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Tax Alert

A focus on topical tax issues – March 2015

New tax bill introduced

In this issue

The Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Bill (the Bill) was introduced by the Minister of Revenue into Parliament on 26 February 2014.

The Bill includes the following reforms:

- Measures to clarify the GST position of bodies corporate
- Proposals for the cash out of research and development tax losses
- Amendments to tackle black hole research and development (R & D) expenditure
- Annual setting of income tax rates for the 2015-16 tax year
- The addition of new charities to Schedule 32 of the Income Tax Act 2007 (the Act)
- Changes to the calculation of fringe benefits from employment-related loans for employers who are in the same group of companies as a person in the business of lending money to the public, which would allow the employer to use the market interest rate method to calculate the value of the fringe benefit.
- A number of remedial changes to the controlled foreign company rules
- The repeal of reforms (not yet in force) which would require individuals who were not required to file an income tax return but chose to do so, to file returns for the previous four income years in addition to the year they have chosen to file.
- Enabling tax pooling funds purchased to be used to meet interest owed as a result of a tax dispute or amended tax assessment. >>

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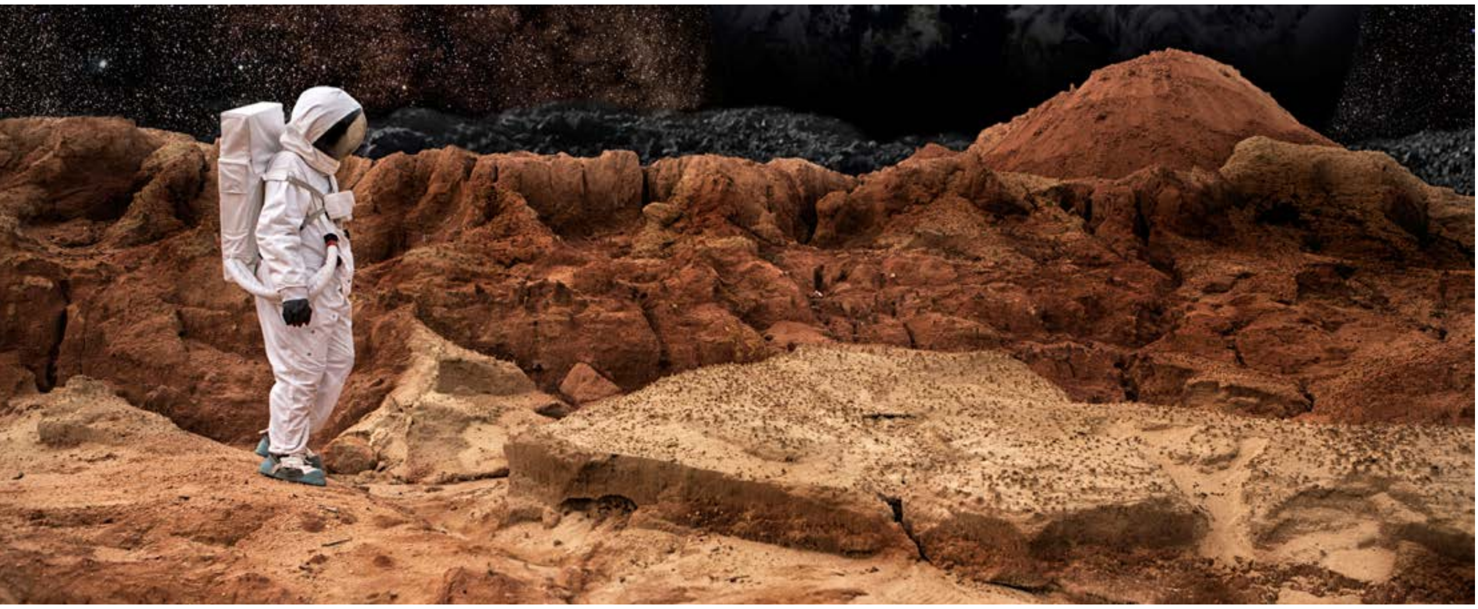

- Remedial amendments to the thin capitalisation reforms enacted in the Taxation (Annual Rates, Employee Allowances and Remedial Matters) Act 2014 in relation to companies which are controlled by non-residents acting together.

- Remedial changes to clarify that the capital limitation does not prevent a deduction for a bad debt of the principal amount of a financial arrangement entered into in the ordinary course of business.

- A number of other remedial changes.

Separate articles appear on the first two items. A brief outline is provided below on a few key areas likely to be of most interest to readers.

Black hole expenditure

Reforms are proposed to target black hole research and development expenditure. These were announced in Budget 2014. The key aspects of the reforms are:

- A taxpayer who has developed an intangible asset (recognised for accounting purposes) that is not depreciable for tax purposes will be allowed an income tax deduction for capitalised development expenditure they have incurred on the asset when the intangible asset is derecognised (i.e. written-off) for accounting purposes (other than by disposal). This will apply to expenditure incurred on or after 7 November 2013 (i.e. the date the discussion document on black hole expenditure was released). The deduction will be allowed irrespective of whether the asset was useful for a period or the R & D was unsuccessful.

- In the event that a derecognised non-depreciable intangible asset is sold or becomes useful again and a deduction has previously been taken for the asset, the deduction will be clawed back.

- Taxpayers who have created an intangible asset that is depreciable for tax purposes will be allowed to include capitalised expenditure that relates to the asset as part of the costs of the asset. In the case of patents, patent applications, plant variety rights, and the new additions to Schedule 14 proposed, the person must have incurred the expenditure on or after 7 November 2013 for the expenditure to be included in the depreciable cost of the item of depreciable intangible property.

- The following assets will become depreciable intangible property in Schedule 14 of the Act for expenditure incurred after 7 November 2013:

  - A design registration;

  - A design registration application; and

  - Copyright in an artistic work that has been applied industrially. >>

Reforms in the Bill will allow taxpayers to use tax pooling arrangements to pay any interest owed as a result of a tax dispute or amended tax assessment.

Filing requirements for individuals

This proposal would see the repeal of reforms (not yet in force) which would have required individuals who were not required to file an income tax return, but chose to do so, to file returns for the previous four income years in addition to the year they have chosen to file. These reforms were enacted in the Taxation (Annual Rates, Returns Filing and Remedial Matters) Act 2012 to prevent taxpayers from only filing income tax returns that would result in a tax refund. These rules were set to apply from the 2017 income year.

The original policy of the reforms was set three years ago and the Government now considers their implementation is no longer a sound investment given Inland Revenue's Business Transformation programme which is expected to deliver a more accurate PAYE structure resulting in fewer people being in a refund or tax-debt position.

Tax pooling and interest liabilities

As previously signalled by the Minister of Revenue, reforms in the Bill will allow taxpayers to use tax pooling arrangements to pay any interest owed as a result of a tax dispute or amended tax assessment. This addresses the situation where taxpayers could not use purchased tax pooling funds to meet interest liabilities in these circumstances (resulting in interest continuing to be charged on the outstanding shortfall and therefore not "stopping the clock" in tax disputes).

The proposed reforms will apply retrospectively from 3 July 2014. This means that taxpayers who had an amended assessment issued or challenge proceedings resolved before 3 July 2014 will be able to access tax pooling funds to pay the interest outstanding if the 60-day period to access tax pooling funds was current on 3 July 2014.

For further information on these issues, please contact your usual Deloitte advisor.

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GST and bodies corporate

By Allan Bullot and Divya Pahwa

The proposed new rules for GST and body corporate entities included in the Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill, (the Bill) will go a long way to resolving many of the issues in this area. The proposed legislation addresses most of the issues enabling body corporate entities to be able to elect to either be GST registered or opt out of the GST system. We consider it is likely there is still some fine tuning required before the final answer is reached, but in its current form the proposed legislation has to be praised as being significantly better than the original changes proposed in 2014.

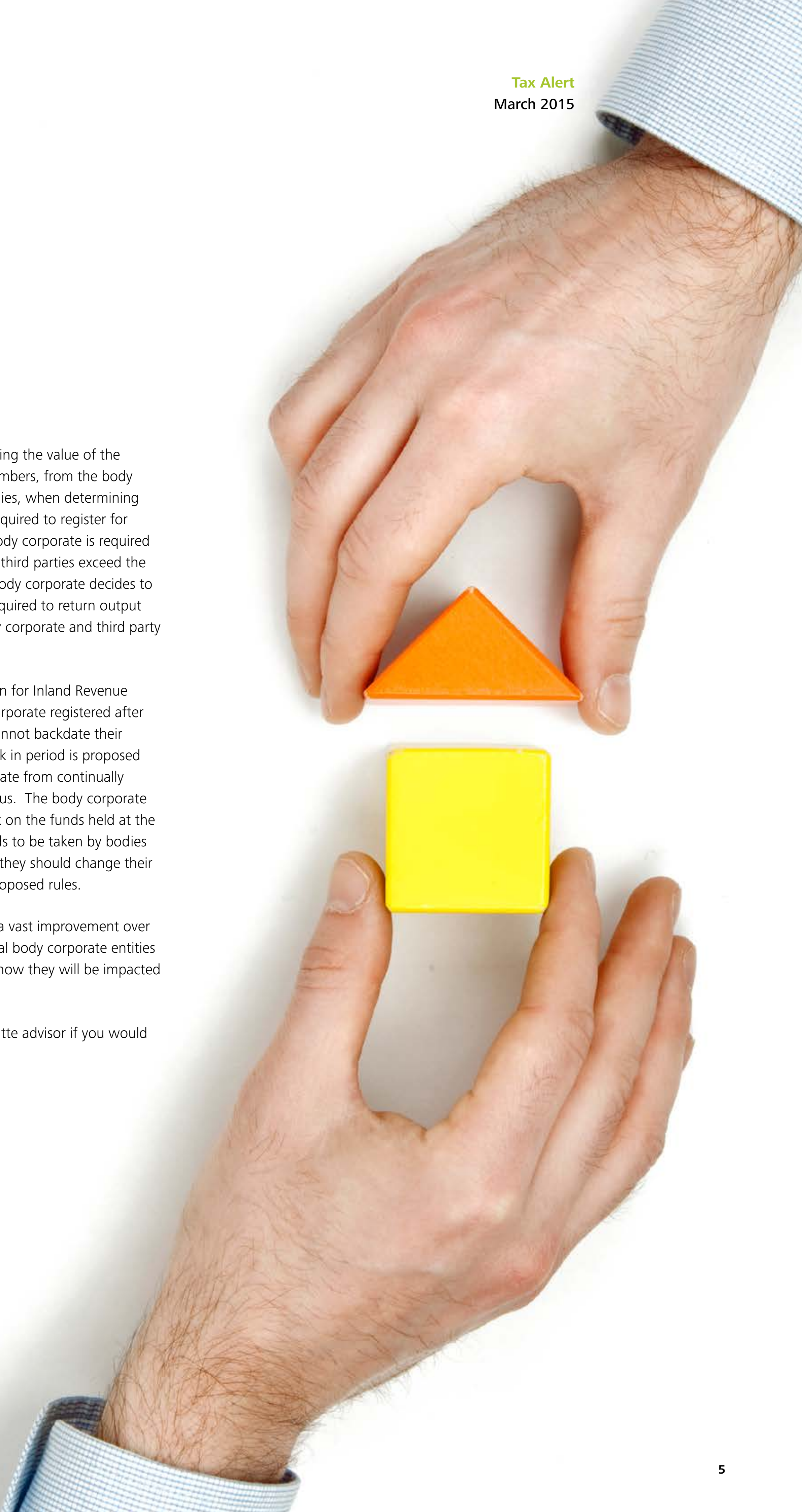
The GST registration of body corporate entities established to look after the routine functions of building and common property areas held under a unit title structure has been an area of focus in recent years. Historically there has been a lot of confusion over positions regarding the GST registration of bodies corporate resulting in some body corporates being GST registered, whilst others opting not to register, resulting in inconsistencies amongst bodies corporate in practically the same situations.

In June 2014 Inland Revenue caused considerable consternation as the draft legislation appeared to be harsh on the bodies corporate posing significant difficulties for body corporate entities that had a mix of GST registered and non-registered entities if it were to be implemented. Submissions were made to Inland Revenue and they have now released the proposed 2015 legislation which addresses most of the issues. It is good to see how Inland Revenue has acted on various suggestions received.

Originally the 2014 June discussion document sought to retrospectively exempt the routine body corporate activities once it was enacted. While this would have pleased a number of bodies corporate, for others it would have imposed considerable issues. The "legislation via press release" retrospective aspect of the 2014 proposed changes was one aspect that caused considerable distress and uncertainty for many.

Inland Revenue has now clarified that it considers a body corporate that makes supplies to its owners to be carrying on a taxable activity. Despite this, a body corporate that makes routine supplies only to its members will not be required to be GST registered. >>

Originally the 2014 June discussion document sought to retrospectively exempt the routine body corporate activities once it was enacted.



This will be achieved by excluding the value of the body corporate supplies to members, from the body corporate's total value of supplies, when determining whether a body corporate is required to register for GST purposes. However, if a body corporate is required to register because supplies to third parties exceed the registration threshold, or the body corporate decides to voluntarily register, it will be required to return output tax on the full value of its body corporate and third party supplies.

As a form of revenue protection for Inland Revenue the Bill provides that a body corporate registered after enactment of the legislation cannot backdate their registration and a four year lock in period is proposed to prevent these bodies corporate from continually changing their registration status. The body corporate also needs to return output tax on the funds held at the date of registration. Care needs to be taken by bodies corporate when considering if they should change their GST status under these new proposed rules.

Overall the new proposals are a vast improvement over the 2014 options, but individual body corporate entities still need to carefully consider how they will be impacted by these changes.

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"Cash out" of R&D losses

By Darren Johnson

The proposals regarding the cashing out of research and development (R&D) tax losses, have finally materialised in the just introduced Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill. A subject of two budgets and an officials' issues paper, the Government is proposing to allow loss-making R&D companies to "cash out" their tax losses from R&D expenditure. We welcome the finer legislative details on how the rules will operate.

The proposals focus on start-up companies engaging in intensive R&D. The intention is to reduce exposure to market failures and tax distortions arising from the current tax treatment of losses. R&D start-ups face high up-front costs with its profit cycle heavily skewed towards early losses. Currently, companies are required to carry forward losses until they make a profit which is an important integrity measure in the tax system to mitigate the creation of artificial losses. However this creates a cash flow problem for R&D companies which is further compounded by the length of period they are in a loss position, broader capital constraints and difficulties in securing financing or investment.

Under the proposals, R&D start-up companies will be able to claim up to 28% of their tax losses from R&D expenditure in any given year.

Eligibility

- An applicant must be a company that is resident in New Zealand for the whole year and not be one treated, under a double tax agreement, as a resident of a foreign country or territory;
- The company must have R&D expenditure relating to research and development activities; and
- It must also have a net loss for the relevant tax year and meet the wage intensity criteria.

The wage intensity criteria help target the proposals to R&D start-ups. Evidence shows loss-making R&D intensive businesses tend to spend a greater portion of their wage and salary costs on R&D. To be eligible, the company must spend 20% of their total labour expenditure on R&D labour. >>

Amount of the "cash out"

The amount of the cash out is to be delivered in the form of a tax credit administered through the tax system, cashed out for the relevant year. The amount is to be the lesser of:

- $500,000 of eligible losses multiplied by the corporate tax rate;
- The company's net loss for the year multiplied by the corporate tax rate;
- The company's R&D expenditure for the tax year multiplied by the corporate tax rate; or
- The company's total R&D labour expenditure for the year, multiplied by 1.5 and also multiplied by the corporate tax rate.

The bill proposes the $500,000 cap on eligible losses to be increased to $2 million over a period of five years in increments of $300,000 per annum.

R&D expenditure

R&D expenditure is defined using the current definition used in the existing R&D provisions with reference to NZ IAS 38. The proposals however limit the qualifying expenditure to ensure that it is targeted as intended. Activities that are excluded expenditure generally take place in a post-development phase, related to routine work or where there is an indeterminate relationship between the activity and economic growth. These activities are likely to take place when the company is less likely to be capital and cash flow-constrained, one of the main policy reasons behind the new proposals. The issues paper had proposed excluding clinical trials and software coding which would have locked out a large proportion of software companies during the most important phase of their R & D investment. It is pleasing to note that Officials have listened to submitters on this point and so such activities have not been excluded. However the caveat is that expenditure on such matters must still fall within the general principles of not being post development, routine work and so on. This is positive news for New Zealand's start-up technology companies, many of whom are software based. The key will be seeing the approach to the caveat in practice.

This is positive news for New Zealand's start-up technology companies.

Reinstatement of losses

As the proposals are intended to provide a temporary cash flow timing benefit when the company is in a tax loss position, it is proposed that the cashed-out payments should be repaid and corresponding losses reinstated (via a deduction mechanism) when:

- The company makes a return on their investment by disposing of or transferring R&D assets;
- The company migrates;
- If the company is liquidated;
- The company amalgamates with another company; or
- If more than 90% of the company has been sold since the company first cashed-out R&D tax losses.

The repayment amount will be reduced by the income tax paid by the company from the time the losses were cashed out. No further repayments will be required if the company derives sufficient taxable income to repay the balance of the cashed-out loans before one of the above occurs.

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Amending return errors: Taxpayer friendly High Court ruling

By Virag Singh and Brad Bowman

Section 113 of the Tax Administration Act 1994 (section 113) gives the Commissioner of Inland Revenue (the Commissioner) the power to "amend an assessment as the Commissioner thinks necessary in order to ensure its correctness". The recent High Court case of **Westpac Securities NZ Limited v Commissioner of Inland Revenue** (Westpac case) considers the application of the Commissioner's power to amend assessments under section 113.

Background

Westpac Securities NZ Limited and Westpac Trust Securities NZ Limited (profit companies) had operations in the United Kingdom. In accordance with the tax laws of the United Kingdom, the profit companies both paid tax on the profits derived from their United Kingdom operations. These companies were also required to file their New Zealand income tax returns within six months of the end of its financial year. However, at the time of filing their New Zealand tax returns, final details regarding the tax paid in the United Kingdom were not available. As such, the New Zealand tax returns were filed without claiming a foreign tax credit for tax paid in the United Kingdom.

> The Commissioner of Inland Revenue declined the request to reverse the loss offsets made.

The Income Tax Act provides for an irrevocable election for one company to elect to make losses available to another company within the same group. In this case, four companies within the Westpac group (loss companies) elected to make losses available to the profit companies. This loss offset had the effect of eliminating any taxable income of the profit companies.

Upon finalising their United Kingdom tax obligations, the profit companies did not have any taxable income to utilise foreign tax credits for overseas tax paid. The profit companies were now unable to utilise the foreign tax credits that would otherwise have been available.

The Westpac group subsequently asked the Commissioner to exercise her power under section 113 to amend the income tax returns by reversing the loss offsets made to the profit companies to allow for the utilisation of foreign tax credits. The Commissioner declined this request for the following reasons:

- Allowing such a request would not be consistent with Inland Revenue's published Standard Practice Statement 07/03 – Requests to amend assessments (2007 SPS) because the loss offsets made by the loss companies did not constitute a "genuine error" and did not fall within her power of amendment under section 113; and
- That because the loss offsets are "irrevocable" neither the taxpayer nor the Commissioner could revoke a valid election.

This was an application for judicial review by the Westpac Group seeking a declaration that the Commissioner was able to amend the relevant assessments and an order requiring the Commissioner to reconsider Westpac's request. >>

Outcome and reasoning

Section 113 gives the Commissioner the power to amend a taxpayer's assessment "in order to ensure its correctness". In assessing the first reason given by the Commissioner in declining Westpac's section 113 request, the High Court held:

1. The wording of section 113 contains no reference to an error being a requirement for the exercise of the Commissioner's power.

2. The definition of "correctness" goes further than merely being free from error; rather the ordinary meaning is "free from error; accurate; in accordance with fact, truth or reason".

3. An assessment being free from "genuine error" does not preclude amending the assessment to ensure it is the most appropriate for the situation.

4. The broader application of section 113 is supported by case law.

The High Court held that the scope of section 113 is wider than instances of "genuine error", as currently prescribed in the 2007 SPS.

Regarding the Commissioner's secondary reason for declining Westpac's section 113 request, the High Court said, while a *taxpayer* is precluded from revoking an irrevocable election, there is nothing preventing *the Commissioner* from amending an irrevocable election.

Clifford J of the High Court held that the Commissioner had, in her 2007 SPS, erred in her interpretation of section 113. The High Court went on to say that the Commissioner may exercise her discretion under section 113 to correct Westpac's returns; however whether the Commissioner considers that she should exercise her discretionary power was a matter outside the scope of this case.

At [62] of the judgment, Clifford J went on to say:

… it is difficult to see why amending an assessment in a manner which results in an outcome clearly available under applicable tax legislation is necessarily problematic simply because it is more favourable to a particular taxpayer.

We wish to emphasise that, while the High Court held the Commissioner may consider using her powers under section 113, her powers are still discretionary and there is no guarantee that the Commissioner will amend assessments on this basis. >>

Standard practice statement

In the 2007 SPS, the Commissioner set out situations in which she will and will not use her powers under section 113. It is worth noting that in early-2014 the Commissioner released an updated draft standard practice statement (draft SPS) for public consultation. This draft SPS was largely the same as the 2007 SPS, however its finalisation has been put on hold pending the outcome of the Westpac case.

Under the 2007 SPS and draft SPS, the Commissioner said she will not amend assessments under section 113 in the following cases:

- Regretted choice – this situation arises when a decision is made to use a certain tax policy, but retrospectively it is discovered that using another legitimate option would have led to a more (or less) favourable outcome.
- Disputed law – occurs where the taxpayer wishes to change their assessment based on a disagreement with the law.

Conversely, the Commissioner will amend assessments under section 113 where the taxpayer has made a genuine error. These primarily arise through accounting errors and oversights.

Having disagreed with the Commissioner's interpretation of section 113, it is clear that the outcome in the Westpac case is contradictory to the Commissioner's standard practice as outlined in the 2007 SPS and draft SPS. The High Court has concluded that the Commissioner could use her power under section 113 to correct the returns of a taxpayer where there was no genuine error. This means instances where the Commissioner can legally amend assessments under section 113 extend beyond instances currently prescribed by the 2007 SPS and draft SPS.

Deloitte comment

Overall this is a positive outcome for taxpayers and confirms that section 113 has a wider application than what the 2007 SPS and draft SPS allows for.

While the Commissioner is likely to argue that the outcome of the Westpac case was one-off and fact dependent, we believe this ruling alters the focus of section 113 requests. Rather than the Commissioner focusing on whether a "genuine error" was made, the focus should be placed on whether the return is "correct" (i.e. whether the return was the most appropriate for the situation).

The ball is still in Inland Revenue's court in regard to section 113 requests, and even with a legitimate argument, a request may still be denied by the Commissioner.

We wait with interest to see how this case is reflected in the updated SPS and whether it will expand the instances where the Commissioner can legally amend assessments under section 113. At the end of the day, the right to amend assessments is entirely at the discretion of the Commissioner. The ball is still in Inland Revenue's court in regard to section 113 requests, and even with a legitimate argument, a request may still be denied by the Commissioner. That being said, it is also the Commissioner's duty to uphold the integrity of the New Zealand tax system which equates to equitable treatment of taxpayers' requests. While the power remains at the Commissioner's discretion, this discretion can be challenged via a judicial review.

For taxpayers that find errors subsequent to filing returns, there are a few options available. The choice depends on the quantum and type of the adjustment and the length of time between filing the return and finding the error. If for example, the error is discovered within 4 months of filing the tax return, the need to rely on the Commissioner's discretion under section 113 is avoided as the taxpayer is able to file a notice of proposed adjustment. When the tax payable as a result of the error is $500 or less, there is an option to correct the error in the next return.

The key message is not to delay if you believe you have discrepancies in current year returns filed or prior year returns that may require an amendment. Please contact your usual Deloitte tax advisor to discuss what options are available to remedy discrepancies.

Consultation sought on related party debt remission

In 2014, Inland Revenue issued a draft QWBA (Question We've Been Asked[1]) on whether certain scenarios constitute tax avoidance. One scenario concerned a debt capitalisation arrangement which is explained as follows:

> *Company D is insolvent. It has assets of $200 (cash) and liabilities of $700 (being a loan from the shareholder). The shareholder subscribes for $500 worth of shares in Company D as partial repayment of the shareholder loan, with the remaining amount repaid in cash.*

The Commissioner of Inland Revenue considered this to be an arrangement that potentially avoided tax that would otherwise be payable on income arising when debt is remitted under the financial arrangement rules. This draft conclusion drew much criticism and created much uncertainty as related party debt capitalisation has been a common planning technique used for several reasons – for example, to eliminate loans owed by insolvent subsidiaries, to reorganise a group prior to a sale of a subsidiary, or to reduce a subsidiary's debt due to thin capitalisation concerns. A key problem that drives the use of debt capitalisation is that the financial arrangement rules create an asymmetrical outcome for debt remission in the context of wholly-owned group companies - i.e. that debt remission income arises to the borrower for the amount remitted, while the related-party lender is denied a deduction for the bad debt.

Officials acknowledged this issue, and as a result, the policy area of Inland Revenue has undertaken a review as to what the correct policy outcome should be in certain situations. The Policy and Strategy Group of Inland Revenue has now released an **issues paper** for consultation on the proposed changes to the law. The conclusion in the paper is a very positive result in that the Government has agreed that under certain scenarios, debt remission income should not arise. The core proposal is:

- that there should be no debt remission income for the debtor when the debtor and the creditor are in the New Zealand tax base, including controlled foreign company debtors; and

- they are members of the same wholly owned group of companies; or

- the debtor is a company or partnership; and

  - all of the relevant debt remitted is owed to shareholders or partners in the debtor; and

  - if we presume that if the debt remitted was instead capitalised, there would be no dilution of ownership of the debtor following the remission and all owners' proportionate ownership in the debtor is unchanged.

It is further proposed that this core proposal be backdated to apply from the commencement of the 2006–07 tax year, although this is to be confirmed following consultation. The paper also notes that, subject to this proposal being finalised, Inland Revenue will not be devoting resources to determine whether debt remission arises in situations covered by the core proposal. It is pleasing to see Officials front-foot the issue of what to do in respect of past positions taken by proposing to backdate the changes - no doubt learning lessons from the way the recent changes to the allowances rules were implemented.

There is still an outstanding and key issue of what the policy answer should be where the owner/creditor is non-resident because the use of related-party inbound debt is a key BEPS (Base Erosion and Profit Shifting) concern. On the one hand having debt remission income arise in this situation will dissuade non-residents from over-gearing, but on the other hand it may also dissuade non-residents from reducing gearing levels because of the consequences. Officials will continue to work on this aspect and are seeking comments.

A chapter of the issues paper covers technical issues associated with the proposed reforms. In particular, there is a concern about the ability of taxpayers to achieve a timing advantage where accrued interest income is written off by the lender but the borrower has not been released from the loan and therefore may continue to accrue interest and claim a deduction under the financial arrangement rules. The solution proposed by Officials is to disallow a bad debt deduction for the associated person's interest receivable, but submissions on this are welcome.

Submissions close on 14 April 2015. For further information on this, please contact your usual tax advisor.

[1] Now finalised as QB 15/01

Tax treatment of life insurance policies

Inland Revenue recently undertook a review of all Public Information Bulletins (PIB) and as a result, identified out of date items that needed replacing. Two draft Questions We've Been Asked (QWBA) have been released to replace items: "Staff insurance scheme" (PIB No 70 (December 1972):11) and "Life and accident insurance policies" (PIB No 106 (July 1980):2), on the income tax treatment of insurance in an employment context.

The first QWBA, **PUB0215: Income Tax – Insurance – Term life insurance policy taken out by employee** looks at the situation where a term life insurance policy is taken out by an employee and the premiums are paid by the employer on the employee's behalf. The Commissioner concludes that:

- The employer will generally be entitled to a deduction for the premium paid
- The amount of the premium is treated as salary and wages and is subject to PAYE as it meets the definition of expenditure on account of an employee under section CE 1(1)(b) of the Income Tax Act 2007 (the Act).
- A lump sum payout under the terms of the policy to the employee would not be taxable income.

The second QWBA, **PUB0215-2: Income Tax – Insurance – Term life insurance policy taken out by employer** deals with the situation where a term life insurance policy is taken out by an employer for the benefit of an employee. Under the scenario contemplated, the premiums payable on a term life policy are unable to be refunded or converted to cash by the employee and the benefits are only payable on the death of the employee or those payable because of accident, disease or sickness of the employee.

The Act expressly excludes, from the definition of expenditure on account of an employee, an amount being a premium that an employer pays on life insurance taken out for the benefit of the employee where the premium cannot be refunded or converted into cash for the employee and benefits are only payable on death of the employee. As such, the PAYE rules do not apply.

Instead, the FBT rules apply as the amount will be classified as an unclassified benefit which an employer >>

provides to an employee in connection with their employment. The employer will be entitled to a deduction for the premium paid while any lump sums paid out under the policy will not be taxable income of the employee (or of the employee's estate).

The two drafts are relatively straight forward and deal with uncontroversial matters. It is noted that there are other types of arrangements which these items do not address. For example where an employer provides life insurance through group life policies and the employer is a beneficiary of the policy. A published Inland Revenue item on this would also be useful.

The deadline for comment is **27 March 2015**. Please contact your usual tax advisor for more information about making a submission or on this issue generally.

Draft re-issue of rulings for interest deductibility

The Commissioner of Inland Revenue has re-issued drafts of public rulings BR Pub 10/14 – 10/19 concerning interest deductibility applying the *Roberts and Smith* principle. The rulings specifically concern interest deductibility for partnerships and some companies under section DB 6 of the Income Tax Act 2007 (the Act). The rulings won't be relevant for companies that are allowed an interest deduction under section DB 7 of the Act where a nexus to income derived is not required. The rulings will be relevant for those companies that cannot rely on section DB 7 of the Act.

Overall, the re-issue makes significant editorial changes to the rulings and commentary but is not intended to change the scope of the arrangements, reasoning or conclusions in BR Pub 10/14 – 10/19.

The *Roberts and Smith* principle (the principle) stems from a decision of the Australian Full Federal Court in *FC of T v Roberts; FC of T v Smith* 92 ATC 4,380 which concerned the deductibility of interest incurred by a partnership that had borrowed to repay partners part of their capital contributions. Whilst the case is Australian, it is relevant in New Zealand because the legislative income tax provisions concerning interest deductibility in both countries are similar. The Court held that the interest was deductible, irrespective of how the partner used the funds that were repaid to them. This is because the new funding takes on the character of the existing funding that is replaced, and the existing funding was used in the partnerships' business for the purposes of deriving income.

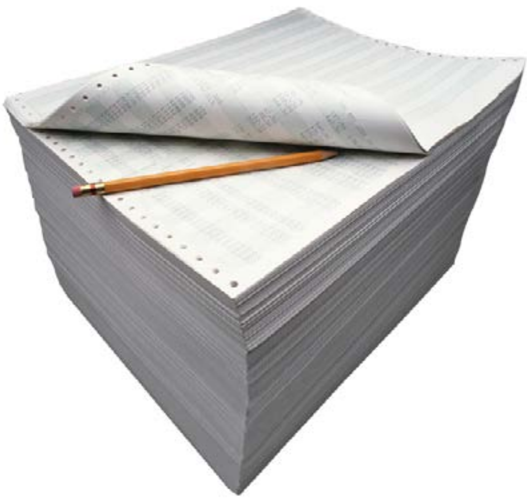
The principle provides that a sufficient nexus will exist where:

- a partnership or taxpayer incurs interest on borrowed funds;
- the borrowed funds are used to replace existing funding and to repay that funding to the person who invested or lent the funds; and
- the existing funding had been used by the partnership or taxpayer to derive income or in carrying on a business for the purpose of deriving income.

The nexus is established through the new funding replacing existing funding. The existing funding must have had a sufficient connection with income, or interest must have otherwise been deductible under other provisions (such as sections DB 7 or DB 8 of the Act). >>

The re-issued rulings cover six scenarios. Interest will be deductible in five of the scenarios where the funds are borrowed:

- by a partnership to return capital contributions to a partner;
- by a partnership to return past years' profits to a partner;
- by a company to repurchase shares;
- by a company to pay dividends; and
- to repay debt.



It should be noted that these rulings expressly deny deductions for funds borrowed to pay current year income, unrealised asset revaluations or internally generated goodwill.

The oddball is the last of the six rulings which states the principle does not apply to allow a deduction for interest incurred in borrowings used by a company to make a subvention payment. The Commissioner considers that in this scenario, there is no replacement of an amount previously advanced by the recipient company or an amount repaid to shareholders for amounts invested in the paying company and so the principle does not apply. However section DB 7 will, in most cases, provide a deduction in any event. This particular ruling therefore clarifies that the principle does not apply in this scenario when interest is not deductible under section DB 7.

The rulings are intended to have the same scope as the previous versions; however the commentary to the draft rulings now makes it clear that these rulings do not apply to a look-through company. This is mostly due to the fact that other rulings have been published on interest deductibility scenarios for look-through companies, as well as the fact that both the look-through and closely-held company regimes are presently under review.

Submissions can be made to **public.consultation@ird.govt.nz**. The deadline for comment is **20 March 2015**.

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