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# TAX INFORMATION

## *Bulletin*

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Inland Revenue
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# YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

| Ref | Draft type | Title | Comment deadline |
|---|---|---|---|
| ED0210 | Standard practice statement | Application of discretion in section 18D(2) of the Tax Administration Act 1994 – an exception to confidentiality | 16 August 2019 |
| PUB00344 | Public ruling | Income tax – application of the employee share scheme rules to employer issued crypto-assets provided to an employee | 6 August 2019 |

# IN SUMMARY

## New legislation



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## Interpretation statements



## Operational statements

# NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

## ORDER IN COUNCIL

### Use-of-money interest rates change

The use-of-money interest rates on underpayments and overpayments of taxes and duties have changed, in line with market interest rates. The new rates are:

- underpayment rate: 8.35% (previously 8.22%)
- overpayment rate: 0.81% (previously 1.02%)

The new rates come into force on 29 August 2019.

Rates are reviewed regularly to ensure they are in line with market interest rates. The new rates are consistent with the Reserve Bank floating first mortgage new customer housing rate and the 90-day bank bill rate.

The rates were changed by Order in Council on 1 July 2019.

*Taxation (Use of Money Interest Rates) Amendment Regulations 2019 (LI 2019/153)*

# BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**



## BR Pub 19/01: Income tax – salary and wages paid in crypto-assets

This is a public ruling made under s 91D of the Tax Administration Act 1994.

### Taxation law

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of s RD 3.

#### The Arrangement to which this Ruling applies

The Arrangement is the payment of remuneration to an employee in crypto-assets in circumstances where the crypto-asset payments:

- are for services performed by the employee under an employment agreement;
- are for a fixed amount; and
- form a regular part of the employee's remuneration.

This Ruling applies only to salary and wage earners, not self-employed taxpayers; and where the crypto-assets being paid:

- are not subject to a "lock-up" period;
- can be converted directly into a fiat currency (on an exchange); and either:
  - a significant purpose of the crypto-asset is to function like a currency; or
  - the value of the crypto-asset is pegged to one or more fiat currencies.

This Ruling does not apply where the crypto-asset provided is a "share" for income tax purposes and is received under an "employee share scheme" as defined in s CE 7.

#### How the taxation law applies to the Arrangement

The taxation law applies to the Arrangement as follows:

- The crypto-asset payments are "PAYE income payments" under s RD 3 and are subject to the PAYE rules.

#### The period or tax year for which this Ruling applies

This Ruling will apply for a period of three years beginning on 1 September 2019.

This Ruling is signed by me on 27 June 2019.

**Susan Price**
Director, Public Rulings

# Commentary on public ruling BR Pub 19/01

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 19/01 ("the Ruling").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

## Summary

1. This Ruling considers the income tax treatment of crypto-assets received by employees as part of their regular remuneration. The commentary discusses when crypto-assets will be treated as part of an employee's salary or wages and, therefore, be subject to PAYE. It also discusses the implications arising from crypto-asset payments being subject to PAYE (such as potentially affecting an employee's student loan repayments, Kiwisaver, and Working for Families entitlements). Payments of crypto-assets not subject to PAYE will be fringe benefits and subject to FBT.

## Background

2. The crypto-asset industry is still evolving and there is currently no standard terminology used. The Ruling uses the term "crypto-asset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
3. It is becoming more common for employees (particularly those working in crypto-asset-related industries) to receive remuneration in crypto-assets. The Commissioner has been asked to provide guidance on how remuneration paid in crypto-assets is taxed. This Ruling sets out the Commissioner's view on the situation where an employee is regularly paid part of their remuneration in crypto-assets.
4. The Commissioner's initial views on this issue were set out in issues paper IRRUIP 11: "Whether remuneration paid to an employee in cryptocurrency is subject to PAYE or FBT", which was released for consultation in June 2018. The submissions received have been taken into account in drafting this Ruling and also the related Ruling "BR PUB 19/02: Income Tax – Bonuses paid in crypto-assets".

## Application of the legislation

### *Introduction*

5. An agreement to pay an employee in crypto-assets could be structured in two ways. The first way is as an agreed deduction from the employee's gross salary or wages (where the employee's after-tax remuneration is, in effect, being traded for a payment of crypto-assets).[2] It is well-settled law that the employee is subject to PAYE on the full amount in this situation.
6. The second way is as a reduction in calculating the employee's gross salary or wages (also known as a salary sacrifice). The following analysis considers how the provision of crypto-assets will be treated when a salary sacrifice arrangement is valid, in particular, whether PAYE or FBT applies.

### *Whether crypto-assets received under a valid salary sacrifice are subject to PAYE or FBT*

7. The first step is to consider whether the payment is subject to PAYE. This is because, to the extent that an employment-related benefit is taxable to an employee, it will not be a fringe benefit (s CX 4). Therefore, if the provision of crypto-assets to an employee falls within the PAYE rules, PAYE will apply even if the FBT rules would also otherwise apply.
8. Section CE 1 sets out the "amounts" that are treated as employment income. Relevantly, these include "salary or wages":

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, bonus, extra pay, or gratuity:
>
> (b) expenditure on account of an employee that is expenditure on account of the person:
>
> (bb) the value of accommodation referred to in sections CE 1B to CE 1E:
>
> (c) [Repealed]
>
> (d) a benefit received under a share purchase agreement:

[1] These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

[2] The leading case on when a salary sacrifice will be valid is *Heaton v Bell* [1970] AC 728. See also *Watts v MNR* 61 DTC 592, *Co-operative Insurance Society Ltd v Commissioners of Customs and Excise* (1992) VATTR 44, and *Goodfellow v The Commissioners* (1986) VATTR 119.

(e) directors' fees:

(f) compensation for loss of employment or service:

(g) any other benefit in money.

[Emphasis added]

9. The situation being considered is an employee receiving part of their regular remuneration in crypto-assets. Therefore, the potentially relevant part of s CE 1 is "salary or wages".[3]

10. It could be argued that the reference in paragraph (g) of s CE 1 to "any other benefit in money" supports the view that the paragraphs that come before it were intended to be limited to benefits in money. However, the fact s CE 1(1) includes benefits that are not in money (for example, the value of employer-provided accommodation) could suggest that this is not the case.

11. Also, "amount" "includes an amount in money's worth" (s YA 1). Therefore, s CE 1 is drafted widely enough to include amounts derived that are "money's worth" (but not money). However, for crypto-assets (which are money's worth) to be included, they must also be "salary or wages".

### *Meaning of "salary" and "wages"*

12. "Salary or wages" is defined in s RD 5 for the purposes of the PAYE rules:

> **RD 5 Salary or wages**
>
> *Meaning*
>
> (1) Salary or wages—
>
> (a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and
>
> (b) includes—
>
> (i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and
>
> ....

13. Neither "salary" nor "wages" is further defined in the Act, so it is necessary to consider their ordinary meanings.

14. "Salary" is relevantly defined in the *Concise Oxford English Dictionary* (Oxford University Press, 12th ed, 2011) as:

> a fixed regular payment made usually on a monthly basis by an employer to an employee, especially a professional or white-collar worker.

15. "Wage" is similarly defined as:

> a fixed regular payment for work, typically paid on a daily or weekly basis.

16. *Deputy Commissioner of Taxation v Applied Design Development Pty Ltd* (in liq) 2002 ATC 4,193 considered the ordinary meaning of "salary" and "wage". Mansfield J defined the terms in the following way (at 4,195):

> Of particular importance in the present application is the absence of statutory definitions of the words "salary" or "wage". In the absence of statutory definitions, meaning should be given to those words according to the ordinary meaning conveyed by the text of the provision, and taking into account their context in the legislative scheme and the objects of the Act. The words "salary" and "wage" denote an amount of money payable, the consideration for which is the performance of work or services. That meaning is reflected in the definitions provided for the terms in the *Oxford English Dictionary*, 2nd ed:
>
> Salary: fixed payment made periodically to a person as compensation for regular work.
>
> Wage: a payment to a person for services rendered.
>
> I adopt those definitions in the determination of these proceedings.

17. The hallmarks of salary and wages were also discussed in a case on the meaning of "allowance". In *Stagg v IRC* [1959] NZLR 1252 the Supreme Court referred to the ordinary meaning of an allowance as "sums of money". The provision in question read:

> All salaries, wages or allowances (whether in cash or otherwise) including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind, in respect of or in relation to the employment of the taxpayer.

18. Hutchison ACJ held that the normal meaning of "allowances" was coloured by the words "salary" and "wages" and was to be read consistently with, or in light of, those words. His Honour considered that the characteristics of salaries that have bearing on the meaning of "allowances" were that they are:

- for an employment or service;
- payable under the contract of service and not as a gratuity (although this factor was affected by the later part of the paragraph that included some gratuities within "salaries, wages, or allowances");

- paid in money (although this factor was affected by the words "whether in cash or otherwise", which meant non-cash allowances could be paid if they were convertible); and
- paid periodically.

19. In summary, this suggests salary and wages are generally considered to be payments that are:
    - in return for work undertaken;
    - fixed, ie of a predetermined amount or rate (not, for example, a share of profits);
    - regular, ie recurring on a regular basis (usually weekly, fortnightly or monthly); and
    - in money.
20. Where an employee has agreed to receive part of their regular remuneration in the form of crypto-assets, most of these requirements would be met. The payments would be fixed, regular amounts received in return for work undertaken. Crypto-assets can also have many of the characteristics of money; for example, the types of crypto-assets covered by this Ruling are readily transferable mediums of exchange, divisible, fungible, durable and hard to counterfeit.
21. In the Commissioner's view, crypto-assets are property. Crypto-assets are not "money" as commonly understood (at least not at the present time). In particular, because crypto-assets are not issued by any government, they are not legal tender anywhere. Further, although acceptance of certain crypto-assets as payment for goods and services is increasing, they are not "generally accepted" as payment. Given the extreme volatility experienced to date, there are also issues around some crypto-assets' ability to be a store of value.

*Interpretation Act 1999*

22. Notwithstanding that crypto-assets are not "money" in the technical sense, it remains to be considered whether the terms "salary" and "wages" in s CE 1 are wide enough to include payments in crypto-assets. Clearly, at the time "salary" and "wages" were first referred to in the Income Tax Act, Parliament would not have contemplated payments of crypto-assets being within the scope of salary and wages as crypto-assets did not exist.
23. However, s 6 of the Interpretation Act 1999[4] provides for an ambulatory approach to statutory interpretation:

    > an enactment applies to circumstances as they arise.

24. This requires old legislation to be interpreted as applying to modern circumstances, that is, the:[5]
    - new developments to which the Act is to be applied are within the mischief that the Act was meant to cure; and
    - words of the Act, albeit by liberal interpretation, are capable of covering these new developments.
25. Or, put another way:[6]

    > The Court's task in deciding such cases is to remain faithful to the original Parliamentary intent, yet to produce a result that is workable in the different world of today.

26. This interpretive approach has been used where technological developments or changes in the way society views something have made old legislation outdated. For example, in *R v Walsh* [2007] 1 NZLR 738, the Court of Appeal applied s 6 of the Interpretation Act 1999 to interpret the meaning of "false document" taking into account the digital age.[7] In *R v Misic* [2001] 3 NZLR 1 the Court of Appeal held that a computer program and disk were documents for the purposes of s 229A of the Crimes Act 1961.
27. Originally, the concept of salary and wages would have been limited to payments in physical notes and coins. Later, payment may have been made by cheque. Now payment is likely to be made by direct credit to an employee's bank account. As such, the concept of salary and wages has shifted over time with different payment methods. Crypto-assets and the blockchain on which they are based have been around since 2009. Crypto-assets have become more widely used in recent times.
28. The question is whether the ordinary meanings of "salary" and "wages" are now wide enough to encompass payments in crypto-assets. Unlike the moves from physical notes and coins to cheques to direct credit (which are all payments of money), the shift to paying in crypto-assets is a more significant one. However, this does not prevent s 6 of the Interpretation Act applying. There is nothing in the Income Tax Act that limits the interpretation of salary and wages to monetary payments. Rather the ordinary meanings apply, and these can change over time. The Commissioner's view is that the meanings of "salary" and "wages" are capable of including payments in crypto-assets.

[4] Section 6 replaced s 5(d) of the Acts Interpretation Act 1924.

[5] J Burrows and J Fogerty (presenters) "Statutory Interpretation" (New Zealand Law Society seminar, 2011).

[6] Bigwood, R (ed) *The Statute Making and Meaning* (LexisNexis, 2004).

[7] The Supreme Court (*R v Walsh* [2007] 2 NZLR 109) later held that such an interpretation was not necessary.

*PAYE generally applies only to monetary benefits*

29. The alternative view is "salary" and "wages" should be interpreted narrowly and, consequently, PAYE will not apply. If a payment of crypto-assets was not subject to PAYE, it would be a fringe benefit and subject to FBT[8].

30. The primary argument for FBT applying is that the scheme of the Income Tax Act suggests that payments in money are subject to PAYE and non-monetary payments are subject to FBT (except where specifically provided for). The PAYE rules apply to "PAYE income payments", which for employees is defined as a payment of "salary or wages" or an "extra pay". "Salary or wages" is defined in s RD 5. Most of the items listed are payments that would generally be expected to be made in money. These include salary, wages, allowances, bonuses, commissions, gratuities, and various benefit, grant and compensation payments. However, employer-provided accommodation under s CE 1(1)(bb) is also expressly included.

31. Similarly, "extra pay" is defined in relation to payments that would generally be made in money. However, it also includes a benefit under certain share purchase agreements.

32. It can be seen from this that the Act broadly distinguishes between monetary and non-monetary payments to employees with the former being subject to PAYE and the latter to FBT. The reference in s CE 1(1)(g) to "any other benefit in money" is also consistent with this. However, this distinction is not absolute, with some non-monetary benefits being included in the PAYE rules. It is less clear whether non-monetary benefits that are not expressly included could also be subject to PAYE.

*Section RD 6*

33. Section RD 6 seems to contemplate other non-monetary benefits being subject to the PAYE rules. It provides timing and valuation rules for non-monetary benefits. Relevantly, it applies to:

> **RD 6 Certain benefits and payments**
>
> *When this section applies*
>
> (1) This section applies when an employee receives—
>
> (a) a benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment); or
>
> **(b) another benefit in kind that is included in their salary or wages; or**
>
> (c) 1 or more of the following payments:
>
> (i) a superannuation payment:
>
> (ii) a pension:
>
> (iii) a retiring or other allowance:
>
> (iv) an annuity; or
>
> (d) a benefit under section CE 2(2) and (4) (Value and timing of benefits under share purchase agreements) in relation to which the employer has made an election under section RD 7B.
>
> [Emphasis added]

34. As well as including the specific non-monetary benefits (employer-provided accommodation and benefits under share purchase schemes) s RD 6 also provides for other benefits in kind that are included in an employee's salary or wages. This suggests there may be other situations where non-monetary benefits are included in an employee's salary and wages for PAYE purposes. However, it is not clear when this will be the case.

35. The original predecessor to s RD 6 (s 9 of the Income Tax Assessment Act 1957) was introduced at the same time as the PAYE rules. The wording of the original subsection was:

> **9 Benefits and superannuation and other payments deemed to be salary and wages—**
>
> (1) Where in respect of his employment an employee receives a benefit referred to in section eighty-nine of the principal Act[9], **or any other benefit in kind which is included in his salary or wages**, or receives a payment by way of superannuation, pension, retiring allowance, or other allowance, or annuity which in included in salary or wages as defined in section two of this Act, the value of the benefit (whether in money or otherwise) or, as the case may be, the amount of the payment shall be deemed to accrue from day to day, and accordingly in each case the amount so accrued for any days in a pay period of the employee shall be deemed to be his salary or wages for the pay period, or, as the case may be, part of his salary or wages for the pay period.
>
> [Footnote and emphasis added]

"Salary or wages" was relevantly defined as meaning "salary, wages, or allowances (whether in cash or otherwise)". Consistent with the current legislation, the value of accommodation was also included in the definition. The wording has remained broadly similar through to the Income Tax Act 2007.

[8] A crypto-asset payment would satisfy the definition of "fringe benefit" in s CX 2 and not fall within any of the exemptions in subpart CX.

[9] Section 89 of the Land and Income Tax Act 1954 included in "assessable income" the value of any employer-provided board, lodging and house allowances.

36. There is limited contemporaneous material discussing what "other benefits in kind" s 9 of the Income Tax Assessment Act 1957 was intended to cover. During the second reading of the Income Tax Assessment Bill 1957, Hon. Mr Watts explained clause 9 of the Bill as follows (8 October 1958, 314 NZPD 2,894):

> Under clause 9 any benefits in kind, for example, the value of a free house, or free meat, or other benefits of that type, are to be taxed at the end of each pay period. If the employee is paid weekly he will also pay on the value of his benefits for the week. Where superannuation is paid and is treated as salary and wages it will be deemed to have accrued from day to day over the period for which it is paid.

37. Many of the taxable benefits that would have been subject to PAYE when s 9 of the Income Tax Assessment Act 1957 was enacted will now be subject to FBT. However, the fact s RD 6(1)(b) is included in the current legislation suggests some non-monetary benefits (other than those specifically mentioned in other paragraphs of s RD 6(1)) may come within the definition of "salary or wages".

### *Conclusion*

38. It is unclear on the face of the legislation whether an employee who regularly receives a part of their normal remuneration in crypto-assets is subject to PAYE or whether FBT applies. Both views are arguable.

39. Broadly, the scheme of the Act is that consideration in money is subject to PAYE, whereas non-monetary benefits are subject to FBT. Crypto-assets are not money in the technical sense (although they share some of the characteristics of money). This might suggest that payments in crypto-assets should be subject to FBT. However, the distinction between monetary and non-monetary payments is not hard and fast. Statutory exceptions make some non-monetary benefits (such as employer-provided accommodation) subject to PAYE. Further, the PAYE rules are drafted widely enough to potentially include some other non-monetary payments.

40. Ultimately, the issue turns on whether regular payments in crypto-assets come within the ordinary meaning of "salary or wages". The answer to this is not certain. While a regular payment received in crypto-assets has many of the hallmarks of salary and wages, historically salary and wages have been payments in money. However, s 6 of the Interpretation Act 1999 requires legislation to be interpreted as applying to modern circumstances. While not free from doubt, on balance, the Commissioner's view is that the concepts of "salary" and "wages" are wide enough to encompass some regular payments in crypto-assets. Consequently, these payments are "salary or wages" under s RD 5. Therefore, they are "PAYE income payments" under s RD 3 and the PAYE rules apply to them.

41. Because the payments are subject to PAYE, the FBT rules will not apply.

#### *Which crypto-assets are subject to PAYE?*

42. In the Commissioner's view, not all types of crypto-assets will be subject to PAYE. To be considered "salary or wages" the crypto-assets need to be sufficiently similar to existing notions of salary and wages. In the Commissioner's view, this will be the case where the crypto-assets have the following features:

- They are not subject to a "lock-up" period;
- They can be converted directly into a fiat currency (on an exchange); and either:
  - a significant purpose of the crypto-asset is to function like a currency; or
  - the value of the crypto-asset is pegged to one or more fiat currencies.

43. Each of these is discussed in more detail below. Taxpayers can contact Inland Revenue if they are having difficulty determining whether a particular crypto-asset satisfies these criteria.

44. For crypto-asset payments that are not subject to PAYE, the FBT rules will apply.

**Not subject to a "lock-up" period**

45. In the Commissioner's view, crypto-assets that cannot be converted or sold by the employee for a material period of time after payment does not sufficiently resemble a payment of salary or wages.

**The crypto-assets can be converted directly into a fiat currency**

46. Most mainstream crypto-assets can generally be traded on an exchange directly for fiat currency (for example, New Zealand dollars (NZD) or United States dollars). For other crypto-assets, this may not be available. Instead, the crypto-assets must first be converted into a more mainstream crypto-asset (such as bitcoin (BTC) or ether (ETH)) and then converted into fiat currency. In the current environment where crypto-assets are not readily accepted as payment for goods and services, the Commissioner's view is that crypto-assets that cannot be converted directly into fiat currency on an exchange (that meets the requirements set out in [57] and [59]) are not sufficiently "money-like" to be considered salary or wages.

**A significant purpose of the crypto-assets is to function like a currency**

47. The range and functions of crypto-assets have evolved in recent times. It is now possible to get crypto-assets that function in a similar way, for example, to vouchers, shares, or debt securities.

48. Some crypto-assets are designed to function as an alternative to fiat currency in the sense they provide a general-purpose peer-to-peer payment system. Examples are bitcoin, bitcoin Cash (BCH), bitcoin Gold (BTG), and Litecoin (LTC). Some crypto-assets are designed with other functions in addition to use as a currency, but the currency purpose is still a significant one. Ether is a common example of this. The Commissioner's view is that payment in these types of crypto-assets (where conversion directly into a fiat currency on an exchange is possible) is sufficiently "money-like" to come within the ordinary meaning of salary or wages.

49. These can be contrasted with crypto-assets that are designed primarily for other purposes (for example, filecoin (FIL), Dentacoin (DCN), and CRYPTO20 (C20)). Common examples are:

    - rights to access, operate, use or control a platform or other property/services (often referred to as "utility tokens");
    - providing rights to underlying tradable assets such as precious metals or real estate (often referred to "asset tokens"); and
    - providing ownership or control of a financial asset (often referred to as "securities tokens").

50. These crypto-assets can also usually be traded peer-to-peer or on an exchange. Therefore, in a sense, they can function in a similar way to currency. However, this can be seen as the equivalent of trading in gold, shares, or gift cards for example. That is, although they share some of the features of currency, they are not intended to operate as such.

**The value of the crypto-assets is pegged to one or more fiat currencies**

51. This refers to so-called "stablecoins" that have their value pegged to one or more fiat currencies. Common examples are USD Tether (USDT) and Paxos Standard (PAX). Regardless of whether these crypto-assets are designed to function like currencies (in the sense discussed above at [47]–[50]) the Commissioner's view is that payment in a stablecoin (where conversion directly into a fiat currency on an exchange is possible) is sufficiently "money-like" to come within the ordinary meaning of salary or wages.

### *Implications of conclusion*

*PAYE is calculated on the gross basis*

52. Where payment is provided in crypto-assets, the employer must gross up the net amount of the crypto-assets provided to the employee when calculating PAYE.

53. Where the employee's employment contract sets out the gross amount (ie amount before tax is deducted) payable in NZD, this will not be an issue. Assume, for example, an employment contract provides for an employee to be paid $100 (gross) of crypto-assets per week. If the employee is on a 33% tax rate, $67 worth of crypto-assets would be payable to the employee and $33 (NZD) must be paid to Inland Revenue as PAYE.

54. However, where an employment agreement provides for an employee to receive either a net amount of crypto-assets calculated in NZD, or an amount denominated in crypto-assets, then the amount provided to the employee will need to be grossed up when calculating the PAYE payable. This works in the same way as the provision of employer-provided accommodation, where the value of the accommodation is grossed up before PAYE is calculated and paid.

*Converting crypto-asset payments to NZD*

55. Generally, arrangements of this type will provide for an employee to be paid an amount of crypto-assets denominated in NZD. In this case, there will be no need to convert the crypto-assets into NZD to calculate the PAYE payable.

56. However, where a crypto-asset payment is not denominated in NZD (for example, if an employee is paid 0.001 bitcoin per fortnight), it is necessary to calculate the NZD value of the crypto-assets on the date it is paid to the employee.

57. Conversion rates may be obtained from any centralised data repository site that may be listed from time-to-time on the Inland Revenue website.

58. Alternatively, conversion rates may be obtained from a public exchange that has comprehensive know-your-customer/anti-money-laundering procedures in place. Which exchange (or exchanges) is appropriate will depend on the circumstances. Using a New Zealand-based exchange listed on the Financial Service Providers Register will be appropriate.

59. If the appropriate valuation cannot be obtained from a New Zealand-based exchange, an overseas-based exchange can be used. For some "alt coins" (crypto-assets other than bitcoin) it may be necessary to convert into US dollars, or another fiat currency, and then convert into NZD.

60. Rates can vary significantly between different exchanges and currencies. Therefore, taxpayers should use a consistent exchange and conversion approach (for example, using a consistent time of day to determine the conversion rates).

*Other implications*

61. There are various circumstances where obligations, eligibility, or entitlements may be calculated based on an employee's salary or wages (for example Kiwisaver, Working for Families Tax Credits, and student loan repayments). The crypto-asset payments must be taken into account when calculating these.

### Example

62. The following example is included to help explain the application of the law.

**Example: Employee paid part of salary in bitcoin**

63. Ken is employed by Cryptowonderland Ltd. His salary is NZ$10,000 per month before tax. Half Ken's salary is payable in NZD direct credited to his bank account. The other half is payable in bitcoin transferred to Ken's bitcoin wallet.

64. PAYE should be calculated on the $10,000 gross payment and withheld and paid to the Commissioner (in New Zealand dollars). The net amount is payable to Ken.

65. If Ken is a Kiwisaver member or is subject to, for example, child support or student loan deductions, the *Employer's Guide (IR335)* and the PAYE calculator (both available on the Inland Revenue website **www.ird.govt.nz**) can be used to assist with calculating these.

## References

**Related rulings**

"BR PUB 19/02 Income tax – bonuses paid in crypto-assets"

**Subject references**

Bitcoin, crypto-asset, cryptocurrency, FBT, PAYE, salary, wages

**Legislative references**

Income Tax Act 2007 – ss CE 1, CE 7, CX 2, CX 4, RD 3, RD 5, RD 6, YA 1 definitions of "amount" and "salary or wages"

Interpretation Act 1999 – s 6

**Case references**

*Co-operative Insurance Society Ltd v Commissioners of Customs and Excise* (1992) VATTR 44

*Deputy Commissioner of Taxation v Applied Design Development Pty Ltd (in liq)* 2002 ATC 4,193

*Goodfellow v The Commissioners* (1986) VATTR 119

*Heaton v Bell* [1970] AC 728

*R v Walsh* [2007] 1 NZLR 738

*R v Walsh* [2007] 2 NZLR 109

*Stagg v IRC* [1959] NZLR 1252

*Watts v MNR* 61 DTC 592

**Other references**

J Burrows and J Fogerty (presenters) "Statutory Interpretation" (New Zealand Law Society seminar, 2011).

Bigwood, R (ed) *The Statute Making and Meaning* (LexisNexis, 2004).

*Concise Oxford English Dictionary* (Oxford University Press, 12th ed, 2011)

## Appendix – Legislation

### *Income Tax Act 2007*

1. Section CE 1(1) provides:

**CE 1 Amounts derived in connection with employment**

*Income*

(1) The following amounts derived by a person in connection with their employment or service are income of the person:

(a) salary or wages or an allowance, bonus, extra pay, or gratuity:

(b) expenditure on account of an employee that is expenditure on account of the person:

(bb) the value of accommodation referred to in sections CE 1B to CE 1E:

(c) [Repealed]

(d) a benefit received under a share purchase agreement:

(e) directors' fees:

(f) compensation for loss of employment or service:

(g) any other benefit in money.

2. Section CE 7 provides:

**CE 7 Meaning of employee share scheme**

*Employee share scheme means—*

(a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—

(i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:

(iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but

(b) does not include an arrangement that—

(i) is an exempt ESS:

(ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:

(iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

3. Section CX 2 provides:

**CX 2 Meaning of fringe benefit**

*Meaning*

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

*Arrangement to provide benefit*

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

*Past, present, or future employment*

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

*Relationship with subpart RD*

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

*Arrangements*

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

4. Section CX 4 provides:

**CX 4 Relationship with assessable income**

To the extent to which a benefit that an employer provides to an employee in connection with their employment is assessable income, the benefit is not a fringe benefit.

5. Section RD 3(1) provides:

**RD 3 PAYE income payments**

*Meaning generally*

(1) The PAYE rules apply to a PAYE income payment which—

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:

(iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.

6. Section RD 5(1), (2), (8) and (9) provide:

**RD 5 Salary or wages**

*Meaning*

(1) Salary or wages—

(a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and

(b) includes—

(i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

(ii) a payment described in subsections (2) to (8); and

(iii) an accident compensation earnings-related payment; and

(iiib) a payment of earnings compensation under the Compensation for Live Organ Donors Act 2016; and

(iv) Repealed.

(c) does not include—

(i) an amount of exempt income:

(ii) an extra pay:

(iii) a schedular payment:

(iv) an amount of income described in section RD 3(3) and (4):

(v) an employer's superannuation contribution other than a contribution referred to in subsection (9):

(vi) a payment excluded by regulations made under this Act.

(d) Repealed.

*Employees' expenditure on account*

(2) A payment of expenditure on account of an employee is included in their salary or wages.

...

*Accommodation benefits*

(8) A benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment) is included in salary or wages.

*Cash contributions*

(9) An amount of an employer's superannuation cash contribution that an employee chooses to have treated as salary or wages under section RD 68 is included in salary or wages.

7. Section RD 6(1) provides:

**RD 6 Certain benefits and payments**

*When this section applies*

(1) This section applies when an employee receives—

(a) a benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment); or

(b) another benefit in kind that is included in their salary or wages; or

(c) 1 or more of the following payments:

(i) a superannuation payment:

(ii) a pension:

(iii) a retiring or other allowance:

(iv) an annuity; or

(d) a benefit under section CE 2(2) and (4) (Value and timing of benefits under share purchase agreements) in relation to which the employer has made an election under section RD 7B.

8. Section YA 1 defines "amount" and "salary or wages" as follows:

**amount—**

(a) includes an amount in money's worth:

...

**salary or wages—**

(a) means salary, wages, or allowances relating to the employment of a person, including all sums received or receivable by way of bonus, commission, extra salary, gratuity, overtime pay, or other remuneration of any kind; and

(b) includes—

(i) the market value of the benefits that a person receives in a tax year, because of their office or position, by way of the provision of board or lodging or the use of a house or quarters, or the payment of an allowance instead of being provided with board or lodgings or the use of a house or quarters, with the market value determined by the Commissioner if there is a dispute; and

(ii) payments that are expenditure on account of an employee; and

(iii) payments under section DC 4 (Payments to working partners); and

(iv) specified superannuation contributions for which an employee makes an election under section NE 2A (Employee election that specified superannuation contributions be treated as salary or wages); and

(v) periodic payments by way of pension, retiring allowance, superannuation, or other allowance or annuity relating to the past employment of a person or of another person of whom the person is or has been the wife, husband, civil union partner, de facto partner or child or dependant; and

(vi) payments of salary or allowances made to a member of Parliament under a determination of the Remuneration Authority; and

(vii) payments of salary and principal allowances made to a judicial officer under a determination of the Remuneration Authority; and

(viii) payments that are income under section CF 1 (Benefits, pensions, compensation, and government grants); and

(ix) payments of income-tested benefits, veterans' pensions, New Zealand superannuation, and living alone payments; and

(x) parental leave payments paid under Part 7A of the Parental Leave and Employment Protection Act 1987; and

(xi) basic grants and independent circumstances grants, made under regulations made under section 193 of the Education Act 1964, section 303 of the Education Act 1989, or an enactment substituted for those sections; and

(xii) under the Accident Compensation Act 1982, payments of earnings related compensation, as defined in section 2, and of compensation under section 80(4), that are not payments on account made under section 88 in circumstances in which, at the time the payments on account are made, the nature of the compensation on account of which they are made has not been determined; and

(xiii) under the Accident Rehabilitation and Compensation Insurance Act 1992, a vocational rehabilitation allowance payable under section 25, payments of compensation for loss of earnings payable under any of sections 38, 39, and 43, compensation for loss of potential earning capacity payable under section 45 or 46, weekly compensation payable under any of sections 58, 59, and 60, and continued compensation payable under section 138; and

(xiv) under the Accident Insurance Act 1998, payments made under it by an insurer, as defined in the Act, of weekly compensation, as defined in the Act; and

(xv) under the Accident Insurance Act 1998, any other payments of compensation for loss of earnings or loss of potential earning capacity in so far as they relate to a work-related personal injury, as defined in the Act, made by an insurer under a policy of personal accident or sickness insurance to which section 188(1)(a) (as it read immediately before its repeal by section 7 of the Accident Insurance Amendment Act 2000) applies; and

(xvi) under the Injury Prevention, Rehabilitation, and Compensation Act 2001, payments made under it by the Corporation, as defined in the Act, of weekly compensation, as defined in the Act; and

(c) does not include—

(i) payments of exempt income, or extra pays, or withholding payments; or

(ii) salary, wages, or other income to which section OB 2(2) (Meaning of source deduction payment: shareholder-employees of close companies) applies; or

(iii) employer's superannuation contributions; or

(iv) payments that are declared by regulations under this Act not to be salary or wages

(d) for the purposes of sections NE 3 and NE 3B (which relate to SSCWT) means salary or wages, as defined in section 4 of the KiwiSaver Act 2006.

### *Interpretation Act 1999*

9. Section 6 provides:

an enactment applies to circumstances as they arise.

# BR Pub 19/02: Income tax – bonuses paid in crypto-assets

This is a public ruling made under s 91D of the Tax Administration Act 1994.

## Taxation law

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of s RD 3.

## The arrangement to which this Ruling applies

The arrangement is the payment of an amount of crypto-assets to an employee in connection with their employment as an incentive or bonus.

This Ruling applies only to salary and wage earners, not self-employed taxpayers; and where the crypto-assets being paid:

- can be converted directly into a fiat currency (on an exchange); and either:
  - a significant purpose of the crypto-assets is to function like a currency; or
  - the value of the crypto-assets is pegged to one or more fiat currencies.

This Ruling does not apply where the crypto-asset provided is a "share" for income tax purposes that is received under an "employee share scheme" as defined in s CE 7.

## How the taxation law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The crypto-asset payment is a "PAYE income payment" under s RD 3 and is subject to the PAYE rules.

## The period or tax year for which this Ruling applies

This Ruling will apply for a period of three years beginning on 1 September 2019.

This Ruling is signed by me 27 June 2019.

**Susan Price**
Director, Public Rulings

# Commentary on public ruling BR Pub 19/02

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 19/02 ("the Ruling").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

## Summary

1. This Ruling considers the income tax treatment of crypto-assets received by employees as a bonus. The commentary discusses when crypto-assets will be subject to PAYE. It also discusses the implications arising from crypto-asset payments being subject to PAYE (such as potentially affecting an employee's student loan repayments, Kiwisaver, and Working for Families entitlements). Payments of crypto-assets not subject to PAYE will be fringe benefits and subject to FBT.

## Background

2. The crypto-asset industry is still evolving and there is currently no standard terminology used. The Ruling uses the term "crypto-asset" to cover digital assets that use cryptography and blockchain technology to regulate their generation and verify transfers.[1]
3. It is becoming more common for employees (particularly those working in crypto-asset-related industries) to receive remuneration in crypto-assets. The Commissioner has been asked to provide guidance on how remuneration paid in crypto-assets is taxed. This Ruling sets out the Commissioner's view on the situation where an employee receives a bonus paid in crypto-assets.

## Application of the legislation

### *Whether crypto-assets received as a bonus are subject to PAYE or FBT*

4. The first step is to consider whether the payment is subject to PAYE. This is because, to the extent that an employment-related benefit is taxable to an employee, it will not be a fringe benefit (s CX 4). Therefore, if the provision of crypto-assets to an employee falls within the PAYE rules, PAYE will apply even if the FBT rules would also otherwise apply.
5. Section CE 1 sets out the "amounts" that are treated as employment income. Relevantly, these include bonuses:

> **CE 1 Amounts derived in connection with employment**
>
> *Income*
>
> (1) The following amounts derived by a person in connection with their employment or service are income of the person:
>
> (a) salary or wages or an allowance, **bonus**, extra pay, or gratuity:
>
> (b) expenditure on account of an employee that is expenditure on account of the person:
>
> (bb) the value of accommodation referred to in sections CE 1B to CE 1E:
>
> (c) *[Repealed]*
>
> (d) a benefit received under a share purchase agreement:
>
> (e) directors' fees:
>
> (f) compensation for loss of employment or service:
>
> (g) any other benefit in money.
>
> [Emphasis added]

6. "Amount" "includes an amount in money's worth" (s YA 1). Therefore, s CE 1 is drafted widely enough to include amounts derived that are "money's worth" (but not money).

### *Meaning of "bonus"*

7. "Bonus" is not defined in the Act. Therefore, it is necessary to consider its ordinary meaning.
8. The Court of Appeal considered the meaning of "bonus" in CIR v Smythe [1981] 1 NZLR 673. Richardson J stated at 676:

> A bonus may be a gratuity or it may be something which an employee is entitled to on the happening of a condition precedent and which is enforceable when the condition is fulfilled (*Sutton v Attorney-General* (1923) 39 LTR 294,297; *Great Western Garment Co v Minister of National Revenue* [1974] Ex CR 458, 467; [1948] 1 DLR 225, 233). In either case it is an addition to regular salary or wages. It is a payment above the normal and it is often, but not always, paid for extraordinary work or service. Its special character is that it is an additional amount, not part of the regular permanent remuneration.

[1] These are sometimes referred to by other terms including "cryptocurrencies" and "tokens".

9. McMullin J stated at 678:

> One of the meanings given in the *Oxford English Dictionary* to the word bonus is: "Money or its equivalent, given as a premium, or as an extra or irregular remuneration, in consideration of offices performed, or to encourage their performance". Often enough a bonus will take the form of something for which no entitlement exists. In that sense it will be a favour, a bounty, largess, something over and above what the donee is entitled to expect. And it may be in some cases quite unexpected and a windfall. But I do not think that the word "bonus" is limited to those payments only for which no entitlement can be established. Indeed, it is not infrequently the case in present conditions of employment that a payment is made to an employee by way of a bonus even though it is directly related to his industry and productivity.

10. It can be seen from this that a bonus is a payment to an employee over and above their regular salary or wages. It is generally paid for good performance. A bonus can be something to which an employee is contractually entitled (if certain conditions are met) or a purely voluntary payment.

11. It also appears that bonuses are not necessarily limited to payments in money. McMullin J in *Smythe* suggested that a bonus could be "money or its equivalent". That suggests that "bonus" may be wide enough to include non-monetary amounts that have the same, or a similar, function or effect as money.

12. It is useful, at this point, to consider whether there is anything in the scheme of the Act that suggests that non-monetary payments should not be treated as employment income.

*Scheme of the Act*

13. As noted above, the Act first requires determining whether the PAYE rules apply. FBT applies only where a payment is not assessable income (s CX 4).

14. There is no express provision in the PAYE or FBT rules that distinguishes between monetary and non-monetary payments. Nevertheless, payments in money are generally subject to PAYE and non-monetary payments are generally subject to FBT. This is because of the types of payments the PAYE rules apply to. The PAYE rules apply to "PAYE income payments", which for employees is defined as a payment of "salary or wages" or an "extra pay". "Salary or wages" is defined in s RD 5. Most of the items listed are payments that would generally be expected to be made in money. These include salary, wages, allowances, bonuses, commissions, gratuities, and various benefit, grant and compensation payments. However, employer-provided accommodation under s CE 1(1)(bb) is also expressly included.

15. Similarly, "extra pay" is defined in relation to payments that would generally be made in money. However, it also includes a benefit under certain share purchase agreements.

16. It can be seen from this that the Act broadly distinguishes between monetary and non-monetary payments to employees with the former being subject to PAYE and the latter to FBT. The reference in s CE 1(1)(g) to "any other benefit in money" is also consistent with this. However, this distinction is not absolute. Some non-monetary benefits are expressly included in the PAYE rules. Also, non-monetary payments are not expressly excluded from items that make up "salary or wages" (which includes bonuses).

*Are crypto-assets money or its equivalent?*

17. In the Commissioner's view, crypto-assets are property. Crypto-assets are not "money" as commonly understood (at least not at the present time). In particular, because crypto-assets are not issued by any government, it is not legal tender anywhere. Further, although acceptance of certain crypto-assets as payment for goods and services is increasing, they are not "generally accepted" as payment. Given the extreme volatility experienced to date, there are also issues around some crypto-assets' ability to be a store of value.

18. However, some crypto-assets have many of the characteristics of money; for example, being readily transferable mediums of exchange, divisible, fungible, durable and hard to counterfeit. As such, some types of crypto-assets with these features could have a similar function or effect as money and, therefore, be a "bonus".

19. In the Commissioner's view, this will be the case where the crypto-assets can be converted directly into a fiat currency (on an exchange) and either:

- a significant purpose of the crypto-asset is to function like a currency; or
- the value of the crypto-asset is pegged to one or more fiat currencies.

20. Each of these is discussed in more detail below. Taxpayers can contact Inland Revenue if they are having difficulty determining whether a particular crypto-asset satisfies these criteria.

21. It could be argued that a wider range of crypto-assets are equivalent to money and, therefore, within the meaning of "bonus". However, the Commissioner's view is that the scheme of the Act suggests that a relatively narrow interpretation should be taken when considering whether non-monetary benefits come within s CE 1.

**The crypto-assets can be converted directly into a fiat currency**

22. Most mainstream crypto-assets can generally be traded on an exchange directly for fiat currency (for example, New Zealand dollars (NZD) or United States dollars). For other crypto-assets, this may not be available. Instead, the crypto-assets must first be converted into a more mainstream crypto-asset (such as bitcoin (BTC) or ether (ETH)) and then converted into fiat currency. In the current environment where crypto-assets are not readily accepted as payment for goods and services, the Commissioner's view is that crypto-assets that cannot be converted directly into fiat currency on an exchange (that meets the requirements set out in [56] and [57]) are not sufficiently equivalent to money to be considered a bonus for PAYE purposes.

**A significant purpose of the crypto-asset is to function like a currency**

23. The range and functions of crypto-assets have evolved in recent times. It is now possible to get crypto-assets that function in a similar way, for example, to vouchers, shares, or debt securities.

24. Some crypto-assets are designed to function similarly to fiat currency in the sense they provide a broad peer-to-peer payment system. Examples are bitcoin and Litecoin (LTC). Some crypto-assets are designed with other functions in addition to use as a currency, but the currency's purpose is still a significant one. Ether is a common example of this. The Commissioner's view is that payment in these types of crypto-asset (where conversion directly into a fiat currency on an exchange is possible) is sufficiently "money-like" to be a bonus.

25. These can be contrasted with crypto-assets that are designed primarily for other purposes (for example, filecoin (FIL), Dentacoin (DCN), and CRYPTO20 (C20)). Common examples are:

    - rights to access, operate, use or control a platform or other property/services (often referred to as "utility tokens");
    - providing rights to underlying tradable assets such as precious metals or real estate (often referred to "asset tokens"); and
    - providing ownership or control of a financial asset (often referred to as "securities tokens").

26. These crypto-assets can also usually be traded peer-to-peer or on an exchange. Therefore, in a sense, they can function in a similar way to currency. However, this can be seen as the equivalent of trading in gold, shares, or gift cards for example. That is, although they share some of the features of currency, they are not intended to operate as such.

**The value of the crypto-assets is pegged to one or more fiat currencies**

27. This refers to so-called "stablecoins" that have their value pegged to one or more fiat currencies. Common examples are USD Tether (USDT) and Paxos Standard (PAX). Regardless of whether these crypto-assets are designed to function like currencies (in the sense discussed above at [21]–[24]) the Commissioner's view is that payment in a stablecoin (where conversion directly into a fiat currency on an exchange is possible) is sufficiently equivalent to money to come within the ordinary meaning of bonus.

### *Conclusion*

28. An amount of crypto-assets paid to an employee in connection with their employment as an incentive or bonus will be a "bonus" under s CE 1 where the crypto-assets being paid:

    - can be converted directly into a fiat currency; and either:
        - a significant purpose of the crypto-asset is to function like a currency; or
        - the value of the crypto-asset is pegged to one or more fiat currencies.

29. A "bonus" comes within the meaning of "salary or wages" for the purposes of s RD 5. Therefore, it is a "PAYE income payment" under s RD 3 and the PAYE rules apply to it.

30. Other types of crypto-assets paid to an employee as an incentive or bonus will be fringe benefits and subject to FBT[2].

### *Implications of conclusion*

*PAYE is calculated on the gross basis*

31. Where payment is provided in crypto-assets, the employer must gross up the net amount of the crypto-assets provided to the employee when calculating PAYE.

32. Where the employee's employment contract sets out the gross amount (ie amount before tax is deducted) payable in NZD, this will not be an issue. Assume, for example, an employment contract provides for an employee to be paid a bonus of $100 (gross) in crypto-assets. If the employee is on a 33% tax rate, $67 worth of crypto-assets would be payable to the employee and $33 (NZD) must be paid to Inland Revenue as PAYE.

[2] A crypto-asset payment would satisfy the definition of "fringe benefit" in s CX 2 and not fall within any of the exemptions in subpart CX.

33. However, where an employment agreement provides for an employee to receive either a net amount of crypto-assets calculated in NZD, or an amount denominated in crypto-assets, then the amount provided to the employee will need to be grossed up when calculating the PAYE payable. This works in the same way as the provision of employer-provided accommodation, where the value of the accommodation is grossed up before PAYE is calculated and paid.

*Converting crypto-asset payments to NZD*

34. Generally, arrangements of this type will provide for an employee to be paid an amount of crypto-assets denominated in NZD. In this case, there will be no need to convert the crypto-assets into NZD to calculate the PAYE payable.

35. However, where a crypto-asset payment is not denominated in NZD (for example, if an employee is paid a bonus of 0.001 bitcoin), it is necessary to calculate the NZD value of the crypto-assets on the date it is paid to the employee.

36. Conversion rates may be obtained from any centralised data repository site that may be listed from time-to-time on the Inland Revenue website.

37. Alternatively, conversion rates may be obtained from a public exchange that has comprehensive know-your-customer/anti-money-laundering procedures in place. Which exchange (or exchanges) is appropriate will depend on the circumstances. Using a New Zealand-based exchange listed on the Financial Service Providers Register will be appropriate.

38. If the appropriate valuation cannot be obtained from a New Zealand-based exchange, an overseas-based exchange can be used. For some "alt coins" (crypto-assets other than bitcoin) it may be necessary to convert into US dollars, or another fiat currency, and then convert into NZD.

39. Rates can vary significantly between different exchanges and currencies. Therefore, taxpayers should use a consistent exchange and conversion approach (for example, using a consistent time of day to determine the conversion rates).

*Other implications*

40. There are various circumstances where obligations, eligibility, or entitlements may be calculated based on an employee's salary or wages (for example Kiwisaver, Working for Families Tax Credits, and student loan repayments). The crypto-asset payments must be taken into account when calculating these.

## Examples

41. The following examples are included to help explain the application of the law. For simplicity the examples do not consider the potential application of, Kiwisaver, student loan, child support or other deductions. *The Employer's Guide (IR335)* (available on the Inland Revenue website **www.ird.govt.nz**) can be used to assist with calculating these.

**Example 1: Calculating PAYE where gross up is not required**

42. Anaru is employed by Cryptowonderland Ltd. In addition to his $150,000 salary, Anaru's contract provides for a NZ$10,000 (gross) bonus payable in bitcoin if Cryptowonderland's profit exceeds the previous year's.

43. Cryptowonderland has an exceptional year and Anaru receives his bonus. The bonus is subject to PAYE. NZ$3,330 ($10,000 × 0.33) must be paid to the Commissioner (in New Zealand dollars). The net amount of $6,670 worth of bitcoin can be transferred to Anaru's bitcoin wallet.

**Example 2: Calculating PAYE where conversion is required**

44. Deidre is employed by Cryptowonderland Ltd. In addition to her $180,000 salary, Deidre's contract provides for a gross payment of 10 Litecoin if Cryptowonderland's profit exceeds the previous year's.

45. Cryptowonderland has an exceptional year and Deidre is entitled to her bonus. Cryptowonderland must calculate the NZ$ equivalent of the Litecoin on the day that Deidre is paid. In accordance with its standard practice, Cryptowonderland uses conversion rates obtained at approximately 5pm from a New Zealand-based exchange that meets it KYC/AML requirements. At the relevant time, 10 Litecoin is worth NZ$1,140. The bonus is subject to PAYE. NZ$376.20 ($1,140 × 0.33) must be paid to the Commissioner (in New Zealand dollars). The net amount of $763.80 worth of Litecoin can be transferred to Deidre.

**Example 3: Calculating PAYE where gross up is required**

46. Sarah is employed by Cryptowonderland Ltd. She receives an annual salary of $130,000 direct credited to her bank account. In addition, Sarah's contract provides for annual bonus payments if Sarah's performance targets are met.

47. Sarah met all of her performance targets this year and was paid a bonus of NZ$5,000 (net) worth of ether.

48. The payment is subject to PAYE. When calculating the PAYE payable, the $5,000 needs to be grossed up ($5,000 ÷ 0.67 = $7,462.69). PAYE is then calculated on the gross amount ($7,462.69 × 0.33 = $2,462.69) and paid to the Commissioner (in New Zealand dollars).



## References

**Related rulings**

"BR PUB 19/01: Income tax – salary and wages paid in crypto-assets"

**Subject references**

Bitcoin, bonus, crypto-asset, cryptocurrency, FBT, PAYE, salary, wages

**Legislative references**

Income Tax Act 2007 – ss CE 1, CE 7, CX 2, CX 4, RD 3, RD 5, and the YA 1 definition of "amount"

**Case references**

*CIR v Smythe* [1981] 1 NZLR 673

## Appendix – Legislation

### *Income Tax Act 2007*

1. Section CE 1(1) provides:

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>
> (b) expenditure on account of an employee that is expenditure on account of the person:
>
> (bb) the value of accommodation referred to in sections CE 1B to CE 1E:
>
> (c) [Repealed]
>
> (d) a benefit received under a share purchase agreement:
>
> (e) directors' fees:
>
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>
> (g) any other benefit in money.

2. Section CE 7 provides:

> **CE 7 Meaning of employee share scheme**
>
> *Employee share scheme means—*
>
> (a) an arrangement with a purpose or effect of issuing or transferring shares in a company (company A) to a person—
>
> (i) who will be, is, or has been an employee of company A or of another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (ii) who will be, is, or has been a shareholder-employee in relation to company A or in relation to another company that is a member of the same group of companies as company A, if the arrangement is connected to the person's employment or service:
>
> (iii) who is an associate of a person described in subparagraph (i) or (ii) (person A), if the arrangement is connected to person A's employment or service; but
>
> (b) does not include an arrangement that—
>
> (i) is an exempt ESS:
>
> (ii) requires market value consideration to be paid by a person described in paragraph (a) for the transfer of shares in the company on the share scheme taxing date:
>
> (iii) requires a person described in paragraph (a) to put shares, acquired by them for market value consideration, at risk, if the arrangement provides no protection against a fall in the value of the shares and none of the consideration for acquiring the shares is provided to the person under an agreement that it is used for acquiring the shares.

3. Section CX 2 provides:

**CX 2 Meaning of fringe benefit**

*Meaning*

(1) A fringe benefit is a benefit that—

(a) is provided by an employer to an employee in connection with their employment; and

(b) either—

(i) arises in a way described in any of sections CX 6, CX 9, CX 10, or CX 12 to CX 16; or

(ii) is an unclassified benefit; and

(c) is not a benefit excluded from being a fringe benefit by any provision of this subpart.

*Arrangement to provide benefit*

(2) A benefit that is provided to an employee through an arrangement made between their employer and another person for the benefit to be provided is treated as having been provided by the employer.

*Past, present, or future employment*

(3) It is not necessary to the existence of a fringe benefit that an employment relationship exists when the employee receives the benefit.

*Relationship with subpart RD*

(4) Sections RD 25 to RD 63 (which relate to fringe benefit tax) deal with the calculation of the taxable value of fringe benefits.

*Arrangements*

(5) A benefit may be treated for the purposes of the FBT rules as being provided by an employer to an employee under—

(a) section GB 31 (FBT arrangements: general):

(b) section GB 32 (Benefits provided to employee's associates).

4. Section CX 4 provides:

**CX 4 Relationship with assessable income**

To the extent to which a benefit that an employer provides to an employee in connection with their employment is assessable income, the benefit is not a fringe benefit.

5. Section RD 3 provides:

**RD 3 PAYE income payments**

*Meaning generally*

(1) The PAYE rules apply to a PAYE income payment which—

(a) means—

(i) a payment of salary or wages, see section RD 5; or

(ii) extra pay, see section RD 7; or

(iii) a schedular payment, see section RD 8:

(b) does not include—

(i) an amount attributed under section GB 29 (Attribution rule: calculation):

(ii) an amount paid to a shareholder-employee in the circumstances set out in section RD 3B or RD 3C:

(iii) an amount paid or benefit provided, by a person (the claimant), who receives a personal service rehabilitation payment from which an amount of tax has been withheld at a rate specified in section RD 10B.

6. Section RD 5(1), (2), (8) and (9) provide:

**RD 5 Salary or wages**

*Meaning*

(1) Salary or wages—

(a) means a payment of salary, wages, or allowances made to a person in connection with their employment; and

(b) includes—

(i) a bonus, commission, gratuity, overtime pay, or other pay of any kind; and

(ii) a payment described in subsections (2) to (8); and

(iii) an accident compensation earnings-related payment; and

(iiib) a payment of earnings compensation under the Compensation for Live Organ Donors Act 2016; and

(iv) Repealed.

(c) does not include—

(i) an amount of exempt income:

(ii) an extra pay:

(iii) a schedular payment:

(iv) an amount of income described in section RD 3(3) and (4):

(v) an employer's superannuation contribution other than a contribution referred to in subsection (9):

(vi) a payment excluded by regulations made under this Act.

(d) Repealed.

*Employees' expenditure on account*

(2) A payment of expenditure on account of an employee is included in their salary or wages.

...

*Accommodation benefits*

(8) A benefit treated as income under section CE 1(1)(bb) (Amounts derived in connection with employment) is included in salary or wages.

*Cash contributions*

(9) An amount of an employer's superannuation cash contribution that an employee chooses to have treated as salary or wages under section RD 68 is included in salary or wages.

7. Section YA 1 defines "amount" as follows:

**amount—**

(a) includes an amount in money's worth:

...

# QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

## QB 19/10: Donations: What is required to establish and maintain a fund under s LD 3(2)(c) of the Income Tax Act 2007?

A person donating money to a donee organisation can receive tax benefits. A donee organisation includes a fund established and maintained exclusively for providing money for specified purposes within New Zealand. This item considers what is required to establish and maintain such a fund so it qualifies as a "donee organisation".

The item complements the Commissioner's statement IS 18/05: Income tax: donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand.

### Key provisions

Section LD 3(2)(c): A donee organisation includes a fund established and maintained exclusively for the purpose of providing money for one or more specified purposes within New Zealand. The fund must be established and maintained by a non-profit entity.

### Question

What is required to establish and maintain a fund under s LD 3(2)(c) of the Income Tax Act 2007?

### Answer

In the Commissioner's view, a fund under s LD 3(2)(c) requires or involves the following:

- The fund must be established and maintained by a non-profit entity.
- The fund must comprise an actual stock of money or other assets set aside for the purpose of providing money for one or more specified purposes within New Zealand.
- A non-profit entity can set up such a fund by making book entries in its financial accounts but it must ensure the entries are supported by an actual stock of money or other assets and show that the fund has been set up on a "firm or permanent basis" for the required purpose. Best practice suggests a fund is established and maintained through a combination of book entries and a document setting out terms for the establishment, operation and winding up of the fund (either as part of the rules of the non-profit entity or as a stand-alone document).
- Maintaining the fund requires maintaining the actual stock of money or other assets consistent with any book entries, as the fund's actual stock of money or other assets at its establishment may change over time. Best practice suggests movements of the money or other assets in the fund are tracked and specifically reported on in the non-profit entity's financial accounts.

### Key terms

**Donee organisation** means an entity or fund described in s LD 3(2) or listed in schedule 32 of the Income Tax Act 2007.

**New Zealand** does not include Niue, the Cook Islands, Tokelau or the Ross Dependency of Antarctica.

**Non-profit entity** is a society, institution, association, organisation or trust that is not carried on for the private pecuniary profit of any individual.

**Required purpose** means the provision of money for a s LD 3(2)(c) fund's specified purposes within New Zealand.

**Specified purposes** means charitable, benevolent, philanthropic, or cultural purposes.

- The fund's money must be used for, or used to provide money for, the required purpose. Whether money is used for the required purpose is determined by where the specified purposes are advanced (ie, within New Zealand) and not where the fund's money is spent. The fund's money may be used:
  - for purposes other than the required purpose, but only if those other purposes are subordinate or incidental to the required purpose and are not independent purposes;
  - by the non-profit entity to meet or reimburse costs it incurs specifically in administering the fund. This includes a contribution to meet a reasonable share of the non-profit entity's administration costs where such costs include the costs of administering the fund; or
  - by the non-profit entity to meet or reimburse costs it incurs furthering the entity's own purposes, provided these are exclusively specified purposes within New Zealand and are consistent with the purposes of the fund.
- The fund must be maintained for the required purpose throughout its lifetime, including the disposal of the fund's money or other assets if wound up.

### Key tax benefit

If a person makes a gift of money of $5 or more to a donee organisation, they can receive a refundable tax credit or an income tax deduction.

## Explanation

### Introduction

1. This item is about **donee organisation** status under the Income Tax Act 2007 (the Act). Taxpayers who make gifts of money to an entity or fund with donee organisation status under the Act can generally get tax advantages. Subject to limits, the tax advantage for an individual is a refundable tax credit of one-third of their gifts of $5 or more to donee organisations each year, under ss LD 1 and LD 2. Companies and Māori authorities making such gifts can get a deduction for the gift under ss DB 41 or DV 12.
2. Donee organisation status can apply to an entity or a fund. For example, a society, institution, association, organisation or trust that is not carried on for the private pecuniary profit of any individual (a **non-profit entity**) can be a donee organisation under s LD 3(2)(a) of the Act if the entity applies its funds "wholly or mainly" to charitable, benevolent, philanthropic or cultural purposes (**specified purposes**) within New Zealand. (For more details on qualifying under s LD 3(2)(a), see Interpretation Statement IS 18/05: *Income tax: donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand* (September 2018) (IS 18/05).)
3. A fund established and maintained by a non-profit entity can also have donee organisation status under s LD 3(2)(c) of the Act, provided the fund is established and maintained exclusively for the purpose of providing money for one or more specified purposes within New Zealand (the **required purpose**). It may be an option where a non-profit entity's situation is such that qualification for donee organisation status under s LD 3(2)(a) may not be possible. A fund held on trust could qualify for donee organisation status under either s LD 3(2)(a) or s LD 3(2)(c) (although, in the latter case, the fund has to be *exclusively* for specified purposes within New Zealand).
4. This item only concerns the donee organisation status of a fund under s LD 3(2)(c) of the Act (the **key provision**). The key provision applies to:

   > (c) a fund established and maintained exclusively for the purpose of providing money for any 1 or more of the purposes within New Zealand set out in paragraph (a), by a society, institution, association, organisation, or trust that is not carried on for the private pecuniary profit of an individual:

5. The key provision refers to certain purposes within New Zealand set out in another paragraph of the legislation: s LD 3(2)(a). These purposes are "charitable, benevolent, philanthropic, or cultural purposes" (ie, specified purposes).
6. This item considers the following terms used in the key provision:
   - Fund (see [12] to [20])
   - Established (see [21] to [25])
   - Maintained (see [26] to [28])
   - Exclusively (see [29] to [31]).

7. None of these terms are defined in the Act. Nor have their meanings been judicially considered in the context of s LD 3(2) or any corresponding predecessor provisions. Some of the terms have, however, been judicially considered in other contexts and jurisdictions as noted below. The relevance of these authorities must be considered in light of the context and purpose of the key provision.
8. The practical implications of the key terms are considered under the heading "what this means in practice" from [32]. These include:
   - how a non-profit entity can establish a fund that qualifies as a donee organisation under s LD 3(2)(c) (see [32] to [36]);
   - what the non-profit entity must do to maintain such a fund (see [37] to [43]); and
   - whether a donee organisation under s LD 3(2)(a) could establish:
     - a s LD 3(2)(c) fund (see [45] to [48]); or
     - an "overseas fund" (see [49] to [50]).
9. Following that, there is an example of the matters that should be considered when establishing and maintaining a s LD 3(2)(c) fund.
10. This item does not consider the following terms:
    - "charitable, benevolent, philanthropic, or cultural purposes"; and
    - "a society, institution, association, organisation or trust that is not carried on for the private pecuniary profit of an individual".
11. This item also does not consider whether the establishment of a s LD 3(2)(c) fund is permitted under the governing documents or terms applicable to the relevant entity.

## Analysis

### *Fund*

12. The ordinary meaning of the term "fund" suggested by the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011) is "a sum of money saved or made available for a particular purpose".
13. The United Kingdom Court of Appeal decision in *Allchin v Coulthard* [1942] 2 All ER 39 is a commonly cited authority on the meaning of the term. In *Allchin v Coulthard*, Lord Greene considered "fund" had two meanings (at 44):

> The word "fund" may mean actual cash resources of a particular kind (e.g., money in a drawer or at a bank) or it may be a mere accountancy expression used to describe a particular category which a person uses in making up his accounts.
>
> …
>
> A fund in the second sense is merely an accountancy category. It has a real existence in that sense, but not in the sense that a real payment can be made out of it as distinct from being debited to it.

14. In *Rapid Metal Developments (NZ) Ltd v Rusher* (1987) 2 PRNZ 85, McGechan J in the New Zealand High Court considered (at 93) dictionary definitions of "fund", including the following definition in the *Shorter Oxford English Dictionary* (vol 1, p 817 (1972)):

> 3. Sources of supply; a permanent stock that can be drawn upon 4(a) sing. A stock or sum of money, esp. One set aside for a particular purpose (b) Pecuniary resources.

15. McGechan J considered that in *Allchin v Coulthard* Lord Greene's second meaning of fund as an accountancy category extended the dictionary definition. McGechan J also considered that the applicable meaning, including whether Lord Greene's extended meaning applied, depended on the context. McGechan J stated (at 93):

> The meaning of "fund" is not necessarily restricted to such dictionary sense of actual stock or sum of money set apart. It can be "a mere accountancy expression used to determine a particular category which a person uses in making up his accounts" *Allchin v Coulthard* [1942] 2 KB 228, 234, per Lord Greene MR.
>
> …
>
> In short, to constitute an [*sic*] "fund" it is not necessary to set aside actual coin. An accountancy device will suffice. … The word "fund" can vary in meaning according to context.

16. McGechan J considered that, under any meaning, the essential features of a fund are purpose and retention (at 94):

> The underlying feature of a "fund" so exemplified is that it is an aggregation of money or an accounting device directing money to a particular purpose, and that such money is still so held or still so allocated for that purpose. On this common usage approach, the essential features are purpose and retention.

17. Where the fund in question involves an actual stock of money or other assets, the assets of the fund need not be static, and the fund's composition may be subject to additions, reductions or alterations (see *Case NT* 96/409 [1998] AATA 895 at [35] and *Scottish Widows plc v Revenue and Customs Commissioners* [2012] 1 All ER 379 (SC) at [55]). This means, at any time, a fund under s LD 3(2)(c) may comprise not only money received from donations that qualified for tax advantages, but also other money and other assets donated or acquired.
18. An example where the context limits the meaning of the term fund to the first of Lord Greene's meanings, in preference to his extended meaning of the term, is found in the New South Wales Court of Appeal decision in *Newcastle City Council v Caverstock Group Pty Ltd* [2008] NSWCA 249. Referring to *Allchin v Coulthard* (CA), the court decided that the word "fund" in the relevant context did not include a mere accounting entry (at [23] to [24]). See also, the Australian cases referred to in [23] below.
19. In the Commissioner's view, the context of s LD 3(2)(c) and its purpose suggest a meaning of "fund" limited to that of the dictionary, in preference to Lord Greene's extended meaning of the term. That is, a s LD 3(2)(c) fund must be an actual stock of money or other assets set aside for the required purpose. This includes, for example, a fund represented by a credit balance in a bank account.
20. The Commissioner considers the purpose of the legislation is to encourage giving in society and to relieve government of some of the burden of providing the goods and services to society that are delivered by entities and funds with donee organisation status (see: IS 18/05 at [123] to [135]). This purpose suggests a fund in the sense of actual money or assets, comprising or including gifts of money to the fund, from which a real payment can be made to provide goods and services to society, rather than an accounting entry.

### *Established*

21. The *Concise Oxford English Dictionary* defines the ordinary meaning of "establish" as including to "set up on a firm or permanent basis" or to "initiate or bring about".
22. Case law in the context of Australian legislation, which allows a deduction for amounts an employer "sets apart as or to a fund" for the benefit of employees, is considered helpful in the current context. This is because setting apart amounts as or to a fund seems analogous to what is required to "establish" a fund.
23. The Australian cases in this context suggest it may be possible to establish a fund by way of accounting entries, without the need for legal separation of the money or other assets of the fund (eg, into a trust). However, actual benefits secured in favour of the employees must exist (or, in the current context, an actual stock of money or other assets comprising the fund must exist). See, for example, *Winchcombe Carson v FCT* (NSW) (1938) 5 ATD 69 (NSWSC) (at 73–74), *Northern Timber and Hardware* (1960) 103 CLR 650 (HCA) (at 657) and *FCT v P Iori and Sons Pty Ltd* 87 ATC 4775 (FCAFC) (at 4789).
24. Case law also suggests that where a fund and its terms are evidenced by a written document (such as a deed of trust), the fund will not be "established" until there is an actual stock of money or other assets, despite the document being executed. See, for example, *Walstern Pty Ltd v FCT* [2003] FCA 1428 (FCA) (at [51]), *JD Mahoney v FCT* (1965) 13 ATD 519 (HCA) (at 525), *Lend Lease Corporation Ltd v FCT* (1990) 21 ATC 402 (FCA) (at 409) and *British Insulated & Helsby Cables v Atherton* [1926] AC 205 (PC) (at 214).
25. The Commissioner also considers that the approach adopted by the Court of Appeal and Supreme Court in *Re Greenpeace New Zealand Incorporated* ([2012] NZCA 533 (CA), [2014] NZSC 105 (SC)) applies in the context of s LD 3(2)(c). In these cases, an organisation was accepted as being capable of changing its rules to become "established" as a charity. This means that an existing fund that may not have been eligible for donee organisation status under s LD 3(2)(c) when first established, could become eligible when it could be shown that the fund was now established exclusively for the required purpose.

### *Maintained*

26. In s LD 3(2)(c), the term "maintained" bears its ordinary meaning suggested by, for example, the *Concise Oxford English Dictionary* definition of "maintain", which is to "cause or enable (a condition or state of affairs) to continue". This suggests that a fund established exclusively for the required purpose must continue to exist for that purpose. This would be shown by considering the use or uses to which the fund's money or other assets are put. Maintaining the fund also suggests maintaining on an ongoing basis the existence of the actual stock of money or other assets, consistent with any book entries recording the fund's continued existence.
27. Accordingly, the Commissioner considers it appropriate, in the context of whether a s LD 3(2)(c) fund is being maintained for the required purpose, to consider the use or uses made of the fund's money or other assets. In this context, whether the money is used for the required purpose is determined by where the specified purposes are advanced (ie, within New Zealand) and not where the fund's money is spent (see: IS 18/05 at [218] – [223]). **New Zealand** in this context does not include Niue, the Cook Islands, Tokelau or the Ross Dependency of Antarctica.

28. Also, in the Commissioner's view, the need to maintain the fund for the required purpose applies at all times throughout the lifetime of the fund and in the event of the fund's cessation. In the latter case, this means that if the fund was wound up, the fund's money and other assets would need to be used for the required purpose. This could include the money and assets being passed to, or used to establish, another fund under s LD 3(2)(c).

### *Exclusively*

29. In s LD 3(2)(c), the term "exclusively" bears its ordinary meaning suggested by, for example, the *Concise Oxford English Dictionary* of "limited to a specific thing or group" or "excluding or not admitting other things".

30. This would mean the required purpose (ie, providing money for one or more specified purposes within New Zealand) must be the sole purpose of the fund.

31. However, case law in the context of whether an organisation is exclusively charitable suggests that purposes other than the required purpose could be ignored if they are subordinate or incidental to the required purpose and are not independent purposes of the fund. See, for example, *The Incorporated Council of Law Reporting for England and Wales v Attorney-General* [1971] 3 All ER 1029 (CA) (at 1047), *CIR v New Zealand Council of Law Reporting* (1981) 5 NZTC 61,053 (CA) (at 61,057) and *Latimer v CIR* (2004) 1 NZTR 14-003 (PC) (at [36]). See also, s 5(3) of the Charities Act 2005 (Meaning of charitable purpose and effect of ancillary non-charitable purpose).

## What this means in practice

### *Establishing a fund*

32. A non-profit entity looking to establish and maintain a fund that qualifies as a donee organisation under the key provision must be able to show that the fund meets the requirements of an actual stock of money or other assets set aside on a firm and permanent basis for the required purpose. The establishment and maintenance of the fund also needs to be within the purposes and powers of the non-profit entity.

33. As a general matter, establishing a fund does not necessarily require written documentation. However, it is unlikely that the Commissioner would be satisfied that a fund meets the requirements of the key provision in the absence of written documentation.

34. The Commissioner also considers that it is preferable for there to be more than just book entries to support the establishment of the fund. The Commissioner's view is that best practice would be to have, in addition to book entries, a founding document setting out terms for the establishment, operation and winding up of the fund, to show that the specific requirements of the key provision are met. This could be in the form of changes to the non-profit entity's own founding or governing documents, or a separate document or documents detailing the terms of the establishment, operation and winding up of the fund. The documents would help satisfy the Commissioner that the fund's establishment and intended operation meet the key provision's requirements (see the example below). This practice may also give greater confidence to the fund's potential donors and help reduce the possibility that they will have to demonstrate their donation is eligible for tax benefits.

35. From 1 April 2020, the Commissioner must be satisfied that the requirements of the key provision are met by the fund for it to be included on the list of donee organisations published by the Commissioner under s 41A of the Tax Administration Act 1994. From that date, the fund's name must be on this list for it to qualify as a donee organisation under the key provision. The onus will be on the entity to ensure that it satisfies the requirements of the key provision in order to obtain and maintain its listing.

36. Also from 1 April 2020, a donee organisation (including a fund under s LD 3(2)(c)), must be registered as a charitable entity under the Charities Act 2005 if, in the opinion of the Commissioner, it is eligible to register. Guidance on the application of these additional requirements applying from 1 April 2020 is to be published separately.

### *Maintaining a fund*

37. Once established, the fund must be maintained for the required purpose. Adequate record keeping on an ongoing basis must show any changes in the composition of the fund and how the fund's money or other assets have been used for the required purpose. As the money or other assets of the fund at its establishment may change over time, maintaining the fund requires maintaining the actual stock of money or other assets comprising the fund, consistent with book entries showing movements of the fund's money and other assets. A suggested approach would be for the movements in the fund to be specifically reported on in financial accounts of the non-profit entity by showing the balance of the fund brought forward from the prior year, donations and other additions to the fund, expenditure and transfers out of the fund, any other gains or losses and the closing fund balance.

38. The records kept may include accounting entries in the financial accounts of the non-profit entity. However, it may be preferable to keep the fund, and in particular the fund's money, separate from the non-profit entity's other money and assets, for instance, by having a separate bank account for the fund. This would make it easier to show that there is an actual stock of money and show that the purposes of the fund have been maintained over time (by seeing how the money in the account has been used).
39. It would also be preferable for donors to clearly indicate they are intending to make a donation to the fund, to avoid any doubt over whether the donation is to the fund or to the non-profit entity (if the circumstances are such that doubt could arise).
40. As to the uses of the money in the fund, the fund must be used for, or used to provide money for, the required purpose. This would include providing money to the non-profit entity that maintains the fund provided this is exclusively for the advancement of specified purposes within New Zealand and consistent with the fund's purposes.
41. The Commissioner is also aware of the following questions that have been raised about the use of the fund's money:
    - Can the non-profit entity use the fund's money to meet or reimburse costs it incurs specifically relating to administering the fund?
    - Can the non-profit entity make a charge against the fund's money to reimburse it for a reasonable share of the non-profit entity's administration costs, where such costs include the costs of administering the fund?
    - Can the fund's money be used to meet any other costs incurred by the non-profit entity?
42. The Commissioner considers that the fund's money can be used to meet or reimburse costs specifically relating to administering the fund. The Commissioner also considers that the fund's money can be used to meet a charge for a share of administration costs incurred by the non-profit entity apportioned to the fund on a reasonable basis where those costs include the costs of administering the fund. In all cases, the Commissioner considers these uses of the fund's money would not jeopardise the fund's donee organisation status. In the Commissioner's view, the use of the fund's money for such administration costs advances, or is subordinate or incidental to advancing, the required purpose.
43. Use of the fund's money to meet any other costs incurred by the non-profit entity may advance the required purpose, but only if the fund's terms permit this and the costs advance purposes that are exclusively specified purposes within New Zealand and consistent with the fund's purposes. Care would be needed if the non-profit entity's purposes included purposes other than specified purposes within New Zealand. This is because using the fund's money to contribute to the non-profit entity's costs could mean the fund's money advances a purpose or purposes *other* than the required purpose. This would be contrary to the key provision's requirement for the fund to be "exclusively" for the required purpose and the donee organisation status of the fund would be jeopardised. For more information on when money is considered to be applied to specified purposes within New Zealand (including apportionment issues) see IS 18/05 at [245] to [280] and examples on 51 – 56.

### Issues concerning s LD 3(2)(a) donee organisations operating a fund

44. The Commissioner is also aware of two issues concerning funds and donee organisations under s LD 3(2)(a). The issues are whether such donee organisations could establish and maintain:
    - a fund under s LD 3(2)(c); or
    - a fund specifically for purposes outside of New Zealand (an "overseas fund").

#### *Whether a donee organisation under s LD 3(2)(a) could establish a s LD 3(2)(c) fund*

45. An entity that is a donee organisation under s LD 3(2)(a) could establish a fund under s LD 3(2)(c) if it wished to do so (subject to the terms of its founding or governing documents). The entity would need to weigh the benefits of doing so against the possibility that establishing the fund may detract from the entity's ability to qualify as a donee organisation under s LD 3(2)(a).
46. If the s LD 3(2)(c) fund is not legally separated from the funds of the s LD 3(2)(a) donee organisation, the fund still belongs to that donee organisation. This means the fund would still be counted when determining whether the donee organisation applies its funds "wholly or mainly" to specified purposes within New Zealand, as required by s LD 3(2)(a). In relation to meeting the latter requirement, in IS 18/05 the Commissioner has confirmed that a "safe harbour" of 75% or more will be applied, so that an entity will generally be accepted as meeting the "wholly or mainly" requirement if that safe harbour threshold is met. Creating a s LD 3(2)(c) fund would not alter how the "wholly or mainly" requirement and safe harbour applies to the s LD 3(2)(a) donee organisation.

47. If the s LD 3(2)(c) fund is legally separated from the funds of the s LD 3(2)(a) donee organisation (eg, the fund is a separate trust fund), the fund would not be counted as part of the donee organisation's funds under s LD 3(2)(a). However, this may then make it difficult for the s LD 3(2)(a) donee organisation to meet the "wholly or mainly" requirement and the safe harbour threshold.

48. In some circumstances, it may be beneficial for an entity that is currently a s LD 3(2)(a) donee organisation to establish a fund under s LD 3(2)(c) so that the entity does not need to maintain its current donee organisation status. For example, if the entity has non-donation income, it could then apply all or any of this income to overseas purposes, while accepting donations to a s LD 3(2)(c) fund established and maintained exclusively for specified purposes within New Zealand. Depending on the relative amounts of the income streams, this may allow the entity to apply more funds to overseas purposes than it could otherwise have done if all of its funds were subject to the "wholly or mainly" requirement under s LD 3(2)(a). Another outcome would be that the entity is relieved of the need to maintain its compliance with that requirement.

### *Whether a donee organisation under LD 3(2)(a) could establish an "overseas fund"?*

49. The converse situation to that just discussed is where a donee organisation under s LD 3(2)(a) establishes a separate bank account as an "overseas fund". That is, the s LD 3(2)(a) donee organisation establishes a fund for purposes *other* than the required purpose. As with the previous situation, unless the money comprising the overseas fund is legally separated from the funds of the donee organisation the money in the overseas fund stays that of the donee organisation. As a result, establishing the overseas fund would not alter the extent to which the donee organisation applies funds to specified purposes within New Zealand. In other words, the organisation's ability to meet the 75% or more "safe harbour" set out in IS 18/05 would be unaltered by setting up the separate overseas fund. This is because the funds in the overseas fund's bank account would still count as funds belonging to the donee organisation when it comes to working out under s LD 3(2)(a) how much of the organisation's funds have been applied to specified purposes within New Zealand.

50. If the s LD 3(2)(a) donee organisation's overseas focus has become such that it can no longer meet the "wholly or mainly" requirement of s LD 3(2)(a), it may wish to consider whether it can seek listing in sch 32 of the Act as an "overseas donee organisation". For more information on sch 32 listing see: IS 18/05 at [112].

**Example**

*The following example is included to help explain the application of the law. It gives an indication of the matters that need to be considered when establishing and maintaining a s LD 3(2)(c) fund.*

XYZ Inc is a charity registered under the Charities Act 2005 whose rules let it pursue its charitable purposes within New Zealand and overseas. The Board of XYZ Inc, which governs the charity and is entitled to exercise the charity's powers, decides to set up a fund to pursue its charitable objects within New Zealand. The Board intends for the fund to have donee organisation status under s LD 3(2)(c) of the Income Tax Act 2007.

The Board resolves to change XYZ Inc's rules (subject to member approval if required under the rules) to provide for the establishment of the fund and set the rules by which the fund is to be maintained.

The changes to the rules cover the following matters:

*Establishment of the fund*

- A fund (the "NZ Purposes Fund") is to be established and maintained exclusively for providing money for charitable purposes within New Zealand that fall within XYZ Inc's charitable purposes.
- For donors to the NZ Purposes Fund to get tax benefits under the Income Tax Act 2007 and its amendments, the fund must be established and maintained exclusively for charitable purposes within New Zealand.
- From 1 April 2020, the name of the fund must appear on the list published by the Commissioner of Inland Revenue under s 41A of the Tax Administration Act 1994 so donors to the fund can continue to receive tax benefits. The Board must take all reasonable measures to make sure the name of the fund appears and remains on the list.
- The Board will make sure the fund is established and maintained by arranging a separate bank account for the fund (called the "NZ Purpose Fund Account") and making sure that:
  - all donations to the fund, and any other moneys intended for the fund are deposited to the NZ Purposes Fund Account;
  - all moneys in the NZ Purposes Fund Account are applied exclusively to advancing XYZ Inc's charitable purposes within New Zealand; and
  - no moneys in the NZ Purposes Fund Account are transferred or withdrawn and deposited to any other bank accounts used by XYZ Inc, unless such money's are to be used by XYZ Inc to advance charitable purposes within New Zealand consistent with the purposes of the NZ Purposes Fund.

*Maintaining the fund – record keeping, reporting and issuing of receipts*

- The Board will make sure that adequate records are kept on the setting up and operation of the fund. These will show the date, amount and source of all donations and other moneys deposited to the NZ Purposes Fund Account and the date, amount, nature and purpose of all debits and withdrawals from the NZ Purposes Fund Account. Records will also be kept of the basis for, and calculation of, any contribution charged against the NZ Purposes Fund Account to meet a reasonable share of XYZ Inc's administration costs where such costs include the costs of administering the fund.
- Movements of the money or other assets in the fund are to be tracked and specifically reported on in XYZ Inc's financial accounts.
- The Board will make sure that where gifts of money of $5 or more are deposited to the NZ Purposes Fund Account, the donors are given a receipt that:
  - has XYZ Inc's official stamp or letterhead;
  - is signed by an authorised person;
  - bears the words "Donation";
  - has the donor's full name;
  - includes the date and amount of the donation;
  - includes the relevant IRD number and/or Charities Registration number (preferably both);
  - has an endorsement that the donation is "Exclusively for XYZ Inc's NZ Purposes Fund Account".
- Where any donation has been received partly for the NZ Purposes Fund and partly for other purposes, the Board will make sure that the donation is deposited accordingly, that separate receipts are issued and that the receipt for the NZ Purposes Fund Account meets the above requirements.
- Where a receipt for the NZ Purposes Fund Account is re-issued as a replacement, it must be clearly marked "copy" or "replacement".

*Closure of the fund*

- The Board will make sure that if the NZ Purposes Fund Account is closed, all money in the account at closure will be transferred to another account or accounts established and maintained under the same rules as set out for the NZ Purposes Fund Account.
- Alternatively, if the NZ Purposes Fund Account is closed and its money is not transferred to any other such account, the funds must be applied in their entirety for charitable purposes within New Zealand.

*Changes affecting the tax status of the fund*

- The rules concerning the establishment and maintenance of the fund cannot be altered or removed in a manner that would adversely affect the availability of tax benefits to donors under the Income Tax Act 2007. Nor can the operation of the NZ Purposes Fund Account (or any replacement account or accounts) change without the Board obtaining assurance that the alteration, removal or change does not affect the status of the fund under the Income Tax Act 2007 and the availability of tax benefits to donors.
- If there is any change that adversely affects the status of the fund under the Income Tax Act 2007 and the availability of tax benefits to donors, the Board will make sure:
  - the Commissioner of Inland Revenue is notified of the change; and
  - XYZ Inc stops giving receipts to donors to the NZ Purposes Fund Account.

## References

**Subject references**

Donee organisation
established
exclusively
fund
maintained

**Legislative references**

Charities Act 2005: s 5(3)
Income Tax Act 2007: ss DB 41, DV 12, LD 1, LD 2, LD 3(2)(a), LD 3(2)(c), sch 32
Tax Administration Act 1994: s 41A

**Other references**

*Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011)
*Shorter Oxford English Dictionary* (vol 1, p 817, 1972)
Interpretation Statement IS 18/05: *Income Tax: donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand* (September 2018)

**Case references**

*Allchin v Coulthard* [1942] 2 All ER 39 (CA)
*British Insulated & Helsby Cables v Atherton* [1926] AC 205 (PC)
*Case NT 96/409* [19998] AATA 895 (AATA)
*CIR v New Zealand Council of Law Reporting* (1981) 5 NZTC 61,053 (CA)
*FCT v P Iori and Sons Pty Ltd* 87 ATC 4775 (FCAFC)
*JD Mahoney v FCT* (1965) 13 ATD 519 (HCA)
*Latimer v CIR* (2004) 1 NZTR 14-003 (PC)
*Lend Lease Corporation Ltd v FCT* (1990) 21 ATC 402 (FCA)
*Newcastle City Council v Caverstock Group Pty Ltd* [2008] NSWSC 249 (NSWSC)
*Northern Timber and Hardware* (1960) 103 CLR 650 (HCA)
*Rapid Metal Developments (NZ) Ltd v Rusher* (1987) 2 PRNZ 85 (HC)
*Scottish Widows plc v Revenue and Customs Commissioners* [2012] 1 All ER 379 (SC)
*Re Greenpeace New Zealand Incorporated* [2012] NZCA 533 (CA)
*Re Greenpeace New Zealand Incorporated* [2014] NZSC 105 (SC)
*The Incorporated Council of Law Reporting for England and Wales v Attorney-General* [1971] 3 All ER 1029 (CA)
*Walstern Pty Ltd v FCT* [2003] FCA 1428 (FCA)
*Winchcombe Carson v FCT* (NSW) (1938) 5 ATD 69 (NSWSC)

# QB 19/11: GST – administrative or management services provided by an unincorporated body to its members

Sometimes a group of property owners, tenants or professionals might form an unincorporated body to manage and administer their common property or practice areas. This item looks at what is an unincorporated body in those circumstances and when it must register for GST.

## Question

When must an unincorporated body that provides administrative or management services to its members register for GST?

## Answer

An unincorporated body that provides administrative or management services to its members must register for GST if:

- it is carrying on a taxable activity; and
- the value of its supplies of goods and services made in New Zealand exceeds the $60,000 registration threshold. This includes the value of supplies of administrative or management services the body makes to its members.

An unincorporated body carrying on a taxable activity with supplies below the registration threshold may voluntarily register for GST. If registered, the body must account for GST on all its supplies of goods and services.

## Explanation

### Introduction

1. This Question We've Been Asked (QWBA) provides guidance on when a group of property owners, tenants or professionals who join together for administration or management of their common interests will be an "unincorporated body" for GST purposes and required to register and charge GST under the Goods and Services Tax Act 1985 (GST Act).
2. This QWBA is consistent with the following items to the extent they address unincorporated bodies and it updates and replaces them:
   - "Question 62 - clinics providing administrative services – taxable activity?" *Public Information Bulletin* Vol 158 (November 1986): 11;
   - "Question 112 - residential management committee – taxable activity?" *Public Information Bulletin* Vol 158 (November 1986): 27; and
   - "GST and property administration" *Public Information Bulletin* Vol 173 (April 1988): 7.
3. This QWBA addresses the GST treatment of unincorporated bodies formed to provide administrative or management services to its members. However, it does not address the GST position of unincorporated bodies formed to provide administrative or management services to its members that are partnerships, joint ventures or the trustees of a trust.
4. In addition, this QWBA does not address bodies corporate under the Unit Titles Act 2010 (or its predecessor, the Unit Titles Act 1972). The GST Act includes specific rules for bodies corporate registered under the Unit Titles Act 2010. (See *Tax Information Bulletin*, Vol 28, No 3 (April 2016): 33.) Bodies corporate registered under the Retirement Villages Act 2003 should refer to the Interpretation Statement "IS 15/02: Goods and services tax – GST and retirement villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6.

### Analysis

5. For a "person" to be required to register for GST, the person must:[1]
   - carry on a "taxable activity"; and
   - the value of supplies it makes, or expects to make, in New Zealand in a 12-month period:
     - was $60,000 or more in the last 12 months; or
     - will be $60,000 or more in the next 12 months.
6. For GST purposes the term "person" includes:
   - a company; and
   - an unincorporated body of persons.

[1] It is assumed none of the exclusions for registration in s 51(1) apply.

7. The term "company" in the GST Act is broader than simply companies incorporated under the Companies Act 1993 (or its predecessor). It means any body corporate (see s 2). A society incorporated under the Incorporated Societies Act 1908 is a body corporate, and so is treated as a company for GST purposes. This means an incorporated society is a "person" for GST purposes.
8. While the term "unincorporated body of persons" is not defined in the GST Act, the term "unincorporated body" is defined in s 2. An "unincorporated body" is an unincorporated body of persons, including a partnership, a joint venture or the trustees of a trust. It follows then that this definition is not exclusive and includes unincorporated bodies of persons that are not partnerships, joint ventures or the trustees of a trust.

### What is an unincorporated body of persons?

9. The meaning of the term "unincorporated body of persons" (and the similar term "unincorporated association") has been considered by the courts in the context of whether a group of individuals, or co-owners of property, are an unincorporated body. The courts have held that:
    - an unincorporated association is an organisation formed by members to effect their purpose in an agreed manner (*Taunton Syndicate v CIR* (1982) 5 NZTC 61,106);
    - a significant degree of regulation governing the relationship between the co-owners of the property is required before finding there is an unincorporated association or body (*Case P70* (1992) 14 NZTC 4,469);
    - the agreement between the members of an unincorporated association might be in the bodies' rules and constitution and include some basic terms covering:
        - the qualification to be a member of the association;
        - the number of members the association may have;
        - how the association is to be managed; and
        - how a member withdraws or retires from the association or disposes of their share in the association (*Taunton Syndicate, Conservative and Unionist Central Office v Burrell* (Inspector of Taxes) [1982] 2 All ER 1);
    - an unincorporated association involves two or more persons bound together for one or more common purposes by mutual undertakings (*Conservative and Unionist Central Office*);
    - the necessity to co-operate where common decisions are needed about commonly-owned property does not amount to an unincorporated body (*Anglesea Builders Partnership v CIR* (1987) 9 NZTC 6,181);
    - for there to be an unincorporated association there must be some sense of mutual duties and obligations between the co-owners, beyond the loosest of moral obligations to consult co-owners (*McElwee v CIR* (1988) 10 NZTC 5,181);
    - while an unincorporated body is more likely to be found to exist where there is a contract between the members, a written contract may not be essential (*Conservative and Unionist Central Office, Anglesea Builders, McElwee*); and
    - a "body of persons" are persons who together are properly to be considered as a body rather than as a number of individuals as there is such regulation of their internal affairs that there is a structure by which they can be recognised as a collective entity – the unincorporated equivalent of a body corporate (*Edwards v Legal Services Agency* [2003] 1 NZLR 145).
10. Based on this case law, a group of individuals or co-owners of property including a residents' association, a property management committee or a clinic or practice manager established by professionals to carry out administrative services may be an "unincorporated body of persons" for GST purposes if they have the following kinds of characteristics:
    - is formed by its members for one or more common purposes;
    - has a significant degree of regulation governing the relationship between its members;
    - has agreed rules, setting out matters like:
        - how it is governed and how decisions are made by the body;
        - how its funds may be used;
        - what happens when members join and leave the group; and
    - is a structure recognised as a collective entity of its members.
11. An unincorporated body will also usually have a name and a bank account.
12. Special rules in s 57 of the GST Act support treating a GST registered unincorporated body as a separate person for GST purposes. These rules are discussed further at [24].

*What is not an unincorporated body of persons?*

13. A group of people will not usually be an "unincorporated body of persons" for GST purposes if:
    - they simply own property together, and all that is involved is a loose moral obligation to consult with their co-owners;
    - they make decisions together, but without forming a body with mutual duties and obligations between members;
    - there is no significant degree of regulation or agreement between them governing their relationship; and
    - their relationship is confined to a cost-sharing arrangement.
14. Cost-sharing arrangements arise when a group of people simply agree between themselves to share in costs associated with pursuing a common interest. They can sometimes involve one person in the group incurring costs and then being reimbursed. Cost-sharing arrangements can also involve property owners contributing on an ad hoc-basis, or a regular basis, to particular expenditure on common property. For example, regular payments might be made by property owners to cover the expense of having a gardener maintain their shared garden every month.
15. Co-owners of cross-leased properties will usually be in a cost-sharing arrangement and not an unincorporated body, unless their cross-leasing arrangements establish a body with agreed rules setting out matters like:
    - how the body is governed,
    - how decisions are made by the body;
    - how its funds may be used; and
    - what happens when lessees join and leave the group.

**When will an unincorporated body be carrying on a "taxable activity"?**

16. To establish whether an unincorporated body must register and charge GST the body must be carrying on a taxable activity. Based on s 6(1) of the GST Act, an unincorporated body that provides administrative or management services to its members will be carrying on a taxable activity when:
    - it carries on an activity continuously or regularly, whether or not for a pecuniary profit;
    - the activity involves or is intended to involve, in whole or in part, the supply of goods and services to any other person; and
    - the supply of goods and services is for consideration.

*Continuous or regular activity*

17. An unincorporated body that provides administrative or management services to its members must carry on an activity that is organised in some coherent way. The activity must be carried on continuously or regularly.
18. The definition of a taxable activity is very broad and applies to any activity carried on continuously and regularly by any person. A taxable activity is not limited to a "business" but also includes any activity carried on in the form of a "… profession, vocation, association, or club". It is not necessary for the activity to have a profit-making purpose.
19. Therefore, in the Commissioner's view an activity carried on in the form of an unincorporated body is recognised as being an activity that, if carried on continuously and regularly, will satisfy the first requirement of the definition of "taxable activity".
20. In the context of an association, a committee, or a society that provides administrative or management services for its members on a not-for-profit basis, it is to be expected that the body will be undertaking an activity on a continuous and regular basis for the members. For example, in the context of a property management committee, the committee would likely be regularly involved in engaging, managing and paying employees or contractors to perform repairs, maintenance, and cleaning. The committee might also take on a financial management and planning role to determine the residents' contributions, and to timetable maintenance requirements. In the Commissioner's view these duties would amount to an activity carried on continuously or regularly by such a committee.
21. Similarly, it is expected an unincorporated body that is a "clinic" established by a group of medical professionals to undertake the administration of their practices would be carrying on an activity regularly and continuously.

*Supply of goods to another person*

22. For an activity to be a taxable activity it must involve, or be intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration. Therefore, the next question is whether an unincorporated body's activity involves making supplies to any other person.

23. This is an important requirement when considering an unincorporated body that provides administrative or management services to its members. For GST purposes an unincorporated body is treated as a separate entity, distinct from its members. Therefore, in the Commissioner's view, when an unincorporated body provides administration or property management services to its members, the unincorporated body is making a supply to another person (the members individually) and has not been implicitly acting as the agent of the members.
24. This view is supported by the definition of "person" and in the case of unincorporated bodies, by the provisions of s 57 of the GST Act. In particular, s 57(2) confirms that an unincorporated body is a separate person for GST purposes by providing that:
    - the members of an unincorporated body cannot register in relation to carrying on the taxable activity carried on by the body (s 57(2)(a));
    - any supply made in the course of carrying on an unincorporated body's taxable activity is treated as supplied by the unincorporated body and not by the members of that body (s 57(2)(b));
    - any supply made to or by a member acting in their capacity as a member of the body *and in the course of the carrying on of the body's taxable activity* is treated as being made to or by the unincorporated body and not the member (s 57(2)(c)). Conversely, where a supply is made to or by a member, and the member is not acting in their capacity as a member of the body nor in the course of the carrying on of the body's taxable activity, then the supply is made to or by the member and not the unincorporated body;
    - the unincorporated body is registered under the body's name (s 57(2)(d)); and
    - any change of members of the unincorporated body has no effect for GST purposes (s 57(2)(e)).
25. This approach is also supported by Gallen J in *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 (HC). *Taupo Ika Nui* was an appeal by the taxpayer against the Taxation Review Authority decision reported as Case S34 (1995) 17 NZTC 7,228. Gallen J upheld Judge Barber's decision in Case S34 that a unit title body corporate was a separate entity from the proprietors of the land, and so there were supplies between that entity and the proprietors. Gallen J (like Judge Barber) rejected the argument that there were no supplies because the proprietors were merely acting on their own behalf.
26. Accordingly, when an unincorporated body makes supplies of administrative or management services to its members, that activity involves the body making supplies to another person, so the second requirement of the definition of "taxable activity" is met. It is also possible a body may be making supplies to third parties.

*Consideration*

27. Finally, the supply of goods and services must be for consideration. The Commissioner considers that any levies or other amounts paid by the members of an unincorporated body for supplies of administrative or management services are consideration.
28. This is because "consideration" is a very widely defined term and includes payments made "in respect of, in response to, or for the inducement of, the supply of any goods and services". The words "in respect of" are words of the very widest meaning. For an unincorporated body that is providing services to its members the question is whether the amounts paid by members are paid "in respect of" the supply of any goods and services so as to amount to consideration.
29. As Cull J notes in *Canterbury Jockey Club Inc v CIR* [2018] NZHC 2,569 at [124] the case authorities are clear that "there needs to be some reciprocity or nexus between the supply made and the consideration passing between supplier and recipient". In the Commissioner's view, a nexus or link exists between the goods and services supplied by an unincorporated body and the levies or other amounts paid by its members (ie, reciprocity). Therefore, the levies or other amounts are paid "in respect of" the supplies of services, so are "consideration".
30. Judge Barber in *Case S34* was easily satisfied that the payment of levies by proprietors to a unit title body corporate was consideration for the supply of services. On the other hand, Gallen J in *Taupo Ika Nui* held there was no consideration because there was no reciprocity. While the facts in *Taupo Ika Nui* are somewhat similar to the situation being addressed in this QWBA, the Commissioner considers the Court of Appeal's decisions in *Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032, *Chatham Islands Enterprises Trust v CIR* [1999] 2 NZLR 388 and *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 are better authority on reciprocity and consideration. This is because those decisions are from a higher court and have been more widely applied in subsequent judgments concerning GST and consideration.
31. For example, in *Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 the High Court held that a development levy, charged under the Airport Authorities Act 1966, was consideration for a service supplied. Departing passengers used the airport to gain access to their plane and the payment of the levy enabled them to access the plane at the Rotorua Airport.

Mallon J applied *Turakina* but distinguished *NZ Refining* and *Chatham Islands* (which both found no reciprocity) to find a nexus (or reciprocity) existed between the payment and the service. She held that the levy was consideration "in respect of" or "in response to" the supply of services.

32. Accordingly, in the Commissioner's view any levies or other amounts paid by the members of an unincorporated body for supplies of administrative or management services are consideration, so the third requirement for a taxable activity is met.

33. It is noted that a legislative change was made to the GST Act following *Taupo Ika Nui* to clarify for unit title body corporates that a levy or other amount paid to a unit title body corporate by a member of the body corporate is to be treated as being consideration received for services supplied by the body corporate to the member (see s 5(8A) of the GST Act). As noted earlier, unit title bodies corporate are not included in this QWBA but s 5(8A) could arguably be seen as clarifying for other bodies that members' levies can be consideration for supplies.

### When must an unincorporated body register for GST?

34. An unincorporated body's liability to be registered for GST depends on it carrying on a taxable activity and also the value of supplies it makes, or expects to make, in the course of that activity in a 12-month period (s 51 of the GST Act). The unincorporated body must register for GST, when the value of supplies the unincorporated body makes, or expects to make, in a 12-month period:

- was $60,000 or more in the last 12 months; or
- will be $60,000 or more in the next 12 months.

35. When calculating the value of supplies it makes, or expects to make, an unincorporated body that is carrying on a taxable activity must include the value of any supplies it makes to its members. (Unit title bodies corporate are treated differently for GST purposes. They are not required to account for the value of supplies made to their members (see s 51(1B) of the GST Act)).

36. Generally, the value of a supply is equal to the consideration for the supply or, where the consideration is not in money, the open market value of the consideration (see s 10(1) of the GST Act).

37. Where the value of an unincorporated body's supplies is under $60,000 it can voluntarily register for GST (see s 51(3) of the GST Act) but it must account for GST on all its supplies of goods and services.

38. The following examples are included to assist in explaining what an unincorporated body is and when an unincorporated body must register for GST.

## Examples

**Example 1 – Residents' committee of a housing community**

The residents of the four freestanding town houses at 10 Harbour Close establish a residents' committee to help them manage the upkeep of their properties and the tree-lined shared driveway, and to provide a forum for addressing any concerns of residents. The committee is not a body corporate under the Unit Titles Act 2010.

Each town house has its own fee simple title, subject to some covenants regarding use and maintenance. For instance, under a covenant the residents must paint their town houses every four years using an agreed colour scheme.

The residents' committee is responsible for ensuring the trees along the driveway are trimmed, the grass by the roadside and under the driveway trees is cut, the electronic security gate is maintained, pot holes in the driveway are repaired, and the drive is re-sealed every 10 years.

The residents draw up some rules for the residents' committee, which provide that the committee comprises one representative from each of the four town houses, and sets out what happens when an owner sells their town house and a new owner joins. Meetings are to be held by the committee on a six-monthly basis. The rules also establish how decisions can be made by the committee and what will happen if there is not unanimous agreement between the committee members. The rules also set out that a separate bank account is to be opened in the residents' committee's name and that any quotes for work must be obtained in the committee's name.

The rules specify that the residents of each town house are to make an annual contribution to the residents' committee of $2,000. These funds are used to meet the residents' committee's ongoing costs. Any surplus funds are retained in the committee's bank account for future expenditure.

The residents' committee is an unincorporated body of persons.

While the residents' committee is not seeking to make a profit, it still carries on a regular and continuous activity involving the making of supplies to another person for consideration. In return for the monthly levies paid by the residents, the committee makes supplies of property management services. Accordingly, the residents' committee is carrying on a taxable activity.

The value of the supplies made by the residents' committee will not exceed the GST registration threshold, so the committee is not required to register for GST. However, the committee may choose to register for GST and in that case would be required to charge GST on the annual contributions requested from residents but the committee can also claim GST input tax deductions for supplies made to them.

**Example 2 – Co-owners of cross-leased land**

Brian, Hemi and Penelope each live in a house on a piece of land in Auckland. A shared driveway on the land leads to the houses, a small turning bay for cars, and a communal garden area.

The land, including the driveway, is subject to a cross-lease. Brian, Hemi and Penelope own the land as tenants in common in equal shares. Each leases their house and a small area for a private courtyard from the others. The term of the lease is 999 years.

The cross-lease arrangements were established some time ago when the houses were developed. The leases contain a number of covenants. They set out that the costs of maintaining the common areas are to be shared between the three lessees, unless any damage or wear is attributable to the use of one of the lessees. They also set out how the three neighbours can use the common areas – for instance, they restrict the lessees from parking their cars in the turning bay.

Although Brian, Hemi and Penelope have all used the common areas reasonably, the driveway has not been resealed in some years and is in desperate need of repair. Brian, Hemi and Penelope agree Hemi will approach three contractors for quotes for the repair and resealing. The best quote is for $20,000 which the three neighbours agree is reasonable. Brian and Penelope pay their one-third share of the $20,000 to Hemi, who pays the contractor.

Brian, Hemi and Penelope all have busy jobs and in the past the shared garden area had become overgrown. The three neighbours decide that the simplest option is to hire a gardener to tend to the garden once a month. The gardener charges $150 per month for the work. Hemi and Brian set up an automatic payment into Penelope's bank account for $50 each per month. This covers the regular cost of the gardener.

Although there are rights and obligations between Brian, Hemi and Penelope arising from the lease covenants and general land law, these obligations do not establish a body with rules relating to its governance or funding. The covenants in the lease agreements are not sufficient to establish an unincorporated body of persons. Accordingly, there is no "person" for GST purposes so collectively Brian, Hemi and Penelope do not need to nor can register for GST as co-owners of the land.

**Example 3 – Clinic supplying administrative services to its members**

Four independent medical practitioners share an old converted villa. They each have a separate lease with the landlord giving them the right to occupy one particular room in the villa and use the villa's shared spaces (a reception/waiting room area, a bathroom and an office).

The four resident practitioners enter into a shared service provider arrangement. The arrangement is governed by a simple agreement signed by each practitioner. Under the arrangement, the practitioners agree to establish the Fit and Well Clinic to manage the day-to-day administration of their practices. The agreement sets out the rules of the arrangement, including:

- how the clinic will be governed;
- how decisions are to be made;
- how its funds may be used; and
- what happens when a practitioner joins or leaves the villa.

The clinic leases a photocopier, provides shared supplies, arranges cleaning and furnishing of the waiting room and employs an administrator/receptionist to greet patients, answer phone calls and take messages. The administrator/receptionist also organises the day-to-day operation of the clinic.

Each month the practitioners pay a levy of $1,500 into the clinic's bank account to cover the clinic's costs. Any amounts left over at the end of each month are retained in the clinic's account to cover the clinic's future unplanned costs.

The clinic is an unincorporated body. While the clinic is not seeking to make a profit, it still carries on a continuous activity involving the making of supplies of administrative services in return for the monthly levies paid by the practitioners. Accordingly, the clinic is carrying on a taxable activity.

The value of the supplies made to the practitioners by the clinic exceeds the GST registration threshold and so the clinic must register for GST. This means the clinic must charge GST on the supplies it makes to the practitioners, but it can also claim GST input tax deductions for its expenses.

## References

**Subject references**

Goods and services tax

Unincorporated bodies

**Legislative references**

Airport Authorities Act 1966

Companies Act 1993

Goods and Services Tax Act 1985, ss 2 ("company"), 5(8A), 6(1) ("taxable activity"), 10(1), 51, 57

Incorporated Societies Act 1908

Retirement Villages Act 2003

Unit Titles Act 1972

Unit Titles Act 2010

**Other references**

"Question 62 - clinics providing administrative services – taxable activity?" *Public Information Bulletin* Vol 158 (November 1986): 11

"Question 112 - residential management committee – taxable activity?" *Public Information Bulletin* Vol 158 (November 1986): 27

"GST and property administration" *Public Information Bulletin* Vol 173 (April 1988): 7

"IS 15/02: Goods and services tax – GST and retirement villages" *Tax Information Bulletin* Vol 27, No 11 (December 2015): 6

"GST and bodies corporate" *Tax Information Bulletin*, Vol 28, No 3 (April 2016): 33.

**Case references**

*Anglesea Builders Partnership v CIR* (1987) 9 NZTC 6,181

*Case P70* (1992) 14 NZTC 4,469 (TRA)

*Case S34* (1995) 17 NZTC 7,228 (TRA)

*Canterbury Jockey Club Inc v CIR* [2018] NZHC 2,569

*Chatham Islands Enterprises Trust v CIR* [1999] 2 NZLR 388 (CA)

*CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA)

*Conservative and Unionist Central Office v Burrell (Inspector of Taxes)* [1982] 2 All ER 1

*Edwards v Legal Services Agency* [2003] 1 NZLR 145

*McElwee v CIR* (1988) 10 NZTC 5,181

*Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC)

*Taunton Syndicate v CIR* (1982) 5 NZTC 61,106

*Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 (HC)

*Turakina Maori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA)

# INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

## IS 19/03: Income tax – exempt income of non-resident entertainers

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in the appendix to this Interpretation Statement.

### Summary

1. Where a non-resident entertainer or sportsperson carries out an activity or performance in New Zealand, the income they earn from that activity or performance will usually be subject to tax in New Zealand. However, in certain circumstances, s CW 20 of the Income Tax Act 2007 provides non-resident entertainers and sportspersons with an exemption. This statement considers s CW 20, and the circumstances in which the exemption will apply.
2. This statement is primarily intended to assist those who are paying non-resident entertainers to decide whether the exemption in s CW 20 applies so that payers do not need to withhold tax from payments made. However, it may also be of assistance to non-resident entertainers who are unsure whether their income is exempt.
3. The exemption in s CW 20 covers income received by a non-resident entertainer in four situations. The situations are where the non-resident entertainer carries out an activity or performance in New Zealand, and one of the following occurs:
   (a) The activity or performance occurs under a government cultural programme. This is where a cultural programme belongs to, and is funded by, either the New Zealand Government or an overseas central government. (See s CW 20(1)(a) and the discussion from [23].); or,
   (b) The activity or performance occurs under a cultural programme that is wholly or partly sponsored by a government. This is where the New Zealand Government or an overseas central government provides more than minimal funding for the cultural programme. (See s CW 20(1)(b) and the discussion from [32].); or,
   (c) The activity or performance occurs as part of a programme that belongs to certain types of overseas bodies. To fall within this category, an overseas body needs to be a foundation, trust or other organisation. The body needs to have a more than minimal purpose of promoting cultural activity. The body also cannot be carried on for the private pecuniary profit of any member, proprietor, or shareholder; that is, none of those persons should be entitled to the body's surpluses or capital. (See s CW 20(1)(c) and the discussion from [43].); or,
   (d) The activity or performance relates to a game or sport, where the participants are official representatives of a body that administers the game or sport at a national level in an overseas country. (See s CW 20(2) and the discussion from [68].).
4. Section CW 20(3) also exempts amounts derived by another person (**the Service Provider**) who provides the services of a non-resident entertainer during a visit to New Zealand if certain conditions are met. In particular, the Service Provider must be related to the entertainer in one of the following ways:
   (a) The Service Provider is the non-resident entertainer's "employer". This can occur by the **Service Provider** engaging the non-resident entertainer as either an employee, or an independent contractor. (See from [101].);
   (b) The Service Provider is a company that has the non-resident entertainer as an officer. This will most commonly occur where the non-resident entertainer is a director of the Service Provider company that derives income by providing the entertainer's services. (See from [107].);
   (c) The Service Provider is a firm that has the non-resident entertainer as a principal. This will most commonly apply where the Service Provider is some other kind of unincorporated business and the entertainer is one of the senior persons in that business. (See from [110].).

5. If the exemption applies, those paying the non-resident entertainer or Service Provider are not required to deduct tax from the payments they make to the non-resident entertainer or Service Provider. If the exemption does not apply, there is a withholding liability on payers to deduct tax from income paid to non-resident entertainers or Service Providers under the PAYE rules in subpart RD.
6. This statement updates and replaces "Non-resident sports people and entertainers – application of section 61(17) of the Income Tax Act 1976" published in *Tax Information Bulletin* Vol 4, No 3 (October 1992) (**the 1992 item**).

## Introduction

7. The term "non-resident entertainer" is defined in s CW 20(4):

> *Meaning of non-resident entertainer*
>
> (4) In this section, non-resident entertainer means a non-resident person, as defined in subpart YD (Residence and source in New Zealand), who carries out an activity or performance in connection with—
>
> (a) a solo or group performance by actors, comperes, dancers, entertainers, musicians, singers, or other artists, whether for cultural, educational, entertainment, religious, or other purposes; or
>
> (b) lectures, speeches, or talks for any purpose; or
>
> (c) a sporting event or sporting competition of any nature.

8. A wide variety of performers and sportspeople are covered by s CW 20(4) and could qualify for the exemption provided the requirements of s CW 20(1), (2) or (3) are met. In the Commissioner's view, the entertainers covered by s CW 20(4) include performers on both stage and screen.
9. This statement does not address whether a person is a non-resident for income tax purposes. More information about residency is in the Commissioner's Interpretation Statement "IS 16/03 Tax Residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016).
10. Under the Act, non-residents are generally taxed on only their New Zealand–sourced income: s BD 1(5). For non-resident entertainers, income that they earn from activities or performances in New Zealand will generally have a source in New Zealand: s YD 4(3), (4) and (17D). Broadly, the Act does one of two things in relation to a non-resident entertainer's income. The Act either:
    (a) exempts the income under s CW 20, which depends on the circumstances of the non-resident entertainer's activity or performance; or,
    (b) creates a withholding liability on payers to deduct tax from the income under the PAYE rules in subpart RD.
11. The analysis in this statement focuses on the scope of s CW 20. The effects of the PAYE rules and double tax agreements are also briefly noted from [118] below, but those paying non-resident entertainers for their services do not need to consider those aspects if the exemption applies.

## Analysis

### Introduction

12. The analysis in this statement is structured in the following way:
    (a) First, the statement discusses the circumstances in which income derived by a non-resident entertainer, other than a sportsperson, will be exempt. The statement separately addresses each of the three circumstances listed in s CW 20.
    (b) Secondly, the statement discusses when income derived by a non-resident entertainer from sporting activities will be exempt.
    (c) Thirdly, the statement discusses what happens if the income is derived by the non-resident entertainer's employer, or by a company or firm with which the entertainer has some connection, rather than by the entertainer.
    (d) Finally, the statement briefly notes the further matters that payers should consider where the exemption does not apply, including the PAYE rules, and applicable double tax agreements.

### Non-resident entertainers other than sportspersons

13. Section CW 20(1) exempts income derived by a non-resident entertainer, other than a sportsperson, from carrying out their "activity or performance" if the activity or performance occurs in one or more of three circumstances listed in the provision. Each circumstance is listed in a separate paragraph of s CW 20(1), and only one of the three paragraphs in s CW 20(1) needs to be met for s CW 20(1) to apply. However, a common theme in each paragraph is the reference to a "cultural" programme or activity.

### *A "cultural" programme or activity*

14. The ordinary meaning of "cultural" includes "relating to the arts and to intellectual achievements" (*Concise Oxford English Dictionary*, Oxford University Press, online ed).
15. Case law also describes "cultural" as covering a wide range of artistic or cultural pursuits. For instance, the Court of Appeal in *Molloy v CIR* (1981) 5 NZTC 61,070 noted that that the word "may properly have attributed to it its ordinary dictionary meaning as relating to the training, development and refinement of mind, tastes and manners".
16. The word "cultural" was also considered in *Conyngham & Ors v Minister for Immigration and Ethnic Affairs* [1986] FCA 238, (1986) 68 ALR 423. *Conyngham* concerned an administrative policy under which temporary entry permits could be issued to entertainers or professionals who possessed a level of talent of such merit as to lead to "the continuing cultural enrichment of the Australian community". An American vocal group known as "The Platters", who sang songs from the 1950s delivered in 1950s style, had been denied a temporary entry permit to Australia under that policy. Wilcox J (at [30]) considered the word "cultural" in this context was not limited to specialised arts practised only by a minority. Rather, the term was used in its full and true sense as "pertaining to civilization". He went on to say that not everyone will appreciate a particular entertainer or their performance. However, this does not prevent the performance from enriching the culture of the community by extending the opportunities and range of those who do appreciate it.
17. That a cultural performance is not limited to specialised arts is consistent with the definition of "non-resident entertainer" in s CW 20(4) which lists a wide variety of activities. Following case law, whether the entertainer is widely appreciated is not relevant.
18. The *Concise Oxford English Dictionary* provides several definitions for "programme". The most relevant of those definitions is:

    > A set of related measures or activities with a particular long-term aim.

19. Taking "programme" to mean a set of related measures or activities with a long-term aim, the ordinary meaning of "cultural programme" would therefore be a set of related measures or activities with a long-term aim of "culture".
20. Given a "programme" refers to a set of related measures or activities, a standalone or one-off project is unlikely to constitute a programme by itself. However, if that project forms part of a wider, for example, event or festival, the event or festival could be considered a programme.
21. For clarity, the Commissioner notes that the "cultural" programmes and activities covered in the provision are not limited to those that were explicitly listed in the 1992 item.
22. This statement goes on to consider separately the three circumstances set out in the three paragraphs in s CW 20(1).

### *Government cultural programmes – s CW 20(1)(a)*

23. The first circumstance (under s CW 20(1)(a)) is where the non-resident entertainer's activity or performance:

    > ...occurs under a cultural programme of the New Zealand government or an overseas government...

24. Having already discussed the meaning of "cultural programme", the remaining issues in this paragraph are whether there is a programme "of" a government, and which "governments" qualify.
25. The ordinary meaning of the word "of" in this context suggests that the cultural programme must be associated with, or belong to, that government: *Concise Oxford English Dictionary* definition of "of".
26. The initial reference to "government" is to "**the** New Zealand" government. This implies that it refers to the national government of New Zealand (that is, central government), rather than to local authorities defined by the Local Government Commission that are independent of, and subordinate to, central government: J Wilson, "Nation and Government: Local Government" in *Te Ara: The Encyclopedia of New Zealand* (Ministry for Culture and Heritage, 2005, updated 16 September 2016). In context, then, the reference to an overseas government is to the national or central government of an overseas country and not to a local or state government.
27. For completeness, if a non-resident entertainer's activity or performance occurs under a cultural programme of, for instance, a local or state government s CW 20(1)(b) or (c) can still apply provided the other requirements in those provisions are met.
28. The policy intention behind s CW 20(1) is to facilitate cultural exchanges between New Zealand and other countries that:
    - are funded by the government; or,
    - occur under a programme of a cultural organisation the activities of which are not carried out for the private pecuniary profit of any member (covered by s CW 20(1)(c) which is discussed from [43]).

29. The same policy reason for s CW 20(1)(a) underlies similar provisions in some of New Zealand's double tax agreements (**DTA**). Some of these DTAs include a provision that income derived by a visiting non-resident entertainer will not be subject to New Zealand tax. In the absence of such a provision, the income will be taxable in the contracting state in which it is derived: art 17 of the OECD Model Tax Convention on Income and on Capital (the **OECD Model Tax Convention**). The OECD, in "Commentary on Article 17", in *Model Tax Convention on Income and on Capital: Condensed Version 2017* (OECD Publishing, Paris, 2017) explains that some DTAs provide that article 17 does not apply if the entertainer or sports person is employed in events **that are supported by public funds**:

> 13. Article 17 will ordinarily apply when the entertainer or sportsperson is employed by a Government and derives income from that Government: see paragraph 6 of the Commentary on Article 19. **Certain conventions contain provisions excluding entertainers and sports persons employed in organisations which are subsidised out of public funds from the application of Article 17**.
>
> 14. **Some countries may consider it appropriate to exclude from the scope of the Article events supported from public funds**. Such countries are free to include a provision to achieve this but the exemptions should be based on clearly definable and objective criteria to ensure that they are given only where intended. Such a provision might read as follows:
>
> > The provisions of paragraphs 1 and 2 shall not apply to income derived from activities performed in a Contracting State by entertainers or sportspersons if the visit to that State is **wholly or mainly supported by public funds of one or both of the Contracting States or political subdivisions or local authorities thereof**. In such a case, the income is taxable only in the Contracting State in which the entertainer or sportsperson is a resident. [Emphasis added]

30. In this light, a cultural programme will belong to the government (New Zealand or overseas) if that programme is funded by the government.

31. For completeness, the Commissioner notes that neither the wording nor the policy of the legislation requires:

- the non-resident entertainer to be an employee of the government or a government agency; or
- the funding to be by way of monetary remuneration to an employee.

For example, the funding may take the form of a grant given under a government cultural programme.

### *Government sponsored cultural programmes – s CW 20(1)(b)*

32. The second circumstance (under s CW 20(1)(b)) is where the non-resident entertainer's activity or performance:

> …occurs under a cultural programme wholly or partly sponsored by the New Zealand government or an overseas government…

33. Unlike in s CW 20(1)(a), this circumstance does not require the cultural programme to *belong* to the New Zealand or overseas government. However, it does require the programme to be "wholly or partly sponsored" by the government (New Zealand or overseas). The meaning of that phrase is considered further below.

#### *"Sponsored"*

34. To sponsor means to be a sponsor. "Sponsor" is defined in the *Concise Oxford English Dictionary*:

> 1 a person or organization who pays or contributes to the costs of an event or broadcast in return for advertising.
> 2 a person who pledges a sum of money to a charity after another person has participated in a fundraising event.
> 3 a person who introduces and supports a proposal for legislation.
> 4 a person taking official responsibility for the actions of another.

35. The meanings of "sponsor" contemplate either financial or non-financial support. As noted in [28], the policy behind s CW 20(1) is to facilitate cultural exchanges between New Zealand and another country that are funded by:

- the government, or
- a cultural organisation the activities of which are not carried out for the private pecuniary profit of any member.

36. In this light, the Commissioner's view is that sponsorship of a cultural programme requires the government (New Zealand or overseas) to pay or contribute to the costs of that programme. That is, the cultural programme must be wholly or partly funded by the government.

37. What must be sponsored is a "cultural programme" and the meaning of that term is discussed at [14] to [19]. Mere sponsorship of an entity is insufficient, unless that entity is carrying on a cultural programme, that cultural programme is sponsored, and the non-resident entertainer's activity or performance occurs under that programme.

#### *"Wholly or partly"*

38. The phrase "wholly or partly" is not defined in the context of s CW 20(1)(b). The ordinary meaning of "wholly" is entirely or fully and the ordinary meaning of "partly" is to some extent or not completely (*Concise Oxford English Dictionary*).

39. In *Dyck v Lohrer* [2000] BCJ No 629, the court interpreted "partly" as meaning something less than the entire part. The word "partly" means a piece, portion or part of a whole. It may mean a very small part or a very large part (*Re Schlatter and Defence Force Retirement and Benefits Authority and Brown* (1985) 8 ALD 133).

40. In *McKenzie v Baddeley* [1991] NSWCA 197, the court considered "partly" in the context of the phrase "wholly or partly dependent". It held that "partly" did not mean substantially. Rather, it meant "more than minimally" or "significantly".

41. The legislative context determines whether the phrase "wholly or partly" is a composite term or whether the word "partly" is read in isolation. The Commissioner's view is that "wholly or partly" is a composite phrase where the meaning of "partly" is coloured by "wholly". The word "partly" used in conjunction with the word "wholly" requires that the promotion of cultural activity must be a more than minimal purpose of the organisation's existence (*McKenzie v Baddeley*).

42. If a cultural programme is only minimally funded by the government, the Commissioner acknowledges that a boundary issue about the meaning of "partly" could arise. However, in such a case the Commissioner's view is that the provision's purpose should be considered. The Commissioner's view is that the provision was intended to promote programmes that are likely to result in little or no profit or might not happen without government funding. In practice, where governments do provide funding, one of the criteria that is likely considered by the agency or authority responsible for that funding is whether a programme is likely to happen without government funding. As such, the Commissioner's view is that a programme that has received government funding to any extent will be the kind of programme that was anticipated to qualify under the exemption.

### *Overseas foundations, trusts or other cultural organisations – s CW 20(1)(c)*

43. The third circumstance (under s CW 20(1)(c)) is where the non-resident entertainer's:

> ... activity or performance occurs as part of a programme of an overseas foundation, trust, or other organisation that—
>
> (i) exists wholly or partly to promote cultural activity; and
>
> (ii) is not carried on for the private pecuniary profit of any member, proprietor, or shareholder.

44. Section CW 20(1)(c) shares some common language with s CW 20(1)(a) and (b). In particular, para (c) refers to a programme "of" an organisation. As in para (a), the word "of" in para (c) also denotes ownership.

45. The programme must belong to an "overseas foundation, trust, or other organisation". These terms are not defined in the Act so the ordinary meanings are relevant. A "foundation" is an institution established with an endowment: *Concise Oxford English Dictionary*. A "trust" is a fiduciary relationship where a person holds the title of property for the benefit of another: *New Zealand Law Dictionary* (8th ed, LexisNexis NZ, Wellington, 2015). An "organisation" is an organised group of people with a particular purpose: *Concise Oxford English Dictionary*.

46. In context, the Commissioner notes that the overseas "foundation, trust, or other organisation" is the same body that must not be "carried on for the private pecuniary profit of any **member, proprietor, or shareholder**". The reference to a shareholder anticipates that an "other organisation" could include a company, since a trust or foundation would not be expected to have shareholders. Similarly, the references to "member" and "proprietor" suggest that other types of unincorporated bodies, such as partnerships or unincorporated societies, will qualify. On balance, the Commissioner's view is that, in practice, the inclusion of "other organisation" in s CW 20(1)(c) indicates that the provision potentially applies to any overseas group of people that meets the stipulated requirements outlined in [43].

47. Importantly, s CW 20(1)(c) will apply only if the cultural programme belongs to an *overseas* foundation, trust or organisation. This means a performance under a programme of a New Zealand organisation will not meet the requirements of s CW 20(1)(c). This is so even if the entertainer is a non-resident. The Commissioner's view is that the reference to an "overseas" body refers to a body that has been constituted, has been established or operates outside New Zealand.

#### *Does the overseas body exist (wholly or partly) to promote cultural activity?*

48. For s CW 20(1)(c) to apply, the overseas organisation must "exist wholly or partly to promote cultural activity". This phrase is undefined in the Act. However, in the Commissioner's view, this phrase suggests a test of the organisation's purpose (or purposes).

49. The organisation's purpose needs to be to "promote cultural activity". The ordinary meaning of "promote" is to move forward or advance (*Aporex Inc v Hoffmann La-Roche Ltd* [2000] OJ No 4732). Therefore, for s CW 20(1)(c) to apply, a purpose of the overseas organisation must be (wholly or partly) to move forward or advance cultural activity. As discussed from [14], culture relates to the training, development and refinement of mind, tastes and manners; it is not limited to specialised arts but pertains to civilisation.

50. The meaning of "wholly or partly" is discussed above at [38] to [42]. In summary, the case law suggests that "wholly or partly" can be read as "significantly" or "more than minimally": *McKenzie v Baddeley*. As discussed at [41], "partly" cannot refer to "significantly". Therefore, in the context of s CW 20(1)(c), the promotion of cultural activity must be a more than minimal purpose of the organisation's existence.

51. In determining if an organisation exists wholly or partly to promote cultural activity, it is necessary to consider the activities that the organisation actually engages in (*Capital Club Pty Ltd v Commissioner of State Revenue* (2007) ATC 4498). For the exemption in s CW 20(1)(c) to apply, the overseas organisation must have promoted cultural activity by providing an activity or performance by a non-resident entertainer in New Zealand as part of a programme. The exemption could apply where an overseas organisation exists to promote cultural activity and for other purposes. This is provided the promotion of cultural activity is a more than minimal purpose for the organisation's existence.

*What does it mean for an activity not to be carried on for the private pecuniary profit of any member, proprietor or shareholder?*

52. The phrase "private pecuniary profit of any member, proprietor or shareholder" is not defined in the Act. Case law suggests that an organisation will be viewed as not being carried on for private pecuniary profit if its surpluses or capital are unavailable for private benefit: *Trustees of the Auckland Medical Aid Trust v CIR* (1979) 4 NZTC 61,404 (HC). However, the cases also indicate that the requirement that funds not be available for the private pecuniary profit of a member does not prevent a person being paid for their services to the entity: *Presbyterian Church of New Zealand Beneficiary Fund v CIR* (1994) 16 NZTC 11,185 (HC) and *Hester & Ors v CIR* (2005) 22 NZTC 19,007 (CA).

53. In s CW 20(1)(c), the relevant individuals or groups are the members, proprietors or shareholders of the overseas foundation, trust or other organisation.

54. The *Concise Oxford English Dictionary* defines "member", "proprietor" and "shareholder" as:

> **member** … a person … that has joined a group, society, or team …
>
> **proprietor** … **1** the owner of a business. **2** a holder of property.
>
> **shareholder** … an owner of shares in a company.

55. The definitions "proprietor" and "shareholder" incorporate the concept of ownership. The meaning of "member" is arguably wider, suggesting that a person is a member because of the nature of their relationship with an organisation. Therefore, the essence of being a member is that a person belongs to an organisation. However, in the context of s CW 20(1)(c), the "member" will be someone who could potentially receive a private pecuniary benefit from the organisation's activity unless prohibited by constitution or other founding document.

56. The grammar of s CW 20(1)(c) indicates that what cannot be carried on for private pecuniary profit of any member, proprietor or shareholder is the *overseas foundation, trust or other organisation*. Provided the requirements in s CW 20(1)(c) are met, it can still apply if the non-resident entertainer profits from their performance – as is clearly envisaged where a non-resident entertainer derives an amount of income from their performance.

57. Whether an organisation is or is not carried out for private pecuniary profit of any member, proprietor or shareholder is tested based on the wording of the constituting documents. These are then tested from a holistic perspective, having regard to the organisation's functions and activities (*CIR v Medical Council of New Zealand* (1997) 18 NZTC 13,088 (CA); *Crown Forestry Rental Trust v CIR* (2002) 20 NZTC 17,737 (CA)).

### *Activity … "in connection with"*

58. To qualify for the exemption in s CW 20(1), a person needs to be a non-resident entertainer under s CW 20(4). They will be a non-resident entertainer if they are a "non-resident person … who carries out an activity or performance **in connection with**" various kinds of entertainment and sporting activities listed in s CW 20(4)(a) to (c).

59. Touring performers will often have supporting personnel. Although those personnel may play an important role in supporting performers, whether they qualify for the exemption depends on whether their activities have a sufficient "connection with", the relevant event, as those words must be interpreted in the provision.

60. The words "in connection with" and (as discussed later in this statement from [86]) "relating to" likely have a similar meaning. Case law has considered the words "relating to" as well as the similar phrases "in relation to" and "in respect of". In one context, the courts have said that the words "in respect of or in relation to" are "words of the widest import": *Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303. However, in *New Zealand Forest Research Ltd v CIR* (1998) 18 NZTC 13,928, the High Court stated that the starting point in interpreting the meaning of "relating to" is to consider the ordinary and natural meaning of the phrase, in the context of the provision in which it is used. That approach is consistent with s 5(1)

of the Interpretation Act 1999, which requires the meaning of an enactment must be ascertained from its text and in the light of its purpose, and the Supreme Court's decision in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767.

61. As noted at [80], the exemption's purpose at the time of enactment was to bring the exemption for certain non-resident entertainers – then set out in Part F of the Income Tax (Withholding Payments) Regulations 1975 – into the general tax law. What were the payment categories in the Income Tax (Withholding Payments) Regulations 1975 are now found in sch 4 of the Income Tax Act 2007. Schedule 4 may therefore be relevant in interpreting s CW 20(4).
62. The Commissioner notes that, in the context of entertainers, the sch 4 category for non-resident entertainers providing a "Part F activity" seems unlikely to include supporting personnel. Relevantly, sch 4 includes a specific category for people providing services on- and off-set for television, video and film productions. That category was added by the Income Tax (Withholding Payments) Amendment Regulations (No 2) 2003 ("the Amendment Regulations").
63. The Commissioner understands that the Amendment Regulations added that category to ensure that those types of supporting personnel were subject to tax in approximately the same way as entertainers. By implication then, the Amendment Regulations would not have been necessary if supporting personnel already came within the entertainer category.
64. The discussion in the *OECD's Commentary on Article 17 concerning the taxation of entertainers and sportspersons* also stipulates at [4] that a distinction should be made between a person performing as an entertainer in a show and another taking a supporting role.
65. Consistent with the approach in sch 4 and the OECD Commentary, the Commissioner's view is that supporting personnel are not included as non-resident entertainers under s CW 20(4).
66. However, supporting personnel may still qualify for the exemption in s CW 19. Section CW 19 gives non-residents who derive personal services income an income tax exemption where they visit for short periods only, work for a person who is a non-resident, and are subject to an equivalent income tax in their residence country.
67. Similar considerations arise for sportspeople and are addressed below from [86].

### Sportspersons

68. Section CW 20(2) contains an exemption for certain non-resident entertainers carrying out an activity or performance relating to a game or sport. It provides:

> Income that a non-resident entertainer derives from carrying out an activity or performance that relates to a game or sport in New Zealand during a visit is exempt income if the participants are the official representatives of a body that administers the game or sport in an overseas country.

#### *Official representative*

69. For the exemption to apply, the participants need to be "official representatives". The *Concise Oxford English Dictionary* defines "official", in its adjective form, as follows:

> 1 Relating to an authority or public body and its activities and responsibilities.
>
> 1.1 Having the approval or authorization of an authority or public body.
>
> 1.2 Employed by an authority or public body in a position of authority.

70. The example given in the *Concise Oxford English Dictionary* for definition 1.2 above is "an official spokesman". Given the reference in the provision is to an "official representative" of a sporting body, definition 1.2 seems most relevant in this context.
71. "Representative" is defined in the Concise Oxford English Dictionary as follows:

> 1 A person chosen or appointed to act or speak for another or others.

72. Taken together, these definitions appear to suggest that an "official representative" is a person chosen or appointed to act as a person employed by an authority or public body in a position of authority, in this context in relation to a sport.
73. In that way, a person who merely affiliates with, or is a member of, an administering body will not qualify for the exemption. Similarly, a person will not qualify if they affiliate with a sporting body but compete on an individual basis rather than as an "official representative" of that body. The person needs to "represent" the administering body.
74. For completeness, the Commissioner notes that while the dictionary definitions use the word "employed", this may not refer to the legal concept of employment. In other words, a person need not have an employment contract with a body to be an official representative of that body.

### *Body that "administers" the game or sport in an overseas country*

75. For the exemption to apply, the body must administer the game or sport "in an overseas country". Income derived by official representatives of a New Zealand body which administers a sport is **not** exempt under this provision.

76. "Administer" is defined in the *Concise Oxford English Dictionary* as follows:

> Manage and be responsible for the running of (a business, organization, etc.)

77. Taking the ordinary meaning of "administer", the provision therefore seems to point towards bodies that manage, or are responsible for running matters to do with, the sport or game in an overseas country. Whether an organisation can be regarded as one that "administers" a game or sport will ultimately be a factual matter. The ordinary meaning of "administers" suggests that an analysis of the organisation's functions will be required. Without limiting the functions that might be considered, some examples of relevant "administrative" functions could include where the body is:

(a) Formally established or constituted;

(b) Responsible for promotion of the sport both within its country and internationally;

(c) Recognised on the international stage as that country's official body for its relevant sport;

(d) Affiliated with, or a member of, an international body responsible for administering the sport;

(e) Responsible for selection of players in international competitions;

(f) Responsible for setting rules or codes in relation to its sport;

(g) Responsible for disciplinary action against players or members.

### *National sporting body*

78. The wording of s CW 20(2) suggests that there may be more than one administrative body for a game or sport in a country. This is because of the use of the indefinite article, "**a** body that administers the game or sport". But it is not clear whether the wording merely allows for the possibility of more than one body at a national level (for example, one for men and one for women), or whether it also allows for bodies at a regional or city level. On one reading of s CW 20(2), there might not appear to be any reason why a member of a club rugby team, who is an official representative of the board or committee who administers the sport for the overseas club, would not be covered by s CW 20(2).

79. However, the explanatory note to cl 5 of the Land and Income Tax Amendment Bill (No 4) 1975, which led to the insertion of what is now s CW 20(2), stated that the exemption related to players officially representing their country or their national organisation:

> Clause 5 exempts from income tax the income derived by non-resident entertainers (within the meaning of the Income Tax (Withholding Payments) Regulations 1975) from any activity or performance–
>
> ...
>
> (c) In relation to any game or sport where the players officially represent their **country** or their **national** organisation. [Emphasis added]

80. Background materials, including submissions made on the Bill, indicate that cl 5 was intended to bring the exemption for certain non-resident entertainers – which already appeared in Part F of the Income Tax (Withholding Payments) Regulations 1975 – into the general tax law. The New Zealand Society of Accountants submitted on cl 5 of the Bill, suggesting that the exemption for certain sportspersons should be widened. As a matter of policy, the Government decided that the exemption should only apply to sportspersons *who officially represent their overseas country*.

81. The Commissioner also notes that the sportspersons exemption has subsequently been treated as applying to only national representatives. For instance, from 27 January 1995 the New Zealand-Australia DTA has included a specific rule for trans-Tasman sporting leagues, intended to reduce compliance costs for non-national sporting representatives: art 17(3) of the New Zealand-Australia DTA. The Finance and Expenditure Committee commented on the rule (at p 7):[1]

> The exclusion does not apply to national representative teams competing in international competitions such as the rugby world cup. **Existing domestic law provisions exempt foreign national representative teams competing in New Zealand.** [Emphasis added]

82. Both the pre-legislative materials and subsequent interpretative approach indicate that the legislative intention of what is now s CW 20(2) was that the "governing body" is the governing body at a national level. Representing a provincial body or a club does not suffice for the exemption to apply.

83. Further, that a visiting club team may have the approval of that governing body or the team's board or committee is not intended to qualify a player for an exemption. Rather, the players must be official representatives of the overseas national governing body for the sport.

1 *International Treaty Examination of the Convention between New Zealand and Australia for the Avoidance of Double Taxation with Respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* (Finance and Expenditure Committee, 2009, **https://taxpolicy.ird.govt.nz/sites/default/files/tax-treaties/2009-nia-dta-nz-australia.pdf**)

84. In conclusion, s CW 20(2) applies when income is derived by a visiting sportsperson provided they officially represent a national body that administers the game or sport in an overseas country.

85. As mentioned above, it is possible that there might also be more than one administrative body at a national level (for instance where there are separate bodies for women and men). The exemption can still apply in such a case.

### *Activity ... that "relates to", or is "in connection with", a game or sport*

86. Similar to the position for non-resident entertainers other than sportspeople, touring sportspeople may have a number of supporting personnel. A similar statutory interpretation issue may arise about the meaning of "in connection with", as is described above at [58] to [67]. And for sportspeople, there is a separate but similar issue in s CW 20(2) because the non-resident entertainer's income is only exempt if it is derived "from carrying out an activity ... **that relates to** a game or sport ... if the participants are the official representatives of [a national administrative body]".

87. The meaning of "in connection with" and "relates to" is set out above at [60]. In the context of s CW 20(2), the Commissioner has again had reference to the schedular payments regime. Notably in sch 4, the definition of "Part F activity" arguably only provides an exclusion from withholding tax deductions for "official representatives" themselves. This suggests that supporting personnel are not covered by s CW 20(2).

88. The discussion in the OECD's *Commentary on Article 17 concerning the taxation of entertainers and sportspersons* also generally appears to refer to sportspersons, rather than supporting personnel, as coming within Article 17 of the OECD Model Tax Convention.

89. Therefore, the Commissioner's view is that the exemption in s CW 20(2) does not apply to supporting personnel. However, as explained at [66] supporting personnel may still qualify for the exemption in s CW 19. Section CW 19 gives non-residents who derive personal services income an income tax exemption where they visit for short periods only, work for a person who is a non-resident, and are subject to an equivalent income tax in their residence country.

### *Income ... "from" an activity or performance that relates to a game or sport*

90. Section CW 20(2) provides an exemption for income that a non-resident entertainer derives "**from** carrying out an activity or performance that relates to a game or sport".

91. In some cases, sportspersons may derive income from sources that are ancillary to the sportsperson's physical performance. Some examples might include:

    (a) Payments by sponsors, for instance where the sportsperson might wear a sponsor's branded clothing; or

    (b) 'Image rights' payments, where the sportsperson is paid for the use of their image, such as where a promoter wishes to use the sportsperson's image to advertise their appearance in the lead up to an event.

92. There may be a question as to whether income of these kinds can be regarded as "from" the sportsperson's activity or performance for the purposes of s CW 20(2). This would seem to depend on whether the income has the required degree of connection to, even if it is not directly from, the sportsperson's physical performance.

93. In many cases, it appears that New Zealand would have a shared right to tax these sources of income. The entertainers and sportspersons article in most of New Zealand's double tax agreements corresponds to Article 17 in the OECD's Model Tax Convention. The OECD's *Commentary on Article 17 concerning the taxation of entertainers and sportspersons* suggests that income from sources other than a sportsperson's (or entertainer's) physical performance can still fall within Article 17 of the OECD Model Tax Convention. This will be the case if the income has a "close connection" with the sportsperson's physical performance. Some examples of when there is a "close connection" are described in the Commentary – for instance, where a sportsperson gives a paid media interview while they are on tour in a country.

94. Section CW 20(2) was inserted alongside the exemptions for non-resident entertainers' cultural performances and activities. As stated at [42], the non-resident entertainers' exemption was intended, at least in part, to ensure that tax is not an impediment to cultural exchanges. The Commissioner considers it reasonable to assume that there was a similar policy rationale for the sportspersons' exemption. That is, Parliament's purpose was to remove the tax impost from sportsperson's incomes that might otherwise have been an impediment to hosting international sporting competitions.

95. If New Zealand imposed tax on income "closely connected" with a sportsperson's physical performance, it could, at the margins, create the kind of impediment to hosting international sporting competitions that Parliament likely sought to avoid. For that reason, the Commissioner's view is that the exemption was likely intended also to apply to income that is closely connected to a sportsperson's physical performance in New Zealand.

96. It is noted that the sportsperson would still need to meet all the elements of s CW 20(2). Most notably, the sportsperson has to be a national sporting representative. So, for instance, a fee paid for an interview with a member of a touring national rugby team while that player is on tour in New Zealand may qualify for the exemption, but a similar payment to a golfer competing on an individual basis may not.

### Service Provider providing services of non-resident entertainer or sportsperson

97. Section CW 20(3) exempts amounts derived by a person (the Service Provider) who provides the services of a non-resident entertainer during a visit to New Zealand:

> *Exempt income: employer of non-resident entertainer*
>
> (3) If income derived from an activity or performance of a non-resident entertainer would be exempt income under this section if derived by the non-resident entertainer, that amount is exempt income if derived by a person who—
>
> (a) provides the services of the non-resident entertainer during the visit to New Zealand; and
>
> (b) is 1 of the following:
>
> (i) the entertainer's employer; or
>
> (ii) a company of which the entertainer is an officer; or
>
> (iii) a firm of which the entertainer is a principal.

98. Section CW 20(3) applies only if the income would have been exempt had it been derived by the non-resident entertainer. Therefore, it is first necessary to consider the application of s CW 20(1) and (2) to the income. If one of these exemptions would have applied, s CW 20(3) will exempt the income in the hands of the Service Provider.

99. There is no restriction in s CW 20(3) on the residency of the Service Provider.

100. The Service Providers who come within the categories listed in s CW 20(3)(b) include:

- the entertainer's employer
- a company of which the entertainer is an officer
- a firm of which the entertainer is a principal

#### *The entertainer's employer*

101. Section CW 20(3)(b)(i) exempts a payment received by a Service Provider that is "the entertainer's employer". The word "employer" is a defined term in s YA 1. The s YA 1 definition states, at para (a), that "employer":

> means a person who pays or is liable to pay a PAYE income payment…

102. Section CW 20(3)(b)(i) refers to "**the entertainer's** employer". Applying the s YA 1 definition in that context, the person referred to in para (a) of the definition of "employer" in s YA 1 is a "person who pays or is liable to pay a PAYE income payment" to the non-resident entertainer.

103. Included within the PAYE income payment definition in s RD 3(1) are "a payment of salary or wages" and "a schedular payment". A "schedular payment" includes a payment to a non-resident entertainer: s RD 8(1)(a)(i) and sch 4, Part F, cl 4.

104. The main difference between a person receiving a payment of "salary or wages" and a person receiving a "schedular payment" is the nature of their relationship with the payer. In essence, a payment of salary or wages is made under a contract of service while a schedular payment is a payment made under a contract for service.

105. The implication from the above is that the definition of "employer" in s YA 1 means that "the entertainer's employer", is not limited to a person who has engaged the entertainer under a contract of service. This is because the definition includes a person paying a PAYE income payment, which may be in the form of either a payment of salary or wages or a schedular payment. Schedular payments are payments made under contracts for services (that is, to independent contractors). And in the context of s CW 20, a payment to a non-resident entertainer who is an independent contractor will come within the schedular payments rules because it is a payment listed in sch 4, Part F.

106. In conclusion, s CW 20(3)(b)(i) covers situations where the "person" has engaged the entertainer either as an employee under a contract of service, or as an independent contractor under a contract for service.

### *A company of which the entertainer is an officer*

107. Section CW 20(3)(b)(ii) exempts a payment received by a Service Provider that is "a company of which the entertainer is an officer". A "company" is defined in s YA 1 as:

> **company—**
>
> (a) means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere:
>
> (ab) does not include a partnership:
>
> (abb) does not include a look-through company, except in the PAYE rules, the FBT rules, the NRWT rules, the RWT rules, the ESCT rules, the RSCT rules, and for the purposes of subpart FO (Amalgamation of companies):
>
> (abc) does not include a company that is acting in the capacity of trustee:
>
> (ac) includes a listed limited partnership:
>
> (ad) includes a foreign corporate limited partnership:
>
> (b) includes a unit trust:
>
> …

108. There is no definition of "officer" in either the Income Tax Act 2007 or in the Companies Act 1993. The *Concise Oxford English Dictionary* defines "officer" as:

> 2 A holder of a public, civil, or ecclesiastical office.
>
> 2.1 A holder of a senior post in a society, company, or other organization.

109. Based on the ordinary meaning, a company "officer" will be a person holding a senior post within the company. The most common example of a company officer is likely to be a company director.

### *A firm of which the entertainer is a principal*

110. Section CW 20(3)(b)(ii) exempts a payment received by a Service Provider that is "a firm of which the entertainer is a principal". The word "firm" is also not defined in the Act. The *Concise Oxford English Dictionary* defines "firm" as:

> 1 A business concern, especially one involving a partnership of two or more people.

111. The ordinary meaning, therefore, suggests that a firm will be some kind of business, perhaps, but not always, involving more than one person. The ordinary meaning also suggests that a firm is likely to include a partnership and a sole trader.

112. In legal dictionaries, "firm" is defined as "an unincorporated body of persons associated together for the purpose of carrying on business": *New Zealand Law Dictionary*.

113. While not directly applicable, it is noted that s 7 of the Partnership Act 1908 defines "firm" for the purposes of that Act:

> Persons who have entered into partnership with one another are for the purposes of this Act called collectively a firm, and the name under which their business is carried on is called the firm name.

114. The Partnership Act 1908 then goes on to use the term "firm" to describe partnerships that are the subject of that Act.

115. A "principal" of a firm is "the most important or senior person in [a firm]": *Concise Oxford English Dictionary*. Although, in the context of s CW 20(3)(b)(ii) which refers to "**a** principal", it is sufficient if the non-resident entertainer is one of the senior persons in that firm.

### *Summary*

116. In summary, s CW 20(3) applies if one of the exemptions for non-resident entertainers and sportspersons in s CW 20(1) or (2) would have applied, but the services are supplied by another person. This is provided that other person has one of the kinds of relationship with the entertainer described at [101] to [115].

117. For instance, a company can qualify for the exemption if it derives income that would have been exempt under s CW 20(1) or s CW 20(2) in the non-resident entertainer's hands. The company needs to supply the entertainer's services, and the entertainer needs to be an employee or officer of the company (for example, director).

## What happens if the exemption does not apply

118. This statement is primarily intended to assist those paying non-resident entertainers to determine whether the exemption in s CW 20 applies. If the exemption applies, the payer will not need to consider withholding any tax or the effect of an applicable DTA.

119. However, for completeness, if the exemption in s CW 20 does not apply, a person paying a non-resident entertainer will need to:

    (a) apply the PAYE rules when making the payment;

    (b) consider whether the non-resident entertainer may be entitled to relief under a DTA.

### *Applying the PAYE rules*

120. A person paying a PAYE income payment is obliged to withhold tax from that payment and pay that tax to the Commissioner.

121. As explained in [103] and [104] above, a PAYE income payment includes both "salary or wages" and a "schedular payment". Non-resident entertainers may be either employees (under a contract of service) or independent contractors (under a contract for services). As such, the first step for a payer is to determine whether the entertainer has been engaged under a contract of service or a contract for services. If the entertainer is an employee, the payer should look to withhold PAYE from the payment. If the entertainer is an independent contractor, the payer should apply the schedular payments rules.

122. Payers will also need to record details of the non-resident entertainer they are paying, the amount of the payment, and the tax withheld as part of the income information filed with Inland Revenue. For further information about PAYE record-keeping, payday filing and tax payment obligations for schedular payments, see the Inland Revenue website: **www.ird.govt.nz**

123. If the payment is a schedular payment and no tax is deducted at source, the non-resident entertainer must pay the tax to the Commissioner by the earlier of the date of their departure from New Zealand or the 20th of the month following payment: s RD 19(3).

124. A non-resident entertainer cannot obtain an exemption certificate under s 24M(2) of the Tax Administration Act 1994.

### *Double tax agreements*

125. The provisions of a DTA may override the domestic tax position for a non-resident entertainer: s BH 1(4).

126. In general, the articles in New Zealand's DTAs relating to entertainers and sportspersons follow the formulation in art 17 of the 2017 OECD Model Tax Convention. The general position in that article is that entertainers' and sportspersons' income may be taxed in the country in which their performance or activity occurs.

127. However, there are exceptions to this rule. One example of an exception is art 17(3) of the New Zealand-Australia DTA, referred to at [81]. Another can be found in Article 17(1) of the New Zealand-United States DTA, which gives sole taxing rights to the entertainer's or sportsperson's country of residence where the relevant payments do not exceed USD$10,000 per year.

128. In each case, the relevant DTA should be consulted.

## Examples

The following examples assist in explaining the application of the law.

**Example 1: Australian cultural artist visiting New Zealand**

The Australian Federal Government establishes a programme aimed at establishing and maintaining a cultural presence in key overseas regions or countries. It provides funding for the programme on an annual basis.

As part of the programme, a group from Arnhem Land travelled to four overseas countries including New Zealand where the group held exhibitions and gave demonstrations of Aboriginal weaving. At the group's New Zealand events, the exhibitions were organised by a promoter who collected a small entry fee from those attending. The net proceeds from the entry fees were paid to the members of the group.

The programme is a cultural programme belonging to and funded by the Australian Federal Government. The group's exhibitions and demonstrations occur under this programme and they are carried out in New Zealand. The members of the group receive income for their performances from the promoter. This income will be exempt under s CW 20(1)(a), so the promoter does not deduct tax from the payment.

**Example 2: Income received by a service provider**

This example follows on from Example 1.

The Arnhem Land cultural group have, for their own administrative purposes, established their group as a company. The members of the group are directors and equal shareholders of the company.

Rather than paying each individual member, the promoter makes a payment to the company. The agreement is that the company will provide the services of each of the non-resident entertainers.

The payments are exempt under s CW 20(3). This is because the income derived by the company would have been exempt if derived by the non-resident entertainers directly (as occurred in Example 1), the company provided the non-resident entertainers' services, and the non-resident entertainers are officers of the company.

**Example 3: New Zealand sponsored programme to facilitate cultural performances**

The Culture Promo Association is an organisation based in Auckland. The Culture Promo Association is not carried on for the private pecuniary profit of any of its members.

The Culture Promo Association establishes a programme to facilitate exchanges between Asian and New Zealand performance groups. The Association is funded from a legacy and contributes towards the travel of the performance groups. The programme is not funded by the New Zealand government in any way. A Japanese pop music group, made up of several professional singers and dancers, gives dance and music performances in New Zealand under the Culture Promo Association's programme and derives several thousand dollars of profit. The profit is split between the Japanese performers.

To the extent that the performances occur under the Culture Promo Association's cultural programme, the income derived is not exempt under s CW 20(1)(b) or (c). Section CW 20(1)(b) does not apply because the cultural programme is not sponsored financially by the New Zealand or an overseas government. Section CW 20(1)(c) does not apply because the Culture Promo Association is not an "overseas" organisation, since it is based in Auckland.

Even if the Japanese pop group's New Zealand tour activity can be regarded as occurring as part of the Japanese pop group's "programme", s CW 20(1)(c) will not apply. This is because the Japanese pop group is carried on for the private pecuniary profit of its proprietors or members.

Therefore, the income derived is not exempt under s CW 20 and the payer must deduct tax from the payment under the PAYE rules.

**Example 4: Canadian curling competition in New Zealand**

The Canadian Curling Association is the body that administers curling in Canada. Although competitions are usually held in Canada, from time to time competitions are also held in other countries to increase the sport's profile. The Association decides to approve a competition between several Canadian champion curlers, representing their local curling clubs, to be held on a curling sheet at a venue in Auckland. The curlers receive a percentage of the ticket sales from the promoter of the event for participating in the competition.

The curlers are not competing in New Zealand as national representatives for Canada. Rather, they are competing as representatives of their local Canadian clubs. The Association's approval does not mean that the curlers are officially representing the Association. Therefore, the income derived by the curlers in New Zealand is not exempt under s CW 20(2) and the payer must deduct tax from the payment under the PAYE rules.

**Example 5: Curling competition against New Zealand curlers**

This example follows on from Example 3.

As well as approving club curlers to compete in a contest in Auckland, the Canadian Curling Association has chosen a team made up of the best Canadian curlers at club level. It is to play a team selected by the New Zealand Curling Players Association. The contest will be held at the same venue in Auckland.

In contrast to example 3, the Canadian team members are official representatives of the Canadian Curling Association, the governing body that administers curling in Canada. Despite each player being a member of a club team, they are officially representing the Canadian Curling Association in this instance. Therefore, the income derived by the curlers in New Zealand is exempt under s CW 20(2), and the payer does not deduct tax from the payment.

**Example 6: Trans-national sports team competing in New Zealand**

A Scandinavian handball team is formed with representative players from Sweden, Denmark and Norway. The national handball administrative bodies for each of the three countries choose official representative players to join the team. The players are engaged by an entity formed to constitute the new team.

The team travels to New Zealand to play a series of handball matches against national and regional New Zealand handball teams. The Scandinavian team's players receive a payment for each match.

The Scandinavian players are "official representatives of a body that administers the game or sport in an overseas country" and will qualify for the exemption in s CW 20(2).

## References


**Subject references**

Exempt income

Non-resident entertainer

**Legislative references**

Income Tax Act 2007, ss BD 1(5), BH 1, CW 19, CW 20, YD 4(3), (4) and (17D), LD 3, Subpart RD, Sch 4

Income Tax (Withholding Payments) Regulations 1975

Income Tax (Withholding Payments) Regulations 1979

Income Tax (Withholding Payments) Amendment Regulations (No 2) 2003

Interpretation Act 1999, s 5

Partnership Act 1908, s 7

Tax Administration Act 1994, s 24M

**Other references**

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**Case references**

*Aporex Inc v Hoffmann La-Roche Ltd* [2000] OJ No 4732

*Capital Club Pty Ltd v Commissioner of State Revenue* (2007) ATC 4498

*CIR v Medical Council of New Zealand* (1997) 18 NZTC 13,088 (CA)

*Commerce Commission v Fonterra Co-operative Group Ltd* [2007] 3 NZLR 767

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*McKenzie v Baddeley* [1991] NSWCA 197

*Molloy v CIR* (1981) 5 NZTC 61,070 (CA)

*New Zealand Forest Research Ltd v CIR* (1998) 18 NZTC 13,928

*Presbyterian Church of New Zealand Beneficiary Fund v CIR* (1994) 16 NZTC 11,185 (HC)

*Re Schlatter and Defence Force Retirement and Benefits Authority and Brown* (1985) 8 ALD 133

*Shell New Zealand Ltd v CIR* (1994) 16 NZTC 11,303

*Trustees of the Auckland Medical Aid Trust v CIR* (1979) 4 NZTC 61,404 (HC)

## Appendix – Legislation

### Income Tax Act 2007

1. Section s CW 20 provides:

**CW 20 Amounts derived by visiting entertainers including sportspersons**

*Exempt income: cultural activities*

(1) Income that a non-resident entertainer derives from carrying out their activity or performance in New Zealand during a visit is exempt income if—

(a) the activity or performance occurs under a cultural programme of the New Zealand government or an overseas government; or

(b) the activity or performance occurs under a cultural programme wholly or partly sponsored by the New Zealand government or an overseas government; or

(c) the activity or performance occurs as part of a programme of an overseas foundation, trust, or other organisation that—

(i) exists wholly or partly to promote cultural activity; and

(ii) is not carried on for the private pecuniary profit of any member, proprietor, or shareholder.

*Exempt income: sporting activities*

(2) Income that a non-resident entertainer derives from carrying out an activity or performance that relates to a game or sport in New Zealand during a visit is exempt income if the participants are the official representatives of a body that administers the game or sport in an overseas country.

*Exempt income: employer of non-resident entertainer*

(3) If income derived from an activity or performance of a non-resident entertainer would be exempt income under this section if derived by the non-resident entertainer, that amount is exempt income if derived by a person who—

(a) provides the services of the non-resident entertainer during the visit to New Zealand; and

(b) is 1 of the following:

(i) the entertainer's employer; or

(ii) a company of which the entertainer is an officer; or

(iii) a firm of which the entertainer is a principal.

*Meaning of non-resident entertainer*

(4) In this section, non-resident entertainer means a non-resident person, as defined in subpart YD (Residence and source in New Zealand), who carries out an activity or performance in connection with—

(a) a solo or group performance by actors, comperes, dancers, entertainers, musicians, singers, or other artists, whether for cultural, educational, entertainment, religious, or other purposes; or

(b) lectures, speeches, or talks for any purpose; or

(c) a sporting event or sporting competition of any nature.

**Defined in this Act:** amount, company, employer, exempt income, income, New Zealand, non-resident, non-resident entertainer

# OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject

## OS 19/03: Square metre rate for the dual use of premises

### Introduction

Operational statements set out the Commissioner's view of the law for the matters discussed and deal with operational issues arising out of the administration of the Revenue Acts.

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a new section DB 18AA into the Income Tax Act 2007[1]. This Statement explains how the Commissioner of Inland Revenue (the Commissioner) will interpret and apply this new section and provides a number of examples of the legislation's practical application.

Unless otherwise stated, all legislative references in this Statement are to the Income Tax Act 2007.

### Application

This Statement applies from 4 July 2019, the date that the Statement was signed.

The Statement appears in T*ax Information Bulletin* Vol. 31, No 7 (August 2019) and on Inland Revenue's website, **www.ird.govt.nz**[2]

### Background

1. Business owners, especially small business owners, often use their private residence for both business and private purposes. This business use may give rise to deductions that can be claimed by the business owner. However, because there are numerous individual expense items that need to be recorded and apportioned between business and personal use, calculating the quantum of any deductible expenditure can create a large compliance obligation compared with the amount of tax at stake. As stated in the commentary to the *Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill*, the purpose of s DB 18AA is to allow taxpayers to use a simplified method for the calculation of deductions for premises … that are used for both business and personal purposes. This will reduce compliance costs for taxpayers.
2. The square metre rate option provides a simplified process that removes the requirement for a taxpayer to:
   - Keep detailed records of the utility costs (electricity, gas, home and contents insurance, telephone, mobile and internet charges) incurred on their private residence, and
   - Apportion these utilities costs between the business and private use of their residence.

   Premises costs (mortgage interest, rates and rent) are still required to be claimed based on the business proportion of the actual expenditure incurred by the taxpayer.

   A taxpayer using this simplified process is not able to claim deductions in respect of any other expenditure (or depreciation loss) that they may have incurred in respect of their private residence.
3. In order to avail themselves of the square metre rate option a taxpayer firstly calculates the percentage of their private residence that is used primarily for business purposes. Using this calculation, they then calculate the available deduction for both the utilities and premise costs that they have incurred.
4. There are no restrictions on the use of this simplified method for calculating the deduction available for the business use of a taxpayer's private premises, nor is its use mandatory. If a taxpayer chooses not to claim a deduction using the simplified calculation method allowed by s DB 18AA (because, for instance, they wish to claim for expenditure that is not included in the square metre rate calculation), they may still be able to claim a deduction based on:
   - the business proportion of the actual amounts of expenditure outlaid on their private residence. Note that if a taxpayer chooses to make a claim based on their actual expenses, the Commissioner would expect them to use the methodology set out in this statement to calculate the area of their private residence that is used primarily for business purposes, or

[1] This section was subsequently amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 (2019/5). Royal Assent: 18 March 2019.

[2] Search term: OS 19/03 (*Technical* results)

- the expenditure apportionment methods set out in Interpretation Statement IS 17/02 Income Tax – Deductibility of farmhouse expenses[3], if the private residence is a farmhouse.

## Discussion

5. Section DB 18AA[4] provides a calculation methodology for determining the amount able to be deducted by a taxpayer to take into account the business use of their private residence. There are three steps required to calculate the amount of the deduction.
6. The first step is to calculate the area of the buildings on the premises used primarily for business purposes. In this step the taxpayer determines the area of their buildings (in square metres) that are both ***separately identifiable parts of the buildings on the premises*** and ***that are used primarily for business purposes***. This dual calculation results in the identification of the ***business square metres***. The business square metres are then multiplied by the ***square metre rate*** to give the first part of the deduction amount. This first step is further discussed at [13] – [26].
7. Per [6], the business square metres are multiplied by the square metre rate to give the first part of the deduction amount. The square metre rate is:
   - set by the Commissioner, based on the national average annual cost of utilities per square metre of housing, but excluding mortgage interest and rates or rent, and
   - updated each year.

   The square metre rate is further discussed at [21] – [25].
8. The second step is to calculate the business proportion of total premises costs. The starting point for this second step is the business square metres that were calculated at [6]. The business square metres are divided by the total area of all the ***buildings on the premises***. The result of this calculation is known as the ***business proportion*** and is expressed as a percentage. This percentage is then applied to the ***total premise costs*** of all ***the buildings and their curtilage on the premises*** to provide the second part of the deduction amount for the square metre rate method. This second step is further discussed at [27] – [36].
9. The *total premises costs* are the total amount of actual mortgage interest, rates and rent that the taxpayer has paid for their residential premises in the income year. The reason this part of the deduction is calculated separately from the Commissioner's square metre rate is because annual mortgage interest, rates and rental costs are too variable for a meaningful national average to be produced.
10. The third step in the calculation involves the amounts calculated at steps 1 and 2 above being added together to give the total amount of the deduction.
11. Note that where a taxpayer chooses to use the square metre rate method, no other deduction in relation to their residential premises can be claimed.
12. To fully understand the calculation methodology that has been outlined in the above 3 step approach, it is necessary that the calculation and some of the words and phrases used in the legislation are explained further.

### The first step

13. The desired outcome of the first step of the calculation is to identify the business square metres and apply this to the annual square metre rate that is published by the Commissioner. To complete this first step a taxpayer must determine the area of their buildings (in square metres) that are both *separately identifiable parts of the buildings on the premises* and *that are used primarily for business purposes*; the business square metres. Multiplying the business square metres by the Commissioner's square metre rate provides the first element of the square metre rate deduction available to a taxpayer.

#### *Separately identifiable parts of the buildings on the premises ...*

14. For an area to be separately identifiable it does not need to be physically separate from any other area. It does not, for example, have to be enclosed by walls. It is not a room by room test, but merely looks to identify those parts of the buildings that are separately identifiable as being used for a business purpose.
15. The use of the phrase *separately identifiable* means that it needs to be obvious that a particular area is "identifiable" as being used for a business purpose that is separate from any other purpose. Whether an area meets this test is considered objectively. It is a positive test, in that the area cannot, objectively, be identifiable as being used for another purpose (a private purpose, for instance), or for a "neutral" purpose; that is, for no particular identifiable purpose. This is discussed further at Steps 2 and 3, at [17] below.

[3] A copy of this Interpretation Statement is available on the Inland Revenue website. Search term: farmhouse (*Technical* results)

[4] See Appendix for a copy of this legislation

16. In practical terms, it will be easier to see that an area of a building is separately identifiable as an area being used for a business purpose if it has a business asset of some kind within it (computer, business records, inventory for instance) that marks out that area in some way.

17. The Commissioner suggests that a taxpayer take the following step by step approach to this identification process:

    Step 1: Identify an area (or areas) which may have a business purpose (a potential business area).

    Step 2: Ignore any part of that potential business area that cannot be used for a business purpose. Generally, this will be because that area is set aside for a non-business purpose. In the context of a family home, this will usually be for a private purpose.

    Step 3: Would it be obvious to a reasonable person that all the area that remains is separately identifiable as being used for a business purpose? If not, is there a smaller area that is "separately identifiable" as being used for this purpose? For instance, does part of the remaining area have a "neutral" purpose? For example, it may simply be an empty space or a traffic area that is passed through, rather than being "used" for any particular purpose, either business or non-business.

    The following example illustrates this three-step approach to identifying those areas that are "separately identifiable" parts of the buildings on the premises used for business purposes:

**Identifying an area that is "separately identifiable"**

Many modern homes have an open plan living area that includes the kitchen, dining and communal living areas. Where part of this area is used for business purposes, it is necessary to calculate how much of this space is being used for business purposes.

Per [17], the first step is to identify an area (or areas) *which may have a business purpose (the potential business area)*. In this example, this will be the entire open plan living space.

The second step is to *ignore any part of that potential business area that cannot be used for a business purpose*. That is, those parts of the open plan living space that are clearly used for a private purpose; the area taken up with household furniture and appliances and the area required for the furniture and appliances to be used.

Removing from further consideration the area identified at step 2, the third step asks, *would it be obvious to a reasonable person that all the area that remains is separately identifiable as being used for a business purpose?* In answering this question we need to exclude so much of the remaining area that is used for neither a business nor private purpose. Generally, this will be areas that are used as "traffic" areas; parts of the open plan living space that are used to get from one area to another. It will also include any areas that are not used at all, areas that are simply empty spaces.

The area that remains is the area that is separately identifiable as being for a business purpose. This will generally equate to the space used to physically store any business furniture/equipment and the area that is required to use that furniture/equipment. We now test whether that area is *used primarily for business purposes*.

### *... that are used primarily for business purposes*

18. To identify the business square metres, a taxpayer must first determine the area of the buildings on the premises (in square metres) that are both separately identifiable parts of these buildings (per [14] – [17]) and that are *used primarily for business purposes*.

19. In the context of this legislation the word primarily takes its ordinary meaning, for the most part, mainly[5]. The Commissioner accepts that a part of the premises can be said to be used primarily for a business purpose when it is used for a business purpose (rather than any other purpose) more than 50% of the time.

20. The area that is identified by following the 3-step process (at [17]) and that is also used primarily for business purposes, is the *business square metres* for the purposes of the s DB 18AA calculation.

[5] Concise Oxford English dictionary, eleventh edition, revised.

### *Square metre rate*

21. The business square metres is multiplied by the square metre rate that is published by the Commissioner[6]. This square metre rate will be set and published by the Commissioner on an annual basis.

22. The square metre rate is set by using information obtained from Statistics New Zealand. The Commissioner uses this information to calculate the national average, annual cost of utilities for the average sized New Zealand household. For the purposes of the square metre rate calculation, "utilities" are limited to gas/electricity, telephone/mobile/internet services, and house/contents insurance costs. To arrive at the final square metre rate, this average cost of utilities is divided by the average square metre size of a New Zealand house[7].

23. Annual mortgage interest, rates or rental costs are excluded from the national, averaging methodology of the square metre rate calculation. This is because, unlike utilities costs these costs are too variable to be included with any accuracy and are best left for a taxpayer to include separately in the second step of the deduction calculation. See [27] – [36] for further discussion.

24. Those taxpayers who use the square metre rate are not able to claim deductions in respect of any other expenditure (or depreciation loss) that they may have incurred on their private residence.

25. For the purposes of section DB 18AA(5), the Commissioner has advised that the square metre rate for the 2017 – 2018 income year is $41.10 per square metre and $41.70 per square metre for the 2018 – 2019 income year. A copy of these determinations and the notes to them can be found on the IR website[8].

26. The first step of the s DB 18AA calculation is completed by multiplying the business square metres (per [20]) by the square metre rate that has been set and published by the Commissioner for the income year in question.

## The second step

27. The desired outcome of the second step is the identification of the *business proportion* and applying this to the *total premise costs of the buildings and their curtilage on the premises*. The result of this calculation provides the second element of the square metre rate deduction available to a taxpayer.

### *The business proportion*

28. The business proportion is calculated by dividing the total area of all the buildings on the taxpayer's premises by the business square metres that was calculated previously (at [20]) and expressing the result as a percentage.

**Example of calculating the business proportion**

Total area of all the buildings on the taxpayer's premises = 150 square metres.

Business square metres = 10 square metres.

$$\frac{10}{150} \times \frac{100}{1} = 6.7\%$$

In this example the business proportion is 6.7%

When undertaking this calculation, the following definitions are relevant:

### *Buildings*

29. What constitutes a building is discussed in Interpretation Statement *IS 10/02 – Meaning of "building" in the depreciation provisions* (IS 10/02). In summary, IS 10/02 states that a building:

- is a structure of considerable size;
- is permanent in the sense that it is intended to last a considerable time;
- is permanent in the sense that it is designed to be located permanently on the site where it stands. A building is fixed to the land on which it stands. However, a building need not be legally part of the land on which it stands;
- is enclosed by walls and a roof;
- can function independently of any other structure. However, a building is not necessarily a physically separate structure.

[6] S DB 18AA(5)

[7] From information available from Quotable Value Limited

[8] Search term: square metre rate (Technical results)

30. To arrive at the *business proportion* requires the calculation of the total area of all the buildings on the taxpayer's property. This will often include buildings other than the taxpayer's residence. For instance, it is the Commissioner's view that a standalone garage is a building, but that many small residential garden sheds are too small to be considered buildings; they are structures[9]. It is relatively common that a taxpayer's premises will include a dwelling and a standalone garage. Where this is the case, the area of both the dwelling and the garage needs to be included in the calculation, whether or not there is any business use of the garage.
31. There is more information on this topic in IS 10/02. This can be found on the IR website[10].

### *Premises*

32. For the purposes of DB 18AA, "*premises*" is a reference to the taxpayer's entire property. In an urban, residential setting this will generally equate to the buildings and their curtilage, though this may not be the case in a rural setting. The question of what constitutes curtilage is further discussed at [34] and [35].

### *Total premise costs*

33. Total premise costs are arrived at by adding together any amount of mortgage interest, rates or rent that the taxpayer has paid in respect of "the buildings and their curtilage on the premises" in the income year. These costs are then multiplied by the *business proportion* (see [28]) to arrive at the *premise costs*. As previously explained, the reason that these expenses are not considered at step 1 is because these costs are too variable for a national average to be struck with any accuracy.

### *Curtilage*

34. In the phrase the "*buildings and their curtilage on the premises*" the word "curtilage" takes on its usual meaning; *an area of land attached to a house and forming one enclosure with it; a small court, yard, or piece of ground attached to a dwelling house and forming one enclosure with it* (Concise Oxford English dictionary, 11th edition)[11].
35. For an urban, residential property, the Commissioner accepts that the *buildings and their curtilage* will likely equate to the area of the entire property; *the premises*. In a rural setting, what constitutes the curtilage will be a matter of fact (viewed objectively) in each case but bearing in mind the above definition.
36. The second step of the s DB 18AA calculation is completed by multiplying the total premise costs (at [33]) by the business proportion percentage (at [28]).

## The third step

37. The third and final step in calculating the quantum of the deduction available under s DB 18AA is to add the amount calculated under the first step (at [26]) with the amount calculated under the second step of the calculation (at [36]). For those taxpayers that wish to use s DB 18AA, this is the amount that they can claim as a deduction.

### *Part year claims and changes in circumstances*

38. By taking account of annualised costs, the amount calculated in the third step presupposes that the business area is used primarily for business purposes for the entire year, and the area used primarily for business purposes does not change at some time during the year. Where this is not the case and the business area and/or the primary use of that area changes, the amount of the deduction will need to be adjusted to take these changed facts into account.
39. The Commissioner accepts that any adjustment required can be completed based on the number of complete weeks that the separately identifiable area is used primarily for business purposes; the apportionment does not need to be completed on a daily basis.

**Calculating the adjustment for a part year**

For instance, if the business area is used for only 32 weeks in a year, the adjustment required would be:

Available deduction (after completing the 3-step calculation at [26], [36] and [37]) ÷ 52 × 32

[9] IS 10/02, at [126]

[10] Search term: meaning of building (Technical results)

[11] See also Black's Law Dictionary, 2nd edition: *The curtilage of a dwelling is a space, necessary and convenient and habitually used for the family purposes, and the carrying on of domestic employments. It includes the garden, if there be one, and it need not be separated from other lands by fence* (State v. Shaw, 31 Me. 523; Com. v. Rarney, 10 Cush. (Mass.) 480; Derrickson v. Edwards, 29 N. J. Law, 474. SO Am. Dec. 220;

40. A similar adjustment calculation will be required when the size of the business area alters during the year. For instance, the separately identifiable area that is used primarily for business purposes may change from 6 square metres at the beginning of the year to 9 square metres during week 16. In this case 2 part-year calculations will be required; the first for the initial 15-week period and the second for the remaining 37 weeks. Both calculations start by applying the three-step process to arrive at the initial annual deduction amounts. Each calculation is then adjusted by using the part year calculation shown at [40].

**Calculating the adjustment when the size of the business area alters**

In respect of the example used in this paragraph, the full calculations would be as follows:

Available annual deduction for first 15-week period (after completing the 3-step calculation at [26], [36] and [37]) ÷ 52 x 15 = A

Available annual deduction for second 37-week period (after completing the 3-step calculation at [26], [36] and [37]) ÷ 52 × 37 = B

This Operational Statement is signed by me on 4 July 2019

**Rob Wells**
Manager, Technical Standards, OCTC

**Example 1: Use of garage for storage**

Background

Because of a lack of suitable, secure storage facilities at her business premises, the taxpayer stores excess inventory along one wall of a separate double garage at her residential address. Also stored in this garage are personal items; the family motor vehicle, children's bikes, gardening equipment and miscellaneous boxes of personal items. No other part of the taxpayer's residence is used for business purposes.

The taxpayer has calculated the quantum of all interest and rates payments on the property to be $22,000.00 for the year ended 31 March 2019.

The total area of all the buildings on the premises is the 35 square metre separate double garage and a 180 square metre dwelling – a total of 215 square metres.

Calculating the business square metres

*Separately identifiable parts of the buildings on the premises…*

Although the potential area of business use is the entire 35 square metre garage, a 20 square metre area is used to store the family's personal effects and can therefore never be used for business purposes. Of the remaining 15 square metres, the taxpayer believes that a reasonable person would see the area that is *separately identifiable* as being used primarily for business purposes, as that area that physically stores the inventory (7 square metres) together with the area immediately surrounding the inventory that allows access to it. She calculates this to be a total area of 9 square metres[12]. The remaining 6 square metres is either empty space or traffic areas.

*…that are used primarily for business purposes*

Given that the sole use of the 9 square metre area is to either store or access the inventory, this area can be said to be primarily used for business purposes.

**In this example the area that can be said to be used *primarily for business purposes* and is *the business square metres* is 9 square metres.**

[12] The remaining area (6 square metres) is not "separately identifiable" as being for any specific purpose, either business or personal, it is simply either an empty space or a traffic area.

Step 1

The first step in the calculation process is completed by multiplying the 9 square metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019. This provides the taxpayer with the first component of their deduction. For the year ended 31 March 2019 the Commissioner's square metre rate was $41.70.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square metre rate × the business square metres

$41.70 × 9 = $375.30

In this example the amount of deduction available under step 1 is $375.30

Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that can be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs; in this case $22,000.00 in interest and rate payments that have been made by the taxpayer.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

| | |
|---|---|
| The total area of all of the buildings on the taxpayer's premises | 215 sq. metres |
| Business square metres (from Step 1) | 9 sq. metres |
| Premise costs | $22,000.00 |

These facts are then applied to the following formula:

$$\frac{9}{215} \times \frac{100}{1} = 4.2\% \times \$22{,}000.00 = \$924.00$$

In this example the amount of deduction available under step 2 is $924.00

Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$375.30 + $924.00 = $1299.30

**Example 2: Use of dedicated home office**

Mr and Mrs Smith have a small room in their home which they use as an office. The room is furnished with a desk that holds a computer and printer, a computer chair, and filing cabinets that holds business records and stationery. The computer is used daily by the Smiths to update the business accounts but also occasionally for private purposes. Their daughter sometimes uses the computer and printer to complete university assignments. However, she has her own laptop for day-to-day use.

The Smiths have calculated the quantum of all interest and rates payments on their property to be $18,700.00 for the year ended 31 March 2019.

The total area of the Smith's dwelling is 160 square metres (inclusive of an attached single garage). There are no other buildings on the property.

Calculating the business square metres

*Separately identifiable parts of the buildings on the premises...*

The area of the room is 8 square metres, with the desk, chair and filing cabinets taking up approximately 4 square metres of this space. When looking objectively at the room, the Smiths believe that a reasonable person would view the whole of the room as being *separately identifiable* as being used for business purposes. They have reached this conclusion because all of the room is available for business use (in that none of the area is used solely for a non-business purpose) and the area of the room is small enough so that none of the area can be said to have no specific purpose; the whole room is either taken up by the furniture or allows the furniture to be accessed and used.

*...that are used primarily for business purposes*

Other than for record storage, the separately identifiable area (in this case, the 8 square metre room) is mainly used for computer work by members of the Smith family. While their daughter occasionally uses the computer for university assignments, and the Smiths sometimes use the computer for private purposes, this occasional use is outweighed by the everyday use of the computer for business purposes. As the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area can be said to be used primarily for business purposes.

**In this example the area that can be said to be used *primarily for business purposes* and is *the business square metres* is 8 square metres.**

Step 1

The first step in the calculation process is completed by multiplying the 8 square metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019.

This provides the taxpayer with the first component of her deduction.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square metre rate × the business square metres

$41.70 × 8 = $333.60

In this example the amount of deduction available under step 1 is $333.60.

Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that cam be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs. In this case $18,000.00 in interest and rate payments that have been made by the Smiths.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

| | |
|---|---|
| The total area of all of the buildings on the taxpayer's premises[13] | 160 sq. metres |
| Business square metres (from Step 1) | 8 sq. metres |
| Premise costs | $18,700.00 |

These facts are then applied to the following formula:

$$\frac{8}{160} \times \frac{100}{1} = 5\% \times \$18{,}700.00 = \$935.00$$

In this example the amount of deduction available under step 2 is $935.00

Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$333.60 + $935.00 = $1268.60

[13] For the purposes of s DB 18AA the word *premises* includes building curtilage. For urban, residential properties the Commissioner accepts that the area of building and curtilage on the property will equate to the area of the entire property. See further at [34] and [35]

**Example 3: Use of a main living area**

As with many contemporary homes, the residence occupied by Mr and Mrs Jones and their two teenage children has a living area that is "open plan"; it includes the kitchen, dining room and lounge. This open plan living area accounts for approximately 50 square metres of the total floor area. Mr and Mrs Jones need to regularly undertake business related work from their home and have located a computer desk, chair and filing cabinets in one corner of this open plan area for this purpose. When not being used for business purposes, the computer is available for the private use of the family.

Mr and Mrs Jones have calculated the quantum of all interest and rates payments on their property to be $26,300.00 for the year ended 31 March 2019.

The total area of the Smith's dwelling is 155 square metres (inclusive of an attached single garage). There are no other buildings on the property.

Calculating the business square metres

*Separately identifiable parts of the buildings on the premises…*

When looking objectively at the open plan living area, Mr and Mrs Jones note that although the potential area of business use is the 50 square metre open plan living area, the majority of this area could not be said to be "separately identifiable" as being available to be used for business purposes. The majority of this large area is used exclusively as the family's personal living space (35 square metres).

Of the remaining area (15 square metres), 9 square metres is not used for either a business or private purpose. It is either empty space or traffic area. The computer desk, chair and filing cabinets take up 4 square metres of the 50 square metre living area. In their view, the area that is "separately identifiable" as being used for a business purpose is that area taken up by the computer desk, chair and cabinets, together with the area that immediately surrounds this furniture that allows it to be used. In total they estimate this to be the remaining area of 6 square metres.

*…that are used primarily for business purposes*

The separately identifiable 6 square metre area is largely used for either business or private computer work by members of the Jones family. While they sometimes use the computer for private purposes, this use is minimal compared to the computer's everyday business use. All members of the family prefer to use other means to access the internet; the teenagers use their smartphones and x-boxes, and Mr and Mrs Jones generally use their smartphones. Because the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area (6 square metres) can be said to be used primarily for business purposes.

**In this example the area that can be said to be used *primarily for business purposes* and is *the business square metres* is 6 square metres.**

Step 1

The first step in the calculation process is completed by multiplying the 6 square metres (the business square metres) by the amount of the Commissioner's square metre rate for the year in question; in this case the year ended 31 March 2019. This provides the taxpayer with the first component of their deduction. For the year ended 31 March 2019 the Commissioner's square metre rate was $41.70.

In this example the calculation of the amount of deduction available under step 1 is:

2019 Commissioner's square meter rate × the business square metres

$41.70 × 6 = $250.20

In this example the amount of deduction available at step 1 is $250.20.

Step 2

This step calculates the amount of premise costs (mortgage interest, rates or rent) that can be allowed as a deduction. This deduction is calculated by taking the percentage of the premises that is used primarily for business use; the business proportion and applying this percentage to the premise costs. In this case $26,300.00 in interest and rate payments that have been made by the Jones family.

Following the calculation at [28], [33] and [36], the information required to arrive at the deduction available at step 2 is:

| | |
|---|---|
| The total area of all of the buildings on the taxpayer's premises | 155 sq. metres |
| Business square metres (from step 1) | 6 sq. metres |
| Premise costs | $26,300.00 |

These facts are then applied to the following formula:

$$\frac{6}{155} \times \frac{100}{1} = 3.9\% \times \$26{,}300.00 = \$1025.70$$

In this example the amount of deduction available under step 2 is $1025.70.

Step 3

The final deduction is calculated by combining the results of the first two steps.

In this example the total amount of the square metre rate deduction is:

$250.20 + $1025.70 = $1275.90

**Example 4: Use of a spare bedroom**

Following on from Example 3, time has moved on and one of the Jones teenagers has moved out of the house and gone flatting. As one of the bedrooms is now vacant, the Jones decide to move some of the furniture out to the garage and move the computer desk, chair and filing cabinets into this bedroom. They retain some bedroom furniture in the room in case they have quests (or the teenager returns). The area of the bedroom is 12 square metres. As with Example 3, the computer is available for both business and personal use.

Calculating the business square metres

*Separately identifiable parts of the buildings on the premises…*

The retained bedroom furniture (bed, bedside cabinet, chest of drawers and wardrobe) take up approximately 5 square metres of the 12 square-metre room. The computer desk, chair and filing cabinets take up 4 square metres (the same as it did when these were situated in the living area of the house).

The 5 square metre area of the room taken up by the bedroom furniture could not be said to be "separately identifiable" as being available to be used for business purposes; its use is as a personal living space and therefore not available for business use. The area that is "separately identifiable" as being used for a business purpose is that area taken up by the computer desk, chair and filing cabinets (4 square metres), together with the area that immediately surrounds this furniture that allows it to be used. Mr and Mrs Jones estimate this to be an area of 6 square metres.

**Note**: Although this is the same area that was separately identifiable when this furniture was situated in the family's open plan living area (at example 3), this is merely a coincidence. The principle to be taken from this is that in what room the furniture is situated is generally **not** relevant in deciding how much of an area can be said to be "separately identifiable" as being used for business purposes; it is a matter of objective fact in each case.

*…that are used primarily for business purposes*

The facts regarding the use of the computer have not changed from Example 3; it is primarily used for business purposes. Because the use of the computer is the primary use of the separately identifiable area, and the computer is used primarily for business purposes, the separately identifiable area can be said to be used primarily for business purposes.

**In this example the area that can be said to be used *primarily for business purposes* and is *the business square metres* remains as it was in example 3; 6 square metres**

As the *business square metres, the business proportion and the premise costs* applicable to the Jones's residence has not altered from example 3, the quantum of the square metre rate deduction remains as it was in example 3.

# APPENDIX

## LEGISLATION

***Premises or land costs***

***DB 18AA Square metre rate method***

*When this section applies*

*(1) A person may choose to apply this section to determine the amount of a deduction, in an income year, for the proportion of business use of premises that is used partly for business purposes and partly for other purposes.*

*Amount of deduction*

*(2) The amount of the deduction allowed in an income year for the business use of the premises is calculated using the formula—*

*(total premise costs × business proportion) + (business square metres × square metre rate).*

*Definition of items in formula*

*(3) In the formula,—*

*(a) **total premise costs** is the total amount of actual mortgage interest, rates, and rent that the person has paid with respect to buildings and their curtilage on the premises in the income year:*

*(b) **business proportion** is determined by dividing business square metres by the total area of buildings on the premises in square metres:*

*(c) **business square metres** is the total area, in square metres, of any separately identifiable parts of buildings on the premises that are used primarily for business purposes:*

*(d) **square metre rate** is the applicable square metre rate that is published by the Commissioner.*

*No other deductions allowed*

*(4) A person who makes an election to apply this section under subsection (1) is not entitled to claim any other deductions for the business use of the premises.*

*Setting square metre rates*

*(5) For the purposes of this section, the Commissioner must from time to time set and pu*blish square metre rates.

*Defined in this Act: amount, business use, Commissioner, deduction, income year*

History: Section DB 18AA inserted on 1 April 2017 (applying for the 2017 – 18 income years) by section 71(1) of the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 (2017 No 3). Royal assent: 21 February 2017.

Amended by the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019 (2019/5). Royal Assent: 18 March 2019.

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