
Perriam & Partners Ltd

Suggested Answers

1. Key Benefits

The key benefit for Ernie is getting access to a luxury yacht but with the cost of ownership defrayed through third party chartering custom.

Other potential benefits include:

- The recovery of GST in respect of the acquisition and operation of the yacht; and
- The deductibility for income tax purposes of expenditure associated with the yacht chartering operation.



“This could be you!!”

2. Recovery of GST

The key requirements for Ernie’s yacht chartering operation to recover GST costs associated with the purchase of the yacht and ongoing running costs will be:

- (a) The yacht chartering operation itself will need to constitute a taxable activity for GST purposes, and
- (b) The yacht will need to be acquired for the principal purpose of making GST taxable supplies.

3. Income tax deductibility

For Ernie to secure income tax deductibility of expenditure and depreciation on a charter yacht, the charter operations will need to constitute a “business” for income tax purposes.

The general permission section DA 1 (1) (b) allows a deduction for expenditure or loss incurred in the course of carrying on a business for the purpose of deriving assessable income.

“Business” is defined in section YA 1 to include:

“...any profession, trade, or undertaking carried on for profit.”

The starting point for determining whether a taxpayer is in business is the classic statement of the Court of Appeal in *Grieve v CIR* (1984) 6 NZTC 61,682 at 61,691, where Richardson J stated that:

“... the decision whether or not a taxpayer is in business involves a twofold enquiry – as to the nature of the activities carried on, and as to the intention of the taxpayer in engaging in those activities. Statements by the taxpayer as to his intentions are of course relevant but actions will often speak louder than words. Amongst the matters which may properly be considered in that enquiry are the nature of that activity, the period over which it is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity, and the financial results.”

And further:

“Businesses do not cease to be businesses because they are carried on idiosyncratically or inefficiently or unprofitably or because the taxpayer derives personal satisfaction from the venture”.

In determining what “profit” must have been intended by the taxpayer it is evident from Grieve that the starting point for determining profit must be ordinary commercial principles although it may be possible to take into account various tax concessions and incentives in properly assessing the overall financial viability of the venture.

In practical terms there are a number of features which would need to be present in relation to any chartering business:

- A credible budget prepared at the time of commencement of the business or earlier which demonstrates accounting profits will be federated over time. This would need to be regularly reviewed and updated as circumstances change.
- Derivation of third party charter income, preferably via the agency of a third party charter.
- The engagement of a skipper and crew where necessary as well as staff or contractors to deal with the administrative and operational aspects of the business.
- Charging of all users (particularly associates) at market rates determined on a commercial basis.
- The acquisition of all licences, consents, insurance, operational capability, safety requirements etc required to run the venture commercially.
- A clear programme of advertising and promotion to secure profitable third party custom.
- Clear availability of the assets for use in deriving third party charter income.

SUMMARY

From this you should be able to pretty much reach your own conclusion as to Ernie’s Charter Venture. Please do not hesitate to contact our office if you would like to discuss any of these points or whether you have your own venture waiting in the wings.