Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill

Commentary on the Bill

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Making Tax Simpler – Employment and investment income information

OVERVIEW

The Government is modernising New Zealand's tax administration system through business process and technology change to make it simpler and more certain for New Zealanders, and to reduce administrative costs (known as Inland Revenue's business transformation programme). A major part of the changes revolves around more efficient provision of information to Inland Revenue.

This Bill contains two sets of proposals which have been the subject of recent public consultation:

- *Making tax simpler: Better administration of PAYE and GST*, which sought feedback on changes to improve the administration of PAYE and GST released in November 2015
- *Making tax simpler: Investment income information,* which sought feedback on changes to improve the administration of investment income information released in July 2016

Public feedback on these proposals was generally supportive and public submissions have helped shape the final proposals contained in this Bill.

Improving the administration of PAYE is an integral part of this reform. Employing staff can add significant compliance costs to a business or not-for-profit organisation.

Increasingly employers are using software to help them run their organisations. This Bill therefore proposes changes to take advantage of modern digital systems to reduce the compliance and administrative costs associated with the PAYE process by making meeting tax obligations part of the process of paying employees rather than a separate and additional activity. Employers using payroll software will be able to report information to Inland Revenue from within their payroll software. Those who choose not to use software will be able to report their employment income information through Inland Revenue's secure online services or, if they fall below the electronic filing threshold, on paper. The key changes in the Bill relating to PAYE are:

- Record keeping (PAYE): consolidating requirements on employers
- Payday provision of employment income information
- Employment income information and threshold amendments to the Income Tax Act 2007
- Tax codes: clarifying the circumstances in which the no notification deduction rate applies
- Consequential changes to employer reporting of employee share scheme benefit information
- Penalties: amendments to retain late filing and non-electronic filing penalties as monthly penalties

- Transitional provisions: to enable voluntary payday reporting from 1 April 2018
- Repealing the subsidy for listed PAYE intermediaries

The proposals aim to make it easier to get an employee's pay right and to quickly address issues, such as using the wrong tax code. The result would be lower compliance costs for employers and improved accuracy of deductions for employees.

The changes will also create opportunities to improve the future administration of social policy, such as child support, KiwiSaver, Working for Families and student loans.

One such improvement may involve shortening the annual period over which some social policies are currently assessed to better match periods of assistance with need.

Because of the more widespread use of electronic services and diversity of payroll products and services that are now available the Government has also decided to repeal the payroll subsidy from 1 April 2018.

The Bill also proposes to consolidate and more logically structure the administrative requirements relating to employment income information in the Tax Administration Act 1994. To achieve this some amendments are proposed to the Income Tax Act 2007 and the introduction of a number of new subparts and schedules is proposed in the Tax Administration Act 1994 as is the shifting of a number of sections within that Act to more appropriate locations.

The second set of proposals relate to the provision of investment income information. Investment income refers to interest, dividends, portfolio investment entity (PIE) income, taxable Māori authority distributions and royalties.

The proposed amendments aim to reduce compliance costs for recipients of investment income and administrative costs for Government, while improving the administration of investment income to ensure that taxpayers' tax obligations and social policy entitlements and obligations are calculated more accurately during the year.

Inland Revenue currently receives limited and infrequent information about the investment income that taxpayers earn and the tax withheld or paid on that income. For interest subject to resident withholding tax (RWT) or non-resident withholding tax (NRWT) and portfolio investment entity (PIE) income, Inland Revenue only receives information about the income taxpayers earned and the tax deducted from that income after the end of the tax year. For dividends, Māori authority distributions and interest income that is exempt from RWT or subject to the approved issuer levy (AIL), Inland Revenue only receives information about the amounts received by recipients when it is specifically requested.

The key changes relate to the following:

- obtaining more frequent and detailed information for interest, dividends and Māori authority distributions;

- bringing forward the due date when PIEs are required to provide information to Inland Revenue;
- encouraging the provision of IRD numbers;
- increasing electronic filing;
- improving the administration of RWT exempt-status (certificates of exemption);
- removing some requirements to provide end-of-year withholding tax certificates; and
- improving error correction.

EMPLOYMENT INCOME INFORMATION

Background

PAYE is a withholding tax mechanism used by New Zealand employers (and PAYE intermediaries) to deduct income tax and the ACC earners' levy from employees' salaries, wages and as appropriate, from schedular payments, and pay it directly to Inland Revenue. The PAYE system is also used to collect payments and information for many income-related social policies including student loan repayments, KiwiSaver contributions and some child support payments.

The changes proposed in the Bill are part of modernising New Zealand's tax administration and are intended to use business/payroll systems to reduce the compliance and administrative costs associated with the provision of PAYE information.

No compulsory changes are proposed to employers' current obligations around the payment of PAYE and other deductions. Employers will however be able to remit PAYE and other deductions to Inland Revenue on payday if they choose to.

The key changes in the Bill are:

- Record keeping (PAYE): consolidating requirements on employers
- Payday provision of employment income information
- Employment income information and threshold amendments to the Income Tax Act 2007
- Tax codes: clarifying the circumstances in which the no notification deduction rate applies
- Consequential changes to employer reporting of employee share scheme benefit information
- Penalties: amendments to retain late filing and non-electronic filing penalties as monthly penalties
- Transitional provisions: to enable voluntary payday reporting from 1 April 2018
- Repealing the subsidy for listed PAYE intermediaries

RECORD KEEPING (PAYE)

(Clauses 169, 197, 199, 201, and 284(1)(a), and schedule 2)

Summary of proposed amendments

The Bill proposals bring together the sections that impose PAYE record-keeping requirements on employers. New schedule 3 itemises the information that employers must record and keep.

Application date

The proposed amendments will come into force on 1 April 2019.

Detailed analysis

All references are to the Tax Administration Act 1994 unless stated otherwise.

Current section	**Proposed changes**
Section 24 provides that an employer who makes a PAYE income payment to an employee must keep proper records showing the amount of income and the amount of tax withheld. The section also requires PAYE intermediaries to keep a proper record of their actions undertaken for the employer. Section 24(2) further requires safe custody of such records and supporting information for a period of seven years unless the Commissioner has notified that retention is not required. Clause 201 proposes to repeal section 24. When information is transmitted electronically section 23(2)(c) permits employers not to retain a return that is an employer monthly schedule. Section RP 8 of the Income Tax Act 2007 also details the record keeping obligations on an employer and requires that the employer provide information to the intermediary within the agreed timeframe.	Proposed new section 22AA contains the PAYE record keeping obligations from section 24 and also requires employers to keep the records required under the KiwiSaver Act 2006; the Student Loan Scheme Act 2011; and Child Support Act 1991. The new section proposes to place the detail of the specific records in new schedule 3 Table 1: Record-keeping requirements for employers and PAYE intermediaries. Clause 199 proposes to amend section 23(2) so that where information has been transmitted electronically an employer is not required to retain the employment income information that has been provided to the Commissioner. Proposed new schedule 3 sets out the items for which records, certificates and notifications are required to be kept. Clause 169 amends section RP 8 so that it no longer repeats the requirements in the proposed new section 22AA.

PAYDAY PROVISION OF EMPLOYMENT INCOME INFORMATION

(Clauses 130, 147, 148, 172(14), (17), (40) and (41), 187(12) and (14), 200, 228, 230, 233, 236, 238, 284(1)(b), 288 and 290, and schedule 2)

Summary of proposed amendments

The Bill defines what is meant by "employment income information", when different groups of employers must provide the information to the Commissioner and how it must be delivered.

An amendment also proposes how acceptable means for error correction and adjustment may be established. Consequential changes are proposed to the Income Tax Act 2007.

Application date

The proposed amendments will come into force on 1 April 2019 but under the transitional provisions employers may choose to adopt payday filing of employment income information beginning on 1 April 2018.

Key features

Clause 200 proposes a new subpart 3C in the Tax Administration Act 1994 (Employment income information) consisting of sections 23B–23P. Proposed new section 23C defines "employment income information" as the items of information set out in schedule 4, tables 1–3. These tables include the information required on the employer monthly schedule, information about employer's superannuation contribution tax (ESCT), which is currently required on the PAYE income payment form, and information about new and departing employees. Date of birth information and contact details will be required from all new employees.

New sections 23E to 23H of the Tax Administration Act 1994 establish four employer groups for the delivery of employment income information to the Commissioner. These groups establish the employers' obligations to file employment income information, including due dates and the means of delivery.

The due date for employment income information from "online employers" above the electronic filing threshold, payroll intermediaries and from employers below the threshold using payroll software is proposed as two working days after payday.

"Threshold employers" below the electronic filing threshold will be able to continue to report employment income information on paper but it is proposed that they will need to do so following each payday. The due date for employment income information from employers below the electronic filing threshold that are not using payroll software is proposed as seven working days following payday.

The Bill proposes that the electronic filing threshold be reduced from $100,000 a year of PAYE and ESCT to $50,000 a year of PAYE and ESCT. The Bill further provides that in future this threshold may be changed by Order in Council following appropriate consultation.

An exemption to electronic filing by the second working day after payday is proposed for "electronic-exempt employers" who while above the electronic filing threshold, cannot access suitable digital services. If an exemption is granted, the exempt employer will be able to file their employment income information on paper and it will not be due until seven working days after payday.

New section 23H proposes how employment income information obligations apply to employers who start employing within a tax year and new section 23I proposes employment information requirements when these fall on an employee.

Proposed section 23J identifies how the employment income information requirements relate to employee share schemes, this provision is dealt with later in this *Commentary* under "Consequential changes to employer reporting of employee share scheme benefit information".

Proposed section 23M of the Tax Administration Act 1994 establishes a regulation making power whereby acceptable means of error correction and adjustment may be set out in regulations, made on the advice of the Minister of Revenue, and following appropriate consultation.

Detailed analysis

All references are to the Tax Administration Act 1994 unless otherwise stated.

Employment income information and employer groups

Proposed sections 23C to 23H define "employment income information" and establish four employer groups, along with requirements for the employment income information for each group and due dates for the proposed requirement that the information is provided on a payday basis. Proposed section 23I sets out the requirements for employees to provide employment income information.

Current section	Proposed changes
Section YA 1 of the Income Tax Act 2007 defines: • employer monthly schedule • PAYE income payment form. Clause 172(14) and (41) propose that these definitions are repealed.	Proposed new section 23C(1) defines "employment income information" as the information set out in new schedule 4, tables 1 – 3 of the Tax Administration Act 1994. This proposed new schedule contains information relating to: • the employer, employee, income and amounts withheld - required each payday, in schedule 4, table 1; • information relating to new employees in schedule 4, table 2; • Information relating to departing employees in schedule 4, table 3. The proposed information fields differ from those currently required as follows: • The requirement for a separate form to accompany payment (the PAYE income payment form) is repealed; this is discussed further in relation to proposed section 23N(2). • Schedule 4, table 1 requires the payday date. • Date of birth information is required if the employee has provided it to the employer. • Contact details are required from all new employees. The proposed requirements for date of birth information and contact details are discussed in more detail in the commentary on proposed new section 23K under "Employment income information for new and departing employees". Proposed new section 23C(2) requires the Commissioner to prescribe one or more electronic forms and means of electronic communication for the delivery of employment income information. See also the commentary on proposed section 23N.
Section 46 requires an employer to provide details of persons employed and of their salaries, wages and other emoluments received in the month. Clause 236 proposes to repeal Section 46 as the requirements are now included in subpart 3C. Section 36E allows an employer not required to file their employer monthly schedule or PAYE income payment form electronically, to elect to do so. It is proposed to repeal this section. Section 48 provides that with prior consent of the Commissioner any requirement for the delivery of information by an employer or PAYE intermediary can be varied. The consent may have conditions and may be varied or revoked at any time. Clause 238 proposes to repeal this section.	Section 23D(1) proposes the establishment of four employer groups for the provision of employment income information on a payday basis; the online group; the threshold group; the electronic exempt group and the new group. Despite the existence of four groups, section 23D(2) proposes that a PAYE intermediary is always included in the online group. Section 23D(3) proposes that any employer can choose to provide their employment income information before the date set out in the relevant section. Under proposed section 23D(4) an employer may choose to provide employment income information electronically even if they are not required to. Section 23D(5) proposes that an employer can seek approval to deliver employment income information in a different way. The Commissioner may consent, with conditions, vary the conditions or cancel the approval at any time.

Current section	**Proposed changes**
Section RD 22 of the Income Tax Act 2007 requires employers who have withheld $500,000 of PAYE and ESCT in a year, or more, to provide a PAYE income payment form with the twice-monthly payments of PAYE, due on the 20th of the month for the first payment period and the 5th of the following month for the second period. These employers must provide the employer monthly schedule by the 5th of the following month. All other employers provide the PAYE income payment form and employer monthly schedule on the 20th of the following month. The changes proposed in clause 148 replace existing RD 22 of the Income Tax Act 2007 with a section which provides an obligation to return PAYE information as set out under sections 23E to 23H of the Tax Administration Act 1994. For further discussion of the changes to RD 22 of the Income Tax Act 2007 see the subsequent section on employment income information and threshold amendments to the Income Tax Act 2007.	The proposed changes replace monthly and twice-monthly filing with payday filing of employment income information. The proposed change from information provision on a monthly and twice-monthly basis to a payday basis is intended to reduce compliance and administrative costs by integrating tax requirements into an employer's existing pay cycle(s). The online employer group proposed in section 23E is the default group. It is proposed that an employer is an online employer unless they fall into one of the other groups (the threshold group, the electronic exempt group and the new group). It is intended that online delivery of employment income information will be possible from within payroll software or using Inland Revenue's secure online service – myIR. An employer in the online group must deliver employment income information to the Commissioner in a prescribed electronic form and using a prescribed form of electronic communication, within two working days following payday. Clause 187(12) proposes the insertion of a definition of "payday" into section 3 of the Tax Administration Act 1994. Payday means the day on which an employer makes a PAYE income payment to an employee. Section YA 1 of the Income Tax Act 2007 defines "pay". The definition includes to distribute an amount to a person, or to credit an amount to them. An online employer who makes a payment to an employee outside the normal payroll cycle would be required to provide the relevant employment income information within two days of the out-of-cycle payday.

Current section	Proposed changes
Section RD 22 of the Income Tax Act 2007 provides that employers who withhold less than $500,000 a year of PAYE and ESCT have until the 20th of the following month to file their employment information. The changes proposed in clause 148 replace existing section RD 22 of the Income Tax Act 2007 with a section which provides an obligation to return PAYE information as set out under sections 23E to 23H of the Tax Administration Act 1994. Section 36A(2B) exempts employers who have withheld less than $100,000 of PAYE and ESCT in the preceding tax year from the requirement to file PAYE information electronically. Clause 228 proposes that section 36A is repealed. Section 36D requires an employer who is not required to file electronically and who has not chosen to do so, to file on a prescribed form. Clause 233 proposes to repeal this section.	The threshold employer group is defined in proposed new section 23F and comprises employers below a threshold of PAYE and ESCT withheld in the previous year and who do not use payroll software. The proposed threshold employer group recognises that some small employers do not use payroll software or other digital systems. These employers nevertheless calculate PAYE information on a payday basis; they need to do so to withhold appropriately. The threshold employer group requires employers below the filing threshold who do not use payroll software, to file employment income information on a payday basis but permits them to file on a prescribed paper form. The due date, of seven working days after payday, allows time to post the information to the Commissioner. A definition of "payroll software" is proposed in new section 23O as a commercially available computer application or service which enables the calculation of salary and wages and the computation of PAYE. The definition also includes a bespoke equivalent of a commercial offering. Section 23F(4) proposes that the threshold be set at $50,000 a year of PAYE and ESCT, and section 23F(6) provides that the threshold may be amended by Order in Council on the recommendation of the Minister of Revenue. The proposed threshold reduction reflects greater use of digital services than in 1999 when the threshold was first introduced. Before making any recommendation to change the threshold the Minister of Revenue must, under proposed section 23F(6), undertake appropriate consultation.
Section 36B provides that the Commissioner may authorise an employer above the electronic filing threshold to furnish the information in a non-electronic format if the employer's accounting system is incapable of providing the information in the prescribed electronic format. In considering whether to allow an employer above the electronic filing threshold to provide an employer monthly schedule in a non-electronic format section 36B requires the Commissioner to have regard to whether the employer employs 50 or fewer employees. Clause 230 proposes to repeal section 36B.	The Bill proposes that employers which are unable to access suitable digital services may be exempted by the Commissioner from the requirement to file electronically. Proposed new section 23G provides that exempt employers may file employment income information in a prescribed non-electronic (paper) format and that employment income information from this group must be delivered to the Commissioner within seven working days after payday. When deciding whether to exempt an employer the Commissioner must have regard to whether the employer can access appropriate digital services and consider the compliance costs that would be incurred by the employer in meeting the online requirements. An employer who does not have a digital payroll system can meet the requirements for the online group in proposed section 23E by filing electronically through myIR. In this context it is not considered appropriate in deciding a case for an exemption to have regard to whether an employer's accounting system is capable of providing the information. Because the electronic filing threshold is calculated on the basis of PAYE and ESCT withheld it exempts micro employers from electronic filing. Proposed new section 23G therefore focuses on the reasons why electronic filing may not be a reasonable expectation rather than on the numbers employed.

Current section	Proposed changes
Section 36A(2B) provides that a new employer is not required to file an employer monthly schedule or a PAYE Income payment form electronically in relation to the months of the year in which the total amount of tax withheld remained under the threshold. As noted above clause 228 proposes the repeal of section 36A. Notwithstanding the requirements in section 36A(2B), section 36CA provides that a new employee who is required to file electronically may furnish an employer monthly schedule on a paper form for the first six months of business. Clause 233 proposes the repeal of this section.	The new group of employers allows employers which start employing and which cross the electronic filing threshold a period of time in which to establish electronic filing systems. Proposed new section 23H provides that new employers who cross the electronic filing threshold within a tax year may choose, for the first six months they employ employees, to deliver their employment information in a non-electronic format, within seven days after payday. The proposed provision differs from existing section 36CA, which allows a new employer over the electronic filing threshold six months to begin electronic filing from the date on which "the employer begins business". The commencement of employment is considered more relevant than the commencement of business. This provision may also apply to employers that are not businesses. If new employers choose to use payroll software during the first six months the section proposes that they are immediately included in the online employer group and must provide their employment information within two days of payday. At the end of the six-month new-employer period, new employers, provided they are over the threshold, are included in the online group. Employment income information from new employers using a payroll intermediary will be required to be delivered electronically because of the proposal in section 23D(2), that all payroll intermediaries are included in the online group.
Section RD 4(2) of the Income Tax Act 2007 requires an employee whose employer has not withheld an amount of tax from a PAYE income payment, to pay the amount of tax and provide an employer monthly schedule to the Commissioner by the 20th of the following month. Section RD 21(1)(a) of the Income Tax Act 2007 provides that if an amount of tax is not withheld the employee must provide an employer monthly schedule with the details and pay the deficiency.	Despite the introduction of payday reporting it is proposed that employees who have an obligation to provide employment income information only have to provide it on a monthly basis within seven days of the end of the month. This recognises that such employees are not employers in the normal sense and are unlikely to have payroll software systems. The obligation applies to employees whose employers have not withheld tax from a PAYE income payment and includes taxpayers whose employers are not obliged to withhold PAYE and other deductions. The group includes private domestic workers and the employees of foreign embassies. Proposed new section 23I provides that employees, who have an obligation to provide employment income information, must deliver the information to the Commissioner within seven working days of the end of the month in which the PAYE income was paid. Clauses 130 and 147 propose to amend the Income Tax Act 2007 as a consequence of the restructuring of the provisions imposing obligations on an employee. For more detail, see the subsequent section on employment income information and threshold amendments to the Income Tax Act 2007.

Commentary on proposed section 23J is included in the separate section on consequential changes to employer reporting of employee share scheme benefit information.

Employment income information for new and departing employees

At present when an employee starts a new job they are generally required to fill in two paper forms for Inland Revenue. The forms include a substantial amount of repetition and often overlap with information the employer collects for its own purposes. The KiwiSaver enrolment form requires an employee's contact details.

New section 23K proposes to modernise the requirements for setting up new employees with Inland Revenue. Once Inland Revenue's business transformation is complete, sending employee details to the department before a new employee is first paid is intended to enable Inland Revenue to automatically check the IRD number and proposed tax code and communicate back in near-real time if changes are necessary or if there are other deductions, such as for child support, to be made. Near real-time checking of employee details before the employee is first paid will minimise the need to subsequently correct errors such as tax codes and deductions. While Inland Revenue will encourage employers to provide "new employee" information before the employee is first paid this will not be a requirement.

Similarly, if an employer could provide earlier advice to the Commissioner when an employee ceases their employment, it will assist the Commissioner to provide correct advice to a new employer about the correct tax code and will enable Inland Revenue to delink the employer and employee so that the previous employer does not continue to be contacted about that employee. Earlier advice of an employee's commencement and cessation dates will also improve the quality of information-sharing with the Ministry of Social Development and the Accident Compensation Corporation.

In addition to information that is currently required, the Bill proposes that the employer will be required to provide a new employee's date of birth and contact details to Inland Revenue to help verify the employee's identity, and maintain contact with individuals.

If date of birth information is provided it should decrease the requirement for contact between Inland Revenue, the employer and employee, to resolve problems that arise when an employee uses a variation of the name used to obtain the IRD (tax file) number or wrongly transcribes their number. As a consequence, it should reduce recourse to the "no notification" withholding rate of 45c in the dollar, which is used when an employee's identity cannot be confirmed. To limit compliance costs employers will not be required to sight verification of the date of birth information provided by an employee, and the obligation to provide the information will only apply when date of birth information is supplied by the employee.

All new employees eligible for enrolment in KiwiSaver and existing employees, who choose to enrol, are required to advise their employer of their address, tax file number and whether they are a KiwiSaver member. The Bill proposes to generalise the requirement for contact details so that employers are required to provide the information to Inland Revenue for all new employees. The information will be used by Inland Revenue to maintain contact with individuals.

The proposed changes to employee information are also intended to simplify the requirements for setting up new employees. Rather than fill out multiple paper forms including a tax code declaration and a KiwiSaver deduction notice, with often overlapping requirements, proposed new section 23K and schedule 4, table 2 will enable a new employee to provide the information required by Inland Revenue directly into an electronic form in the employer's software system. The required information can then be sent to Inland Revenue by the employer directly from the system, either at the time it is first added, or with the first return of employment income information that includes the new employee. For those still using paper it is intended that there will be a single paper form.

Current section	Proposed changes
The employer monthly schedule definition in section YA 1 of the Income Tax Act 2007 requires an employee's commencement date to be included in the month the employee started and their cessation date in the month in which their employment ended, as noted earlier it is proposed to repeal these definitions. Section 24B(3) requires an employee including a new employee, to provide their employer with a tax code notification. The prescribed tax code notification form states that if the name, tax code and tax file number are not provided the employee will be on the no-notification (45%) tax code. The name, tax file number and tax code are included in the definition of the employer monthly schedule in section YA 1 of the Income Tax Act 2007. For further commentary on the replacement provisions see the subsequent commentary on tax codes. Section 22 of the KiwiSaver Act 2006 requires every new employee to give notice to their employer of name, address and tax file number and whether they are already a KiwiSaver member. If they are a member they are required to provide further information about their KiwiSaver status (deduction rate, contribution holiday or non-deduction status). Clause 288 proposes to amend this section. Section RD 3(2) to (4) of the Income Tax Act 2007 provide how a shareholder employee in a closely held company may treat PAYE income payments. Section 46(7) includes in the definition of employees for the purposes of section 46 (Employers to make returns as to employees), any person who receives a payment which would but for section RD 3(2) to (4) of the Income Tax Act 2007, be a PAYE income payment. Clause 236 proposes that this subsection is repealed as part of the general repeal of section 46.	New section 23K proposes that if an employer choses to they may provide early advice of a new employee (subsection (3)) or departing employee (subsection (4)). To enable an employer to provide early advice to Inland Revenue of a new or departing employee it is proposed to separate out the information required each payday (schedule 4, table 1) from that required if stand-alone advice of a new employee (schedule 4, table 2) or ceased employee (schedule 4, table 3) is given. The requirement proposed in section 23K is, however, that the information be included with the first or last payday return of employment income information relating to that employee. In addition to the information required to identify the employer it is proposed in schedule 4, table 2 that employers provide to Inland Revenue a new employee's: • name • contact details • date of birth if supplied • commencement date • tax file number if supplied • tax code as supplied • KiwiSaver status under section 22 of the KiwiSaver Act. For a departing employee it is proposed in schedule 4, table 3 that the following information is required: • name • cessation date • tax file number. Under section 23K(5) it is proposed, for the avoidance of repetition, that if the new or ceased employee information is provided electronically, along with payday income information, only the additional information is required (that is, no requirement to repeat the name, tax code and tax file number that are already included in the return). Clauses 288 and 290 propose to replace the requirement on a new employee or on an employee opting in, to give the employer a KiwiSaver deduction notice with a requirement to advise the employer of the employee's KiwiSaver status or of a desired change in status. It is envisaged that this advice could be entered directly into the employer's software system or on a prescribed paper form. Section 23K(6) proposes a remedial change to the section 46(7) by narrowing the scope of the reporting obligation. Section 23K(6) proposes that the only requirement on employers of shareholder employees, which are not subject to withholding, is to provide information about commencement and cessation dates.

When an employer ceases to employ and ability to correct errors in employment income information

New section 23L proposes a requirement to notify Inland Revenue when an employer ceases to employ staff.

Compared with annual tax processes such as filing an IR 3 or company business tax returns, PAYE and related withholding processes are characterised by high volumes of data and short turnaround times. The process for error correction and adjustment should have low compliance and administrative costs, and must be fair to employees.

New section 23M proposes that the manner in which errors can be corrected will be set out in regulations and that the Minister of Revenue, before recommending the content of the regulation, must consult appropriately. Early consultation work is currently under way.

Current section	**Proposed changes**
Section RD 22(6) of the Income Tax Act 2007 requires an employer whose business has ended to notify Inland Revenue by the 15th day of the second month following the month in which business is ended. Clause 148 proposes to replace section RD 22 of the Income Tax Act 2007; the replacement section does not include this requirement.	For obligations relating to employment income information, it is status as an employer, not as a business, that is relevant. It is therefore proposed to replace the obligation on employers to notify Inland Revenue when business ends with a requirement to notify when they permanently cease to employ, which will include when a business ends. Notification will eliminate the possibility of an employer being penalised for failure to file employment income information. New section 23L proposes to require an employer, who intends to permanently cease to employ, to notify Inland Revenue within 30 working days of the date on which they ceased to employ any staff.

Current section	Proposed changes
The only specific legislative provision relating to the amendment of PAYE information is in section 15L, which provides that a payroll intermediary may make amendments to a monthly schedule and is then responsible for the accuracy of the amendment. It is proposed to update this section by replacing the reference to the "employer monthly schedule" with "employment income information". Inland Revenue's published guidance requires employers to amend already filed PAYE information by correcting the previously filed information. Employers can do this by submitting an amendment form, which requires the previously filed details and the corrected information or, if it is straightforward, an employer can phone the information in. This information then has to be manually entered into the record by Inland Revenue staff. Inland Revenue also accepts the practice whereby employers make changes to past periods in the current period, provided none of the items on the employer monthly schedule become negative. Payroll intermediaries can file an automated employer monthly schedule amendment.	Compared with annual tax processes, such as filing an IR 3 or company business tax return, PAYE and related withholding processes are characterised by high volumes of data and short turnaround times. Payday reporting of employment income information will shorten the turnaround time and reduce the time available to employers to correct employment income information before it is sent to Inland Revenue. In this context the process for error correction and adjustment must have low compliance and administrative costs and must provide materially accurate employee information. To balance the potentially competing requirements of employers, employees, software providers and the tax administration, the Bill proposes a regulation-making power in new section 23M and requires the Minister of Revenue to consult before making recommendation on the content of the regulations. The consultation will seek to understand the impact of the proposals on software providers, on employers' compliance costs and on the accuracy of employee information. Proposed new section 23M provides that the manner in which PAYE and related errors can be corrected will be set out in regulation and that the Minister before recommending the content of regulations must consult appropriately. Early consultation work is currently underway and will inform more comprehensive consultation later this year.

Setting electronic and non-electronic filing requirements

New section 23N proposes to require the Commissioner to prescribe both electronic and non-electronic forms and means of delivery for employment income information. These requirements are intended to ensure that:

- employment income information can be automatically read and processed by Inland Revenue;
- external parties, such as those using payroll software that communicates with Inland Revenue, can do so securely; and
- customers using such software are able to have their identity verified.

The Bill does not retain the current distinction between an information return (the employer monthly schedule) and a form to accompany payment (the PAYE income payment form). Payday reporting and faster processing should ensure that employment income information precedes or accompanies payment. The objective is to eliminate the requirement to repeat the summary information on both forms. During the implementation period the requirement for summary information is, however, likely to remain and it is also possible that a requirement may remain for certain classes of employers – for example, those who continue to submit paper returns. The Bill therefore proposes that the Commissioner may require some employment income information to accompany payment.

Current section	**Proposed changes**
Section 36A requires the Commissioner to prescribe an electronic format for the employer monthly schedule and enables the Commissioner to prescribe an electronic format for the PAYE income payment form. Clause 228 proposes to repeal section 36A. The paper forms for these returns are prescribed under the Commissioner's general power to prescribe forms in section 35. Section RD 22(1) of the Income Tax Act 2007 provides that an employer who withholds an amount of tax from a PAYE income payment must provide an employer monthly schedule and a PAYE income payment form in relation to the amount. Clause 148 proposes to replace this with a section that imposes an obligation to return PAYE information as set out under sections 23E to 23H of the Tax Administration Act 1994.	Proposed new section 23N(1) requires the Commissioner to prescribe both electronic and non-electronic forms and means of communication and proposes that the Commissioner may set specifications for payroll software for use in the delivery of information. Section 23N(2) provides that to enable processing of a payment the Commissioner may notify employers that certain items of employment income information must accompany the payment.

Definition of "payroll software" and variation of requirements

The Bill proposes that employers below the electronic filing threshold who use payroll software and new employers who use payroll software become part of the online group. The Bill also provides that the Commissioner may set specifications for payroll software to be used in the delivery of employment income information. To support these provisions a definition of "payroll software" is provided in section 23O.

Proposed new section 23P provides that the Commissioner can vary the requirements in subpart 3C and schedule 4.

Current section	**Proposed changes**
Payroll software is not currently defined but the Commissioner does issue specifications to payroll software providers setting the required formats for prescribed electronic forms.	Proposed new section 23O defines payroll software as a commercially available computer application or service or bespoke equivalent which enables the calculation of amounts of salary or wages and amounts that are required to be withheld under the PAYE rules.

Current section	Proposed changes
Section 24P provides that the Commissioner may vary the requirements set out in RD 22 of Income Tax Act 2007 (Returns for amounts of tax paid to the Commissioner); 24B (PAYE tax codes); 24H (When entitlement to use a tax code ends); 24I (PAYE tax code notification and certificate) and 24L (schedular notifications). Clause 207 proposes to repeal this section. Section 46(2) and (3) provide that the Commissioner may vary requirements relating to particulars of commencement or cessation of employment but no variation can impose a more onerous requirement on the employer than is imposed by the employer monthly schedule. Clause 236 proposes the repeal of section 46. The definition of an employer monthly schedule in section YA 1 of the Income Tax Act 2007 includes other particulars as required by the Commissioner for a class of employers. As noted above, it is proposed to repeal this definition.	It is proposed in new section 23P to provide the Commissioner with the power to vary the requirements in subpart 3C and schedule 4. The scope of the proposed power to vary is broadly analogous to the scope of the existing provision. The requirement that variations to requirements around commencement and cessation be no more onerous than those imposed by the employer monthly schedule has been omitted as the definition of the employer monthly schedule itself provides for "other particulars required by the Commissioner for a class of employers". See the following commentary on tax codes in proposed new section 24 regarding the power to vary provisions relating to tax codes.

EMPLOYMENT INCOME INFORMATION AND THRESHOLD AMENDMENTS TO THE INCOME TAX ACT 2007

(Clauses 130, 147 and 148)

Summary of proposed amendments

The Bill has been drafted to consolidate the administrative requirements relating to PAYE in the Tax Administration Act 1994. This change and the proposed requirement for payday reporting of PAYE income require a number of changes to the Income Tax Act 2007. It is also proposed that the threshold for PAYE and other deductions to be paid twice monthly should be able to be changed by Order in Council.

Application date

The amendments will come into force on 1 April 2019.

Key features

The changes proposed to the Income Tax Act 2007 are largely consequential on the introduction of payday reporting of employment income information.

The obligation on an employee to provide information about their gross income and PAYE and other deductions, when their employer had not withheld, is currently included in both sections RD 4(2) and RD 21(1)(a). It is proposed to remove the requirement to provide information from section RD 4(2) and rely on an updated section RD 21(1)(a).

Although there is currently no proposal to alter the threshold, the Bill also provides that the threshold above which employers are required to pay PAYE and other deductions twice monthly, currently set at $500,000 a year of PAYE and ESCT, should in future be able to be changed by Order in Council following appropriate consultation.

The requirement for consultation is intended to ensure that the potential impact of any change, for example on cash flows and compliance costs, is appropriately considered.

Detailed analysis

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

Current section	Proposed changes
Section RD 4 sets out the requirements for once monthly and twice-monthly remittance of PAYE. Subsection (1) provides that employers must pay PAYE and other deductions twice monthly unless they are an employer to whom section RD 22(3) or (4) applies. This section defines the due dates for providing an employer monthly schedule and a PAYE income payment form. Section RD 4(2) establishes an employee's liability to pay tax and provide information when an amount of PAYE is not withheld. Section RD 22 establishes an obligation on employers to provide an employer monthly schedule and PAYE income payment form. It also establishes the due dates for these returns. The general rule is that the PAYE income payment form must be provided twice monthly and the employer monthly schedule must be provided monthly by the 5th of the following month. Section RD 22(3) and (3B) create an exception for employers that withhold less than $500,000 a year of PAYE and ESCT. These employers are required to provide a PAYE income payment form and employer monthly schedule by the 20th of the following month. Section RD 22(4), requires new employers to file their employer monthly schedule and PAYE income payment form by the 20th of the following month until the amount of PAYE and ESCT withheld exceeds $500,000; they are then covered by the general rule. Section RD 22(5) and (7) set out how the threshold is to apply if an employer runs more than one business, or is a group of companies, a partnership or if they are persons in whom property has become vested or to whom control has passed. Section RD 22(6) requires an employer whose business has ended to notify the Commissioner by the 15th day of the second month following the month in which business is ended.	Clause 130 proposes replacing section RD 4. Some of the changes proposed to section RD 4 are consequential to changes to section RD 22 (Returns for amounts of tax paid to Commissioner). However it is also proposed that the obligation in section RD 4(2) on an employee whose employer has not withheld to provide information to the Commissioner, should no longer be contained in that section. Section RD 21(1)(a) already sets out the obligations on an employee when tax has not been withheld. Clause 147 proposes replacing section RD 21(1)(a). The proposed replacement paragraph establishes an obligation on an employee whose employer has not withheld some or all of an amount of tax, to provide employment income information as set out in section 23I of the Tax Administration Act 1994. Section RD 22 details the obligation on the employer to provide information returns for amounts of tax withheld from a PAYE income payment. The changes proposed in clause 148 replace RD 22 with a section which establishes an obligation on an employer who withholds tax under section RD 4 to return employment income information as set out under sections 23E to 23H of the Tax Administration Act 1994. These proposed sections require PAYE information to be provided on a payday rather than a monthly basis. Replacement section RD 22 does not include an equivalent of section RD 22(6) (When business ended) but proposed new section 23L of the Tax Administration Act 1994, requires an employer to notify the Commissioner if they cease to employ with the intention that it is a permanent cessation. Although employers will be able to choose to remit PAYE on a payday basis, the payment obligation in section RD 4 will remain as a once or twice-monthly obligation. Because the once or twice-monthly payment obligation can no longer be defined in terms of the payday information obligation, the proposed replacement section RD 4 includes the rules, previously in section RD 22, setting the $500,000 a year threshold for twice-monthly payment, the rules for new employers, and how the threshold is to be applied if the employer runs more than one business or is a person to whom control has become vested or passed. In addition, section RD 4(7) proposes that the threshold contained in subsection (2) for twice monthly payment may be amended by Order in Council on the recommendation of the Minister of Revenue following appropriate consultation.

TAX CODES

(Clauses 139, 146, 203, 204, 207, 284(1)(c), 303, 305 and 306(2), and schedule 2)

Summary of proposed amendments

The Bill proposes to clarify the circumstances in which the "no notification" deduction rate applies and to restructure the provisions relating to the use of tax codes more logically by placing much of the detail in schedule 5.

Application date

The amendments will generally come into force on 1 April 2019.

Key features

The Bill sets out the core requirements relating to tax codes in proposed subpart 3D of the Tax Administration Act 1994, placing the detail in new schedule 5, parts A to C. The intent is to restructure the existing provisions to improve clarity, and in some circumstances, such as the proposed obligation to notify an employer of a changed tax code in replacement section 24B, to make explicit what was previously implicit.

Section 24B(3) of the Tax Administration Act 1994 requires that the employee must notify their employer of their tax code. Section 24B(3B) of the same Act provides that if an employee does not provide the employer with a tax code notification and the Commissioner has not done so, they have a "no notification" tax code. The no notification tax code results in tax being withheld at the rate of 45c in the dollar.

The prescribed form for a tax code notification requires the employee to provide their name and tax file number, in addition to their tax code. The employee's name and tax file number are critical to establishing their identity. It is now proposed that the implication of not providing a name or tax file number – being placed on the "no-notified" tax code – is spelled out in proposed new section 24E. The no notification tax code has now been renamed the "non-notified" tax code.

Detailed analysis

All references are to the Tax Administration Act 1994 unless otherwise stated.

Current section	Proposed changes
Section 24B(1) and (2) provide that tax codes apply for the purposes of the PAYE rules and do not apply to extra pays; schedular payments or the payment of income-tested benefits. Clause 204 proposes to replace section 24B.	Proposed section 24B defines a tax code for the purposes of the PAYE rules as: • a code set out in schedule 5, part A; • a tax code provided by the Commissioner; or • a non-notified tax code. Subsection (4) proposes that the basic tax rates for the tax codes are set out in the Income Tax Act 2007, schedule 2, part A. The section proposes that tax codes do not apply to extra pays or schedular payments, and that the amount of tax for income-tested benefits is set out in section RD 11(3) of the Income Tax Act 2007.
Section 24B(3) requires an employee to notify their employer of their tax code and lists the codes. Section 24I(4) requires that a tax code notification must include a statement of entitlement to work in New Zealand under the Immigration Act 2009. Clause 204 proposes to replace these sections.	Replacement section 24C proposes that an employee must notify their employer of their applicable tax code, or of a change in tax code. The section refers to schedule 5, part A where the tax codes are listed. The section further proposes that the obligation to notify the employer of a tax code does not apply: • if the Commissioner has provided a tax code to the employer; or • to a non-resident seasonal worker for their first month of employment in New Zealand. Replacement section 24C also proposes that in providing a tax code notification an employee must state their entitlement to work for their employer under the Immigration Act 2009.
Section 24F provides that an employee may apply for a special tax code to apply for a veteran's pension, superannuation or other employment income. Clause 204 proposes to replace section 24F.	Replacement section 24D proposes that an employee may seek a special tax code from the Commissioner to apply in the same way as section 24F(1AB) currently provides. Schedule 5, part B proposes how the Commissioner may issue a special tax code and how the amount of tax is to be calculated.

The definition of the "no notification" tax code in section 24B(3B) provides that it applies when the employee has not provided their employer with a tax code notification and the Commissioner has not provided the employer with a tax code or special tax code for the employee.
 	
Clause 204 proposes to replace section 24B.
	It is proposed to set out in replacement section 24E the circumstances in which a non-notified tax code will apply, as follows:
	• the employee has not notified their employer of their:
	  – name; and
	  – tax file number; and
	  – tax code.
	• the Commissioner has not provided the employer with a tax code or change in tax code; and
	• the employee is not a non-resident seasonal employee during their first month of employment.

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 inserted a new section RD 10B into the Income Tax Act 2007 and amended section 24L to allow contractors who are subject to the schedular payment rules to elect their own withholding rate without having to apply for a special tax code.	Proposed section 24F identifies how standard, payee and set rates for schedular tax payments apply and where they are set out. Proposed section 24G provides that a payee may apply to the Commissioner for a special tax rate. The detail is contained in proposed schedule 5, part C. The changes proposed to these sections are consequential on the re-organised tax code and tax rate provisions.

<table>
<tr><th>Current section</th><th>Proposed changes</th></tr>
<tr><td>Subsection 24B(3) contains a list of tax codes.

Subsection 24B(4) provides how tax codes from another Act may be combined with the tax codes in section 24B(3).

Section 24G provides the steps that the Commissioner may take when she considers an incorrect tax code is being used, and the consequent requirements on the employer.

Section 24H provides when entitlement to use a tax code ends.

Section 24I provides that an employee who wishes to have their amount of tax reduced may notify their employer of the applicable tax code.

Clause 204 proposes to replace these sections.</td><td>The proposed schedule 5, part A contains detailed provisions in relation to the application of general (not special) tax codes. As noted above, the intent is to improve clarity, not to amend the provisions.

Part A proposes provisions relating to:

• combining tax codes;
• changes to tax codes and when changes to tax codes apply;
• the steps the Commissioner may take if she considers that an incorrect tax code is being used, and the consequential requirements on the employer;
• when entitlement to use a tax code ends;
• a table of tax codes.</td></tr>
<tr><td>Section 24F provides that the Commissioner may provide the employee with a special tax code certificate.

If a special tax code is issued in respect of a veteran’s pension or superannuation the Commissioner must notify the responsible department.

The section sets out what the special tax code may include how it should be calculated and the overriding nature of the special tax code certificate.

Section 24F(6) provides that the Commissioner may cancel a special tax code at any time.

Section 24E provides that a private domestic worker can apply to the Commissioner for a tax code.

Section 24F(5B) prevents a non-resident seasonal worker from applying for a special tax code.

Clause 204 proposes to replace sections 24E and 24F.</td><td>The proposed schedule 5, part B contains detailed provisions relating special and particular tax codes. As with part A, the intent is to clarify rather than change the existing legislation.

Part B includes provisions relating to:

• the Commissioner’s ability to provide a special tax code;
• what a special tax code may apply to, what it may require and how the Commissioner is to calculate it;
• the requirement on the Commissioner to notify the relevant department if the code is issued in relation to superannuation or veteran’s pension income;
• the overriding nature of a special tax code;
• the Commissioner’s ability to cancel a special tax code;
• tax codes for private domestic workers; and
• tax codes for non-resident seasonal workers.</td></tr>
<tr><td>Section 24P provides the Commissioner with the power to vary sections: 24B (PAYE tax codes); 24H (When entitlement to use a tax code ends); 24I (PAYE tax code notification and certificate) and 24L (schedular notifications). Clause 207 proposes to repeal section 24P.</td><td>New section 24H proposes that the Commissioner can vary the requirements of section 24B and schedule 5, part A, clause 4.

This new section is intended to carry over the Commissioner’s power to vary, as it relates to tax codes, from section 24P.</td></tr>
</table>

PENALTIES

(Clauses 268, 269(1), (5) and (6), 270, 271, 272 and 275(2))

Summary of proposed amendments

Because there are no mandatory changes proposed for the timing of PAYE and related deductions, the Bill does not change the penalty provisions around non-payment of PAYE and related deductions.

The proposed requirement for employers to file employment income information on a payday basis will increase the number of times most employers file information relating to PAYE income payments. The Bill proposes, however, that late filing penalty and non-electronic filing penalties will remain monthly penalties. Regardless of how many times an employer fails to file electronically in a month, or has failed to file employment income information on time during a month, only one penalty will be imposed for non-electronic filing, and a maximum of one penalty will be imposed for late filing.

The due date for paying the penalties is proposed as 30 days from the end of the month in which the information was due.

Application date

The proposed amendments will come into force on 1 April 2019.

Key features

It is proposed that the non-electronic filing penalty will remain a monthly penalty. Regardless of how often an employer fails to file electronically in a calendar month the maximum penalty will be $250 or $1 for each employee for whom information was returned in a format other than the prescribed electronic format.

The late filing penalty under the proposals in the Bill will continue to be a penalty that is not imposed for a first instance of late filing. If an employer fails to meet the filing due date, the Commissioner must notify them that a further failure to file on time after receipt of the Commissioner’s notice will result in the imposition of a $250 penalty. The Bill proposes that the maximum late payment penalty that may be imposed on an employer is $250 a calendar month.

The Bill also proposes that the shortfall penalty for not paying an employer monthly schedule amount is renamed as a penalty for unpaid amounts of employer withholding payments. The current monthly penalty and maxima for an employer who fails to withhold PAYE from a non-resident contractor entitled to double tax relief, will remain.

Detailed analysis

All references are to the Tax Administration Act 1994 unless otherwise stated.

Current section	Proposed changes
Section139A(6) provides that if a taxpayer has filed their employer monthly schedule on time for the previous 12 months, the Commissioner must give notice that a further failure to file will result in a penalty. If the taxpayer has not filed on time for the previous 12 months, following a further failure to file on time the Commissioner must give notice to the taxpayer that the late filing penalty is payable. Clause 268 proposes to amend section 139A; the amendments include replacing subsection (6). Section 142(1A) provides that the due date for payment of a late filing penalty is the 5th of the month following the month in which a twice-monthly payer of PAYE is required to file their employer monthly schedule and the 20th of the following month for all other taxpayers. Clause 272(2) proposes to replace section 142(1A)	New section 139A(6) proposes that the late filing penalty will remain one that is not imposed for a first instance of late filing of employment income information in a 12-month period. If the taxpayer has filed on time for the previous 12 months: a. After an initial failure to file employment income information on time the Commissioner must notify the taxpayer that a further to file on time will result in a penalty. b. After further failure to file on time, within 12 months of the first failure, the Commissioner must notify the taxpayer that the penalty is payable. It is proposed that the late filing penalty will remain a monthly penalty. The maximum penalty that could be imposed for a failure to file employment income on time is proposed as $250 a month regardless of the number of failures to file on time in that month. Clause 272(2) proposes to amend section 142(1A) so that the due date for the payment of a late filing penalty is 30 days after the end of the month in which the taxpayer is required to deliver their employment income information.
Section 139AA provides that a non-electronic filing penalty may be imposed on an employer required to provide returns in a prescribed electronic format, who does not do so. The non-electronic filing penalty in subsection 139AA(4) is the greater of $250 or $1 for each employee employed during the month to which the employer monthly schedule relates. Clause 269 proposes to amend section 139AA; the amendments include replacing section 139AA(4). Section 142G provides that a non-electronic filing penalty is due on the 5th of the month following the month in which the employer was required to furnish an employer monthly schedule in a prescribed electronic format. Clause 275(2) proposes replacing section 142G.	It is proposed to amend section 139AA to replace a reference to the requirement to file electronically with a reference to section 23E (the online group). Under proposed replacement section 139AA(4) the non-electronic filing penalty will remain a monthly penalty. Regardless of how often an employer fails to file electronically in a calendar month the maximum penalty will be $250 or $1 for each employee for whom information was returned in that month. The proposed replacement section 142G provides that the non-electronic filing penalty is due 30 days after the end of the month in which the information was due to be received in a prescribed electronic form or by means of the prescribed electronic communication.
Section 141AA imposes a capped shortfall penalty for an employer who fails to withhold PAYE from a non-resident contractor, entitled to double tax relief.	Clause 270 amends the references in section 141AA to the “employer monthly schedule” and “return period” so that the $250 per contractor per month penalty capped at a total of $1,000 per month remains.

<table>
<tr><th>Current section</th><th>Proposed changes</th></tr>
<tr><td>Section 141ED(1) provides that an employer is liable for a shortfall penalty if it:

• returns an employer monthly schedule but fails to pay some, or all of the amount by the due date;
• is given notice of the penalty by the Commissioner.

Clause 271 proposes to replace this section.</td><td>Clause 271 proposes to rename the penalty in section 141ED, for not paying an employer monthly schedule amount, as the employers’ withholding payment penalty.

It is proposed that section 141ED be replaced with a section which clarifies the circumstances in which the penalty applies and replaces references to employer monthly schedule with employment income information. The proposed replacement section does not intend to change the operation of the penalty.</td></tr>
</table>

CONSEQUENTIAL CHANGES TO EMPLOYER REPORTING OF EMPLOYEE SHARE SCHEME BENEFIT INFORMATION

(Clauses 13, 132, 136, 148, 172(19) and (41), 187(5), 200, 284(1)(b) and schedule 2)

Summary of proposed amendments

From 1 April 2017, employers will be required, under amendments made to the Income Tax Act 2007 and the Tax Administration Act 1994 by the Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016, to disclose the value of share benefits employees receive under employee share schemes (and any tax they choose to withhold under the PAYE rules). This disclosure is to be captured on the employer monthly schedule as part of PAYE information reporting.

To ensure that employers can meet their employee share scheme benefit information reporting obligations in the proposed new PAYE reporting environment, the Bill proposes to defer the recognition of benefits derived by an employee under an employee share scheme by 20 days from when the employee receives the benefit, with effect from 1 April 2019, in order to provide all employers with sufficient time to compile information to support the required disclosures and deduction of tax, if to be withheld. These measures do not change the date on which the value of the benefit is determined.

Application date

The amendments will come into force on 1 April 2019.

Key features

Proposed amendments to section CE 2 of the Income Tax Act 2007 will defer the date that an employee who receives a benefit under an employee share scheme is treated as deriving income in relation to the benefit by 20 days from the taxing point. This deferral will apply for all employees who receive benefits under an employee share scheme that their employer is required to report to Inland Revenue about as part of employment income information.

A proposed amendment to section RD 6 of the Income Tax Act 2007 will mean that an employee share scheme benefit from which an employer has chosen to withhold tax under the PAYE rules will be treated as paid on the 20th day after the taxing point for the benefit received by the employee.

Proposed replacement section RD 22(2) will require employers to provide employment income information in relation to employee share scheme benefits to Inland Revenue under proposed new sections 23E to 23H of the Tax Administration Act 1994 as modified by section 23J of that Act.

Proposed new section 23J(1) of the Tax Administration Act 1994 specifies that the payday for an employee share scheme benefit is the 20th day after the taxing point for the benefit received by the employee. The payday is relevant for the purposes of determining the due date for the provision of employment income information to Inland Revenue for the various groups of employers described in proposed new sections 23E to 23H of that Act.

Proposed new section 23J(2)(a) of the Tax Administration Act 1994 specifies that employers are not required to provide Inland Revenue with information on:

- employee share scheme benefits received by former employees if they have not chosen to withhold tax from the benefit; or
- benefits arising under tax-exempt, widely offered employee share schemes.

Proposed section 23J(2)(b) and new schedule 4, table 1 of the Tax Administration Act 1994 specify the particulars in relation to employee share scheme benefits that must be provided to Inland Revenue by employers who are subject to the reporting requirements.

Detailed analysis

From 1 April 2017, employers will be required to disclose the value of share benefits employees receive under employee share schemes (and any tax they choose to withhold under the PAYE rules). This disclosure is to be captured on the employer monthly schedule as part of PAYE information reporting.

Employers who have until the 20th of the following month to provide an employer monthly schedule for a given month to Inland Revenue, will be required to include information in relation to a benefit received (at any time during a month) by an employee under an employee share scheme in the employer monthly schedule they file for that month. This gives the employer a minimum of 20 days to compile information to support the required disclosures and deduction of tax, if to be withheld.

"Large" employers are required to provide an employer monthly schedule for a given month to Inland Revenue by the 5th of the following month. This would not provide these employers with sufficient time to compile information to support the required disclosures and deduction of tax, if to be withheld, in relation to benefits received during the second half of the month by employees under an employee share scheme. Therefore, a special rule defers the recognition of benefits received by employees of "large" employers under an employee share scheme. The effect of this deferral rule is to provide "large" employers with the same minimum period of 20 days that other employers have to compile information to support the required disclosures and deduction of tax, if to be withheld.

Changes to employer reporting of benefits derived by employees under employee share schemes (and any tax withheld) are necessary as a consequence of the proposed shift to reporting of employment income information on a payday basis from 1 April 2019.

To ensure that employers can meet their employee share scheme benefit information reporting obligations in the proposed new employment income information reporting environment, it is proposed to defer recognition of benefits derived by an employee under an employee share scheme by 20 days from when the employee receives the benefit, with effect from 1 April 2019. The proposed new deferral rule will apply in relation to all (rather than only "large") employers who are required to report employee share scheme benefit information as part of employment income information on a payday basis. The rationale for widening the application of the deferral rule is that all employers (regardless of size) will require additional time to compile information to support the required disclosures and deduction of tax, if to be withheld.

Requirements from 1 April 2017	**Proposed changes**
Section CE 2 specifies when an employee derives a benefit under an employee share scheme. The combined effect of subsections (10) and (11) is to defer the timing of the derivation of income in relation to employee share scheme benefits received by employees of "large" employers (that is, those required to provide an employer monthly schedule for a given month to Inland Revenue by the 5th of the following month, and that are required to remit PAYE deductions on a twice-monthly basis) to the next "PAYE income payment form period" after the one in which they receive the benefit.	Proposed amendments to section CE 2 of the Income Tax Act 2007 will defer the date that an employee who receives a benefit under an employee share scheme is treated as deriving income in relation to the benefit by 20 days from when they receive the benefit. The proposed amendment names this 20th day after an employee receives a benefit the "ESS deferral date". This deferral will apply for all employees who receive benefits under an employee share scheme that their employer is required to report to Inland Revenue about as part of employment income information.
Section RD 6 specifies when a benefit under an employee share scheme from which an employer has chosen to withhold tax under the PAYE rules is treated as paid. In the case of "large" employers, the benefit is treated as paid on the first day of the "PAYE income payment form period" after the one in which they receive the benefit. In the case of other employers, the benefit is treated as paid on the date the benefit vests in the employee. The date on which the employee share scheme benefit is treated as paid will be the end date of the four-week period referred to in the extra pay tax rate calculation in section RD 17, which employers will use to calculate the amount of tax they must withhold from the benefit. It will also influence when the employer is required to pay the withheld tax to Inland Revenue by.	A proposed amendment to section RD 6 of the Income Tax Act 2007 will mean that an employee share scheme benefit from which an employer has chosen to withhold tax under the PAYE rules will be treated as paid on the 20th day after the benefit is received by the employee. This will apply irrespective of the size of the employer.

Requirements from 1 April 2017	**Proposed changes**
Section RD 7B enables an employer to elect to withhold tax from a benefit received by an employee or former employee under an employee share scheme. The section specifies that an employer makes such an election by calculating the amount of tax required to be withheld from the benefit and paying it to Inland Revenue, and by reporting the value of the benefit to Inland Revenue on their employer monthly schedule by the relevant due date.	A proposed amendment to section RD 7B will replace the requirement to report the value of the benefit to Inland Revenue on their employer monthly schedule by the relevant due date with a requirement to include the value of the benefit in their employment income information under proposed new subpart 3C of the Tax Administration Act 1994, treating the 20th day after the employee received the benefit as the relevant payday.
Section YA 1 defines the payment period for which an employer must provide a PAYE income payment form under section RD 22(2) as the "PAYE income payment form period". The "PAYE income payment form period" definition is relevant for the deferral in the recognition of benefits under employee share schemes of "large" employers. For a given month, the first "PAYE income payment form period" runs from the 1st day to the 15th day of the month, and the second "PAYE income payment form period" will run from the 16th day to the end of the month.	The Bill proposes to repeal the definition of "PAYE income payment form period" in section YA 1. The Bill proposes to insert a new defined term "ESS deferral date" into section YA 1 of the Income Tax Act 2007 and section 3(1) of the Tax Administration Act 1994 which refers to the definition of that term in proposed new section CE 2(9).

Requirements from 1 April 2017	Proposed changes
The requirement for employers to report employee share scheme benefit information to Inland Revenue on their employer monthly schedule under the PAYE rules if they have elected to withhold tax from the benefit is supplemented by section 46 of the Tax Administration Act 1994. Section 46 requires employers to file an employer monthly schedule containing particulars of the persons employed by them in a month and of all salaries, wages, and other emoluments received in that month by each person employed. Section 46(6B) specifies that "other emoluments" includes a benefit that an employee receives under an employee share scheme in relation to which the employer has not made an election under the PAYE rules to withhold an amount of tax, except if the benefit was received by a former employee or the benefit arose under a tax-exempt, widely offered scheme.	Section 46 of the Tax Administration Act 1994 is proposed to be repealed. Proposed replacement section RD 22(2) of the Income Tax Act 2007 will require employers to provide employment income information in relation to employee share scheme benefits to Inland Revenue under proposed new sections 23E to 23H of the Tax Administration Act 1994 as modified by section 23J of that Act. Proposed replacement section RD 22(3) specifies that employers are not required to provide Inland Revenue with information on: • employee share scheme benefits received by former employees if they have not chosen to withhold tax from the benefit; or • benefits arising under tax-exempt, widely offered employee share schemes. Proposed new section 23J(1) of the Tax Administration Act 1994 specifies that the payday for an employee share scheme benefit, for the purposes of determining the due date for the provision of employment income information to Inland Revenue for the various groups of employers described in proposed new sections 23E to 23H of that Act, is the 20th day after the taxing point for the benefit received by the employee. Proposed new section 23J(2)(a) of the Tax Administration Act 1994 specifies that employers are not required to provide Inland Revenue with information on: • employee share scheme benefits received by former employees if they have not chosen to withhold tax from the benefit; or • benefits arising under tax-exempt, widely offered employee share schemes. Proposed new section 23J(2)(b) and proposed new schedule 4, table 1 of the Tax Administration Act 1994 specify the particulars in relation to employee share scheme benefits that must be provided to Inland Revenue by employers who are subject to the reporting requirements. The employee share scheme benefit-specific information that employers who are required to report employee share scheme benefit information for current employees is: • the value of the benefit to the employee; and • the amount of tax withheld from the benefit, if any. Employers who are required to report employee share scheme benefit information for former employees because they have chosen under the PAYE rules to withhold tax from the benefit, must report: • the employee's name; • the employee's IRD number, if known by the employer; • the value of the benefit; and • the amount of tax withheld from the benefit.

Example

Under the proposed rules, if an employee received a benefit under an employee share scheme on 5 July 2019, they would be treated as deriving income in relation to the benefit on 25 July 2019.

For the purposes of their employer's obligation to provide information in relation to the benefit to Inland Revenue under the proposed new requirement for employers to report employment income information to Inland Revenue on a payday basis, 25 July 2019 would also be the relevant payday. This would mean that their employer would be required to report information about the value of the benefit received by the employee and any tax withheld in relation to the benefit by the 2nd working day after 25 July 2019 if they are an employer above the $50,000 per annum of PAYE and ESCT threshold, or by the 7th working day after 25 July 2019 if they are below the threshold.

25 July 2019 would also be the relevant date for determining the due date for the payment of tax withheld in relation to the benefit (assuming that the employer elected to withhold tax in relation to the benefit). In this example, the due date for paying the tax withheld to Inland Revenue would be 5 August 2019 if the employer was above the $500,000 per annum of PAYE and ESCT threshold, or 20 August 2019 if they are below the threshold.

EMPLOYMENT INCOME INFORMATION CONSEQUENTIAL AMENDMENTS

Consequential amendments to the Income Tax Act 2007

Clauses 105 (section LB 1) 108 (section LB 8) 110 (section LD 4) 111 (section LD 5) 127 (section RC 3) 129(2) (section RD 2) 137 (section RD 8) 138(3) (section RD 10) 143 (section RD 13B) 145(2) and (3) (section RD 17) 149(1), (3) and (4) (section RD 23) 170 (section RP 14) 181(1), (2), (4), (5) and (7) (schedule 2)	These clauses propose amendments as a result of the new rules for employment income information and the replacement of the employer monthly schedule and in some cases the PAYE income payment form.
150 (section RD 24) 172(22) (section YA 1)	These clauses propose to delete a reference to an *exemption certificate* and replace it with an *exemption*.

Consequential amendments to the Tax Administration Act 1994

Clauses 194, 195, 234 insert new headings 187(3), (23) and (24) (section 3) 192 (section 15L) 196 (section 22) 208 (section 24Q) 237 (section 47) 255 (section 80D) 257 (section 80KT) 267 (section 125) 277 (section 183A) 278 (section 183D) 279 (section 183F)	These clauses propose to update references as a result of the new rules for employment income information and the replacement of the employer monthly schedule and the proposed changes to the structure of the Act. In some cases the changes reflect the proposed renaming of the “penalty for not paying the employer monthly schedule amount” as the “employers’ withholding payment penalty”.

Consequential amendments to the KiwiSaver Act 2006

Clauses 286 (section 4) 287 (section 17) 289 (section 23) 291 (section 42) 292 (section 60) 294(2) (section 64) 295 (section 73) 296 (section 93) 297 (section 97) 298 (section 98) 299 (section 98A) 300 (section 99)	These clauses propose to update references as a result of the new rules for employment income information and the replacement of: • the employer monthly schedule and the PAYE income payment form; or • the obligation to provide a KiwiSaver deduction notice with an obligation to advise of KiwiSaver status or of a change in KiwiSaver status.

TRANSITIONAL PROVISIONS

(Clause 282)

Summary of proposed amendments

The application date for the changes relating to payday filing of employment income information is 1 April 2019. Employers may however choose to adopt payday filing from 1 April 2018.

The transitional period is from 1 April 2018 to 1 April 2019 but for information relating to PAYE income payments made in March 2019 the transitional period extends until 30 April 2019.

Application date

The transitional provisions will come into force on 1 April 2018.

Key features

Although the Bill proposes that the provisions relating to payday filing of employment income information are effective from 1 April 2019, it is proposed that employers, if they wish to take advantage of the new arrangements, can choose to file on a payday basis from 1 April 2018.

Employers who choose to file on a payday basis will, however, not be subject to a late filing penalty unless they fail to meet the current filing dates for an employer monthly schedule relevant to them.

The Bill also proposes to require early adopters of payday employment income information reporting to apply the proposed modifications to the employee share scheme rules early as well.

Detailed analysis

The transitional period for the provision of the information required on an employer monthly schedule or PAYE income payment form is proposed as 1 April 2018 to 1 April 2019. However under proposed section 227D(1) for information relating to PAYE income payments made in March 2019 the transitional period is proposed to extend until 30 April 2019. This is to allow employers who have not adopted payday reporting of employment income information prior to 1 April 2019 to provide information on PAYE income payments made in March 2019 in an employer monthly schedule filed during April 2019. Proposed new section 227D(2) contains an exception for employee share scheme benefits received between 16 March 2019 and 31 March 2019 by employees or former employees of employers who are required to remit PAYE deductions on a twice-monthly basis. These employers will be required to apply the proposed modifications to the employee share scheme rules described in the preceding section of this *Commentary*, rather than being required to provide information about these benefits during May 2019 in an employer monthly schedule relating to the month of April 2019.

New section 227C(2) proposes that despite the effective date for payday filing of employment income information being 1 April 2019, employers may choose to file on a payday basis from 1 April 2018. If an employer wishes to start filing on a payday basis during the 2018–19 year it is not necessary, that they start with the information relating to the first PAYE income payment made in April 2018. An employer could start to file employment income information on a payday basis in an appropriately prescribed manner at the beginning of any month during the 2018–19 year.

Proposed new section 227C(3) and (4) propose that an employer who elects under proposed subsection (2) to adopt payday filing of employment income information during the transitional period must apply the proposed modifications to the employee share scheme rules described in the preceding section of this *Commentary* for all employee share scheme benefits received by their employees or former employees on or after the day that is 20 days before they made the election.

New section 227C(6)(b) proposes that an employer who chooses to file employment income information on a payday basis during the transitional period will not be subject to a late filing penalty unless they fail to meet the current filing dates of the 5th of the month for employers who have a twice-monthly payment obligation or the 20th of the month for all other employers.

Section 227C(7) proposes that an employer who elects to provide employment income information on a payday basis before 1 April 2019 may not revert to providing the information on a monthly basis unless the Commissioner agrees to the change.

REPEALING THE SUBSIDY FOR LISTED PAYE INTERMEDIARIES

(Clauses 129(1), 151(1), 167, 168, 171, 172(32), (42) and (64), 187(22) and (25), 188, 190, 191, 193, 280, 281, 317 and 318)

Summary of proposed amendments

The Bill proposes that the subsidy currently paid to listed PAYE intermediaries that undertake payroll obligations for small employers ceases on 1 April 2018.

Application date

The amendments will come into force on 1 April 2018.

Transitional provisions will ensure that listed PAYE intermediaries can claim and receive the subsidy for PAYE income payments made in periods up to but excluding 1 April 2018.

Key features

It is proposed that the payroll subsidy paid to listed PAYE intermediaries ceases. Relevant provisions in the Income Tax Act 2007, the Tax Administration Act 1994 and the Income Tax (Payroll Subsidy) Regulations 2006 are being repealed or amended to abolish the legislative framework for the payment of the payroll subsidy.

Employers can continue to transfer their PAYE and ESCT obligations to a PAYE intermediary, but the use of the intermediary's services will no longer be subsidised.

Background

This subsidy is currently paid by the Commissioner of Inland Revenue to listed PAYE intermediaries who assume PAYE obligations for employers who are only required to remit PAYE monthly. The subsidy is $2 per employee per PAYE income payment made in a period and is payable for up to five employees of the employer.

The way many businesses manage their payroll and the payroll services available have changed since the subsidy was introduced in 2006. For example, a growing number of small employers make use of payroll software or digital services to manage their payroll and PAYE. There is a range of different payroll products and services available. The subsidy incentivises only one model of payroll services. Because only services provided by listed payroll intermediaries are subsidised, the payroll subsidy potentially distorts employers' choices between different types of payroll products and services. The Government therefore proposes that the payroll subsidy is repealed.

INVESTMENT INCOME INFORMATION

Background

The key changes relate to the following:

- obtaining more frequent and detailed information for interest, dividends and Māori authority distributions;
- bringing forward the due date when PIEs are required to provide information to Inland Revenue;
- encouraging the provision of IRD numbers;
- increasing electronic filing;
- improving the administration of RWT exempt-status (certificates of exemption);
- removing some requirements to provide end-of-year withholding tax certificates; and
- improving error correction.

Application date

Most of the proposed changes come into force on 1 April 2020, although some apply from 1 April 2018 and 1 April 2019.

DETAIL AND FREQUENCY OF INVESTMENT INCOME INFORMATION

(Clauses 212, 239, 241, 246, 283 and 284(1)(d), and schedule 2)

Summary of proposed amendments

Several amendments are proposed to enable Inland Revenue to receive more frequent and detailed information from investment income payers on the amount of income taxpayers earn and the tax withheld on that income. The proposed changes are as follows:

- Payers of interest (including interest subject to the approved issuer levy but limited to domestically issued debt), dividends and taxable Māori authority distributions are to provide **investment income information** to Inland Revenue by the 20th of the month following the month in which the income was paid.
- Payers of interest, dividends and taxable Māori authority distributions exempt from withholding are to report **investment income information** yearly by 20 April, or monthly at the payer's preference.
- Multi-rate PIEs are to report investors' prescribed investor rates (PIRs) six-monthly.[1]
- A transitional measure: payers of interest are to report the currently required year-end information by 15 May, rather than 31 May, until the above monthly reporting changes take effect.

Application dates

The first three amendments will come into force on 1 April 2020, however payers can apply the new rules voluntarily from 1 April 2019.

The fourth amendment will apply from 1 April 2018 until 1 April 2019 (for payers who elect to apply the new rules early), or until 1 April 2020 for all other withholders.

Key features

Amendments are proposed to the Tax Administration Act 1994 to require payers of interest, dividends and taxable Māori authority distributions to provide investment income information by the 20th of the month following the month in which the income was paid, and for payers of income exempt from withholding to provide investment income information at year-end by 20 April.

[1] Note, it is also proposed that multi-rate PIEs that are not superannuation schemes or retirement savings schemes provide their investment income information by 15 May rather than 31 May, see section in this *Commentary* on bringing forward due dates for provision of information by PIEs.

Investment income information includes:

- the name, IRD number and contact details of the payer of investment income;
- the customer's name, contact details, IRD number and date of birth (if held);
- the customer's tax rate/PIR;
- the amount and type of income paid;
- the amount of tax withheld (if any) and the date it was withheld, as well as any imputation or Māori authority credits attached; and
- for PIE funds, whether the fund the payer is invested in is a retirement savings scheme or not.

This information will be required for all owners of an account, where the account has multiple owners and the income payer has information on the joint owners.

An amendment is proposed to require payers of interest to report year-end information by 15 May, rather than 30 May, until the monthly reporting changes take effect.

It is also proposed that PIEs will report investors' PIRs six-monthly.

Background

Currently, Inland Revenue does not receive sufficiently detailed or frequent information about the investment income that taxpayers earn and the tax withheld or paid on that income. If Inland Revenue received more frequent information, it would be able to ensure taxpayers' tax and social policy obligations/entitlements were more accurate during the year. For example, if Inland Revenue knows how much investment income a taxpayer earns during the year, it will be able to ensure that social policy entitlements the taxpayer receives take the investment income into account, as the entitlement relates to the income the person receives. It will also be in a position to advise the taxpayer of the appropriate withholding rate to use, as well as pre-populate tax returns for the taxpayer at the end of the year. Taxpayers who have not paid the correct tax or received the correct social policy entitlements during the year will need to square up at the end of the year, resulting in a debt or refund. Often taxpayers are unaware of these obligations. This means Inland Revenue may pay out more in social policy entitlements than it otherwise should and taxpayers may pay less tax and social policy obligations than they should.

It is estimated that $21 to $27 million of income tax per annum is forgone due to interest income not being correctly returned as income. This would be identified if interest income were pre-populated into tax returns and personal tax statements. Further, in 2015, at least 185,000 individuals did not have their interest income taken into account for Working for Families purposes.[2]

[2] Refer to paragraph 78 of the RIS titled "Changes to the tax administration of investment income information".

The proposed amendments focus on obtaining more detailed and frequent information on the investment income that taxpayers earn so Inland Revenue can pre-populate tax returns, proactively adjust tax rates and ensure taxpayers' tax obligations and social policy entitlements and obligations are calculated more accurately during the year.

Obtaining more frequent and detailed information on income that is exempt from withholding tax, subject to NRWT or subject to AIL is intended to allow Inland Revenue to determine whether the tax treatment applied is appropriate, and if it is not, to take that income into account in the person's tax affairs.

Requiring payers of interest to provide their year-end information by 15 May rather than 31 May until monthly reporting takes effect will give Inland Revenue sufficient time to pre-populate that information onto taxpayers' tax returns and personal tax summaries. While interest subject to NRWT will not be pre-populated, given it relates to non-residents, it is still proposed to be required by 15 May for ease of compliance so that payers do not have to provide their interest information on two separate dates.

Date of birth information is proposed to be required (when the payer holds that information) so that Inland Revenue can use it as a data verification point to help determine the IRD numbers of non-declared taxpayers or those whose IRD number does not appear to be correct.

It is proposed that payers provide Inland Revenue with taxpayers' tax rates and PIRs to better enable Inland Revenue to assess whether the relevant taxpayer is on the appropriate rate, based on the information that Inland Revenue holds about that individual, and to enable Inland Revenue to proactively correct the rate if they are not.

Detailed analysis

Proposed new subpart 3E of the Tax Administration Act 1994 (clause 212 of the Bill, proposed new sections 25B to 25S) codifies the requirements regarding information that payers of investment income must provide to the Inland Revenue. The persons who are required to provide this investment income information are listed in section 25E. Each person covered in section 25E has a specific section in subpart 3E which outlines the information that must be provided by reference to proposed new schedule 6 of the Tax Administration Act 1994, and when it must be provided. The following analysis outlines what each proposed new section does. This is followed by a comparative table, which outlines the current provisions of the Tax Administration Act 1994 that relate to investment income information, and the changes that are proposed.

Information on interest (proposed new section 25F in clause 212, clauses 239 and 241)

The Bill proposes that a payer of interest (including interest subject to the approved issuer levy, but limited to domestically issued debt) must deliver investment income information to Inland Revenue in electronic form by the 20th of the month following the month in which the amount of investment income was paid to the investor.

Like all of subpart 3E, this provision comes into force on 1 April 2020. To ensure that payers of interest are required to report the currently required year-end information by 15 May, rather than 31 May, clauses 239 and 241 amend sections 49 (NRWT withholding certificates and annual reconciliations) and 51 (RWT withholding reconciliation statements) respectively, to require this information to be filed by 15 May from 1 April 2018 until monthly filing comes into effect on 1 April 2020.

Information on dividends (proposed new section 25G)

The Bill proposes that a payer of dividends must deliver investment income information to Inland Revenue in electronic form by the 20th of the month following the month in which the dividend was paid to the investor.

Information on royalties (proposed new section 25H)

This provision provides that a person paying royalties to non-residents must provide investment income information to Inland Revenue by 31 May after the end of the tax year. This is the same as currently required by section 49 – the provision has simply been moved as part of codifying the investment income information requirements.

Information on Māori authority distributions (proposed new section 25I)

The Bill proposes that a Māori authority that makes a taxable distribution to a member must provide investment income information to Inland Revenue by the 20th of the month following the month in which that distribution is paid to the member.

Information on attributed PIE income (proposed new sections 25J and 25K, and clause 246)

Proposed new sections 25J and 25K essentially reproduce what is currently required by section 57B of the Tax Administration Act 1994. The only differences are:

- Investment income information will be required by 15 May (rather than 31 May) for a multi-rate PIE that is not a superannuation fund or retirement savings scheme (see section on bringing forward due dates for provision of information by PIEs).
- Six monthly reporting of PIRs will be required for all multi-rate PIEs (by 20 October for the first six months of the year, and with the year-end report for the final six months of the year).

These sections apply from 1 April 2020. To ensure that year-end PIE information is provided by 15 May from 1 April 2018, clause 246 amends section 57B(7) to this effect from 1 April 2018, and repeals it from 1 April 2020.

Information from emigrating companies (proposed new section 25L)

This provision retains the three month timeframe provided for in sections 49 and 51 for an emigrating company to provide information to the Commissioner in relation to the dividend that the company is treated as paying to shareholders under section FL 2(1) of the Income Tax Act 2007.

Information in relation to persons with RWT-exempt status (proposed new section 25M)

This provision requires payers of interest, dividends and Māori authority distributions to provide taxpayer-specific information to Inland Revenue in relation to payments made to persons with RWT-exempt status (the new equivalent of a RWT exemption certificate) by 20 April following the end of the year or, if the payer prefers, the 20th of the month following the month in which the income was paid.

It replaces section 51(2A), which provides that the Commissioner may require taxpayer-specific information in relation to interest (including certain dividends) paid to a person holding an RWT exemption certificate. There are currently no information requirements in relation to dividends (other than dividends treated as interest or dividends from which a trustee or agent is required to withhold RWT) and Māori authority distributions paid to a person holding an RWT exemption certificate.

Information from payers with no withholding obligations (proposed new section 25N)

This provision reproduces section 52 of the Tax Administration Act 1994 (see the table below); the section has simply been moved as part of codifying the investment income information requirements.

Information on financial arrangements (proposed new section 25O)

New section 25O requires a person with RWT-exempt status who acquires or disposes of a financial arrangement from/to another person to provide the Commissioner with detailed information regarding the acquisition or disposal of that financial arrangement with their return of income for the year.

This provision reproduces section 53 of the Tax Administration Act 1994.

Investment income information: variation of requirements (proposed new section 25S)

This provision allows the Commissioner to vary the requirements set out in new proposed subpart 3E and apply those requirements as varied.

It replaces sections 51(6) and 49(5) which allow the Commissioner to vary the information requirements relating to interest subject to RWT, and income subject to NRWT.

Transitional provision: application of investment income information provisions (proposed new section 227E, clause 283)

New section 227E allows payers of investment income to voluntarily apply the provisions relating to the delivery of investment income information and the correction of errors under the new proposed subpart 3E from 1 April 2019, before the provisions become compulsory from 1 April 2020.

Changes at a glance

Current section	Proposed change
Section 49 – This section requires payers of non-resident passive income to provide investment income information to Inland Revenue by 31 May.	Investment income information relating to interest, dividends and Māori authority distributions subject to NRWT will now be required by the 20th of the following month per proposed new sections 25F, 25G and 25I. Information regarding royalties paid to non-residents will continue to be required by 31 May following the end of the tax year per proposed new section 25H. The definition of "reconciliation statement" in section 3 of the Tax Administration Act 1994 will also be removed given the proposed repeal of section 49.
Section 49(4) and (4C) – This section provides that a payer who ceases to carry on a taxable activity in New Zealand must provide the information required by section 49 (relating to income subject to NRWT) to Inland Revenue before 40 working days after the end of the month in which the taxable activity ceases.	This information will now be required by the 20th of the month following the month in which the income was paid to align it with the general rule regarding the provision of investment income information. This also aligns with when payment of the NRWT is currently required when a taxable activity ends (section RA 16). As such, this specific provision is not contained in the new legislation.
Section 49(4B) and (4C) – This section provides that when an emigrating company is treated as paying a dividend, it must provide the investment income information required by section 49 to the Commissioner before three months after the time of emigration.	This information will continue to be required by three months after the time of emigration per proposed new section 25L. This aligns with when the payment of NRWT is currently required for emigrating companies (section RA 18).
Section 49(5) – This section allows the Commissioner to vary the requirements of section 49 and apply the requirements as varied.	This is now contained in proposed new section 25S.
Section 50 – This section requires a payer of resident passive income to provide Inland Revenue with summary information to accompany the payment of RWT relating to interest and dividends.	Summary information will no longer be required to accompany a payment of RWT. Instead, per proposed new sections 25F (interest) and 25G (dividends), detailed investment income information will be required to accompany the payment – which is the 20th of the month following the month in which the income is paid to the investor.
Section 51 – This section requires payers of interest (including certain dividends) subject to RWT to provide investment income information to Inland Revenue by 31 May following the end of the year (note that the 31 May date was inadvertently removed from the section as a result of an amendment in 2006, but continues to apply in practice).	Detailed year-end information for interest will no longer be required. Instead, detailed information will be required monthly, as outlined above.
Section 51(2A) – This section provides that the Commissioner may request investment income information from a payer who pays interest to a recipient holding an RWT exemption certificate.	Proposed new section 25M provides that payers of interest, dividends and Māori authority distributions must provide taxpayer specific information to Inland Revenue in relation to payments made to persons with RWT-exempt status by 20 April following the end of the tax year, or at the payer's preference, the 20th of the month following the month in which the income was paid.

Current section	Proposed change
Section 51(3) – This section provides the due date for information where the Commissioner has requested this information.	This provision is no longer required given detailed information will be required by the 20th of the month following the month in which the income is paid.
Section 51(4) and (5C) – This section provides that a person who ceases to carry on a taxable activity or business in New Zealand must provide the information required by section 51 (interest subject to RWT) before 40 working days after the end of the month in which the business/taxable activity ceases.	This information will now be required by the 20th of the month following the month in which the income was paid to align it with the general rule regarding the provision of investment income information. This also aligns with when payment of the RWT is currently required when a taxable activity ends (section RA 16). As such, this specific provision is not contained in the new legislation.
Section 51(5) and (5C) – Under section RE 4 of the Income Tax Act 2007, a person has an obligation to withhold RWT from interest if the payment is made as part of carrying on a taxable activity in New Zealand. In order to ensure a withholding obligation applies to exempt persons such as charities or entities carrying on financial services (which do not constitute a taxable activity) that pay interest, section RE 4(3) states that a person holding an RWT exemption certificate also has a withholding obligation. Sections 51(5) and (5C) provide that where a person ceases to hold an RWT exemption certificate (and is not required to withhold RWT by virtue of making payments in the course of a taxable activity in New Zealand), they must provide the information required by section 51 before 40 working days after the end of the month in which they ceased to hold the RWT exemption certificate.	This information will now be required by the 20th of the month following the month in which the income was paid, as explained above. This also aligns with when the payment of RWT is currently required when an RWT exemption certificate expires (section RA 17).
Section 51(5B) and (5C) – This section provides that when an emigrating company is treated as paying a dividend (previously companies could migrate without paying tax on all income earned in New Zealand, section FL 2 of the Income Tax Act 2007 deems a liquidation and dividend to shareholders to ensure tax is paid) it must provide the information required by section 51 before three months after the time of emigration.	This information will continue to be required within three months after the time of emigration as proposed in new section 25L. This is consistent with when the payment of RWT is currently required for emigrating companies (section RA 18).
Section 51(6) – This section provides that the Commissioner may vary the requirements of section 51 in relation to any person and apply the requirements as varied.	This is now contained in proposed new section 25S.
Section 51(7) – This section states that a dividend paid by an RWT proxy is treated as interest for the purposes of section 51.	This provision will no longer be necessary as the proposed information requirements for interest and dividends will be the same.

Current section	Proposed change
Section 52 – This section provides that a payer of interest who is not required to withhold RWT because the payment of interest was not made in the course of a taxable activity or was less than the minimum threshold of $5,000 for the tax year must provide investment income information to the Commissioner with their return of income for the year when the interest is allowed as a deduction.	This provision is now contained in section 25N.
Section 53 – This section requires a person with RWT-exempt status who acquires or disposes of a financial arrangement from/to another person to provide the Commissioner with detailed information regarding the acquisition or disposal of that financial arrangement with their return of income for the year.	This provision is now contained in proposed section 25O.
Section 54 – This section allows the Commissioner to request from a payer taxpayer-specific information relating to recipients of resident passive income.	This provision will no longer be needed as payers of resident passive income will be required to provide this information to the Commissioner.
Section 57B – This section sets out the return requirements for multi-rate PIEs, although it is different from the other sections discussed in this *Commentary* as it covers payment of the tax as well as providing the information.	Section 57B(7), which relates to providing information and not to payment of the tax, has been moved to proposed sections 25J and 25K.
Section 67 – This section provides that an ICA company which declares a dividend must provide information regarding that dividend to the CIR with the return of income for the year.	This information must now be provided on the 20th of the month following the month in which the dividend is paid, per proposed new section 25G.
Section 68B – this section requires a Māori authority to provide Inland Revenue with summary information regarding any Māori authority distributions paid with the return of income for the year.	This is now covered by proposed new section 25I.

BRINGING FORWARD DUE DATES FOR PROVISION OF INFORMATION BY PIES

(Clauses 212, 246 and 284(1)(d), and schedule 2)

Summary of proposed amendments

Amendments are proposed to enable Inland Revenue to receive detailed information earlier from multi-rate PIEs that are not superannuation funds or retirement schemes by 15 May,[3] rather than 31 May, following the end of the income year.

Application date

The amendments will come into force on 1 April 2018.

Key features

Proposed new subpart 3E (clause 212 of the Bill) of the Tax Administration Act 1994, along with current section 57B, codifies the information requirements for multi-rate PIEs. Proposed section 25J provides that the detailed year-end information to be provided by PIEs that are not superannuation funds or retirement savings schemes is to be provided by 15 May after the end of the tax year. The information required is set out in proposed new schedule 6 of the Tax Administration Act 1994. Proposed section 25J will come into force on 1 April 2020. Clause 246 amends section 57B(7) to require the detailed year end information by 15 May (applying from 1 April 2018) and then repeals section 57B(7) from 1 April 2020.

The table below outlines the provisions of these sections and highlights the changes that are proposed.

Changes at a glance

Current section	Proposed change
Section 57B (7)(a) – requires a multi-rate PIE , that has a corresponding income year that does not end after the end of the tax year and is not a superannuation fund or a retirement savings scheme, to provide Inland Revenue with detailed recipient information for the year by 31 May after the end of the tax year.	Multi-rate PIEs (that have a corresponding income year that does not end after the end of the tax year and are not a superannuation fund or a retirement savings scheme) will be required to report detailed recipient information for the year to Inland Revenue by 15 May after the end of the tax year.

[3] The information will still be due by the end of the second month after that in which the PIE's corresponding income year ends, if the PIE has a corresponding income year that ends after the end of the tax year or by the end of the third month after that in which the PIE loses PIE status, if the cessation occurs in the corresponding income year.

Background

Currently, Inland Revenue receives detailed PIE income information for multi-rate PIEs (other than superannuation funds and retirement savings schemes) by 31 May following the end of the income year. While the PIE tax in respect of this PIE income is treated as a final tax (unless the prescribed investor rate chosen is too low) the income from these PIEs does need to be taken into account for social policy income calculations.

Receiving the information on or around 31 May is too late to associate the PIE income with recipients' other income records held by Inland Revenue as part of the personal tax summary process. By bringing the due date forward to 15 May the PIE information will be able to be associated with recipients' employment income, which will give Inland Revenue a better understanding of recipients' overall income position and will help enable Inland Revenue to ensure taxpayers' tax and social policy obligations/entitlements are correctly calculated. It will also help Inland Revenue to ensure that PIE investors are selecting the correct PIR for the following year.

MEASURES TO ENCOURAGE PROVISION OF IRD NUMBERS

(Clauses 81, 85, 180 and 215)

Summary of proposed amendments

Amendments are proposed to the Tax Administration Act 1994 to encourage taxpayers to provide their IRD numbers to payers of investment income. The use of IRD numbers improves the overall administration of the tax system as it ensures Inland Revenue can attribute income to the taxpayer. In order to encourage taxpayers earning interest income to provide their IRD numbers, the non-declaration rate (the rate that applies when a taxpayer has not provided their IRD number) will increase from 33% to 45%. For PIE income, investors opening new investments in multi-rate PIEs will be required to provide their IRD number to the PIE in order to remain a member of the PIE.

Application date

The changes to the non-declaration rate for interest income will come into force on 1 April 2020. The requirement for new investors in a PIE to provide their IRD numbers in order to stay invested in the PIE will come into force on 1 April 2018.

Key features

Non-declaration rate

Clause 180 increases the non-declaration rate that applies to taxpayers (including non-natural persons) who do not provide their IRD number to payers of interest income from 33% to 45%.

PIE funds

Deemed exit

Clause 215 (section 28B) requires an investor in a multi-rate PIE to notify the PIE of their tax file number within six weeks of becoming an investor in the PIE.

Clause 85 (section HM 62) requires multi-rate PIE funds to close a member's account and refund their investment if they have not provided their IRD number to the PIE within six weeks of opening their account.

Tax effects of deemed exit

Clause 81 (section HM 4) provides that an investor who has not provided their IRD number to the multi-rate PIE within six weeks of becoming a member is treated as reaching the exit level. This requires the PIE to calculate its tax liability in relation to the exiting investor, under sections HM 42 and HM 47 of the Income Tax Act 2007.

Clause 85 (section HM 62) amends section HM 62 of the Income Tax Act to update the definition of exit level to include where an investor has failed to provide their IRD number to the PIE within six weeks of becoming an investor.

Background

Inland Revenue has difficulty attributing income to a taxpayer if it does not have the taxpayer's IRD number. Around 20 percent of the interest certificates received by Inland Revenue do not contain the recipient's IRD number. In relation to PIE income, 2 percent of investors have not provided their IRD number to their PIE fund.

Currently, taxpayers are not incentivised to provide their IRD number to Inland Revenue as the non-declaration rate may be too low. The non-declaration rate is 33% for interest income and 28% for PIE income, which equates to the top marginal tax rate for the respective income types. As a result, these rates do not incentivise taxpayers on the top marginal tax rate to provide their IRD number. Further, taxpayers with social policy entitlements or obligations may have much higher effective tax rates (taking into account abatement of entitlements or additional obligations) and may realise that by not providing their IRD number, it is unlikely that their investment income will be taken into account when social policy entitlements/obligations are calculated. This may mean they receive more social assistance or pay less in child support and student loan repayments than they should.

No changes are proposed to encourage provision of IRD numbers in relation to dividends and Māori authority distributions due to capability concerns, and because Inland Revenue is unable to determine the extent of the non-declaration problem in relation to these types of income until after Inland Revenue begins to receive detailed recipient information. This makes it very difficult to make a satisfactory analysis of the compliance cost versus the benefit at this stage.

Example

Laura is a single mother with sole custody of her two children. She earns $50,000 a year and has a student loan. She invested some money from an inheritance which returns her $5,000 income a year. She has not provided her IRD number to her investment income payer. As a result, Laura would receive $1,352 per year more in Working for Families than otherwise entitled, and pay $600 less off her student loan per year than otherwise required, if she did not return this income.

Aim of proposed changes

The proposed changes should encourage people to provide their IRD numbers so that income is allocated to the relevant taxpayer, ensuring the taxpayer pays the right amount of tax, and receives the correct amount in social policy entitlements, and pays the correct amount in social policy obligations.

Having one non-declaration rate for all New Zealand-resident recipients of interest income is easier to understand for taxpayers and may reduce the compliance burden for payers of investment income.

The level of non-declaration experienced by PIEs is much lower than the level of non-declaration for interest. As such the IRD number requirement suggested during consultation has been proposed rather than proposing a higher non-declaration rate for PIEs.

Consultation highlighted numerous problems with imposing a 45% non-declaration rate for PIEs, such as the unfairness of applying it to retirement savings (which are not taken into account for social policy purposes) and whether the savings would be returned to the taxpayer’s retirement account once the overpaid PIE tax was subsequently recovered. The potential for investors subject to the non-declaration rate receiving PIE losses cashed out at 45% was also concerning.

ENCOURAGING ELECTRONIC FILING

(Clauses 212, 269 and 275)

Summary of proposed amendments

An amendment is proposed to require all investment income payers to file their investment income information electronically, unless they receive an exemption from the Commissioner.

An amendment is also proposed to the non-electronic filing penalty, to ensure it applies to payers who fail to provide their investment income information in a prescribed electronic form.

Application date

The amendment compelling payers to file electronically will come into force on 1 April 2020, but from 1 April 2019 for payers who voluntarily provide monthly information.

The changes to the non-electronic filing penalty will come into force on 1 April 2020.

Key features

Payers of the following types of income will be required to provide their investment income information to Inland Revenue electronically:

Type of income	**Proposed new section**
Interest	25F
Dividends	25G, 25L (in relation to emigrating companies)
Royalties paid to non-residents	25H
Māori authority distributions	25I
Attributed PIE income	25J and 25K[4]
Income paid to persons with RWT exempt status	25M
Interest with no withholding obligation that is allowed as a deduction	25N
Financial arrangements	25O

[4] Note that electronic filing is already a requirement in relation to PIE returns.

Proposed new section 25Q (clause 212) provides that the Commissioner may grant an exemption from electronic filing if the investment income payer would experience unreasonable compliance costs or other hardship as a result of the requirement to file digitally. In considering whether to exercise her discretion, the Commissioner must have regard to:

- the capability of the investment income payer;
- the nature and availability of suitable digital services; and
- the compliance costs involved with complying.

The Commissioner will publish guidelines on how the exemption will apply.

Clause 269 amends the non-electronic filing penalty, so that it applies to payers who fail to provide their investment income information in a prescribed electronic format.

Clause 275 provides that this penalty is due 30 days after the end of the month in which the payment of investment income was required to provide the information in the prescribed electronic form to the Commissioner.

Background

The majority of current investment income returns are paper-based. For returns that are able to be filed electronically, there is no electronic filing threshold to require payers of a certain size to file electronically. Paper filing is slower, more expensive in terms of compliance costs for payers of investment income and administrative costs for Inland Revenue, and more prone to errors.

This amendment is intended to ensure that everyone, other than those who are genuinely unable to access digital services, files electronically. This will not require payers to purchase software as payers will be able to enter the relevant details into an online form through MyIR. Having to apply to the Commissioner for an exemption may encourage people who may be able to file digitally, but would otherwise choose not to, to do so.

IMPROVING THE ADMINISTRATION OF RWT EXEMPT STATUS

(Clauses 161, 163, 172(21), (51), 220 and 224)

Summary of proposed amendments

Amendments are proposed that will change the terminology for RWT exemptions from a person "having an RWT exemption certificate" to "having RWT-exempt status" and will ensure that persons that have RWT-exempt status will be included in an electronic register maintained by Inland Revenue. Investors with RWT-exempt status will have to notify their investment provider of their status and payers of investment income will be able to confirm that investors have RWT-exempt status on the electronic register.

Recipients of investment income that are exempt from tax under another Act will need to apply for RWT-exempt status and will then be included on the electronic register if they wish to continue to be treated as being exempt from RWT. The income would still be exempt income so if the recipient did have RWT deducted they could apply to Inland Revenue for a refund of the deducted RWT. This amendment is intended to make it easier for payers of investment income to determine whether the recipient has current RWT-exempt status.

Application date

The amendments will come into force on 1 April 2020.

Key features

Clauses 161, 163, 172, 220 and 224, which propose changes to sections RE 27, RE 29 and section YA 1 of the Income Tax Act 2007, and sections 32H and 32L of the Tax Administration Act 1994, codify the changes in respect of RWT-exempt status. A number of other clauses include changes to change the terminology from "RWT exemption certificate" to "RWT-exempt status" and have not been specifically covered in this *Commentary*.

The table below outlines the provisions of these sections and highlights the changes that are proposed to the extent that the changes are more than just terminology changes from RWT exemption certificate to RWT-exempt status.

Changes at a glance

<table>
<tr><th>Current section</th><th>Proposed change</th></tr>
<tr><td>Section RE 27 – sets out rules regarding applying for RWT exemption certificates, when a certificate expires and obliges the holder of a certificate if they become aware that they no longer meet the requirements to hold a certificate.</td><td>Clause 161 (amending section RE 27) provides that a person who has RWT-exempt status must notify their investment provider of their status and of any change in their status. This means that investment providers will be prompted to confirm the persons RWT-exempt status on the electronic register to be provided by the Commissioner and then to treat the person as exempt from RWT. It also means that the person holding RWT-exempt status would have to inform their investment providers if their RWT-exempt status expired or was cancelled.</td></tr>
<tr><td>Section RE 29 – sets out the ways available to a person to establish whether another person is a person holding an RWT exemption certificate. These include:
taking reasonable steps to determine whether the other person is a person section 32E(2)(a) to (h) of the Tax Administration Act 1994; or
having seen the other person’s RWT exemption certificate and taken reasonable steps to establish that they are the person named on the certificate.
The section also sets out requirements about notices of cancellation published in the Gazette and several other requirements.</td><td>Clause 163 (proposed section RE 29) provides that a person may establish whether another person has current RWT-exempt status by searching the electronic register provided by the Commissioner. This change simplifies the process for determining whether a person has RWT-exempt status and whether that status is current.</td></tr>
<tr><td>Section YA 1 – definition of “exempt interest”. The definition of exempt interest in section YA 1 sets out a range of types of interest that are excluded from being resident passive income under section RE 2(3)(a). The definition includes interest that is exempt income under section CW 64 (Exemption under other Acts).</td><td>Clause 172 (21) removes income that is exempt under other Acts from the definition of “exempt interest”. This means that recipients of investment income that are exempt under other Acts will need to apply for RWT-exempt status (which they are eligible for) in order to be treated as exempt from RWT. They will then be included on the electronic register discussed above.

The income will still be exempt from income tax so even if the recipient did not apply for RWT-exempt status and RWT was deducted the RWT would be refundable.</td></tr>
<tr><td>Section YA 1</td><td>Clause 172 (51) inserts a new definition of “RWT-exempt status”. The definition refers to the status applied for under section RE 27 by eligible persons.</td></tr>
<tr><td>Section 32H – sets out the rules around providing exemption certificates and replacing lost or destroyed certificates.</td><td>Clause 220 replaces existing section 32H and requires the Commissioner to add a person who meets the requirements and has applied for RWT-exempt status to the electronic register of persons with RWT-exempt status and to notify the person that they have been issued RWT-exempt status (and the start and end date as applicable). This obligation on the Commissioner to add successful applicants to the electronic register means that the register should be kept up to date and should be a reliable source of information for payers of investment income.</td></tr>
</table>

Current section	Proposed change
Section 32L – sets out the rules regarding the cancellation of RWT exemption certificates and includes a requirement to publish a list of cancellations in the *Gazette*.	Clause 224 replaces existing section 32 L. It removes the requirement to publish a list of cancellations in the *Gazette* and instead requires the Commissioner to publish on the electronic register a list of persons whose RWT-exempt status has been revoked. It also provides that a person with an existing RWT certificate of exemption will be treated as having RWT-exempt status if their name appears on the electronic register of persons with RWT-exempt status. This allows persons with existing RWT exemption certificates to be transitioned on to the register and to have RWT-exempt status without having to go through the application process again.

Background

Currently, Inland Revenue issues certificates of exemption, and the holders of the certificates then provide copies of the certificates to their investment provider. These certificates can be cancelled on the basis that they have expired or been revoked. Information on the issues and cancellations of RWT exemption certificates is published quarterly in the *New Zealand Gazette*. Recipients of investment income who are exempt from tax under other Acts can also request their investment providers to treat them as exempt from RWT without needing to get a certificate of exemption.

The *Gazette* process is infrequent and causes some problems for payers of investment income. Payers have issues determining whether a recipient is still exempt and can also have problems determining whether a recipient who informs them that they are exempt under another Act is actually exempt.

REMOVING SOME REQUIREMENTS TO PROVIDE END-OF-YEAR WITHHOLDING TAX CERTIFICATES

(Clause 211)

Summary of proposed amendments

Under the proposed amendments the requirements to provide end-of-year withholding tax certificates to recipients of interest (or dividends treated as interest and dividends subject to section RE 9(2)) will be limited to recipients that have not provided their IRD number to their investment income payer.

Application date

The amendments will come into force on 1 April 2020.

Key features

Clause 211 proposes amendments to section 25 of the Tax Administration Act 1994 (and renumbers section 25 as section 26C) to remove the requirement to provide RWT withholding tax certificates to interest (or dividends treated as interest and dividends subject to section RE 9(2)) recipients that have provided their IRD number to their investment provider. Instead, the investment providers will only have to provide end-of-year certificates to recipients who have not provided their IRD number.

Background

Currently, payers of interest (or dividends treated as interest and dividends subject to section RE 9(2)) that have made payments to recipients and have deducted RWT are required to provide a tax certificate to the recipient (typically after the end of the tax year). There are a number of specific pieces of information that are required to be included on the certificates and a number of financial institutions face significant time pressure to send out the certificates. As Inland Revenue will be getting investment income information more frequently and making it available on the person's MyIR account there is no longer a need to have such tight requirements around sending out tax certificates. If payers want to continue to provide year-end tax information they will still be able to do that but they will not be required to do it.

The exception is for people that have not provided their IRD number to their investment provider. As the investment income paid to these people may not be able to be associated with their tax records there will still be a requirement to provide them with year-end withholding tax certificates. This will also help to highlight to these people that they are being subjected to the higher non-declaration rate which may prompt them to file a tax return (which would involve providing their IRD number).

Payers of dividends and taxable Māori authority distributions will still need to send shareholder dividend statements or Māori authority distribution statements (as applicable) to the recipients of these types of income as they are likely to be paid sporadically and it would be useful for the recipient to be informed at the time of the payment.

CORRECTION OF ERRORS IN INFORMATION PROVIDED

(Clauses 122, 123, 212 and 283)

Summary of proposed amendments

Amendments are proposed that will make it easier to correct errors when the payer has not deducted enough withholding tax in the following tax year. The ability to make adjustments in the following tax year will be subject to a threshold, and the payer will be required to notify Inland Revenue of the correction. Subject to meeting the requirements, the correction will not be subject to penalties or interest.

Application date

The amendments will come into force on 1 April 2020 or on 1 April 2019 for payers who choose to apply the new investment income information rules before they become compulsory.

Key features

The proposed changes mean that errors will still be able to be corrected in the year that they occurred in, but in addition, they will be able to be corrected in the following year if they are under the threshold for error correction. The payments made to correct the error would be treated as having been made in time and as such would not be subject to penalties or interest.

Where tax has been withheld at a higher rate than it should have been, the additional tax credits will be pre-populated into the recipient's tax records and will be able to be refunded by Inland Revenue if it results in the recipient's income tax being overpaid.

These changes also broaden the application of the error correction provisions and apply to all forms of income subject to RWT or NRWT.

Background

Currently, errors where the payer has not deducted enough withholding tax from interest subject to RWT or non-resident passive income that is subject to NRWT can be corrected in the same tax year by payers of investment income but where the errors are not discovered until the following tax year the correction must be done by amending a prior year return. The proposed amendments are intended to make it easier for payers to correct errors where the correction is made within a reasonable length of time. The error correction provisions do not change the obligation to provide correct returns initially and are only available to correct errors as opposed to allowing payers to choose to defer the payment of withholding tax.

Detailed analysis

Clauses 122 and 123, which propose changes to sections RA 11 and RA 12 of the Income Tax Act 2007 and clauses 212 and 283, which propose new sections for the Tax Administration Act 1994, codify the changes on error correction.

The table below outlines the provisions of these sections and highlights the changes that are proposed.

Changes at a glance

Current section	Proposed change
Section RA 11 – sets out the rules regarding error correction where there is an underpayment of RWT (in respect of interest or dividends treated as interest) or NRWT caused by a failure to deduct enough from a payment made to a recipient. The section allows the error to be corrected in the same year by subtracting the amount from a later payment to the recipient or recovering the amount from the recipient. The later payment can only be a payment of interest, a dividend treated as interest or a payment of non-resident passive income.	Clause 122 provides that the error correction can be made in respect of any payment subject to RWT or NRWT. The correction can be made by subtracting an amount from a subsequent payment to the payee (no restriction on the type of payment) or by recovering an amount from the payee directly provided the correction is made in the same year. The error can also be corrected by deducting an amount from a subsequent payment to the payee made in the following year provided that the tax being corrected is no more than the greater of $2,000 or 5 percent of the payer's RWT or NRWT withholding liability (as applicable) for the year in which the error occurred. For example, if the payer paid $1,000,000 of RWT in the year of the error an RWT error of up to $50,000 could be corrected in the following year. Proposed section RA 11(5) provides that a correction made that meets the requirements set out above will be treated as being made on the due date for the withholding tax and as such it would not be subject to interest or penalties. A requirement to notify the Commissioner of the adjustments made in the following year is also included in the clause. This notification would be expected to be made separately to the main withholding tax information being filed to allow Inland Revenue to have a correct understanding of the recipient's tax positions for each income year.
Section RA 12 – sets out the rules regarding error correction when there is an overpayment of RWT or NRWT because the payer has in error withheld too much tax. The error can only be corrected by the payer in the same year (before the relevant certificate has been sent out or if the certificate has been returned and cancelled). Section RA 12(5) requires that the Commissioner must refund the payment if the excess amount has been paid to the Commissioner.	Clause 123 allows the payer to pay the excess amount to the recipient at any time before the 20^{th} of April after the end of the tax year provided the payer has not reported to the payee via a RWT withholding certificate, shareholder dividend statement, or Māori Authority distribution statement. If the relevant certificate has been sent out, the payer will need to inform the Commissioner and the payee of the amount that needs to be refunded to the payee. This means the payer can make the correction up to the point that the final withholding information for the year is provided to the Commissioner/or the payee when the certificate has been sent out earlier. Once the year-end information has been provided to the Commissioner the information will be pre-populated into the recipient's tax records and if

Current section	Proposed change
	the excess tax puts the recipient's overall income tax position into a refund position the recipient will be able to claim a refund from Inland Revenue.
	Clause 212 inserts proposed section 25P, which effectively directs withholding tax payers to the error correction sections at sections RA 11 and RA 12.
	Clause 283 introduces proposed section 227E, which gives transitional provisions for early adopters of the new investment income information rules. Section 227E(2) provides that early adopters who choose to apply the new rules in the period between 1 April 2019 and 31 March 2020 can also apply the new error correction rules.

Other Making Tax Simpler items

SETTING A NEW DUE DATE FOR DEFAULT ASSESSMENTS

(Clauses 273 and 274)

Summary of proposed amendment

Currently, section 142A of the Tax Administration Act 1994 sets different due dates for payment of an Electronic Default Assessment (EDA) and Non-electronic Default Assessment (NDA). There are also different treatments for any tax payable from a subsequent amendment to that default assessment.

The amendments bring the two different types of default assessment under the same rules to reduce confusion and simplify the rules around default assessments.

Application date

The amendments will apply on a date appointed by the Governor-General by Order in Council, and one or more orders may be made appointing different dates for different tax types and purposes. The new rules will only apply to taxes that have migrated to Inland Revenue's new computer system, START, and do not have incremental penalties applying.

Key features

Amendments to section 142A align the due date for payment of tax for default assessments. Currently there are different treatments between default assessments that are made by electronic means and those that are made manually.

There is no reason why these treatments should be different, and taxpayers can be confused about which payment rules apply.

The amended rules will only apply when the default assessment relates to a tax type that has been migrated to the new START system and when incremental penalties do not apply to the particular tax type.

Background

Section 142A sets different due dates for payment of an EDA and NDA.
For an EDA:

- The amount payable from the default assessment is due on the original due date for the tax type and period. This means that if the EDA is made after the original due date, as is always the case for GST, late payment penalties will be immediately applied, back-dated to the original due date.

- When the EDA is amended, a new due date will be set that is at least 30 days following the notice advising the taxpayer of the new amount to pay. Therefore, any late payment penalties applied to the EDA will be reversed, and the taxpayer will not be penalised further unless they do not pay any amount due by the new due date.

Example

Horribear Ltd the maker of zombie teddy bears is due to file its GST return for the period 31 March 2017 on 28 April 2017. Because of an upward demand for the new Demon Teddy range, Horribear forgets to file the return in its attempts to produce more Demon bears.

Because the return is unfiled the Inland Revenue computer system automatically applies an EDA of $1,000 on 14 May 2017. The due date for the EDA is 28 April 2017, so immediately retrospective penalties are applied on the amount of the EDA, with effect from the day after the original due date.

Horribear then files the return on 30 May 2017, and the information from that return is used to replace the EDA with a new assessment of $1,500 to pay.

The taxpayer is given at least 30 days – until 30 June 2017 to pay the $1,500 assessment. There are no back-dated penalties unless they do not pay by the new due date.

For an NDA:

- The amount payable from the default assessment is due at least 30 days from the notice of assessment.
- If the assessment is subsequently amended, then the taxpayer is only given a new due date for any amount payable that is greater than the amount previously payable from the NDA. This new due date will also be at least 30 days after the notice advising the taxpayer of the additional tax to pay.

Example

Dream Liner Ltd a manufacturer of scented industrial bin liners is due to file its GST return for the period ended 31 March 2017 on 28 April 2017.

An Inland Revenue investigator decides to make a Commissioner's assessment of $1,000 on 14 May 2017 due to Dream Liner not having filed a number of returns, including this one. Dream Liner is given a due date to pay the $1,000 on 15 June 2017.

The taxpayer then files its return, and the information from the return is accepted as an amendment to the NDA on 30 June 2017, with the resulting assessment being $1,500 to pay.

The $1,000 from the NDA is still due, as of 15 June 2017, and the taxpayer is given a new due date of 30 July 2017 to pay the additional $500 of the increased assessment.

Detailed analysis

Proposed new section 142AB of the Tax Administration Act 1994 will apply from the date appointed by the Governor-General through Order in Council, and one or more orders may be made appointing different dates for different tax types and for different purposes. It is intended that as tax types are migrated to Inland Revenue's new START system the new rules will apply.

The new rules will also only apply to tax types where incremental penalties have been removed. The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 contains provisions that remove incremental penalties from goods and services tax (GST), income tax and Working for Families tax credits.

Section 142AB will apply to set a new due date for certain assessments. Section 142AB will not apply to assessments made in the absence of a return and to which section 106(1) applies. Section 106 deals with the issue of default assessments, both electronic and non-electronic.

Section 142A, which applies to tax types that proposed section 142AB does not apply to, has application to assessments other than EDAs made in the absence of a return and to which section 106(2) applies, which relates to EDAs only. Section 142AB removes this distinction entirely so that no new due date is set for any default assessment, manual or automatic.

In addition, proposed section 142AB does not set a new due date for an increased assessment from a default assessment. This will mean that any subsequent amendments to a default assessment will be due at the original due date. This change reflects the fact that no return was originally filed and removes a benefit to those who do not file compared with those who do file returns and pay tax on time.

Example

Using the facts in the Dream Liner Ltd example above, Dream Liner is due to file its GST return for the period 31 March 2019 on 28 April 2019. GST is a tax which has migrated to START and has had incremental penalties removed.

An Inland Revenue investigator decides to make a Commissioner's assessment of $1,000 on 14 May 2019 due to Dream Liner not having filed a number of returns. Section 142AB will not apply to this default assessment and the tax will be due on the original due date of 28 April 2019.

The taxpayer then files its return, and the information from the return is accepted as an amendment to the NDA on 30 June 2017, with the resulting assessment being $1,500 to pay.

Again, section 142AB will not apply as the reassessment relates to the reassessment of a default assessment and thus the $1,500 from the reassessment is still due on the original due date for the tax, 28 April 2019.

Example

Carrying on from the Horribear Ltd example above, in the 2019 year Horribear has a GST review performed by Inland Revenue on its GST return for the period ended 31 March 2017.

Inland Revenue discovers that Horribear has understated its GST output tax for the period by $500. The investigator issues a reassessment for the period to reflect the increase in GST payable.

Assuming that GST has been migrated to the START system and that no incremental penalties apply to GST, section 142AB will apply to the reassessment as it is not a reassessment of a default assessment and therefore a new due date can be set for the payment of the extra GST. The due date for the tax is set for at least 30 days after the reassessment.

THE DATE INTEREST STARTS

(Clause 263)

Summary of proposed amendment

This amendment reduces the number of working days referred to in the definition of "date interest starts" from 15 working days to 10 working days because of the migration of GST to Inland Revenue's START system. This will mean taxpayers who have a GST refund and file early will have use of money interest (UOMI) calculated on that refund earlier than is the current rule. This reflects efficiencies in processing time for GST returns in the new START system.

Application date

The amendments will apply from the date of enactment.

Key features

Section 120C of the Tax Administration Act 1994 outlines the date on which UOMI is calculated from. Specifically, in the definition of "date interest starts", paragraph (c) outlines the date on which a GST refund begins to accrue UOMI. With the migration of GST to Inland Revenue's START system, and the efficiencies this creates, it is now possible to reduce the time before UOMI begins to accrue on GST refunds from 15 working days to 10 working days.

Background

Under the current rules the definition of "date interest starts" in section 120C(c) outlines the date at which interest commences to accrue on a GST refund. This is the latest of the following dates:

(i) The day after the earlier of –

  (A) the 15^{th} working day after the taxpayer provides a tax return for the return period to which the GST refund relates; and

  (B) the original due date for payment of output GST in respect of that return period; and

(ii) the day after the day on which the tax return is provided; and

(iii) the day after the date on which the payment is made.

The 15 working days was originally designed to give Inland Revenue time to review and process the GST refund before interest would accrue.

Example

The Drake Ltd operates a bar specialising in vegan cocktails. Due to the strong demand for vegan cocktails The Drake files its GST return monthly but for the month of June 2018 it has a GST refund, due to a large number of purchases made that month getting ready for the Vegan July festival and files its GST return before the due date of 28 July.

The GST return is filed on 7 June 2018. Interest will start accruing to The Drake 15 working days after that, being 28 June if it has not been refunded.

Because of efficiencies in processing GST returns through Inland Revenue's business transformation it is now possible to reduce the 15 working day delay in paying interest in section 120C(1)(c) which will enable taxpayers to earn UOMI sooner when a refund is delayed.

Example

Using the facts from The Drake example above under the proposed rule The Drake would earn UOMI on its refund from 21 June rather than the 28th under the current rules.

THE DATE AN EXCESS CREDIT ARISES

(Clause 276)

Summary of proposed amendments

There are currently rules within section 173L, and in particular section 173L(2), which outline the earliest date that taxpayers are able to transfer all or part of an excess credit. The current rules do not appropriately deal with taxpayers who file their returns early or late. The proposed amendment alters the date a credit arises in respect of goods and services tax (GST) to better reflect when a taxpayer files their return as this is the date that establishes the amount of the credit.

Application date

The amendments will apply from the date of enactment.

Key features

The date that a credit arises for a taxpayer in respect of GST will change to more closely reflect the date the taxpayer files their return, as this is the day that the amount of the credit is established. For taxpayers who file their GST return on time there will be no change from the current position and the credit will arise the day after the end of the GST return period in which the refund arose.

For those taxpayers who file their return before the due date, the refund will be available on the earlier of:

- the day after the date on which the return is filed; or
- the day after the end of the GST period to which the refund relates.

For taxpayers who file after the due date, the refund will be available on the day after the date the return is filed.

Background

The current rules around when excess tax is available to be transferred, does not reflect the date on which a taxpayer files a GST return. The filing of a return establishes the amount of the credit which is available to the taxpayer to use or be refunded.

For taxpayers who file their GST return early this can cause a delay in obtaining a credit when they may be closing down a business or require the funds for other liabilities. Conversely, for taxpayers who file their return late a credit can be available at a date that is earlier than the amount of the refund has been calculated.

Detailed analysis

To more closely align the calculation of the refund with its availability to taxpayers, the proposed change alters the current rules around when the excess tax is available to be used by a taxpayer by moving this date closer to when the return is filed.

For most taxpayers who file their GST return on time, the proposed new rules will not change the current date on which a credit is available. These new rules will only affect taxpayers who file their returns early or late.

For taxpayers who file early the date the excess tax becomes available will be the earlier of:

- the day after the date on which the return is filed; or
- the day after the end of the GST return period in which the refund arose.

This will mean that a GST credit will be available to a taxpayer on the day after a GST return is filed if that return is filed before the end of the taxable period. This situation will be rare but may be when a business is closing down and files a return until the date of cessation.

In this situation the credit will be available to the taxpayer the day after the return is filed or the end of the GST return period, whichever is the earlier.

Example

Scotty Cycles Ltd sells spin bikes to gyms. They are in an unusual position for the two-month GST period ending 30 June 2018. They have imported a large number of spin bikes and associated parts on 1 June 2018 from the United States for a large order for a leading New Zealand chain of gyms. It will take the rest of the month of June to assemble and test the bikes before they are handed over to the buyer.

Scotty works out that the company will have no other GST credits arising for the rest of the month and it will have no output tax. Because of the timing of the sale and the supply of the bikes Scotty has a GST refund arising for the June period and would like to transfer the refund as soon as possible to pay some other tax liabilities. Scotty completes and files its GST return online through its accounting software on 5 June.

The credit is processed by Inland Revenue and is available for Scotty to transfer on 6 June.

Conversely, for taxpayers who file after the due date, the credit arising will only be available to them once the credit has been established, which is when they file their return for the GST period in question.

Example

Campbell's Hemp Emporium Ltd is a company that sells products made of hemp. It files its GST on a two-monthly basis with the next return due on 30 September 2018. In October 2018 Campbell has a strong upturn in the sale of hemp swimwear as people gear up for the summer season. Because the company is busy making hemp swimwear Campbell, the owner, forgets to file his 30 September GST return. He realises this in November and files his September return on 18 November. His calculation is a refund amount of $3,000. This credit is available to Campbell's Hemp Emporium Ltd on 19 November.

TAX TREATMENT OF ADVANCE PAYMENTS OF HOLIDAY PAY OR SALARY OR WAGES

(Clauses 142, 294(1) and 306(1))

Summary of proposed amendment

To strike a balance between the desire for more accurate withholding of PAYE and the impact on compliance costs, a proposed amendment to the Income Tax Act 2007 will give employers the option to tax holiday pay (or salary or wages) paid in advance as if the lump sum payment was paid over the pay periods to which it relates, or under the existing extra pay method.

Application date

The amendments will apply from 1 April 2018.

Key features

Proposed replacement section RD 13 will allow employers to tax holiday pay (or salary or wages) paid in advance as if the lump sum payment was paid over the pay periods to which it relates, or under the existing extra pay method.

Employers who choose, under section RD 13, to treat the lump sum advance payment as if it had been paid over the pay periods to which it relates will be required, if they make future payments for these pay periods, to calculate PAYE based on all earnings for the pay period, less PAYE already deducted for the pay period.

Background

The tax treatment of holiday pay depends on whether the holiday pay is a lump sum payment (in which case it should be treated as an extra pay), or is included in an employee's regular pay or paid in substitution for an employee's ordinary salary or wages when annual paid holidays are taken (in these cases it should be treated as salary or wages).

In the case of holiday pay paid in advance (for example, where an employee takes four weeks' annual leave and receives a lump sum payment of holiday pay covering the four weeks in advance), extra pay tax treatment has a tendency to result in over-withholding of PAYE. This is because extra pay tax treatment essentially over-taxes the leave payment by using the employee's marginal rate (for a payment that does not represent an increase in total annual earnings), while the payments made in each of the subsequent periods that have only part of the earnings are under-taxed.

More accurate withholding outcomes could be achieved if PAYE was deducted as if the lump sum payment was paid in its normal cycle over the pay periods to which the leave relates (the alternative approach). Feedback received from the Government's *Making Tax Simpler: Better administration of PAYE and GST* consultation suggested it was common practice to apply this alternative approach for end of (calendar) year holiday pay paid as a lump sum. Anecdotally, it is common for employees in some industries to work longer hours in the lead up to Christmas, which can exacerbate the over-withholding if the extra pay formula is used. This, combined with receiving no income during the following weeks when the holiday is taken, may cause financial hardship. Moreover, prior to Inland Revenue clarifying its operational position on the correct tax treatment of holiday pay in November 2015, some payroll software applied the alternative approach described above to holiday pay paid in advance, and some payroll software providers expressed a desire during consultation to be allowed to use this more accurate alternative withholding method.

This alternative treatment would, however, be more complicated for employers to apply than treating the payment as an extra pay. This is due to the need, when future payments are made for pay periods to which the leave relates, for employers to calculate PAYE based on all earnings for the pay period, less PAYE already deducted for the pay period. This will occur for pay periods that are not taken entirely on leave, but partially taken on leave and partially worked in. This makes the alternative method too complex to be suitable for employers who do their payroll manually to be required to use; extra pay tax treatment remains appropriate for them.

A similar issue arises in the situation of salary or wages paid in advance.

Detailed analysis

Proposed replacement section RD 13 will apply when an employee receives:

- an advance payment of salary or wages; or
- a lump sum payment of holiday pay made before the employee takes their holiday, if the employee's employment is continuing. That is, section RD 13 will not apply to a lump sum payment of holiday pay made on termination of employment. Employers will continue to be required to tax lump sum payments of holiday pay made on termination of employment as extra pays.

When section RD 13 applies, an employer may choose, for the purposes of withholding PAYE, to treat the lump sum payment:

- as an extra pay; or
- as if it had been paid in its normal cycle for the pay periods to which it relates.

If an employer chooses that latter option, the employer would calculate the amount of PAYE to withhold from the lump sum payment by:

- apportioning the lump sum payment to the pay period or pay periods to which it relates based on the employee's usual hours of work; and

- calculating the amount of PAYE for each portion of the lump sum, as if the portion were the only salary payment they made to the employee for the particular pay period; and
- adding together the PAYE amounts for each portion.

If an employer, subsequent to making a lump sum payment to an employee where PAYE was calculated using the proposed new method, makes a salary payment to the employee for one of the pay periods to which the lump sum relates, the employer will be required to calculate the amount of PAYE to be withheld from the salary payment by:

- adding together the salary payment and the portion of the lump sum that relates to the pay period; and
- calculating the amount of PAYE that would be required to be withheld from this aggregate amount, as if that amount were a single payment of salary paid by the employer to the employee for the pay period; and
- subtracting the amount of previously withheld PAYE for the portion of the lump sum that relates to the pay period.

The proposed amendment to section 67(3)(a) of the KiwiSaver Act 2006 specifies that proposed replacement section RD 13 of the Income Tax Act 2007 does not apply for the purposes of calculating employee KiwiSaver contribution deductions.

The proposed amendment to schedule 2 of the Student Loan Scheme Act 2011 specifies that proposed replacement section RD 13 of the Income Tax Act 2007 does not apply for the purposes of calculating student loan deductions from payments of salary or wages.

Example

This example concerns an employer who chooses to treat holiday pay paid in advance as if the lump sum payment was paid over the pay periods to which it relates.

An employee on an "M" tax code is paid weekly wages with the pay period ending on a Sunday and a normal payday of the Tuesday following the end of the pay period. She takes annual leave for the period Thursday, 10 December to 16 December and requests that this is paid to her prior to her taking this leave. The gross payment for this leave is calculated based on Holidays Act calculations at $1,000. Her ordinary wages payment for Monday to Wednesday of the first pay period containing the leave is $600, and her ordinary wages payment for the Thursday to Friday of the second pay period containing the leave is $400. On the Tuesday of the week in which the leave is taken, the employee is paid for the previous week as normal and is also paid her holiday pay as a separate payment.

Note that, in the table below which forms part of this example, the weekly PAYE table for the 1 April 2015 to 31 March 2016 tax year, has been used to determine the PAYE deductions. This is intended to be purely illustrative. To determine PAYE deductions, employers will have to use the relevant PAYE table for the tax year in which the payments are made and their pay period length.

Pay period end date	**Payment type**	**Pay date**	**Payment amount**	**PAYE withheld**	**Notes**
8 Nov	Ordinary salary or wages	10 Nov	$1,000	$180.26	
15 Nov	Ordinary salary or wages	17 Nov	$1,000	$180.26	
22 Nov	Ordinary salary or wages	24 Nov	$1,000	$180.26	
29 Nov	Ordinary salary or wages	1 Dec	$1,000	$180.26	
6 Dec	Ordinary salary or wages	8 Dec	$1,000	$180.26	
13 Dec	Holiday pay	8 Dec	$400	$56.95	PAYE initially calculated based on $400 for the pay period (for 2 days of leave)
20 Dec	Holiday pay	8 Dec	$600	$94.85	PAYE initially calculated based on $600 for the pay period (for 3 days of leave)
13 Dec	Ordinary salary or wages	15 Dec	$600	$123.31	PAYE calculated on the new total for the pay period of $1,000 ($400 + $600). PAYE withheld from this pay is the difference between the PAYE on $1,000 ($180.26) and what has already been deducted for the pay period ($56.95)
20 Dec	Ordinary salary or wages	22 Dec	$400	$85.41	PAYE calculated on the new total for the pay period of $1,000 ($400 + $600). PAYE withheld from this pay is the difference between the PAYE on $1,000 ($180.26) and what has already been deducted for the pay period ($94.85)
		Total	$7,000	$1,261.82	

APPLICATION OF LEGISLATED RATE AND THRESHOLD CHANGES

(Clauses 140, 144, 152, 293, 301 and 304)

Summary of proposed amendment

Proposed amendments to the Income Tax Act 2007, the KiwiSaver Act 2006 and the Student Loan Scheme Act 2011 align the rules about how legislated rate or threshold changes are applied across the different types of PAYE income payments and social policy initiatives administered through the PAYE system, such that the rates and thresholds to be applied are those in force on the date the payment is made.

Application date

The amendments will apply from 1 April 2018.

Key features

Proposed new section RD 10C of the Income Tax Act 2007 provides that, when a tax rate or threshold change occurs that affects the amount of tax for a PAYE income payment, the rates and thresholds to be applied to determine the amount of tax to be withheld are those in force on the date on which the PAYE income payment is paid. If the PAYE rules treat a PAYE income payment as paid on a particular date (which may differ from the actual date of payment), the rates and thresholds to be applied are those in force on the date on which the PAYE income payment is treated as paid.

Section RD 14 of the Income Tax Act 2007, which sets out the current rules for determining the amount of tax to be withheld from a payment of salary or wages when a change occurs to tax rates or thresholds, is proposed to be repealed.

Proposed new section RD 67B of the Income Tax Act 2007 provides that, when a tax rate or threshold change occurs that affects the amount of tax for an employer's superannuation cash contribution, the rates and thresholds to be applied to determine the amount of tax to be withheld are those in force on the date on which the PAYE income payment to which the contribution relates is paid. If the PAYE rules treat a PAYE income payment to which the contribution relates as paid on a particular date (which may differ from the actual date of payment), the rates and thresholds to be applied are those in force on the date on which the PAYE income payment is treated as paid. Where an employer's superannuation cash contribution is made that is not tied to a particular PAYE income payment, the rates and thresholds to be applied are those in force on the date on which the contribution is paid to the superannuation fund or under the KiwiSaver Act 2006 to Inland Revenue (whichever applies).

Proposed new section 64(3B) of the KiwiSaver Act 2006 provides that, when a change occurs to the minimum employee KiwiSaver contribution rate that affects the contribution that must be deducted from a payment of salary or wages, the rate to be applied to determine the amount of the contribution is the rate applying on the day on which the salary or wages are paid.

Proposed amendments to section 101D of the KiwiSaver Act 2006 provide that the compulsory employer contribution rate to be applied in calculating the amount of a compulsory employer KiwiSaver contribution to be made for a payment of gross salary or wages is the rate applying on the day on which the salary or wages are paid.

Proposed new section 37(3B) of the Student Loan Scheme Act 2011 provides that, when a change occurs to the rate at which student loan deductions are required to be from a payment of salary or wages, the deduction rate to be applied is the rate applying on the day on which the salary or wages are paid.

Background

At present, different types of PAYE income payments and social policy initiatives administered through the PAYE system have different rules about what is to be done when there is a legislated rate or threshold change during a pay period, or if there is a legislated rate or threshold change between the date the payment is made and the pay period to which the payment relates. The rates and thresholds that apply are sometimes based on the pay date, sometimes pay period end-date or pay period start-date, while sometimes apportionment applies. This creates complexity and confusion for employers, in particular for pays that occur in the period around the end of one tax year and start of the next, when there has been legislated rate and/or threshold changes. This adds to employers' compliance costs and increases the risk of errors.

TAX TREATMENT OF A RETROSPECTIVE INCREASE IN SALARY OR WAGES

(Clause 134)

Summary of proposed amendment

The de minimis rule in section RD 7 of the Income Tax Act 2007 relating to the tax treatment of a retrospective increase in salary or wages is to be repealed, as it is now redundant.

Application date

The amendment will apply from 1 April 2018.

Key features

The proposed amendment to section RD 7 repeals the de minimis rule in relation to the tax treatment of a retrospective increase in salary or wages.

Background

Under the PAYE rules, a retrospective increase in salary or wages is treated as an extra pay. This is subject to a de minimis provision, so only applies where the total salary or wages a person earns in a week (including the increase) is more than $4. If a person earned less than $4 for the week, the payment would be treated as salary or wages.

This restriction has been part of the PAYE rules since PAYE was introduced in 1958, with the only change to the provision being when it changed to $4 from its original £2 upon the change to decimal currency in 1967.

Given that the current adult minimum wage is $15.25 an hour and the current starting-out and training minimum wage is $12.20 an hour, it is extremely unlikely anyone earning salary or wages in New Zealand would receive less than $4 in a week. Therefore, the existing restriction is effectively redundant.

ELECTRONIC FILING REQUIREMENT FOR GST RETURNS

(Clauses 187(18), 227, 231, 232, 269(3), (7) and 275(1))

Summary of proposed amendments

The Bill proposes an electronic filing requirement for some GST-registered persons over a taxable supplies threshold. The threshold will be set by Order in Council following appropriate consultation. A limited exemption will be provided in some circumstances. A penalty will apply to registered persons required to file their GST return electronically but who fail to do so.

Application date

The proposed amendments will apply from the date of enactment. However, it will only affect registered persons once a threshold for the electronic filing requirement is set by Order in Council at a later point in time.

Key features

Proposed section 36BD will provide for the setting of a threshold above which GST-registered persons are required to file their GST return with Inland Revenue electronically in a prescribed format. The threshold will be set separately by Order in Council.

Subsection (1)(a) of section 36BD preserves the option for GST-registered persons below the threshold to voluntarily file electronically. As currently, registered persons who choose to transmit their return electronically must do so in a format prescribed by Inland Revenue.

There will be an exemption to the electronic filing requirement available for registered persons who do not have sufficient digital services available to them, and if the cost incurred in complying with the electronic filing requirement would be unreasonable in the circumstances.

The Commissioner of Inland Revenue will publish guidelines on how the exemptions will apply.

To encourage taxpayers to file electronically and to recover the additional costs of administering paper returns it is proposed that a penalty of $250 applies for taxpayers who are, in the future, required to file in an electronic format and who fail to do so.

Section 142G is being amended to set the due date for the payment of the penalty 30 days after the end of the month in which the registered person is required to provide the return to the Commissioner electronically.

Background

Currently GST-registered persons have a choice whether to provide Inland Revenue with their GST return on paper or electronically. The use of electronic channels for filing GST returns has increased over recent years. Electronic transfer of GST returns compared with paper returns has the long-term benefit of reducing compliance and administrative costs and transcription errors.

The proposed changes will enable further encouragement of electronic filing, if necessary, in the future.

Employee share schemes

OVERVIEW

Employee share schemes – arrangements for companies to provide shares and share options to their employees – are an important form of employee remuneration in New Zealand and internationally. Although the design and the accounting treatment of these plans have evolved considerably over recent decades, the tax rules applying to them in New Zealand have not been comprehensively reviewed during that period and are now out of date.

Employee share schemes can have beneficial economic effects and it is important that the tax rules do not raise unintended barriers to their use. In some circumstances, the current rules can result in over-taxation; in others they result in under-taxation.

The current system impedes the use of employee share schemes in a number of ways.

- There is considerable uncertainty about how the current rules apply to taxation of employees and employers, which may deter firms from offering these schemes.
- The cost to an employer of providing shares directly to an employee is not explicitly deductible. Non-deductibility creates over-taxation, which is a disincentive to using employee share schemes. Arrangements which currently do allow employers to take deductions for shares provided directly, or indirectly by other companies, produce deductions which do not reflect the amount or timing of the income recognised by the employee.

The current treatment of some sophisticated employee share schemes can result in employment income being treated as tax-free capital gains and so escaping taxation. This undermines the fairness of the tax system.

The Bill proposes new core rules for determining the amount and time of derivation of income and incurring of expenditure under an employee share scheme. The objective of the proposals is neutral tax treatment of employee share scheme benefits. That is, to the extent possible, the tax position of both the employer and the employee should be the same whether remuneration for labour is paid in cash or shares. Generally these rules will apply to benefits where the taxing point under current law has not occurred before the day 6 months after the enactment of the Bill.

The Act also currently provides a concessionary regime to encourage employers to offer shares to employees under certain widely-offered employee share schemes (commonly referred to as "exempt schemes"). Income derived by employees under these schemes is exempt from tax and there is a deemed 10% notional interest deduction allowed to employers who provide loans as part of such schemes. The law governing these schemes is out of date, complex and no longer fit for purpose. In addition, it not consistent with our broad-base, low-rate (BBLR) income tax system.

Accordingly, the Bill also proposes a simplified set of rules for these exempt schemes, with a greater level of exempt benefit able to be provided and more flexibility in the design of these schemes. The Bill aims to clarify that employers offering exempt benefits will not be entitled to a deduction for the cost of providing those benefits.

The retention of the tax exemption for exempt schemes is an exception to the neutrality principle, but is justified on compliance cost grounds.

The Bill also proposes a number of consequential and miscellaneous changes, and provides transitional arrangements for existing schemes.

The proposed new rules for employee share schemes have been developed through a public consultation process beginning with the release of the officials' issues paper Taxation of employee share schemes in May 2016 and further consultation in September 2016.

SCOPE OF THE NEW RULES

(Clauses 11, 12, 14 and 41)

Summary of proposed amendment

The proposed new income and deduction rules will apply to arrangements where employees receive shares as part of their remuneration package. There are a number of qualifications and carve outs to the definition of "employee share scheme" to ensure the rules are appropriately targeted.

Application date

The new rules will generally apply to benefits provided under employee share schemes which are not taxed under the existing rules within 6 months of enactment of the Bill. There is further detail of the transitional arrangements below.

Key features

The proposed new rules will apply to benefits provided under arrangements that involve issuing or transferring shares to past, present and future employees[5] or shareholder-employees (or their associates) of the issuing company (or a group company).

However, they will not apply to arrangements that require employees to:

(a) pay market value for the shares on the "share scheme taxing date" (described in more detail below, but generally the date on which the employee holds the shares like any other shareholder);

(b) put at risk shares they acquired for market value, where the scheme provides no protection to the person against a fall in the value of the shares.

They will also not apply to exempt schemes (which have their own specific rules, discussed below).

Background

The definition of "employee share scheme" is a key component of the rules.

The core employee share scheme rules in the Income Tax Act 2007 currently apply to "share purchase agreements". These are agreements to dispose of or issue shares to an employee, entered into in connection with the employee's employment or service, whether or not an employment relationship exists when the employee receives a benefit under the agreement.

[5] Which includes any person receiving a PAYE income payment (for example, certain directors).

Under current rules there is some uncertainty as to whether this definition encompasses arrangements entered into before a person commences a formal employment relationship and has received a PAYE income payment.

This definition also excludes shareholder-employees to the extent to which they choose not to deduct PAYE.

There is no policy rationale for excluding these classes of recipients of employee share scheme benefits.

Detailed analysis

Clauses 11, 12 and 14 propose that under sections CE 1(1)(d), CE 2, and CE 6 – 7D, a benefit received under an **employee share scheme** is income of a person. Similarly, clause 41 proposes a new section DV 27 that governs what deductions are available when a person is party to an employee share scheme.

Clause 14 proposes a definition of "employee share scheme" in new section CE 7. The definition is initially fairly wide.

It is an *arrangement* with a purpose or effect of issuing or transferring shares in a company to a person who *will be, is, or has* been an employee (or *shareholder-employee*) of that company or of another company in the same group. It also includes the provision of shares to an associate of the employee or shareholder-employee, if the arrangement is connected with that person's employment or service.

The use of the term "arrangement" covers all aspects of a scheme, for example, direct transfers of shares, loans to buy shares, bonuses, put and call options and transfers to trusts etc. The definition also covers past, present and future employees, and includes shareholder-employees.

However, an employee share scheme does not include an arrangement that requires an employee, shareholder-employee or associate to:

(a) pay market value for the shares on the "share scheme taxing date" (described in more detail below, but generally the date on which the employee holds the shares like any other shareholder); or

(b) put at risk shares they acquired for market value, where the scheme provides no protection to the person against a fall in the value of the shares.

Example 1

Jim is employed by ABC Co, a closely-held company. As part of his employment agreement, after he has worked for the company for 3 years, if the company's other shareholders are happy with his performance, they will let him buy 25% of the company's shares for their current market value.

While this is an arrangement with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee), market value will be paid for the shares on the share scheme taxing date. Accordingly, this arrangement is not an employee share scheme for the purposes of the proposed new definition.

Example 2

Casey, Hamish and Steve get together and incorporate a company to develop some technology intellectual property (IP). They are each employed by the company in different roles. When the shares are issued they are worth virtually nothing (on a balance sheet basis) and a nominal subscription price of $0.01 is paid by each shareholder-employee. The shareholders' agreement states that to ensure they commit to developing the IP over three years, if they leave within 3 years they lose their shares. After this point they keep their shares no matter what.

While this is an arrangement with a purpose or effect of issuing or transferring shares in a company to a person who will be, is, or has been an employee (or shareholder-employee), market value was paid for the shares and the employees have then chosen to put the shares at risk. Accordingly, this arrangement is not an employee share scheme for the purposes of the proposed new definition.

Example 3

Melissa is hired as CEO by X Co, a closely-held company with exciting but uncertain prospects. She is paid a $120,000 salary. Because she is an employee, she is also able to buy $50,000 worth of shares (which is the current market value – established by an independent valuation). If Melissa leaves employment within 3 years, X Co has the right to buy her shares back for the lesser of $50,000 and market value. After that date, it has to buy the shares back for full market value.

This is because if she leaves, X Co does not want Melissa to hold its shares if she is not part of their team, but after 3 years they are prepared for Melissa to receive the upside in the shares. Before, then, she bears the risk of loss but no chance of gain. If the shares fall to $10,000 and Melissa leaves X Co within three years, the company will buy her shares back for $10,000 and she will lose $40,000 of her $50,000 investment.

If Melissa leaves the company and the shares are worth $1m, then the company will buy them back and Melissa will be denied the upside.

As above, this arrangement is not an employee share scheme as defined as Melissa has paid market value for her shares and has then effectively put them at risk for 3 years.

The definition of employee share scheme also excludes exempt schemes (which have their own specific rules, discussed below).

TIMING AND AMOUNT OF EMPLOYEES' INCOME

(Clauses 11, 12, 14 and 41)

Summary of proposed amendment

The proposed amendments ensure the timing and amount of employees' income from employee share schemes is consistent with other forms of employment income.

Application date

The new rules will generally apply to benefits provided under employee share schemes which are not taxed under the existing rules within 6 months of enactment of the Bill. There is further detail on the transitional arrangements below.

Key features

Clauses 11, 12 and 14 provide that benefits provided under an employee share scheme (usually in the form of shares) are assessable income for an employee at the earlier of the date when:

- the benefits are either transferred or cancelled for consideration; or
- the employee share scheme beneficiary owns the shares in the same way as any other shareholder. They will not own the shares in the same way as any other shareholder if (for example) the employee is required to forfeit the shares if they choose to leave the company, or the employee is entitled to be compensated for a decline in the value of the shares.

This is referred to as the "share scheme taxing date". No change is proposed to the tax treatment of straight-forward employee share options, which already reflects this principle, in that the employee is not taxed until the option is exercised.

The amount of the benefit should be the amount received for the transfer or cancellation, or the value of the shares at the share scheme taxing date. It should be reduced by the amount paid (if any) for the benefit.

The proposed rules require matching between the employee's income and the employer's deduction, so the rules outlined above also determine the amount and time of the deduction to the employer (the employer's deduction is discussed further below).

Background

Any reward for services is generally taxable as income, under the ordinary definition. However, the application of the common law of income tax to the provision of rewards in the form of property, for example shares or options, has sometimes been problematic.

For that reason, since 1968, New Zealand tax law has contained special provisions relating to the taxation of employee share scheme benefits. Currently these are contained in sections CE 1 – CE 4, CE 6 and CE 7.

Under current law, shares provided under an employee share scheme are taxable when the employee acquires the shares. Section CE 6(2) provides that:

- shares acquired pursuant to an option are treated as acquired when the option is exercised. This means that an employee is not taxed on the grant or vesting of an option, but on its exercise; and
- shares acquired by a trustee for the benefit of an employee (that is, a specific employee) are treated as acquired by the employee, even if the employee may be required to forfeit the shares.

The second of these rules leads to outcomes that are neither tax-neutral nor consistent with the taxation of employee share options.

Example 1

Jim has a tax rate of 33%. If his employer offers him a $1,000 bonus if he is still working for the employer in a year's time, he will receive (if he satisfies the condition) $1,000 of taxable income.

If instead his employer decides to pay Jim the same bonus in shares, the tax neutral outcome would be for the employer to provide $1,000 of shares, and for Jim to pay $330 tax.

In both cases Jim receives $1,000 of before-tax income and has paid $330 of tax. Tax will not be a factor in how Jim wants to be paid.

Example 2

Suppose that Jim's employer offers him a cash bonus on the same terms as in example 1, except that the amount of the bonus is the value of 1,000 shares in one year's time. Suppose that 1,000 shares are worth $1,000 at the start of the year, when the offer is made, and $1,500 at the end of the year. Jim will not be taxed on $1,000. He will be taxed on $1,500 when he receives the cash bonus.

Instead of offering a cash bonus dependent on the value of the shares, suppose Jim's employer transfers 1,000 shares to a trustee, on the basis that the trustee will transfer them to Jim at the end of the year if he is still with the company, and not otherwise. The economic benefit to Jim is the same as in the first variation of this example. However, under current law, Jim has income of $1,000 when the shares are transferred to the trustee. This is not consistent with the treatment of equivalent cash remuneration (i.e. the first variation of this example), and therefore is not a neutral tax treatment.

Example 3

Jane's employer decides to provide her with options to buy 1,000 shares in the company. The shares are currently worth $1, and the options have a strike price of $1 (that is, they are issued "at the money"). The options can be exercised only if Jane is still employed in a year. Suppose there is an equal chance that the shares will be worth $600 or $1,600 in a year's time. If they are worth $1,600, Jane exercises the options, and has $600 of taxable income. If they are worth $600, she does not exercise the options, and gets nothing.

Example 4

Instead of providing options, suppose Jane's employer sells her 1,000 shares for $1,000, and provides her with an interest-free loan to fund the purchase. The loan must be repaid after one year. The employer specifies that if the shares have fallen in value at the repayment date, Jane must sell the shares back to the employer for $1,000. Suppose the same share values and probabilities as in example 3. If the shares are worth $1,600 in one year, Jane will keep the shares and pay off the loan. If they are worth $600, she will sell them to the employer for $1,000 and use that money to pay off the loan.

Under current law, Jane has no taxable income from this arrangement, even though it produces outcomes identical with the option arrangement, under which Jane has $600 of income if she acquires the shares.

The proposed new rules prevent these inconsistent outcomes by deferring the time at which an employee recognises income from an employee share scheme in certain situations. In examples 2 and 4 above, under the new rules, both Jim and Jane would be taxed on the value of the shares once the employment condition is satisfied (in Jim's case) or the employer's right to acquire the shares for $1,000 no longer exists (in Jane's case).

Detailed analysis

Timing of income

The time when the employee is taxable is defined as the "share scheme taxing date", and is defined in proposed section CE 7B (clause 14 of the Bill).

Unless an employee first transfers its share scheme benefits to a non-associate, or the company cancels them, the share scheme taxing date is when:

- there is no real risk that beneficial ownership of the shares will change, or that the shares will be required to be transferred or cancelled;
- the employee is not compensated for a fall in the value of the shares; and
- there is no real risk that there will be a change in the terms of the shares affecting their value.

If the benefits are cancelled or transferred to a non-associate before these events occur, then the share scheme taxing date is at the time of the cancellation or transfer.

In determining whether there is a risk of a change of ownership, transfer or cancellation, certain rights and requirements do not affect the employee's status as the economic owner of the shares under the scheme (proposed section CE 7B(2)) and are ignored. They are rights or requirements:

- for transfer for market value;
- not contemplated by the employee share scheme;
- that have no real risk of occurring;
- that are of no real commercial significance; or
- that also apply to shares not subject to the employee share scheme.

The following series of examples illustrate how these proposed rules will work in practice for common types of employee share schemes.

Example 1 – Simple vesting period

Facts

A Co transfers shares worth $10,000 to a trustee on trust for an employee. If the employee leaves the company for any reason during the next three years, the shares are forfeited for no consideration. After three years, the shares are transferred to the employee.

Result

The share scheme taxing date is when the three years is up and the employee is still employed.

Analysis

The risk of loss of the shares for the first three years means there is a real risk that the beneficial ownership of the share will change. None of the exceptions applies.

Example 2 – Vesting period with good leaver exception

Facts

As for Example 1, except that if the employee ceases employment because of death, illness, disability, redundancy or retirement within the three-year period they are entitled to the shares.

Result

The share scheme taxing date will be the end of the vesting period, or when the person leaves for any of the above reasons.

Analysis

There is a real risk that the employee will leave employment for some other reason than those listed (for example, a better opportunity presents itself) and therefore the share scheme taxing date does not occur so long as that risk exists.

Example 3 – Vesting subject to misconduct

Facts

As for Example 1, except that if the employee ceases employment for any reason other than being subject to disciplinary action or committing some form of employment-related misconduct during the three-year period (i.e. being a "bad leaver") the employee is entitled to the shares.

Result

The share scheme taxing date is when the shares are initially transferred to the trust, and the income will be their value at that time.

Analysis

The risk of the employee losing their job for these "bad" reasons during the three year period is not sufficiently real to require deferral.

Example 3A – Vesting subject to misconduct with accrual

Facts

As for Example 3, except that if the employee ceases employment for any reason other than being a bad leaver, they are entitled to only a pro rata portion of the shares based on completed years' service (for example, nothing for the first year, one third of the shares if the employee leaves between one and two years, etc.).

Result

There will be three share scheme taxing dates – at the end of years 1, 2 and 3 respectively. The employee will be taxed at the end of each year on the value at that time of one third of the shares.

Analysis

Until the end of the first year, if the employee leaves for another job, they will not be entitled to any shares. Once the first year is completed, they will be entitled to one third of the shares, provided they are not a bad leaver during the next two years. The risk that the employee will leave for another job is sufficiently real that it defers the share scheme taxing date. The risk that the employee will leave as a bad leaver is sufficiently unlikely that it does not defer the share scheme taxing date. The fact that the shares are held by the trustee until the end of year three does not of itself defer the share scheme taxing date.

Example 3B – Performance hurdles

Facts

As for Example 3A, except that the employee is not entitled to the shares at all unless a total shareholder return[6] hurdle (measured as an annual percentage) is also met. If the hurdle is met in year 1, one third of the shares vest. If it is met in year 2, a further one third of the shares vest. Also, if it was not met in year 1, but is met on a combined basis over years 1 and 2, a further one-third of the shares will vest. The same approach applies in year 3.

[6] Annual "total shareholder return" is a combination of dividends paid and appreciation in share price during a year.

Result

There will be three possible share scheme taxing dates – at the end of years 1, 2 and 3 respectively. The employee will be taxed at the end of each year on the value of the shares that vest at that time.

Analysis

Until the end of the first year, if the employee leaves for another job, they will not be entitled to any shares. Once the first year is completed, they will be entitled to retain one third of the shares, provided they are not a bad leaver during the next two years, and provided the year 1 performance hurdle is met. The risk that the employee will be a bad leaver is sufficiently unlikely that it does not defer the share scheme taxing date. The fact that the shares are held by the trustee until the end of year 3 does not of itself defer the share scheme taxing date.

Example 4 – Vesting period, with compulsory sale for market value thereafter

Facts

As for Example 1, except that even after the three-year period ends, the trustee retains legal ownership of the shares, and the employee must transfer their rights back to the trustee or A Co when the employee leaves. However, once the three-year period is up, the employee will receive the market value of the shares when their beneficial ownership is transferred.

Result

As for Example 1.

Analysis

Once the three-year period has expired, the employer's or trustee's right to acquire the beneficial interest in the shares is for market value, and therefore is not taken into account in determining the share scheme taxing date.

Example 5 – Insubstantial put option

Facts

As for Example 4, except that the employee has the right at all times to sell the shares back to the trustee for a total price of $1.

Result

The share scheme taxing date would be the same as in Example 4.

Analysis

The employee's right to sell the shares for $1 is not, at the time it is granted, a right which has a real risk of being exercised, given that there is no liability attached to the shares and that they are then worth $10,000. This right would therefore not defer the share scheme taxing date.

Example 6 – Loan funded scheme A

Facts

B Co provides an employee with an interest-free full recourse loan of $10,000 to acquire shares in B Co for market value, on the basis that:

- the shares are held by a trustee for three years;
- dividends are paid to the employee from the time the shares are acquired;
- if the employee leaves within three years, the shares must be sold back to the trustee for $10,000, which must be used to repay the loan;
- if the employee is still employed by B Co after three years, the employee can either sell the shares to the trustee for the loan amount, or choose to continue in the scheme; and
- if the employee chooses to continue, the loan is only repayable when the shares are sold.

Result

The share scheme taxing date will be the earlier of when the employee leaves employment, or the expiry of the three years.

Analysis

Until the three years are up, if the employee leaves B Co for whatever reason, they lose their beneficial ownership of the shares for an amount that is not their market value. So the share scheme taxing date will on the face of it be the end of that three-year period. If the employee leaves within that period and is therefore required to transfer their rights, the sale price will be taxed, but since the sale price is the same as the amount contributed, there will be no gain or loss. Once the three-year period is up, the employee will either have no income (if they sell the shares back to the trustee for $10,000) or will pay tax on the difference between the value of the shares at that time and their $10,000 price (if they choose to keep the shares).

Example 7 – Loan funded scheme B

Facts

As for Example 6, except that:

- the loan is limited recourse for the first three years (i.e., during that period, the amount repayable is limited to the value of the shares at the time of repayment); and
- if the employee leaves within three years, or chooses at the end of the three years to sell the shares to the trustee, they must be sold back to the trustee for market value.

Result

As for Example 6.

Analysis

The limited recourse loan provides a benefit to the employee which compensates the employee for a fall in the value of the shares. Accordingly the share scheme taxing date is the same as for Example 6 – that is, the end of three years (when the loan ceases to be limited recourse) or when the shares are sold to the trustee. If the employee sells the shares for less than $10,000 (because that is their market value), the employee will have a deductible loss from the scheme under the employee share scheme rules. They will have debt forgiveness income of an equal amount.

Example 8 – Loan funded scheme C

Facts

As for Example 6, except that:

- as in Example 7, the sale back to the trustee must be for market value, whenever it occurs;
- at the time of such a sale, the employer must pay the employee the amount of any decline in the value of the shares since the grant date.

Result

As for Example 6.

Analysis

The employer's promise to pay a bonus equal to the decline in the value of the shares is a benefit which compensates the employee for a decline in the value of the shares. If the employee sells the shares for less than $10,000 they will have a deductible loss from the scheme, which will be equal to the income they will recognise due to the payment from the employer.

Example 9 – Loan funded scheme D

Facts

As for Example 8, except that there is no arrangement for the employer to pay the employee the amount of any decline in value of the shares.

Result

The share scheme taxing date is when the agreement is entered into.

Analysis

From the time the agreement is entered into, the employee has the full risk and reward of share ownership.

Example 10 – Vesting only in the event of a sale or IPO

Facts

C Co transfers 1,000 shares to a trustee for an employee. The shares remain held on trust until the employee leaves, more than 50% of C Co is sold, or C Co is listed (whichever happens first). If the employee leaves first, the shares are forfeited. If more than 50% of C Co is sold, the employee's shares must also be sold and the employee will receive the proceeds. If C Co is listed, the shares are released to the employee.

Result

The share scheme taxing date is when the employee leaves, or C Co is sold or listed.

Analysis

Because the employee forfeits the shares for no consideration if they leave, the share scheme taxing date will be deferred until the employee leaves (in which case there will be no income), the shares are sold (in which case the sale price will be taxable), or the shares are released to the employee (the market value of the shares will be taxable).

Amount of income

The amount of income to the employee will be the value of the shares at the share scheme taxing date (or the transfer price if transferred to a non-associate, or the amount paid for cancellation, if cancelled by the employer) less the amount paid for them. Even where benefits are conferred on or transferred to an associate of an employee, it is always the employee who is taxed on the income. If the amount paid exceeds the value of the shares, the difference is deductible to the employee (proposed new section CE 2(3) in clause 12 and proposed new section DV 27(3) in clause 41).

Apportionment for overseas service

The proposed new rules contain an expanded income apportionment formula (proposed section CE 2(5) and (6) in clause 12). The expanded formula applies to all employees (rather than only transitional residents as in current section CE 2(9)). It excludes from taxable income employee share scheme benefits which accrue while a person is neither New Zealand resident nor deriving New Zealand source income. The extent of such accrual is determined by first establishing the entire period over which the benefit accrues, and then determining the proportion of that period during which the person is non-resident and not deriving New Zealand source income from their employment. The period of accrual ends once the rights vest, rather than when the income arises. So, for example, in the case of an option, the period of accrual ends once the options are *exercisable* rather than when they are actually *exercised*.

The employee share scheme income is treated as non-residents' foreign source income (which is not taxable income) to the extent of this proportion.

Transfers to associates

No change is proposed for the treatment of transfers to associates. Such transfers are ignored for purposes of calculating the employee's share scheme income.

Rollover relief for transfer to new scheme

If a person's employee share scheme rights are cancelled and replaced with rights in a different scheme, the value of the replacement rights is not included in the person's income arising due to the cancellation of the original scheme (proposed sections CE 2(2)(c) in clause 12 and CE 7D in clause 14).

The benefit provided by the replacement scheme will be taxed appropriately by applying the proposed new rules to that scheme

TIMING AND AMOUNT OF EMPLOYERS' DEDUCTION

(Clauses 23 and 41)

Summary of proposed amendment

The Bill proposes to provide a deduction to employers providing employee share benefits which matches the income to employees in timing and quantity. Deductions currently available for other payments need to be disallowed where those payments would otherwise lead to a double deduction.

Application date

The proposed changes will have the same application date as for the provisions applying to the taxation of employees – that is, they generally apply to benefits provided under employee share schemes which are not taxed under the existing rules within six months of enactment of the Bill.

Key features

The proposals will allow a deduction to employers equal in amount and timing to the income derived by an employee under the new rules. It would explicitly preserve deductions for the costs of running an employee share scheme, and for the cost of any bonus associated with a share scheme paid to an employee. No other deductions will be allowed.

Background

The principle of neutral tax treatment of employee share scheme benefits supports employers being entitled to a deduction for the value of the benefit provided. The fact that the issue of shares by a company does not involve an explicit cash cost does not affect this principle. That is, there is a transfer of value to the employee from the other shareholders, which arises whether that value is transferred as cash or as shares in the company.

Under the corporate tax system, where company expenses are deducted by the company as a separate taxpayer from its shareholders, this cost must be recognised in the calculation of income by the company rather than the shareholders on whose behalf it is earned.

Ways to create a deduction do exist. For example, payment of a bonus to the employee which is used to fund a full value share acquisition, contributions to an employee share trust or reimbursement to a parent company. However, the tax treatment of these transactions can be uncertain, and structuring to achieve these should not be necessary (they just incur unnecessary transaction costs).

There is also the potential for the amount and timing of the deduction created by these transactions to not correctly reflect the economic cost to the company of providing the employee share scheme benefits.

Detailed analysis

An employer is denied a deduction for provision of employee share scheme benefits (proposed section DV 27 in clause 41), except for:

- costs incurred in administering or managing the scheme (proposed section DV 27(4)). These costs include legal and accounting fees incurred in setting up the scheme, as well as on-going management fees. Deductibility of these costs will be left to the usual tests, e.g. the capital/revenue test. Costs incurred by an employee share scheme trust will be treated as incurred by the employer or issuing company, as a result of the new provision treating an employee share scheme trust as a nominee;
- the amount of the employee’s income, which is treated as a cost incurred at the same time as the employee recognises the income (proposed section DV 27(6)-(8)). Deductibility of this cost will depend on meeting the usual tests; and
- amounts which are taxable to the employee as employment income other than as employee share scheme benefits (proposed section DV 27(5)). This is intended to preserve a deduction for the cost of paying a bonus where the payment of the bonus is part of the terms of an employee share scheme.

Accordingly:

- payments to fund an employee share scheme trust to acquire shares, or to reimburse a parent for providing shares, will not be deductible; and
- as a practical matter, employers will need to either prohibit employees from transferring their rights to a non-associate before the share scheme taxing date, or place a requirement on employees to inform them of the time and amount paid in such a transfer, in order to correctly calculate their deduction.

In order to prevent double deductions, when shares are provided to an employee and a deduction has been taken for that provision other than in accordance with to the new section, the deduction under the new section is reduced by the earlier deduction (proposed section DV 27(8)(b)).

EFFECT OF DEDUCTION AND PAYMENTS ON AVAILABLE SUBSCRIBED CAPITAL

(Clauses 7 and 10)

Summary of proposed amendment

The new rules seek to tax any benefit conferred on an employee by the issue of shares in an employee share scheme in the same way as an equivalent cash payment followed by an acquisition of shares in the issuing company. Consistent with this principle, the proposed rules provide for an increase in the employer's available subscribed capital (ASC) by the amount deemed to be paid (plus actually paid) for the shares. The proposed rules also cater for the situation where the employer is not the company issuing the shares.

This is a taxpayer-friendly measure to ensure employee share schemes are not disadvantaged as a form of remuneration compared with an equivalent cash transaction, which would generally give rise to an ASC increase.

Application date

The ASC rules will apply to the provision of shares which are taxed under the new rules.

Key features

The ASC proposals deal with the effect of employee share scheme transactions on the employer and (if different) the company issuing the shares.

The amount of the deduction to the employer will give rise to additional ASC for both the employer and, if the shares issued are in the parent of the employer, the parent. In the latter case, any reimbursement paid to the parent will reduce the subsidiary's ASC but will not increase the parent's ASC. If the employer has income from the issue of the shares, that will reduce its ASC.

The proposals also ensure that the acquisition of shares as part of an employee share scheme can be treated as an acquisition of treasury stock, regardless of whether the shares are acquired by the company itself and not cancelled, or are acquired by a trustee who is treated as a nominee of the company.

Background

To ensure neutrality between provision of benefits under an employee share scheme and an equivalent cash transaction, as well as providing for the income and deduction consequences, the new rules must provide for changes to a company's ASC.

To do this, the proposed rules provide for an increase in the employer's ASC by the amount deemed to be paid (plus actually paid) for the shares. The proposed rules also cater for the situation where the employer is not the company issuing the shares (this is common where the employer company is a subsidiary and the employee receives shares in the parent company).

Additionally, in order to cater for the common practice of acquiring employee share scheme shares from other shareholders rather than by a fresh issue of shares, it is also necessary to ensure that the treasury stock regime can apply sensibly to employee share schemes.

Detailed analysis

Under clause 10, if the employer is also the company whose shares are provided, then the employer's ASC will be:

- increased by:
  - the amount received for the provision of the shares (under existing section CD 43(2)(b)); and
  - the amount of its deduction for the provision of the shares (under proposed section CD 43(6E)(a));
- decreased by the amount of any income arising if it has income because the value of the shares provided is less than the amount received from the employee (under proposed section CD 43(29)).

Example 1

Facts

Employer Co issues 700 shares worth $3 each to an employee for $2 per share (that is, at a $1 per share discount). The scheme taxing date is the date of issue. The employee has $700 income and Employer Co has $700 deduction.

ASC Result

Employer Co's ASC increases by $2,100, being the total of the $1,400 received and its $700 expenditure.

Example 2

Facts

Employer Co issues 700 shares worth $3 each to an employee for $2 per share, funded by a loan from the employer. If the employee is still employed by the company after one year, the employee will receive a $1,400 bonus, which must be used to repay the loan. Otherwise, the employee must return the shares to the employee in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $4 each.

ASC result

Issuing the shares gives rise to ASC of $1,400. If the shares are repurchased because the employee does not remain employed, that will usually give rise to an ASC reduction of $1,400. Otherwise, at the share scheme taxing date, Employer Co's ASC will increase by $1,400, the amount which is both taxable to the employee and expenditure for Employer Co (making for a total increase in ASC as a result of the employee share scheme of $2,800).

Example 3

Facts

As for example 2, except that after one year the shares are worth $1 each.

ASC result

As for example 2, except that if the employee remains employed, Employer Co's ASC will decrease by $700, the same amount that is both deductible to the employee and taxable to Employer Co.

If the employer is not the company whose shares are provided, then its ASC will be:

- increased by the amount of its deduction for providing the shares (proposed section CD 43(6E)(a));
- decreased by the amount of any income arising if it has income because the value of the shares is less than the amount received from the employee (proposed section CD 43(29));
- decreased by the amount of any reimbursement paid to the share provider (proposed section CD 43(6H)).

The adjustment should be made to the employer's share class most similar to the shares provided under the scheme. If the decrease due to reimbursement exceeds the increase arising due to a deduction, and the excess is greater than the ASC of the relevant share class, the reimbursement amount is to that extent taxed as a dividend (proposed section CD 43(6I)).

Example 4

Facts

Parent Co, the 100% owner of Employer Co, issues 700 shares worth $3 each to an employee of Employer Co for $2 per share. The scheme taxing date is the date of issue. The employee has $700 income and Employer Co has $700 deduction.

ASC result for Employer Co

Employer Co's ASC increases by the amount of its $700 expenditure.

Example 5

Facts

Parent Co issues 700 shares worth $3 each to an employee of Employer Co for $2 per share, funded by a loan from Parent Co. If the employee is still employed by the Employer Co after one year, the employee will receive a $1,400 bonus from Employer Co, which must be used to repay the loan. Otherwise, the employee must return the shares to the employer in full repayment of the loan at the time she leaves employment. After one year, the shares are worth $4 each.

ASC result for Employer Co

If the employee stays employed for the year, at the share scheme taxing date, Employer Co's ASC will increase by $1,400, the amount which is both taxable to the employee and expenditure for Employer Co under the employee share scheme rules.

Example 6

Facts

As for example 5, except that if the shares are not forfeited, Employer Co pays Parent Co $1 per share reimbursement.

ASC result for Employer Co

Employer Co's ASC will increase by $700 if the employee remains employed, which is the difference between its $1,400 deduction and its $700 reimbursement to Parent Co.

If the shares are provided by the ultimate parent of the employer, the ASC of the parent company will be:

- increased by:
  - the amount paid by the employee for the shares (under existing section CD 43(2)(b)); and
  - the amount of the employer's deduction for the provision of the shares (proposed section CD 43(6E)(b));

- decreased by the amount of any income arising to the employer if it has income because the value of the shares provided is less than the amount received from the employee (proposed section CD 43(29)); and
- unaffected by any amount paid to it by the employer (proposed section CD 43(20B)).

Example 7

Facts

As for example 4 above.

ASC result for Parent Co

Parent Co's ASC increases by the $1,400 received for the issue of its shares plus the $700 deductible to Employer Co (for a total ASC increase of $2,100).

Example 8

Facts

As for example 5.

ASC result for Parent Co

The issue of the shares gives rise to ASC of $1,400. If the shares are repurchased by Parent Co because the employee does not remain employed, that will usually give rise to an ASC reduction of $1,400. Otherwise, at the share scheme taxing date, Parent Co's ASC will increase by $1,400, the amount which is both taxable to the employee and expenditure for Employer Co.

ASC Example 9

Facts

As for example 6, except that the shares are worth $1 each after one year.

ASC result

Parent Co's ASC will increase by $1,400 when the shares are issued. If the employee remains employed, (a) the reimbursement of $1 per share does not affect Parent Co's ASC (b) Parent Co's ASC decreases by $700 – the amount of the income arising to Employer Co as a result of the amount payable by the employee for the shares ($1,400) being in excess of the value of the shares at the share scheme taxing date ($700).

Treasury stock

If an employee share scheme trustee acquires shares for the purposes of the scheme, it is proposed that those shares will be treated as acquired by the share issuer (proposed section CE 6). The amount paid to the selling shareholder for their acquisition will be a dividend, unless one of the exceptions to dividend treatment applies.

If the shares are held by the trustee, the treasury stock rules will apply to them. Amendments are proposed to the treasury stock rules so that they apply more clearly in such a case.

Proposed measures in clause 7 make it explicit that the treasury stock regime can apply to an acquisition by an employee share scheme trust, just as if the shares were acquired by the company and not cancelled (amendments proposed to section CD 25(1)(a)).

It is proposed that the shares are allocated to an employee within one year of their acquisition, their acquisition and re-issue will be ignored by the share issuer (but not an employer who is not the share issuer) for ASC purposes (amendments proposed to section CD 25(2)(b)). Note that the shares would only have to be *allocated* to the employee under the scheme to qualify for treasury stock treatment, they do not have to be transferred to the employee.

It is proposed that shares which are allocated to an employee within a year and then forfeited are treated as acquired by the company at that time *for the amount the trustee paid for them when originally acquired* (proposed section CD 25(7)).

It is proposed that shares which are not allocated within one year be treated as having been acquired on market and cancelled (also amendments proposed to section CD 25(2)(b)).

Example 10

Facts

As for example 6 except that the shares are sold to the employee at the start of the period by an employee share scheme trust which acquired them on market for $2.50 per share six months before the allocation. The $1,400 loan is also provided by the trust. The trustee will hold the shares until the 12 months is up, and then either retain them in satisfaction of the loan, or transfer them to the employee.

ASC result for Parent Co

The trustee's acquisition of the shares is treated as an on-market acquisition of treasury stock by Parent Co. Therefore both the acquisition and provision of shares to the employee have no effect on Parent Co's ASC. There is no increase in Parent Co's ASC as a result of Employer Co's $1,400 deduction. If the employee does not stay for 12 months, Parent Co will be treated as acquiring the shares for $2.50 per share, the amount for which they were initially acquired on market. This acquisition will not affect Parent Co's ASC if the shares are allocated to another employee within 12 months.

ASC result for Employer Co

If the employee stays for 12 months, Employer Co will have additional ASC of $700, being the excess of its $1,400 deduction over the $700 reimbursement paid to Parent Co.

EXEMPT SCHEMES

(Clauses 25, 31, 42 and 248)

Summary of proposed amendment

The Income Tax Act 2007 currently provides a concessionary regime to encourage employers to offer shares to employees under certain widely-offered "share purchase schemes" (commonly known as "exempt schemes").

The current rules are out of date, complex and no longer fit for purpose. They also do not fit within New Zealand's broad base, low rate framework. The proposed amendments:

- modernise and simplify the criteria for these schemes, including removing employers' 10% notional interest deduction;
- increase the monetary threshold for the schemes (which has not been increased since 1980); and
- address the current ability for employers to claim unintended deductions for the cost of providing the exempt share benefit to employees.

Application date

It is proposed that the amendments will generally apply from the date of enactment. However, clause 42 (new section DV 28), which denies employers a deduction for the cost of acquiring shares provided under an exempt scheme, applies from the date of the Bill's introduction.

Key features

The proposed amendments, seek to simplify and clarify the legislation relating to exempt schemes, while retaining many of the key features of the original schemes and their tax treatment. In many cases, the requirements will be relaxed. Where the original policy is no longer appropriate or unintended consequences have arisen, the proposed amendments address this.

Under the proposed amendments, shares provided to employees under schemes that meet certain criteria (described below in the detailed analysis) will be exempt income to the employees. Benefits provided under schemes that qualify for the current tax-exempt treatment will simply continue to qualify under the new legislation, but such schemes will be entitled to provide the same level of exempt benefit as new schemes.

For all exempt schemes, from the date of introduction of the Bill, employers will be explicitly denied a deduction for the cost of providing the shares (other than scheme management and administration costs) and the 10% notional interest deduction will be repealed from the date of enactment.

The automatic exemption from fringe benefit tax (FBT) for loans provided under exempt schemes in section CX 10(2) will continue.

Background

Since the 1970s, the Income Tax Act has contained a concessionary regime to encourage employers to offer shares to employees under certain widely-offered employee share schemes. The concession is on the basis that the schemes are designed to increase employee engagement at all levels of the company and align employee and shareholder incentives. They may also assist employees to develop and improve financial literacy skills.

There are currently two main tax benefits available under the regime.

1. Exemption for employee: The value of a benefit received by an employee under a concessionary scheme is not taxable to the employee.

2. Deemed interest deduction for employer: The employer is given a deemed deduction of 10% notional interest on loans made to employees to buy shares. This is additional to any deduction for actual interest incurred on money borrowed to finance the scheme.

Another benefit under the regime is that interest-free loans made under an exempt scheme are automatically exempt from FBT. The FBT-exempt status of the loans is a limited benefit. In most cases such loans would be FBT-exempt in any event, as "employee share loans" (that is, any loan provided by an employer to an employee to purchase its shares under an employee share scheme). The only real benefit of the specific FBT exemption is that the interest-free loan can be FBT-exempt regardless of the company's dividend paying policy.

To qualify as an exempt scheme, currently the scheme must meet all the following criteria.

- The cost to employees of shares made available for purchase must not exceed their market value at the date of purchase (but may be less).
- The amount that an employee spends on buying shares under the scheme (or a similar scheme) must not exceed $2,340 within a three-year period.
- Every full-time permanent employee must be eligible to participate in the scheme on an equal basis with every other full-time permanent employee. If the scheme applies to part-time employees or to seasonal employees, they must also be eligible to participate on an equal basis with every other part-time employee or every seasonal employee.
- Any minimum period of service which may be required before a full-time permanent employee becomes eligible to participate must not exceed three years (or the equivalent of three years full-time service).
- Loans to employees for the purchase of shares must be free of all interest and other charges.

- The repayment of loans by employees is to be by regular equal instalments at intervals of not more than one month over a period between three and five years from the date of the loan.
- A trustee must hold the shares on trust for the employee for a period of restriction (generally at least three years).

The benefits of the regime do not apply to shares given to directors of the company or a person who (with any associated person) holds 10% or more of the issued capital of the company.

On the expiry of the restrictive period, the employee has two options. First, the employee can opt to have the shares transferred from the trust to them. Secondly, the employee can opt for the trust to buy the shares back at the market value (but not more than the price paid by the employee).

Problems with the current law

There are various issues with the current regime:

- the regime is complex and inflexible;
- the tax benefits of the regime are uncertain and poorly targeted;
- the regime does not explicitly limit the amount of tax-free benefit that can be conferred;
- there are some minor drafting issues with the legislation; and
- the maximum amount an employee can pay for shares ($2,340 over a three-year period) has not been adjusted since 1980, and this means as a practical matter that the benefits available under the regime are very limited. Adjusted for wage inflation, the figure would now be around $13,000.

Detailed analysis

Income tax exemption for shares provided under exempt schemes

Clause 25 (new section CW 26B) provides that amounts derived from exempt schemes are exempt income.

While a tax exemption for employment income does not fit generally within New Zealand's broad-base, low-rate (BBLR) tax framework, given there is a limit on the amount of benefit that can be provided under the scheme ($2,000 per employee per annum) and the scheme has to be offered to almost all employees, it is appropriate to retain the tax exemption to minimise compliance costs.

The amendments propose retaining the exemption, but with a limit on the tax-free benefit that can be provided.

The existing law achieves the tax exemption by deeming the benefit derived under an exempt scheme to be zero (section CE 2(7)). The proposed amendments locate the exemption in subpart CW, which is a more appropriate part of the Income Tax Act for an exemption.

Employer deduction for shares provided under exempt schemes

There are currently several potential deductions associated with exempt schemes:

1. the 10% notional interest deduction with respect to employee share loans;
2. costs associated with setting up and running the scheme; and
3. in some cases, the direct or indirect costs of acquiring shares for the scheme.

Clause 31 repeals the 10% notional interest deduction in 1 above. The original policy rationale for this benefit is unclear and it is inconsistent with our BBLR tax framework.

Clause 42 proposes a new section DV 28 which denies a deduction for any costs associated with exempt schemes, other than administrative and management fees associated with setting up and running the scheme. This ensures that the unintended deductions identified in item 3 above are no longer available, but the deductions identified in item 2 are still available, subject to the usual limitations. This is consistent with the general deductibility provision for employee share scheme benefits in proposed new section DV 27 that only allows a deduction for administrative and management fees and for the provision of employee share scheme benefits to the extent that the benefit is assessable income to the employee.

Meaning of exempt scheme and criteria for qualifying for exemption

The proposed amendments have been designed to ensure existing schemes that meet the criteria described below can continue to operate without unnecessary disruption. Therefore, to the extent possible the existing rules have been retained and simply clarified.

It is proposed that existing exempt schemes approved by the Commissioner under previous legislation (for example, section DC 12 of the Income Tax Act 2007), would continue to be "exempt schemes" and be eligible for the tax exemption, provided they continue to meet the existing criteria as modified by the increase in the benefit level in proposed section CW 26C(2).

See proposed section CW 26C(1)(a).

The underlying policy of the criteria is to ensure:

1. the scheme is genuinely offered to the vast majority of employees on equal terms – for example, it cannot just be targeted towards executives;
2. related to 1, all employees have to be able to afford to participate in the scheme, not just the more highly paid employees – this is achieved by limiting the cost of the shares that can be offered, requiring employers to provide financing for any cost or because the employee does not have to pay anything for the shares;

3. there is a limit on the benefit that can be provided tax-free; and
4. the scheme is genuinely a share scheme and not just a mechanism to provide tax-free cash to employees (this is why there is a restriction period).

Criteria

To achieve this policy, all the following proposed criteria must be met in order for a scheme to be exempt.

- The cost to employees of shares made available for purchase must not exceed their market value at the date of purchase but may be less (proposed section CW 26C(2)(a)).
- The maximum value of shares provided under an exempt scheme is $5,000 per annum (proposed section CW 26C(2)(b)).
- The maximum discount an employer can provide to an employee is $2,000 per annum (proposed section CW 26C(2)(c)). This means that the most an employee can spend buying shares per annum is $3,000 ($3,000 plus the $2,000 discount means a maximum value of $5,000 worth of shares). This equates to a maximum cost of $9,000 over three years.
- 90% or more of full-time permanent employees who are not subject to securities law of other jurisdictions must be eligible to participate in the scheme. If the scheme applies to part-time employees or to seasonal employees, the same threshold applies (proposed section CW 26C(3)(a)-(c)). Currently, all full time employees must be eligible to participate.
- If the scheme has a minimum spend requirement, the amount can be no more than $1,000 per annum (proposed section CW 26C(3)(d)). This is the updated equivalent of section DC 13(4) and increases the $624 per three year figure.
- Any minimum period of service which may be required before an employee becomes eligible to participate must not exceed three years (or the equivalent of three years full-time service) (proposed section CW 26C(3)(e)).
- If the employee is required to pay any amount for the shares, then the employer must provide a loan for that amount or allow the employee to pay for the shares in instalments (proposed section CW 26C(4)(a)).
- Loans to employees for the purchase of shares must be free of all interest and other charges (proposed section CW 26C(4)(b)).
- Employees will repay loans by regular equal instalments at intervals of not more than one month over a period between three and five years from the date of the loan (proposed section CW 26C(4)(c)).
- Generally speaking, the shares have to be held for three years (either by the employee or by a trustee of a trust on behalf of the employee) – this is to ensure that the scheme is really a share purchase scheme, and not a mechanism for providing cash remuneration. If the employee has paid full market value for the shares, then they only have to hold them until they have fully repaid the loan – at this point they are like any other shareholder and should not have extra restrictions placed on them (proposed section CW 26C(7)).

- The employee can choose to withdraw from the scheme by giving the employer 1 month's notice and have their shares purchased back for the lesser of market value and cost (proposed section 26C(5)).

- If participation in the scheme is causing serious hardship for the employee, the terms of payment can be varied or employees can be allowed to withdraw from the scheme and receive the market value of their shares (proposed section CW 26C(6)).

- If the employee leaves employment before the three years is up, then:

  – if they leave because of death, accident, sickness, redundancy or retirement at normal retiring age they can keep the shares (subject to repayment of the loan) or have the shares bought back for the lesser of market value and cost; and

  – if they leave for any other reason, the shares are bought back at the lesser of cost and market value. (see proposed section CW 26C(6) and (9)).

- The exempt scheme is not required to be approved by the Commissioner of Inland Revenue, however, the Commissioner must be notified of the scheme's existence and the employer must advise the Commissioner when grants are made under the scheme (see clause 248 which contains proposed section 63B of the Tax Administration Act 1994 and clause 31 which repeals section DC 12 – DC 15).

- There is no requirement for a scheme to have a trust – many schemes have trusts as a matter of convenience. Removing this requirement provides greater flexibility (especially for small employers who may not want the administrative expense of operating a trust for a fairly small scheme).

TECHNICAL, CONSEQUENTIAL AND TRANSITIONAL MATTERS

(Clauses 12, 14, 28, 60, 70, 74 and 187(26))

Summary of proposed amendments

A number of transitional and consequential provisions are needed to support the core amendments. These provisions:

- specify a cost base for shares acquired under an employee share scheme (proposed section CE 2(4));
- provide for the treatment of employee share scheme shares subject to the foreign investment fund (FIF) rules (amended section EX 38);
- specify the treatment of employee share scheme trusts (proposed section CE 6 and repeal of existing section HC 27(3B));
- introduce a specific anti-avoidance rule to counteract tax avoidance transactions with respect to employee share schemes (proposed section GB 49B);
- make a minor amendment to the penalties applying to employers who do not take reasonable care in reporting employee share scheme benefits (proposed amendments to the definition of "tax shortfall" in section 3(1) of the Tax Administration Act 1994);
- provide transitional rules for existing schemes to ensure taxpayers have sufficient time to amend schemes (if necessary) to take account of the new law following enactment of the Bill (proposed new section CZ 1); and
- replaces the former terminology – share purchase agreement – with the new term – employee share scheme – throughout the Income Tax Act 2007 and Tax Administration Act 1994.

Application date

There are various application dates for each of the amendments, as specified below.

Detailed analysis

Cost base

It is proposed that income from an employee share scheme benefit, be added to the cost of the shares for tax purposes (clause 12, proposed new section CE 2(4)). *Similarly a deduction reduces the cost base.*

This provision applies from the date six months after the date of enactment.

FIF regime

The Bill effectively excludes from the FIF regime employee share scheme shares which are treated as owned by the employee for tax purposes but for which the share scheme taxing date has not arisen. Before that time, it is appropriate to tax the dividends on the shares, but not appropriate to tax any change in value, since that will be taxed when the shares give rise to income under section CE 2. See clause 60, proposed amendments to section EX 38.

This provision applies from the date six months after the date of enactment.

Trusts

As referred to above, an employee share scheme trustee will be treated as the nominee of the employer and (if different) the share issuing company (see clause 14, proposed section CE 6). This means that the activities of the trustee on behalf of those companies will be treated as undertaken directly by the companies themselves. They will therefore have no effect on the trustee's taxable income.

Section HC 27(3B), which deals with the situation where an employer has claimed a deduction for a settlement on an employee share scheme trustee, is proposed to be repealed, as such settlements will no longer be deductible. See clause 74.

These provisions apply from the date six months after the date of enactment.

Specific anti-avoidance provision

Clause 70 of the Bill contains a specific anti-avoidance provision, in proposed section GB 49B. This allows the Commissioner to counteract any tax advantage gained from an arrangement which attempts to circumvent the intent and application of the share scheme taxing date, by seeking to have shares taxed either earlier or later than is consistent with that intent.

This provision applies from the date six months after the date of enactment.

Penalties

Clause 187(26) of the Bill amends the definition of a "tax shortfall", so that an employer who is required to report the amount of an employee's share scheme income in a tax return, and who fails to take reasonable care in determining the amount of that income, is liable for the same shortfall penalty whether or not the employer has elected to pay PAYE on the benefit. There is no basis for differentiating in this respect between employers who do and those who do not withhold PAYE.

This provision applies from the date of enactment.

Transitional rules

Employee share schemes are often long-term arrangements, lasting three or more years. Additionally, new share schemes are set up fairly regularly by companies and it is important for companies and employee participants to have clarity around the tax laws when they enter into these arrangements.

Accordingly, it is important to provide sufficient transitional measures for existing and contemplated employee share schemes. It is not desirable to put employers and employees in a position where employees are being granted employee share scheme benefits without certainty as to their tax treatment. However, it would also not be appropriate for employers and employees to be able to unduly extend the application of the existing rules by artificially qualifying for grandparenting grants of employee share scheme benefits which are not, in substance, intended to be conferred until a much later time.

To balance these competing objectives, a 6 month period after enactment is proposed when benefits can continue to be taxed under the old law in specific circumstances. Clause 28 proposes section CZ 1 which provides that the new employee share scheme rules do not apply to shares granted or acquired before the publication of the officials' issues paper on 12 May 2016. The new rules would also not apply to a particular share if:

(i) that share was granted or acquired before the date that is six months after the date of enactment;

(ii) the shares were not granted with a purpose of avoiding the application of the new law; and

(iii) the share scheme taxing date under the new law is before 1 April 2022.

If shares benefits are taxed under both the existing and proposed new rules, the new rules provide the employee with a credit for income recognised under the old rules.

This transitional provision applies from the date six months after the date of enactment.

Other policy matters

ANNUAL SETTING OF INCOME TAX RATES

(Clause 3)

Summary of proposed amendment

The Bill sets the annual income tax rates that will apply for the 2017–18 tax year. The annual rates to be confirmed are the same that applied for the 2016–17 tax year.

Application date

The provision will apply for the 2017–18 tax year.

Key features

The annual income tax rates for the 2017–18 tax year will be set at the rates specified in schedule 1 of the Income Tax Act 2007.

DEMERGERS – COMPANY SPLITS BY AUSTRALIAN ASX LISTED COMPANIES

(Clauses 8, 45, 63, 172(3) and 182)

Summary of proposed amendment

Amendments to the dividend rules in the Income Tax Act 2007 are proposed so that certain transfers of shares received by New Zealand shareholders as a result of a company split (demerger) by a listed Australian company are not treated as a dividend.

Application date

The amendments will apply for the 2016–17 and later income years.

Key features

New section CD 29C proposes that the transfer by an Australian Stock Exchange (ASX) listed company of shares in a subsidiary company is not a dividend.

New section ED 2B sets out the conditions needed for section CD 29C to apply and the tax consequences for taxpayers who hold the ASX-listed company's shares as revenue account property. The new section also provides for the adjustment of available subscribed capital amounts.

Consequential changes are proposed to sections FC 2 and YA 1. Schedule 25 is also to be consequentially amended.

Background

A demerger occurs when a corporate group splits off part of itself and distributes that part to its shareholders. As a consequence, companies that were grouped under a single shareholding are separated into two different shareholdings.

Demergers, which do not involve a distribution of income, should not give rise to taxation consequences. However, under the Income Tax Act's current dividend rules, the full value of the shares in the demerged (spun-out) company is treated as a dividend (even though there is no distribution of income and the shareholder's economic ownership does not change). In practice, the amount of the dividend is usually significant, as it will equal a significant percentage of the corporate group's total market value.

The proposed amendments in the Bill deal with demergers by certain ASX-listed companies. The limited scope of the amendments is intended to deal with where the tax problems with demergers are the most immediate. Consideration of a more comprehensive set of rules for demergers by New Zealand and non-resident companies generally would need to be separately prioritised under the Government's tax policy work programme.

Detailed analysis

Scope of the proposed amendments

The proposed amendments apply to shares and stapled securities issued by Australian-resident companies listed on the ASX. A company is considered an ASX-listed Australian company if it has shares included in an index that is an approved index under the ASX Operating Rules. From the 2017–18 income years, the scope of the ASX-listed Australian company definition will be widened to include a company included on the official list of ASX Limited, in line with the changes to the term made by the Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016.

The requirement that the Australian company maintain a franking credit account means that the proposed amendment does not apply to unit trusts. Unit trusts are not generally taxed as companies under Australian tax law and distributions from unit trusts are not taxed as dividends in Australia.

To ensure that the proposed changes are not used to effect an in-substance distribution of income, proposed section ED 2B(1)(d) requires that the transfer is not a dividend under the Australian Income Tax Assessment Act 1936. Taxpayers can refer to statements from the Australian Taxation Office or the company's demerger documents to help determine this.

As different countries have different taxation rules for companies and dividends, the scope of the provision is limited to companies that are resident in Australia. Australian tax law already includes anti-avoidance rules that are designed to prevent abuse and ensure that any relief from dividend taxation applies to demergers that do not involve an in-substance distribution of income.

Treatment of shareholders

Proposed section ED 2B sets out the consequences for taxpayers affected by a demerger that holds the shares as revenue account property. The new section sets out the rules for determining a new cost base for shares in the splitting company and shares in the new company. For pragmatic and compliance reasons, it is proposed that available subscribed capital amounts should be unchanged for the splitting company, and set at zero for the new company.

BANK ACCOUNT REQUIREMENT FOR IRD NUMBERS

(Clause 244)

Summary of proposed amendment

Currently, offshore persons applying for an IRD number generally need to provide the Commissioner with evidence of a functional New Zealand bank account. Due to practical issues associated with this requirement, the proposed amendment gives the Commissioner a discretion to issue IRD numbers in cases where there is no New Zealand bank account but the Commissioner is satisfied with the applicant's identity.

Application date

The proposed amendment will apply from the date of enactment of the Bill.

Background

Section 24BA of the Tax Administration Act 1994 provides that the Commissioner must not allocate an IRD number in response to an offshore person's request unless the Commissioner first receives a current New Zealand bank account number for the offshore person. This section is subject to a limited number of exceptions. A bank account is not required when:

- A person requires an IRD number only because they are a non-resident supplier of goods and services under the Goods and Services Tax Act 1985.
- A reporting entity under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 has conducted customer due diligence procedures for the offshore person.

The bank account requirement is also simplified for non-resident seasonal workers. They can use the NSW tax code for the first month of their employment, even though they may not have an IRD number and/or a New Zealand bank account. After that month, an IRD number must be provided for the NSW tax code to continue to apply, and a bank account is then required.

The current bank account requirement has however caused practical issues in a number of cases. Significant delays or inability to obtain a New Zealand bank account in some cases have made it difficult for people to comply with their New Zealand tax obligations. The requirement can also impose undue compliance costs in some cases.

The proposed amendment provides the Commissioner with a discretion to issue IRD numbers to offshore persons who do not have a New Zealand bank account, if she is satisfied with the identity of the offshore person.

PETROLEUM MINING DECOMMISSIONING

(Clauses 17–21, 33–38, 48–52, 57, 95, 99, 100, 102–104, 113, 172(8), (44), (45), (47) and (49), 265 and 266)

Summary of proposed amendments

The tax rules for petroleum mining currently include a "spread-back" process which allows prior income tax periods to be reopened to include losses arising from decommissioning expenditure incurred in the current year. This method ensures that decommissioning expenditure, which is a large cost incurred near or at the end of production, does not result in a loss carried forward that would be of no value to the petroleum miner unless it had income from another source.

As the spread-back requires Inland Revenue to amend assessments for previous periods it incurs high compliance and administration costs and is considered an outdated process. A number of other issues have also been identified where the current petroleum mining decommissioning rules are not sufficiently detailed or arrive at an incorrect outcome.

As well as correcting the identified issues, the spread-back mechanism for deducting decommissioning costs is proposed to be replaced with a refundable credit similar to other refundable credits already included in the Income Tax Act 2007, most relevantly the refundable credit for mineral mining rehabilitation expenditure.

Application date

The proposed replacement of the spread-back with a refundable credit and other related provisions will apply for the 2018–19 and later income years.

The proposed repeal of the terminating provisions in sections IZ 2 and IZ 3 and consequential changes will also apply for the 2018–19 and later income years.

The proposed correction of the cross-reference in section IS 5(1)(a) will apply for the 2008–09 and later income years to align with the commencement of the Income Tax Act 2007.

The proposed change to confirm credit use-of-money interest (UOMI) does not arise for the loss spread-back will apply to income tax returns filed after the introduction date of the Bill. This provision will be repealed for the 2018–19 and later income years along with the other spread-back provisions, as noted above.

Key features

Refundable credit

The main effect of the proposals in the Bill is to replace the existing spread-back process for petroleum mining decommissioning with a refundable credit. As part of these amendments a number of further refinements to the existing legislation have been included.

Under the proposed new rules, a petroleum miner will be eligible for a refundable credit for the following amounts:

- any decommissioning expenditure in the year it is incurred; and
- any development expenditure that has not been deducted at the time commercial production ceases.

The refundable credit will be calculated by multiplying the qualifying expenditure by the petroleum miner's current tax rate. The maximum refundable credit will be limited to income tax paid by the petroleum miner, or a consolidated group it is a member of, in prior years. The exception to this is when a petroleum miner is decommissioning operations outside New Zealand, in which case the maximum refundable credit will be limited to income tax paid on petroleum mining operations outside New Zealand.

To prevent a petroleum miner from temporarily ceasing commercial production in order to access a refundable credit, any expenditure qualifying for a refundable credit will be added back as income if production restarts.

Use-of-money interest

When a petroleum miner uses the spread-back process it receives a refund of income tax paid in prior years. This is a mechanism for recognising the tax benefit of expenditure incurred in a current period rather than a reduction in tax payable in those prior years. Accordingly, it was never intended that these refunds should be eligible for credit UOMI. The current provisions do not reflect this intent. The Bill therefore proposes to introduce a provision to ensure credit UOMI is not paid on any refunds arising from the current spread-back process.

Terminating provisions

Sections IZ 2 and IZ 3 are terminating provisions to preserve concessionary treatment that applied to petroleum miners before the rules changed in 1990. These provisions, and a number of consequential provisions, are now redundant and are proposed to be repealed.

One of these consequential provisions is the section YA 1 definition of a "petroleum mining company". The Bill proposes to remove this definition and several provisions that employ it. Under the proposals in the Bill, one instance of "petroleum mining company" will remain in the Income Tax Act 2007 – in the section YA 1 definition of a "controlled petroleum mining holding company". This usage was not intended and will not rely on the "petroleum mining company" definition. Instead it will continue to rely on the ordinary meaning of the words as a company that undertakes petroleum mining.

Background

The tax rules for petroleum mining split the life of a petroleum field into two distinct phases: exploration and development. "Exploration" is generally done under a prospecting or exploration permit and involves looking for oil and gas reserves that can be extracted in commercially feasible quantities, whereas "development" is done under a mining permit and involves the extraction of oil or gas for commercial production.

"Exploration expenditure" is deductible when incurred whereas "development expenditure" is spread over either seven years or under the reserve depletion method which spreads the deduction over the remaining life of the field.

A petroleum miner will incur significant decommissioning expenditure before relinquishing its mining permit. Decommissioning is what happens to wells, installations and surrounding infrastructure when a petroleum field reaches the end of its economic life. Offshore decommissioning usually involves:

- the plugging and abandoning of wells;
- removal of equipment; and
- the complete or partial removal of installations and pipelines.

The policy underlying the current tax rules recognises that this expenditure is an unavoidable consequence of the production process and that industry-specific timing rules should allow deductions for this expenditure to be effectively offset against income derived in earlier periods.

In the absence of industry-specific tax rules a petroleum miner may pay tax in earlier periods then incur decommissioning expenditure which would be carried forward as a loss to future periods. Unless the petroleum miner had income from other sources, such as a separate field, this loss would never be utilised. The petroleum mining rules recognise that this would be inappropriate and would discourage petroleum exploration and development. Or, it could encourage a petroleum miner to decommission a field that still contained economically recoverable reserves to ensure that any deductions could be offset against the higher income amounts that are derived in earlier years of a field's life.

To address this issue, a petroleum miner can request that the Commissioner reopen earlier tax years to claim a deduction for losses arising "because of the relinquishment of the permit". This process is referred to as a "spread-back". Deductions are spread back to a previous year to the extent taxable income was returned generating a refund of tax, and if those deductions exceed the amount of profit the remainder is carried back another year and so on.

Historically, there were a number of spread-back provisions, for both income and deductions, in the Income Tax Act 2007. These spread-backs are viewed as an outdated approach that results in high compliance and administration costs. Many spread-back provisions have been removed as part of previous reforms and there are no remaining provisions that spread back deductions equivalent to the petroleum decommissioning rules.

The need to amend the petroleum mining rules is an opportunity to modernise the decommissioning rules in a manner that is broadly consistent with existing policy but reduces compliance and administration costs.

Detailed analysis

Amount of the refundable credit

Under the proposed amendments a refundable credit will only be available to a petroleum miner for qualifying deductions. The deductions that can qualify for a refundable credit are expenditure on decommissioning or any previously undeducted development expenditure at the time petroleum mining operations are permanently ceased.

To the extent a petroleum miner has a loss that is equal to or less than the qualifying deductions this amount is multiplied by the petroleum miner's tax rate. For example, a petroleum miner with a $1,000,000 loss for a year, including $800,000 of decommissioning expenditure, could qualify for a refundable credit of $800,000 x 28% = $224,000.

The refundable credit will be capped at the amount of income tax paid by the petroleum miner, and any consolidated group it is a member of, in all previous years.

If the refundable credit arises from petroleum mining operations outside New Zealand, the amount of the refundable credit will be limited to New Zealand tax paid on those operations. No similar ring-fencing is proposed for petroleum mining operations within New Zealand.

Any losses that did not qualify for a refundable credit would continue to be carried forward, subject to satisfying ordinary rules.

Relinquishment of a permit

The current spread-back process is driven off either the year in which a petroleum permit is relinquished or expenditure is incurred because of the relinquishment of the petroleum permit.

This restriction causes a number of issues where the law is either unclear if a spread-back is available or disallows a spread-back when there is no good policy reason to do so. These issues include:

- when a petroleum miner is required to undertake actions that are akin to removal or restoration operations while production is still continuing;

- when a petroleum miner has undertaken removal or restoration operations as part of a wind-up phase when production has ceased but there is a delay in relinquishing the permit; and
- when a petroleum miner incurs removal or restoration expenditure before surrendering acreage from a petroleum mining permit but does not relinquish the entire permit.

The Bill proposes that the requirement for a permit to be relinquished is replaced. Instead, a refundable credit will be available in the year qualifying decommissioning expenditure is incurred. In addition, a refundable credit will be available to the petroleum miner for any previously undeducted development expenditure in the year commercial production ceases.

Decommissioning

The definition of "removal or restoration operations" will effectively be replaced by the new definition of "decommissioning". This change arises predominately due to the removal of the relinquishment of a permit criterion, as discussed above.

The proposed definition of "decommissioning" is intended to cover actions undertaken by (or on behalf of) a petroleum miner to transition from the commercial production of petroleum to the eventual relinquishment of the permit. These actions can be undertaken at any point during the life of the permit area and will no longer be linked directly to the relinquishment of the permit.

It is intended that, except as noted below, the definition of "decommissioning" does not apply to an exploration well. Expenditure on abandoning an exploration well will continue to be deductible under section DT 1(1) but will generally not meet the definition of "decommissioning" so will not qualify for a refundable credit.

Actions to abandon a well that was drilled as an exploration well will only meet the definition of "decommissioning" in the following circumstances:

- Exploration wells that have been subsequently used for commercial production. These wells will have triggered sections CT 3 and DT 7 and will meet the definition of a "commercial well" in paragraph (b)(i) of the decommissioning definition.
- Exploration wells that are geologically contiguous with, and abandoned as part of an arrangement that includes decommissioning a commercial well. Such wells are used, or are suspended for potential future use, to support the extraction from commercial wells, and it may be commercially sensible for them to be abandoned at the same time that the commercial well is decommissioned.

In addition to the actions above, the decommissioning definition also includes the ongoing monitoring of a commercial or exploratory well that had itself met the "decommissioning" definition.

Petroleum mining operations

The definition of "petroleum mining operations" in section CT 6B is proposed to be amended by removing the "removal or restoration operations" criteria. The equivalent of "removal or restoration operations" in the proposed legislation is "decommissioning". However, decommissioning has not been added to the definition of petroleum mining operations as the proposed definition of decommissioning uses the term "petroleum mining operations" so including decommissioning as part of petroleum mining operations would create a circular reference. So that the scope of petroleum mining operations is broadly maintained, a number of references within the Income Tax Act 2007 to petroleum mining operations are proposed to have "and decommissioning" added.

Ceasing commercial production

A petroleum miner who meets the other requirements will be entitled to a refundable credit for any previously undeducted development expenditure. This entitlement will be triggered once a petroleum miner permanently ceases commercial production. The definition of "petroleum mining operations" will be amended to exclude removal or restoration operations so that decommissioning will not be part of petroleum mining operations. As a consequence, in most instances, a petroleum miner that ceases commercial production will do so while continuing to undertake decommissioning, and production will cease in a period prior to the relinquishment of the permit.

"Commercial production" is not a defined term but is already used in a number of places in the Income Tax Act 2007. It aligns with the term used in section DT 6 as "petroleum produced in commercial quantities on a continuing basis under a petroleum permit". Petroleum extracted from an exploration well or under an exploration permit would not be treated as commercial production as it is not intended to be extracted on a continuing basis.

Undeducted development expenditure will arise when a petroleum miner spreads development expenditure:

- under the default method and ceases commercial production within seven years of development expenditure being incurred; or
- under the reserve depletion method and ceases production before extracting all of the petroleum included in the probable reserve amount in the formula in section EJ 12B(3).

The justification for allowing a refundable credit when commercial production ceases is that at this point the petroleum miner will no longer be deriving an enduring benefit from this development expenditure in future years even if the petroleum permit has not yet been relinquished.

Restarting commercial production

To prevent a petroleum miner from temporarily ceasing production in order to obtain a refundable credit before restarting production, a provision will add back as income amounts of undeducted development expenditure qualifying for a refundable credit in the year commercial production restarts. This income will then be spread, consistent with other development expenditure, in a similar manner to that which already applies for the claw-back of exploration wells used for commercial production.

This provision will apply when production is restarted to the extent that petroleum assets that were used in the original commercial production are reused in the resumed commercial production. This provision will not apply when a petroleum miner restarts production in the same area using entirely new assets.

Notification requirements

A petroleum miner must notify Inland Revenue before filing a return that includes a refundable credit. A separate email address for the petroleum mining desk within the Assurance area of Inland Revenue will be set up for this notification to be sent to. Further details on this notification process will be set out in a *Tax Information Bulletin* shortly after enactment of the Bill.

This requirement has been included in the proposed legislation due to the potential size of a refundable credit and also because a petroleum miner that has finished decommissioning may no longer have a presence in New Zealand if the refundable credit was subsequently found to be incorrect.

Aside from being before filing the return of income, no specific time will be specified for this notification to be provided. However, officials expect that providing the notification as soon as possible prior to the return being filed may assist in facilitating a timely refund.

A petroleum miner that did not satisfy the notification requirement may be prevented from accessing a refundable credit in which case any losses would be carried forward in the standard manner.

Interaction with imputation credit accounts

A petroleum miner that is an ICA company will be required to have a sufficient credit balance in its imputation credit account to obtain a refund from a refundable credit. This arises under the existing legislation, as a refundable credit is a refund of overpaid tax under section RM 2(1B) and a refund of overpaid tax for an ICA company is restricted by section RM 13.

Farm-out arrangements

Farm-out arrangements are an existing feature in the petroleum mining rules where another party undertakes work for the petroleum miner in exchange for an interest in the permit or the profits arising from the permit. A farm-in party is already entitled to a deduction for farm-in expenditure, that if it were incurred by a farm-out party would be petroleum development expenditure, exploratory well expenditure, or prospecting expenditure.

To the extent a farm-in party incurs decommissioning expenditure or has unamortised development expenditure upon the cessation of commercial production these deductions will also be eligible for a refundable credit. For the avoidance of doubt a number of provisions are proposed to specifically allow for this treatment by a farm-in party.

As with a petroleum miner, a farm-in party with unamortised development expenditure will only be eligible for a refundable credit when commercial production in a permit area ceases. If a farm-in party ceases production in that permit area but commercial production continues by a petroleum miner or another farm-in party no refundable credit will be available.

SCHEDULE 32 OVERSEAS DONEE STATUS

(Clause 183)

Summary of proposed amendments

The Bill proposes to amend the Income Tax Act 2007 by adding five charities to the list of donee organisations in schedule 32.

Application date

The amendments will come into force on 1 April 2017.

Key features

It is proposed to add five charitable organisations to schedule 32 of the Income Tax Act 2007, making donors to the following charities eligible for tax benefits on their donations.

- Byond Disaster Relief New Zealand
- Flying for Life Charitable Trust
- Médecins Sans Frontières
- Tony McClean Nepal Trust
- Zimbabwe Rural Schools Library Trust.

Background

Donors to organisations listed in schedule 32 are entitled, as individual taxpayers, to a tax credit of $33^1/_3$% of the monetary amount donated, up to the value of their taxable income. Companies and Māori Authorities may claim a deduction for donations up to the level of their net income. Charities that apply funds towards purposes that are mostly outside New Zealand must be listed in schedule 32 of the Income Tax Act 2007 before donors become eligible for these tax benefits.

Detailed analysis

The five charitable organisations proposed to be added to schedule 32 are engaged in the following activities:

Byond Disaster Relief New Zealand

Byond Disaster Relief New Zealand was formalised in 2015 to carry out New Zealand's operations under the United Kingdom charity Byond Disaster Relief banner. The New Zealand charity's purposes are directed at providing sustained support and assistance to communities in the immediate aftermath of a natural disaster (emergency relief and supplies) and early long-term recovery. Their work focuses on supporting the rebuild and repair of infrastructure, particularly damaged schools, hospitals and medical clinics. The New Zealand trust has been involved in the responses to the recent Nepal earthquake and the 2016 cyclones and typhoons affecting Vanuatu and Fiji.

Flying for Life Charitable Trust

Established in 2009, Flying for Life Charitable Trust is the humanitarian aid arm of Mission Aviation Fellowship New Zealand (a charity that has been in existence since 1959). Flying for Life's objectives are directed at the relief of poverty and providing emergency responses to natural disasters in the form of mobile (aviation) medical assistance and supporting aid agencies with transport of personnel and freight. Flying for Life's largest project is focused on Papua New Guinea. It is also currently active in Africa, Timor Leste, Bangladesh and Mongolia.

Médecins Sans Frontières New Zealand Charitable Trust

Formed in 1971, Médecins Sans Frontières (also known as "Doctors Without Borders") is a humanitarian organisation focused on providing emergency medical assistance to people affected by armed conflicts, epidemics, natural disasters and exclusion from healthcare around the world. The Médecins Sans Frontières New Zealand Charitable Trust was incorporated on 9 March 2016. The New Zealand trust activities are directed at raising funds in New Zealand to support Médecins Sans Frontières' projects in nearly 70 countries around the world.

Tony McClean Nepal Trust

The Tony McClean Nepal Trust is active in the Lamjung district of Nepal. The Trust's efforts are directed at improving education outcomes and the district's infrastructure. Projects include providing the means for communities to access clean drinking water, reducing air pollution in homes through flued wood burners and funding the salaries of teachers and health care professionals in Lamjung. More recently, the Trust has been involved in providing disaster relief in the region following the 2015 Nepal earthquake.

Zimbabwe Rural Schools Library Trust

The Zimbabwe Rural Schools Library Trust, established in 2013, provides education and reading resources to underprivileged rural schools in Zimbabwe.

TRUSTEE CAPACITY

(Clauses 77(1), (2), and (4), 172(5), 172(35), 173, 175, 176, 185, 187(10), 264(1), and 309, and schedule 1)

Summary of proposed amendment

The Bill proposes to introduce a general rule into Part Y of the Income Tax Act 2007 to distinguish between a trustee's personal or body corporate capacity, and their separate trustee capacity. A number of exceptions to this general rule are proposed where it would be contrary to the policy intent of the provisions to exclude a corporate or natural person trustee. There are also a number of proposed consequential amendments to the Income Tax Act 2007, the Tax Administration Act 1994, and the Goods and Services Tax Act 1985 resulting from the general trustee capacity amendment.

Application date

The amendments will apply from the date of enactment.

Key features

The key changes proposed in the Bill relate to the following:

Income Tax Act 2007

- The introduction of a general rule to recognise that a person acting as a trustee of a trust is acting in a capacity that is separate from their other capacities.
- An amendment to the "company" definition in section YA 1 excluding a company acting in its capacity as trustee.
- An amendment to the "natural person" definition in section YA 1 excluding a natural person acting in their capacity as trustee.
- A number of consequential amendments of a rationalising nature resulting from the general trustee capacity amendment.
- An amendment to the "close company" definition in section YA 1 to allow trustees to continue to qualify as shareholders of a close company.
- An amendment to section HD 15 (asset stripping of companies) to ensure the provision applies to a company that is acting in the capacity of trustee.
- An amendment to the residence rules in sections YD 1 and YD 2 to ensure that the residence rules for natural persons and companies continue to apply to these persons acting in the capacity of trustee.

Tax Administration Act 2007

- Introducing a new definition of "natural person" to exclude a natural person acting in their capacity as trustee except for the purposes of the definition of qualifying resident foreign trustee and the serious hardship provisions in sections 177 and 177A.

Goods and Services Tax Act 1985

- The introduction of a provision into the GST associated person definition to associate a trustee and a person with the power to appoint or remove that trustee.

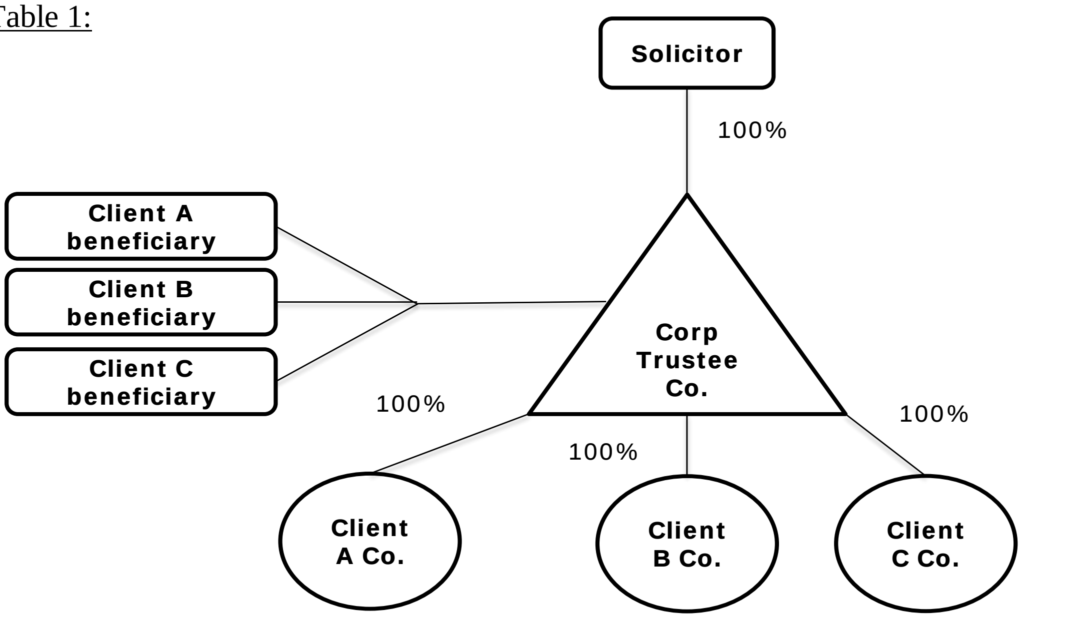
Background

The measure is intended to address the uncertainty surrounding the application of the voting interest test for corporate trustees as a result of two recent High Court decisions, *Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140 and *Staithes Drive Development Ltd v Commissioner of Inland Revenue* [2015] NZHC 2593. These decisions have changed how the voting interest test, which is used to measure the ownership of companies, including their association, is applied to corporate trustees. In both cases, the High Court held that the voting interests in the relevant companies were held by the legal owner of shares, and effectively ignored the capacity in which those shares were held. This means that the voting rights attached to shares owned by a corporate trustee are attributed to that trustee's natural person shareholders in their personal capacity.

Applying this approach may lead to overreach of the application of the associated person rules. For example, if a solicitor holds shares in a trustee company, which in turn holds shares in a number of unrelated client companies on trust for unrelated beneficiaries, the otherwise unrelated client companies would be associated for tax purposes (see Table 1). This could also be the case for other trustee companies that hold shares in companies for otherwise unrelated trusts.

While the High Court's decision resulted in the correct outcome in these cases (that the companies were associated), the approach is inconsistent with the stated policy intention, which is that corporate trustees should be treated as ultimate shareholders and not looked-through.

Table 1:



The Bill proposes an amendment to align the legislation with the original policy intent as reflected in *Tax Information Bulletin* No 5, November 1989; *Tax Information Bulletin* Vol 3, No 7, April 1992; and *Tax Information Bulletin* Vol 21, No 8, 2009. The proposed amendment addresses this by introducing a general rule for trustee capacity, and some consequential changes to defined terms and operative provisions. The general rule confirms that a person's trustee capacity is separate from a person's other capacities.

Detailed analysis

General rule - general trustee capacity amendment

Proposed section YA 5 will provide the core rule to distinguish between a trustee's personal, body corporate, or other capacity, and their separate trustee capacity. The proposed amendment will clarify that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal, body corporate, or other capacities.

The proposed amendment clarifies that:

- any reference to "company" in the Income Tax Act does not include a corporate trustee (subject to any identified exceptions); and
- any reference to "natural person" in the Income Tax Act does not include a natural person trustee (subject to any identified exceptions).

Officials consider that the amendment is consistent with the policy intent of most of the rules referring to companies and natural persons. Officials have also identified some specific exceptions to the general rule which are explained below.

The proposed amendment will also address the overreach that may arise as a result of the High Court decisions by ensuring that if a person is the trustee of more than one trust, the person is acting in a different capacity for each trust. In particular, the amendment will ensure that a corporate trustee is not looked-through, including for the purpose of association.

"Company" and "natural persons" definitions

As part of the introduction of the general trustee capacity rule, the Bill proposes amendments to the section YA 1 definitions of "company" and "natural person".

"Company"

The amendment to the definition of "company" in section YA 1 introduces a new limb which excludes corporate trustees from the definition. Under this proposed rule, if a company is acting in its capacity as corporate trustee, it will be treated, for tax purposes, as a trustee (and not a company).

This is consistent with the policy intent of most of the rules referring to companies. For example, the various company loss grouping and dividend provisions are not intended to apply to a company acting in its capacity as trustee. Also the exemption in section CW 9 for dividends derived from a foreign company would not apply to dividends derived by a corporate trustee resident in New Zealand.

Another consequence of the general rule is that corporate trustees will not be able to apply the automatic interest deduction for companies in section DB 7. Like other non-corporates, they will need to satisfy the general permission to claim a deduction for interest expenditure under section DB 6.

"Natural person"

Similarly, the amendment to the definition of "natural person" introduces a new limb which excludes natural person trustees from the definition. Under this proposed rule, if a natural person is acting in their capacity as natural person trustee, they will be treated, for tax purposes, as a trustee (and not a natural person).

Exceptions to general rule

Officials have also identified a number of exceptions to the general rule which are explained below.

"Close company" definition

In response to the general trustee capacity amendment, the Bill proposes an amendment to section YA 1 to include trustees (natural person or corporate) in the definition of "close company". The amendment recognises that many close companies are owned in family trust structures.

As a consequence of this change, a minor amendment to section DG 3 is proposed to remove the reference to natural person trustees – as the clarification will no longer be necessary.

Asset stripping of companies

The Bill proposes an amendment to section HD 15 (asset stripping of companies) to ensure the provision applies to a company acting in its capacity as trustee. The amendment is consistent with Inland Revenue's view that section HD 15 applies to corporate trustees. Section HD 15 authorises the Commissioner of Inland Revenue to recover income tax from the directors and shareholders of a company who have entered into an arrangement or transaction to deplete the company's assets so that it is unable to satisfy its tax liabilities. Without the proposed amendment, a corporate trustee could enter an arrangement to deplete its assets so that it is unable to satisfy its tax liabilities, and the Commissioner would have no means of recovering any of the corporate trustee's unpaid income tax from its directors or shareholders.

Residence rules

The Bill proposes an amendment to the residence rules in subpart YD of the Income Tax Act to clarify that both the natural person residency test in section YD 1, and the company residency test in section YD 2, continue to apply to trustees. Without this amendment, there would be no means of testing trustee residence.

Along with this amendment, the Bill proposes to align section YD 1 with its original policy intent by replacing all references to "person" in the section with "natural person". This clarifies the current practical application of section YD 1 to natural persons only.

Consequential amendments

A number of consequential amendments to the Income Tax Act are proposed to ensure the core rule applies consistently throughout the Act. These amendments either remove or replace phrases that will no longer be necessary given the general trustee capacity rule, or they repeal provisions that will no longer be necessary as a result.

The proposed consequential amendments affect the following provisions:

- CQ 5(1)(d) (When FIF income arises)
- DG 3(3) (Meaning of asset for this subpart)
- DG 14(1)(b)(i) (Interest expenditure: non-corporate shareholders)
- DN 6(1)(d) (When FIF loss arises)
- EX 68(1)(a) (Measurement of cost)
- FE 3(1)(a) (Interest apportionment for individuals)
- FE 4(1), paragraph (c) of the definition of excess debt entity
- FE 4(1), definition of natural person
- HA 7(1)(a) (Shareholding requirements)
- MA 1 (What this subpart does)
- OB 1(2)(ii) (General rules for companies with imputation credit accounts)

- RE 11(1) (Notification by companies)
- RE 12(5)(a)(ii) (Interest)
- YA 1, paragraphs (a) and (b) of the definition of initial provisional tax liability
- YA 1, paragraph (a)(i) of the definition of "look-through counted owner"
- YA 1, paragraph (c) of the definition of "look-through interest"
- YB 3(5) (Company and a person other than company)
- Schedule 1, part D, clause 4 (Basic tax rates: income tax, ESCT, RSCT, RWT, and attributed fringe benefits)

Tax Administration Act 1994

The Bill proposes a new "natural person" definition in section 3 of the Tax Administration Act 1994 to exclude a natural person acting in their capacity as trustee, consistent with the position under the Income Tax Act. The "company" definition in the Income Tax Act 2007 will continue to apply to the Tax Administration Act 1994 by virtue of section 3(2).

The proposed amendment includes a carve-out to ensure all references to "natural person" in the "qualifying resident foreign trustee" definition and both sections 177 and 177A (serious hardship provisions), include a natural person trustee. The proposed carve-out is consistent with Inland Revenue's policy that the hardship provisions in the Tax Administration Act 1994 are applicable to natural person trustees as natural person trustees are personally liable for trustee debts.

Goods and Services Tax Act 1985

The Bill proposes new section 2A(1)(hb) in the Goods and Services Tax Act 1985. This will provide a mirror provision to section YB 11 of the Income Tax Act 2007, by providing a test associating a trustee and a person with the power to appoint or remove that trustee. This will help ensure that there would be association in similar situations to those that arose in the above High Court decisions.

The proposed provision excludes a person holding the power of appointment or removal from the associated person test if they hold their position by virtue of their position as a provider of professional services. This carve-out is consistent with the equivalent test in section YB 11 of the Income Tax Act.

PHARMAC REBATES AND GST

(Clauses 308 and 310)

Summary of proposed amendment

The amendment addresses current uncertainty around the GST treatment of rebates paid to Pharmac under an agreement to list a pharmaceutical on the Pharmaceutical Schedule. The amendment would ensure that the GST treatment for rebates paid to Pharmac is the same regardless of whether the rebates relate to pharmaceuticals purchased for use in the hospital setting (hospital rebates) or purchased for use in the community setting (community rebates).

Application date

The amendment will apply to rebates paid to Pharmac on or after 1 July 2018.

Key features

Section 25 of the Goods and Services Tax Act 1985 (the GST Act) is being amended to exclude rebates paid to Pharmac (either acting on its own account or as an agent for a public authority) under a Pharmac agreement, from altering the previously agreed consideration for the supply of pharmaceuticals.

The amendment would mean that regardless of the rebate, pharmaceutical suppliers and recipient DHBs will not have to make the necessary GST adjustments required under section 25 of the GST Act.

The terms "Pharmac", "Pharmac agreement", and "Pharmaceutical" are defined in proposed section 25(7) of the GST Act and are linked to the definitions and concepts in the New Zealand Public Health and Disability Act 2000.

Background

Under section 25 of the GST Act, suppliers and recipients are required to make adjustments when the agreed consideration for the supply of goods and services changes – for example, because of an offer of a discount or otherwise. The adjustments ensure that the correct amount of GST is returned and claimed on the supply. Credit and debit notes are used to adjust GST if a tax invoice or GST return has already been issued.

Currently, rebates are paid to Pharmac (acting as agent for GST-registered DHBs) under a Pharmac agreement for a range of different circumstances, including when the pharmaceutical supplier wishes to provide a discount on a confidential basis. These rebate payments are passed onto DHBs in full. Owing to the unique way pharmaceuticals are publicly purchased in New Zealand, these rebates paid by suppliers to Pharmac can have different GST treatments depending on whether the pharmaceuticals are purchased in the community setting or the hospital setting.

Community rebates (which relate to pharmaceuticals purchased for use in the community by pharmacies) are not subject to GST as these payments are not considered to alter the previously agreed consideration for the supply of pharmaceutical products. In other words, there is not a sufficient connection between the rebate payment and the original purchase of the pharmaceuticals. Conversely, hospital rebates (which relate to pharmaceuticals purchased by DHBs for use in hospitals) are considered to alter the previously agreed consideration for the supply of pharmaceuticals and, therefore, are subject to GST.

The different GST treatment gives rise to uncertainty and compliance costs for Pharmac and their suppliers in having to differentiate, for GST purposes, between community and hospital rebates and has become unworkable in practice.

In the 2015–16 financial year, community rebates comprised 93 percent of all Pharmac rebates, while hospital rebates made up the remaining 7 percent. The proposed amendment clarifies the current uncertainty associated with the different GST treatments. It would also minimise the administrative costs of change to Pharmac and its suppliers by aligning the GST treatment of hospital rebates with 93 percent of Pharmac rebates that are already not subject to GST.

The fiscal impact of the rebates is neutral under either setting. In the hospital setting the supplier grosses up the rebate payments by the GST amount, and the subsequent adjustments made by the supplier and DHBs cancel each other out.

LLOYD'S OF LONDON – TAX SIMPLIFICATION

(Clauses 16, 43, 62, 76, 78, 91, 172(31), (33), (38), (55) and (69), 179 and 180(1))

Summary of proposed amendments

Amendments to the Income Tax Act 2007 are proposed to simplify tax compliance obligations for Lloyd's of London (Lloyd's) in connection with the taxation of life insurance business carried on in New Zealand.

Application date

The amendments will apply to Lloyd's term life insurance policies sold on and after 1 April 2017.

Key features

Collectively the proposed amendments create a special presumptive tax on premiums received by Lloyd's from the sale of term life insurance policies in New Zealand. Tax would be assessed and returned by Lloyd's authorised New Zealand agents.

The presumptive tax would be calculated on the basis of 10 percent of gross premiums. The tax rate applicable to this income would be 28%, consistent with the current rate of company tax. This approach is consistent with the policy framework for taxing general insurance sold to the New Zealand market by non-resident insurers.

New section YD 8B determines when the sale of life insurance by Lloyd's has a source in New Zealand. The new section specifies that 10 percent of the gross premium has a source in New Zealand if the life insurance policy is offered or was offered and entered into New Zealand. The section also specifies the special tax rules that apply to the New Zealand sourced income and the type of life insurance policies affected. The section applies to term life insurance policies – life insurance policies that insure life risk only. Profit participation policies and savings product policies are not within the scope of the proposed amendments.

New section CR 3B treats the portion of the premium that has a source in New Zealand as taxable income.

New section DW 3B denies deductions for any expenditure or loss that has a nexus to income under section CR 3B.

Section EY 10 is being amended to ensure that the life insurance taxation rules do not apply to Lloyd's in respect of any income to which section CR 3B applies. This change ensures that section EY 48 does not have application to Lloyd's New Zealand life business.

New section HR 13 sets out the obligations on Lloyd's under the Income Tax Act 2007 and treats Lloyd's underwriters as one person. This section establishes that Lloyd's is a New Zealand taxpayer in respect of income that is treated as having a source in New Zealand. This section allows for the operation of section HD 17B in connection with the payment and return of tax by Lloyd's authorised agents.

New section HD 17B treats an agent for Lloyd's as responsible on Lloyd's behalf for:

- calculating the tax payable on income under section CR 3B;
- paying the required amount of tax; and
- providing the necessary returns of income.

The obligation on the agent under section HD 17B is limited to the premiums the agents is required to pay to Lloyd's. The section ensures that the agent is only responsible for the Lloyd's business it facilitates, not the entire extent of Lloyd's New Zealand life business. Section HD 17B also ensures that banks and other non-bank deposit takers are not treated as an agent of Lloyd's to the extent that they facilitate payment of any life insurance premiums.

Section HD 3 is being consequentially amended in respect of the obligations on Lloyd's agents under section HD 17B.

Schedule 1 is being amended to specify that the tax rate on income under section CR 3B is 28%.

Background

Lloyd's is an insurance market, not an insurance company, and has regulatory approval from the Reserve Bank of New Zealand to underwrite life risk in New Zealand. Members of Lloyd's, both corporate and individuals, join together in syndicates to insure risk.

The current taxation rules for non-resident life insurers would mean that each Member would be required to obtain an Inland Revenue number and file an annual tax return for any life business in New Zealand. The cost of compliance and associated administration cost under current tax law is considered to be disproportionate to the projected tax revenue involved and could act as a barrier to enter the New Zealand life insurance market.

The proposed amendments seek to reduce compliance and administration costs with an associated immaterial fiscal impact relative to the status quo. Precedent exists in tax and prudential supervision law in New Zealand and Australia to accommodate Lloyd's unique business structure.

Tax policy officials propose to review in 2020, and periodically thereafter, whether the proposed amendments fairly reflect the tax that should be paid on profit Lloyd's makes from selling life insurance in New Zealand.

Remedial items

EMPLOYEE MEAL ALLOWANCES AND DEFINITION OF "EMPLOYER'S WORKPLACE"

(Clause 24)

Summary of proposed amendments

The term "employer's workplace" in section CW 17CB of the Income Tax Act 2007 (Payments for certain work-related meals) is to be clarified as meaning the workplace of the employer at which the employee normally works.

Application date

The amendment applies from 1 April 2015, to coincide with the application date of section CW 17CB.

Background

Generally meal allowances and similar payments made to employees are taxable to the employee as they provide a private benefit to the employee. However, there is an exemption for meal allowances and similar employer meal payments that are provided to employees who are working away from their employer's workplace.

This exemption is a practical way of recognising that although the cost of a meal is a private expense, there are additional costs for the employee as a result of their employer requiring them to work away from their usual place of work.

Section CW 17CB, enacted in 2014, specifies the situations when the exemption applies.

For the exemption to apply, the legislation requires the employee to be working away from his or her "employer's workplace". When an employer has multiple workplaces, the issue is whether the workplaces that are not the employee's normal place of work are intended to be covered by the term "employer's workplace". For example, an employer may have offices throughout New Zealand and while employees are generally based at particular offices, their work may require them to occasionally work at other offices.[7]

From a policy perspective, meal allowances and reimbursements should be tax-free if they are genuinely business-related, irrespective of where the work takes place away from the employee's normal workplace. This includes work at other offices of the employer. The proposed amendment clarifies this intention.

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[7] Officials' understanding is that even in the case of employees that have multiple workplaces the employee will be assigned to a particular cost centre or office.

PIE REMEDIALS

(Clauses 80, 82–83, 86–88, 172(25) and 217)

Summary of proposed amendments

The Bill makes a number of amendments to the portfolio investment entity (PIE) rules to ensure the legislation aligns with the policy intent and operational practice.

Application date

The amendments will come into force on the date of enactment.

Key features

Notification requirements

A multi-rate PIE must elect to use any of the exit calculation, quarterly calculation or provisional tax calculation options. The provisions that allow for these elections state that the notice requirements are set out in section 31B of the Tax Administration Act 1994.

While existing section 31B sets out the notification requirements for PIEs, the provisions only relate to notification requirements when an entity elects to become a PIE or cancel its PIE status.

Proposed section 31B(1B) will provide the notification requirements for these elections consistent with the existing process.

PIE losses

In general, multi-rate PIEs are able to cash out their tax losses for the current tax year. Provisional tax PIEs are an exception to this general approach – they are required to carry forward their losses to a later tax year. This less favourable treatment of tax losses was part of the policy trade-off for provisional tax PIEs getting simpler rules.

When an entity elects to become a PIE any loss brought forward is treated as a formation loss and spread over three years. Allowing that loss balance to be immediately cashed out could potentially have a significant impact on aggregate tax collections. The formation loss rules therefore exist largely to protect the Government's revenue flows.

The legislation does not currently cover the treatment of a loss carried forward by a provisional tax PIE when it elects to use the quarterly or exit options. The policy intention is this should also be treated as a formation loss so that a provisional tax PIE cannot cash out its losses by electing out of the provisional tax calculation method.

However, the current definition of a "formation loss" only includes losses incurred prior to the entity becoming a PIE rather than when it was already a PIE using a different calculation method.

The Bill proposes to extend the definition of "formation losses" to include a tax loss arising from a period a PIE applied the provisional tax calculation method before applying a different calculation method.

Ownership interests

Subject to a number of exceptions, a PIE (or investor class within a PIE) can only own up to 20 percent of another entity. This is known as the outbound investment test and is designed so that the PIE cannot exert a significant influence on the underlying entity.

Unlike most comparable tests in the Income Tax Act 2007, this test currently only applies to voting interests without having a market value interest test. A consequence is that a PIE can potentially undertake investments that are any proportion of the value of the underlying entity provided voting interests do not exceed 20 percent. This would allow the PIE to undertake investments that could not be considered portfolio investments and would not be comparable with anything available to an individual investor other than through a PIE.

The Bill proposes to insert a rule that a PIE cannot hold a market value interest of greater than 20 percent other than when an existing exemption applies.

Unit trusts and the PIE rules

The entrance criteria to the PIE rules for collective schemes and foreign PIE equivalents, in addition to other entity types such as a company or a superannuation scheme, both include a criteria starting with "the trustee of a trust that would be a unit trust". Two issues arise from these provisions.

The intention of this category is to allow trusts, which meet the other requirements, to be a PIE, including when an entity with sufficient owners to meet the PIE entrance requirements in its own right holds all the units in a trust that elects to be a PIE.

The phrase "the trustee of a trust" is used in numerous places in the Income Tax Act 2007 and reflects that a trust has no legal personality and instead the trustee is liable for the trustee's actions on behalf of the trust and its beneficiaries. However, in this context, applying the test to the trustee instead of the trust is inappropriate.

This is because the PIE rules are intended to apply to widely held investment vehicles, or vehicles that are used for investment by other widely held investment vehicles. However, the current provisions would allow a person who was not intended to receive the benefits of the PIE regime (for example, a New Zealand trading company) to set up a PIE using a trust where the trustees met the PIE entrance requirements. This issue could be resolved by removing the words "the trustee of" from the relevant provisions.

Historically it was considered that one of the requirements for a trust to be a unit trust was that it had more than one unit holder (for example, see public ruling BR Pub 95/5A *Relationship between the "unit trust" and "qualifying trust" definitions*). This restriction was not considered necessary for the purposes of a trust accessing the PIE rules, hence the wording of sections HM 3(1)(b)(iii) and HM 9(c) including "a trust that would be a unit trust if there were more than 1 subscriber, purchaser, or contributor participating as beneficiaries under the trust".

On 29 July 2016 Inland Revenue released interpretation statement IS 16/02: *Income Tax – Unit Trusts – When a unit trust can have a single unit holder*. This interpretation statement concludes that the essential feature of a unit trust is the provision of the facilities for subscribers to participate, and that is not altered by there being only one subscriber or the intention that there will continue to be only one subscriber.

On the basis of this interpretation the relevant wording of the entrance provisions shown above is now largely redundant as a trust that would be a unit trust if there were more than one subscriber, purchaser, or contributor would already not be excluded by only having one subscriber, purchaser, or contributor provided there were facilities for more than one subscriber, purchaser, or contributor. These trusts will therefore be unit trusts which meet the existing entrance criteria as a company in sections HM 3(1)(b)(i) and HM 9(a).

The Bill therefore proposes to repeal sections HM 3(1)(b)(iii) and HM 9(c) as they are no longer necessary.

DONATION TAX CREDITS FOR DONATIONS TO COMMUNITY HOUSING ENTITIES

(Clause 109)

Summary of proposed amendment

An amendment to section LD 3(2)(ac) of the Income Tax Act 2007 clarifies that tax credits for donations made to community housing entities can only be claimed for the period the entity qualifies for the income tax exemption in section CW 42B.

Application date

The amendment will apply from 14 April 2014, when the sections LD 3(2)(ac) and CW 42B came into force.

Key features

The proposed amendment to section LD 3(2)(ac) will ensure that donation tax credits are only available for donations made to a community housing entity during the period the entity qualifies for the income tax exemption under section CW 42B.

Background

From 14 April 2014 donations made to community housing entities that meet the requirements to derive exempt income under section CW 42B qualify for a donation tax credit.

Due to an earlier change to section LD 3(2)(ac), donors have been able to claim a tax credit for a donation made to a community housing entity when the entity does not meet the requirements of section CW 42B. This has occurred because the current wording of section LD 3(2)(ac) states that a donation tax credit is available for donations made in a tax year that the entity meets the requirements to derive exempt income under section CW 42B. This means that a donation made to an entity that began a tax year qualifying for the section CW 42B income tax exemption, but ceased to qualify later in that year, would still qualify for a donation tax credit.

For example, if a community housing entity met the section CW 42B requirements from 1 April 2016 until 30 September 2016, under the current wording of section LD 3(2)(ac), any donations made to that entity between 1 October 2016 and 31 March 2017 would qualify for a donation tax credit because the donation was made during the 2016–17 tax year. This was not the intention of the provision.

The amendment will bring the provision in line with its underlying policy intention.

THE USE OF PART-YEAR ACCOUNTS FOR THE ACCOUNTING STANDARDS TEST

(Clauses 58(2) and (3), and 59)

Summary of proposed amendment

New section EX 21F of the Income Tax Act 2007 will allow a person (or a member of their group) who only holds an income interest in a controlled foreign company (CFC) for part of an accounting period to use accounts that cover that part-period to calculate whether the CFC passes the active business test under the accounting standards test.

Application date

The amendment will come into force on 1 July 2009.

Background

The proposed amendment addresses the concern that a person who only owns an income interest in a CFC for part of an accounting period may not have access to the CFC's prepared accounts for the full accounting period and must therefore use the default test to determine whether the CFC passes or fails the active business test.

To determine whether a CFC is a non-attributing active CFC under section EX 21B, two different methods are available – the default test in section EX 21D and the accounting standards test in section EX 21E. The default test uses tax concepts specified in the Income Tax Act 2007, while the accounting standards test allows the taxpayer to use accounts prepared under a permitted accounting standard (for example, International Financial Report Standards (IFRS) with some adjustments. If less than 5 percent of the CFC's total income is passive income under either method, the active business test is passed, the CFC is a non-attributing active CFC and no CFC income or loss is required to be attributed.

If a person uses the accounting standards test and breaches the 5 percent threshold, they may then do the calculation using the default test. If they fail the active business test using the default test, they are required to calculate their attributable CFC income or loss for the accounting period. There is some overlap between the calculations undertaken for the default test and the calculations undertaken to calculate the attributable CFC income or loss.

The calculation under both the default test and the accounting standards test look at the full accounting period for the CFC. Under the accounting standards test, this requires a set of accounts for the full accounting period prepared under an applicable accounting standard, for example IFRS.

One issue is that when a person only has an income interest in a CFC for part of the accounting period, they may not have a set of accounts for the full accounting period which meets the required standard. This means they are unable to use the accounting standards test and must instead use the default test, which can be more compliance intensive, even if it is clear that the CFC is an active business.

Proposed new section EX 21F will allow a person who (or a member of their group) only holds an income interest in a CFC for part of an accounting period to determine whether the active business test is passed under the accounting standards test, using accounts prepared for that part-period of ownership, provided the accounts meet the other requirements set out in sections EX 21C and EX 21E. If the accounts do not meet the requirements of section EX 21C or if they do not cover the entire part of the accounting period when the CFC is owned by the person or a member of the person's group, they must use the default test in section EX 21D.

If the CFC passes the active business test using the part-period accounts, it will be a non-attributing active CFC for the full accounting period, but only for that person (or a member of that person's group) whose income interest in the CFC covers the part-period, as provided for in proposed new section EX 21F(3). Other income interest holders must undertake their own calculations.

In the event that the CFC fails the active business test using the accounting standards test for the part-period, proposed new section EX 21F(4) clarifies that the person must use the default test for the full accounting period.

AVAILABILITY OF FOREIGN TAX CREDITS

(Clause 112)

Summary of proposed amendment

Under the proposed change, a foreign tax credit will be available under section LK 1 of the Income Tax Act 2007 for foreign income tax paid in relation to a CFC from which attributable income is derived, when the foreign income tax has been paid by the taxpayer's parent or a member of the taxpayer's group.

Application date

The amendment will come into force on 1 July 2009.

Background

The proposed amendment recognises that there are some situations in which foreign income tax has been paid, but not by the CFC or the direct New Zealand shareholder and that a foreign tax credit should be available when it has been paid by a person who is part of the same functional economic unit – for example, the New Zealand shareholder's group.

Under section LK 1, a person with attributed CFC income is provided a tax credit for income tax paid in relation to the CFC. This ensures that the income derived by the CFC is not double taxed.

Similarly, a foreign tax credit is also provided under section LK 1 for foreign income tax (including withholding tax) paid in relation to the CFC against the New Zealand shareholder's income tax liability.

For a foreign tax credit to be available under section LK 1, the foreign income tax must be paid by the CFC from which the income is derived or by the person with the attributed CFC income in relation to the CFC from which the income is derived.

In some situations, it is possible that foreign income tax has been paid in relation to the CFC from which the attributed income is derived, but neither by the CFC nor by the person with the attributed CFC income. This could occur, for example, if both the CFC and the person are seen as transparent by the CFC's home jurisdiction. As a result, the foreign income tax may in reality be paid by the person's parent company or another member of the person's group.

Section LK 6 provides for the use of credits by group companies in some situations. To make a tax credit available to another group company under section LK 6, the requirements of the loss grouping rules under subpart IC must be met (by reading references to a tax loss as a reference to a tax credit).

However, as a starting point, a tax credit must first exist under section LK 1. This means that the person must have an amount of attributed CFC income before a tax credit can be used under section LK 6.

In the example outlined above, the company that has paid the foreign income tax in relation to the CFC may not necessarily have attributed CFC income, which means it does not have a tax credit under section LK 1 and therefore cannot allow the taxpayer that does have the income tax liability under the CFC rules to access the credit under section LK 6.

Proposed new section LK 1(1B) will provide the person paying the foreign income tax, whether it be the parent or a group member of the person with the attributed CFC income, a tax credit under sections LK 1 and LK 6.

The rationale for the proposed amendment is that foreign income tax has been paid in relation to the CFC and by a taxpayer who is economically part of the same unit as the person who has the income interest in the CFC.

INSURANCE BUSINESS CFCS

(Clause 260)

Summary of proposed amendment

Section 91AAQ of the Tax Administration Act 1994 provides that the Commissioner of Inland Revenue may issue a determination that an overseas insurance business is a non-attributing active CFC. The proposed amendment removes the requirement that the CFC must have been owned prior to 30 June 2009 for a determination to be issued under section 91AAQ, which will allow overseas insurance businesses acquired after 30 June 2009 to qualify.

Application date

The amendment will come into force on 1 April 2017.

Background

Under the CFC rules, income from insurance is treated as passive income and therefore must be attributed to the New Zealand shareholder. As a result, New Zealand insurance companies with foreign subsidiaries operating active insurance businesses in foreign markets do not pass the active business test and are required to attribute income back to New Zealand under the CFC rules.

Several constraints, including the complexity of the issues involved precluded the drafting of special rules for financial institutions (including insurance companies), it was not possible to do so at the same time the active income exemption was introduced. This work was due to be taken forward in the second phase of the international tax review, alongside the work on non-portfolio FIFs and offshore branches. Legislation for the extension of the active income exemption for non-portfolio FIFs was enacted in 2012 and work on the application of the active business test to financial institutions would have followed the work on offshore branches, but for other priorities.

A transitional measure was introduced at the same time as the active income exemption, which allows the Commissioner to issue a determination under section 91AAQ of the Tax Administration Act 1994. This measure allows a New Zealand insurance company to pass the active business test in relation to an offshore active insurance business if it can demonstrate that the offshore insurance business is an active business. The determination facility was not made available for other types of financial institutions because the boundary between active and passive income is less apparent.

One of the requirements that must be met for the Commissioner to be able to issue a determination is that before 30 June 2009, the offshore insurance business must have been controlled by a New Zealand resident and it must have operated a business of insurance in its country of residence. This date requirement was deemed necessary as the determination facility was only intended to be a transitional measure until further work could be completed on extending the active business test to financial institutions more generally.

As it is not clear when this work will be progressed, the Bill proposes to remove the 30 June 2009 ownership requirement from section 91AAQ.

This will allow New Zealand insurances companies with offshore insurance subsidiaries to apply for a determination under section 91AAQ to deem the subsidiary a non-attributing active CFC, regardless of when the subsidiary was acquired.

Section 91AAQ also lists a number of other requirements that the Commissioner must be confident are satisfied before issuing a determination. There is no proposal to amend these as they ensure that only legitimate active insurance businesses are able to make use of section 91AAQ and not subsidiaries that are only set up to arrange insurance for related parties, for example.

UPDATING THE STATE-OWNED ENTERPRISES SCHEDULE

(Clause 184)

Summary of proposed amendment

The Bill adds two state enterprises to the list of state enterprises in schedule 36, part A of the Income Tax Act 2007.

Under the Income Tax Act 2007 public authorities are exempt from income tax. State enterprises and mixed-ownership enterprises are excluded from this exemption and are required to pay income tax. Schedule 36, part A of the Income Tax Act 2007 contains a list of state enterprises that are excluded from the public authority exemption.

Application date

The amendments will apply from the date of enactment.

Key features

It is proposed to add the following state enterprises to schedule 36, part A of the Income Tax Act 2007:

- Animal Control Products Ltd
- Kordia Group Ltd.

TRADING GAINS OF NON-RESIDENT INVESTMENT FUNDS

(Clauses 26 and 30)

Summary of proposed amendment

The amendment clarifies that the trading gains of non-resident investment funds (foreign PIE equivalents) from the disposal of shares and financial arrangements are to be treated as excluded (non-taxable) income. It is also provided that foreign PIE equivalents are not entitled to a deduction for expenditure incurred in deriving that excluded income.

This amendment ensures consistency of tax treatment for foreign PIE equivalents and other methods of inbound foreign portfolio investment in New Zealand, such as the foreign investor variable rate PIE regime.

Application date

The amendment will have retrospective effect from 1 April 2012, the date on which the foreign investor variable rate PIE provisions came into effect.

PREVENTING UNINTENDED DEDUCTIONS FOR CONSOLIDATED GROUPS

(Clause 29)

Summary of proposed amendment

The proposed amendment addresses an anomaly whereby a member of a consolidated group is currently entitled to a deduction for the cost of purchasing shares (or other excepted financial arrangements) as revenue account property in a company outside the group which subsequently joins the group. The deduction the amendment seeks to remove arises when the shares are cancelled (whether by redemption, amalgamation, liquidation or otherwise) and where at the time of cancellation the issuer of the shares and the holder are members of the same consolidated group. Because the cancellation does not give rise to any income to the holder, removing the deduction results in a net nil position for income tax. This matches the economic reality.

Application date

The amendment will apply for the 2016–17 and later income years.

Key features

The anomaly sought to be addressed by the proposed amendment arises when a company subscribes for shares in an entity that is not in the same consolidated group, then the two entities subsequently become members of the same consolidated group thus cancelling the shares. In this case the holder is currently still entitled to a deduction for the cost of the shares but the amount derived from the cancellation of the shares will be excluded income under the consolidation regime.

This anomaly arises as the consolidation provision that eliminates the income only achieves the correct result if there has not already been a deduction. To address this anomaly the amendment in new section DB 23B will deny the holder a deduction for the cost of the revenue account shares that cease to exist in that year as a result of a transaction or arrangement between two members of a consolidated group.

Where the shares are cancelled in the year they are acquired, the deduction denied is the expenditure incurred as the cost of revenue account property. When the shares are cancelled in a subsequent year the deduction denied is the value of the shares at the end of the previous income year calculated at their cost price.

Background

When a person acquires shares, or any other excepted financial arrangements, as revenue account property they are entitled to a deduction for the cost of the shares in the year they are acquired. If the shares are still held at the end of the year they derive income equal to the cost of those shares, so there is no net deduction. In following years they are entitled to a deduction for the cost of the shares at the start of the year and if still held at the end of the year they derive income equal to the cost of the shares so again there is no net deduction. In the year the shares are disposed of or are cancelled the person derives income for the amount they receive from that transaction. In that final year the opening deduction (for the original cost of the shares) and income on disposal or cancellation result in net income or a net loss.

If the shares were issued by a company in a consolidated group to another company in that consolidated group, the consolidation provisions ensure no assessable income or deductions arise as all transactions are within that consolidated group.

However, under current law, if a holder acquires shares (and so is entitled to a deduction as described above) and then enters a consolidated group with the issuer of the shares the group will not derive income if the shares are cancelled, as that cancellation occurs entirely within the consolidated group. Through this process the consolidated group will be entitled to a deduction with no corresponding income even though there has been no economic loss to the group. The amendment will align the law with the policy intent by preventing a deduction in this circumstance.

CHILD SUPPORT (PRISON WORK INCOME)

(Clauses 313 and 314)

Summary of proposed amendment

The amendment clarifies that payments made by the Department of Corrections to prisoners are not considered "income" for the purposes of granting an exemption from payment of financial support.

Application date

The amendment comes into force on 1 April 2017.

Key features

Sections 89D and 89F of the Child Support Act 1991 clarify that income earned from employment under section 66 of the Corrections Act 2004 does not prevent a liable person from receiving an exemption from payment of financial support.

Background

Under the Child Support Act 1991 liable parents who are long-term prisoners are eligible to seek an exemption from payment of financial support (child support and domestic maintenance) on the grounds that they have no income, or only a very small amount of income from investments, while in prison.

The Department of Corrections makes small incentive payments to prisoners participating in prisoner employment activities (under section 66 of the Corrections Act 2004). Prisoners receiving these payments have historically qualified for an exemption as the payments were not considered "income".

Inland Revenue recently determined that these payments are, in fact, income. This means prisoners receiving them will no longer qualify for an exemption. The policy intent is that prisoners should be eligible for an exemption despite receiving these small payments.

TAX ON NET ASSETS OF DEREGISTERED CHARITIES – REMEDIAL AMENDMENTS

(Clause 90)

Summary of proposed amendment

Amendments are being made to the Income Tax Act 2007 to ensure that the net assets tax for deregistered charities also applies to non-registered entities exempt under section CW 42 of the Income Tax Act and which cease being "charitable" at law. The amendments also clarify that all entities that cease to be charitable at law must transfer their accumulated income and assets for charitable purposes.

Application date

The amendments will have retrospective effect from 14 April 2014 (when section HR 12 of the Income Tax Act was first enacted), with a "savings" provision to allow taxpayers who have already filed returns before the introduction of this Bill to rely on the position they have taken.

Key features

Amendments are being made to section HR 12 of the Income Tax Act 2007 to ensure that:

- The tax on the net assets of deregistered charities applies to the accumulated assets and income of non-registered entities exempt under section CW 42 of the Income Tax Act which cease being charitable at law.
- Entities that cease to be charitable at law must transfer their accumulated income and assets for charitable purposes.

Background

In 2014 new rules were introduced to address the tax consequences for deregistered charities – that is, when a charity is removed from the Charities Register.

These rules ensure that any income or assets accumulated while an entity was exempt from tax as a registered charity are always destined for a charitable purpose. Tax concessions should only be available to genuine charities. To protect the integrity of the revenue base, deregistered charities are held to account for assets and income accumulated while they were exempt from income tax.

Section HR 12 of the Income Tax Act 2007 taxes the net assets of deregistered charities. One year following the day of the final decision to deregister the entity, the accumulated assets and income of the organisation will be included as income of that organisation. Excluded from this net asset calculation are assets distributed or applied for charitable purposes, or in accordance with the entity's rules contained on the register. Also excluded are assets received from the Crown in relation to a Treaty of Waitangi settlement claim, and non-cash assets which were gifted to the organisation.

The proposed amendments are aimed at ensuring that the policy objectives are met by:

- amending section HR 12 so that it applies to any person who is not registered as a charity under the Charities Act 2005 but derives exempt income under section CW 42, and subsequently ceases to meet the requirements of section CW 42; and
- amending the wording of section HR 12 so that deregistered charities are required to "transfer" their assets, as opposed to "distribute or apply". The current wording of section HR 12 may allow deregistered charities to escape payment of the deregistration tax in certain circumstances.

LOCAL AUTHORITIES AND CONSOLIDATED GROUPS

(Clauses 64, 68(6) and (7))

Summary of proposed amendment

The proposed amendment corrects an inadvertent outcome resulting from amendments to the eligibility rules for consolidated groups in the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006.

Application date

The amendment will come into force on the date of enactment. This protects tax positions taken by local authorities on the basis of the existing law.

Key features

A local authority will no longer be eligible to form or join a consolidated group from the date of the Bill's enactment. Nor will a local authority be eligible to continue as a member of a consolidated group from the first day of the first income year (or earlier at the election of the taxpayer) commencing after the date of enactment.

Background

The correct policy intention is for a local authority to be fully taxed on income derived from its council-controlled organisations (CCOs), as if the council was the ultimate individual shareholder.

A 2006 amendment to the consolidated group rules relating to dual resident companies inadvertently permitted local authorities to enter or form a consolidated group. If a local authority forms a consolidated group with its council-controlled organisations, the local authority would not be taxed on any income derived from its CCOs. The proposed amendment corrects this unintended outcome.

LOSSES FROM SPECIFIED ACTIVITIES

(Clauses 92–94, 97, 101, 172(29), (63) and (68))

Summary of proposed amendments

The proposed amendments repeal the restriction on the use of losses from "specified activities" and incorporate any residual amounts of those losses in the general loss use and carry-forward rules in the Income Tax Act 2007.

Application date

The amendments will apply to losses from specified activities that remain at the end of the 2017–18 income year.

Key features

The current rule limiting the use of losses from specified activities to $10,000 in any one income year will be repealed.

When a taxpayer has an amount of loss from specified activities remaining at the end of the 2017–18 income year, that amount will be subtracted from the taxpayer's net income (if any) for the 2018–19 income year before taking into account any other loss balance carried forward from the 2017–18 income year.

The amount subtracted is limited to the amount of net income for the 2017–18 income year. Any excess amounts of loss from specified activities remaining after this subtraction from net income are added to the taxpayer's tax loss for the year. If the taxpayer has zero net income for the 2018–19 income year, the entire amount of loss from specified activities remaining at the end of the 2017–18 income year would be added to the person's tax loss for the income year.

The use of losses from specified activities is also proposed to be subject to the ordering rule for the use of losses from the 2018–19 income year. The ordering rules ensure that, if a taxpayer with losses from specified activities is a company, the continuity and commonality rules must be satisfied in order for the company to either:

- carry the losses beyond the 2018–19 income year, or
- to group the losses from specified activities in the 2018–19 income year or later income year.

Background

The specified activity loss rules were introduced in the early 1980s, at a time when the top personal marginal tax rate reached 66%. Their purpose was to discourage the use of a range of primary sector activities as tax shelters. Examples of primary sector activities subject to the specified activity loss rules include: animal husbandry, bloodstock, bee farms, silviculture, viticulture, aquaculture and land leasing or licensing.

These specified activity loss rules ensured that losses incurred from these primary sector activities that were not a taxpayer's main business activity were subject to a maximum tax deductible loss of $10,000 in each income year. Any loss exceeding that threshold was carried forward and offset, initially against any profit arising from the specified activity in the immediately following income year and then against income from other sources up to a maximum of $10,000. This process was repeated for each subsequent income year.

The reduction in the top marginal tax rates to 33% from the 1989 tax year resulted in a significant decline in the use of these primary sector activities as tax shelters. As a result, the specified activity loss rules were amended from the 1991 income year to ring-fence them from the general loss rules. The ring-fencing of these rules required any unabsorbed balance at the end of an income year to be carried forward and offset, initially against any profit arising from the specified activity in the 1991 income year and then against income from other sources up to a maximum of $10,000. This process was repeated in 1992 and subsequent income years, until the loss was extinguished.

The specified activity loss rules are now largely spent, as there are a very low number of affected taxpayers and the amount of affected losses is immaterial. The proposed amendments are to give effect to the spent nature of these rules.

TAX RATE FOR EXTRA PAYS PAID TO NON-RESIDENT SEASONAL WORKERS AND EMPLOYEES ON NON-NOTIFIED TAX CODES

(Clauses 138(1), (2) and (4), 145(1) and (4) and 181(8))

Summary of proposed amendment

Proposed amendments will ensure that employers are required to withhold tax from extra pays paid to non-resident seasonal workers and to employees on non-notified tax codes at rates of 10.5% and 45%, respectively.

Application date

The amendments will apply from the date of enactment.

Key features

Proposed amendments to section RD 10 and schedule 2, part B, table 1 provide that the amount of tax that an employer must withhold from an extra pay paid to a non-resident seasonal worker is to be calculated at a 10.5% rate.

Proposed amendments to section RD 10 and schedule 2, part B, table 1 provide that the amount of tax that an employer must withhold from an extra pay paid to an employee who has not notified their employer of their tax code is to be calculated at a 45% rate.

A proposed amendment to section RD 17, which contains the general rule for calculating the amount of tax to withhold from an extra pay, specifies that this section does not apply to extra pays paid to non-resident seasonal workers or employees who have not notified their employer of their tax code.

Background

A non-resident seasonal worker is either employed by a recognised seasonal employer under the RSE scheme or is employed in line with Immigration instructions for the foreign crew of fishing vessels instructions. These workers use the "NSW" tax code which attracts a withholding rate of 10.5% on their salary or wages. Non-resident seasonal workers are not required to file an income tax return, so the tax withheld is a final tax for them.

Non-resident seasonal workers are entitled to holiday pay under the Holidays Act 2003, which is either included in the worker's regular pay or paid as a lump sum at the end of the worker's employment.

If the holiday pay is paid as lump sum at the end of their employment, the amount is treated as an extra pay under the PAYE rules. Under the rules for taxing extra pays, tax will generally be withheld from non-resident seasonal workers at a higher rate than 10.5%. The taxation of extra pays paid to non-resident seasonal workers at a rate higher than 10.5% is contrary to the policy intent for this class of employee, which is that the 10.5% flat rate should apply to all their employment income and be full and final.

An employee who has not provided their tax code to their employer is taxed at a withholding rate of 45% on their salary or wages. Notifying their employer of their tax code also requires an employee to provide their name and IRD number to their employer. However, under the rules for taxing extra pays, tax will be withheld at a lower rate than 45%. The taxation of extra pays paid to employees who have not notified their employer of the required information at a rate lower than 45% is contrary to the policy intent for this class of employee, which is that all employment income paid to them should have tax withheld at a 45% rate.

MULTIPLE PAYMENTS OF SALARY OR WAGES

(Clause 141)

Summary of proposed amendment

Section RD 12 of the Income Tax Act 2007 provides that where an employee receives multiple payments of salary or wages in a week or part of a week ending on a Saturday the total amounts of tax to be withheld is calculated as if all the payments were treated as one payment from one employer. Section RD 12 does not apply when an employee leaves one full time employment before commencing another and it does not apply to wages derived as a casual agricultural employee, election day worker or non-resident seasonal worker.

Clause 141 proposes to amend section RD 12 to clarify that it only applies to multiple payments from the same employer. The limitation to a week or part of a week "ending on a Saturday" has also been removed as pay periods commonly end on other days. These amendments are intended to clarify rather than change the operation of this section.

Application date

The amendment applies from 1 April 2019.

RWT FROM NON-CASH DIVIDENDS CLARIFIED

(Clauses 6, 106, 159 and 160)

Summary of proposed amendment

The proposed amendment will ensure that the taxation of non-cash dividends derived from overseas is the same, irrespective of whether the dividend is derived:

- directly by an individual resident in New Zealand; or
- by an intermediary acting on behalf of an individual resident in New Zealand.

The dividend rules are also being clarified to confirm that the amount of a dividend includes any withholding tax paid or withheld in relation to that dividend.

Application date

The amendment will apply to non-cash dividends distributed during the 2017–18 and later income years. The amendments clarifying that withholding taxes are included in the amount of the dividend will apply from date of enactment.

Key features

A New Zealand-resident intermediary will not be required to account for withholding tax on a distribution of a non-cash dividend derived from overseas provided that:

- the non-cash dividend is distributed to a New Zealand resident; and
- the distribution occurs in the same income year that the intermediary derives the non-cash dividend.

Background

When a non-cash dividend derived from a foreign company by an intermediary on behalf of an individual resident in New Zealand is distributed to that person, the distribution is resident passive income.

The current rules require the intermediary to account for RWT on that distribution. As the intermediary would have no funds to account for the withholding tax, this imposition of RWT generally results in the withholding tax being funded by the individual person receiving the non-cash dividend distributed by the intermediary.

This aspect of the RWT rules can result in different tax imposts on non-cash dividends ultimately derived by a New Zealand resident natural person, depending on whether the dividend is derived directly or indirectly via an intermediary. It is also unclear whether resident withholding tax paid for a non-cash dividend is included in the amount of the dividend.

The proposed amendments clarify the correct outcome.

MEMORANDUM ACCOUNTS: OPENING BALANCES

(Clauses 116, 117 and 121)

Summary of proposed amendments

The proposed amendment ensures that:

- the closing balance of a memorandum account as at 31 March of any tax year is equal to the opening balance of that memorandum account on 1 of April following; and
- the original debit or credit dates are retained for all debit or credit amounts included in the closing balance of a memorandum account (at 31 March, as memorandum accounts are required to be balanced at that date each year).

Application date

The amendments will apply from the beginning of the 2008–09 tax year.

Key features

The proposed amendments clarify that the original date on which a credit or debit is made to a memorandum account is to remain the date for that credit or debit to be carried forward in the closing balance from one tax year to the next. In addition, the references to the date of the debit or credit for an opening balance of a memorandum account are omitted from all tables in the memorandum account rules.

Together the proposed amendments ensure that the opening balance of a memorandum account cannot be interpreted as being reset to zero on 1 April of each tax year.

Background

An imputation system allows the benefit of tax paid at the corporate level to be passed through to shareholders (as tax credits attached to dividends paid) so that a shareholder's tax liability on dividends is limited to the shareholder's marginal rate of tax.

Our imputation system requires most New Zealand-resident companies (and some Australian companies) to maintain memorandum accounts. These memorandum accounts are balanced annually to ensure that companies do not over-distribute tax credits to shareholders.

The most common form of memorandum account is the imputation credit account. This is used to record tax paid by the company (credits to the imputation credit account) and also to record when the benefit of the tax is passed through to shareholders (debits to the imputation credit account). In general the use of imputation credits is governed by a "first-in first-out" basis and is subject to the company satisfying shareholder continuity rules.

A recent review of the rules for memorandum accounts identified some issues that could be interpreted in a manner inconsistent with the policy intention of the memorandum account rules.

Under that interpretation, the legislation could reset the opening balance of each memorandum account to zero at 1 April each tax year (except when applying the shareholder continuity rules to imputation credits). The proposed amendment makes it clear that this interpretation is incorrect.

Rewrite remedials

AVAILABLE CAPITAL DISTRIBUTION AMOUNT AND DISREGARDED DIVIDENDS

(Clauses 9, 27 and 61)

Summary of proposed amendment

The proposed amendments clarify that dividends and gains that are disregarded in calculating foreign investment fund (FIF) income are treated as excluded income.

Application date

The amendments apply from the date of enactment.

Background

Some offshore investments by New Zealand residents are taxed under the FIF rules. There are four methods that can be used to calculate FIF income: the comparative value method, the deemed rate of return method, the fair dividend rate method or the cost method. Because these returns are effectively taxed on an accruing basis, actual dividends derived by the investor from an interest in a FIF and gains from disposing of the interest, are disregarded for income tax purposes.

However, under the rewritten core provisions, an amount derived by a New Zealand resident is excluded from the calculation of taxable income only if that amount is either excluded income or exempt income. In the rewrite of the FIF rules, this relationship with the core provisions was not made clear when stating that distributions or gain arising from an interest in a FIF are disregarded when calculating the person's income tax liability.

This has resulted in a question being raised about whether a disregarded amount derived by a corporate investor from a FIF is treated as a capital amount and able to be included in the available capital distribution amount, which, in some circumstances, is able to be later distributed tax-free. The policy intention is that a dividend or gain arising from an interest in a FIF and which is disregarded when calculating taxable income has an income nature and so should not be included in the available capital distribution amount. The amendments ensure the correct policy outcome is achieved.

IMPUTATION CREDIT ACCOUNTS AND USE OF PRE-CONSOLIDATION IMPUTATION CREDITS

(Clauses 118–120)

Summary of proposed amendment

The proposed amendment corrects an unintended change arising from the rewrite of the Income Tax Act 2007, which relates to the limit on the use of pre-consolidation imputation credits belonging to an individual company in a consolidated group.

The proposed amendment restores the law to the position that existed in the Income Tax Act 2004. This limits the amount of pre-consolidation credit the individual company may transfer to the consolidated group's imputation credit account (group ICA) to no more than the amount of the debit balance that would otherwise arise after a debit entry to the group ICA.

Application date

The amendment will apply from the beginning of the 2008–09 tax year.

Key features

A consolidated group of companies maintains an imputation credit account for tax paid for the consolidated group. Each member company of a consolidated group may also have an imputation credit account in relation to imputation credits the company has before it joins a consolidated group.

Those pre-consolidation credits may be used to offset a debit balance arising in the consolidated group's imputation credit account. However, an ambiguity arising in the rewrite of this provision into the Income Tax Act 2007 may permit pre-consolidation imputation credits in excess of this limit to be transferred to the consolidated group's imputation credit account.

The transfer of imputation credits from an individual company's imputation credit to the imputation account of a consolidated group (of which the individual company is a member) is intended to be allowed when:

- a debit entry is made to the group ICA; and
- that debit entry would result in the group ICA having a debit balance after the debit entry.

ELIGIBILITY REQUIREMENTS TO FORM OR JOIN A CONSOLIDATED GROUP

(Clause 69)

Summary of proposed amendments

The amendment restores the law to the same outcome that existed under the Income Tax Act 2004 so that when one company elects to leave an imputation group, the imputation group continues to exist.

Application date

The amendment will come into force on 1 April 2008, and ensures that the adverse effect of the unintended legislative change does not arise.

Background

The rewrite of the consolidated group rules into the Income Tax Act 2007 has resulted in an unintended legislative change in relation to the meaning of “eligible company” for imputation group purposes.

The issue relates to a member of a consolidated group (company X) electing to leave the imputation group (that consisted of companies X, Y and Z) but remaining within the consolidated group. The consolidated group consists of companies X, Y and Z. The unintended change results in the following differences between the two Acts:

- Under the 2004 Act, Company X’s election to leave the imputation group would not affect the eligibility of Companies Y and Z to be in the imputation group.
- Under the 2007 Act, Company X’s election to leave the imputation group results in companies Y and Z no longer being eligible to be in the imputation group.

The proposed amendment restores the original intention of the 2004 Act.

RECIPROCAL SHIPPING EXEMPTION

(Clause 178)

Summary of proposed amendments

The proposed amendment corrects an unintended change arising from the rewrite of the Income Tax Act 2007, with respect to the reciprocal shipping exemption at section YD 6(3) of the Act.

The exemption applies on the basis of reciprocity. That is, New Zealand will agree not to tax the income of a shipping operator of another country if in reciprocal circumstances a New Zealand resident shipping operator will not be taxed by that other country.

Prior to the rewrite, the legislation referred to a New Zealand resident shipping operator either being *"not liable to, or exempt from"* income tax in the other country. During the rewrite, however, the words *"not liable to"* were omitted. Concerns have since been raised that this inadvertently narrowed the scope of the provision. The proposed amendment therefore reinstates the words *"not liable to"*, to restore the full original meaning.

Application date

The amendment will apply from 1 April 2008 (the date from which the Income Tax Act 2007 had effect).

Key features

The original policy intent of the provision was for it not to matter whether the income is exempt from tax or not liable to tax in the first instance. Under the rewrite of the Income Tax legislation, this was narrowed to only permit the exemption to apply when the income is exempt from tax. This proposed remedial amendment will restore the original wider meaning.

Maintenance and minor rewrite items

MAINTENANCE AMENDMENTS

Summary of proposed amendments

The following amendments reflect minor technical maintenance items arising from both the rewrite of Income Tax legislation and subsequent changes. Unless otherwise stated in the following table, all the amendments are to the Income Tax Act 2007 (2007 Act).

Application dates

Unless otherwise stated in the following table, all amendments come into force on the date of enactment.

Minor maintenance items

The following amendments relate to minor maintenance items to correct any of the following:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

Maintenance table – schedule of clause numbers and changes to text

Clause	Section	Enactment	Amendment	Commencement date
5	BF 1, defined terms list	Income Tax Act 2007	Omit redundant readers' aid	2 June 2016
39	DU 7(1B)	Income Tax Act 2007	Improve drafting consistency	2008-09 income year
40	DV 2(8B)	Income Tax Act 2007	Replace heading with updated terminology	1 April 2008
44(1)	EA 2(1)(e)	Income Tax Act 2007	Improve drafting consistency	1 April 2008
46	EE 7	Income Tax Act 2007	Omit redundant cross-reference	1 April 2014
47	EE 34(7)	Income Tax Act 2007	Correct minor drafting error	2015–16 income year
53	EJ 22	Income Tax Act 2007	Omit redundant cross-reference	2008–09 income year
54	EW 13(2)	Income Tax Act 2007	Correct grammar	1 April 2009
55	EW 15H(1)(e)	Income Tax Act 2007	Correct cross-references	1 April 2011
56	EW 31(7)(b)	Income Tax Act 2007	Correct cross-references	1 April 2008
58(1)	EX 21B(2)(b)	Income Tax Act 2007	Correct cross-references, drafting consistency	Date of enactment
65, 66, 67 and 68(1)–(5)	FM 36(2), FM 37(c), FM 38(2), FM 40(1)-(4)	Income Tax Act 2007	Omit redundant wording	1 April 2008
71	GB 52(1)	Income Tax Act 2007	Correct grammar	1 October 2015
73	HC 2(2)(b)	Income Tax Act 2007	Correct cross-reference	1 April 2008
75	HC 33	Income Tax Act 2007	Omit redundant wording	2008–09 income year
84	HM 30	Income Tax Act 2007	Correct cross-reference	Date of enactment
89	HR 10(1)	Income Tax Act 2007	Correct grammar	1 June 2010
96	IA 8, defined terms list	Income Tax Act 2007	Omit redundant term	1 April 2008
98	IC 3(3), (4)	Income Tax Act 2007	Correct cross-references	1 April 2008
114	MX 1(1)	Income Tax Act 2007	Insert a subsection heading	1 April 2015
115	MX 4	Income Tax Act 2007	Insert a subsection heading	1 April 2015
128	RC 19(2)	Income Tax Act 2007	Correct cross-reference	1 April 2008

Clause	**Section**	**Enactment**	**Amendment**	**Commencement date**
149(2)	RD 23(3)(c)	Income Tax Act 2007	Correct cross-reference	2 June 2016
172(4)	YA 1 charitable purpose (b)(ii)	Income Tax Act 2007	Improve drafting for clarity	1 April 2008
172(10)	YA 1 distinctive work clothing	Income Tax Act 2007	Correct cross-reference	1 July 2013
172(11)	YA 1 dwelling	Income Tax Act 2007	Correct minor drafting error	1 April 2011
172(26)	YA 1 goods	Income Tax Act 2007	Correct minor drafting error	1 April 2015
172(27)	YA 1 high-priced livestock (a)	Income Tax Act 2007	Correct minor drafting error	1 April 2015
172(54)	YA 1 savings product policy	Income Tax Act 2007	Correct minor drafting error	1 July 2010
172(56)	YA 1 settlement of relationship property	Income Tax Act 2007	Omit redundant definitions	1 April 2011
174	YC 4(1)	Income Tax Act 2007	Correct minor drafting error	1 April 2008
177	YD 4 compare note	Income Tax Act 2007	Correct minor drafting error	1 April 2008
181(3)	Schedule 2, Part A, Clause 3	Income Tax Act 2007	Correct cross-reference	2 June 2016
187(6)	3(1) exempt person	Tax Administration Act 1994	Correct cross-reference	1 April 1995
189	15F(2)	Tax Administration Act 1994	Correct minor drafting error	1 April 2008
211(1)	25(2) proviso	Tax Administration Act 1994	Update terminology	1 April 2008
218(3)	32E(2)(k)	Tax Administration Act 1994	Correct cross-reference	1 April 2008
225	33(1D)	Tax Administration Act 1994	Correct inadvertent drafting error	1 April 2008
252	70(2)	Tax Administration Act 1994	Update terminology	1 April 2008
253	74(1)(b)(iii)	Tax Administration Act 1994	Correct minor drafting error	1 April 2003
254	80A(1)(b)	Tax Administration Act 1994	Correct cross-reference	9 December 2009

Clause	Section	Enactment	Amendment	Commencement date
258	85(6) debtor (c)	Tax Administration Act 1994	Correct minor drafting error	21 December 2004
259	85H(2)	Tax Administration Act 1994	Update terminology	26 April 2005
261	91FD(1)(bb)	Tax Administration Act 1994	Correct minor drafting error	7 September 2010