Part E – Timing and quantifying rules

EA – Income credited in account

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EA 1 Matching rule for employment income of shareholder-employee

If a company is allowed a deduction for expenditure on employment income under section CE 1 (Amounts derived in connection with employment) that is paid or is payable to a shareholder-employee, the income is allocated in the following way:

(a) to the income year to which the deduction allowed to the company was allocated, an amount equal to the deduction minus the unexpired portion of the company's expenditure on the income; and

(b) to the income year or years in which the company's expenditure on the income is no longer treated as the unexpired portion of the company's expenditure under section EB 3 (7) (Prepayments and certain deferred payments), the balance of the income.

Origin:	EB 1(3), (4).
Defined terms:	amount, company, deduction, employment income, income year, shareholder-employee.

EA 2 Interest from inflation-indexed instruments

When this section applies

(1) This section applies when—

(a) an amount of money lent is outstanding at the end of the lender's current income year; and

(b) an amount is payable to the lender for the money lent, in a future income year of the lender; and

(c) the amount payable is determined by a fixed relationship to one or more indices of general price inflation in New Zealand; and

(d) the amount payable that has accrued at the end of the lender's current income year differs from any amount payable that had accrued—

(i) at the time the money was lent, if it was lent during the lender's current income year; or

(ii) at the end of the lender's previous income year, if it was lent before the lender's current income year.

Increase treated as credited

(2) If the difference is an increase, the increase is treated as having been credited in account and capitalised by the borrower for the benefit of the lender on—

(a) the day following the day on which the level of the relevant index at the end of the lender's current income year becomes public knowledge; or

(b) if the level of the relevant index is not calculated for the end of the lender's current income year, the last date before the end of the income year for which the level is calculated.

This subsection is overridden by subsection (3).

Increase not treated as credited

(3) An increase is not treated as having been credited to the extent to which—

(a) the money lent has been repaid; or

(b) an amount on account of the increase has already been paid to the lender; or

(c) the increase represents a recovery of a decrease in the amount payable over a previous income year of the lender.

Origin:	(1) EB 4(2), (7). (2) EB 4(1), (3), (6), (7). (3) EB 4(4), (5).
Defined terms:	amount, income year, interest, money lent, New Zealand, pay.

EB – Matching rules: revenue account property and prepayments

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EB 1 Stock and excepted financial arrangements

When this section applies

(1) This section applies when a person has—

(a) trading stock valued under subpart EC (Valuation of trading stock (including dealer's livestock)):

(b) livestock valued under subpart ED (Valuation of livestock):

(c) excepted financial arrangements that are revenue account property valued under subpart EE (Valuation of excepted financial arrangements).

Adjustment to income

(2) When the closing value of trading stock, livestock, and excepted financial arrangements in total for an income year is more than the opening value, the income of a person is adjusted by an amount equal to the total of the amounts calculated separately for trading stock, livestock, and excepted financial arrangements using the formula—

closing value – opening value.

Adjustment to deduction

(3) When the opening value of trading stock, livestock, and excepted financial arrangements in total for an income year is more than the closing value, the deduction that a person is allowed is adjusted by an amount equal to the total of the amounts calculated separately for trading stock, livestock, and excepted financial arrangements using the formula—

opening value – closing value.

Definition of items in formula

(4) The items in the formulas are defined in subsections (5) and (6).

Closing value

(5) **Closing value** means—

(a) for trading stock, the value of the trading stock that the business holds at the end of the income year (see section EC 3 (Valuation of trading stock (including dealer's livestock))):

(b) for livestock, the value of the livestock that the business holds at the end of the income year (see section ED 2 (General rule for the valuation of livestock)):

(c) for excepted financial arrangements, the value of the excepted financial arrangements that the person holds at the end of the income year (see section EE 1 (Valuation of excepted financial arrangements)).

Opening value

(6) **Opening value** means the closing value of the trading stock, livestock, or excepted financial arrangements, as applicable, at the end of the previous income year.

Origin:	(1) EE 2(1). (2) EE 2(2), (3), (4). (3) EE 2(2), (3), (4). (4) EE 2(3). (5) EE 2(2). (6) EE 2(2).
Defined terms:	amount, business, closing value, deduction, excepted financial arrangement, income, income year, opening value, person, revenue account property, trading stock.
Comment:	This provision adds all the valuations of various forms of stock, including excepted financial arrangements, from subparts EC, ED, and EE. The resulting net change in value is treated as either income or a deduction depending on whether the aggregate closing value exceeds the aggregate opening value, or vice versa.

EB 2 Other revenue account property

When this section applies

(1) This section applies to revenue account property that is not—

(a) trading stock valued under subpart EC (Valuation of trading stock (including dealer's livestock)):

(b) livestock valued under subpart ED (Valuation of livestock):

(c) an excepted financial arrangement valued under subpart EE (Valuation of excepted financial arrangements):

(d) a financial arrangement valued under subpart EH (Financial arrangements rules):

(e) a specified lease or a lease to which section EK 17 (Payment by lessee under personal property and operating leases) applies:

(f) a film or a right in a film:

(g) property that arises as a result of petroleum development expenditure or petroleum exploration expenditure.

Allocation

(2) A deduction for the cost of revenue account property of a person is allocated to the later of—

(a) the income year in which the person disposes of the property; and

(b) the income year or years in which the person derives income from disposing of the property.

Allocation to more than one year

(3) If subsection (2)(b) applies and the person's income from disposing of the property is derived in 2 or more income years, the proportion of the deduction that the income derived in that year represents as a proportion of the total income from the disposal is allocated to each income year.

Reasonable estimate of income

(4) If, when making an allocation under subsection (2), a person cannot identify the total income from the disposal of the property, they must allocate an amount that they reasonably expect to derive from the disposal.

Origin:	(1) EF 2(2). (2) EF 2(1). (3) EF 2(3). (4) EF 2(4).
Defined terms:	amount, deduction, derived, excepted financial arrangement, film, financial arrangement, income, income year, lease, person, petroleum development expenditure, petroleum exploration expenditure, revenue account property, right in a film, specified lease, trading stock.
Comment:	Livestock and excepted financial arrangements have been added to the items included in subsection (1) as they have been separated from trading stock. Accordingly, current section EF 2 (1A), relating to excepted financial arrangements, has not been replicated. To clarify the relationship between the current sections EF 1 and EF 2, draft section EB 2 (which is the equivalent of current section EF 2) will take precedence, and draft section EB 3 (the equivalent of current section EF 1) will apply only to goods that are not revenue account property. The draft section makes it explicit that draft section EB 2 does not cover operating leases as they have their own timing rule (current section EO 2A).

It may be necessary to provide that section EB 2 does not apply (and instead section EB 3 applies) to consumable aids.
Further work is being undertaken on the definition of 'revenue account property'. There is currently an element of circularity with the definition of 'depreciable property'. There may be a need to define 'revenue account property' by reference to specific categories of property.

EB 3 **Prepayments and certain deferred payments**

When this section applies

(1) This section applies when—

(a) a person has been allowed a deduction for expenditure under this Act or under the Income Tax Act 1976; and

(b) the expenditure was not incurred on the items listed in subsection (2), which are each already subject to different deduction timing rules; and

(c) part or all of the expenditure is unexpired under the rules in subsections (4) to (9) at the end of the person's income year.

Expenditure not subject to this section

(2) This section does not apply to expenditure on—

(a) trading stock valued under subpart EC (Valuation of trading stock (including dealer's livestock)):

(b) livestock valued under subpart ED (Valuation of livestock):

(c) an excepted financial arrangement valued under subpart EE (Valuation of excepted financial arrangements):

(d) a financial arrangement valued under subpart EH (Financial arrangements rules):

(e) a specified lease or a lease to which section EK 17 (Payment by lessee under personal property and operating leases) applies:

(f) a film or a right in a film:

(g) property that arises as a result of petroleum development expenditure or petroleum exploration expenditure.

(h) revenue account property to which section EB 2 applies.

Adjustment for unexpired portion

(3) The unexpired portion of a person's expenditure at the end of an income year is income of the person in the income year under section CG 11 (Prepayments for services and some goods and deferred payments) and is allowed as a deduction in the following income year under section DB 38 (Adjustment for prepayments and deferred payments).

Unexpired portion: expenditure on goods

(4) An amount of expenditure on goods is unexpired at the end of an income year if the person has not used up the goods by the end of the income year in deriving income.

Unexpired portion: expenditure on services

(5) An amount of expenditure on services is unexpired at the end of an income year if the services have not been performed by the end of the income year. But the special rule in subsection (7) for expenditure on employment income overrides this subsection.

Unexpired portion: expenditure on chose in action

(6) An amount of expenditure on a chose in action is unexpired at the end of an income year if the amount relates to a period of enforceability of the chose in action falling after the income year.

Unexpired portion: expenditure on employment income

(7) An amount of expenditure on employment income under section CE 1 (Amounts derived in connection with employment) is unexpired at the end of an income year, even though the services have been performed during the income year, if the amount is still unpaid 63 days after the end of the income year.

Extension of payment period: shareholder-employee income

(8) In the case of employment income paid to a shareholder-employee, the 63-day payment period for a payment in subsection (7) is extended until the last date by which the person could file a return of income for the income year if the maximum extension of time were allowed under section 37 (5) of the Tax Administration Act 1994.

Allowances reimbursing employees: related to anticipated timing

(9) In the case of expenditure subject to section CW 13 (Reimbursement of employees and expenditure for their benefit) and section CW 14 (Allowance for additional transport costs), this section applies on the basis that the relevant services were performed in the year in which the employee’s expenditure is expected to occur.

Commissioner’s discretionary relief

(10) The Commissioner may allow a person not to comply with the rules in this section under section 91AJ of the Tax Administration Act 1994.

Definitions for this section

(11) In this section,—

goods means all real or personal property, but not money or a chose in action

services means anything that is not goods or money or a chose in action.

Origin:	(1) new. (2) OB 1 ‘accrual expenditure’. (3) EF 1(1). (4) EF 1(5)(a). (5) EF 1(5)(b). (6) EF 1(5)(d). (7) EF 1(5)(c), (6)(a). (8) EF 1(6)(b). (9) EF 1(5A). (10) EF 1(3), (4). (11) EF 1(7).
Defined terms:	amount, Commissioner, deduction, derived, employee, employment income, goods, income, income year, person, return of income, revenue account property, services, shareholder-employee.
Comment:	It is proposed that the draft section EB 2 revenue account property rules apply in priority to draft section EB 3 (see draft section EB 3 (2)(b)). The contents of current sections EF 1 (3) and (4) are in draft section 91AJ of the Tax Administration Act 1994, which appears in the consequential amendments in volume 3.

EC – Valuation of trading stock (including dealer's livestock)

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Introductory provisions

EC 1 When this subpart applies

This subpart applies when a person who owns or carries on a business holds trading stock for the purpose of selling or exchanging it in the ordinary course of the business.

Origin:	EE 1.
Defined terms:	business, person, trading stock.
Comment:	Consistently with the current law, a person has to be using the trading stock in their business to be covered by these provisions. Likewise, the link with a purpose of sale or exchange has been retained. The usual tests would apply to establish whether a business was being undertaken. The phrase 'owns or carries on a business' has been retained. The words 'carries on' were added in 1951 to cover a situation in which a business was on-sold after hours (see *S Trustees v Commissioner of Taxes (NZ)* (1950) 5 AITR 31 at 43). This instance is not directly relevant in the case of ongoing ownership of a business as envisaged by the trading stock valuation provisions, but can be relevant when a business is being sold.

EC 2 'Trading stock' defined

Property held in business

(1) **Trading stock** means property that a person who owns or carries on a business holds for the purpose of selling or exchanging in the ordinary course of the business.

What is included in 'trading stock'

(2) Trading stock includes—

(a) partly completed work that would, if completed, be trading stock under subsection (1):

(b) property that the person holds for use in producing trading stock:

(c) property on which the person has incurred expenditure, when the property would, if they held it, be trading stock under subsection (1) or paragraph (a) or paragraph (b):

(d) property leased under a hire purchase agreement when the property—

(i) is treated as having been acquired by the lessor under section FC 10 (2) (Taxation of hire purchase agreements); and

(ii) is an asset of a business that the lessor carries on.

What is excluded from 'trading stock'

(3) Trading stock does not include—

(a) land:

(b) depreciable property:

(c) a financial arrangement:

(d) an excepted financial arrangement:

(e) livestock not used in dealing operations:

(f) a consumable item to be used in the process of producing trading stock:

(g) a spare part not held for sale or exchange.

Origin:	(1) OB 1 'trading stock'. (2) OB 1 'trading stock'. (3) OB 1 'trading stock'.
Defined terms:	business, depreciable property, excepted financial arrangement, financial arrangement, hire purchase agreement, land, lessor, person, trading stock.
Comment:	The components of the current definition of 'trading stock' have been incorporated into the body of draft subsections (1) and (2). The current definition of 'trading stock' builds upon the common law notion of trading stock, which in turn draws upon commercial use. As such, the definition is not exhaustive. This inclusive approach to defining trading stock has not been changed in the rewrite process. The equivalent term in Financial Reporting Standard No 4 (FRS 4) is 'inventories'. But there are differences between 'inventories' and 'trading stock'. Notably, consumable aids (items such as fuel oil that are used in the production process but do not form part of the finished product) are inventories but are excluded from the definition of 'trading stock'. Instead, consumable aids are dealt with under the accrual expenditure provisions (current section EF 1, draft section EB 3). Similarly, spare parts held for maintaining plant are either dealt with under the accrual expenditure provisions or are depreciated. The other key difference is the inclusion of services in FRS 4. As noted in the general commentary, livestock, including bloodstock, used in a business and excepted financial arrangements have been removed from the definition of 'trading stock' but remain revenue account property. This change has no practical effect as livestock on hand at year end will continue to be valued annually (see separate subparts for livestock and excepted financial arrangements). Depreciable property has been explicitly included in the list of exclusions from trading stock to save the reader having to trace through other definitions. Depreciable property cannot be trading stock under the definition of 'depreciable property'. The exclusion of excepted financial arrangements implicitly subsumes the intent of current section DK 3E, which excludes excepted financial arrangements held by life insurers from being trading stock. As a result, current section DK 3E is no longer needed.

EC 3 Valuation of trading stock

Taking into account closing values

(1) A person who carries on a business must determine the value of their trading stock at the end of an income year by a method that is available under this subpart for them to use. The value of that closing stock is the closing value to be taken into account in section EB 1 (Stock and excepted financial arrangements).

Opening value

(2) The opening value of trading stock is the value of the person's closing stock at the end of the previous income year.

Origin:	(1) EE 2(1), (3), (4). (2) EE 2(2), (4).
Defined terms:	business, closing stock, closing value, income year, opening value, person, trading stock.
Comment:	The draft section makes explicit that these rules are applied at the end of the income year. This is not a change in the law. The other instance when the rules are relevant is when part-year accounts have to be prepared (for part-year loss purposes), in which case section IF 1 (4) requires the rules to be applied as if it were an income year.

EC 4 Summary of valuation methods

Standard valuation

(1) The standard valuation methods for trading stock are—

(a) cost, determined using generally accepted accounting principles:

(b) discounted selling price, if used for financial reporting purposes:

(c) replacement price, if used for financial reporting purposes:

(d) market selling value, if this value is lower than cost.

Valuation by low-turnover trader

(2) A person who is a low-turnover trader may choose to value closing stock using a standard valuation method or a low-turnover valuation method (see section EC 12).

Transfers of trading stock within wholly-owned group

(3) Special rules apply when trading stock is transferred between companies in a wholly-owned group of companies (see section EC 21).

Origin:	(1) EE 3(1). (2) EE 3(2). (3) new.
Defined terms:	closing stock, company, cost, generally accepted accounting principles, low-turnover trader, person, trading stock, wholly-owned group of companies.
Comment:	The draft brings together the provisions scattered through current subpart EE dealing with small taxpayers. The term ‘small taxpayer’ is replaced by ‘low-turnover trader’, defined in draft section EC 12. A low-turnover trader has the option of applying the rules specific to low-turnover traders or the general rules, regardless of whether financial statements have been prepared. However, should a low-turnover trader decide to comply with generally accepted accounting principles, they must comply with the consistency and disclosure requirements of Financial Reporting Standard No 1. Other low-turnover traders are subject to different consistency requirements (see draft section EC 20*).*

Standard valuation

EC 5 Cost of trading stock

Valuation at cost

(1) A person may determine the value of their trading stock at the end of an income year at cost. If the person chooses this method, they must include and allocate costs in accordance with generally accepted accounting principles, and the valuation must be substantially correct.

Materially correct valuation

(2) In subsection (1), if the value of closing stock is substantially different from the value obtained by applying the reporting standard to that closing stock, then the person has not complied with generally accepted accounting principles. The standard is Financial Reporting Standard No 4 (Accounting for Inventories) approved under the Financial Reporting Act 1993, or an equivalent standard issued in its place.

Allocation of costs for manufactured or produced stock

(3) This subsection applies to a person (other than a low-turnover trader) who determines the value of closing stock at cost, using a budgeted method or a standard cost method of cost allocation in a business of manufacturing or producing trading stock. If any difference arises between the estimated costs of production that are included in the financial statements of the business for the income year and the actual costs of production, the person must apportion this variance between the cost of trading stock sold during the income year and the closing stock.

Origin:	(1) EE 5(1). (2) EE 5(2). (3) EE 5(3).
Defined terms:	business, closing stock, cost, financial statements, generally accepted accounting principles, income year, low-turnover trader, person, trading stock.

EC 6 Identifying trading stock

When items of trading stock are not separately identifiable, a person must use a cost-flow method to identify those items of trading stock that are included in closing stock, and the cost of those items. A person may also use a cost-flow method to calculate the cost of trading stock that can be separately identified.

Origin:	EE 5(5), (6).
Defined terms:	closing stock, cost, person, trading stock.
Comment:	The use of ‘separately’ and ‘specifically’ has been standardised by using ‘separately’.

EC 7 Cost-flow methods of assigning costs

Cost-flow methods

(1) The cost-flow methods of assigning costs are—

- (a) the first-in first-out (FIFO) method:
- (b) the weighted average cost method.

Consistent use

(2) When calculating the value of closing stock at cost, a person must adopt the same cost-flow method of assigning costs as they use in their financial statements for that income year.

Origin:	(1) EE 6(1). (2) EE 6(2).
Defined terms:	closing stock, cost, financial statements, income year, person.

EC 8 Discounted selling price

Valuation by discounted selling price

(1) A person may determine the value of their trading stock at the end of an income year at its discounted selling price. But they may use this valuation method only if they use discounted selling price for the trading stock in their financial statements.

Establishing discounted selling price for retailers

(2) If the person is a retailer, the discounted selling price for each department or category of goods is the sum of retail selling prices of the goods minus the normal gross profit margin for the department or category of goods. For a modification of this valuation method for retailers whose turnover is less than $1,000,000, see section EC 17.

Establishing discounted selling price for others

(3) If the person is not a retailer, the discounted selling price for each category of goods is the total market selling value of the goods minus the normal gross profit margin for the category of goods.

'Normal gross profit margin' defined

(4) In this section, **normal gross profit margin** means the proportion of the selling price that is the normal gross profit margin of the relevant goods. The person must calculate the normal gross profit margin for each income year for each department or category of goods. In calculating the total cost of the goods, they must comply with generally accepted accounting principles, and must include all costs as required under Financial Reporting Standard No 4 (Accounting for Inventories) approved under the Financial Reporting Act 1983, or an equivalent standard issued in its place.

Origin:	(1) EE 8(1); EE 10(1). (2) EE 8(2). (3) EE 10(2). (4) EE 8(2), (3), (4); EE 10(3), (4).
Defined terms:	cost, financial statements, generally accepted accounting principles, income year, normal gross profit margin, person, trading stock, turnover.

EC 9 Replacement price

Valuation by replacement price

(1) A person may determine the value of their trading stock at the end of an income year at its replacement price. But they may use this valuation method only if they use replacement price for the trading stock in their financial statements.

Establishing replacement price

(2) The replacement price is the market price of acquiring the equivalent trading stock on the last day of the income year. If there is no such market price, the replacement price is the last price that the person paid during the income year in acquiring equivalent trading stock.

Origin:	(1) EE 11(1). (2) EE 11(2), (3).
Defined terms:	financial statements, income year, person, trading stock.

EC 10 Market selling value

Valuation by market selling value

(1) A person may determine the value of their trading stock at the end of an income year at its market selling value. But they may use this valuation method only if the market selling value is less than the cost of the trading stock.

Establishing market selling value

(2) The market selling value of trading stock is found by taking the amount that the person would normally expect to receive in the ordinary course of business at the end of an income year from the sale of the trading stock, and subtracting the following costs:

(a) the usual costs of completing production of the trading stock; and

(b) the expected costs of selling the trading stock.

Expected costs of selling the trading stock

(3) In subsection (2)(b), the expected costs of selling the trading stock are the costs that the person usually incurs for the following:

(a) transportation:

(b) insurance:

(c) sales commissions:

(d) discounts to buyers.

If the person prepares financial statements, the costs must have been taken into account in the statements in calculating net realisable value.

Substantiating market selling value

(4) If the person uses market selling value to value closing stock, they must be able to substantiate that value. If they cannot substantiate that value, to value their closing stock they must use—

(a) cost (see section EC 5 or section EC 13); or

(b) discounted selling price (see section EC 8 or section EC 17); or

(c) replacement price (see section EC 9 or section EC 18).

Origin:	(1) EE 3(1). (2) EE 12(1). (3) EE 12(2). (4) EE 12(3).
Defined terms:	amount, business, closing stock, cost, financial statements, income year, person, trading stock.

EC 11 Valuing closing stock consistently

In calculating the value of closing stock at cost, or by discounted selling price or replacement price, a person must comply with the consistency and disclosure requirements of Financial Reporting Standard No 1 (Disclosure of Accounting Policies) approved under the Financial Reporting Act 1993, or an equivalent standard issued in its place.

Origin:	EE 16(1).
Defined terms:	closing stock, cost, person.

Low-turnover valuation

EC 12 Low-turnover valuation

Option to use a standard method or a low-turnover method

(1) A person who is a low-turnover trader may value closing stock by a standard valuation method as described in sections EC 5 to EC 11, or by a low-turnover valuation method as described in sections EC 12 to EC 20.

Low-turnover valuation methods

(2) The low-turnover valuation methods are—

(a) cost for low-turnover traders (see section EC 13); or

(b) discounted selling price for low-turnover traders (see section EC 17); or

(c) replacement price for low-turnover traders (see section EC 18); or

(d) market selling value for low-turnover traders (see section EC 19).

'Low-turnover trader' defined

(3) In this subpart, **low-turnover trader** means a person who carries on a business when, in an income year, the total of the turnover of the business and the turnover of associated persons (as defined in section OD 8 (1)(a) or (b)) is not more than the greater of—

(a) $3,000,000; and

(b) the amount set by the Governor-General by Order in Council.

Turnover limit

(4) For the purposes of subsection (3), the Governor-General may alter the turnover limit set out in that subsection by Order in Council, but the amount prescribed must be at least $3,000,000.

Origin:	(1) new. (2) new. (3) OB 1 'small taxpayer'. (4) OB 1 'small taxpayer'.
Defined terms:	amount, associated person, business, closing stock, cost, income year, low-turnover trader, person, prescribed, turnover.
Comment:	The definition of 'low-turnover trader' is the current paragraph (b) of the definition of 'small taxpayer'. Paragraph (a) of the definition of 'small taxpayer' has not been included as it is already covered by paragraph (b). Association is limited to section OD 8 (1)(a) and (b), as currently.

EC 13 Cost for low-turnover traders

Valuation at cost

(1) A low-turnover trader may determine the value of their trading stock at the end of an income year at cost. If they choose this method, the low-turnover trader must calculate the value either in accordance with generally accepted accounting principles, or under section EC 14 and section EC 16, as applicable.

Option to use cost-flow methods

(2) Section EC 6 applies to a valuation under this section.

Origin:	(1) EE 3(1); EE 5(7). (2) EE 5(5), (6).
Defined terms:	cost, generally accepted accounting principles, income year, low-turnover trader, trading stock.

EC 14 Costs of manufacturing or producing trading stock

Costs involved

(1) For the purposes of section EC 13, in determining the cost of closing stock that a low-turnover trader manufactures or produces, the low-turnover trader must take into account the following costs of production:

(a) direct and indirect material costs:

(b) direct and indirect labour costs:

(c) utilities costs:

(d) costs of repairing and maintaining factory plant:

(e) costs of rent of factory plant:

(f) amounts of depreciation loss on factory plant.

Additional costs

(2) If a low-turnover trader prepares financial statements and, in an income year, includes in the financial statement production costs that are in addition to the costs described in subsection (1), the trader must include those production costs in determining the cost of closing stock in that income year.

Origin:	(1) EE 7(1). (2) EE 7(2).
Defined terms:	closing stock, cost, depreciation loss, financial statements, income year, low-turnover trader, trading stock.

EC 15 Allocation of costs for manufactured or produced trading stock

When this section applies

(1) This section applies when a low-turnover trader chooses a low-turnover valuation method, and determines the value of closing stock at cost, using a budgeted or standard cost method of allocation in a business of manufacturing or producing trading stock.

Variances

(2) When subsection (1) applies, the low-turnover trader is not required to adjust the value of the closing stock for any differences that arise between the estimated costs of production that are included in the financial statements of the business for the income year and the actual costs of production.

Origin:	(1) EE 5(3). (2) EE 5(3).
Defined terms:	business, closing stock, cost, financial statements, income year, low-turnover trader, trading stock.

EC 16 Costs of acquiring trading stock

For the purposes of section EC 13, in determining the cost of closing stock that a low-turnover trader acquires other than by manufacture or production, the low-turnover trader must take into account, in addition to the purchase price, any direct transport and insurance costs that they incur in bringing the trading stock to the place and condition in which they hold it.

Origin:	EE 7(3); OB 1 'cost'.
Defined terms:	closing stock, cost, low-turnover trader, trading stock.

EC 17 Discounted selling price for low-turnover traders

Valuation by discounted selling price

(1) A low-turnover trader who does not prepare financial statements may determine the value of their trading stock at the end of an income year at its discounted selling price. A low-turnover trader who prepares financial statements may use this method only if they use discounted selling price for the trading stock in their financial statements.

Establishing discounted selling price for retailers

(2) If the low-turnover trader is a retailer, the discounted selling price for each department or category of goods is the total of the retail selling prices of the goods minus the normal gross profit margin for the department or category of goods. For retailers whose turnover is less than $1,000,000, see subsection (5).

Establishing discounted selling price for others

(3) If the low-turnover trader is not a retailer, the discounted selling price for each category of goods is the total market selling value of the goods minus the normal gross profit margin for the category of goods.

'Normal gross profit margin' defined

(4) In subsections (2) and (3), **normal gross profit margin** means the proportion of the selling price that is the normal gross profit margin for the relevant goods calculated under Financial Reporting Standard No 4 (Accounting for Inventories) or an equivalent standard issued in its place. The low-turnover trader must calculate the normal gross profit margin for each income year for each department or category of goods. They must include all costs required under sections EC 5 and EC 6 or sections EC 13 and EC 14, as applicable.

Turnover of $1,000,000 or less

(5) Despite subsection (2), a low-turnover trader who is a retailer whose turnover is not more than $1,000,000 may determine the discounted selling price of all closing stock valued under this method in an income year by discounting the total of the retail selling prices of the stock by

the average gross profit margin for all trading stock valued under this method in that income year.

Turnover limit

(6) For the purposes of subsection (5), the Governor-General may alter the turnover limit set out in that subsection by Order in Council, but the amount prescribed must be at least $1,000,000.

Origin:	(1) EE 8(1); EE 10(1).
	(2) EE 8(2).
	(3) EE 10(2).
	(4) EE 8(2), (3), (4); EE 10(3), (4).
	(5) EE 9.
	(6) EE 9; EE 21(1), (2).
Defined terms:	amount, closing stock, cost, financial statements, income year, low-turnover trader, normal gross profit margin, prescribed, trading stock, turnover.

EC 18 Replacement price for low-turnover traders

Valuation by replacement price

(1) A low-turnover trader who does not prepare financial statements may determine the value of their trading stock at the end of an income year at its replacement price. A low-turnover trader who prepares financial statements may use this valuation method only if they use replacement price for the trading stock in their financial statements.

Establishing replacement price

(2) The replacement price is the market price of acquiring the equivalent trading stock on the last day of the income year. A low-turnover trader may, however, use the last price paid in an income year for equivalent stock as the replacement price.

Origin:	(1) EE 11(1).
	(2) EE 11(2), (4).
Defined terms:	financial statements, income year, low-turnover trader, trading stock.

EC 19 Market selling value for low-turnover traders

Valuation by market selling value

(1) A low-turnover trader may determine the value of their trading stock at the end of an income year at its market selling value, whether that value is higher or lower than cost. But if the value is higher than cost, the trader must be consistent from one income year to the next in their use of market selling value to determine the value of closing stock.

Establishing market selling value

(2) Section EC 10 (2) to (4) apply to a valuation under this section.

Origin:	(1) EE 3(2); EE 16(3).
	(2) EE 12(1), (2), (3).
Defined terms:	closing stock, cost, income year, low-turnover trader, trading stock.

EC 20 Valuing closing stock consistently

Valuation under generally accepted accounting principles

(1) In calculating the value of closing stock at cost, or by discounted selling price or replacement price, a low-turnover trader who determines the value of closing stock under generally accepted accounting principles must comply with the consistency and disclosure requirements of Financial Reporting Standard No 1 (Disclosure of Accounting Policies) approved under the Financial Reporting Act 1983, or an equivalent standard issued in its place.

Matters requiring consistency from year to year

(2) When subsection (1) does not apply, a low-turnover trader must be consistent from one income year to the next in—

(a) their choice of valuation method:

(b) the extent to which they include indirect costs in the cost of stock that they manufacture or produce:

(c) their use of a cost-flow method of assigning costs under section EC 7:

(d) their method of calculating discounted selling price:

(e) their use of market selling value if it is greater than cost.

When changes allowed

(3) Despite the requirement for consistency in subsection (2), a low-turnover trader may make changes in relation to the matters described in subsection (2) if—

(a) the change is justified by sound commercial reasons (the advancement, deferral, or reduction of an income tax liability is not a sound commercial reason):

(b) the change is required by another provision in this subpart.

Records

(4) A low-turnover trader may not make the change referred to in subsection (3) if they do not keep sufficient details of and reasons for the change in accordance with section 22 of the Tax Administration Act 1994.

Origin:	(1) EE 16(2).
	(2) EE 6(3); EE 16(3).
	(3) EE 16(4).
	(4) EE 16(5).

Defined terms:	closing stock, cost, generally accepted accounting principles, income tax liability, income year, low-turnover trader.

Group company transfers

EC 21 Transfers of trading stock within wholly-owned groups

When this section applies

(1) This section applies in an income year to trading stock held by companies that are members of the same wholly-owned group of companies when all the following paragraphs apply:

- (a) one group company (group company A) originally acquires and holds the trading stock; and
- (b) from the time it is acquired to the end of the income year, the trading stock is held within the group by a company or companies that are resident in New Zealand; and
- (c) through transfers within the group, another group company (group company B) holds the trading stock at the end of the income year; and
- (d) group company A and group company B remain members of the group at the end of the income year; and
- (e) either—
  - (i) the income years of group company A and group company B end on the same date; or
  - (ii) if they end on different dates, the Commissioner has approved both dates as corresponding to the end of a business cycle and as necessary to avoid material distortion of net income that would occur if the income years ended on the same date.

Choice of treatment

(2) When subsection (1) applies, group company B may choose to value the closing stock at the value of the trading stock to group company A.

When company stops being member of group

(3) Despite subsection (2), if group company B stops being a member of the wholly-owned group, the company is treated as disposing of and reacquiring the trading stock at its market value at the time the company stops being a member of the group. If the market value of the trading stock cannot be determined separately from other property, the value of the trading stock is taken to be its market value at the time group company B acquired it.

Origin:	(1) EE 15(1). (2) EE 15(1). (3) EE 15(2).
Defined terms:	business, closing stock, Commissioner, company, income year, market value, net income, resident in New Zealand, trading stock, wholly-owned group of companies.
Comment:	This adjustment does not apply if company B chooses to value at market value from the initial transfer. The Commissioner's approval of different income years has been retained because the requirement is for anti-avoidance reasons. Its retention is consistent with self-assessment. The inclusion in current section EE 15 (2) of a liquidation of the company as a means of the company ceasing to be a member of the group has not been replicated as it was there merely to remove any doubt.

Definitions

EC 22 Definitions for this subpart

In this subpart,—

generally accepted accounting principles means the accounting practice that is generally accepted for inventories, as it applies to trading stock

turnover—

(a) means the total income that a business derives in an income year from the sale or exchange of trading stock; and

(b) does not include the value of closing stock.

Origin:	EE 20(1), (2); OB 1 'generally accepted accounting principles', 'turnover'.
Defined terms:	business, closing stock, derived, generally accepted accounting principles, income, income year, trading stock.
Comment:	The definition of 'turnover' has been amended to make it clear that it relates only to the sale of trading stock, so that foreign exchange or depreciation gains or losses are not generally taken into account.

ED – Valuation of livestock

Index

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Introductory provisions

ED 1 Valuation of livestock

Livestock groups

(1) This subpart sets out the rules for valuing livestock. For this purpose, livestock is divided into four groups: listed livestock, other livestock, high-priced livestock, and bloodstock.

Dealing operations excluded

(2) This subpart applies only to livestock held for use in a business, but not to livestock used in dealing operations. For the valuation of livestock used in dealing operations, see sections EC 1 to EC 4.

Origin:	(1) new. (2) EE 2(1).
Defined terms:	bloodstock, business, high-priced livestock, listed livestock, livestock, other livestock.
Comment:	The provision refers to livestock having to be used in a business to qualify. This is not a change as the test is implicit in the current legislation through the general trading stock rules referring to 'a taxpayer who carries on or owns a business'.

ED 2 General rule for the valuation of livestock

A person must determine the value of their livestock at the end of an income year by a method that is available for them to use. The value determined is the livestock's closing value to be taken into account in section EB 1 (Stock and excepted financial arrangements).

Origin:	EL 1(1).
Defined terms:	closing value, income year, livestock, person.

ED 3 Summary of valuation methods

Listed livestock

(1) Listed livestock are sheep, beef cattle, dairy cattle, deer, goats, and pigs, and any other livestock types listed in schedule 8, column 1. High-priced animals of these livestock types have separate valuation rules (see subsection (3)). Four methods are available to determine the value of listed livestock. The methods are described in sections ED 9 to ED 26.

Other livestock

(2) Other livestock are livestock other than listed livestock, high-priced livestock, and bloodstock. The methods available to determine the value of other livestock are standard value, cost price, replacement price, or market value, as described in sections ED 28 to ED 30.

High-priced livestock

(3) High-priced livestock are animals that are listed livestock, that are bought at a premium price, and that are capable (or are expected to be capable) of being used for breeding. The value of high-priced livestock is determined under sections ED 31 to ED 35.

Bloodstock

(4) Bloodstock is any horse that is a standardbred or a thoroughbred horse, and a reference to bloodstock includes a property interest in a standardbred or a thoroughbred horse. The value of bloodstock is determined under sections ED 36 to ED 43.

Movement between valuation methods

(5) Restrictions apply to movements between valuation methods for listed livestock (see section ED 25).

Origin:	(1) EL 1(1). (2) EL 1(1). (3) EL 1(1). (4) EL 1(1). (5) EL 1(1).
Defined terms:	bloodstock, cost price, high-priced livestock, listed livestock, livestock, market value, other livestock, price, replacement price, standard value, type.
Comment:	This section is a summary of the subpart and the subsections are not intended to be definitions of the categories. Two terms have been renamed: 'specified livestock' becomes 'listed livestock' and 'non-specified livestock' becomes 'other livestock'. Otherwise, terms are the same as in current subpart EL. The reference to current section EE 2 has been deleted as livestock has been separated from the definition of 'trading stock'. Both livestock and trading stock remain revenue account property and both subparts set out valuation methods that feed into the valuation adjustment rule that is in current section EE 2.

ED 4 Interests in livestock

Joint election of valuation method

(1) When listed livestock is owned jointly by 2 or more persons, those owners must choose a valuation method. For it to be effective, the election must be made jointly by all the owners.

When election ineffective

(2) If there is not an effective election, listed livestock owned jointly is valued as follows:

(a) if the owners bail or lease the livestock to another person during the income year, at market value:

(b) if the owners enter into a profit-sharing arrangement for the livestock, at market value:

(c) in any other case, under the national standard cost scheme.

Partnerships and other interests

(3) For the purposes of an election under this section, a person's interest in a partnership that owns livestock is treated separately from any other interest that the person has in livestock. Separate elections are required for the person's partnership interest and for their other livestock interests. But the person is not required to choose the same valuation method in both cases.

Origin:	(1) EL 2(6). (2) EL 2(6). (3) EL 2(6).
Defined terms:	income year, lease, listed livestock, livestock, market value, national standard cost scheme, person, profit-sharing arrangement.

Comment:	Draft subsection (3) has been added to clarify that a person's partnership interest is to be treated separately from other interests for election purposes. The intention has always been that, despite the standard rule that an election applies to all of a person's livestock, the person could make a separate election for the partnership interest from their individual interests. Therefore, a farmer who owns their own farm and is also a partner in another farming venture does not have to apply the same valuation method chosen for the partnership to livestock on their own farm. Current section EL 2 (6)(c) has not been replicated as it is inconsistent with self-assessment.

ED 5 Changes in partnership interests

Related interests

(1) A new partnership that owns listed livestock is subject to a rule about related interests that applies in the income year in which the change in partnership interests occurs.

When the rule applies

(2) The rule applies when, at the end of the income year, more than 50% of the property of the new partnership is owned by persons who, during that income year or in the previous income year, owned all the property of another partnership that—

(a) was formed before the new partnership; and

(b) derived income in either income year from listed livestock of the same type as that owned by the new partnership.

Valuation in the income year of change

(3) When the rule applies, the value of listed livestock owned by the new partnership must be taken into account in the way the other partnership determines the value of livestock of the particular type at the end of the income year of change. If the other partnership has no listed livestock of the type on hand at the end of that income year, the value is taken into account as that partnership would have determined it, had it owned listed livestock of that type.

Origin:	(1) EL 1(2).
	(2) EL 1(2).
	(3) EL 1(2).
Defined terms:	derived, income, income year, listed livestock, livestock, person, type.

ED 6 Value of livestock on death of person

Market value

(1) On the death of a person who was deriving income from livestock, the value of livestock on hand at the date of death is its market value at that time. This section overrides both the person's chosen valuation method and the general provisions of section ED 2.

Death of partner

(2) On the death of a partner in a partnership that is deriving income from livestock, the partner's share of the livestock of the partnership is its market value at the date of death.

Livestock in herd scheme

(3) If a person who is deriving income from herd livestock dies before 1 February in an income year, and their return of income to the date of death is filed before the national average market values for the income year are set, the value of the livestock is its herd value for the previous income year. If the person has elected to use a herd value factor, the value of the livestock is its herd value multiplied by the factor applying in the previous income year.

Origin:	(1) EL 1(3). (2) EL 1(4). (3) EL 5(6).
Defined terms:	derived, herd livestock, herd scheme, herd value, herd value factor, income, income year, livestock, market value, national average market value, person, return of income.
Comment:	Current section EL 5 (6) has been divided into two, with the relevant provisions relating to the disposal of livestock as a result of a person's ceasing business now being located in draft section ED 15.

ED 7 Transfers of livestock within wholly-owned groups

When this section applies

(1) This section applies in an income year to livestock held by companies that are members of the same wholly-owned group of companies when all the following paragraphs apply:

(a) one group company (group company A) originally acquires and holds the livestock; and

(b) from the time it is acquired to the end of the income year, the livestock is held within the group by a company or companies that are resident in New Zealand; and

(c) through transfers within the group, another group company (group company B) holds the livestock at the end of the income year; and

(d) group company A and group company B remain members of the group at the end of the income year; and

(e) either—

(i) the income years of group company A and group company B end on the same date; or

(ii) if they end on different dates, the Commissioner has approved both dates as corresponding to the end of a business cycle and as necessary to avoid material distortion of net income that would occur if the income years ended on the same date.

Choice of treatment

(2) When subsection (1) applies, group company B may choose to value the closing stock at the value of the livestock to group company A.

When company stops being member of group

(3) Despite subsection (2), if group company B stops being a member of the wholly-owned group, the company is treated as disposing of and reacquiring the livestock at its market value at the time the company stops being a member of the group. If the market value of the livestock cannot be determined separately from other property, the value of the livestock is taken to be its market value at the time group company B acquired it.

Origin:	(1) EE 15(1). (2) EE 15(1). (3) EE 15(2).
Defined terms:	business, closing stock, Commissioner, company, income year, livestock, market value, net income, resident in New Zealand, wholly-owned group of companies.

Valuation of listed livestock

ED 8 Valuation of listed livestock

Sections ED 9 to ED 26 set out the rules for valuing listed livestock. Listed livestock are sheep, beef cattle, dairy cattle, deer, goats, and pigs, and any other livestock of the types listed in schedule 8, column 1 but not high-priced livestock.

Origin:	EL 1(1)(d).
Defined terms:	high-priced livestock, listed livestock, livestock, type.

ED 9 Valuation methods for listed livestock

Election

(1) Four methods are available for valuing listed livestock. A person must choose 1 method, making their election by using the method chosen in their return of income for an income year. The methods are:

(a) the herd scheme described in sections ED 10 to ED 16:

(b) the national standard cost scheme described in sections ED 17 to ED 19:

(c) one of the cost price, market value, or replacement price options described in section ED 20:

(d) as applicable, one of the bailment options described in sections ED 21 to ED 24.

When the election applies

(2) When a person chooses a valuation method, that method continues to apply in following income years unless they choose another method that is available to them.

Commissioner's determination

(3) If a person chooses a valuation method that is not available to them and they later make no valid election, the Commissioner must determine the method to be used. In doing so, the Commissioner must consult with the person.

Restrictions

(4) Restrictions apply to the use of valuation methods and the making of elections (see section ED 25).

Origin:	(1) EL 2(1). (2) EL 2(1). (3) EL 2(8). (4) new.
Defined terms:	Commissioner, cost price, herd scheme, income year, listed livestock, market value, national standard cost scheme, person, replacement price, return of income.
Comment:	Current section EL 2 (3) and (4) have been relocated to a general section on election notice requirements (see draft section ED 26).

Herd scheme

ED 10 Herd scheme

Election to use herd scheme

(1) A person may choose to value listed livestock of any type and class under the herd scheme. But, subject to the two restrictions described in subsections (3) and (4), a person who has chosen to value livestock of a particular type under the herd scheme may nevertheless value any or all livestock of that type by another method. The alternative valuation options are national standard cost, cost price, market value, and replacement price.

Election to leave herd scheme

(2) A person who wishes to stop valuing livestock of a particular type under the herd scheme must give 2 years' notice to the Commissioner in the way described in section ED 26. However, notice is not required if the person values livestock of that type by another method (being one that is available for use in conjunction with the herd scheme).

Restriction: reduced numbers in herd scheme

(3) The first restriction on the use of an alternative valuation option occurs when livestock of a particular class are valued under the herd scheme. The numbers of livestock in that class must not be reduced below the number valued in that class under the herd scheme at the end of the previous income year.

Restriction: male breeding stock

(4) The second restriction on the use of an alternative valuation option occurs when livestock of a particular type are valued both under the herd scheme and under a cost option (being the national standard cost scheme or cost price). All male breeding stock of that type must be valued under the herd scheme in that income year.

Former elections

(5) A notice of election under former section 85A (3) of the Income Tax Act 1976 (as in force before its repeal by section 21 of the Income Tax Amendment Act (No 2) 1993) to value livestock previously valued under the herd scheme is treated as notice of election under this section to cease to value livestock of that type under the herd scheme.

Livestock transferred under matrimonial agreement

(6) For the valuation of listed livestock that are transferred under a matrimonial agreement, see section FF 9.

Origin:	(1) EL 5(3). (2) EL 2(4). (3) EL 2(2); EL 5(4). (4) EL 2(2). (5) EL 2(7). (6) new.
Defined terms:	class, Commissioner, cost price, herd scheme, income year, listed livestock, market value, matrimonial agreement, national standard cost scheme, notice, person, replacement price, type.
Comment:	See the comment on draft section ED 21.

ED 11 Valuation under herd scheme

Closing value of herd livestock

(1) The value of herd livestock to be taken into account at the end of an income year is either its herd value based on the national average

market values set for each class for that year or, if a herd value factor is adopted, its herd value multiplied by its herd value factor.

Opening value of herd livestock

(2) Despite section ED 2, the opening value of herd livestock in an income year is taken into account when a person—

(a) has livestock on hand at the start of an income year; and

(b) has valued the livestock under the herd scheme in the previous income year; and

(c) has not chosen for that income year to value the livestock by a different method.

Value taken into account

(3) The value of herd livestock to be taken into account at the start of the income year is either its herd value for the income year or, if the person has adopted a herd value factor, its herd value for that income year multiplied by its herd value factor for the previous income year.

Origin:	(1) EL 5(1). (2) EL 5(2). (3) EL 5(2).
Defined terms:	class, closing value, herd livestock, herd scheme, herd value, herd value factor, income year, national average market value, opening value, person.

ED 12 Herd value factor

Adoption of herd value factor

(1) A herd value factor is available for a person to use in calculating the value of listed livestock in the herd scheme. A person may adopt a herd value factor for herd livestock of a particular type by giving notice in the way described in section ED 26. A person may also adopt a recalculated factor by giving notice in the same way.

Chatham Islands livestock

(2) Herd value factors calculated under subsection (5) do not apply to livestock on the Chatham Islands. For the Chatham Islands adjustment to the herd value factor, see section ED 14.

When the herd value factor applies

(3) When a person adopts a herd value factor for livestock of a particular type, the factor applies in the income year specified in the notice and in later income years until—

(a) the income year in which it is superseded by a recalculation of the factor; or

(b) the income year in which the person stops valuing livestock of that type under the herd scheme; or

(c) the income year following 2 consecutive income years in which the person has not valued livestock of that type under the herd scheme.

Assessment of average value

(4) For the purpose of calculating a herd value factor, a person must obtain from a recognised livestock valuer an assessment of the value of an average animal of that person in each applicable class of livestock. The value is determined as at the 30 April that is closest to the day on which the national average market values are set.

Calculation of herd value factor

(5) The herd value factor for livestock of a particular type is calculated using the formula—

$$\frac{\Sigma[\text{average value} \quad x \quad \text{number}]}{\Sigma[\text{herd value} \quad x \quad \text{number}].}$$

The result of the calculation is rounded to the nearest of the following figures: 0.9, 1.0, 1.1, 1.2, 1.3.

Definition of items in formula

(6) In the formula,—

(a) **Σ** is the total of the individual calculations for all applicable classes of livestock type valued under the herd scheme:

(b) **average value** is the average value of an animal in a class (see subsection (4)):

(c) **number** is the number of all livestock of that class on hand at the end of the income year (including livestock that are not in the herd scheme, but not including high-priced livestock):

(d) **herd value** is the herd value of livestock for a class.

Origin:	(1) EL 6(1). (2) EL 6(5). (3) EL 6(1). (4) EL 6(3). (5) EL 6(2). (6) EL 6(2).
Defined terms:	class, herd livestock, herd scheme, herd value, herd value factor, high-priced livestock, income year, listed livestock, livestock on the Chatham Islands, national average market value, notice, person, type.
Comment:	The term ‘factor’ is used rather than ‘ratio’ as it is a better description. The factor is used as a multiplier of the herd value. The current formula has merely been re-expressed.

ED 13 Inaccurate herd value factor

The Commissioner may require a person who is using an inaccurate herd value factor for a type of livestock in an income year to recalculate the herd value factor. If the recalculation differs from the existing factor for that income year, the Commissioner may amend the assessment of income tax for that year and any later year, and may substitute the recalculated herd value factor for that previously applied by the person.

Origin:	EL 6(4).
Defined terms:	Commissioner, herd value factor, income tax, income year, livestock, person, type.

ED 14 Chatham Islands adjustment to herd value

Adjustment for herd livestock on Chatham Islands

(1) A person may adopt an adjustment for herd livestock on the Chatham Islands by giving notice in the way described in section ED 26.

When the adjustment applies

(2) When a person adopts a Chatham Islands adjustment as a herd value factor, it applies as a herd value factor to a particular type of livestock on the Chatham Islands at the end of the income year specified in the notice and in later income years until—

- (a) the income year in which the person stops valuing livestock of that type in the herd scheme; or
- (b) the income year following 2 consecutive income years in which the person has not valued livestock of that type on the Chatham Islands under the herd scheme.

Setting the Chatham Islands adjustment

(3) The Commissioner must set and may vary from time to time the level of Chatham Islands adjustment to the herd value factor that applies in an income year.

Origin:	(1) EL 6(6). (2) EL 6(6). (3) EL 6(7).
Defined terms:	Commissioner, herd livestock, herd scheme, herd value, herd value factor, income year, livestock on the Chatham Islands, notice, person, type.
Comment:	The notice requirements for adopting a Chatham Islands adjustment are located in the general notice provision, draft section ED 26.

ED 15 Herd livestock disposed of before values set

When this section applies

(1) This section applies when, in an income year, a person—

(a) stops deriving income from listed livestock; and

(b) disposes of herd livestock before the 1 February that precedes the setting of the national average market values for the income year; and

(c) gives notice to the Commissioner before that 1 February that they choose that this section applies to the valuation of that herd livestock.

Value of herd livestock

(2) When this section applies, the value of herd livestock that is disposed of is either the herd value of the livestock for the previous income year or, if a person has adopted a herd value factor, that herd value multiplied by the herd value factor applying in the previous income year.

Origin:	(1) EL 5(6). (2) EL 5(6).
Defined terms:	Commissioner, derived, herd livestock, herd value, herd value factor, income, income year, listed livestock, national average market value, notice, person.

ED 16 Setting national average market values

The Commissioner must determine for an income year a national average market value for each class of listed livestock set out in schedule 8, column 2. The value determined applies to that income year whether it began before, on, or after the date on which the determination is made.

Origin:	EL 8.
Defined terms:	class, Commissioner, income year, listed livestock, national average market value.
Comment:	Current section EL 8 (2), relating to the time by which a determination must be published, and EL 8 (3), relating to the revocation of a determination, have been relocated to the Tax Administration Act 1994 (see draft section 91AI in the consequential amendments in volume 3).

National standard cost scheme

ED 17 National standard cost scheme

Election to use national standard cost scheme

(1) A person may choose to value listed livestock under the national standard cost scheme, subject to the 3 restrictions described in subsections (2) to (4). Under the national standard cost scheme, livestock are grouped by category. The categories are listed in schedule 9.

Restriction: bailed or leased livestock

(2) The first restriction occurs when a person has bailed or leased listed livestock to another person under a long-term bailment. The national standard cost scheme is not available to the person to value the livestock in that income year. But this restriction does not apply if the person makes the livestock available under a profit-sharing arrangement. For the treatment of livestock under a bailment, lease, or other arrangement, see sections ED 21 to ED 24.

Restriction: determination

(3) The second restriction occurs when a determination made under section ED 19 precludes the use of the national standard cost scheme for any livestock. The scheme is not available to a person to value the livestock.

Restriction: cost price

(4) The third restriction occurs when a person values any listed livestock in an income year at cost price. The option to value livestock under the national standard cost scheme is not available for that income year.

Closing value

(5) When a person chooses to value listed livestock under the national standard cost scheme, the closing value of the livestock at the end of an income year is the cost of that livestock calculated under the determination issued by the Commissioner under section ED 19.

Origin:	(1) EL 4(1). (2) EL 4(2); EL 7(2). (3) EL 4(3). (4) EL 3(3). (5) EL 4(1).
Defined terms:	closing value, Commissioner, cost price, income year, lease, listed livestock, livestock, long-term bailment, national standard cost scheme, person, profit-sharing arrangement.

ED 18 Determination of national standard cost by Commissioner

Determination of costs

(1) The Commissioner must determine national standard costs for each category of listed livestock. The determination must take into account, as applicable,—

(a) the average breeding, rearing, and growing costs for animals in the category:

(b) the average rearing and growing costs for animals in the category.

When the determination applies

(2) The national standard costs determined under subsection (1) may apply to an income year whether or not the income year began before, on, or after the date on which the determination is made.

Origin:	(1) EL 3A(1). (2) EL 3A(1).
Defined terms:	Commissioner, income year, listed livestock.
Comment:	The contents of current section EL 3A (2) and (3) are in draft section 91AI of the Tax Administration Act 1994, which appears in the consequential amendments in volume 3. The subsections set the timing requirements for publishing a determination, the time from which a replacement determination applies, and the matters that may be included in a determination.

ED 19 Methods for determining costs using national standard cost scheme

Determination of methods for calculation of cost

(1) The Commissioner must determine the methods for calculating the cost of livestock listed in schedule 9, column 2. The costs determined in this way apply to the calculation of the value of listed livestock under section ED 17.

Average cost

(2) For the purposes of subsection (1), the determination must establish a process for finding an average cost to be applied to all listed livestock valued under the national standard cost scheme. The process must take into account—

(a) the number of homebred livestock that a person has on hand at the end of the year, applying to that number the relevant national standard costs determined under section ED 18:

(b) in addition to paragraph (a), the number in each category of livestock listed in schedule 9, column 2 that a person has on hand at the end of the year, applying to that number the relevant national standard costs determined under section ED 18:

(c) the number of bought livestock that a person has on hand, applying to that number the purchase costs associated with that livestock.

Origin:	(1) EL 4(4). (2) EL 4(5).
Defined terms:	Commissioner, listed livestock, livestock, national standard cost scheme, person.
Comment:	Current section EL 4 (6) to (8) have been relocated to the Tax Administration Act 1994 (see draft section 91AI in the consequential amendments in volume 3). The subsections set the timing requirements for publishing a determination, the time from which a replacement determination applies, and the matters that may be included in a determination.

Cost price, market value, and replacement price options

ED 20 Cost price, market value, or replacement price

Election

(1) A person may choose to value listed livestock at its cost price subject to the two restrictions described in subsections (2) and (3), or at its market value, or at its replacement price.

Restriction: bailed or leased livestock

(2) The first restriction on the use of the cost price option occurs when a person has bailed or leased their listed livestock to another person. The first person must not value that livestock in an income year at cost price unless—

(a) the livestock is bailed or leased under a short-term bailment (see section ED 22); or

(b) the livestock is bailed or leased under a profit-sharing arrangement (see section ED 23).

Restriction: national standard cost scheme

(3) The second restriction on the use of the cost price option occurs when a person values any listed livestock in an income year under the national standard cost scheme. The option to value livestock at cost price is not available for that income year.

Changing to the cost price option

(4) If a person chooses in an income year to change to the cost price option from another valuation method, the opening value of the affected livestock is the closing value of that livestock at the end of the previous income year determined under the method used in that previous year.

Origin:	(1) EL 3(1). (2) EL 3(2); EL 7(2). (3) EL 3(3). (4) EL 3(4).
Defined terms:	closing value, cost price, cost price option, income year, lease, listed livestock, market value, national standard cost scheme, opening value, person, profit-sharing arrangement, replacement price, short-term bailment.
Comment:	No attempt has been made to define what is meant by ‘cost price’, ‘market value’, or ‘replacement price’ beyond the definitions that exist in section OB 1. These terms have been left to general practice and case law. Outside the legislation some guidance on costs is provided in relation to one cost option (the self-assessed cost option). The replacement price option has been retained, given that it was retained for trading stock when the trading stock provisions were reviewed in 1999.

Listed livestock under bailment, lease, or other arrangements

ED 21 Bailee’s treatment of livestock

When this section applies

(1) This section applies when a bailment, lease, or agreement to use listed livestock or high-priced livestock exists, and the terms require a person who has the use of the livestock either to return the livestock to the person who made it available, or to pay full compensation for the livestock.

Closing value of livestock: formula

(2) A person who has the use of livestock under a bailment, lease, or agreement described in subsection (1) must take into account at the end of an income year the total amount for all classes calculated using the formula—

$$\text{total livestock} - \text{bailed livestock.}$$

Definition of items in formula

(3) In the formula,—

(a) **total livestock** is all the livestock that the person has on hand in each class at the end of the income year, including the livestock that the person owns, and the livestock that the person has the use of under the bailment, lease, or agreement:

(b) **bailed livestock** is all the livestock in a class that a person has been given the use of under a bailment, lease, or agreement that remains in force at the end of the income year.

Result of applying formula

(4) If the result of applying the formula in subsection (2) is positive, the person is treated as the owner of any surplus livestock. If the result is negative, the person must make an adjustment for the deficiency by treating it as a negative number.

Origin:	(1) EL 7(1). (2) EL 7(1). (3) EL 7(1). (4) EL 7(1).
Defined terms:	class, closing value, high-priced livestock, income year, lease, listed livestock, person.
Comment:	For those using the herd scheme, bailment deficiencies are valued under the herd scheme when the deficiency takes the number of stock in a class below the number valued in the herd scheme in the previous year (see draft section ED 10 (3)).

ED 22 Bailor's treatment of livestock

When this section applies

(1) This section applies to a bailment, lease, or agreement to use listed livestock or high-priced livestock, when a person who owns livestock makes the livestock available to another person.

Restriction on use of national standard cost scheme

(2) The national standard cost scheme is not available to the person who makes listed livestock available for use under a long-term bailment. But this restriction does not apply to profit-sharing arrangements (see section ED 23).

Restriction on use of cost price option

(3) The cost price option is available to the person only when they make listed livestock available for use under a short-term bailment or a profit-sharing arrangement. If the short-term bailment is made between associated persons, the consideration paid by the person to the bailee or lessee must be the market value.

Origin:	(1) new. (2) EL 7(4). (3) EL 7(4).
Defined terms:	associated person, cost price option, high-priced livestock, lease, lessee, listed livestock, long-term bailment, market value, national standard cost scheme, person, profit-sharing arrangement, short-term bailment.
Comment:	The definitions 'long-term bailment' and 'short-term bailment' have been developed from current section EL 7 (2) and (3). The current reference in relation to agreements between associated persons being at 'fair market value' has been replaced with 'market value' on the basis that market values are implicitly fair as they involve willing parties acting at arm's length.

ED 23 Profit-sharing arrangements for livestock

When this section applies

(1) This section applies to profit-sharing arrangements under which a person makes listed livestock available to another person for use in the other person's business, and in return participates directly or indirectly in the profits and losses of the business.

Single venture

(2) Under a profit-sharing arrangement for listed livestock, if the method used to calculate the value of listed livestock in an income year is either the national standard cost scheme or the cost price option, then the venture is treated as one venture, and all the following are treated as the single owner of the livestock:

(a) the person who owns the livestock; and

(b) the person who has the use of the livestock; and

(c) any other person who has made livestock of the same type available to the person referred to in paragraph (b) under a profit-sharing arrangement.

Profit-sharing arrangement: national standard cost scheme

(3) Under a profit-sharing arrangement for listed livestock, the national standard cost scheme is not available to a person to value the livestock if the person who has the use of the livestock has valued livestock of the same type at cost price. This restriction also applies when another person has made livestock of that type available to the person under a profit-sharing arrangement and values them at cost price.

Profit-sharing arrangement: cost price option

(4) Under a profit-sharing arrangement for listed livestock, the cost price option is not available to a person to value the livestock if the person who has the use of the livestock has valued livestock of the same type under the national standard cost scheme. This restriction also applies when another person has made livestock of that type available to the person under a profit-sharing arrangement and values them under the national standard cost scheme.

Origin:	(1) EL 7(2), (3). (2) EL 7(4). (3) EL 7(4). (4) EL 7(4).
Defined terms:	business, cost price, cost price option, income year, listed livestock, national standard cost scheme, person, profit-sharing arrangement, type.
Comment:	Draft subsection (1) draws on the definition of 'profit-sharing arrangement' currently located in section OB 1.

ED 24 Definitions for sections ED 21 to ED 23

In sections ED 21 to ED 23,—

long-term bailment is a bailment or lease under which, at the time of delivery of the livestock, a person does not expect to have the same livestock delivered back to them

short-term bailment is a bailment or lease under which—

(a) at the time of delivery of the livestock, a person expects to have the same livestock delivered back to them; and

(b) the bailee or lessee did not provide consideration to the person for the delivery of the livestock; and

(c) the term of the bailment or lease ends on or before the end of the income year following the income year in which the arrangement is made.

Origin:	EL 7(2), (3).
Defined terms:	arrangement, income year, lease, lessee, livestock, long-term bailment, person, short-term bailment.
Comment:	The definitions ‘long-term bailment’ and ‘short-term bailment’ have been developed from current section EL 7 (2) and (3).

General provisions for listed livestock

ED 25 Restrictions and limitations on the use of valuation methods

Restrictions and limitations

(1) This section sets out the circumstances in which certain valuation methods are either not available to a person for the purpose of valuing listed livestock, or are limited in their application.

National standard cost

(2) The national standard cost scheme is not available to a person to value listed livestock if—

(a) in an income year they value other listed livestock at cost price:

(b) in the income year before the year in which the election is to apply, they have valued listed livestock at cost price and have not given at least 2 years’ notice to the Commissioner of their election to value listed livestock under the national standard cost scheme:

(c) they have made the livestock available for use under a long-term bailment:

(d) they have the use of livestock under a profit-sharing arrangement and, in an income year, they (or another person who has made livestock available to that person under a profit-sharing arrangement) have valued livestock of that type at cost price.

Cost price

(3) The cost price option is not available to a person to value listed livestock if—

(a) in an income year they value other listed livestock under the national standard cost scheme:

(b) in the income year before the year in which the election is to apply, they have valued listed livestock under the national standard cost scheme and have not given 2 years' notice to the Commissioner of their election to value listed livestock at cost price:

(c) they have made the livestock available for use under a long-term bailment, but this rule does not apply to a short-term bailment:

(d) they have the use of livestock under a profit-sharing arrangement and, in an income year, they (or another person who has made livestock available to that person under a profit-sharing arrangement) have valued livestock of that type under the national standard cost scheme.

Reduced numbers under herd scheme

(4) A person who values livestock of a particular class under the herd scheme must not use an alternative valuation option for that class if doing so would reduce the number of livestock in that class below the number valued in that class in the herd scheme at the end of the previous income year.

Male breeding stock

(5) A person who values livestock of a particular type under the herd scheme must value all male breeding stock of that type under the herd scheme if in an income year they also value any livestock of that type under the national standard cost scheme or at cost price.

Bailed or leased livestock

(6) A person must value listed livestock that is bailed or leased in accordance with sections ED 21 to ED 24.

Determination

(7) A person must not value listed livestock of the same type, class, or category using both the national standard cost scheme and another

valuation method if doing so would be contrary to a determination made under section ED 18.

General

(8) A person must not value listed livestock in a way that contravenes sections ED 1 to ED 26.

Origin:	(1) new. (2) EL 2(2)(a). (3) EL 2(2)(b). (4) EL 2(2)(d). (5) EL 2(2)(e); EL 5(5). (6) EL 2(2)(f). (7) EL 2(2)(c). (8) EL 2(2)(g).
Defined terms:	class, Commissioner, cost price, cost price option, herd scheme, income year, lease, listed livestock, long-term bailment, national standard cost scheme, notice, person, profit-sharing arrangement, short-term bailment, type.
Comment:	Draft subsection (2) is not explicit in the current legislation but is implicit given that the cost option is not available to those who value any stock under national standard cost (current section EL 3 (3)).

ED 26 Notices of election

Forms of notice

(1) This section specifies the 2 forms of notice that a person must give to the Commissioner, and when each must be used. When a person notifies the Commissioner of an election under this section, the election is irrevocable in the first year in which it applies.

When notice in same year required

(2) For the elections described in this subsection, a person must give notice by the date of filing their return of income for the income year in which the election is first to apply. Notice in the same year is required for an election—

(a) to value livestock of a particular type under the herd scheme, as described in section ED 10:

(b) to adopt a herd value factor or the Chatham Islands adjustment to the herd value factor for livestock of any type when the income year is the first income year in which the particular livestock is valued under the herd scheme, as described in sections ED 12 to ED 14.

When 2 years' notice required

(3) For the elections described in this subsection, a person must give notice by the date of filing their return of income for an income year that is at

least 2 income years before the income year in which the election is first to apply. Two years' notice is required for an election—

(a) to stop valuing listed livestock of a particular type under the herd scheme (but not when the person continues to value some livestock of that type under the herd scheme or when another valuation method is available (see section ED 10)):

(b) to value listed livestock under the national standard cost scheme when the person has, in the year before the application of the new election, valued the same livestock at cost price in the way described in section ED 17 (4):

(c) to value listed livestock at cost price when the person has, in the year before the application of the new election, valued the same livestock under the national standard cost scheme in the way described in section ED 20 (3):

(d) after having adopted the herd scheme, to adopt a herd value factor or recalculated herd value factor or the Chatham Islands adjustment for any livestock type, as described in sections ED 12 to ED 14.

Information for notices of election

(4) Notices of election must state—

(a) the income year in which the election is first to apply:

(b) the type, class, or other description of the applicable livestock:

(c) the existing and proposed methods of valuing the applicable livestock:

(d) for an election to use a herd value factor or recalculated herd value factor under section ED 12,—

   (i) the value assessed under section ED 12 (4) of an average animal of each applicable class of livestock:

   (ii) the date on which the valuation of each animal was made:

   (iii) the name and address of the valuer.

Origin:	(1) EL 2(3), (4). (2) EL 2(3), (4). (3) EL 2(3), (4). (4) EL 2(5).
Defined terms:	Commissioner, cost price, herd scheme, herd value factor, income year, listed livestock, livestock, national standard cost scheme, notice, person, return of income, type.

Valuation of other livestock

ED 27 Valuation of other livestock

Other livestock is livestock other than listed livestock, high-priced livestock, or bloodstock. The rules for valuing other livestock are set out in sections ED 28 to ED 30. For the valuation of other livestock that are transferred under a matrimonial agreement, see section FF 10.

Origin:	new.
Defined terms:	bloodstock, high-priced livestock, listed livestock, livestock, matrimonial agreement, other livestock.

ED 28 Closing value options

A person may choose to value other livestock on hand at the end of an income year using one of the following options:

(a) its cost price:

(b) its market value:

(c) the price at which it can be replaced:

(d) if the Commissioner agrees, its standard value.

Origin:	EL 1(1)(c); EL 9(1).
Defined terms:	closing value, Commissioner, cost price, income year, market value, other livestock, person, price, standard value.
Comment:	The replacement price option has been retained because it was kept for trading stock following the review of the trading stock provisions in 1999.

ED 29 Enhanced production

When this section applies

(1) This section applies when a person who derives income from other livestock enhances production in an income year. Enhanced production occurs when the person—

(a) starts (or restarts) to derive income from other livestock; or

(b) brings land into production (or substantially increased production) for the purpose of deriving income from other livestock, or acquires additional land for that purpose.

Adjustment

(2) If a person enhances their production and as a result, in an income year or over the following 3 income years, buys more other livestock that is valued at its standard value, the value of the additional livestock is—

(a) for the income year in which the livestock was bought, its standard value plus two-thirds of the difference between the cost price of the livestock and that standard value:

(b) for the following income year, its standard value plus one-third of the difference between the cost price of the livestock and that standard value:

(c) for other years, its standard value.

For this purpose, the additional livestock must not be replacement livestock.

Origin:	(1) EL 9(4). (2) EL 9(2).
Defined terms:	cost price, derived, income, income year, other livestock, person, standard value.
Comment:	The definition of 'deductible excess' has been deleted from these provisions and, instead, its intent has been incorporated into the simplified text. A similar simplification may also be possible in the other place where the definition currently appears, section FF 10.

ED 30 Setting standard values

The Commissioner may set standard values for an income year for any type or category of other livestock. The standard values set apply to that income year, whether or not that income year began before, on, or after the date on which the standard values were set.

Origin:	EL 9(3); OB 1 'standard value'.
Defined terms:	Commissioner, income year, other livestock, standard value, type.

Valuation of high-priced livestock

ED 31 High-priced livestock

When sections ED 31 to ED 35 apply

(1) Sections ED 31 to ED 35 apply to listed livestock that a person buys at a price above the minimum set out in subsection (2) when, at the time it is bought, the livestock is capable of being used for breeding, or is expected to be so when it reaches maturity. But section ED 32 does not apply to livestock that, under sections ED 33 and ED 34, have ceased to be treated as high-priced livestock.

Minimum price

(2) For the purposes of this section, the purchase price must be at least—

(a) $500; and

(b) five times the national average market value for the applicable class either in the income year of purchase or in the previous income year, whichever is greater.

For the valuation of high-priced livestock that is transferred under a matrimonial agreement, see section FF 11 (High-priced livestock).

Valuation method

(3) To value high-priced livestock, a person may choose to use either the straight-line method or the diminishing value method. If a person chooses to use the diminishing value method, they must give notice to the Commissioner that they are using the method at the time of filing their return of income for the first income year in which the value of the high-priced livestock is calculated under section ED 32. A person cannot then revoke the election to use the diminishing value method for the livestock.

Origin:	(1) OB 1 'high-priced livestock'. (2) OB 1 'high-priced livestock'. (3) EL 10(6).
Defined terms:	class, Commissioner, diminishing value method, high-priced livestock, income year, listed livestock, matrimonial agreement, national average market value, notice, person, price, return of income, straight-line method.
Comment:	Draft subsection (1) incorporates the contents of the definition of 'high-priced livestock' save for one modification. The reference to pre-1992-93 livestock has been deleted as current section EL 10 (7) has been removed on the basis that it is no longer relevant. That subsection set out the methods for valuing livestock that was classified as high-priced livestock before 1992-93. Our expectation is that none of that livestock will still be on hand by the time the rewritten legislation comes into effect.

ED 32 Closing value of high-priced livestock

Value in year of purchase and later years

(1) The closing value of high-priced livestock at the end of the income year in which it is bought is its cost price minus the reduction applying in that year. In a later income year, the value is its opening value minus the reduction applying in that year until the value reaches or falls below the national average market value of the relevant class.

Straight-line method

(2) Unless a person has chosen to use the diminishing value method, the reduction is calculated using the formula—

$$\text{cost price } x \text{ depreciation percentage.}$$

Diminishing value method

(3) When a person has chosen to use the diminishing value method, the reduction is calculated as follows:

(a) in the first income year in which the election applies, the cost price multiplied by the diminishing value equivalent of the depreciation percentage for that year:

(b) in later income years, the opening value of the livestock multiplied by the diminishing value equivalent of the depreciation percentage for that year.

Immature livestock excluded

(4) When high-priced livestock is less than 1 year old at the end of the income year in which it is bought, its closing value at the end of that income year is its cost price.

Recently bought livestock excluded

(5) If high-priced livestock is bought within 6 months of the end of an income year, and during that time is not used for insemination or collection of semen (in the case of male livestock), or does not give birth and does not have ova removed, the closing value of the livestock is its cost price.

'Diminishing value equivalent' defined

(6) For the purposes of this section, **diminishing value equivalent** means the amount set out in schedule 11, column 1, that is the diminishing value depreciation rate to which the amount set out in schedule 11, column 2 is equal to the depreciation percentage expressed as the straight-line equivalent. If no such amount is equal to the depreciation percentage, the amount closest rounded down to that percentage is taken.

Origin:	(1) EL 10(1). (2) OB 1 'specified writedown'. (3) OB 1 'specified writedown'. (4) EL 10(2). (5) EL 10(2). (6) OB 1 'diminishing value equivalent'.
Defined terms:	class, closing value, cost price, depreciation percentage, diminishing value equivalent, diminishing value method, high-priced livestock, income year, national average market value, opening value, person, straight-line method.
Comment:	As with the other valuation methods, the closing value feeds into the valuation adjustment rule (current section EE 2).

ED 33 Livestock reaching national average market value

Valuation in initial income year

(1) In the income year in which high-priced livestock reaches or falls below the national average market value for livestock of that class, the closing value is determined as follows:

(a) when the person values any listed livestock of that type under the herd scheme in that year, the value of the animal under the herd scheme:

(b) when the person values all listed livestock of that type that is older than 1 year under a cost option (being the national standard cost scheme or the cost price option), the national average market value for the relevant class in that income year:

(c) when the person values all listed livestock of that type that is older than 1 year at market value or replacement price, the market value or replacement price of the animal at the end of that income year.

Valuation in later years

(2) In later income years, the animal that was high-priced livestock is treated as the person's listed livestock, and is valued according to the valuation method chosen for that listed livestock.

Entry into herd scheme in later years

(3) If, in a later income year, the person values the animal under the herd scheme and, in the income year before that income year, has valued any listed livestock of the same type under the herd scheme, the animal is treated as if it were valued under the herd scheme at the end of that previous income year.

Origin:	(1) EL 10(3). (2) EL 10(4). (3) EL 10(4).
Defined terms:	closing value, cost price, cost price option, herd scheme, high-priced livestock, income year, listed livestock, market value, national average market value, national standard cost scheme, person, replacement price, type.
Comment:	The purpose of draft subsection (3) is to provide an opening value for high-priced livestock that has been written down to the NAMV and will now be valued in the herd scheme. Calculation of the opening value is required by current section EL 5 (2).

ED 34 Livestock no longer used in breeding

If, in an income year, a person no longer expects to use an animal that is high-priced livestock for breeding purposes, and does not intend to dispose of the animal to another person for breeding purposes, the value of that livestock in that income year is determined as if it had reached the national average market value for the relevant class.

Origin:	EL 10(3)(b), (4)(a).
Defined terms:	class, high-priced livestock, income year, national average market value, person.

ED 35 Setting depreciation percentages

For the purpose of valuing high-priced livestock, the Commissioner must set depreciation percentages for types, classes, or categories of livestock for an income year. The percentages represent the average percentage decline in the value of livestock of that type, class, or category, and the Commissioner must take into account the following criteria:

(a) the average cost of livestock of that type, class, or category:

(b) the estimated useful life of that livestock:

(c) the average estimated residual market value of that livestock.

Origin:	EL 10(5); OB 1 'assigned percentage'.
Defined terms:	class, Commissioner, depreciation percentage, estimated residual market value, estimated useful life, high-priced livestock, type.

Valuation of bloodstock

ED 36 Bloodstock

Application of sections ED 36 to ED 43

(1) Sections ED 36 to ED 43 apply to a property interest in a standardbred or a thoroughbred horse.

'Bloodstock owner' defined

(2) In this subpart, **bloodstock owner** means a person who has a property interest in a standardbred or a thoroughbred horse.

Origin:	(1) OB 1 'bloodstock'. (2) new.
Defined terms:	bloodstock, bloodstock owner, person.
Comment:	The reference to 'property interest' is to recognise the possibility of joint ownership. In such cases, each person with an interest in the bloodstock is still an owner of the bloodstock. Removing livestock from the definition of 'trading stock' also automatically takes bloodstock out of the same definition. Nevertheless, both bloodstock and livestock more generally remain revenue account property.

ED 37 Closing value of bloodstock

Valuation of bloodstock

(1) This section specifies the methods that a bloodstock owner must use to determine the closing value of bloodstock.

First income year in breeding business

(2) This subsection applies to bloodstock that is 2 years of age or older at the end of the first income year in which a bloodstock owner—

(a) uses the bloodstock for breeding purposes in their stud business; or

(b) buys the bloodstock, intending to use it for breeding purposes in their stud business; or

(c) owns the bloodstock in their stud business, intending to use it for breeding purposes.

The closing value of the bloodstock at the end of the first income year is its cost price minus the reduction applying in that year. To determine the reduction that applies, see section ED 38.

Later income years in breeding business

(3) In the income years that follow the year specified in subsection (2), the closing value of bloodstock used for breeding purposes is the opening value of the bloodstock minus the reduction applying in that year. If a bloodstock owner has not taken a closing value of the bloodstock into account in the previous income year, the closing value is the cost price of the bloodstock minus the reduction applying in the income year in which they make the calculation. To determine the reduction that applies, see sections ED 38 and ED 39.

Other bloodstock

(4) If subsections (2) and (3) do not apply, the closing value of the bloodstock is its cost price. But, in cases where section ED 40 applies, the closing value of the bloodstock is its market value.

Residual value of bloodstock

(5) When, if this subsection did not exist, the closing value of bloodstock would be less than $1, the value to be taken into account is $1.

Origin:	(1) new. (2) EM 1(1)(a). (3) EM 1(1)(b). (4) EM 1(1)(c). (5) EM 1(3).
Defined terms:	bloodstock, bloodstock owner, business, closing value, cost price, income year, market value, opening value.

ED 38 Reduction: bloodstock not previously used for breeding

When this section applies

(1) This section applies when bloodstock—

(a) has not been used for breeding purposes in New Zealand before 16 December 1991; and

(b) before it was acquired by the bloodstock owner, has not been used for breeding purposes in New Zealand by any other person, unless—

(i) the other person transferred the bloodstock under a matrimonial agreement to which section FF 12 (Bloodstock) applies; or

(ii) the other person and the bloodstock owner were companies in the same wholly-owned group at the time the bloodstock owner acquired the bloodstock from the other person.

Stallion

(2) The reduction applying to the valuation of a stallion is 25% of the cost price of the bloodstock unless the bloodstock owner chooses to value the stallion by the diminishing value method.

Stallion valued by diminishing value method

(3) When a bloodstock owner chooses to value the stallion by the diminishing value method, the reduction applying to the valuation of the stallion is 37.5% of its cost price in the first income year, and 37.5% of its opening value in each later income year. The bloodstock owner must give notice to the Commissioner of their election in their return of income for the first income year.

Broodmare

(4) The reduction applying to the value of a broodmare is calculated using the formula—

$$\frac{1.25 \quad x \quad \text{cost price of the broodmare}}{[15 \quad - \quad \text{age of broodmare}].}$$

For this purpose, the age of the broodmare is taken as 12 unless, for a broodmare to which section ED 37 (2) applies, the age is 11 or less at the end of the income year, in which case the actual age is used in the formula.

Origin:	(1) EM 1(4), (5). (2) EM 1(4), (5). (3) EM 1(4), (5). (4) EM 1(4), (5).

Defined terms:	bloodstock, bloodstock owner, Commissioner, company, cost price, diminishing value method, income year, matrimonial agreement, New Zealand, notice, opening value, person, return of income, wholly-owned group.

ED 39 Reduction: bloodstock previously used for breeding

Stallion

(1) The reduction applying to the valuation of a stallion to which section ED 38 (2) does not apply is 20% of its cost price.

Broodmare

(2) The reduction applying to the value of a broodmare to which section ED 38 (4) does not apply is calculated using the formula—

$$\frac{\text{cost price of the broodmare}}{[15 \ - \ \text{age of the broodmare}]}.$$

For this purpose, the age of the broodmare is taken as 12 unless, for a broodmare to which section ED 37 (2) applies, the age is 11 or less at the end of the income year, in which case the actual age is used in the formula.

Origin:	(1) EM 1(4), (5). (2) EM 1(4), (5).
Defined terms:	bloodstock, bloodstock owner, cost price, income year.
Comment:	This section is considered still to be relevant even though most of the breeding stock will not have been used for breeding purposes until after 15 December 1991. The provision also covers breeding stock that has been previously used and sold within New Zealand, which falls outside the criteria in draft section ED 38 (1).

ED 40 Infertility, birth deformity, or accident

If because of infertility, birth deformity, or accident the market value of bloodstock on hand at the end of an income year is less than 50% of what would otherwise be the market value, the bloodstock owner may value the bloodstock at its market value. The value of that bloodstock in later income years is its market value in the applicable income year.

Origin:	EM 1(2).
Defined terms:	bloodstock, bloodstock owner, income year, market value.

ED 41 Use of bloodstock for racing

General treatment

(1) If in an income year a bloodstock owner uses bloodstock for racing, and they are in the business of breeding bloodstock for sale, the use of the bloodstock for racing is treated as use in the course of that business.

Bloodstock not used in business

(2) When bloodstock that is used in an income year for racing is not actually used in the course of a business of breeding bloodstock for sale, the bloodstock owner may apply to the Commissioner to have the use of the bloodstock treated otherwise than in accordance with subsection (1).

Non-breeding bloodstock

(3) If a bloodstock owner expects that bloodstock is not able to be used for future breeding purposes, the use in an income year of the bloodstock for racing is not treated as use in the course of a business of breeding bloodstock for sale. But if the bloodstock owner uses the bloodstock in the course of their business of breeding bloodstock for sale, they may apply to the Commissioner to have the use of the bloodstock treated as use in the course of that business.

Applications to the Commissioner

(4) For the purposes of applications made under this section, the bloodstock owner must apply in writing with the supporting information that the Commissioner requires within 1 month after the day on which the horse is first prepared for racing, or the day on which it is first raced, whichever is earlier.

Origin:	(1) EM 2(3). (2) EM 2(2). (3) EM 2(1), (4). (4) EM 2(3), (5).
Defined terms:	bloodstock, bloodstock owner, business, Commissioner, income year.
Comment:	In line with self-assessment, the reference to the Commissioner having to be otherwise satisfied has been removed. However, the requirement to apply to the Commissioner has been retained (see current section EM 2 (3) and (4)). The second sentence in draft subsection (3) covers situations where, even though a horse is not itself used for breeding purposes, it can add value, such as through winning races, thereby increasing the value of related progeny.

ED 42 Change of use of bloodstock in course of business

Use outside business

(1) If a bloodstock owner who is in the business of breeding bloodstock for sale starts to use bloodstock otherwise than in the course of that business, they are treated as having disposed of that bloodstock. The disposal is treated as having occurred at market value on the day on which they changed the use of the bloodstock.

Use in business

(2) If a bloodstock owner who is in the business of breeding bloodstock for sale has been using bloodstock for other purposes, and they start to use the bloodstock in the course of the business, the bloodstock is treated as having been bought by the bloodstock owner. The purchase is treated as having occurred at market value on the day on which the bloodstock owner changed the use of the bloodstock.

Origin:	(1) EM 2(6). (2) EM 2(7).
Defined terms:	bloodstock, bloodstock owner, business, market value.
Comment:	A disposal is treated as a disposal of revenue account property (see current section EF 2, draft section EB 2).

ED 43 Replacement breeding stock

When this section applies

(1) This section applies when a bloodstock owner—

- (a) disposes of bloodstock that they had previously used for breeding purposes in the course of a business of breeding bloodstock for sale; or
- (b) receives a payment of insurance or other compensation for the loss or death of, or permanent injury to, bloodstock that they had previously used for breeding purposes in the course of a business of breeding bloodstock for sale, or that they had bought for use in that business.

In this section, the bloodstock is called breeding stock.

Reduction: disposing of breeding stock

(2) When subsection (1)(a) applies, a bloodstock owner may request the Commissioner to determine the amount by which their income is reduced to reflect the disposal of the breeding stock. The maximum amount that the Commissioner may determine is the net gain realised on the disposal.

Reduction: replacing breeding stock

(3) When subsection (1)(b) applies, a bloodstock owner may request the Commissioner to determine the amount by which their income is reduced to reflect the cost of replacing breeding stock. The maximum amount that the Commissioner may determine is the net gain.

Application

(4) An application under subsection (2) or subsection (3) must be made in writing within 6 months after the end of the income year in which the amount would otherwise be income (or, if the Commissioner approves in a case or in a class of cases, a longer period). The application must relate only to breeding stock bought before the application is made.

Delay in replacing breeding stock

(5) In the case of lost, dead, or permanently injured breeding stock, the Commissioner may extend the time limit under subsection (4). But valid commercial reasons must exist for the delay in replacing the breeding stock, and the replacement breeding stock must have been acquired before the end of the second income year following the income year in which the loss, death, or permanent injury occurred.

Refund

(6) When subsection (1)(b) applies and the conditions in subsection (5) are met, the Commissioner may refund an amount equal to the bloodstock owner's income tax liability on the net gain (that is, the gross proceeds minus the value of the breeding stock) and apply the net gain to reduce the cost of replacing the breeding stock.

Definitions for this section

(7) In this section,—

gross proceeds means, as applicable, the amount of the proceeds of disposing of the breeding stock, or the amount paid by way of insurance or other compensation for the breeding stock

net gain means an amount equal to the gross proceeds minus the value of breeding stock

value of breeding stock means the closing value of the breeding stock in the income year before the breeding stock, as applicable, was disposed of, or was lost, or died, or was permanently injured.

Origin:	(1) EM 3(1), (2), (3). (2) EM 3(1). (3) EM 3(2)(a). (4) EM 3(1), (2)(a). (5) EM 3(2)(b). (6) EM 3(2)(b). (7) EM 3(3).
Defined terms:	amount, bloodstock, bloodstock owner, business, closing value, Commissioner, gross proceeds, income, income tax liability, income year, net gain, pay, value of breeding stock.

Comment:	This section incorporates the definition of ‘breeding stock’ into the body of the text. In line with self-assessment, the reference to the Commissioner having to be satisfied has been removed but an application still has to be made to the Commissioner. Also, the Commissioner’s discretion as to the length of the extension period has been retained as it is not appropriate for this to be self-assessed.

EE – Valuation of excepted financial arrangements

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EE 1 Valuation of excepted financial arrangements

Valuation at cost

(1) A person who holds revenue account property that consists of an excepted financial arrangement must determine the value of the property at the end of an income year. They must value the property at cost using a cost-flow method of assigning costs (for cost-flow methods, see section EC 7 (Cost-flow methods of assigning costs)). The value determined is the closing value to be taken into account in section EB 1 (Stock and excepted financial arrangements).

Valuing closing stock consistently

(2) In calculating the value of closing stock, the person must comply with the consistency and disclosure requirements of Financial Reporting Standard No 1 (Disclosure of Accounting Policies) approved under the Financial Reporting Act 1983, or an equivalent standard issued in its place.

Worthless arrangements

(3) If an excepted financial arrangement has no present or likely future market value and has been written off as worthless, it may be valued at zero.

Origin:	(1) EE 3(3); EE 13(1), (2). (2) EE 16(1). (3) EE 13(3).
Defined terms:	closing stock, closing value, cost, excepted financial arrangement, income year, market value, person, revenue account property.

EE 2 Transfers of certain excepted financial arrangements within wholly-owned groups

When this section applies

(1) This section applies when—

(a) one company in a wholly-owned group of companies (company A) transfers to another company in the same group (company B) an excepted financial arrangement that is revenue account property to company A; and

(b) both companies are resident in New Zealand on the date of the transfer; and

(c) the market value of the excepted financial arrangement on the date of the transfer is less than its cost to company A.

Transfer at cost

(2) When subsection (1) applies, the consideration for the transfer is the cost of the excepted financial arrangement to company A.

When company stops being member of group

(3) Despite subsection (2), if company B stops being a member of the wholly-owned group, the company is treated as disposing of and reacquiring the excepted financial arrangement at its market value at the time the company stops being a member of the group.

Dividend rules

(4) A transfer of an excepted financial arrangement to which this section applies does not give rise to a dividend.

Origin:	(1) EE 14(1), (2A). (2) EE 14(2). (3) EE 14(3). (4) EE 14(4).
Defined terms:	company, cost, dividend, excepted financial arrangement, market value, resident in New Zealand, revenue account property, wholly-owned group of companies.
Comment:	A reference to draft subsection (4) may be placed in the dividend rules in draft subpart CD (Income from equity).

EF – Depreciation

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Introductory provision

EF 1 What this subpart does

Quantifies depreciation loss and depreciation recovery income

(1) This subpart—

(a) quantifies the amount of depreciation loss for which a person is allowed a deduction if the provisions of Part D (Deductions) are met; and

(b) quantifies the amount of depreciation recovery income that is income under Part C (Income).

When depreciation loss arises

(2) A person has an amount of depreciation loss for an item for an income year if—

(a) the person owns an item of property, as described in sections EF 2 to EF 5; and

(b) the item is depreciable property, as described in sections EF 6 to EF 8; and

(c) the item is used, or is available for use, by the person in the income year; and

(d) the amount of depreciation loss is calculated for the person, the item, and the income year using the rules in, or described in, sections EF 9 to EF 11.

When depreciation recovery income arises

(3) A person has an amount of depreciation recovery income for an item for an income year if—

(a) the person owns an item of property, as described in sections EF 2 to EF 5; and

(b) the item is depreciable property, as described in sections EF 6 to EF 8; and

(c) the amount of depreciation recovery income is calculated for the person, the item, and the income year under any of sections EF 22 (5), EF 31 (4), EF 40 (1), EF 41 (1), EF 42 (3), and EF 43 (3).

Origin:	(1) new. (2) EG 1(1). (3) new.
Defined terms:	amount, deduction, depreciable property, depreciation loss, depreciation recovery income, income, income year, person, property.

What ownership means

EF 2 Nature of ownership of item

Kinds of ownership

(1) The reference to ownership in section EF 1—

(a) means legal or equitable ownership; and

(b) includes ownership of the kinds described in sections EF 3 to EF 5.

Shared ownership

(2) When more than one person owns an item of depreciable property, the reference to ownership in section EF 1 means the interest that the person has in the item.

Origin:	(1) new. (2) EG 19(8).
Defined terms:	depreciable property, person.
Comment:	The owner's interest in property need not be legal ownership. Equitable ownership can also qualify, depending on whether the item is used or available for use. Other instances are a lessee making an improvement (current section EG 1A) and purchasers who have not settled but have taken possession of the item (current section EG 1B). The concept of shared ownership encompasses current section EG 19 (8) but is not confined to that provision only. The concept applies across all the depreciation provisions.

EF 3 Ownership of goods subject to reservation of title

When this section applies

(1) This section applies when—

(a) a person (the buyer) enters into an unconditional contract to buy an item of depreciable property; and

(b) the contract is not a hire purchase agreement and the item is not a hire purchase asset that is the subject of a hire purchase agreement; and

(c) the contract is subject to the Sale of Goods Act 1908; and

(d) title to the item does not pass until the purchase price is paid in full; and

(e) the buyer takes possession of the item before title to it passes.

Buyer treated as owning

(2) For the purposes of section EF 1, the buyer is treated as owning, and the seller is treated as not owning, the item from the later of the following times:

(a) the time at which the buyer enters into the contract; and

(b) the time at which the buyer takes possession of the item.

Buyer ceases to be treated as owner

(3) Subsection (2) ceases to apply when one of the following occurs:

(a) title to the item passes to the buyer; or

(b) the seller repossesses the item.

Origin:	(1) EG 1B(1), (3). (2) EG 1B(2). (3) EG 1B(2).
Defined terms:	depreciable property, hire purchase agreement, hire purchase asset, person.
Comment:	Current section EG 1B is considered still to be necessary because under the Sale of Goods Act 1908 the timing of transfer of legal ownership depends on the intention of the parties. This issue is discussed further in *Rulings Exposure Draft IS3817*.

EF 4 Ownership of lessee's improvements: lessee

When this section applies

(1) This section applies when—

(a) a lessee of land incurs expenditure during the term of the lease in erecting a fixture on the land or making an improvement to the land; and

(b) the lessor owns the fixture or improvement.

Lessee treated as owner

(2) For the purposes of section EF 1, the lessee is treated as owning the fixture or improvement for the term of the lease.

Origin:	(1) EG 1A(1). (2) EG 1A(1).
Defined terms:	improvement, lessee, lessor, term of the lease.
Comment:	Neither current section EG 1A (2) nor current section EG 1A (3) has been replicated, on the basis that they are unnecessary. In the case of current section EG 1A (2), if somebody else incurs the cost, the owner of the land has no cost to depreciate. If the owner of the land incurs a cost, the owner is able to depreciate the cost.

EF 5 Ownership of lessee's improvements: other person

When this section applies: first case

(1) This section applies when—

- (a) a lessee of land incurs expenditure during the term of the lease in erecting a fixture on the land or making an improvement to the land; and
- (b) the lessee has been allowed a deduction for an amount of depreciation loss for the fixture or improvement; and
- (c) the lessee disposes of their interest in the lease to another person; and
- (d) the other person pays the lessee for the fixture or improvement.

When this section applies: second case

(2) This section also applies when—

- (a) a lessee of land has been allowed a deduction for an amount of depreciation loss for a fixture on the land, or an improvement to the land, that a previous lessee erected or made; and
- (b) the lessee disposes of their interest in the lease to another person; and
- (c) the other person pays the lessee for the fixture or improvement.

Other person treated as owner

(3) For the purposes of section EF 1, the other person is treated as owning the fixture or improvement from the time at which they pay the lessee for it.

Origin:	(1) EG 1A(4). (2) EG 1A(4). (3) EG 1A(4).
Defined terms:	amount, deduction, depreciation loss, improvement, lease, lessee, person, term of the lease.

What is and is not depreciable property

EF 6 What is depreciable property

Description

(1) For the purposes of section EF 1, depreciable property is property that, in normal circumstances, might reasonably be expected to decline in value while it is used or available for use—

(a) in deriving counted income; or

(b) in carrying on a business for the purpose of deriving counted income.

Subsections (2) and (3) expand on this subsection.

Property: tangible

(2) An item of tangible property is depreciable property if—

(a) it is described by subsection (1); and

(b) it is not described by section EF 7.

Property: intangible

(3) An item of intangible property is depreciable property if—

(a) it is within the definition of 'depreciable intangible property'; and

(b) it is described by subsection (1); and

(c) it is not described by section EF 7.

Origin:	(1) OB 1 'depreciable property'. (2) new. (3) new.
Defined terms:	business, counted income, depreciable intangible property, depreciable property, derived, property.
Comment:	The current legislation does not require 'depreciable intangible property' to be 'depreciable property'. However, this is the intent, and it is also the intent that the exclusions from 'depreciable property' apply, if relevant, to 'depreciable intangible property'. The rewritten section makes that clear (see draft subsection (3)). Current section DE 1 affects the definition of depreciable property. However, it has not been replicated because its replication would duplicate the employment limitation in draft section DA 2 (4).

EF 7 What is not depreciable property

For the purposes of section EF 1, the following property is not depreciable property:

(a) land, although buildings, fixtures, and the improvements listed in schedule 16 are depreciable property if they are described by section EF 6 (1):

(b) trading stock:

(c) livestock to which subpart EE applies:

(d) financial arrangements:

(e) excepted financial arrangements:

(f) property that will not decline in value, as far as its owner is concerned, because, when they dispose of it, they have a right to be compensated for any decline in its value:

(g) property that its owner chooses, under section EF 8, to treat as not depreciable:

(h) property that its owner chooses, under section EF 31, to deal with under that section:

(i) property for whose cost a person other than the property's owner is allowed a deduction:

(j) property for whose cost a person is allowed a deduction under a provision of this Act outside this subpart or under the Income Tax Act 1976 or under the Land and Income Tax Act 1954.

Origin:	OB 1 'depreciable property'.
Defined terms:	deduction, depreciable property, excepted financial arrangement, financial arrangement, person, property, trading stock.
Comment:	Draft paragraph (e) makes a separate reference to excepted financial arrangements because draft section EC 2 ('Trading stock' defined) takes them out of the definition of 'trading stock'. For reasons of simplification, draft paragraph (j) differs in presentation from the current subparagraphs (vi) and (viii) of the definition of 'depreciable property' in that it does not specifically name the relevant sections. However, the principle remains the same, namely, that costs that have been allowed as a deduction elsewhere are not depreciable. This includes revenue account property that is allowed as a deduction under current section BD 2 (1)(b)(i) and (ii) (and then timed under current section EF 2).

EF 8 Election that property not be depreciable

Item acquired

(1) A person may choose that an item of property they acquire not be depreciable property even though, in the absence of the election, it would be depreciable property.

Item changing use

(2) A person may choose that an item of property they own ceases to be depreciable property if—

(a) the use of the item changes; and

(b) before the use changes, the person did not have an amount of depreciation loss for the item; and

(c) after the use changes, in the absence of the election, the person would have an amount of depreciation loss for the item.

Retrospective election

(3) A person who has not deducted all the amounts of depreciation loss for which they were allowed a deduction for an item of property, in the income year in which they acquired it and in each later year, may retrospectively choose that the item not be depreciable property.

How elections made

(4) An election under this section is made as follows:

(a) a person makes an election under subsection (1) by giving the Commissioner notice of it in their return of income for the income year in which they acquire the item:

(b) a person makes an election under subsection (2) by giving the Commissioner notice of it in their return of income for the income year in which the item's use changes:

(c) a person makes an election under subsection (3) by giving the Commissioner notice of it in their return of income for any income year after they acquire the item, including an income year after they dispose of the item.

Effect of election

(5) An election under this section has effect for the person for—

(a) the income year for which they make the election; and

(b) all later income years until—

(i) the item is disposed of, although this reference to disposal does not include the disposal of an item of intangible property as part of an arrangement to replace it with an item of the same kind; or

(ii) an event described in section EF 39 occurs involving the item.

Retrospective effect of election

(6) An election made under subsection (3) also has retrospective effect for the person for—

(a) the income year in which they acquire the property; and

(b) all intervening years until the income year in which they make the election.

Origin:	(1) EG 16A(1). (2) EG 16A(2). (3) EG 16A(3). (4) EG 16A(4). (5) EG 16A(5). (6) EG 16A(6).
Defined terms:	amount, Commissioner, deduction, depreciable property, depreciation loss, income year, notice, person, property, return of income.

How depreciation loss and depreciation recovery income are calculated

EF 9 Description of elements of calculation

Depreciation methods

(1) Sections EF 12 to EF 24 deal with the methods of calculating an amount of depreciation loss. The methods are—

(a) the straight-line method, which is dealt with in sections EF 13 to EF 19:

(b) the diminishing value method, which is also dealt with in sections EF 13 to EF 19:

(c) the pool method, which is dealt with in sections EF 20 to EF 24.

Depreciation rates

(2) Sections EF 25 to EF 29 deal with the rates of depreciation. The rates are—

(a) the economic rate, which is dealt with in section EF 25:

(b) the annual rate, which is dealt with in sections EF 26 and EF 27:

(c) a special rate or a provisional rate, both of which are dealt with in sections EF 28 and EF 29.

Improvements, low value items, and items no longer used

(3) Sections EF 30 to EF 32 deal with the cases of—

(a) an improvement made to an item of depreciable property:

(b) an item of depreciable property that is of low value:

(c) an item of depreciable property that is no longer used.

Transfers between associated persons

(4) Sections EF 33 to EF 35 deal with the transfer of items of depreciable property between associated persons.

Disposals and similar events

(5) Sections EF 36 to EF 43 deal with disposals of property and events that involve property and are similar to disposal.

Interpretation provisions

(6) Sections EF 44 to EF 58 deal with the following interpretation matters:

(a) section EF 44 deals with the effect of goods and services tax on cost:

(b) sections EF 45 to EF 51 deal with the meaning of **adjusted tax value**:

(c) sections EF 52 to EF 58 contain definitions.

Previous depreciation rules

(7) Sections EZ 4 to EZ 20, in subpart EZ (Terminating provisions), deal with items acquired in periods before 24 September 1997.

Origin:	(1) new. (2) new. (3) new. (4) new. (5) new. (6) new. (7) new.
Defined terms:	adjusted tax value, amount, annual rate, associated person, depreciable property, depreciation loss, depreciation method, diminishing value method, economic rate, goods and services tax, improvement, pool method, property, provisional rate, special rate, straight-line method.

EF 10 Calculation rule: item temporarily not available

An item of depreciable property is treated as being available for use while subject temporarily to repair or inspection, if it was available for use immediately before going for repair or inspection.

Origin:	EG 2(2A).
Defined terms:	depreciable property.

EF 11 Calculation rule: income year in which item disposed of

Generally no depreciation loss

(1) A person does not have an amount of depreciation loss for an item of depreciable property for the income year in which they dispose of it. This subsection is overridden by subsections (2) to (5).

Exception for building or petroleum-related depreciable property

(2) A person has an amount of depreciation loss for an item of depreciable property for the income year in which they dispose of it, if it is—

(a) a building; or

(b) an item of petroleum-related depreciable property.

Exception for empty pool

(3) A person has the amount of depreciation loss calculated under section EF 22 (4)(a) for an income year for a disposal to which the subsection applies.

Exception if consideration less than adjusted tax value

(4) A person has the amount of depreciation loss calculated under section EF 40 (2) for a disposal or event to which the subsection applies.

Exception for item partly used for business

(5) A person has the amount of depreciation loss calculated under section EF 41 (3) for a disposal or event to which the subsection applies.

Origin:	(1) EG 1(2). (2) EG 1(2). (3) new. (4) new. (5) new.
Defined terms:	amount, business, depreciable property, depreciation loss, income year, person, petroleum-related depreciable property.

Methods

EF 12 Depreciation methods

Methods described

(1) The methods a person may use to calculate an amount of depreciation loss, called the depreciation methods, are—

(a) the diminishing value method, which may be used for any item of depreciable property other than—

(i) an item of fixed life intangible property; or

(ii) an item of property in the circumstances described in section EZ 4 (Pool method for items accounted for by globo method for 1992-93 income year):

(b) the straight-line method, which—
    (i) may be used for any item of depreciable property; and
    (ii) must be used for an item of fixed life intangible property:
(c) the pool method, which—
    (i) may be used for any item of poolable property; and
    (ii) must be used for an item of property in the circumstances described in section EZ 4 (Pool method for items accounted for by globo method for 1992-93 income year).

Person chooses

(2) A person chooses which of the depreciation methods they will use for each item of depreciable property they own.

How person chooses

(3) The person chooses the method by using the chosen method for the item in their return of income for the income year for which they make the election.

Diminishing value or straight-line method fixed for income year

(4) If the person chooses the diminishing value method or the straight-line method, they must use the method for the item and the income year and must not change the election for the income year.

Pool method fixed for income year and later income years

(5) If the person chooses the pool method, they must use the method for the item and the income year and must not change the election for—
(a) the income year; or
(b) a later income year in which the item is still poolable property that they own.

Origin:	(1) EG 3(1), (2). (2) EG 3(1). (3) EG 3(3). (4) EG 3(4). (5) EG 3(4).
Defined terms:	amount, depreciable property, depreciation loss, depreciation method, diminishing value method, fixed life intangible property, income year, person, pool method, poolable property, property, return of income, straight-line method.

Depreciation loss under diminishing value method or straight-line method

EF 13 Application of sections EF 14 to EF 19

Sections EF 14 to EF 19 apply to the calculation of the amount of depreciation loss that a person using the diminishing value method or the straight-line method has.

Origin:	new.
Defined terms:	amount, depreciation loss, diminishing value method, person, straight-line method.

EF 14 Diminishing value or straight-line: working out depreciation loss

Most depreciable property

(1) The lesser of the amounts dealt with in section EF 15 and section EF 16 is the amount of depreciation loss that the person has for an income year for an item of depreciable property. This subsection is overridden by subsections (2) and (3).

Petroleum-related depreciable property

(2) The lesser of the amounts dealt with in section EF 15 and section EF 17 is the amount of depreciation loss that the person has for an income year for an item of petroleum-related depreciable property.

Depreciable property partly used for business

(3) An amount calculated under section DE 1 (1) (When this subpart applies) or section FB 7 (Depreciation: partial income-producing use) is the amount of depreciation loss that the person has for an income year for an item of depreciable property used, or available for use, only partly in deriving counted income or carrying on a business for the purpose of deriving counted income.

Origin:	(1) EG 2(1). (2) EG 2(1). (3) new.
Defined terms:	amount, business, counted income, depreciable property, depreciation loss, derived, income year, petroleum-related depreciable property.
Comment:	Draft section FB 7 appears in the consequential amendments in volume 3.

EF 15 Amount of adjusted tax value

For the purposes of the comparison of amounts required by section EF 14 (1) and (2), the amount dealt with in this section is the item’s adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year.

Origin:	EG 2(1)(c).
Defined terms:	adjusted tax value, amount, deduction, depreciation loss, income year.

EF 16 Amount resulting from standard calculation

Amount

(1) For the purposes of the comparison of amounts required by section EF 14 (1), the amount dealt with in this section is calculated using the formula—

$$\text{annual rate} \times \text{value or cost} \times \frac{\text{months}}{12}.$$

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (5).

Annual rate

(3) **Annual rate** is the annual rate that, in the income year, applies to the item of depreciable property under the depreciation method that the person uses for the item. It is expressed as a decimal.

Value or cost

(4) **Value or cost** is,—

(a) when the person uses the diminishing value method, the item's adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year:

(b) when the person uses the straight-line method, the item's cost to the person, excluding expenditure for which the person is allowed a deduction under a provision of this Act outside this subpart. (Adjustments to **cost** are in sections EF 18 and EF 19.)

Months: income year of normal length or shorter

(5) **Months**, for a person whose income year contains 365 days or fewer (or 366 days or fewer in a leap year), is the lesser of the following:

(a) 12; and

(b) the number of whole or part calendar months in the income year in which—

(i) the person owns the item; and

(ii) the person uses the item or has it available for use for any purpose.

Months: income year of longer than normal length

(6) **Months**, for a person whose income year contains more than 365 days (or more than 366 days in a leap year) is the number of whole or part calendar months in the income year in which—

(a) the person owns the item; and

(b) the person uses the item or has it available for use for any purpose.

Origin:	(1) EG 2(1)(a). (2) EG 2(1)(a). (3) EG 2(1)(a). (4) EG 2(1)(a). (5) EG 2(1)(a). (6) new.
Defined terms:	adjusted tax value, amount, annual rate, deduction, depreciable property, depreciation loss, depreciation method, diminishing value method, income year, person, straight-line method.
Comment:	The use of calendar months in current section EG 2 (1) can produce a year with 13 months if the taxpayer has a balance date that is not at the end of the month. The definition of 'months' in draft subsection (6) removes this possibility.

EF 17 Amount resulting from petroleum-related depreciable property calculation

Amount

(1) For the purposes of the comparison of amounts required by section EF 14 (2), the amount dealt with in this section is calculated using the formula—

$$\text{annual rate} \times \text{value or cost} \times \frac{\text{days}}{365}.$$

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (5).

Annual rate

(3) **Annual rate** is the annual rate that, in the income year, applies to the item of depreciable property under the depreciation method that the person uses for the item. It is expressed as a decimal.

Value or cost

(4) **Value or cost** is,—

(a) when the person uses the diminishing value method, the item's adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year:

(b) when the person uses the straight-line method, the item's cost to the person. (An adjustment to **cost** is in section EF 18.)

Days

(5) **Days** is the number of whole or part days in the income year on which—

(a) the person owns the item; and

(b) the person uses the item or has it available for use for any purpose.

Origin:	(1) EG 2(1)(b). (2) EG 2(1)(b). (3) EG 2(1)(b). (4) EG 2(1)(b). (5) EG 2(1)(b).
Defined terms:	adjusted tax value, amount, annual rate, deduction, depreciable property, depreciation loss, depreciation method, diminishing value method, income year, person, straight-line method.

EF 18 Cost: change from diminishing value to straight-line method

When this section applies

(1) This section applies when a person changes from the diminishing value method to the straight-line method for an item of property for an income year.

How straight-line method applies

(2) For the purposes of the formulas in sections EF 16 and EF 17, the item's cost is treated as being the item's adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for the item for the income year.

Origin:	(1) EG 3(6). (2) EG 3(6).
Defined terms:	adjusted tax value, amount, deduction, depreciation loss, diminishing value method, income year, person, property, straight-line method.

EF 19 Cost: fixed life intangible property

When this section applies

(1) This section applies when—

(a) a person owns an item of fixed life intangible property; and

(b) the person incurs additional costs in an income year for the item; and

(c) the person is not allowed a deduction for the additional costs other than a deduction for an amount of depreciation loss.

Additional costs for fixed life intangible property

(2) For the purposes of the formula in section EF 16, the item's cost at the start of the income year is treated as being the total of—

(a) the item's adjusted tax value at the start of the income year; and

(b) the additional costs the person incurs.

Origin:	(1) EG 2(3). (2) EG 2(3).
Defined terms:	adjusted tax value, amount, deduction, depreciation loss, fixed life intangible property, income year, person.

Depreciation loss under pool method

EF 20 Application of sections EF 21 to EF 24

Sections EF 21 to EF 24 apply to the calculation of the amount of depreciation loss that a person using the pool method has.

Origin:	new.
Defined terms:	amount, depreciation loss, person, pool method.

EF 21 Pool method: working out depreciation loss

Depreciation loss subtracted from pool's value

(1) The amount of depreciation loss that a person has for an income year for a pool of depreciable property is—

(a) first, calculated under subsection (2); and

(b) second, subtracted from the pool's adjusted tax value at the end of the income year.

Amount

(2) The amount of depreciation loss is calculated using the formula—

$$\text{rate} \times \frac{\text{starting adjusted tax value} + \text{ending adjusted tax value}}{2} \times \frac{\text{months}}{12}.$$

Definition of items in formula

(3) The items in the formula are defined in subsections (4) to (8).

Rate

(4) **Rate** is the diminishing value rate. It is one of the following:

(a) if the same rate applies to all items depreciated in the pool in the income year, that rate; or

(b) if different rates apply to items depreciated in the pool in the income year,—

(i) the lower of the rates, if there are 2 items in the pool; or

(ii) the lowest of the rates, if there are 3 or more items in the pool.

Starting adjusted tax value

(5) **Starting adjusted tax value** is—

(a) the pool's adjusted tax value at the start of the income year; or

(b) zero, if the pool did not exist at the start of the income year.

An adjustment to **starting adjusted tax value** is in section EF 22 (2)(b).

Ending adjusted tax value

(6) **Ending adjusted tax value** is the pool's adjusted tax value at the end of the income year before the deduction of an amount of depreciation loss for the pool for the income year.

Months: income year of normal length or shorter

(7) **Months**, for a person whose income year contains 365 days or fewer (or 366 days or fewer in a leap year), is the lesser of the following:

- (a) 12; and
- (b) the number of whole or part calendar months in the income year in which—
  - (i) the person owns the item; and
  - (ii) the person uses the item or has it available for use for any purpose.

Months: income year of longer than normal length

(8) **Months**, for a person whose income year contains more than 365 days (or more than 366 days in a leap year) is the number of whole or part calendar months in the income year in which—

- (a) the person owns the item; and
- (b) the person uses the item or has it available for use for any purpose.

Origin:	(1) EG 2(2); EG 11(2). (2) EG 11(1). (3) EG 11(1). (4) EG 11(1). (5) EG 11(1). (6) EG 11(1). (7) EG 11(1). (8) new.
Defined terms:	adjusted tax value, amount, deduction, depreciable property, depreciation loss, diminishing value rate, income year, person, pool.
Comment:	The use of calendar months in current section EG 11 (1) can produce a year with 13 months if the taxpayer has a balance date that is not at the end of the month. The definition of 'months' in draft subsection (8) removes this possibility.

EF 22 Cases affecting pool

Acquired item included

(1) If a person chooses in an income year to include in a pool an item of poolable property that they acquire in the income year, the pool's adjusted tax value is increased by the item's cost.

Separately depreciated item included

(2) If a person chooses in an income year to include in a pool an item of poolable property that they depreciated separately in the previous income year,—

(a) the pool's adjusted tax value is increased by the item's adjusted tax value on the date it is included in the pool; and

(b) the item's adjusted tax value at the end of the previous income year is included in **starting adjusted tax value** in section EF 21 (5).

Item disposed of

(3) If a person disposes of an item included in a pool, any consideration they derive from the disposal is subtracted from the adjusted tax value of the pool in which the item was included on the date of the disposal.

All items disposed of

(4) If, on the last day of an income year, the adjusted tax value of a person's pool is positive but the person has disposed of all items that were in the pool,—

(a) the pool's adjusted tax value is the amount of depreciation loss that the person has for the pool for the income year; and

(b) on the first day of the following income year, the pool's adjusted tax value is zero.

Negative adjusted tax value

(5) If, on the last day of an income year, the adjusted tax value of a person's pool is negative,—

(a) the amount by which the adjusted tax value is negative is depreciation recovery income of the person derived in the income year; and

(b) on the first day of the following income year the pool's adjusted tax value is zero.

Limit on amount of income

(6) Section EZ 5 (Pool: items accounted for by globo method for 1992-93 income year) limits the amount of income arising under subsection (5)(a) in the circumstances described in the section.

Origin:	(1) EG 11(3).
	(2) EG 11(3A).
	(3) EG 11(4)(a).
	(4) EG 11(4)(c).
	(5) EG 11(4)(b).
	(6) EG 11(4A).

Defined terms:	adjusted tax value, amount, depreciation loss, depreciation recovery income, derived, income, income year, person, pool, poolable property.
Comment:	The reference in current section EG 11 (4)(b)(i) to income being ‘as if it were […] income derived by virtue of section EG 19 (2)’ has not been carried over because it appears to be superfluous (see draft subsection (5)(a)).

EF 23 Combined pools

Combining pools allowed

(1) A person using the pool method may at any time combine any number of pools to form a single pool.

Consequences

(2) When a person combines pools,—

(a) the new pool’s adjusted tax value is the same as the sum of the adjusted tax values of the constituent pools; and

(b) the adjusted tax value of each of the constituent pools at the end of the income year in which the pools are combined is zero; and

(c) each of the constituent pools ceases to exist.

Origin:	(1) EG 11(5). (2) EG 11(5).
Defined terms:	adjusted tax value, income year, person, pool, pool method.
Comment:	The draft ensures that the old pool ceases to exist on merger of the pools (see draft subsection (2)(c)). Currently, the pool can continue to exist but it has no value.

EF 24 Property ceasing to qualify for pool

If a person starts using an item of property included in a pool in such a way as to cause the item to cease to meet section EF 57 (4), they must account for it as if, on the day they first used it in that way,—

(a) they disposed of it for its market value; and

(b) they immediately reacquired it for its market value.

Origin:	EG 11(8).
Defined terms:	person, pool, property.

Depreciation rates

EF 25 Economic rate

What this section is about

(1) This section is about setting the economic depreciation rate that applies to a kind of item of depreciable property (not including fixed life intangible property or excluded depreciable property, for which an economic rate cannot be set).

Rate set by Commissioner

(2) The Commissioner sets the rate from time to time by—

(a) following the procedure in this section; and

(b) issuing a determination under section 91AB of the Tax Administration Act 1994.

Procedure for setting economic rate

(3) To set the diminishing value rate for a kind of item of depreciable property, the Commissioner—

(a) gets a figure by applying the formula in subsection (4) to items of that kind; and

(b) rounds the figure up or down to the nearest rate specified in schedule 11, column 1; and

(c) sets the same rate for some or all of the kinds of items of depreciable property that are similar to one another, if the Commissioner thinks it is appropriate to do so having regard to—

(i) the rate calculated for each kind; and

(ii) the reduction in compliance costs that is likely to be achieved.

Formula

(4) The formula is—

$$1 - \frac{\text{residual value}}{\text{cost}}^{\frac{1}{\text{estimated useful life}}}$$

Definition of items in formula

(5) In the formula,—

(a) **estimated useful life** has the meaning given to it by section EF 54:

(b) **residual value** is the greater of—

(i) estimated residual market value, which has the meaning given to it by section EF 58; and

(ii) 13.5% of cost:

(c) **cost** is the cost of items of the kind to which the formula is applied.

Origin:	(1) EG 4(1). (2) new. (3) EG 4(4), (5). (4) EG 4(3). (5) EG 4(3).
Defined terms:	Commissioner, depreciable property, diminishing value rate, economic rate, estimated residual market value, estimated useful life, excluded depreciable property, fixed life intangible property.
Comment:	Draft section 91AB of the Tax Administration Act 1994 appears in the consequential amendments in volume 3.

EF 26 Annual rate for item acquired in person's 1995-96 or later income year

What this section is about

(1) This section is about the annual rate that applies to an item of depreciable property that a person acquires in their 1995-96 income year or a later income year (not including fixed life intangible property or excluded depreciable property, for which rates are set in section EF 27 and section EZ 10 (Annual rate for excluded depreciable property) respectively).

Rate

(2) The rate is one of the following:

(a) the item's economic rate, for an item not described in either paragraph (b) or paragraph (c):

(b) the item's economic rate multiplied by 1.2, for an item that—

(i) has not been used or held for use in New Zealand as an item of depreciable property before the date on which the person acquires it; and

(ii) is not a building; and

(iii) is not a used imported motorcar; and

(iv) is not an international aircraft:

(c) a diminishing value rate of 15% or a straight-line rate of 10%, for an international aircraft.

Origin:	(1) EG 6; EG 7. (2) EG 6; EG 7.
Defined terms:	annual rate, depreciable property, diminishing value rate, economic rate, excluded depreciable property, fixed life intangible property, income year, international aircraft, New Zealand, person, straight-line rate.

EF 27 Annual rate for fixed life intangible property

What this section is about

(1) This section is about the annual rate that applies to an item of fixed life intangible property (not including an item of excluded depreciable property, for which a rate is set in section EZ 10 (Annual rate for excluded depreciable property)).

Rate

(2) The rate is the rate calculated using the formula—

$$\frac{1}{\text{legal life.}}$$

Definition of item in formula

(3) In the formula, **legal life** is,—

(a) if section EF 19 applies, the item's remaining legal life from the start of the income year in which a person incurs the additional costs referred to in that section:

(b) if section EF 19 does not apply, the item's remaining legal life from the time at which a person acquires it.

How rate expressed

(4) The rate given by the formula is expressed as a decimal and rounded to 2 decimal places, with numbers at the midpoint or greater being rounded up and other numbers being rounded down.

Origin:	(1) EG 8. (2) EG 8. (3) EG 8. (4) EG 8.
Defined terms:	annual rate, excluded depreciable property, fixed life intangible property, income year, legal life, person.

EF 28 Special rate or provisional rate

A special rate or a provisional rate is set under sections 91AC to 91AF of the Tax Administration Act 1994. A special rate or a provisional rate applies to an item of depreciable property (not including an item of fixed life intangible property or an item of excluded depreciable property, for which a special rate or a provisional rate cannot be set).

Origin:	new.
Defined terms:	depreciable property, excluded depreciable property, fixed life intangible property, provisional rate, special rate.
Comment:	Draft sections 91AC to 91AF of the Tax Administration Act 1994 appear in the consequential amendments in volume 3.

EF 29 Using economic or provisional rate instead of special rate

Allowed to use economic or provisional rate

(1) A person may depreciate an item to which a special rate applies by applying, instead, the economic rate applicable to the item or a provisional rate applicable to the item. This subsection is overridden by subsection (2).

Not allowed to use economic or provisional rate

(2) The person must not depreciate the item by applying the economic rate or the provisional rate, if the following circumstances exist:

- (a) a special rate applies to the item; and
- (b) the special rate is higher than the economic rate; and
- (c) the person applies the special rate to the item for an income year; and
- (d) in a later income year, the item's market value declines at a rate equal to or greater than the special rate; and
- (e) it is a reasonable conclusion from all the circumstances of the case that the person's reason, or one of the person's reasons, for wanting to change from the special rate to the economic rate or the provisional rate for the later income year is to enable the person to defer the deduction that the person is allowed for the amount of depreciation loss for the item's decline in value.

Origin:	(1) EG 10(10). (2) EG 10(11).
Defined terms:	amount, deduction, depreciation loss, economic rate, income year, person, provisional rate, special rate.

Improvements, items of low value, or items no longer used

EF 30 Improvements

When this section applies

(1) This section applies when a person makes an improvement to an item of depreciable property.

Income year in which improvement made

(2) In the income year in which the person makes the improvement, the provisions of this subpart apply to the improvement, as if it were a separate item of depreciable property, in the period that—

(a) starts at the start of the month in which the person first uses the improvement or has it available for use; and

(b) ends at the end of the income year.

Following income years

(3) For income years following the income year in which the person makes the improvement,—

(a) a person who uses the diminishing value method or the straight-line method for the item that was improved may choose to apply subsection (4) or subsection (5):

(b) a person who uses the pool method for the item that was improved must apply subsections (6) and (7).

Improvement treated as separate item

(4) For the purposes of subsection (3)(a), a person may choose to treat the improvement as a separate item of depreciable property.

Improvement treated as part of item

(5) For the purposes of subsection (3)(a), a person may choose to treat the improvement as part of the item of depreciable property that was improved. They must do one of the following for the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use:

(a) if they use the diminishing value method for the item, add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year:

(b) if they use the straight-line method for the item,—

(i) add the improvement's adjusted tax value at the start of the income year to the item's adjusted tax value at the start of the income year; and

(ii) add the improvement's cost to the item's cost.

Pool method

(6) A person who uses the pool method for the item that was improved must treat the improvement as a separate item of depreciable property. If its cost is equal to or less than its maximum pooling value, they must include it in a pool in the first income year, after the income year in which they made the improvement, in which they use the improvement or have it available for use.

Adjustment of pool's value

(7) When an improvement is included in a pool under subsection (6),—

(a) the pool's adjusted tax value is increased by the improvement's adjusted tax value on the date it is included in the pool; and

(b) the improvement's adjusted tax value at the end of the previous income year is included in **starting adjusted tax value** in section EF 21 (5).

Origin:	(1) new. (2) new. (3) new. (4) new. (5) new. (6) new. (7) new.
Defined terms:	adjusted tax value, depreciable property, diminishing value method, improvement, income year, maximum pooling value, person, pool, pool method, straight-line method.
Comment:	The origin of this section is 'Expenditure on Improvements', pages 10 to 11 of 'Depreciation'*, Tax Information Bulletin* vol 4, no 9 (May 1993).

EF 31 Items of low value

When this section applies

(1) This section applies when—

(a) a person acquires, in an income year, an item of property for a total cost of $200 or less; and

(b) the person uses the item, or has the item available for use, in the income year; and

(c) the item would be depreciable property if the person did not deal with it under this section; and

(d) the item has not and will not become part of any other property that is depreciable property; and

(e) the person is not allowed a deduction for the cost of the item if the person does not deal with the item under this section; and

(f) the item is not acquired at the same time and from the same supplier as any other items to which the same depreciation rate would apply if they were all treated as items of depreciable property, although this paragraph does not apply if—

(i) the total cost of all the items is $200 or less; or

(ii) the total cost of all the items that are not treated by the person purely as trading stock, when the items generally constitute the person's trading stock, is $200 or less.

Depreciation loss

(2) If the person chooses to deal with the item under this section, the item's cost is the amount of depreciation loss that the person has for the item for the income year.

How election is made

(3) The person makes the election by claiming, in their return of income for the income year for which the election is made, a deduction for the amount of depreciation loss described in subsection (2).

Depreciation recovery income

(4) If the person disposes in an income year of an item for which they have been allowed a deduction on a claim under subsection (2), the consideration they derive from the disposal is depreciation recovery income for the income year.

Change of use treated as disposal

(5) Subsection (6) applies when—

(a) a person has been allowed a deduction on a claim under subsection (2) for an item; and

(b) at a later time, the person stops using the item, or having the item available for use, mainly in deriving counted income or carrying on a business for the purpose of deriving counted income; and

(c) the use to which the item is put at the later time is not subject to fringe benefit tax.

Disposal

(6) The person is treated as having disposed of the item for its market value at the later time.

Increase in amount

(7) The Governor-General may, by Order in Council, increase the amount specified in subsection (1)(a) and (f).

Origin:	(1) EG 16(1); OB 1 'low value property'. (2) EG 16(1). (3) EG 16(4). (4) EG 16(2). (5) EG 16(3). (6) EG 16(3). (7) OB 1 'low value property'.
Defined terms:	amount, business, counted income, deduction, depreciable property, depreciation loss, depreciation recovery income, derived, fringe benefit tax, income year, person, property, return of income, trading stock.
Comment:	The definition of 'low value property' that is currently in section OB 1 has been subsumed into the body of the provision.

EF 32 Items no longer used

What this section is about

(1) This section is about the amount of depreciation loss that a person has for an income year for an item of depreciable property that is no longer used (not including a building or an item that has been depreciated using the pool method).

Depreciation loss under this section

(2) The person has an amount of depreciation loss under this section and under no other provision of this subpart.

Circumstances

(3) The person has an amount of depreciation loss if—

(a) they no longer use the item in deriving counted income or carrying on a business for the purpose of deriving counted income; and

(b) neither they nor a person associated with them intends to use the item in deriving counted income or carrying on a business for the purpose of deriving counted income; and

(c) the costs of disposing of the item would be more than any consideration they could derive from disposing of it.

Amount

(4) The amount of depreciation loss is the item's adjusted tax value at the start of the income year.

Adjusted tax value at end of year

(5) The item's adjusted tax value at the end of the income year is zero.

Origin:	(1) EG 12(1). (2) EG 12(3)(b). (3) EG 12(5), (6). (4) EG 12(2). (5) EG 12(3)(a).
Defined terms:	adjusted tax value, amount, business, counted income, depreciable property, depreciation loss, derived, income year, person, pool method.
Comment:	Current section EG 12 (4) is now located in the disposal provisions (see draft section EF 38).

Transfers of depreciable property between associated persons

EF 33 Transfer of depreciable property on or after 24 September 1997

When this section applies

(1) This section applies when, on or after 24 September 1997, a person (person A) acquires, directly or indirectly, an item of property from an associated person to whom one of the paragraphs in subsection (2) applies. The income year referred to in the paragraphs is the income year of the associated person.

Associated person

(2) The associated person must be a person to whom one of the following paragraphs applies:

(a) the associated person has an amount of depreciation loss for the item for the income year in which person A acquires it:

(b) the associated person would have had an amount of depreciation loss for the item for the income year in which person A acquires it, if section EF 11 (1) had not applied:

(c) the associated person had an amount of depreciation loss for the item for the income year before the income year in which person A acquires it:

(d) the associated person has been allowed a deduction for the item under section DZ 7 (Premium paid for lease of land) for the income year in which person A acquires it:

(e) the associated person has been allowed a deduction for the item under section DZ 7 (Premium paid for lease of land) for the income year before the income year in which person A acquires it:

(f) the associated person would have had an amount of depreciation loss for the item for the income year in which person A acquires it, if the associated person had incurred a cost for the item for which the person was allowed no other deduction and if section EF 11 (1) had not applied:

(g) the associated person would have had an amount of depreciation loss for the item for the year before the income year in which person A acquires it, if the associated person had incurred a cost for the item for which the person was allowed no other deduction:

(h) the associated person would have been allowed a deduction for the item under section DZ 7 (Premium paid for lease of land) for the income year in which person A acquires it, if the associated person had incurred a cost for the item for which the person was allowed no other deduction:

(i) the associated person would have been allowed a deduction for the item under section DZ 7 (Premium paid for lease of land) for the income year before the income year in which person A acquires it, if the associated person had incurred a cost for the item for which the person was allowed no other deduction:

(j) the associated person would have been a person to whom any of paragraphs (a) to (i) applied, if the associated person had not made an election under section EF 8.

Cost of item to person A

(3) For the purposes of determining the amount of depreciation loss that person A has, the cost of the item to person A is treated as one of the following:

(a) if section EF 48 applies for the associated person and the item, the lesser of—

(i) the cost of the item to person A; and

(ii) the item’s market value at the time at which a person was first allowed a deduction for it after the associated person acquired it; or

(b) if section EF 48 does not apply for the associated person and the item, the lesser of—

(i) the cost of the item to person A; and

(ii) the cost of the item to the associated person.

This subsection is overridden by subsection (4).

Exclusions

(4) Subsection (3) does not apply in the following cases:

(a) if—

(i) the item is not depreciable intangible property; and

(ii) the Commissioner decides that it is appropriate to use the cost of the item to person A for the purposes of determining the amount of depreciation loss that person A has for the item:

(b) if the cost to person A is income of the associated person, other than under section EF 40 (1):

(c) if person A acquires the item under a matrimonial agreement to which section FF 16 (1) (Depreciable property) applies.

Rate

(5) The annual rate that person A applies to the item must be one of the following (not including an item of fixed life intangible property, for which the rate is set in section EF 27):

(a) if person A uses the same depreciation method for the item as that used by the associated person for it, the annual rate that person A applies to it must not be more than the annual rate that the associated person applied to it:

(b) if person A uses a depreciation method for the item different from the method that the associated person used for it, the annual rate that person A applies to it must not be more than a rate equivalent to the rate that the associated person applied to it, as determined by schedule 10.

Origin:	(1) EG 17(1), (5), (8). (2) EG 17(1). (3) EG 17(1), (8). (4) EG 17(2), (3), (8). (5) EG 17(4), (8).
Defined terms:	amount, annual rate, associated person, Commissioner, deduction, depreciable intangible property, depreciation loss, depreciation method, fixed life intangible property, income, income year, matrimonial agreement, person, property.
Comment:	Current section FF 16 appears in a rewritten form in the consequential amendments in volume 3.

EF 34 Transfer of radiocommunications licence right on or after 24 September 1997

When this section applies

(1) This section applies when, on or after 24 September 1997, the holder of management rights created under the Radiocommunications Act 1989, other than the Crown, grants a licence right under that Act to an associated person.

Cost of licence right

(2) For the purposes of determining the amount of depreciation loss that the associated person has, the cost of the licence right to the associated person is treated as zero.

Origin:	(1) EG 17(6), (8). (2) EG 17(6), (8).
Defined terms:	amount, associated person, depreciation loss.

EF 35 Transfer of depreciable intangible property on or after 1 July 1997

When this section applies

(1) This section applies when, on or after 1 July 1997, a person (person A) acquires, directly or indirectly, from an associated person an item of depreciable intangible property that—

(a) was not depreciable property of the associated person because it was not of a kind listed in schedule 17 at the time the associated person acquired it; and

(b) was not an item for whose cost the associated person was allowed a deduction under a provision of this Act outside this subpart.

No depreciation loss

(2) Person A does not have an amount of depreciation loss for the item.

Origin:	(1) EG 17(7). (2) EG 17(7).
Defined terms:	amount, associated person, deduction, depreciable intangible property, depreciable property, depreciation loss, person.

Disposals and similar events

EF 36 Application of sections EF 40 to EF 43

When sections apply

(1) Sections EF 40 to EF 43 apply when a person derives consideration from the disposal of an item or from an event involving an item, if—

(a) the consideration is consideration of a kind described in section EF 37; and

(b) the item is an item of a kind described in section EF 38; and

(c) the event is an event of a kind described in section EF 39.

This subsection is overridden by subsection (2).

When sections do not apply

(2) Sections EF 40 to EF 43 do not apply when a person disposes of an item of intangible property as part of an arrangement to replace it with an item of the same kind.

Origin:	(1) new. (2) EG 19(9)(b).
Defined terms:	arrangement, derived, person, property.

EF 37 Consideration for purposes of section EF 36

General rule: amount derived

(1) For the purposes of section EF 36, the consideration is the amount that the person derives, minus any amount that they incur in deriving it. Two qualifications are—

(a) if the person is a registered person, 'the amount that the person derives' does not include any goods and services tax charged on a taxable supply they make:

(b) 'any amount that they incur' does not include an amount for which the person is allowed a deduction under a provision of this Act outside this subpart.

This subsection is overridden by subsections (2) to (8).

Other than market value

(2) If the person derives a consideration that is not the item's market value, the consideration for the purposes of section EF 36 is the item's market value. Three qualifications are—

(a) if the person makes a taxable supply, 'market value' means the market value minus any goods and services tax that would be charged on the supply:

(b) this subsection does not apply to a transfer under a matrimonial agreement:

(c) this subsection does not apply in a case described in any of subsections (3) to (8).

Item leaving New Zealand permanently

(3) The consideration that a person derives from the event described in section EF 39 (2) is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, 'market value' means the market value minus any goods and services tax that would be charged on the supply:

(b) this subsection does not apply to a transfer under a matrimonial agreement.

Change of use or location of use

(4) The consideration that a person derives from the event described in section EF 39 (3) is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, 'market value' means the market value minus any goods and services tax that would be charged on the supply:

(b) this subsection does not apply to a transfer under a matrimonial agreement.

Loss or theft

(5) The consideration that a person derives from the event described in section EF 39 (4) is the amount of insurance or other compensation (amount A) they receive for the loss or theft. If the person is a registered person, amount A does not include the amount (if any) of goods and services tax charged on amount A to the extent to which amount A is treated as being consideration received for a supply of services by the registered person under section 5 (13) of the Goods and Services Tax Act 1985.

Irreparable damage

(6) The consideration that a person derives from the event described in section EF 39 (5) is the amount of insurance or other compensation (amount A) they receive for the irreparable damage. If the person is a registered person, amount A does not include the amount (if any) of goods and services tax charged on amount A to the extent to which amount A is treated as being consideration received for a supply of services by the registered person under section 5 (13) of the Goods and Services Tax Act 1985.

Repossession

(7) The consideration that a person derives from the event described in section EF 39 (6) is the item's cost minus the net amount paid. Two qualifications are—

(a) if the person is a registered person, the 'consideration that the person derives' does not include any goods and services tax charged on a taxable supply they make:

(b) 'net amount paid' means the amount paid by the buyer to the seller for the item under the contract minus any amount refunded by the seller to the buyer.

Other items

(8) The consideration that a person derives from the disposal of an item along with any other item, or from the occurrence of an event involving an item that also involves other items, is the item's market value. Two qualifications are—

(a) if the person makes a taxable supply, 'market value' means the market value minus any goods and services tax that would be charged on the supply:

(b) this subsection does not apply to a transfer under a matrimonial agreement.

Origin:	(1) ED 4(6)(a); EG 19(10)(b). (2) ED 4(6)(c); EG 19(7). (3) ED 4(6)(c); EG 19(7)(d).

	(4) ED 4(6)(c); EG 19(7)(d). (5) ED 4(6)(d); EG 19(6A). (6) ED 4(6)(d); EG 19(6A). (7) ED 4(6)(a); EG 19(10A), (10B). (8) ED 4(6)(c); EG 19(7).
Defined terms:	amount, deduction, derived, goods and services tax, goods and services tax charged, matrimonial agreement, New Zealand, person, registered person, services, taxable supply.
Comment:	Draft subsection (1), current section EG 19 (10)(b), applies to any depreciable property, not just software (see 'Questions We Have Been Asked', *Tax Information Bulletin* vol 7, no 13 (May 1996)).

EF 38 Items for purposes of section EF 36

Items to which sections EF 40 to EF 43 apply

(1) For the purposes of section EF 36, an item of property to which sections EF 40 to EF 43 apply is an item of depreciable property that a person owns, including an item for which the person has been allowed a deduction for an amount of depreciation loss they have had under section EF 32. This subsection is overridden by subsection (2).

Items to which sections EF 40 to EF 43 do not apply

(2) Sections EF 40 to EF 43 do not apply to—

(a) an item of property that, on the date on which the disposal or the event occurs, is accounted for in a pool; or

(b) an item of petroleum-related depreciable property; or

(c) an item of intangible property that is excluded depreciable property; or

(d) a land improvement that is excluded depreciable property of a kind for which no depreciation deduction was allowed under section 108 of the Income Tax Act 1976.

Origin:	(1) EG 12(4); EG 19(1). (2) EG 19(1).
Defined terms:	amount, deduction, depreciable property, depreciation loss, excluded depreciable property, person, petroleum-related depreciable property, pool, property.
Comment:	The draft section no longer deals separately with the depreciation of software. Current law refers to the taxpayer having claimed any deduction for the purchase or creation of software (current section EG 19 (1)(a)(ii)). This means it covers software before and after 1 April 1993 even though the pre-1 April 1993 software is not depreciable property. The draft tries to make this more explicit by separating out disposals of pre-1 April 1993 software and including them as part of recoveries (see draft section CZ 1). This does not result in any change in the law's effect as, under draft section CZ 1, the disposal of software purchased or created before 1 April 1993 is treated as if it were a disposal of depreciable property covered by draft sections EF 40 to EF 43.

EF 39 Events for purposes of section EF 36

Events to which sections EF 40 to EF 43 apply

(1) For the purposes of section EF 36, this section describes the events to which sections EF 40 to EF 43 apply.

Item leaving New Zealand permanently

(2) The first event is the cessation of use in New Zealand, and the taking out of New Zealand for use outside New Zealand, of an item of property for which a first-year allowance has been granted under section 112 (1) to (7) of the Income Tax Act 1976, except when the item—

(a) has been taken out of New Zealand temporarily; and

(b) will, after its return to New Zealand, be used in or for the purpose of a business in New Zealand.

Change of use or location of use

(3) The second event is the change of use, or change of location of use, of an item of property, as a result of which a person does not have an amount of depreciation loss for the item for the next income year. The event is treated as occurring on the first day of the next income year.

Loss or theft

(4) The third event is the loss or theft of an item of property, if the item is not recovered in the income year in which the loss or theft occurs.

Irreparable damage

(5) The fourth event is the irreparable damage of an item of property.

Repossession

(6) The fifth event is the seller's repossession of an item of property to which section EF 3 applies because the buyer wholly or partly fails to pay the consideration. The event is treated as occurring on the date on which the item is repossessed.

Statutory acquisition

(7) The sixth event is the acquisition of an item of property by a person acting under statutory authority.

Distribution

(8) The seventh event is the distribution of an item of property.

Cessation of ownership under section EF 4 or section EF 5

(9) The eighth event is the cessation of ownership of a fixture or improvement—

(a) that a lessee is treated as having under section EF 4 (2); or

(b) that a person is treated as having under section EF 5 (3).

Cessation of rights in intangible property

(10) The ninth event is an occurrence that has the effect that the owner of an item of intangible property is no longer able, and will never be able, to exercise the rights that constitute or are part of the item.

Origin:	(1) new. (2) EG 19(9). (3) EG 19(9). (4) EG 19(9). (5) EG 19(9). (6) EG 19(10A). (7) EG 19(9). (8) EG 19(9). (9) EG 19(9). (10) EG 19(9).
Defined terms:	amount, business, depreciation loss, improvement, income year, lessee, New Zealand, person, property.

EF 40 Effect of disposal or event

Depreciation recovery income

(1) For the purposes of section EF 36, if the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs, the lesser of the following amounts is depreciation recovery income derived by the person for the income year in which the disposal or the event occurs:

(a) the amount by which the consideration is more than the item's adjusted tax value on the date on which the disposal or the event occurs; and

(b) the total of the amounts of depreciation loss for which the person has been allowed deductions under this Act for the item and depreciation deductions that the person has been allowed under the Income Tax Act 1976 for the item.

Depreciation loss

(2) For the purposes of section EF 36, if the consideration is less than the item's adjusted tax value on the date on which the disposal or the event occurs, the person has an amount of depreciation loss, for the income year in which the disposal or the event occurs, that is the amount by which the consideration is less than the item's adjusted tax value on that date. This subsection does not apply if the item is a building.

Origin:	(1) EG 19(2). (2) EG 19(3).
Defined terms:	adjusted tax value, amount, deduction, depreciation loss, depreciation recovery income, derived, income year, person.

EF 41 Depreciation recovery income and depreciation losses when items partly used for business

Item to which this section applies

(1) This section applies to an item of property that—

(a) is an item to which this section applies (see section EF 38); and

(b) is, at any time during the period the person owns it, subject to—

(i) section DE 1 (1) (When this subpart applies); or

(ii) section FB 7 (Depreciation: partial income-producing use); or

(iii) any applicable paragraph in section EZ 6 (Depreciation recovery income and depreciation losses for part business use in or before 1992-93 income year).

Income

(2) If the consideration referred to in section EF 36 is less than or equal to the cost of the item to the person, the depreciation recovery amount that is income of the person is calculated using the formula in subsection (4).

Depreciation loss

(3) If the consideration referred to in section EF 36 is less than the item's adjusted tax value on the date on which the disposal or the event occurs, an amount calculated using the formula in subsection (4) is the amount of depreciation loss that the person has. This subsection does not apply if the item is a building.

Formula

(4) The formula is—

$$\frac{\text{all deductions}}{(\text{base value} - \text{adjusted tax value})} \quad x \quad \text{depreciation recovery income or depreciation loss.}$$

Definition of items in formula

(5) The items in the formula are defined in subsections (6) to (9).

All deductions

(6) **All deductions** is all amounts of depreciation loss that the person has had under this Act for the item and all depreciation deductions that the person has been allowed under section 108 of the Income Tax Act 1976 for the item, in each of the income years in which the person owns the item.

Base value

(7) **Base value** has the applicable one of the meanings in sections EF 47 to EF 50.

Adjusted tax value

(8) **Adjusted tax value** is the item's adjusted tax value on the date on which the disposal or the event occurs. In the case of disposal by a life insurer, **adjusted tax value** is calculated on the basis that the value to which the item has or would have been reduced by the amounts of depreciation loss for which the person has or would have been allowed a deduction is the same as the item's acquisition value or cost minus all amounts of depreciation loss.

Depreciation recovery income or depreciation loss

(9) **Depreciation recovery income or depreciation loss** is the amount described in section EF 40 (1) or section EF 40 (2), as applicable.

Origin:	(1) EG 19(4). (2) EG 19(4). (3) EG 19(4). (4) EG 19(4). (5) EG 19(4). (6) EG 19(4). (7) EG 19(4). (8) EG 19(4), (11). (9) EG 19(4).
Defined terms:	adjusted tax value, amount, business, deduction, depreciation loss, depreciation recovery income, income, income year, life insurer, person, property.
Comment:	As signalled in issues paper 2 (June 1998), item 'b' of the formula has been amended from 'cost' to 'base value' to reflect the intent of the formula to apportion the gain or loss on disposal in the same business/private use proportion as the depreciation deductions were apportioned.

EF 42 Depreciation recovery income when lost or stolen items recovered

When this section applies

(1) This section applies when an item of property to which section EF 39 (4) applies—

(a) is recovered in a later income year; and

(b) is still owned by the person; and

(c) is still used or available for use by the person.

Person treated as acquiring item

(2) The person is treated as having acquired the item, on the date of recovery, for its adjusted tax value at the start of the income year in which it was lost or stolen.

Person treated as deriving income: amount

(3) The person is treated as deriving depreciation recovery income equal to the amount of depreciation loss that the person has under section EF 40 (2) for which they have been allowed a deduction.

Person treated as deriving income: income year

(4) The income year in which the person derives the income is—

(a) the income year in which the item is lost or stolen, if the person chooses that year; or

(b) the income year in which the item is recovered, in any other case.

Origin:	(1) EG 19(6B). (2) EG 19(6B). (3) EG 19(6B). (4) EG 19(6B).
Defined terms:	adjusted tax value, amount, deduction, depreciation loss, depreciation recovery income, derived, income year, person, property.

EF 43 Depreciation recovery income when compensation received

When this section applies

(1) This section applies when a person receives compensation for an item of property to which this section applies (see section EF 38), other than compensation for an item that is lost, stolen, or irreparably damaged.

Compensation subtracted

(2) An amount must be subtracted from the item's adjusted tax value. The amount is the amount by which the compensation that the person receives is more than the expenditure that the person incurs because of the event for which the person receives the compensation.

Income

(3) If the item's adjusted tax value becomes negative in an income year through the application of subsection (2), the negative amount is depreciation recovery income derived by the person in the income year.

Origin:	(1) EG 19(5). (2) EG 19(5). (3) EG 19(6).
Defined terms:	adjusted tax value, amount, depreciation recovery income, derived, income year, person, property.

Interpretation provisions

EF 44 Cost: goods and services tax

When this section applies

(1) This section applies when an amount of depreciation loss or depreciation recovery income is calculated by reference to the cost of an item of depreciable property to a person.

Cost reduced: input tax

(2) The item's cost is reduced by subtracting the amount (if any) of input tax applying to the supply of the item to the person. This subsection is overridden by subsection (3).

Cost reduced: input tax

(3) This subsection applies to an item that was not acquired or produced for the principal purpose of making taxable supplies but is applied in an income year principally for that purpose. The item's cost is reduced by subtracting a proportion of the amount (if any) calculated under sections 21F and 21G, and deductible under section 20 (3)(e), of the Goods and Services Tax Act 1985. The proportion is the proportion of the amount that arises from the application of the item in the income year principally for the purpose of making taxable supplies.

Cost increased: output tax

(4) This subsection applies to an item that was acquired or produced for the principal purpose of making taxable supplies but is applied in an income year other than for that purpose. The item's cost is increased by adding the amount (if any) of output tax charged in the income year for the supply of the item because section 21 (1) of the Goods and Services Tax Act 1985 applies to the supply.

Origin:	(1) ED 4(4). (2) ED 4(4)(a), (6)(b). (3) ED 4(4)(a). (4) ED 4(4)(b).
Defined terms:	amount, depreciable property, depreciation loss, depreciation recovery income, goods and services tax, income year, input tax, output tax, person, taxable supply.

Adjusted tax value

EF 45 Adjusted tax value

Adjusted tax value means,—

(a) for an item in a pool, the pool's adjusted tax value:

(b) for an item of depreciable property other than one dealt with in paragraph (a), the amount calculated using the formula in section EF 46.

Origin:	OB 1 'adjusted tax value'.
Defined terms:	adjusted tax value, amount, depreciable property, pool.

EF 46 Formula

Formula

(1) The formula referred to in section EF 45(b) is—

$$\text{base value} \quad - \quad \text{total deductions.}$$

Definition of items in formula

(2) In the formula,—

(a) **base value** has the applicable one of the meanings in sections EF 47 to EF 50:

(b) **total deductions** has the meaning given to it by section EF 51.

Origin:	(1) OB 1 'adjusted tax value'.
	(2) OB 1 'adjusted tax value'.

EF 47 Base value in section EF 46 when none of sections EF 48 to EF 50 applies

When this section applies

(1) This section applies when none of sections EF 48 to EF 50 applies.

Base value

(2) **Base value** is the cost of the item to the person.

Cost

(3) In this section, 'cost' is qualified as follows:

(a) expenditure is excluded from it if it is expenditure for which a person has been allowed a deduction for an amount of depreciation loss they have had under any of sections EF 31 (2), EF 40 (2), and EF 41 (3):

(b) expenditure is not excluded from it if it is expenditure for which a person has been allowed a deduction for an amount of depreciation loss they have had under any other provision of this subpart:

(c) expenditure is excluded from it if it is expenditure for which a person has been allowed a deduction under any other subpart:

(d) expenditure is not excluded from it if it is expenditure for which a person has been allowed a depreciation deduction under any of sections 108 to 108N or section 113A of the Income Tax Act 1976:

(e) expenditure is excluded from it if it is expenditure for which a person has been allowed a depreciation deduction under any other provision of the Income Tax Act 1976.

Origin:	(1) OB 1 'adjusted tax value' (a)(i). (2) OB 1 'adjusted tax value' (a)(i). (3) OB 1 'adjusted tax value' (a)(i).
Defined terms:	amount, deduction, depreciation loss, person.

EF 48 Base value in section EF 46 when no previous deduction

When this section applies

(1) This section applies when all the following apply to the item:

(a) it is neither a building nor an item of petroleum-related depreciable property; and

(b) it is not an item that the person acquired to use or have available for use in deriving counted income or carrying on a business for the purpose of deriving counted income, and first used for the purpose of deriving counted income; and

(c) it has been, since the person acquired it and first used it or had it available for use for any purpose, an item for which the person could not in any income year have been allowed a deduction for an amount of depreciation loss or have been allowed a depreciation deduction under section 108 of the Income Tax Act 1976, whether because of the nature of the person's use of the item or the person's non-residence or for any other reason; and

(d) in relation to the 1992-93 income year,—

(i) it was acquired by the person after the end of that income year; or

(ii) it was an item for which the person could not have been allowed a depreciation deduction under section 108 of the Income Tax Act 1976 for that income year.

Base value

(2) **Base value** is the item's market value at the time the person first had an amount of depreciation loss for it after they began to own it.

Origin:	(1) OB 1 'adjusted tax value' (a)(iii). (2) OB 1 'adjusted tax value' (a)(iii).
Defined terms:	amount, business, counted income, deduction, depreciation loss, derived, income year, person, petroleum-related depreciable property.

EF 49 Base value in section EF 46 when property is petroleum-related depreciable property

When this section applies

(1) This section applies when the item is an item of petroleum-related depreciable property to which both the following apply:

(a) section EF 50 does not apply to it; and

(b) the person (person A) acquires it from an associated person.

Base value

(2) **Base value** is the lower of—

(a) the cost of the item to person A; and

(b) the total of the amounts described in subsections (3) and (4).

First amount for purposes of subsection (2)(b)

(3) The amount is the cost of the item to—

(a) the associated person, if the associated person did not acquire the item from either person A or another person associated with person A; or

(b) whoever owned the item, whether person A or the associated person, at the start of an unbroken chain of ownership made up of person A and one or more persons associated with person A.

Second amount for purposes of subsection (2)(b)

(4) The amount is all expenditure incurred for the item by person A and the associated person or associated persons before the date on which person A acquired the item.

Cost and expenditure

(5) In this section, cost and expenditure are qualified as follows:

(a) expenditure is excluded from them if it is expenditure for which a person has been allowed a deduction for an amount of depreciation loss they have had under any of sections EF 31 (2), EF 40 (2), and EF 41 (3):

(b) expenditure is not excluded from them if it is expenditure for which a person has been allowed a deduction for an amount of depreciation loss they have had under any other provision of this subpart:

(c) expenditure is excluded from them if it is expenditure for which a person is allowed a deduction under any other subpart:

(d) expenditure is excluded from them if it is expenditure for which a person would have been allowed a deduction under any other subpart if this Act had applied.

Origin:	(1) OB 1 'adjusted tax value' (a)(iv). (2) OB 1 'adjusted tax value' (a)(iv). (3) OB 1 'adjusted tax value' (a)(iv). (4) OB 1 'adjusted tax value' (a)(iv). (5) OB 1 'adjusted tax value' (a)(iv).
Defined terms:	amount, associated person, deduction, depreciation loss, person, petroleum-related depreciable property.

EF 50 Base value in section EF 46 when section 108 of Income Tax Act 1976 applies

When this section applies

(1) This section applies when both the following apply to the item:

(a) the person could have been allowed a depreciation deduction for it under section 108 of the Income Tax Act 1976 for the 1992-93 income year; and

(b) the person has owned it continuously since the 1992-93 income year.

Base value

(2) **Base value** is the amount at which the item was recorded in the person's accounts for taxation purposes for the 1992-93 income year.

Origin:	(1) OB 1 'adjusted tax value' (a)(ii). (2) OB 1 'adjusted tax value' (a)(ii).
Defined terms:	amount, income year, person.

EF 51 Total deductions in section EF 46

Total deductions

(1) **Total deductions** is the total, calculated as at a particular time, of—

(a) the amount described in subsection (2); and

(b) the amount described in subsection (3).

First amount for purposes of subsection (1)

(2) The amount is the amount that one or more of the following provisions has required to be subtracted from the item's adjusted tax value since the start of the 1993-94 income year:

(a) section EF 43 (2):

(b) the section EG 19 (5) that was in this Act immediately before the section was repealed by the Income Tax Amendment Act 2002:

(c) section 117 (5) of the Income Tax Act 1976.

Second amount for purposes of subsection (1)

(3) The amount is deductions for amounts of depreciation loss under this Act and depreciation deductions under the Income Tax Act 1976, calculated using the method described in subsection (4), that, in the period described in subsection (5),—

(a) the person was allowed for the item; or

(b) the person would have been allowed if they had used the item wholly in deriving counted income or carrying on a business for the purpose of deriving counted income.

Method

(4) The method is—

(a) the depreciation method that the person used in each relevant income year; or

(b) the diminishing value method, if the person did not make deductions for amounts of depreciation loss for the item under this Act.

Period

(5) The period ends with the end of the income year before the income year in which the particular time occurs, and starts with,—

(a) if section EF 47 applies to the item, the date on which the person acquired the item; or

(b) if section EF 48 applies to the item, the start of the month in the income year in which the person first had an amount of depreciation loss under this Act for the item or a depreciation deduction under section 108 of the Income Tax Act 1976 for the item; or

(c) if section EF 49 applies to the item, the date on which person A or the relevant associated person acquired the item; or

(d) if section EF 50 applies to the item, the end of the 1992-93 income year.

Origin:	(1) OB 1 ‘adjusted tax value’ (a)(i). (2) OB 1 ‘adjusted tax value’ (a)(i). (3) OB 1 ‘adjusted tax value’ (a)(i). (4) OB 1 ‘adjusted tax value’ (a)(i). (5) OB 1 ‘adjusted tax value’ (a)(i).
Defined terms:	adjusted tax value, amount, associated person, business, counted income, deduction, depreciation loss, depreciation method, derived, diminishing value method, income year, person.
Comment:	The reference in draft subsection (2) to the Income Tax Amendment Act 2002 is a reference to the Act that will implement the rewrite of Parts A to E.

Definitions

EF 52 Annual rate

Meaning

(1) **Annual rate** means the annual depreciation rate applying to an item of depreciable property that a person owns. The rate is one of the rates described in subsections (2) to (6).

1995-96 income year or later

(2) The rate is the rate set by section EF 26 (2)(a) or (b) if both the following apply to the item:

(a) the person acquires it in their 1995-96 income year or a later income year; and

(b) the item is not dealt with in any of subsections (3) to (6).

1995-96 income year or later: international aircraft

(3) The rate is the rate set by section EF 26 (2)(c) if the item is an international aircraft that the person acquires in their 1995-96 income year or a later income year.

Fixed life intangible property

(4) The rate is the rate set by section EF 27 if both the following apply to the item:

(a) the item is an item of fixed life intangible property; and

(b) the item is not an item of excluded depreciable property.

1994-95 income year

(5) The rate is the rate set by section EZ 8 (Annual rate for item acquired on or after 1 April 1993 and before end of person’s 1994-95 income year) if both the following apply to the item:

(a) the person acquired it before the end of their 1994-95 income year; and

(b) the item is not an item of fixed life intangible property; and

(c) the item is not an item of excluded depreciable property.

Excluded depreciable property

(6) The rate is the rate set by section EZ 10 (Annual rate for excluded depreciable property) if the item is an item of excluded depreciable property.

Origin:	(1) OB 1 ‘annual depreciation rate’. (2) OB 1 ‘annual depreciation rate’. (3) OB 1 ‘annual depreciation rate’.

	(4) OB 1 'annual depreciation rate'.
	(5) OB 1 'annual depreciation rate'.
	(6) OB 1 'annual depreciation rate'.
Defined terms:	depreciable property, excluded depreciable property, fixed life intangible property, income year, international aircraft, person.

EF 53 Depreciable intangible property

Meaning

(1) **Depreciable intangible property** means the property listed in schedule 17.

Criteria for listing in schedule 17

(2) For property to be listed in schedule 17, the criteria are as follows:

(a) it must be intangible; and

(b) it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.

Schedule 17 prevails

(3) Property that is listed in schedule 17 is depreciable intangible property even if the criteria are not met.

Origin:	(1) OB 1 'depreciable intangible property'.
	(2) OB 1 'depreciable intangible property'.
	(3) OB 1 'depreciable intangible property'.
Defined terms:	depreciable intangible property, property.
Comment:	Paragraph (b) of the current definition of 'depreciable intangible property' has not been replicated because it has not proved possible to predict accurately which items of intangible property fulfil the criterion of presenting a low risk of being used in tax avoidance schemes.

EF 54 Estimated useful life

Item of depreciable property (not copyright in sound recording)

(1) **Estimated useful life**, for an item of depreciable property, other than a copyright in a sound recording, means the period over which the item might reasonably be expected to be useful in deriving counted income or carrying on a business for the purpose of deriving counted income, taking into account—

(a) the passage of time, likely wear and tear, exhaustion, and obsolescence; and

(b) an assumption of normal and reasonable maintenance.

Copyright in sound recording

(2) **Estimated useful life**, for a copyright in a sound recording, means the period from the time at which the copyright might reasonably be expected to be first useful in deriving counted income until the end of

the income year in which it might reasonably be expected that 90% of all the income that will be derived from it has been derived.

Origin:	(1) OB 1 'estimated useful life'. (2) OB 1 'estimated useful life'.
Defined terms:	business, counted income, depreciable property, derived, estimated useful life, income year, sound recording.

EF 55 Excluded depreciable property

Meaning

(1) **Excluded depreciable property** means, for a person,—

(a) depreciable property for whose purchase or construction the person entered into a binding contract before 16 December 1991; or

(b) depreciable property that the person used or had available for use for any purpose whatever within New Zealand, other than as trading stock, before 1 April 1993; or

(c) depreciable property that is an intangible item that the person used or had available for use before 1 April 1993; or

(d) depreciable property that is or has been a qualifying item for the person; or

(e) depreciable property to the extent to which it is or has been a qualifying improvement for the person.

This subsection is overridden by subsection (2).

Exclusion

(2) **Excluded depreciable property** does not include property to which both the following apply:

(a) it existed at the end of the 1992-93 income year; and

(b) the Commissioner allowed it to be accounted for in that income year using the standard value method, the replacement value method, or the annual revaluation method.

Origin:	(1) OB 1 'excluded depreciable property'. (2) OB 1 'excluded depreciable property'.
Defined terms:	Commissioner, depreciable property, excluded depreciable property, income year, New Zealand, person, property, qualifying improvement, qualifying item, trading stock.

EF 56 Maximum pooling value

Meaning

(1) **Maximum pooling value**, for an item of depreciable property, means the greater of—

(a) $2,000; and

(b) the value set in a determination issued under section 91AA of the Tax Administration Act 1994 applying to the item.

Increase in amount

(2) The Governor-General may, by Order in Council, increase the amount specified in subsection (1)(a).

Origin:	(1) OB 1 ‘maximum pooling value’. (2) OB 1 ‘maximum pooling value’.
Defined terms:	amount, depreciable property, maximum pooling value.
Comment:	Draft section 91AA of the Tax Administration Act 1994 is in the consequential amendments in volume 3.

EF 57 Poolable property

Meaning

(1) **Poolable property**, for an income year, means an item of depreciable property that a person owns to which subsections (2) to (4) apply.

Not a building

(2) The item is not a building.

Maximum pooling value or globo method

(3) The item—

(a) is acquired in the income year for a cost equal to or less than its maximum pooling value; or

(b) was previously accounted for separately but has, as at the start of the income year, an adjusted tax value equal to or less than its maximum pooling value; or

(c) was accounted for at the end of the 1992-93 income year using, with the Commissioner’s permission, the globo accounting method.

Wholly used or subject to fringe benefit tax

(4) The item—

(a) is wholly used or available for use by the person in deriving counted income or carrying on a business for the purpose of deriving counted income; or

(b) is partly used or available for use by the person in deriving counted income or carrying on a business for the purpose of deriving counted income and is partly used in a way that is subject to fringe benefit tax.

Origin:	(1) OB 1 'poolable property'. (2) OB 1 'poolable property'. (3) OB 1 'poolable property'. (4) OB 1 'poolable property'.
Defined terms:	adjusted tax value, business, Commissioner, counted income, depreciable property, derived, fringe benefit tax, income year, maximum pooling value, person.

EF 58 Other definitions

In this Act,—

depreciation method means a method described in section EF 12

diminishing value method means the method of calculating an amount of depreciation loss for an item of depreciable property by subtracting, in each income year, a constant percentage of the item's adjusted tax value from the item's adjusted tax value

diminishing value rate means the rate that a person using the diminishing value method applies to an item of depreciable property

economic rate means the economic depreciation rate of an item of depreciable property, set under section EF 25

estimated residual market value means, for an item of depreciable property, its market value at the end of its estimated useful life, estimated reasonably as at the date of acquisition and based on an assumption of normal and reasonable maintenance over its estimated useful life

fixed life intangible property means property that—

(a) is depreciable intangible property; and

(b) has a legal life that could reasonably be expected, on the date of the property's acquisition, to be the same length as the property's remaining estimated useful life

improvement means an alteration, extension, or repair of an item of depreciable property that increases its capital value

international aircraft means a jet-engined aircraft that a person uses in an income year mainly in regular commercial service to transport passengers between New Zealand and any other place

legal life means the number of years, months, and days for which an owner's interest in an item of intangible property exists under the contract or statute that creates the owner's interest, assuming that the owner exercises any rights of renewal or extension that are either essentially unconditional or conditional on the payment of predetermined fees

petroleum-related depreciable property means depreciable property that is—

(a) petroleum drilling rigs; or

(b) support vessels for offshore petroleum drilling rigs; or

(c) support vessels for offshore petroleum production platforms

pool means items of depreciable property that a person chooses under section EF 12 to depreciate as a pool using the pool method

pool method means the method of calculating an amount of depreciation loss set out in section EF 21

provisional rate means a provisional rate as described in section EF 28

special rate means a special rate as described in section EF 28

straight-line method means the method of calculating an amount of depreciation loss for an item of depreciable property by subtracting, in each income year, a constant percentage of the item's cost, to its owner, from the item's adjusted tax value

straight-line rate means the rate that a person using the straight-line method applies to an item of depreciable property.

Origin:	OB 1 'basic economic depreciation rate', 'capital improvement', 'diminishing value method', 'estimated residual market value', 'fixed life intangible property', 'international aircraft', 'legal life', 'pool', 'pool method', 'schedule depreciable property', 'straight-line method'
Defined terms:	adjusted tax value, amount, depreciable intangible property, depreciable property, depreciation loss, depreciation method, diminishing value method, diminishing value rate, economic rate, estimated residual market value, estimated useful life, fixed life intangible property, improvement, income year, legal life, New Zealand, person, petroleum, pool, pool method, property, provisional rate, special rate, straight-line method, straight-line rate.

EG – Life insurance rules

Index

Index continued

Introductory provisions

EG 1 What this subpart applies to

This subpart applies to life insurance. Life insurance is defined in section EG 2.

Origin:	new.
Defined terms:	life insurance.

EG 2 'Life insurance' defined

Meaning

(1) **Life insurance** means insurance under which—

(a) person A (a life insurer) is liable to provide person B (a policyholder) with a benefit described in subsection (2); and

(b) the life insurer is entitled to receive consideration in return, either from the policyholder or from some other person.

Benefits

(2) The benefits are—

(a) a benefit whose payment is contingent on the death of 1 or more human beings, including an annuity whose term is contingent on human life; or

(b) a benefit whose payment is contingent on the survival of 1 or more human beings to a date, or an age, specified as part of the arrangement, including an annuity whose term is contingent on human life; or

(c) a benefit that is an annuity whose term is not contingent on human life, if the life insurer enters into the arrangement to provide the annuity as part of their business of providing life insurance.

Exclusion: death benefits provided under accident or medical insurance

(3) **Life insurance** does not include accident or medical insurance under which—

(a) one or more benefits are payable for the death of the insured; and

(b) all the benefits referred to in paragraph (a) are either—

(i) payable incidentally to the provision of accident or medical benefits; or

(ii) payable if the death is caused by a specified cause named in the policy.

Exclusion: death benefits provided by superannuation funds

(4) **Life insurance** does not include an arrangement in which—

(a) a superannuation fund is liable to pay, as a benefit to a beneficiary of the fund, a lump sum on—

(i) the death of 1 or more human beings specified in the trust deed; or

(ii) the survival of 1 or more human beings specified in the trust deed to a date, or an age, specified in the trust deed; and

(b) the lump sum is made up of—

(i) superannuation contributions made by or for the beneficiary; and

(ii) allocated investment earnings attributable to contributions made by or for the beneficiary; and

(iii) any other allocation from the profits of the superannuation fund attributable to contributions made by or for the beneficiary.

Life insurance policy

(5) **Life insurance policy** means a policy to the extent to which it states the terms of the life insurance that the life insurer and the policyholder have entered into.

Origin:	(1) OB 1 'life insurance'. (2) CM 2; OB 1 'life insurance'. (3) OB 1 'life insurance'. (4) OB 1 'life insurance'. (5) new.
Defined terms:	arrangement, business, life insurance, life insurance policy, life insurer, pay, payment, person, policyholder, superannuation contribution, superannuation fund.

EG 3 'Life insurer' defined

Meaning

(1) **Life insurer** means a person carrying on a business of providing life insurance.

Exclusion

(2) A person carrying on a business of providing life insurance is treated as not carrying on a business of providing life insurance while the person has full reinsurance.

Inclusion

(3) An association of persons, a body of persons, or a trustee is treated as carrying on a business of providing life insurance to the extent to which—

(a) the association, body, or trustee provides life insurance; and

(b) the consideration for the provision is something other than natural love and affection.

Parties to policies treated as being unrelated

(4) Every life insurance policy entered into by the association, body, or trustee as insurer is treated as entered into with an unrelated party, even if the life insurer and the policyholder are, for example,—

(a) an association and a member of the association; or

(b) a trustee and a beneficiary of the trust.

Section HF 1 does not apply

(5) Section HF 1 (Profits of mutual associations in respect of transactions with members) does not apply to the business of providing life insurance of the association, body, or trustee.

Origin:	(1) OB 1 'life insurer'. (2) OB 1 'life insurer'. (3) CM 14. (4) CM 14. (5) CM 14.
Defined terms:	business, full reinsurance, life insurance, life insurance policy, life insurer, person, policyholder, trustee.

EG 4 'Life reinsurance' defined

Meaning

(1) **Life reinsurance** means insurance provided to a life insurer by another person (person C), under which person C—

(a) relieves the life insurer, fully or partially, from the life insurer's liability under a life insurance policy; or

(b) secures the life insurer, fully or partially, against the life insurer's liability under a life insurance policy.

Full reinsurance

(2) The life insurer has full reinsurance if all the following apply:

(a) the life insurer holds a life reinsurance policy or policies covering every life insurance policy under which they have liability; and

(b) the life insurer is fully relieved from liability or fully secured against liability by the life reinsurance policy or policies; and

(c) the life insurer offered or was offered or entered into the life insurance policy or policies covered by the life reinsurance policy or policies,—

(i) in the case of a life insurer resident in New Zealand, as part of their business of providing life insurance; or

(ii) in the case of a life insurer not resident in New Zealand, as part of their New Zealand business; and

(d) the life insurer offered or was offered or entered into the life reinsurance policy or policies in New Zealand.

Partial reinsurance

(3) The life insurer has partial reinsurance if all the following apply:

(a) the life insurer—

(i) holds a life reinsurance policy or policies fully relieving them from liability or fully securing them against liability for one or some, but not all, of the life insurance policies under which they have liability; or

(ii) holds a life reinsurance policy or policies for all the life insurance policies under which they have liability but only partially relieving them from liability or partly securing them against liability; and

(b) the life insurer offered or was offered or entered into the life insurance policy or policies covered by the life reinsurance policy or policies,—

(i) in the case of a life insurer resident in New Zealand, as part of their business of providing life insurance; or

(ii) in the case of a life insurer not resident in New Zealand, as part of their New Zealand business; and

(c) the life insurer offered or was offered or entered into the life reinsurance policy or policies in New Zealand.

Life reinsurer

(4) **Life reinsurer** means a person in the position of person C.

Life reinsurance policy

(5) **Life reinsurance policy** means a policy to the extent to which it states the terms of the insurance that the life insurer and the life reinsurer have entered into.

Origin:	(1) new. (2) CM 12. (3) new. (4) new. (5) new.
Defined terms:	business, full reinsurance, life insurance, life insurance policy, life insurer, life reinsurance, life reinsurance policy, life reinsurer, New Zealand business, offered or entered into in New Zealand, partial reinsurance, person, resident in New Zealand.

EG 5 Life insurance and life reinsurance: how sections relate

Life insurance definitions

(1) Sections EG 2 and EG 3 define terms relating to life insurance.

Life reinsurance definitions

(2) Section EG 4 defines terms relating to life reinsurance.

Life insurance term usually includes life reinsurance term

(3) A reference in this Act to any of the terms defined in sections EG 2 and EG 3 includes the equivalent term in section EG 4 – for example, **life insurer** includes **life reinsurer** – unless the provision in which the term is used indicates otherwise.

Origin:	(1) new. (2) new. (3) new.
Defined terms:	life insurance, life insurer, life reinsurance, life reinsurer.
Comment:	Draft subsection (3) is intended to ensure that the Act addresses retrocessionary arrangements.

EG 6 'Actuarial reserves' defined

Meaning

(1) **Actuarial reserves** means a life insurer's reserves as calculated under section EG 7.

Link between actuarial reserves and life insurer

(2) Actuarial reserves, for a life insurer at any time, means the life insurer's actuarial reserves at that time.

Origin:	(1) CM 8(1). (2) CM 8(1).
Defined terms:	actuarial reserves, life insurer.

EG 7 Actuarial reserves: calculation

Calculation by actuary

(1) The life insurer's actuarial reserves must be calculated by an actuary.

All reserves or 1 or more amounts

(2) The actuary may calculate either—

(a) the actuarial reserves for all the life insurance policies for which the life insurer is the insurer; or

(b) the amount in the life insurer's actuarial reserves for 1 or more life insurance policies for which the life insurer is the insurer.

Interest, mortality, and other assumptions and bases of calculation

(3) The actuary must do the calculation using interest, mortality, and other assumptions and bases of calculation that—

(a) are based on the same principles as those used in the actuarial advice on which the following are calculated:

(i) the level of surplus funds available for allotment or payment, by a life insurer, to shareholders or policyholders; or

(ii) the level of surplus funds available for allotment, by a superannuation scheme, to other objects of the scheme; and

(b) are likely to produce a reasonable estimation of the future experience of life insurance policies of which the life insurer is the insurer, having regard to the past experience of life insurance policies of which the life insurer was the insurer; and

(c) conform with commercially acceptable practice.

Reserves for policy never negative

(4) The amount in the actuarial reserves for a life insurance policy must never be negative.

Reserves for all policies never less than total of surrender values

(5) The actuarial reserves must never be less than the total of the surrender values of all the life insurance policies they cover.

Reserves for policies same at end of one, and start of next, income year

(6) The amount in the actuarial reserves for life insurance policies at the start of an income year is the same as the amount in the actuarial reserves for the life insurance policies at the end of the previous income year.

Effect of partial reinsurance

(7) The actuarial reserves of a life insurer who has partial reinsurance must be reduced by an amount that the actuary responsible for actuarial control of the life insurer considers appropriate having regard to the nature of the life reinsurance policies.

Origin:	(1) CM 8(1). (2) CM 8(1). (3) CM 8(1). (4) CM 8(2)(a)(i). (5) CM 8(2)(a)(ii). (6) CM 8(2)(b). (7) CM 13(1)(d).

Defined terms:	actuarial reserves, actuary, amount, income year, life insurance policy, life insurer, life reinsurance policy, partial reinsurance, payment, shareholder, superannuation scheme.

EG 8 Actuarial reserves: actuary's declaration

Content

(1) The actuary responsible for actuarial control of a life insurer must provide, with the life insurer's return of income, a declaration that—

(a) states that the actuary is the actuary responsible for actuarial control of the life insurer; and

(b) states the specific interest, mortality, and other assumptions and bases of calculation applied in calculating the life insurer's premium loading, mortality profit, discontinuance profit, and policyholder income or policyholder net loss for the income year of the return; and

(c) states that the assumptions and bases of calculation comply with section EG 7.

Form

(2) The declaration must be in the form, if any, required by the Commissioner.

Origin:	(1) CM 8(2)(c). (2) CM 8(2)(c).
Defined terms:	actuarial reserves, actuary, Commissioner, discontinuance profit, income year, life insurer, mortality profit, policyholder income, policyholder net loss, premium loading, return of income.

EG 9 Actuarial reserves: powers of Commissioner

Seek advice from Government Actuary or other actuary

(1) The Commissioner may seek the advice of the Government Actuary or any other actuary on the interest, mortality, and other assumptions and bases of calculation used by the actuary who did the calculation under section EG 7 (3).

Assess on different basis

(2) Whether or not the Commissioner seeks or obtains any such advice, the Commissioner may make assessments of the taxable income and the income tax liability of a life insurer in a tax year, or the terminal tax payable by a life insurer in a tax year, on the basis of interest, mortality, and other assumptions and bases of calculation different from those used by the actuary who did the calculation under section EG 7 (3).

Origin:	(1) CM 8(3). (2) CM 8(3).
Defined terms:	actuarial reserves, actuary, Commissioner, income tax liability, life insurer, tax year, taxable income, terminal tax.

EG 10 'Claim' defined

'Claim' in life insurance rules

(1) The definition of **claim** in this section applies in the life insurance rules, except when the word 'claim' is used in the expression 'claim arising'.

Meaning

(2) **Claim** means the amount that a life insurer is liable to pay under a life insurance policy, as described in subsections (3) to (6).

Amount may be zero

(3) The amount that a life insurer is liable to pay may be zero.

Includes provision of cash and non-cash benefits

(4) The amount that a life insurer is liable to pay includes a benefit to be provided otherwise than in cash, as well as, for example,—

(a) a payment on the death of a life insured:

(b) a payment on maturity:

(c) a payment of a cash bonus:

(d) a payment on the surrender of a policy:

(e) an annuity payment.

Does not include advance or amount in actuarial reserves

(5) The amount that a life insurer is liable to pay does not include—

(a) an advance against the security of the policy; or

(b) a bonus or other discretionary amount added to a policy.

Means amount before certain deductions

(6) The amount that a life insurer is liable to pay means the amount before the subtraction of the following amounts payable to the life insurer:

(a) an advance against the security of the policy; and

(b) an unpaid premium for the policy; and

(c) interest on an amount referred to in paragraph (a) or paragraph (b).

Origin:	(1) new. (2) new. (3) OB 1 'claim'. (4) OB 1 'claim'. (5) OB 1 'claim'. (6) OB 1 'claim'.

Defined terms:	actuarial reserves, amount, claim, deduction, life insurance policy, life insurance rules, life insured, life insurer, pay, payment, premium.
Comment:	Draft section EG 10 (4)(b) uses the same language as draft section DR 3 (1)(c) (Specific deductions not allowed to life insurers and fully reinsured persons).

EG 11 Other matters

The matters to which this subpart relates are—

(a) life insurers' premium loading (sections EG 12 to EG 21):

(b) life insurers' mortality profit (sections EG 22 to EG 31):

(c) life insurers' discontinuance profit (sections EG 32 to EG 38):

(d) life insurers' policyholder income (sections EG 39 to EG 42):

(e) life insurers' income and deductions when disposing of property (sections EG 43 and EG 44):

(f) non-resident life insurers (sections EG 45 and EG 46).

Origin:	new.
Defined terms:	deduction, discontinuance profit, income, life insurer, mortality profit, non-resident, premium loading, property.

Premium loading

EG 12 How premium loading is worked out

Life insurer providing life insurance at start of income year

(1) Section EG 13 sets out the steps that a life insurer follows to work out the life insurer's premium loading for an income year if the life insurer is in the business of providing life insurance at the start of the income year.

Life insurer not providing life insurance at start of income year

(2) Section EG 14 sets out the steps that a life insurer follows to work out the life insurer's premium loading for an income year if the life insurer has started the business of providing life insurance in the income year.

Premium loading formula (life)

(3) Section EG 15 (1) sets out the premium loading formula (life). This is the formula a life insurer applies, as the first step in working out the life insurer's premium loading for an income year, to a life insured under a life insurance policy, except to the extent to which an annuity is being paid under the policy at some time in the income year.

Premium loading formula (active annuities)

(4) Section EG 15 (2) sets out the premium loading formula (active annuities). This is the formula a life insurer applies, as the first step in working out the life insurer's premium loading for an income year, to a

life insured under a life insurance policy, to the extent to which an annuity is being paid under the policy at some time in the income year.

Origin:	(1) CM 6(1). (2) CM 6(1), (3). (3) CM 6(1)(a). (4) CM 6(1)(b).
Defined terms:	business, income year, life insurance, life insurance policy, life insured, life insurer, pay, premium loading, premium loading formula.

EG 13 When life insurers providing life insurance at start of income year

Working out premium loading

(1) If a life insurer is in the business of providing life insurance at the start of an income year, the life insurer works out their premium loading for the income year by following the steps in subsection (2).

Steps

(2) The steps are,—

(a) first, apply the relevant premium loading formula to calculate an amount for each life insured under each life insurance policy existing at the start of the income year:

(b) second, for each such life insurance policy, add together the amounts for the lives insured under it:

(c) third, add together the totals reached under paragraph (b).

Origin:	(1) CM 6(1). (2) CM 6(1).
Defined terms:	amount, business, income year, life insurance, life insurance policy, life insured, life insurer, premium loading, premium loading formula.

EG 14 When life insurers not providing life insurance at start of income year

Working out premium loading

(1) If a life insurer has started to carry on a business of providing life insurance in an income year, the life insurer works out the life insurer’s premium loading for the income year by following the steps in subsection (2).

Steps

(2) The steps are,—

(a) first, apply the relevant premium loading formula, adjusted as described in section EG 16, to calculate an amount for each life insured under each life insurance policy existing at some time in the income year:

(b) second, for each such life insurance policy, add together the amounts for the lives insured under it:

(c) third, add together the totals reached under paragraph (b).

Origin:	(1) CM 6(3). (2) CM 6(3).
Defined terms:	amount, business, income year, life insurance, life insurance policy, life insured, life insurer, premium loading, premium loading formula.

EG 15 Premium loading formulas

Premium loading formula (life)

(1) The premium loading formula (life) is—

$$0.2 \times \text{claim probability} \times (\text{opening sum assured} - \text{opening actuarial reserves}).$$

Premium loading formula (active annuities)

(2) The premium loading formula (active annuities) is—

$$0.01 \times \text{claim probability} \times \text{opening actuarial reserves}.$$

Definition of items in formulas

(3) The items in the formulas are defined in subsections (4) to (6).

Claim probability

(4) **Claim probability** is the probability of a claim arising under the policy for the life insured's death in the income year. It is determined at the start of the income year using the same mortality assumptions as are used to calculate the life insurer's actuarial reserves for the income year. It is expressed as a decimal. Adjustments to **claim probability** are in sections EG 16 (2) and EG 17 (2).

Opening sum assured

(5) **Opening sum assured** is the claim that would be payable under the policy for the life insured's death in the income year, and is payable only for death, or, if no such claim would be payable, the claim that would be payable under the policy for the life insured's survival to the relevant date or age specified in the policy. It is determined at the start of the income year. It may be zero. Adjustments to **opening sum assured** are in sections EG 16 (3), EG 18 (2), EG 19 (3), and EG 20 (2).

Opening actuarial reserves

(6) **Opening actuarial reserves** is the amount in the life insurer's actuarial reserves for the life insured under the policy. It is determined at the start of the income year. An adjustment to **opening actuarial reserves** is in section EG 16 (4).

Origin:	(1) CM 6(1). (2) CM 6(1). (3) CM 6(1). (4) CM 6(1). (5) CM 6(1). (6) CM 6(1).
Defined terms:	actuarial reserves, amount, claim, income year, life insured, life insurer, pay, premium loading formula.
Comment:	The definition of 'opening sum assured' in draft subsection (5) contains the phrase 'and is payable only for death' but the definition of 'opening sum assured' in draft section EG 25 (4) does not. The difference replicates current law – compare item s0 in current section CM 6 (1), which contains the word 'only', with item s0 in current section CM 5 (1), which does not. The question arises as to whether it is necessary to preserve this difference.

EG 16 Premium loading formulas: when life insurer not providing life insurance at start of income year

When this section applies

(1) This section applies when a life insurer has started to carry on a business of providing life insurance in an income year.

Claim probability

(2) In applying the relevant premium loading formula, the life insurer treats the reference in **claim probability** to the start of the income year as a reference to the date on which the life insurer and the policyholder enter into the life insurance policy.

Opening sum assured

(3) In applying the premium loading formula (life), the life insurer treats the reference in **opening sum assured** to the start of the income year as a reference to the date on which the life insurer and the policyholder enter into the life insurance policy.

Opening actuarial reserves

(4) In applying the relevant premium loading formula, the life insurer treats the reference in **opening actuarial reserves** to the start of the income year as a reference to the end of the income year.

Origin:	(1) CM 6(3). (2) CM 6(3). (3) CM 6(3). (4) CM 6(3).
Defined terms:	actuarial reserves, business, claim, income year, life insurance, life insurance policy, life insurer, policyholder, premium loading formula.

EG 17 Premium loading formulas: option when more than one life insured

When this section applies

(1) This section applies when a life insurance policy covers more than one life insured.

Claim probability

(2) In applying the relevant premium loading formula, the life insurer may use as **claim probability** a common factor for all the lives insured under the policy.

Features of common factor

(3) The common factor must be a reasonable approximation of the average probability of a claim arising under the policy for each life insured's death in the income year. It must be weighted as necessary to take account of—

(a) differing claims for individual lives insured under the policy; and

(b) differing amounts in the life insurer's actuarial reserves for individual lives insured under the policy.

Origin:	(1) CM 6(2). (2) CM 6(2). (3) CM 6(2).
Defined terms:	actuarial reserves, amount, claim, income year, life insurance policy, life insured, life insurer, premium loading formula.

EG 18 Premium loading formula (life): when annuity payable on death

When this section applies

(1) This section applies when, and to the extent to which, a life insurance policy provides for the payment of an annuity the start of which is contingent on the life insured's death.

Opening sum assured

(2) In applying the premium loading formula (life), the life insurer uses as **opening sum assured** the net present value of the annuity. The net present value is determined—

(a) at the start of the income year; and

(b) on the assumption that the life insured died at the start of the income year; and

(c) using the same assumptions and bases of calculation as are used to calculate the life insurer's actuarial reserves for the income year.

Origin:	(1) CM 6(4). (2) CM 6(4).
Defined terms:	actuarial reserves, income year, life insurance policy, life insured, life insurer, payment, premium loading formula.

EG 19 Premium loading formulas: when annuity payable on survival to date or age specified in policy

When this section applies

(1) This section applies when, and to the extent to which, a life insurance policy provides for the payment of an annuity the start of which is contingent on the life insured's survival to the relevant date or age specified in the policy.

Claim probability

(2) In applying the relevant premium loading formula, the life insurer must use **claim probability** as defined in section EG 15 (4), without regard to the fact that the payment of the annuity is not contingent on the life insured's death.

Opening sum assured

(3) In applying the premium loading formula (life), the life insurer must use as **opening sum assured** the net present value of the annuity. The net present value is determined—

- (a) at the relevant date or age specified in the policy; and
- (b) on the assumption that the life insured survived to the date or age; and
- (c) using the same assumptions and bases of calculation as are used to calculate the life insurer's actuarial reserves for the income year.

Origin:	(1) CM 6(5). (2) CM 6(5)(a). (3) CM 6(5)(b).
Defined terms:	actuarial reserves, claim, income year, life insurance policy, life insured, life insurer, pay, payment, premium loading formula.

EG 20 Premium loading formula (life): when partial reinsurance exists

When this section applies

(1) This section applies when a life insurer has partial reinsurance.

Opening sum assured

(2) In applying the premium loading formula (life), the life insurer must reduce **opening sum assured** by the claim receivable by the life insurer under the life reinsurance policy for the contingency that the life insurance policy covers the life insured for.

Origin:	(1) CM 13(1)(a), (b). (2) CM 13(1)(a), (b).
Defined terms:	claim, life insurance policy, life insured, life insurer, life reinsurance policy, partial reinsurance, premium loading formula.

EG 21 Premium loading formulas: individual result may never be negative

If a life insurer gets a negative result from applying a premium loading formula to a life insured under a life insurance policy for an income year, the result is treated as zero.

Origin:	CM 6(6).
Defined terms:	income year, life insurance policy, life insured, life insurer, premium loading formula.

Mortality profit

EG 22 How mortality profit is worked out

Life insurer providing life insurance at start of income year

(1) Section EG 23 sets out the steps that a life insurer follows to work out their mortality profit for an income year if they are in the business of providing life insurance at the start of the income year.

Life insurer not providing life insurance at start of income year

(2) Section EG 24 sets out the steps that a life insurer follows to work out their mortality profit for an income year if they have started the business of providing life insurance in the income year.

Mortality profit formula

(3) Section EG 25 sets out the mortality profit formula that a life insurer applies, as the first step in working out the life insurer's mortality profit for an income year, to a life insured under a life insurance policy.

Origin:	(1) CM 5(1). (2) CM 5(3). (3) CM 5(1).
Defined terms:	business, income year, life insurance, life insurance policy, life insured, life insurer, mortality profit, mortality profit formula.

EG 23 When life insurers providing life insurance at start of income year

Working out mortality profit

(1) If a life insurer is in the business of providing life insurance at the start of an income year, the life insurer works out the life insurer's mortality profit for the income year by following the steps in subsection (2).

Steps

(2) The steps are,—

(a) first, apply the mortality profit formula to calculate an amount for each life insured under each life insurance policy existing at the start of the income year:

(b) second, for each such life insurance policy, add together the amounts for the lives insured under it:

(c) third, add together the totals reached under paragraph (b):

(d) fourth, if the result is positive, take it as the mortality profit, (if the result is negative, sections EG 30 and EG 31 apply.)

Origin:	(1) CM 5(1). (2) CM 5(1).
Defined terms:	amount, business, income year, life insurance, life insurance policy, life insured, life insurer, mortality profit, mortality profit formula.

EG 24 When life insurers not providing life insurance at start of income year

Working out mortality profit

(1) If a life insurer has started to carry on a business of providing life insurance in an income year, the life insurer works out the life insurer's mortality profit for the income year by following the steps in subsection (2).

Steps

(2) The steps are,—

(a) first, apply the mortality profit formula, adjusted as described in section EG 26, to calculate an amount for each life insured under each life insurance policy existing at some time in the income year:

(b) second, for each such life insurance policy, add together the amounts for the lives insured under it:

(c) third, add together the totals reached under paragraph (b):

(d) fourth, if the result is positive, take it as the mortality profit, (if the result is negative, sections EG 30 and EG 31 apply.)

Origin:	(1) CM 5(3). (2) CM 5(3).
Defined terms:	amount, business, income year, life insurance, life insurance policy, life insured, life insurer, mortality profit, mortality profit formula.

EG 25 Mortality profit formula

Formula

(1) The mortality profit formula is—

claim probability x (opening sum assured – opening actuarial reserves) – (closing sum assured – opening actuarial reserves).

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (8).

Claim probability

(3) **Claim probability** is the probability of a claim arising under the policy for the life insured's death in the income year. It is determined at the start of the income year using the same mortality assumptions as are used to calculate the life insurer's actuarial reserves for the income year. It is expressed as a decimal. Adjustments to **claim probability** are in sections EG 26 (2) and EG 27 (2).

Opening sum assured

(4) **Opening sum assured** is the claim that would be payable under the policy for the life insured's death in the income year. It is determined at the start of the income year. It may be zero. Adjustments to **opening sum assured** are in sections EG 26 (3), EG 28 (2), and EG 29 (2).

Opening actuarial reserves

(5) **Opening actuarial reserves** is the amount in the life insurer's actuarial reserves for the life insured under the policy. It is determined at the start of the income year. An adjustment to **opening actuarial reserves** is in section EG 26 (4).

Closing sum assured if life insured dies in current income year

(6) If a life insured dies in the income year to which the formula is being applied, **closing sum assured** is the claim payable under the policy for the death. It may be zero. An adjustment to **closing sum assured** is in section EG 29 (3).

Closing sum assured if life insured dies in 1990-91 income year or year up to current income year

(7) If a life insured dies in the 1990-91 income year or a later income year before the income year to which the formula is being applied, and the claim has not already been included in **closing sum assured** for an income year, **closing sum assured** is the claim payable under the policy for the death. It may be zero. An adjustment to **closing sum assured** is in section EG 29 (3).

Closing sum assured if subsections (6) and (7) do not apply

(8) If subsections (6) and (7) do not apply, **closing sum assured** is the same as **opening actuarial reserves**.

Origin:	(1) CM 5(1). (2) CM 5(1). (3) CM 5(1). (4) CM 5(1). (5) CM 5(1). (6) CM 5(1). (7) CM 5(1). (8) CM 5(1).
Defined terms:	actuarial reserves, amount, claim, income year, life insured, life insurer, mortality profit formula, pay.

EG 26 Mortality profit formula: when life insurer not providing life insurance at start of income year

When this section applies

(1) This section applies when a life insurer has started to carry on a business of providing life insurance in an income year.

Claim probability

(2) In applying the mortality profit formula, the life insurer treats the reference in **claim probability** to the start of the income year as a reference to the date on which the life insurer and the policyholder enter into the life insurance policy.

Opening sum assured

(3) In applying the mortality profit formula, the life insurer treats the reference in **opening sum assured** to the start of the income year as a reference to the date on which the life insurer and the policyholder enter into the life insurance policy.

Opening actuarial reserves

(4) In applying the mortality profit formula, the life insurer treats the reference in **opening actuarial reserves** to the start of the income year as a reference to the end of the income year.

Origin:	(1) CM 5(3). (2) CM 5(3). (3) CM 5(3). (4) CM 5(3).
Defined terms:	actuarial reserves, business, claim, income year, life insurance, life insurance policy, life insurer, mortality profit formula, policyholder.

EG 27 Mortality profit formula: option when more than one life insured

When this section applies

(1) This section applies when a life insurance policy covers more than one life insured.

Claim probability

(2) In applying the mortality profit formula, the life insurer may use as **claim probability** a common factor for all the lives insured under the policy.

Features of common factor

(3) The common factor must be a reasonable approximation of the average probability of a claim arising under the policy for each life insured's death in the income year. It must be weighted as necessary to take account of—

(a) differing claims for individual lives insured under the policy; and

(b) differing amounts in the life insurer's actuarial reserves for individual lives insured under the policy.

Origin:	(1) CM 5(2). (2) CM 5(2). (3) CM 5(2).
Defined terms:	actuarial reserves, amount, claim, income year, life insurance policy, life insured, life insurer, mortality profit formula.

EG 28 Mortality profit formula: when annuity payable on death

When this section applies

(1) This section applies when, and to the extent to which, a life insurance policy provides for the payment of an annuity the start of which is contingent on the life insured's death.

Opening sum assured

(2) In applying the mortality profit formula, the life insurer uses as **opening sum assured** the net present value of the annuity. The net present value is determined—

(a) at the start of the income year; and

(b) on the assumption that the life insured died at the start of the income year; and

(c) using the same assumptions and bases of calculation as are used to calculate the life insurer's actuarial reserves for the income year.

Origin:	(1) CM 5(4). (2) CM 5(4).
Defined terms:	actuarial reserves, income year, life insurance policy, life insured, life insurer, mortality profit formula, pay, payment.

EG 29 Mortality profit formula: when partial reinsurance exists

When this section applies

(1) This section applies when a life insurer has partial reinsurance.

Opening sum assured

(2) In applying the mortality profit formula, the life insurer must reduce **opening sum assured** by the claim receivable by the life insurer under the life reinsurance policy for the contingency that the life insurance policy covers the life insured for.

Closing sum assured

(3) In applying the mortality profit formula, the life insurer must reduce **closing sum assured** by the claim receivable by the life insurer under the life reinsurance policy for the contingency that the life insurance policy covers the life insured for.

Origin:	(1) CM 13(1)(a). (2) CM 13(1)(a). (3) CM 13(1)(a).
Defined terms:	claim, life insurance policy, life insured, life insurer, life reinsurance policy, mortality profit formula, partial reinsurance.

EG 30 Mortality profit formula: individual result may be negative only in some cases

Rule: not negative

(1) If a life insurer gets a negative result from applying the mortality profit formula to a life insured under a life insurance policy for an income year, the result is treated as zero. However, a negative result is not treated as zero if one of the exceptions in subsections (2) to (4) applies.

Exception 1

(2) The first exception is when the life insured died in the income year.

Exception 2

(3) The second exception is when—

(a) the life insured died in the 1990-91 income year or a later income year before the income year to which the formula is being applied; and

(b) the claim has not already been included in **closing sum assured** for an income year.

Exception 3

(4) The third exception is when, and to the extent to which, the benefit under the policy is an annuity that is being paid at some time in the income year.

Origin:	(1) CM 5(5). (2) CM 5(5). (3) CM 5(5). (4) CM 5(5).
Defined terms:	claim, income year, life insurance policy, life insured, life insurer, mortality profit formula, pay.

EG 31 Mortality profit formula: negative result

When this section applies

(1) This section applies when a life insurer is allowed a deduction under section DR 1 (Mortality profit formula: negative result).

Amount

(2) The amount of the deduction is the negative result.

Allocation

(3) The life insurer is allowed the deduction for the income year.

Origin:	(1) DK 3A. (2) DK 3A. (3) new.
Defined terms:	amount, deduction, income year, life insurer.

Discontinuance profit

EG 32 How discontinuance profit is worked out

Life insurer providing life insurance at any time

(1) Section EG 33 sets out the steps that a life insurer follows to work out the life insurer's discontinuance profit for an income year.

Discontinuance profit formula (existing business)

(2) Section EG 34 sets out the discontinuance profit formula (existing business). This is the formula a life insurer applies, as the first step in working out the life insurer's discontinuance profit for an income year, to a life insurance policy to which both the following apply:

(a) it exists at the start of the income year; and

(b) it terminates, wholly or partly, in the income year in one of the following ways:

(i) it terminates for a reason other than the life insured's death or the life insured's survival to the relevant date or age specified in the policy; or

(ii) a claim is paid under it for a reason other than the life insured's death or the life insured's survival to the relevant date or age specified in the policy.

Discontinuance profit formula (new business)

(3) Section EG 35 sets out the discontinuance profit formula (new business). This is the formula a life insurer applies, as the first step in working out the life insurer's discontinuance profit for an income year, to a life insurance policy to which both the following apply:

(a) it does not exist at the start of the income year; and

(b) it terminates in the income year for a reason other than the life insured's death or the life insured's survival to the relevant date or age specified in the policy.

Origin:	(1) CM 7(1). (2) CM 7(1). (3) CM 7(1).
Defined terms:	business, claim, discontinuance profit, discontinuance profit formula, income year, life insurance policy, life insured, life insurer, pay.

EG 33 Discontinuance profit for income year

Working out discontinuance profit

(1) A life insurer works out the life insurer's discontinuance profit for an income year by following the steps in subsection (2).

Steps

(2) The steps are,—

(a) first, apply the relevant discontinuance profit formula to calculate an amount for each life insurance policy existing at some time in the income year:

(b) second, add all the amounts together.

Origin:	(1) CM 7(1). (2) CM 7(1).
Defined terms:	amount, discontinuance profit, discontinuance profit formula, income year, life insurance policy, life insurer.

EG 34 Discontinuance profit formula (existing business)

Formula

(1) The discontinuance profit formula (existing business) is—

$$\text{pre-termination actuarial reserves} - \text{post-termination actuarial reserves} - \text{surrender value.}$$

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (5).

Pre-termination actuarial reserves

(3) **Pre-termination actuarial reserves** is the amount in the life insurer's actuarial reserves for the life insurance policy, determined immediately before the policy terminates in one of the ways described in

section EG 32 (2)(b). It is calculated using the same assumptions and bases of calculation as were used at the start of the income year to calculate the amount in the life insurer's actuarial reserves for the policy.

Post-termination actuarial reserves

(4) **Post-termination actuarial reserves** is the amount in the life insurer's actuarial reserves for the life insurance policy, determined immediately after the policy terminates in one of the ways described in section EG 32 (2)(b) and having regard to the fact that it has terminated. It is calculated using the same assumptions and bases of calculation as were used at the start of the income year to calculate the amount in the life insurer's actuarial reserves for the policy.

Surrender value

(5) **Surrender value** is the claim payable by the life insurer on the termination of the policy in one of the ways described in section EG 32 (2)(b). It may be zero. An adjustment to **surrender value** is in section EG 36 (2).

Origin:	(1) CM 7(1)(a). (2) CM 7(1)(a). (3) CM 7(1)(a). (4) CM 7(1)(a). (5) CM 7(1)(a).
Defined terms:	actuarial reserves, amount, business, claim, discontinuance profit formula, income year, life insurance policy, life insurer, pay.

EG 35 Discontinuance profit formula (new business)

Formula

(1) The discontinuance profit formula (new business) is—

$$\text{premium} \; - \; \text{surrender value}.$$

Definition of items in formula

(2) The items in the formula are defined in subsections (3) and (4).

Premium

(3) **Premium** is all the premiums paid to the life insurer for the life insurance policy, including a premium due before, but paid after, it terminates. Section EG 37 (2) gives **premium** a different meaning for the purposes of that section.

Surrender value

(4) **Surrender value** is the claim payable by the life insurer when the life insurance policy terminates. It may be zero. An adjustment to **surrender value** is in section EG 37 (3).

Origin:	(1) CM 7(1)(b). (2) CM 7(1)(b). (3) CM 7(1)(b). (4) CM 7(1)(b).
Defined terms:	business, claim, discontinuance profit formula, life insurance policy, life insurer, pay, premium.

EG 36 Discontinuance profit formula (existing business): when partial reinsurance exists

When this section applies

(1) This section applies when a life insurer has partial reinsurance.

Surrender value

(2) In applying the discontinuance profit formula (existing business), the life insurer must reduce **surrender value** by the claim receivable by the life insurer under the life reinsurance policy for the termination of the life insurance policy in one of the ways described in section EG 32 (2)(b).

Origin:	(1) CM 13(1)(c). (2) CM 13(1)(c)(ii).
Defined terms:	business, claim, discontinuance profit formula, life insurance policy, life insurer, life reinsurance policy, partial reinsurance.

EG 37 Discontinuance profit formula (new business): when partial reinsurance exists

When this section applies

(1) This section applies when a life insurer has partial reinsurance.

Premium

(2) In applying the discontinuance profit formula (new business), the life insurer must use as **premium** the result of subtracting, from the total of the premiums receivable by the life insurer in the income year for the life insurance policy, the part covering the life insurance policy of the premiums payable by the life insurer in the income year for a life reinsurance policy or policies.

Surrender value

(3) In applying the discontinuance profit formula (new business), the life insurer must reduce **surrender value** by the claim receivable by the life insurer under the life reinsurance policy for the termination of the life insurance policy.

Origin:	(1) CM 13(1)(c). (2) CM 7(1); CM 13(1)(c)(i). (3) CM 13(1)(c)(ii).

Defined terms:	business, claim, discontinuance profit formula, income year, life insurance policy, life insurer, life reinsurance policy, partial reinsurance, premium.

EG 38 Discontinuance profit formulas: individual result may never be negative

If a life insurer gets a negative result from applying a discontinuance profit formula to a life insurance policy for an income year, the result is treated as zero.

Origin:	CM 7(2).
Defined terms:	discontinuance profit formula, income year, life insurance policy, life insurer.

Policyholder income

EG 39 How policyholder income is worked out

Section EG 40 sets out the policyholder income formula that a life insurer applies to each income year to work out the life insurer's policyholder income for the income year.

Origin:	CM 15(1).
Defined terms:	income year, life insurer, policyholder income, policyholder income formula.

EG 40 Policyholder income formula

Formula

(1) The policyholder income formula is—

$$\frac{\text{(claim + (closing actuarial reserves – opening actuarial reserves) – (premium – underwriting result)}}{\text{(1 – tax rate).}}$$

Definition of items in formula

(2) The items in the formula are defined in subsections (3) to (8).

Claim

(3) **Claim** is the total of—

(a) each claim that becomes due and payable in the income year; and

(b) each claim that became due and payable in a previous income year to the extent to which—

(i) the claim relates to a contingency that was met in the 1990-91 income year or a later income year before the income year to which the formula is being applied; and

(ii) the claim has not already been included in **claim** in an income year.

Closing actuarial reserves

(4) **Closing actuarial reserves** is the life insurer's actuarial reserves, determined at the end of the income year. An adjustment to **closing actuarial reserves** is in section EG 42 (2).

Opening actuarial reserves

(5) **Opening actuarial reserves** is the life insurer's actuarial reserves, determined at the start of the income year. An adjustment to **opening actuarial reserves** is in section EG 42 (3).

Premium

(6) **Premium** is all the premiums due and payable to the life insurer in the income year. **Premium** does not include a premium due and payable to the life insurer in a previous income year. An adjustment to **premium** is in section EG 41.

Underwriting result

(7) **Underwriting result** is the total of the following that the life insurer has in the income year:

(a) the premium loading; and

(b) the mortality profit; and

(c) the discontinuance profit.

Tax rate

(8) **Tax rate** is the rate of tax specified in schedule 1, part A, clause 1, expressed as a decimal.

Positive result

(9) A positive result from applying the policyholder income formula is policyholder income for the income year.

Negative result

(10) A negative result from applying the policyholder income formula is policyholder net loss for the income year, and is dealt with under section II 1 (Policyholder net losses) and section II 2 (Policyholder net loss for income year preceding 1990-91).

Origin:	(1) CM 15(1). (2) CM 15(1). (3) CM 15(1). (4) CM 15(1). (5) CM 15(1). (6) CM 15(1). (7) CM 15(1); OB 1 'underwriting result'. (8) CM 15(1). (9) CM 15(2). (10) CM 15(2), (4).

Defined terms:	actuarial reserves, claim, discontinuance profit, income year, life insurer, mortality profit, pay, policyholder income, policyholder income formula, policyholder net loss, premium, premium loading, tax.

EG 41 Policyholder income formula: when partial reinsurance exists

When this section applies

(1) This section applies when a life insurer has partial reinsurance.

Premium

(2) In applying the policyholder income formula, the life insurer must reduce **premium** by an amount calculated using the formula—

$$\text{reinsurance premium} - \text{reinsurance claim.}$$

Definition of items in formula

(3) The items in the formula are defined in subsections (4) and (5).

Reinsurance premium

(4) **Reinsurance premium** is the total of the premiums due and payable by the life insurer in the income year under the life reinsurance policies under which the life insurer has partial reinsurance. **Reinsurance premium** does not include premiums due and payable by the life insurer in previous income years.

Reinsurance claim

(5) **Reinsurance claim** is the total of the claims receivable by the life insurer in the income year under the life reinsurance policies under which the life insurer has partial reinsurance. **Reinsurance claim** does not include claims receivable by the life insurer in previous income years.

Origin:	(1) CM 17(1). (2) CM 17(1). (3) CM 17(1). (4) CM 17(1). (5) CM 17(1).
Defined terms:	amount, claim, income year, life insurer, life reinsurance policy, partial reinsurance, policyholder income formula, premium.

EG 42 Policyholder income formula: when life insurance business transferred

When this section applies

(1) This section applies when a life insurance business is transferred in a transfer to which all the following apply:

(a) the transferor and the transferee, whether or not resident in New Zealand, are members of the same wholly-owned group of companies immediately before and immediately after the transfer; and

(b) one of the following is met:

(i) if the transferor is resident in New Zealand, all the transferor's life insurance business is transferred to the transferee; or

(ii) if the transferor is not resident in New Zealand, all the life insurance policies offered or entered into in New Zealand that are held by the transferor are transferred to the transferee; and

(c) the Commissioner receives confirmation from the Government Actuary that—

(i) paragraph (b) is met; and

(ii) no policyholder will be unduly disadvantaged as a result of the transfer; and

(d) the Commissioner is satisfied that the transfer is being undertaken for commercial reasons and that no undue tax advantage to either the transferor or the transferee will arise as a result of the transfer.

Closing actuarial reserves

(2) In applying the policyholder income formula to the income year in which the transfer occurs, the transferor must use as **closing actuarial reserves** the transferor's actuarial reserves immediately before the transfer.

Opening actuarial reserves

(3) In applying the policyholder income formula to the income year in which the transfer occurs, the transferee must use as **opening actuarial reserves** the total of—

(a) the transferee's actuarial reserves, determined at the start of the income year; and

(b) the transferee's actuarial reserves for the business or policies transferred to the transferee, determined immediately after the transfer.

Origin:	(1) CM 18(2). (2) CM 18(1). (3) CM 18(1).
Defined terms:	actuarial reserves, business, Commissioner, income year, life insurance, life insurance policy, offered or entered into in New Zealand, policyholder, policyholder income formula, resident in New Zealand, wholly-owned group of companies.

Disposal of property

EG 43 Income from disposal of property

When this section applies

(1) This section applies when a life insurer disposes of any property of their life insurance business.

Property generally

(2) An amount that a life insurer derives from disposing of any property of their life insurance business is income of the life insurer under section CR 1(5) (Income of life insurer). However, if the property is a financial arrangement, subsections (3) to (5) apply instead of this subsection.

Financial arrangement: application of financial arrangements rules

(3) If the life insurer disposes of a financial arrangement to which the financial arrangements rules apply, subpart EH (Financial arrangements rules) applies.

Financial arrangement: application of old financial arrangements rules

(4) If the life insurer disposes of a financial arrangement to which the old financial arrangements rules apply, sections EZ 26 to EZ 46 apply.

Financial arrangement: before old financial arrangements rules

(5) If the life insurer receives an amount on or after 1 April 1982 as repayment or partial repayment of a financial arrangement to which the old financial arrangements rules would have applied if section EZ 38 (Application of old financial arrangements rules) had not existed, the amount is income of the life insurer.

Origin:	(1) CM 10. (2) CM 10. (3) CM 10. (4) CM 10. (5) CM 10. (5) CM 10.
Defined terms:	amount, business, derived, financial arrangement, financial arrangements rules, income, life insurance, life insurer, old financial arrangements rules, property.
Comment:	Sections EZ 26 to EZ 46 are current sections EH A1 to EH 18 and EZ 10. Sections EZ 26 to EZ 46 do not appear in the exposure draft but will appear in the Act implementing the rewritten Parts A to E.

EG 44 Deductions for disposal of property

When this section applies

(1) This section applies when a life insurer is allowed a deduction under section DR 2 (Disposal of property).

Amount of deduction

(2) The amount of the deduction is described in subsection (3), subsection (4), or subsection (5).

Most property

(3) The amount of the deduction is the property's acquisition value or cost, for property to which neither subsection (4) nor subsection (5) applies.

Land or buildings acquired before last day of 1989-90 income year

(4) The amount of the deduction is the market value of the property on the last day of the 1989-90 income year, for property to which both the following apply:

(a) the property is land or buildings acquired on or before the last day of the 1989-90 income year; and

(b) the profit from the property's disposal on or before the last day of the 1989-90 income year, had it been disposed of then at a profit, would have been a capital profit or gain and not a profit on disposal of an investment subject to income tax under section 204 of the Income Tax Act 1976 (as that section was immediately before its repeal and substitution by section 13 (1) of the Income Tax Amendment Act (No 2) 1990).

Property acquired on or before last day of 1982-83 income year

(5) The amount of the deduction is the specified base cost for 1983 income year property, for property to which both the following apply:

(a) the property was acquired on or before the last day of the 1982-83 income year; and

(b) subsection (4) does not apply to the property.

Allocation

(6) The life insurer is allowed the deduction in the income year in which they dispose of the property.

Origin:	(1) DK 3B(1). (2) DK 3B(1). (3) DK 3B(1)(b). (4) DK 3B(3).

	(5) DK 3B(1)(a).
	(6) DK 3B(1).
Defined terms:	amount, deduction, income tax, income year, life insurer, property, specified base cost for 1983 income year property.

Non-resident life insurers

EG 45 Non-resident life insurers with life insurance policies in New Zealand

When this section applies

(1) This section applies when a life insurer not resident in New Zealand offers or is offered or enters into life insurance policies in New Zealand.

Income derived from New Zealand

(2) The life insurer's income from the business of providing life insurance, as determined under this section, is income derived from New Zealand.

Underwriting income and policyholder income

(3) The life insurer applies the items of the premium loading formula, the mortality profit formula, the discontinuance profit formula, and the policyholder income formula only to—

(a) the life insurance policies the life insurer, as insurer, offered or was offered or entered into in New Zealand; and

(b) the life reinsurance policies held by the life insurer that relate exclusively to the life insurance policies the life insurer, as insurer, offered or was offered or entered into in New Zealand.

Other income

(4) The life insurer's income from the business of providing life insurance, other than under a formula referred to in subsection (3), is determined only in relation to the life insurer's New Zealand business.

Origin:	(1) CM 13(2); CM 16; CM 17(2); CN 3(1), (1A).
	(2) CN 3(1A).
	(3) CM 13(2); CM 16; CM 17(2); CN 3(1).
	(4) CM 13(2); CM 16; CM 17(2); CN 3(1), (1A).
Defined terms:	business, discontinuance profit formula, income derived from New Zealand, life insurance, life insurance policy, life insurer, mortality profit formula, New Zealand, New Zealand business, non-resident, offered or entered into in New Zealand, policyholder income formula, premium loading formula, resident in New Zealand.

EG 46 Non-resident life insurer may become resident

Non-resident life insurer may apply

(1) A life insurer not resident in New Zealand may apply to be treated for its New Zealand business as resident in New Zealand on and after the first day of a particular income year.

Application

(2) The life insurer applies by—

(a) completing a written application specifying the particular income year; and

(b) giving the application to the Commissioner not less than 20 working days before the start of the particular income year.

Commissioner may grant

(3) The Commissioner may grant the application.

Company resident in New Zealand

(4) If the application is granted, the life insurer's New Zealand business is treated, on and after the first day of the particular income year, as being carried on by a company resident in New Zealand in which the life insurer holds all the issued shares.

Life insurer agent for company

(5) The life insurer is treated as carrying on its New Zealand business as agent for the company and is liable, as agent for the company, to pay amounts payable to the Commissioner and to provide returns and other information required by the Commissioner.

Company and life insurer separate persons

(6) The life insurer and the company are treated as being separate persons in relation to the life insurer's New Zealand business.

Origin:	(1) OE 3(1). (2) OE 3(2). (3) OE 3(1). (4) OE 3(3)(a). (5) OE 3(3)(b). (6) OE 3(3)(c).
Defined terms:	agent, amount, Commissioner, company, income year, life insurer, New Zealand business, non-resident, person, resident in New Zealand, working day.