



## WEEKLY COMMENT: FRIDAY 28 NOVEMBER 2014

1. This week I continue looking at the amendments to the financial arrangements rules enacted in the *Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014*. Last week I looked at the amendments to the tax treatment of foreign ASAPs affecting IFRS taxpayers.
2. This week and next week I look at the new foreign ASAP rules for non-IFRS taxpayers. This week I look at the new foreign ASAP rules for non-IFRS taxpayers and the valuation rules when a foreign ASAP expressly includes interest. Next week I will look at the valuation rules for 12-month ASAPs and non-12-month ASAPs for non-IFRS taxpayers.
3. As noted last week, the new rules apply from the 2014-15 income year. Foreign ASAPs entered into before the 2014-15 income year remain subject to the old rules. Non-IFRS taxpayers can also apply the new rules retrospectively from the 2011-12 income year, providing their tax returns consistently reflect that treatment, as discussed in paragraph 22 onwards below.
4. As also noted last week, the new rules apply only to a “**foreign ASAP**”, defined in s. YA 1 as meaning a financial arrangement that is an agreement for the sale and purchase of property or services if, at the time the ASAP is entered into, 50% or more of the consideration in New Zealand dollars is in a foreign currency, measured using spot rates at that time.

### **Non-IFRS taxpayers**

5. The key change for non-IFRS taxpayers is that *Determination G29* is no longer to be used for foreign ASAPs. However, a footnote on page 80 of *Tax Information Bulletin* Vol. 26 No. 7 August 2014 (the “TIB item”) states that:

“After further analysis, it is considered that as currently drafted, the legislation does not give the intended result for cancelling the use of Determination G29 for new foreign currency ASAPs from the application dates. Legislative amendments are expected to be made in the next tax bill to achieve the intended result, with the application date for the amendments likely to be the same as the application dates for the new rules for foreign currency ASAPs.”
6. Page 83 of the TIB item contains a useful flowchart that summarises the line of reasoning to be adopted when applying the new rules to foreign ASAPs of non-IFRS taxpayers:
  - (a) If the foreign ASAP expressly includes interest, the property or services are to be valued in foreign currency using s. EW 32(2C);

- (b) If the foreign ASAP does not expressly include interest, but is a **12-month ASAP** as defined in s. YA 1, the property or services are to be valued in foreign currency using s. EW 32(2D);
- (c) For all other foreign ASAPs, the property or services are to be valued in foreign currency using s. EW 32(2E);
- (d) In all cases, the foreign currency values are to be converted into NZ dollars at spot rates using new s. EW 33C;
- (e) In all cases, gains or losses from non-IFRS designated FX hedges are to be included in the value of property or services if an election is made under s. EW 33B(2) and s. EW 33B(4);
- (f) In all cases, income and expenditure is to be spread using an applicable spreading method (in s. EW 16 to s. EW 22); however, there is no income or expenditure when s. EW 32(2E) applies.

### **General rule for valuing property or services that are the subject of a foreign ASAP**

- 7. As noted last week, s. EW 32 applies when an original party to an agreement for the sale and purchase of property or services, a hire purchase agreement, a specified option, or a finance lease pays or is paid consideration that includes property or services. The value of the property or services is determined by applying s. EW 32(2B) to EW 32(6) in numerical order until a subsection applies. The application of s. EW 32 is modified by sections EW 33B, EW 33C and EW 34.
- 8. Section EW 32(2B) applies to IFRS taxpayers, as discussed last week. The remaining subsections of s. EW 32 apply to non-IFRS taxpayers.

### **When property or services in foreign ASAPs are to be valued by non-IFRS taxpayers**

- 9. The point at which property or services relating to a foreign ASAP are to be valued is the **rights date**, which is defined in s. YA 1 as meaning, for an agreement for the sale and purchase of property or services, the date on which the first right in the property is transferred or the services are provided.
- 10. The “rights date” definition applies only to foreign ASAPs of non-IFRS taxpayers because:
  - (a) IFRS taxpayers will apply the IFRS recognition dates for property or services in foreign ASAPs; and
  - (b) Section EW 32 will continue to apply to all other agreements for the sale and purchase of property or services (non-foreign ASAPs) of non-IFRS, under which the “lowest price” is established by reference to the time the first “right” in the property is transferred.
- 11. “Right” is a defined term in s. YA 1 for the purpose of s. EW 32. The words “the date on which the first right in the property is transferred or the services are provided” in the new “rights date” definition are the same as the words used in s. EW 32(3) for determining the lowest price for non-foreign ASAPs. It is stated on page 80 of the TIB item that:

“It is intended that this is the same point at which the property or services would be valued under the old rules for foreign currency ASAPs and the ongoing rules for non-foreign currency ASAPs. For instance, if the first right in the property under the foreign currency ASAP was to possession, that would be the rights date under the new rules and the point at which the value was established under the old rules.”

### **Valuation when a foreign ASAP expressly includes interest**

12. New s. EW 32(2C) applies to a non-IFRS taxpayer when a foreign ASAP expressly includes interest. The value of the property or services is the value of the amounts paid or payable under the foreign ASAP for the property or services, but ignoring amounts that are expressly provided in the agreement as paid or payable on account of the future value, or the discounted value, or a combination of both the future and discounted values, on the rights date, of amounts paid or payable.
13. According to page 81 of the TIB item, the exclusion of “amounts that are expressly provided in the agreement as paid or payable on account of the future value, or the discounted value, or a combination of both the future and discounted values, on the rights date, of amounts paid or payable” is intended to apply to interest which has been agreed on a commercial basis where there are payments before or after the rights date. These amounts will be income or expenditure under foreign ASAPs and spread using an applicable spreading method.
14. Once the value of the property or services has been determined in foreign currency, s. EW 33C applies to translate amounts into NZ dollars (see paragraphs 15 to 17 below). After that s. EW 33B may then apply in relation to FX hedges if the non-IFRS taxpayer so elects (see paragraphs 18 to 21 below). It is noted on page 83 of the TIB item that:

“It is intended that amounts from non-IFRS designated FX hedges attributed to the value of property or services are attributed after the provisions of other sections are applied to arrive at the relevant values. Therefore s. EW 32(2C) (to determine the interest) and s. EW 33C (to convert foreign currency amounts into New Zealand dollars) are applied before amounts for non-IFRS designated FX hedges are attributed.”

### **Translation of foreign currency amounts into NZ dollars**

15. Section EW 33C applies when the consideration paid under a foreign ASAP by a non-IFRS taxpayer is in a foreign currency. The general rule in s. EW 33C(2) is that the spot rate, on the date an amount of consideration is paid or payable in foreign currency, must be used to convert the amount of consideration into New Zealand dollars.
16. Section EW 33C(3) provides two alternatives if no spot rate is available for an amount under the financial arrangement, because the amount is deferred into an income year after a person's current income year and that deferral is for a day after the person is required to file a return of income for the current income year. (This wording is presumably to allow for transitional years when balance dates are changed.) In that case, the person may use for the deferred amount:
  - (a) The spot rate at the end of the current income year; or
  - (b) The spot rate on the date an amount of consideration is paid or payable, if it is paid or payable within 93 days of the end of the current income year.
17. It is noted on page 82 of the TIB item that differences between the New Zealand dollar amounts converted using the alternative spot exchange rates allowed under s. EW 33C(3) and the NZ dollar amounts converted using the actual spot exchange rates on the dates of payment will be income or expenditure for the foreign ASAPs.

### **Inclusion of gains or losses from non-IFRS designated hedges**

18. Under s. EW 33B(2) and (4), the value of property or services relating to a foreign ASAP of a non-IFRS taxpayer, as determined under s. EW 32(2C), (2D) or (2E), is *modified by the amount that would otherwise be the base price adjustment for the relevant non-IFRS designated FX hedge* when:
- (a) The foreign ASAP relates to:
    - (i) Property that is or will be depreciable property or revenue account property; or
    - (ii) Services, the sale or purchase of which, as relevant for the person, gives rise to assessable income or deductions under this Act outside of the financial arrangements rules; and
  - (b) The person has made, at the time of filing a return of income for the income year in which they enter into the financial arrangement or at the time of filing a return of income for an earlier income year, an irrevocable election in writing to apply this section to all financial arrangements for property and services described in paragraph (a)(i) and (ii); and
  - (c) The person holds a “non-IFRS designated FX hedge” in relation to the foreign ASAP.
19. A **non-IFRS designated FX hedge** is defined in s. YA 1 as meaning a forward contract for the sale or purchase of foreign currency:
- (a) For which a person uses *Determination G14B: forward contracts for foreign exchange and commodities: an expected value approach* under the financial arrangements rules; and
  - (b) Entered into by the person after the start of the first income year for which an election described in s. EW 33B(2)(b) (see paragraph 18 above) applies; and
  - (c) Entered into by the person for the sole purpose of hedging the foreign exchange risk of a foreign ASAP for which s. EW 32(2C), (2D), or (2E) applies, and the person enters into the foreign ASAP after the start of the first income year for which an election described in s. EW 33B(2)(b) (see paragraph 18 above) applies.
20. Under s. EW 33B(5), amounts relating to an IFRS designated FX hedge that are attributed to the value of property or services under s. EW 33B are excluded from being taken into account when the financial arrangements rules (i.e. spreading method and base price adjustment) are applied to the hedge itself. This avoids double counting. It is noted on page 83 of the TIB item that:
- “The intention is to allow non-IFRS taxpayers to ignore spreading of income and expenditure on non-IFRS designated FX hedges. ...
- The elective hedging rules for non-IFRS taxpayers apply in a different manner to IFRS-designated hedging and all gains or losses on non-IFRS designated hedges are mandatorily included in the value of property or services. So where the overall gain or loss for a non-IFRS designated FX hedge is included in the value of property or services there is no income or expenditure to spread and the base price adjustment will be nil.”
21. As noted in paragraph 14 above, adjustments for FX hedges are undertaken last – i.e. after the values of property or services has been determined under the valuation provisions and after the foreign currency amounts determined under those valuation provisions have been converted into New Zealand dollars.

### **Retrospective application of the rules**

22. Section EZ 76 contains a “savings” positions for a person who does not use IFRSs to prepare financial statements and to report for financial arrangements, and:
- (a) Who has a financial arrangement that is a foreign ASAP for which the new rules in s. EW 32 apply to value the relevant property or services; and
  - (b) Who enters into the foreign ASAP before the end of the 2013–14 income year; and
  - (c) For the foreign ASAP, the person has filed returns of income in accordance with s. EZ 76 for the 2013–14 income year and every earlier income year.
23. Under s. EZ 76(2), the person may treat the amendments to s. EW 32 as applying to the financial arrangement for the 2013–14 income year and every earlier income year. Section EW 33B is excluded. Therefore, a non-IFRS taxpayer cannot retrospectively include amounts relating to non-IFRS designated hedges in the value of property or services. It is stated on page 85 of the TIB item that the exclusion of s. EW 33B means that returns filed in prior years for relevant foreign ASAPs based on spot exchange rates are confirmed.



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