit s CB 3, Personal property deals ss CB 4 and 5

S CB 3 Profit-making undertaking or scheme
An amount [in the nature of income] that a person derives
-from carrying on/out an undertaking/scheme
-entered into/devised for the [dominant] purpose of making a profit
Is income of the person
Not restricted to personal property

Scheme/undertaking and revenue profit

"A scheme denotes design and planning with a definite end in comtempation" jefferies J in railway Timber Co limited v CIR"

Even if a scheme/undertaking exists, profit sough must be of an income nature, not a capital gain.

Purpose

Income profit must be the dominant purpose of the undertaking or scheme

Mere realisation of a capital asset in the most advantageous way is not a profit making scheme or undertaking

CIR v Walker (1963)

W bought 63 acres of land next to his farm

W sold 3 acres with road frontage

CIR taxed profit

CA: dominant purpose to buy land next to farm

>Since 1976 special provisions apply to land sale

>Not income as not dominant purpose

Duff v CIR (1983)

P'ship bought land to subdivide for profit

Crown bough land

Was the profit taxable under [CB 3]?

There was a scheme, the purpose of profit was pursued, therefore profit taxable under [CB 3]

Eunson v CIR (1963)

E bought land to farm

Later found out part of land could be subdivided for housing

Subdivided and sold in 8 sales

Held [CB 3] no applicable - no scheme, just realisation to best advantage of a capital asset

(Capital even though 8 payments received)

Share in companies

Criterion	Ordinary shares	Preference shares
Can shareholder vote?	Yes	No
When is shareholder rewarded if profits made?	Last	Immediately after creditors
When is shareholder paid on liquidation	Last – if at all	Immediately after creditors

Plimmer v CIR (1958)

Example
Amy wins a Suzuki Swift in a competition with her local radio station. She can't drive, so she sells it
Ben buys a painting for his lounge in a junk shop. He finds out it's a lost Colin McCahon painting and sells it at auction for a large profit
After an earthquake, Carla's house is red stickered. The govt pays her a lump sum for the house and all its contents. She makes a gain on the chattels
Dave claims he always meant to keep the race horse but he bought it on short-term finance at a very high rate of interest
Eva bought Spark shares to provide herself with income when she retires. However, when she loses her job, she sells the shares

P bought ordinary and preference shares to gain control of Co

Ords and prefs came as a package

P always intended to sell prefs - made some profit

Dominant purpose to obtain control of Co - acquiring prefs necessary part of that

Beazley v CIR (1980)

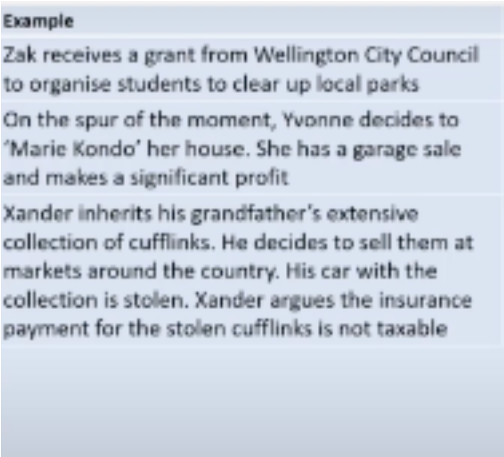
Syndicate of investors spent $10 million buying 32 commercial bills (tradable loan instruments) over 6 months

Held to be profit making scheme or undertaking - profits were clearly income in nature (i.e interest)

<u>Section CB 3</u>

Is an income amount received
Is an undertaking or scheme carried on
Was the dominant purpose profit

<u>Is s CB 3 likely to apply?</u>



Example
Zak receives a grant from Wellington City Council to organise students to clear up local parks
On the spur of the moment, Yvonne decides to 'Marie Kondo' her house. She has a garage sale and makes a significant profit
Xander inherits his grandfather's extensive collection of cufflinks. He decides to sell them at markets around the country. His car with the collection is stolen. Xander argues the insurance payment for the stolen cufflinks is not taxable

>No- no profit
>No- not dominant purpose
>No- converting capital into cash Yes - going to market to profit, scheme

<u>Property acquired for the purpose of sale or disposal - s CB 4</u>

An amount that a person derives from
    -disposing of personal property
Is income of the person
    -if they acquired the property for the [dominant] purpose of disposing of it

No distinction between capital and revenue items
Personal property only - but see s CB 6
No need for business scheme or dealing

<u>Section CB 4</u>

-acquisition is active i.e not gifts or inheritance
-must have the purpose of disposing at time of acquisition
-dominant purpose indicated by action
-short-term holding indicates sale purpose
-intervening events relevant

>is an amount received
>from disposing of personal property
>was the dominant purpose to dispose

<u>Is CB 4 likely to apply?</u>

>no/yes - why did she enter if she cant drive/dominant purpose of disposal isn't profit
>yes
>no - disposal wasn't for purpose of profit, not acquire for disposal in future
>no/yes - disposal wasn't for purpose of profit, not acquire for disposal in future, short-term holding indicates sale purpose
>yes - purpose of disposal was to profit, acquire for disposal in future

Week 6
Lecture 2
Schemes for making profit and personal property sales etc

Subpart CB - Income from business or trade-like activities
Business generally
CB 1 amounts derived from business
Cb 2 amount received on disposal of business assets that include trading stock

Scheme for profit
CB 3 Profit making undertaking or scheme

Personal property
CB 4 Personal property acquired for purpose of disposal
CB 5 Business of dealing in personal property

Section CB 5
An amount a person derives from
-disposing of personal property
Is income of the person
-if their business is to deal in property of that kind

Does CB 5 cover all sales?
-Zak is a dealer in antique furniture
-Zak sells his own antique dining room table to his brother
-Does CB 5 apply?
-Court says “No”
-But CB 5 stops dealer from selling stock on private account

Is the taxpayer dealing?
Is there a pattern of similar transaction involving the type of personal property (regularity)
Were the transaction undertaken with the objective of making a profit?
What was the taxpayer’s status of the time of the sale?
Is the property sold in the same state as it was bought (i.e not processed)

>dealing may fall short of a business
>plausible to deal without having a business

Why do people buy and sell shares?

Reason	Tax treatment	ITA reference
Buy to keep indefinitely	Dividends are income If sold, amount received is non-taxable capital	s CD 1 General principles
Buy and sell for profit as business	Shares are trading stock and so amount received is income	s CB 1
Profit-making scheme	Amount received is income	s CB 3
Once-off acquisition to dispose of	Amount received is income	s CB 4
Dealing in shares	Amount received is income	s CB 5
Regular buying and selling to maintain dividend income	Dividends are income If sold, amount received may be non-taxable capital or proceeds of dealing	s CD 1 General principles/s CB 5

Business of dealing in shares
YES
-Spends significant part of day share trading
-10k at risk
-10 transaction a month

NO
-No trading activity
-<10k invested in 2 or 3 Company shares

CIR v Stockwell (1993) cf Grieve
S part-time investing in shares owned for 2-8 months
[CB 4 applied] but not CB 5
CA (Hardie boys J) observed:
One would normally expect to find a considerable number of purchases and sales over an applicable period of time before he could be regarded as dealing in shares and a substantial capital investment before one would take the next step of regarding him being in the business of dealing in shares

Why do non-dealer sell shares from their portfolios? See King v CIR (2007)
Maintain
- -overall balance
- -exposure to certain sectors

Sell when
- -Brokers issue a caution
- -Management changes
- -Takeover
- -Market indicates shares overvalued

National Distributors Ltd v CIR (1989)
NDL a private company with extensive property portfolio
NDL sold supermarket, invested proceeds in listed shares and commercial properties
NDL undertook share transactions on haphazard basis
Shares sold when MD felt a share has “peaked” and dividend yield was low
Objective of investment to “make some capital for the family” and to protect capital against inflation
HC and CA: NDL was not caring on a business of dealing in shares and thus the sale is not taxable under (s CB 5)
But..
CA: shares bought for the dominant purpose of to resell - taxable under [s CB 4]
Taxpayer failed to prove another dominant purpose

Compare with King
No “coherent pattern in these various transaction such as to suggest that there was a systematic policy of sales and purchases of a kind that might be expected if those sales and purchases were part of a business.

“Share transaction were carried out in a somewhat haphazard manner that no more than rather intermittent attention was given to the need to avoid shareholdings falling out of line with inflationary result.”

<u>Section CB 5</u>
> Does the person receive an amount
>Is there a disposal of personal property?
> Does the recipient deal in this kind of property? But..

<u>Is CB 5 likely to apply?</u>

Example	YES/NO
Fatima has an online business selling collectible teapots. She spots a vintage dress at a flea market and sells it for a profit on her webpage [CB 4 may apply]	
Gerrit buys old motor bikes, renovates them, then sells them for a profit	
Hemi inherits an extensive stamp collection from his uncle. He sets up a website to sell the stamps individually. He discovers that collectors tend to buy pairs of stamps. He therefore starts buying other stamps to match the ones he has; and then sell the pairs at a profit.	

>No, doesn't deal in this type of property
>Yes, receives amount, disposes, deals in bikes
>Yes, receives amount, disposes, deals in stamps

<u>PIE exemption to ss CB 3, 4. And 5</u>
Portfolio investment entity (PIE)
Widely collective investment vehicle (CIV)
Hold passive investments e.g bond, shares and property e.g kiwisaver
Sales of shares in NZ resident (and some Australian Company shares)
Excluded income under s CX55
SS CB 3, 4, and 5 do not apply to sale of shares by PIEs

<u>Could we eliminate these complexities</u>
Haig Simons - no distinction between income and capital - both increments in economic wherewithal
Carter Commission (Canada) "a buck is a buck" e.g Irish capital accessions tax

History of ss CB 3, CB 4, and CB 5 (personal property element)

Act	Provision
Land and Income Tax Act 1923	Only applied to profits and gains from sale of 'fruits' of land
Land and Income Tax Amendment Act 1951	Applies to all profits and gains from disposal etc of all types of personal property
Taxation (Core Provisions) Act 1996	Applies to gross receipts from disposal etc of personal property
Income Tax Act 2007	Applies to gross receipts from disposal etc of personal property

<u>What is capital gains tax (CGT)?</u>
Tax on the sale of capital item
Many different versions of CGT
Tax working group key recommendation:
- -realised gains only
- -No indexation
- -Exclusion of principal residence
- -Exclusion of all personal assets (including artworks and collectable0
- -Taxed at marginal rate

Would a CGT be better than current rules?

Would solve some problems with the tax treatment of property sales (especially the uncertainty, inconsistency and inequities) but creates new ones.

Some CGT problems
Lock in effect - the higher the tax rates the greater this effect
Extra complexity with many transactions (more work for tax professional)
Unlikely to improve housing affordability but politically can be sold as trying to assist new home buyers
Once introduced likely to be extended and increased as evidence of avoidance emerges
Revenue volatility for the government