Taxation (Annual Rates, GST and Miscellaneous Provisions) Bill

Commentary on the Bill

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GST

AMENDMENTS TO THE GOODS AND SERVICES TAX ACT 1985

Overview

This bill introduces changes to the Goods and Services Tax Act 1985 resulting from the review of the goods and services tax (GST).

Several developments since the introduction of GST made it timely to review the tax. In particular, a number of issues that have arisen suggested the original policy intent of the legislation was either not being achieved, or was ambiguous and needed clarification.

The objective of the review was to re-examine GST in light of those developments to determine whether it was possible to achieve further reductions in the costs of paying and collecting GST revenue. Specifically, the review sought to:

- reduce compliance and administrative difficulties in the practical application of GST;
- limit the scope for obtaining unintended GST advantages; and
- generate discussion on the longer-term issues of the GST treatment of imported services and financial services.

The review has not been a forum to reconsider the principle of a broad-based, single rate tax with few exceptions, nor the other principles underlying the overall design of GST. These underlying principles remain fundamentally sound, and the changes to the Act are consistent with them.

In March 1999 the then Government, as a part of the Generic Tax Policy Process, released the discussion document *GST: A Review*, outlining proposals for reform of the Act.

The proposals in the discussion document covered compliance cost reduction, base maintenance and remedial measures as outlined below:

- ***Compliance cost saving measures***

  These include:

  - increasing the threshold for compulsory registration and other thresholds; and
  - easing the compliance costs of making adjustments for private and other non-taxable use.

- ***Base maintenance measures***

  These include:

  - restricting the second-hand goods input tax credit in transactions between associated persons;
  - changing the rules affecting deregistration;
  - removing avoidance opportunities in relation to deferred settlements; and
  - amending the general anti-avoidance provision (section 76 of the Act).

- ***Remedial***

  There were numerous other proposals of a remedial nature, including changes to the definition of "financial services", the treatment of going concerns, the definition of "associated persons", the zero-rating of services in relation to exported goods and exported information services and the treatment of factored debts.

In addition, longer-term issues were discussed, namely the treatment of imported services and the future treatment of financial services. These issues are being considered as a part of the next stage of the review.

The amendments in this bill are based on the proposals in the discussion document, as modified after submissions and consultation. Issues that have arisen during the consultative process, or that officials have identified, are also included in this bill.

Key amendments

There are several amendments to key sections in the scheme of the Act to ensure that the policy intent of the legislation is achieved and that the costs of paying and collecting GST revenue are reduced.

The registration threshold

The threshold over which people are required to register for GST was last adjusted in 1990 as a result of recommendations from the Taxation Simplification Consultative Committee. It is therefore necessary to adjust the level of the threshold to take account of inflation since 1990.

The registration threshold will be increased from $30,000 to $40,000, in line with inflation since 1990 and with expected inflation for the next five to ten years. The increased threshold will apply from 1 October 2000.

Adjustments to input and output tax

Inland Revenue requires adjustments to be made in each taxable period that an asset is owned to reflect continuing changes in use. This can result in high compliance costs for small amounts of revenue.

The amendments will give registered persons the option to pay additional output tax for private or exempt use on a one-off or annual basis rather than in each taxable period. If the one-off basis were chosen, further adjustments would be required at the time a change in use of 20 percent or more occurred. Registered persons will also be allowed to make input tax adjustments on an annual rather than a tax-period basis. Several other, more minor amendments will also reduce compliance costs.

The input tax credit allowed under the existing section 21(5) for changes from non-taxable to taxable use will be limited to supplies of goods and services which satisfy the requirements for an input tax credit, except for the requirement that the goods and services be acquired for the principal purpose of making taxable supplies and certain additional requirements in the case of second-hand goods. This will ensure that assets imported into New Zealand (such as ships) without incurring a GST liability will not qualify for an input tax credit. This amendment will apply to transactions entered into from 1 October 1986, unless the Commissioner of Inland Revenue has agreed in writing to the input tax credit claim before the date the bill is introduced.

The second-hand goods input tax credit

The input tax credit for second-hand goods acquired from non-registered vendors has enabled registered purchasers to claim large GST refunds in relation to goods (particularly land) on which GST has not been paid by the vendor. This is particularly problematic where assets are held for many years before they are sold. In some cases it appears that second-hand goods are sold to an associated person principally to gain the input tax credit. Allowing input tax credits in such circumstances merely subsidises the purchase price and creates an unintended GST advantage.

The amendment limits the credit available in relation to supplies of second-hand goods between associated parties to the GST component (if any) of the purchase price to the vendor to remove the incentive to enter into transactions primarily to gain the input tax credit.

Deregistration

The current deregistration rule allows scope for avoidance activity and creates a more favourable treatment for assets retained and then sold as opposed to assets sold before deregistration.

On deregistration, output tax is payable on the lesser of the cost or open market value of goods and services held by a registered person. However, if that person sold those goods and services while still registered, output tax would be payable on the sale price (usually equivalent to the open market value). Therefore, assuming the lesser cost option is adopted, a lower output tax liability arises in relation to assets held on deregistration that have appreciated in value. Since the requirement to pay GST on deregistration is intended to reflect that the registered person has, in effect, made a supply to themselves in their private capacity, this difference is anomalous.

Furthermore, if the deregistered person then sells the goods to a registered person, a second-hand goods input tax credit may be claimed for one-ninth of the purchase price, or if the parties are associated, one-ninth of the lesser of the purchase price or the open market value. If the deregistered person has paid output tax on the basis of the cost of the goods, significant tax advantages may arise from the sale of goods which have increased in value since they were originally acquired.

The amendment requires GST to be paid on the open market value of assets retained on deregistration. This will reduce the scope for avoidance activity in this area and the more favourable treatment for assets retained and then sold, as opposed to assets sold before deregistration, ensuring that the output tax payable is the same in both cases.

The Government has noted concerns that in relation to assets acquired before the introduction of GST, for which no input tax credits were allowed, taxing increases in value since acquisition could create a significant tax burden for some. The deemed supply on deregistration of pre-GST assets will, therefore, continue to be able to be valued at the lower of cost or open market value.

Deferred settlements

By substantially deferring the date of settlement, timing advantages can be gained in transactions between registered persons using different bases of accounting for GST. A purchaser on the invoice basis is able to claim an immediate input tax credit but a vendor on the payments basis is able to defer the payment of output tax until payment is received.

The amendment requires output tax to be returned on an invoice basis for any supply exceeding $225,000 (including GST) in value.

To ensure that cash flow and compliance concerns do not arise for shorter term deferred settlements, agreements where settlement must be made within 93 days will be excluded. The period of 93 days is consistent with the exclusion for short-term agreements in the accrual rules in the Income Tax Act 1994.

To prevent registered persons from entering into arrangements to avoid the $225,000 threshold by splitting a supply of goods or services into a number of transactions, the Commissioner will be given a discretion to require the registered person to account for those transactions on an invoice basis.

The general anti-avoidance provision

The general anti-avoidance provision has a number of possible deficiencies which may limit its potential application. For example, in determining whether there is tax avoidance the section relies on the subjective test of the taxpayer's intention in entering into an arrangement. A further possible problem is that section 76 applies only where "the application of the Act" is defeated. Many avoidance arrangements are structured so that the specific provisions of the Act do apply, and there is an argument that section 76 does not apply in these circumstances.

Section 76 will be amended to follow more closely the general anti-avoidance provisions of the Income Tax Act 1994, sections BG 1 and GB 1. This will achieve consistency between the general anti-avoidance provisions in the GST and Income Tax Acts and will allow a similar analysis to be used when considering the respective provisions. Aligning the provisions would also allow the case law dealing with the income tax provision to be used to interpret the GST provision.

Application dates

Unless otherwise stated, the amendments will apply from the date of enactment.

DEFINITION OF “ASSOCIATED PERSONS”

(Clauses 66(2) and 67)

Summary of proposed amendments

The amendment addresses several deficiencies in the definition of “associated persons”.

The new definition will be based on the broader definition used in section OD 8(3) of the Income Tax Act 1994 for international tax and certain other purposes, with the following main modifications:

- The rule for determining whether a company and an individual are associated will use a 25 percent interest threshold.
- A new rule will require the aggregation of all interests held directly by a person with those held by associated persons for the purpose of determining whether two companies or a company and an individual are associated.
- The “relatives test” will include people in a relationship in the nature of marriage.
- A universal test for treating as associated persons those with a common relationship to another person will be introduced.
- There will be no “habitually acting in concert” test.

Background

The current definition of “associated persons” for GST purposes is largely based on that in section OD 8(4), used for the provisions of the Income Tax Act 1994 relating to land. It is deficient in relation to some trust arrangements and does not apply to relationships in the nature of marriage. It also has inadequate nominee “look through” rules.

Furthermore, the definition treats as associated persons individuals who have a minor level of association with a company (a voting or market value interest of 10 percent or more). This percentage is no longer appropriate, given changes to the fringe benefit tax rules some time ago.[1]

Key features

The new definition of “associated persons” will have the following features:

- It will use a 25 percent interest threshold for determining whether a company and an individual are associated.

[1] The relevant Income Tax Act 1994 provision was repealed with effect from 1 April 1989.

- It will replace the nominee "look through" rules with a rule requiring the aggregation of all interests held directly by a person with those held by associated persons for the purpose of determining whether two companies or a company and an individual are associated.
- It will use the more narrow definition of "relatives" contained in paragraph (b) of the definition of "relative" in section OB 1 of the Income Tax Act 1994.
- It will extend the "relatives" test to include people in a relationship in the nature of marriage.
- It will retain the existing "trustee-beneficiary" test in the GST Act definition.
- It will treat as associated a trustee of a trust and a settlor of that trust.
- It will treat as associated a trustee of a trust and a trustee of another trust if there is a common settlor of both trusts.
- It will use a universal tripartite test to treat as associated any two persons where one of those persons is associated with a third person who is associated with the other of those two persons.

IMPORTERS ACTING AS AGENTS FOR NON-RESIDENTS

(Clause 69(1))

Summary of proposed amendment

The amendment allows importers acting as agents for principals outside New Zealand to claim input tax credits for goods they import. Under the current legislation, as legal title to any goods imported does not pass to the importer, they may be denied input tax credits, even though they have paid GST on the importation of the goods.

Background

Goods that are imported into New Zealand are subject to GST administered by the New Zealand Customs Service. The importer may claim an input tax credit for the GST if the goods were acquired for the principal purpose of making taxable supplies. The Taxation Review Authority in *Case T35*[2] held that the word “acquired” meant that legal title to the goods had to pass to the importer.

This can have adverse consequences for an importer who acts as agent for an unregistered principal who is outside New Zealand – for example, for the purposes of consumer warranty agreements with a non-resident manufacturer.

Key feature

The definition of “input tax” will be amended to include the situation where goods are imported into New Zealand and applied for the principal purpose of making taxable supplies.

[2] (1997) 18 NZTC 8,235.

"FINANCIAL SERVICES"

(Clauses 68, 73(9) and 76(1) and (6))

Overview

If a service falls within the definition of "financial services" it qualifies as an exempt supply under section 14(a). Financial services are exempt from GST because of the practical difficulties involved in identifying the amount of value added by suppliers of financial services, since the margin that is charged by the supplier is hard to separate from the total funds transferred. The broad policy underlying the definition of financial services is to encompass services provided under agreements involving the exchange of money or close substitutes for money, such as shares. In contrast, agreements that involve the supply of a commodity should generally be included in the GST base.

The amendments address areas where change is needed to ensure that the intended scope of the definition, and therefore the scope of the exemption, is achieved. The need for such changes is inevitable as there will always be innovations in the financial services area that could not have been contemplated when the definition was enacted.

Debt collection services

(Clause 68(2))

Summary of proposed amendment

The supply of debt collection services other than by the creditor whose debt is being collected will be treated as a taxable supply.

Background

Debt collection services are currently treated as an exempt supply of financial services. This treatment of debt collection came about unintentionally, as a result of the insertion of section 3(1)(ka) in 1986. Section 3(1)(ka) included the collection of interest, dividends and principal in the financial services definition. This section was intended to clarify that the payment of dividends, principal and interest was exempt.

However, as section 3(1)(ka) is within the scope of section 3(1)(l), agreeing to do or arranging the collection of dividends, principal and interest is exempt, so many of the services performed by debt collection agencies are exempt,[3] contrary to the original policy intent.

[3] See *Public Information Bulletin* No. 164, August 1987; *Public Information Bulletin* No. 168, January 1988; and *Tax Information Bulletin* Vol. 6, No. 7, December 1994.

The supply of debt collection services by third parties should be a taxable supply because more than the mere receipt of money is involved. Thus the rationale for exempting the collection of interest, dividends and principal does not apply.

The amendment is aimed at taxing the activity of debt collecting as carried out by debt collection agencies, not internalised collection functions undertaken by the holder or issuer of a financial instrument, such as a bank.

Key features

Section 3 will be amended by inserting a new provision specifically excluding the activity of debt collection by third party agents from the definition of “financial services”. Debt collection services carried out directly by the creditor whose debt is being collected will remain exempt.

Financial options

(Clause 68(1))

Summary of proposed amendment

The amendment will ensure that the supply of a financial option is treated as an exempt supply.

Background

The buying and selling of options on recognised markets have been treated by taxpayers as an exempt activity under section 3(1)(k), which relates to futures contracts, since all that is being supplied is the right to either buy or sell a given amount of a specified commodity on a specified date. This is an acceptable policy result because an option is comparable to a futures contract.

Nevertheless, the technical nature of an option is distinct from a futures contract. Unlike the holder of a futures contract, the option holder is not obliged to exercise the rights or obligations under the contract. This technical distinction between futures contracts and options is recognised under the accrual rules of the Income Tax Act 1994.

Key feature

The amendment will include financial options in the definition of “financial services”.

Deliverable and non-deliverable futures contracts

(Clause 68(1))

Summary of proposed amendments

The amendments will ensure that only futures contracts that in effect trade exempt financial services at arm’s length or in a defined market are treated as exempt financial services.

Background

Futures contracts fall into two categories:

- contracts that provide for the delivery of a commodity (deliverable contracts); and
- contracts that do not provide for the delivery of a commodity (non-deliverable contracts).

The present definition of “financial services” does not specify any distinction between deliverable and non-deliverable contracts. All that is required under section 3(1)(k) is that a “futures contract” be traded on a “futures exchange”.

When a futures contract is non-deliverable, all that is being traded is money, and no underlying commodity is exchanged. A deliverable contract, in comparison, can involve the trade of an underlying commodity and is, therefore, more equivalent to a contract for the supply of goods or services.

Non-deliverable contracts will continue to be exempt from GST, since all that is being traded is money or a close substitute for money. On the other hand, deliverable contracts will be exempt only if the supply of the underlying commodity would be exempt.

The requirement that a futures contract be traded through a futures exchange ensures that there is a genuine market trading in derivatives, and that there are arm’s length terms of trade.

However, the Act does not include a definition of “futures exchange”, and this has created uncertainty as to the meaning of the term. Because arm’s length transactions can occur outside a recognised exchange, the reference to a futures exchange is also arguably too restrictive.

The reference to a futures exchange will, therefore, be removed from the Act and replaced with a requirement that the futures contract be traded on a defined market or on arm’s length terms.

Key features

Section 3(1) will be amended so that:

- Non-deliverable futures contracts are exempt from GST.
- Deliverable futures contracts will be exempt only if the underlying commodity being traded is exempt.
- Futures contracts must be traded on a defined market or on arm's length terms to be exempt.

Subrogation payments

(Clause 73(9))

Summary of proposed amendment

The amendment will ensure that the interest component of amounts recovered by insurers as a result of the exercise of rights acquired through subrogation is not taxed.

Background

An insurer, in settling a claim under a contract of insurance, may make a payment to an insured person and receive under the contract of insurance the insured person's legal rights in relation to the insured item (for example, the right to sue a third party who has damaged an insured car). If the insurer has claimed an input tax credit for that payment, any amount the insurer recovers from the third party (a subrogation payment) as a result of the exercise of those rights is taxable.

Often the amounts received by the insurer contain an interest component, which should not be taxed, to compensate the insurer for the delay between the recovery of any amount (say damages) and the payment to the insured person under the contract of insurance. However, the Act taxes the whole of the payment to the insurer. The Act will, therefore, be amended to ensure that the GST liability of the insurer is limited to the amount of the input tax credit the insurer received for making the payment to the insured person.

Key feature

The amendment will provide that the interest component of amounts recovered by insurers as a result of the exercise of rights acquired by subrogation does not give rise to GST, by limiting the output tax payable to the amount of the input tax credit originally claimed.

Zero-rating of exported “financial services”

(Clause 76(1) and (6))

Summary of proposed amendment

The reference to “subparagraph” in section 14(a)(i) is to be changed to “paragraph” with application to supplies made on or after 19 December 1989.

Section 14(a)(i) ensures that the zero-rating of exported financial services takes precedence over the normal exemption of financial services. However, the reference to “subparagraph” in section 14(a)(i) is incorrect and should be changed to “paragraph”.

Application date

This amendment will have retrospective application to supplies made on or after 19 December 1989, being the application date of the amendment which contained this error.

TOKENS, STAMPS AND VOUCHERS

(Clauses 70(4), 72(1), 73(8) and (10))

Summary of proposed amendment

The amendment provides that the supply in relation to a token, stamp or voucher redeemable for goods and services will be recognised when the token, stamp or voucher is acquired. However, to reduce the compliance costs that may arise in some cases, there will be an option for the supplier to account for GST when a token, stamp or voucher with a monetary face value is redeemed.

Background

Under the current legislation the recognition of a supply of a token, stamp or voucher depends on whether or not it has a monetary face value. A voucher with a face value is subject to GST on redemption; other vouchers and postage stamps are subject to GST on acquisition. This distinction creates a number of problems in accounting for GST.

First, the existing treatment creates compliance costs in relation to progressively redeemable vouchers with a face value (for example, phone cards).

The proposed amendment will provide that the supply in relation to a token, stamp or voucher redeemable for goods and services will be recognised both for suppliers and recipients when the token, stamp or voucher is acquired.

To reduce compliance costs for suppliers in relation to other vouchers, an exception to the new general rule will apply to vouchers with a face value so that the output tax is recognised on redemption at the supplier's option.

Another issue is the inability of lottery organisers to claim input tax credits on the purchase of vouchers to be used as prizes. The amendment will mean that no further change to ensure that the input tax credit is allowed, as foreshadowed in the discussion document, is required here. This is because the input tax credit will be allowed on acquisition.

Key features

Sections 10(16), (16A), (17) and 17(A) will be replaced with new provisions so that:

- The supply of a token, stamp or voucher will be recognised on its acquisition.
- A supplier may choose to recognise the supply of a token, stamp or voucher with a monetary face value when that token, stamp or voucher is redeemed for goods or services.

Supplies of postage stamps, or supplies of “exported services” described in existing section 11(2A) in exchange for tokens, stamps or vouchers (whether or not with a face value) will continue to be recognised at the time of acquisition.

GENERAL INSURANCE

(Clauses 70(5) and 83(2))

Summary of amendments

The amendments will ensure that:

- An insured party is liable for output tax where payment in accordance with its contract of insurance is made directly to a third party.
- Payments to registered recipients for losses incurred in the course or furtherance of a taxable activity are taxed.
- General insurers can claim input tax credits for payments made under contingency policies and registered recipients of such payments are correspondingly taxed.

For GST purposes, supplies of general insurance services are treated as taxable supplies. The inherent difficulties in valuing such supplies are overcome by taxing the flows of money to and from insurance companies as follows:

General insurer:
- Charges GST on premiums received; and
- Claims input tax credits for insurance payments and costs of providing general insurance services.

Insured party:
- Claims input tax credits on premiums paid (if GST-registered); and
- Returns output tax (if GST-registered) on payments received from general insurers.

Payments to third parties

If an insurer makes a payment under an insurance contract to a GST registered third party there is an argument that the insurer is entitled to an input tax credit but the third party recipient does not incur a corresponding output tax liability. However, if the payment is made directly to the insured party a corresponding output tax liability does arise.

For example, Liable Company (“L Co.”) sells defective goods to Victim Company (“V Co.”). These goods cause damage to V Co.’s factory, which L Co. is liable for. L Co. has an insurance policy covering such liability. L Co.’s insurance company can either make a payment to settle any claim to L Co. (which would be taxed by section 5(13)), or directly to V Co. (which would, following the argument above, not be taxed).

Section 5(13) will, therefore, be amended to clarify that the insured party is liable for output tax where payment is made directly to a third party.

Use of the term "taxable supply" in section 5(13)

The use of the term "taxable supply" in section 5(13) (relating to the receipt of insurance payments by persons registered for GST) may have the unintended effect of narrowing the application of the provision to insurance payments if there is a direct relationship between the insurance payment and a particular supply made by the insured person.

For example, if a retailer's warehouse is destroyed owing to arson there is an argument that the loss is not incurred "in the course of making a taxable supply", as section 5(13) requires. Although the retailer can claim input tax credits for the cost of the insurance policy, as they are costs incurred in the course or furtherance of a taxable activity, it might be argued that there is no corresponding output tax liability on payments received in this situation.

The term "taxable supply" in section 5(13) will, therefore, be changed to "taxable activity" to remove the possible narrowing effect of the former term.

Indemnity payments

According to the legislation, if insurance payments are indemnity payments they give rise to an input tax credit for general insurers and a corresponding output tax liability for registered recipients. On one interpretation, the terms "indemnify" and "indemnity" used in the legislation have a narrow meaning in this context, so that only payments under contracts that reimburse the insured for any loss suffered in the value of an insured item are included. Following this line of argument, contingency insurance such as sickness and personal accident insurance would, therefore, fall outside the ambit of the legislation, meaning that general insurers could not claim input tax credits in relation to these policies, even though they would be charging GST on premiums for them.

The potential for a narrow interpretation of "indemnify" and "indemnity" undermines the policy intent of treating general insurance as a taxable supply under the method outlined. The words "indemnify" and "indemnity" will, therefore, be removed to clarify that general insurers may claim input tax credits and to ensure that registered recipients are correspondingly taxed.

Key features

- Section 5(13) will be amended to clarify that insured parties are liable for output tax where payment in accordance with their contract of insurance is made directly to a third party.
- The term "taxable supply" in section 5(13) will be replaced with "taxable activity".
- The word "indemnity" will be removed from section 5(13).
- The word "indemnify" will be removed from section 20(3)(d).

TERMINATION OF A TAXABLE ACTIVITY

(Clauses 71, 77(1), 80(3), 92 and 93(2))

Summary of proposed amendment

The amendment alters the definition of "taxable activity" to ensure that section 6(2) applies to both a premature ending of a taxable activity and to a successful completion of a taxable activity.

Background

Under section 6(2), anything done in connection with the termination of a taxable activity is deemed to be carried out in the course or furtherance of that taxable activity. This provision ensures that GST applies to supplies made in completing a taxable activity as well as to supplies made as part of normal trading activities. Because the completion of a taxable activity by a registered person is regarded as involving a taxable supply, an output tax liability should arise.

In *Commissioner of Inland Revenue* v *Drummond and Ors*[4] the High Court found that the objectors' forestry activity had ceased earlier than planned for a number of reasons outside the objectors' control. By satisfying the conditions of section 51(1)(c) the objectors were not required to register for GST.

The court suggested that an activity is terminated only when it has run its intended full course. A supply made because of a premature conclusion of a business would be made on "cessation" of the activity rather than its "termination". Therefore the application of section 6(2) may be unintentionally limited to the completion of a taxable activity in the ordinary course of events.

Key feature

Section 6(2) will be amended to include in the definition of taxable activity, anything done in connection with the beginning, ending or premature ending of a taxable activity.

The same amendment is made in other provisions which refer to the cessation of a taxable activity.

[4] (1998) 18 NZTC 13,745.

TIME OF SUPPLY FOR RATES

(Clause 72(3))

Summary of proposed amendment

The amendment clarifies the time of supply for rates so that local authorities using the invoice basis of accounting will pay output tax on the earlier of:

- the date of an instalment notice for a single payment; or
- the due date for payment; or
- the date when payment is received.

This clarification is desirable as most local authorities will be required to account for GST on the invoice basis from 1 July 2001.

A notice issued at the beginning of the year which merely sets out the amounts due and the dates for each rate payment will not trigger a GST liability.

Key features

Section 9 will be amended to provide that the time of supply for rates is the earlier of:

- the date of an instalment notice for a single payment; or
- the due date for payment; or
- the date when payment is received.

UPLIFT TO MARKET VALUE RULES IN SECTIONS 10(3), 10(3A)

(Clause 73(1) and (2))

Summary of proposed amendments

Sections 10(3) and 10(3A) will be amended to ensure that supplies made at less than market value to unregistered persons or persons making exempt supplies are valued at market value for GST purposes.

There are two problems with the rules in sections 10(3) and 10(3A) that the amendments address:

- a gap in section 10(3) whereby the provision would not apply if the only consideration for a supply is non-monetary consideration that is less than the open market value of the supply;
- circularity between section 10(3), which requires an uplift to market value for supplies between associated persons (and, therefore, potentially lifts a person above the registration threshold), and section 10(3A), which provides that section 10(3) does not apply if the supply is between registered persons.

Key features

- The two references in section 10(3) to "consideration in money" will be replaced by references to "consideration".
- The reference to any supply made by a "registered person" in section 10(3A) will be replaced by a reference to any supply made by a "person".

THE USE OF THE TERM “CASH PRICE” IN SECTION 10(5)

(Clause 73(4))

Summary of proposed amendment

The amendment will ensure that a supply of goods or services made under a credit contract is correctly valued for GST purposes.

Background

When a supply is made under a credit contract, the “consideration in money” for that supply is deemed under section 10(5) to be the “cash price” of the goods or services provided under the credit contract.

The definition of “cash price” in the Credit Contracts Act 1981 is used for the purposes of section 10(5). The “cash price” is either the lowest price for which anyone could have purchased the goods or services from that vendor on the basis of payment in full when the contract was entered into, or, if there is no such price, the fair market value of the goods or services when the contract was made.

There are several problems with using the term “cash price” for GST purposes:

- There is uncertainty as to the boundary with respect to determining the vendor – for example, whether it extends to any branch of that vendor in New Zealand, or, depending on the price, branches overseas.
- The definition of “cash price” does not distinguish between classes of customers, such as retail and wholesale customers.
- Theoretical lowest prices could be used. For example, managers of retail outlets may have a discretion to give a maximum discount of, say, 30 percent. Even though managers may never give this level of discount, it is theoretically the “lowest price.”

The use of “cash price” in the GST Act was meant to determine the consideration given by the purchaser for the non-credit portion of the credit contract (for the goods or services). This may not, however, be a suitable measure of consideration for GST purposes, as it can result in an under-valuation of the true consideration given for the supply of a good or service. The consideration in money for goods or services supplied under a credit contract should correctly reflect the consideration provided for those goods or services.

The amendment will, therefore, deem the consideration in money for a supply of goods or services made under a credit contract to be the higher of the open market value or the cash price of those goods or services.

Key feature

Section 10(5) will be amended so that the consideration in money for a supply of goods or services made under a credit contract is deemed to be the higher of the open market value or the cash price of those goods or services.

DEREGISTRATION

(Clause 73(6) and (7))

Summary of proposed amendment

The amendment requires GST to be paid on the open market value of assets retained on deregistration, so that supplies on deregistration are valued in the same way as other supplies made before deregistration. Assets acquired before the introduction of GST will be excluded from this change.

The reason for deeming a supply of assets held on deregistration to have been made is to reflect that the registered person has, in effect, made a supply to themselves in their private capacity. The problem with the current rule, however, is both the scope for avoidance activity and the fact that it creates a more favourable treatment for assets retained and then sold as opposed to assets sold before deregistration. The amendment ensures that the output tax payable is the same in both cases.

Background

Registered persons who deregister and retain any assets that were used in their taxable activity are treated as having, in effect, made a supply of those goods and services to themselves in their capacity as a final consumer.

On deregistration, output tax is payable on the lesser of the cost or open market value of goods and services held by a registered person. However, if that person sold those goods and services while still registered, output tax would be payable on the sale price (usually equivalent to its open market value). Therefore, assuming the lesser cost option is adopted, a lower output tax liability arises in relation to assets held on deregistration that have appreciated in value.

If the deregistered person then on-sells goods to a registered person, a second-hand goods input tax credit may be claimed for one-ninth of the purchase price, or if the parties are associated, one-ninth of the lesser of the purchase price or the open market value. If the deregistered person has paid output tax on the basis of the cost of the goods, significant tax advantages may arise from the sale of goods, such as land, which have increased in value since they were originally acquired by the deregistered person.

It is recognised that, in relation to assets acquired before the introduction of GST for which no input tax credits were allowed, taxing increases in value since acquisition could create a significant tax burden for those registered persons holding such assets at deregistration.

To address these concerns the deemed supply on deregistration of assets acquired before GST was introduced will continue to be valued at the lower of cost or open market value. Any second-hand goods input tax credit in relation to goods on-sold by the deregistered person to a registered associate would in these circumstances be limited in accordance with the proposal relating to second-hand goods.

Key feature

Section 10 will be amended so that GST is paid on the open market value of assets retained on deregistration, unless the assets were acquired before GST was introduced, in which case GST will be paid on the lower of the cost or open market value of those assets.

EXPORTED GOODS AND SERVICES

(Clauses 74, 66(4), 70(7), 73(3), 76(2) & (4), 83(3), 86(2) and 97(1))

Overview

Several amendments are being made to section 11, the zero-rating provision of the Act, in line with the principle that GST is a tax on goods and services consumed in New Zealand. Section 11 will also be restructured and split into three separate sections, dealing respectively with zero-rated goods, zero-rated services and the zero-rating of certain supplies by territorial authorities.

Services supplied in relation to exported goods

Summary of proposed amendment

The amendment zero-rates services supplied directly in connection with exported goods if the services are supplied to a non-resident who is outside New Zealand at the time the services are performed. As the goods are to be exported, the services, although performed in New Zealand, can be regarded as being consumed offshore, so should not be subject to GST.

The amendment addresses the anomaly of the different tax treatment when services relating to exported goods are supplied separately to a non-resident (not zero-rated) and when the value of the services is incorporated into the price paid by the non-resident for the exported goods (zero-rated).

Key feature

The amendment inserts a new provision to zero-rate services supplied directly in connection with goods to which any provision of the existing section 11(1)(a) to (ad) (goods that have or will be exported) applies if the services are supplied to a non-resident who is outside New Zealand at the time the services are performed.

Zero-rating of exported information services

Summary of proposed amendment

The amendment will zero-rate exported information services that are directly connected with moveable personal property situated inside New Zealand at the time the services are performed if the services are supplied to a non-resident who is outside New Zealand at the time the services are performed. In many cases, the connection with moveable personal property situated in New Zealand is incidental, for example, when pharmaceutical samples are supplied from offshore by a non-resident to a New Zealand tester. In these cases the services should be regarded as being consumed offshore, so should not be subject to New Zealand GST.

In addition, anomalous situations could occur without this amendment under the proposal to zero-rate services supplied in relation to exported goods if the goods are not actually exported. For example, a non-resident investigating the purchase of goods from New Zealand contracts a New Zealand business to test or examine the goods in order to ascertain whether they meet the specifications required by the non-resident or claimed by the New Zealand seller. If the goods were not actually exported because the quality testing report showed they were below standard the testing services would not, without this amendment, be zero-rated, even under the proposal to zero-rate services supplied in relation to exported goods.

Key features

The amendment inserts a new provision to zero-rate services that comprise the supply of information from a place in New Zealand to a place outside New Zealand if supplied directly in connection with movable personal property situated in New Zealand to a non-resident who is outside New Zealand at the time the services are performed.

Goods destroyed prior to export

Summary of proposed amendment

The amendment will ensure that goods which have been sold to a non-resident for export but cannot be exported because they die or otherwise cease to exist can still be zero-rated.

The Act allows the zero-rating of goods that are physically exported. Therefore if goods otherwise destined for export cease to exist and are not physically exported, the supplies will not currently be zero-rated.

Zero-rating will apply to supplies of goods that were to be exported but cease to exist owing to circumstances outside the control of either the supplier or purchaser of the goods. The new rule would apply, for example, to race horses that are sold for export but die before they leave New Zealand, or wine purchased by a non-resident for import that is destroyed in a warehouse by a fire before it is shipped.

Key feature

The amendment inserts a new provision to zero-rate supplies of goods that were to be exported but which cease to exist owing to circumstances outside the control of either the supplier or purchaser of the goods.

Exported aircraft

Summary of proposed amendment

The amendment will allow the zero-rating of the supply by way of sale of an aircraft which is exported from New Zealand under its own power.

Section 11(1)(ag) zero-rates the supply by way of sale of a boat which is exported from New Zealand under its own power. There is no equivalent provision for aircraft which are exported from New Zealand under their own power.

The provision will be subject to the time limit rules in existing section 11(1E) and 11(1F), which generally require the craft to be exported within 60 days of the time the recipient takes physical possession of it.

Key feature

The new provision will allow the zero-rating of the supply by way of sale of an aircraft which is exported from New Zealand under its own power.

UPDATING REFERENCES IN SECTION 11

(Clause 74)

Shipping and Seamen Act 1952 references

Amendments will be made to section 11 to update references to definitions in the now repealed Shipping and Seamen Act 1952:

The term “coastal waters” in existing section 11(1)(bb), which zero-rates goods supplied for use as stores for consumption outside New Zealand on aircraft or ships, will be replaced with the term “New Zealand fisheries waters”. This term will be defined as having the same meaning as in the Fisheries Act 1996.

The term “fishing vessel” in existing section 11(1)(bb) will be replaced with the term “fishing ship”. This term will be defined as having the same meaning as in the Maritime Transport Act 1994.

A new definition of “foreign-going ship” will be inserted for the purpose of existing section 11(1)(bb). This definition will refer to “a ship, other than a pleasure craft (as defined in the Maritime Transport Act 1994) or a fishing ship (as defined in the Maritime Transport Act 1994), going to a destination outside New Zealand”.

Civil Aviation Act 1964 reference

The reference to the now repealed “Civil Aviation Act 1964” in existing section 11(1A) will be replaced by a reference to the “Civil Aviation Act 1990”.

Zero-rating of local authorities petroleum tax

New section 11B will be updated by removing references to “regional council” and “united council” to reflect changes made to local government structures and the local authorities petroleum tax scheme in Part XI of the Local Government Act 1974.

"GOING CONCERNS"

(Clauses 74 and 103)

Summary of proposed amendments

The amendments will remove uncertainties as to when the "going concern" test is to be applied and the meaning of "going concern".

Background

Section 11(1)(c) zero-rates the transfer of a taxable activity as a "going concern".

The current wording of section 11(1)(c)(i) creates uncertainty as to when the going concern test is to be applied, by using the phrase "supply to a registered person of a taxable activity, that is, or is to be, transferred".

Cases dealing with the pre-1995 provision, such as *Belton* v *Commissioner of Inland Revenue*[5] and *K R Pine* v *Commissioner of Inland Revenue*[6], have stated that the test is to be applied at settlement.

As stated in the *Tax Information Bulletin* Volume 6, No 12,[7] whether a taxable activity is supplied as a going concern was intended to be determined at the time of supply – generally the earlier of invoice or payment. The time of settlement or transfer is not relevant to determining the status of the supply, although the taxable activity must continue to be carried on by the vendor until the time of transfer for the supply to be zero-rated.

The time of supply is the better time at which to apply the "going concern" test. The time of supply will generally be when the parties enter into an agreement to transfer a taxable activity. It will also be the time at which the parties consider whether the taxable activity is a going concern.

The policy intent behind the "going concern" provisions was that the taxable activity must be received as, and capable of being operated as, a going concern by the purchaser for the zero-rating provisions to apply. The taxable activity must be capable of seamless operation during its transfer, although it is not necessary that the purchaser in fact operate the taxable activity as a going concern after its transfer.

However, the majority of the Court of Appeal in *K R Pine* held otherwise. In *K R Pine* a registered person sold a taxable activity of commercial leasing to another registered person whose partnership had been the tenant of the commercial property. The partnership had, however, been terminated by agreement before the purchase of the lease, and the registered person had become the lessee.

[5] (1997) 18 NZTC 13,403.

[6] (1998) 18 NZTC 13,570.

[7] May 1995, page 31.

On purchase of the taxable activity, the purchaser’s legal estates as lessor and lessee merged and, therefore, at law, the purchaser could not carry on the taxable activity as a going concern. The majority of the Court of Appeal, however, held that the transfer of a going concern had still occurred, stating that it did not matter that a taxable activity could not be operated as a going concern. The test was the form of the taxable activity supplied by the vendor, and in *K R Pine* the vendor had supplied a going concern.

The section will, therefore, be amended to ensure that a transferred taxable activity must be capable of operation by the purchaser for the supply to be zero-rated as that of a going concern.

Key features

The “going concern” test will be amended to ensure that:

- The test for a “going concern” is applied at the time of supply.
- To qualify for zero-rating the purchaser must be able to continue to carry on the activity as a going concern.

TEMPORARY IMPORTS

(Clause 74)

Summary of proposed amendment

The amendment zero-rates all services provided directly in connection with temporary imports.

This removes the existing requirement that services provided directly in connection with temporary imports be supplied to a non-resident, and extends the zero-rating to services provided to residents. As the goods have only a temporary connection with New Zealand, the services provided directly in connection with them should be treated as being consumed outside New Zealand and, therefore, not subject to GST.

Key feature

Subparagraph (ii) of existing section 11(2)(ca) will be repealed.

RESIDENTIAL ACCOMMODATION

(Clause 76(3) and (5))

Summary of proposed amendment

The amendment will treat as exempt the supply of a property which is to be used as residential accommodation for lease or rental under a head lease. This will align supplies where the recipient is able to occupy the dwelling (an exempt supply) and those where the recipient cannot (a taxable supply).

Background

Section 14(c) exempts the supply of residential accommodation in a dwelling. The supply of property to a company by way of lease is arguably a supply of a leasehold interest in residential property rather than the supply of residential accommodation, and on this basis the exemption would not apply. In other words, because a company is unable to occupy a property as residential accommodation it does not receive the supply of accommodation.

Key features

Section 14 will be amended to ensure that the supply of residential property for lease or rental under a head lease will be an exempt supply if the property is acquired for the purpose of providing residential accommodation. However, both the supplier and recipient will be able to agree that the exemption does not apply.

The exclusion is necessary to ensure that any supplies under existing leases of residential property that are currently treated as taxable are not required to be re-characterised as exempt supplies.

PENALTY INTEREST

(Clause 76(5))

Summary of proposed amendment

The amendment will treat interest in the nature of a penalty imposed under a contract for goods or services as consideration for an exempt supply.

Background

If a purchaser fails to make payment under a contract the supplier may, if the contract permits, charge the purchaser interest for the use of the money to induce payment. The interest is generally called penalty or default interest.

The nature of penalty interest is conceptually indistinguishable from that of other forms of interest, which the Act exempts under section 3(1)(ka).

The provision of a credit contract[8] and certain services relating to credit contracts are within the definition of "financial services" and, therefore, exempt from GST. However, penalty interest charged under a contract does not necessarily make the contract a "credit contract", so penalty interest may be subject to GST when the underlying supply is taxable.

Key feature

Section 14 will be amended to insert a provision treating penalty interest imposed under a contract for goods or services as consideration for an exempt supply.

[8] As defined in the Credit Contracts Act 1981.

THE SIX-MONTHLY FILING PERIOD

(Clause 78)

Summary of proposed amendment

Taxpayers may file six-monthly rather than two-monthly if their turnover does not exceed $250,000 per annum. The amendment gives the Commissioner of Inland Revenue the discretion on written application to allow taxpayers to file on a six-monthly basis to reduce any excessive compliance costs from more frequent filing.

Background

The Government recognises that filing on a two-monthly basis once turnover exceeds $250,000 may involve significant compliance costs for taxpayers required to shift to the new basis. These costs can be disproportionately high when balanced against the cost to the Government in cash flow terms.

Taxpayers affected in this way are those who have in the past filed on a six-monthly basis but have just started to exceed the $250,000 threshold. Another group affected is taxpayers with seasonal businesses that have a fluctuating turnover and for which accounts are generally prepared at the end of the season.

Key features

Section 15 will be amended to give the Commissioner the discretion on written application to allow taxpayers to file on a six-monthly basis taking into account:

- whether the taxpayer has a history of accurate and timely filing and payment of GST;
- whether the taxpayer has good record-keeping practices;
- whether the taxpayer has previously been entitled to account for GST on a six-monthly basis;
- the nature of the taxable supplies made by the taxpayer;
- the volume of taxable supplies made by the taxpayer.

THE LAST DAY OF A TAXABLE PERIOD

(Clause 77)

Summary of proposed amendment

The amendment gives the Commissioner the right to reverse an earlier decision to allow registered persons to determine a day in substitution for the last day of their taxable period if they cannot provide sound commercial reasons, other than a tax timing advantage, for maintaining the change.

Background

Under section 15(7) taxpayers may, with the Commissioner's approval, use an alternative reporting period close to that used for their internal accounting as the basis for their GST returns if the alternative reporting period ends within seven days of the last day of their taxable period. This is intended to reduce compliance costs for taxpayers unable to harmonise their internal reporting with the last calendar day of the taxable period because of industry practice or the expense involved.

Taxpayers are able to engineer sizeable timing advantages from the existing section 15(7) in combination with their suppliers. However, the Commissioner does not explicitly have the right to reverse a decision to allow a change in the last day of taxable period granted to a taxpayer.

Key features

The Commissioner will be given the power to revoke approval to determine a day in substitution for the last day of a taxable period if:

- there is no longer any sound commercial reason, other than a tax timing advantage, for the taxpayer maintaining a change in the last day of the taxable period; and
- the approval has given rise to a tax timing advantage.

THE PAYMENTS BASIS THRESHOLD

(Clause 80(2) and (5))

Summary of proposed amendment

The threshold under which taxpayers can account for GST when payment is received, rather than the earlier of when a payment is due or received, is to be increased to $1.3 million. The change is in line with inflation since 1990 (the date of the last increase) and with expected inflation for the next five to ten years.

Application date

The increased threshold will apply from 1 October 2000.

Background

Taxpayers are generally required to account for GST as debts become due – the "invoice basis" of accounting. Widespread application of this rule ensures consistency in the timing of output tax payments by suppliers and input tax credit claims by purchasers. However, for compliance reasons, some exceptions to this rule apply to registered persons with turnover less than $1 million and to certain other taxpayers. These people are able to account for GST as payment is received – the "payments basis" of accounting.

Key feature

The payments basis threshold in section 19A will be increased from $1 million to $1.3 million.

THE ACCOUNTING BASIS FOR LOCAL AUTHORITIES

(Clauses 80(1) and (4) and 81)

Summary of proposed amendment

The amendment will remove the automatic entitlement of local authorities to account for GST using the payments basis unless their turnover is under the prescribed threshold.[9] Allowing local authorities to account for GST using the payments basis is in most cases no longer appropriate given recent reforms[10] that require local authorities to adopt generally accepted accounting practice.

Application date

The removal of the automatic entitlement of local authorities to use the payments basis of accounting will apply from 1 July 2001.

Background

Most registered persons are required to account for GST on the invoice basis of accounting. Some exceptions apply for compliance reasons to registered persons with low turnover and to non-profit bodies, who are able to account for GST as payment is received. Local authorities are also entitled to use the payments basis. Until 1992 government departments were able to use the payments basis, but this ability was removed as part of reforms to move government departments' financial accounts to the accrual system.

The removal of the automatic entitlement of local authorities to use the payments basis of accounting will apply from 1 July 2001 to give local authorities sufficient time to make the transition.

It is possible that some local authorities will experience difficulties in complying with an invoice basis of accounting by 1 July 2001 and will require further time to make the adjustment from a payments to an invoice basis. To address these difficulties an Order in Council procedure to allow continued use of the payments basis of accounting for a specified period has been included in the amendment.

Key feature

The existing unrestricted right for local authorities to account for GST using the payments basis will be removed from 1 July 2001, but provision will be made for specific time-limited extensions to this date to be made.

[9] Currently $1 million but to be increased to $1.3 million.

[10] The Local Government Amendment Act (No. 3) 1996 requires local authorities to adopt generally accepted accounting practice and allows them greater scope to raise finance.

DEFERRED SETTLEMENTS

(Clauses 79(1) and 82)

Summary of proposed amendment

The amendment will address a significant base maintenance problem with deferred settlement transactions involving two registered persons using different bases of accounting for GST. The amendment requires output tax to be returned on an invoice basis for any supply for which the consideration exceeds $225,000 (including GST).

Background

By deferring the date of settlement it is possible to gain a significant timing advantage in relation to transactions involving two registered persons using different bases of accounting for GST. Specifically, a purchaser on the invoice basis is able to claim an immediate input tax credit but a vendor on the payments basis is able to defer the payment of output tax until payment is received.

The target of the proposal to require output tax to be returned on an invoice basis for supplies exceeding $225,000 is longer-term deferred settlements. To limit cash flow and compliance concerns for shorter-term deferred settlements, agreements where settlement must be made within 93 days will be excluded. The period of 93 days is consistent with the exclusion for short-term agreements in the accrual rules in the Income Tax Act 1994.

To prevent registered persons from entering into arrangements to avoid the $225,000 threshold by splitting a supply of goods or services into a number of transactions, the Commissioner will be given a discretion to require the registered person to account for those transactions on an invoice basis.

Key features

A new section will be inserted requiring output tax to be returned on an accrual basis for any supply exceeding $225,000 (including GST) in value if settlement is not required within 93 days. The Commissioner will also be given a discretion to require accounting on an invoice basis where a supply of goods or services is split into a number of transactions to avoid the $225,000 threshold.

THE SECOND-HAND GOODS INPUT TAX CREDIT

(Clauses 83(1), 69(1), 101 and 102)

Summary of proposed amendment

The amendment will limit the input tax credit available in relation to supplies of second-hand goods between associated parties to remove the current tax advantages.

Background

If a registered person acquires new or second-hand goods from a GST registered person the GST component is shown on the tax invoice[11] and can be claimed as an input tax credit.

If a registered person purchases second-hand goods from an unregistered person the supply is not subject to GST. However, the registered person may claim one-ninth of the purchase price as an input tax credit, provided sufficient records of the supply are kept.[12]

Allowing a credit is intended to recognise the GST paid when the non-registered supplier acquired the goods and so ensure that only the final consumer incurs the GST cost on the amount of value added by registered persons.

The input tax credit for second-hand goods has been used by registered purchasers to claim large GST refunds in relation to goods (particularly land) on which GST has not been paid by the seller. In some cases second-hand goods appear to be sold to an associated person primarily to claim the input tax credit with no real change in ownership. It is likely that the goods would not have been sold if a credit were not available. Therefore in these cases the credits are windfall gains to the registered purchaser rather than refunds of tax previously paid. This issue is particularly problematic when assets are held for many years before they are on-sold.

Limiting the input tax credit between associated persons is preferred to the implementation of a “margin scheme”, such as that proposed in Australia for land sales, which defers the input tax credit until the sale of assets. To remove the potential for associated persons to claim windfall input tax credits early by merely interposing another transaction it would be necessary for a margin scheme to require all goods acquired and sold under the scheme to continue to be sold under the scheme. This could cause unreasonably high compliance costs, including requiring a non-associated purchaser to know the “GST status” of an asset (whether margin scheme or non-margin scheme). There could also be significant record-keeping and apportionment issues.

[11] Or can be calculated from the “GST inclusive” amount.

[12] Section 24(7) specifies the type of information that must be provided (including a description of the goods, the date of the supply, and the name and address of the supplier).

The option of excluding land from the GST base is not favoured as it is contrary to the objective of a broad-based tax with minimal exemptions.

Key features

The amendment limits the input tax credit available in relation to supplies of second-hand goods between associated parties to the lesser of:

- the GST component (if any) of the original cost of the goods to the supplier; or
- one-ninth of the purchase price; or
- one-ninth of the open market value.

When a vendor pays GST based on market value on deregistration and subsequently sells second-hand goods to a registered associate, the amount of the input tax credit available to the purchaser will continue to be one-ninth of the lesser of the purchase price or open market value.

ADJUSTMENTS TO INPUT AND OUTPUT TAX

(Clauses 84, 70(8), 72(2), 73(5), 83(4), 94(2), 95(1), 99 and 106)

Summary of proposed amendments

Several changes reduce the compliance costs associated with making adjustments for changes in use.

The main change is to give registered persons the option to pay additional output tax for private or exempt use on a one-off or annual basis rather than in each taxable period. If the one-off basis is chosen further adjustments will be required at the time a change in use of 20 percent or more occurs. Registered persons will also be allowed to make input tax adjustments on an annual rather than a taxable-period basis.

Background

A registered person can claim input tax credits in relation to goods and services acquired principally for business purposes. Those goods and services may also be used for a private or exempt purpose. The Act deems such use to be a taxable supply by the registered person, and output tax is charged accordingly.

A registered person cannot claim input tax credits in relation to goods and services acquired principally for private or exempt purposes. If those goods or services are also used for business purposes the Act allows an input tax credit to reflect that taxable use.

The principal objective of change in use adjustments is to ensure that input tax credits reflect the extent of the taxable use of goods and services. This is achieved by making adjustments to output tax or input tax if the original intended use of the goods and services changes or if the goods and services are acquired for both taxable and non-taxable purposes.

The requirement to make output tax adjustments ensures that tax is borne by the final consumer when there is private or exempt use of goods or services. For example, the private use of goods or services acquired by a registered person for the principal purpose of making taxable supplies represents a supply of goods or services to the registered person in his or her private capacity and, as such, should be subject to GST.

Inland Revenue requires adjustments to be made in each taxable period that the asset is owned to reflect the continuing changes in use. This can result in high compliance costs for small amounts of revenue.

An alternative to the “adjustments” approach is the “apportionment” approach, which is adopted in a number of other jurisdictions, including Australia. This limits the initial input tax credit to the estimated proportion of taxable use. Therefore in relation to an asset used, say, 60 percent for taxable purposes, an input tax credit of 60 percent of the GST component of the purchase price would be allowed. This amount would be further adjusted to reflect any changes in the asset’s continuing taxable use. The output tax on sale of the asset would also be similarly apportioned.

The relative merits of the adjustments and apportionment approaches will be considered in the next stage of the GST review. In the meantime, the changes outlined above will assist in reducing compliance costs.

Key features

Amendments will be made to:

- Legislate the current methods of allocation in the GST Act. Taxpayers will be required to adopt the method that gives the fairest and most reasonable allocation.
- Give taxpayers the choice when making adjustments for changes from taxable to non-taxable use to make continuing output tax adjustments either once when the change in use occurs or the asset is acquired, annually, or in each taxable period. If they choose to make a one-off adjustment, additional adjustments will be required if the relative use changes further by 20 percent or more.
- Give taxpayers the choice when making adjustments for changes from non-taxable to taxable use to make continuing input tax adjustments annually or in each taxable period.
- Limit the input tax credit allowed under the existing section 21(5) for changes from non-taxable to taxable use to supplies of goods and services which satisfy the requirements for an input tax credit except for the requirement that the goods and services be acquired for the principal purpose of making taxable supplies. There will also be additional requirements in the case of second-hand goods, in particular, that the second-hand goods have always been situated in New Zealand, or had GST levied on them under section 12 when they were imported into New Zealand. This amendment will apply to transactions entered into from 1 October 1986 unless the Commissioner of Inland Revenue has agreed in writing to this input tax credit claim before the date the bill is introduced.
- Increase the $10,000 threshold for one-off input tax adjustments for changes from non-taxable to taxable use to $18,000. (This increase is in line with inflation since 1986 and to keep the threshold current for the next five to ten years.)
- Increase the minimum threshold for exempt supplies (over which adjustments must be made) from $48,000 to $90,000. (This increase is in line with inflation since 1986 and to keep the threshold current for the next five to ten years.)

- Ensure that output tax adjustments for any non-taxable use apply to goods and services acquired or produced, as well as applied, for the principal purpose of making taxable supplies.
- Ensure that an adjustment is triggered by any dual or multiple use (not just a subsequent change of use).
- Ensure that fringe benefits provided to past employees (including associated persons) are subject to GST.

ADJUSTMENTS TO INPUT AND OUTPUT TAX: OTHER ISSUES

(Clause 84)

Summary of proposed amendments

The scope and calculation of change in use adjustments are being clarified.

Key features

The amendments:

- Ensure that section 21 does not give rise to an unintended output tax liability for services provided by employees. For example, the services of an employee for which no input tax credit is available may be acquired for the principal purpose of making taxable supplies. These services may then be used in relation to exempt supplies. The amendment ensures no output tax liability will arise in this situation.
- Ensure section 21(1) does not apply if a deemed supply has arisen because of a change in the legislation. For example, changing the status of a particular supply from taxable to exempt.
- Clarify that the time of supply of output tax adjustments for non-deductible entertainment expenditure is the same time as when the income tax return is due (or furnished, whichever is the earlier). Currently, the time of supply depends on whether income tax returns are filed early or on time. To minimise compliance costs, the time of supply should be aligned with the filing of an income tax return.
- Ensure that section 21 allows an input tax adjustment in relation to goods and services acquired on or after 1 October 1986, rather than after that date.

THE ABBREVIATED TAX INVOICE THRESHOLD

(Clause 86(1) and (3))

Summary of proposed amendment

To reduce compliance costs, the threshold under which an abbreviated tax invoice (under section 24(4)) is acceptable is to be increased from $200 to $1,000.

Application date

The increased threshold will apply from 1 October 2000.

Background

Tax invoices are the key means by which Inland Revenue can maintain an audit trail and verify the deduction of input tax credits from output tax. To qualify as a tax invoice, a document must meet certain criteria set out in the Act. However, if the consideration paid for a supply of goods or services is less than $200, an abbreviated tax invoice is acceptable. An abbreviated tax invoice does not require the inclusion of the name and address of the recipient, the quantity or volume of the goods and services or the amount of tax charged if the amount is other than the tax fraction of the consideration.

The amendment increases the threshold for an abbreviated invoice from $200 to $1,000. This measure is aimed at further reducing the compliance cost burden of the requirement to hold detailed tax invoices for small items of expenditure.

Key feature

Section 24(4) will be amended to increase the threshold for simplified tax invoices to $1,000.

FACTORED DEBTS

(Clauses 87 and 88)

Summary of proposed amendments

To re-establish parity between the two accounting bases and remove opportunities for recharacterising credit sales, registered persons accounting for GST on a payments basis will be required to pay GST on the remaining book value of a debt when it is factored. It is also being clarified that when a debt is factored on a recourse basis the assignor can claim a deduction if the debt becomes bad after it is returned to the assignor.

Background

For assignors of debt on an accrual basis, any output tax liability on the assignment of debt will have arisen before the assignment. The assignment of debt is an exempt supply, but GST is payable on the full value of the underlying supply, irrespective of whether full payment is received. If the assignor is on a payments basis, output tax must be paid on any amount received for that debt before the assignment and any amount received on the assignment. This means that GST is not payable on the discount component of a factoring transaction.

In relation to payments basis taxpayers, therefore, it is possible to convert part of a taxable supply of goods and services into an exempt supply. This is possible because the sale of debt is generally an exempt financial service.

When a debt is sold back to the assignor and is, or becomes, bad in the assignor’s hands, a bad debt deduction ought to be allowed. Section 26 does not contemplate that the assignor may sell a debt and purchase it back. Arguably, deductibility under the section would not, therefore, be prevented.

To achieve certainty, however, an amendment will ensure that recourse debt factoring can give rise to a bad debt deduction if the debt becomes bad after it is returned to the assignor.

Key features

New section 26A will be inserted to provide that registered persons accounting for GST on a payments basis must pay GST on the remaining book value of a debt when it is factored. Section 26 will be amended to clarify that when a debt is factored on a recourse basis the assignor can claim a deduction if the debt becomes bad after it is returned to the assignor.

THE REGISTRATION THRESHOLD

(Clause 93)

Summary of proposed amendment

The amendment increases the compulsory registration threshold from $30,000 to $40,000, in line with inflation since 1990 and with expected inflation for the next five to ten years. Approximately 25,000 small businesses fall within the $30,000 to $40,000 band. The registration threshold was last adjusted in 1990 as a result of recommendations from the Taxation Simplification Consultative Committee.

Application date

The increased threshold will apply from 1 October 2000.

Background

Anyone who makes taxable supplies exceeding $30,000 in value in a 12-month period must register for GST. It is also possible for a person carrying on a taxable activity to register voluntarily if below that threshold.

In setting the registration threshold there are two competing considerations:

- A high registration threshold reduces compliance costs because it allows many small businesses to fall outside the GST system.
- A low threshold reduces the potential for smaller businesses to place significant competitive pressures on businesses operating above the threshold.

The proposed adjustment maintains a reasonable balance between these two considerations.

Key feature

Section 51(1)(a) will be amended to increase the compulsory registration threshold from $30,000 to $40,000.

UNINCORPORATED BODIES

(Clauses 90, 94 and 95)

Summary of proposed amendments

Minor legislative changes are being made to clarify provisions relating to the recovery of the GST debts of an unincorporated body and the extent of a member's liability for GST.

Background

Section 42 makes the Commissioner a preferential creditor in relation to GST that is unpaid at the time of a bankruptcy, liquidation, or receivership. This ranking is appropriate because input tax credits in relation to a supply may be refunded to a purchaser regardless of whether or not the vendor pays output tax.

Section 57(3) provides that members of unincorporated bodies are liable jointly and severally for all tax payable by the body while they are members. The estate of a deceased member is severally liable for any unpaid liabilities of the member.

In some areas there is a lack of clarity or an unintentional limitation of the scope of the provisions, and the amendments address these problems.

Key features

- The preferential status of GST debts recoverable from individual members of an unincorporated body will be confirmed.
- The preferential status for unpaid GST debts of an unincorporated body will apply if a receiver is appointed other than by court order.
- The liability of a member of an unincorporated body for GST payable will extend beyond the period of membership, but only in respect of liabilities arising during the period the person was a member.
- The existing requirement to provide written notification to the Commissioner will involve actual receipt of the notice by the Commissioner, and the change in membership will take effect from this date.

SPECIFIED AGENTS

(Clauses 91, 94(1) and 96)

Summary of proposed amendments

These legislative changes will clarify the scope of section 58 relating to specified agents carrying out a taxable activity in the place of an incapacitated registered person.

Background

Section 58 provides that the "specified agent" of an "incapacitated person" personally carries on the taxable activity of the incapacitated person during an "agency period", so has all the obligations and liabilities of a registered person carrying on the taxable activity. If the section did not exist, persons making taxable supplies on behalf of others might not be liable to account for GST.

An incapacitated person is defined "as a registered person who dies, or goes into liquidation or receivership, or becomes bankrupt or incapacitated". A specified agent is defined as "a person carrying on the taxable activity as the agent, personal representative, liquidator or receiver of an incapacitated person".

In some areas there is a lack of clarity or an unintentional limitation of the scope of the provisions, and the amendments address these problems.

Key features

- Section 58(1A) will be amended to include appointments of receivers to control only part of a taxable activity.
- It will be clarified that an agency period terminates when the taxable activity is no longer carried on by a specified agent whether by a liquidator, receiver or both.
- Section 58 will be amended to ensure that input tax credits available to an incapacitated person but not claimed by that person in relation to pre-agency supplies can be claimed by the person's specified agent. This will be subject to new sections 46(7)-(9). This new provision will ensure that the Commissioner can set off pre-agency period tax debt against pre-agency period input tax credits claimed by specified agents.
- It will be clarified that section 58(1A) overrides section 5(2).
- It will be clarified that a specified agent is not personally liable for any liability incurred on (as well as before) the date of commencement of the agency period.
- It will be clarified that the appointment of a specified agent does not affect the membership of a group of registered persons.

GENERAL ANTI-AVOIDANCE PROVISION

(Clause 100)

Summary of proposed amendment

The amendment adopts the general anti-avoidance provision of the Income Tax Act 1994 (sections BG 1 and GB 1) as a model for an amended section 76, the general anti-avoidance rule, of the Goods and Services Tax Act 1985.

Background

Section 76 has a number of possible deficiencies which may limit its potential application. In determining whether there is tax avoidance the section relies on the subjective test of the taxpayer's intention in entering into an arrangement. In many circumstances this is difficult to determine.

A further possible problem is that section 76 applies only where "the application of the Act" is defeated. Many avoidance arrangements are structured so that the specific provisions of the Act do apply, and it is arguable that section 76 does not apply in these circumstances.

It is desirable to achieve consistency between the general anti-avoidance provisions in the GST and Income Tax Acts as this would allow a similar analysis to be used when considering the application of these provisions. Aligning the provisions would also allow the case law dealing with the income tax provision to be used to interpret the GST provision.

Key features

The new anti-avoidance provision will apply if an arrangement is entered into and directly or indirectly:

- has tax avoidance as its purpose or effect; or
- has tax avoidance as one of its purposes or effects, whether or not another purpose or effect relates to business or family dealings, if the purpose or effect is not merely incidental.

Tax avoidance will be defined to include:

- a reduction in the liability to pay tax;
- a postponement in the liability to pay tax;
- an increase in an entitlement to a refund;
- an earlier entitlement to a refund; and
- a reduction in consideration payable for a supply.

MINOR ISSUES, REMEDIAL AMENDMENTS AND CORRECTIONS

Redundant provisions and references repealed

(Clauses 66(3), 70(1), 70(2), 70(3) and (11), 70(6), 73(11) and (14), 83(5), 83(7), 84, 85, 89, 104 and 105)

The following redundant provisions are repealed:

- section 5(3A)
- section 10(20)
- section 20(3)(ea)
- section 20(3A)
- section 20(3AB)
- section 20(3B)
- section 23(2)
- section 27(1)(ea)
- section 82
- section 83

The following redundant references are repealed or replaced:

- The references to sections 23(2), 27(4) and 41(2) in the definition of "due date" in section 2.
- The reference to section 533 of the Local Government Act 1974 in the proviso to section 5(7)(a).
- The references to the "Chatham Islands County Council", "County Council" and "county dues" in section 5(7)(b) will be replaced with references to the "Chatham Islands Council" and "council dues" (as defined in section 2 of the Chatham Islands Council Act 1995) respectively. The application date for these amendments will be 1 November 1995, being the application date of the Chatham Islands Council Act 1995.
- The reference in section 5(13A) to a registered person's taxable activity is corrected.
- The references in section 21(3B) to section FB 5 of the Income Tax Act 1994.

References to the Customs and Excise Act 1996 and the Tariff Act 1988

(Clause 75)

Section 12 will be amended to update incorrect references to the Customs and Excise Act 1996 and the Tariff Act 1988. The updated references to the Customs and Excise Act 1996 will have retrospective application, applying on and after 1 October 1996.

Calculation of output tax

(Clause 83(6))

The reference to “a supply” in section 20(4)(a) will be changed to “the supply” to be consistent with the reference to “a supply” in the wording preceding paragraph (a).

The reference to “that supply” in section 20(4)(b)(i) is also inconsistent with other wording in section 20(4)(b) and will be changed to “the supply”.

No change in meaning is intended by these changes.

Shareholder and director liability

(Clause 98)

Section 61 will be amended to have the same section heading as section HK 11 of the Income Tax Act 1994, which section 61 incorporates into the Goods and Services Tax Act 1985. The section heading will be changed to:

“Liability for tax payable by company left with insufficient assets”.

Other policy changes

GROUP INVESTMENT FUND MANAGEMENT FEES

(Clauses 7, 20, 21, 44 and 109)

Summary of proposed amendment

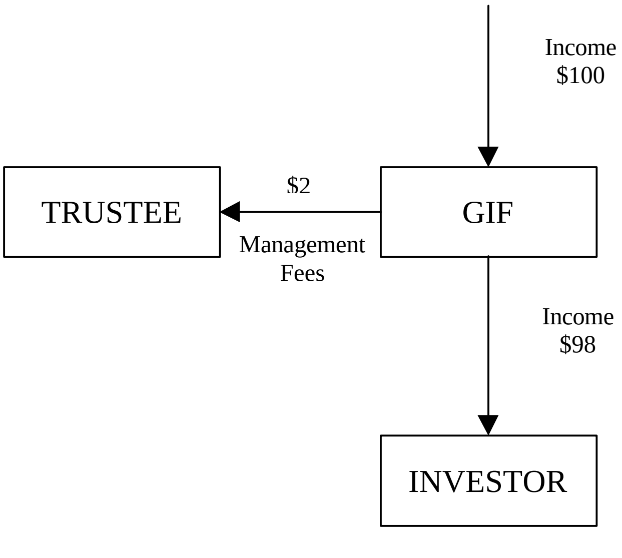
Group investment funds (GIFs) will be allowed to claim deductions for management fees paid to trustee companies on behalf of GIF investors, which will reduce compliance and administrative costs.

Application date

The amendment will apply from 1 April 1993.

Background

Under section 32 of the Trustee Companies Act 1967, trustees of GIFs are prohibited from charging management fees to GIFs. Consequently, it has become industry practice for the GIFs' trust deeds to allow the trustee companies to charge the management fees directly to investors. GIFs deduct these fees from amounts due to investors and pay the management fees to the trustee companies on behalf of the investors. GIFs then distribute the net amount owed to investors. This can be depicted simply as follows:



As it is the investors who incur the management fees, under current law, the investors should claim a deduction for those fees. However, that approach would impose significant compliance and administrative costs, on the GIFs, their investors, and Inland Revenue.

In order to reduce those costs, the law is being amended to allow GIFs to claim a deduction for the management fees involved.

This is an interim measure. The Trustee Companies Act 1967 will be amended to allow trustee companies to charge management fees to GIFs. Until that amendment can be made, the deduction provision in this bill will ensure that GIFs are not disadvantaged for tax purposes by the current practice.

Key features

A new section, section DI 3A of the Income Tax Act 1994, provides that management fees paid by GIFs to trustee companies on behalf of GIF investors will now be able to be claimed as a deduction by the GIF.

An equivalent provision is being added to section 211A of the Income Tax Act 1976, to deal with the period from 1 April 1993 to 31 March 1995, before the Income Tax Act 1994 came into force.

DEDUCTIONS FOR 1998-1999 ACCIDENT INSURANCE BASE PREMIUMS

(Clauses 9 and 11)

Summary of proposed amendments

To ensure that deductions for the 1998-1999 accident insurance base premiums are not deferred beyond the year in which they are paid, the amendment provides that if the base premium is paid on or before a discount date, the deduction may be claimed on the discount date. An exception is when an employer and the ACC have reached an agreement on a due date which is before the discount date. In these cases the deduction can be claimed on the due date.

Two minor amendments clarify that:

- Section ED 1A(3) does not apply to base premiums.
- Interest paid under an instalment plan for payment of a base premium is deductible on the date when the interest is applied, according to the relevant instalment plan.

Application date

All of the amendments apply to 1998-1999 accident insurance base premiums.

Background

Under current law, base premiums payable under the Accident Insurance Act 1998 are deductible in the year in which the premium is due and payable. However, under the Accident Insurance (Payments of Base Premiums) Regulations 1999, some 1998-1999 base premiums may be due and payable on 30 June 2000, but the regulations contain an incentive (by way of a discount) for payment within 30 days from the date of the invoice.

The effect is that, under current law, tax deductions for many of these payments would have been deferred until the year ending 31 March 2001 – the year in which the date 30 June 2000 falls. This would have been the case even if payment was made before 31 March 2000.

To solve this problem the Income Tax Act 1994 is being amended to provide that, generally, if the payments are made on or before the discount date a deduction can be claimed in the year in which the discount date falls. If payment is not made by the discount date, the deduction will be allowed on the due date.

Key features

Section ED 1A of the Income Tax Act 1994 is being amended to provide that:

- If payment of a 1998-1999 base premium is made on or before a discount date, and the discount date is before the due date, the deduction for the base premium can be claimed in the income year in which the discount date falls.
- Subsection (3) does not apply to base premiums.

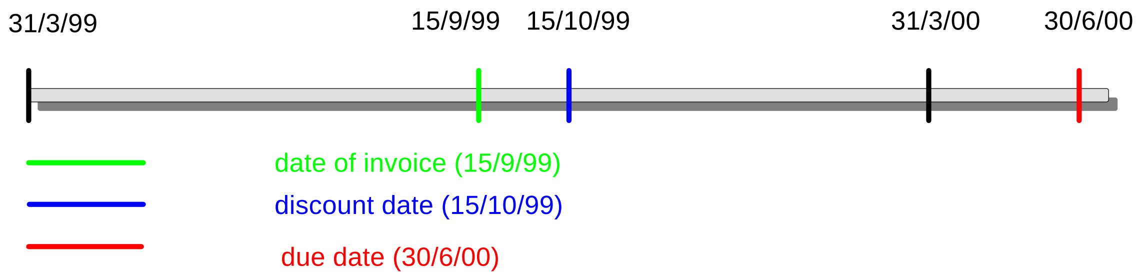
A new section ED 6A provides that interest paid under an instalment plan for payment of a base premium is deductible on the date when the interest is applied, according to the relevant instalment plan.

Detailed analysis

Example – general case

In the general case, payment will be made by the discount date and the due date will be 30 June 2000. Under the amendment, deductions for these payments may be claimed on the discount date. As shown in the following example, the deduction can be claimed on 15 October 1999 instead of 30 June 2000. An employer who has a balance date of 31 March will be able to claim the deduction in the 1999-2000 income year, the year in which it is paid.

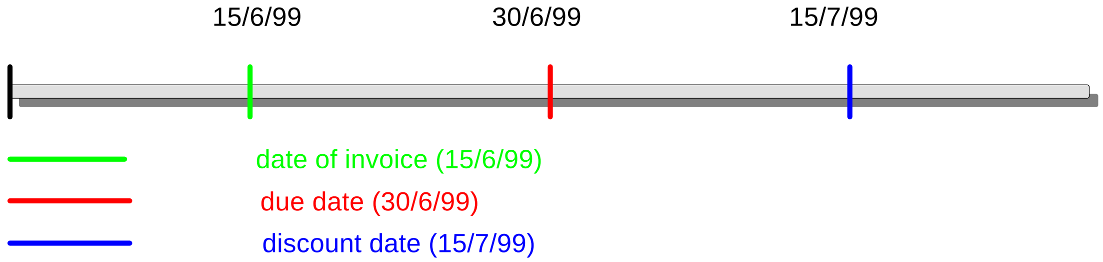
However, if payment is not made by the discount date, a deduction would be allowed on the due date, 30 June 2000.



Although the general rule for some payments is for the due date to be 30 June 2000 with an earlier discount date, there is a provision for the ACC and an employer to agree on a due date other than 30 June. Some employers have requested that the due date be changed so that the deduction can be claimed in the income year in which the payment is made. If a due date earlier than the discount date has been set, a deduction can be claimed on the due date.

Example – ACC and employer set a new due date

In the following example, because the due date is before the discount date, the deduction is claimed on the due date. For an employer with a 30 June balance date, this ensures that payment can be claimed during the 1998-1999 income year, and not deferred until the 1999-2000 income year, as would have happened if the discount date had been treated as the due date.



Minor ancillary amendments

Levies and premiums due on terminal tax date

ACC levies and premiums for self-employed persons are paid on the terminal tax date for income tax payments. Although the terminal tax date has been extended for taxpayers with tax agents, who have an extension of time for filing their income tax returns, the extension does not apply for payment of ACC levies.

Section ED 1A(3) of the Income Tax Act 1994 ensures that those ACC levies and premiums are due on 7 February each year. Theoretically, section ED 1A(3) is irrelevant to base premiums, because they are never payable on the terminal tax date. Payments of premiums due 30 days after an invoice is issued could, nevertheless, be caught by the words of the provision.

A new subsection (3A) is being added to section ED 1A providing that subsection (3) does not apply to base premiums.

Interest on instalment plans

A further issue relates to daily interest paid under an instalment plan for 1998-1999 base premiums of $2,000 or more. Interest is calculated on the basis of 10 per cent of the amount of premium remaining unpaid after 30 June 2000. The interest is applied at each relevant instalment date.

It is not entirely clear when the interest is deductible for tax purposes. For the sake of clarity the Income Tax Act 1994 is being amended to provide that interest is deemed to be due and payable on the relevant instalment date when the interest is applied. A new section, ED 6A, is being inserted to provide for this.

GIFTS OF FINANCIAL ARRANGEMENTS

(Clauses 13, 15, 108, 111 and 112)

Summary of proposed amendment

Financial arrangements transferred for nil or inadequate consideration will be deemed to have been transferred at market value. This amendment will ensure that the transferor of a financial arrangement that is gifted will not receive a deduction under the accrual rules for the value of the financial arrangement.

Application date

The amendment will apply to all financial arrangements gifted since the implementation of the accrual rules (1986), unless a transferor has claimed a deduction in relation to the transfer in a tax return filed by the date of introduction of the bill. If the transferor has already claimed a deduction, the existing provisions will apply for both the transferor and the transferee.

Background

Following the decision of the Court of Appeal in *Auckland Harbour Board* v *CIR* in September 1999, the transferor of a financial arrangement that is gifted is able to receive a deduction under the accrual rules for the value of the financial arrangement. This result was unintended and is undesirable for two reasons:

- Such a deduction is inconsistent with the monetary limit placed on rebates and deductions for cash gifts.
- A deduction for gifts is inconsistent with the function of the base price adjustment mechanism and allows tax-planning opportunities.

To address this problem, and prevent the transferor from receiving a deduction, a financial arrangement transferred for nil or inadequate consideration will be deemed to be transferred at market value.

Key features

Section EH 16(3) (Division 1) and section EH 49(1) (Division 2) of the Income Tax Act 1994 are to be amended to provide that all financial arrangements transferred for inadequate consideration are deemed to be transferred at market value. At present, the transfer is deemed to be at market value only when the transferor purchases the financial arrangement to sell or dispose of it, or the transferor’s business includes dealing in financial arrangements.

The amendment will prevent the transferor of a financial arrangement that is gifted from receiving a deduction under the accrual rules for the value of the financial arrangement. Section 64J(3) of the Income Tax Act 1976 is to be amended in the same way.

Consequentially, sections 75BA, 75BB and 75BC will be added to the Estate and Gift Duties Act 1968 to ensure that gift duty will not be levied when the market value rule is applied.

FOREIGN TAX CREDITS

(Clauses 17, 25, 26, 27, 28 and 29)

Summary of proposed amendments

Anti-avoidance amendments are being made to:

- put beyond doubt that foreign tax credits can be reconstructed in a tax avoidance arrangement;
- deny a foreign tax credit, and require disclosure, when an equivalent benefit is provided to the taxpayer or an associate; and
- allow the schedule of countries with abusive tax practices for which New Zealand provides only limited recognition of taxes paid to be updated through an Order in Council.

Application date

The amendments apply from 5 April 2000, the date of the Government's announcement on this legislation.

Background

On 2 June 1994 the Taxation Reform (Companies and Other Matters) Bill was introduced and referred to the Finance and Expenditure Committee. The bill contained anti-avoidance measures to prevent the abuse of foreign tax credits by denying taxpayers credits for foreign tax when, in substance, the tax has not been paid.

In particular, the measures were aimed at situations where a taxpayer seeks a credit in New Zealand for tax paid in a foreign country, but the taxpayer or an associated person receives, in effect, a refund of the foreign tax. These measures were to apply to tax credit benefits received from 2 June 1994.

The bill also included an amendment to the general anti-avoidance provision in the Income Tax Act 1994. Although it was always the Government's view that the current anti-avoidance provisions would apply, the amendment was to put beyond doubt that this provision can be used against tax avoidance schemes that involve the use of tax credits.

There was also an amendment to allow the use of an Order in Council rather than legislative change to update the list of countries with abusive tax practices for which there is a blanket denial of foreign tax credits for taxes paid. This was to expedite the process by which countries could be added and taken off the list.

Consideration of these provisions was deferred by the Finance and Expenditure Committee until the Commission of Inquiry into Certain Matters Relating to Taxation (commonly referred to as the “wine-box inquiry”) had reported.

The Commission of Inquiry has reported. Consistent with its recommendations, the Government considers it remains desirable for the foreign tax credit anti-avoidance measures to be enacted. However, rather than have the Finance and Expenditure committee report back to the House on the original bill, the amendments have been included in the present bill. This will give interested parties the opportunity to comment further on the amendments before they are enacted.

The amendments, as originally introduced, were to take effect from 2 June 1994. However, it is now proposed that they apply from 5 April 2000. This later application date avoids the need to make complicated retrospective amendments to the now repealed Income Tax Act 1976.

Key features

- New subsections GB 1(2A) to (2C) of the Income Tax Act 1994 enable Inland Revenue to disallow tax credits in whole or in part if the credits are part of an avoidance arrangement.
- New subsections LC 1(3A) to (3B) ensure that when a refund of foreign tax has been received either by taxpayers or their associates, a tax credit will not be allowed against New Zealand tax.
- Section LC 13(b) is being amended to oblige taxpayers who are claiming tax credits for foreign tax paid to disclose to Inland Revenue any refunds of foreign tax paid to them or an associate.
- Section LC 3 is being amended to enable full recovery of any foreign tax credit allowed in New Zealand when the underlying foreign tax has been refunded.
- New Section LC 1A allows amendment to Schedule 6 by Order in Council. New Zealand does not allow tax credits for foreign taxes paid in countries listed in Schedule 6, as these countries have abusive tax practices.

ALIENATION OF INCOME FROM EMPLOYMENT

(Clauses 5, 6, 8, 18 and 40)

Summary of proposed amendment

The bill introduces an anti-avoidance rule broadly aimed at employees who circumvent the top personal tax rate of 39 percent by interposing a company, trust or partnership between themselves and their employer in order to have their income taxed at a lower rate. The rule will attribute what generally is, in substance, employment income to the employee. It supports the general anti-avoidance provisions of the Income Tax Act 1994.

The attribution rule will apply for income tax purposes only, and will not have any impact on the commercial and/or legal consequences of transactions entered into by the interposed entity.

Application date

The attribution rule will apply from the income year beginning 1 April 2000, to coincide with the date on which the 39 percent top personal tax rate took effect. Arrangements made before 1 April 2000 will be subject to the rule.

Background

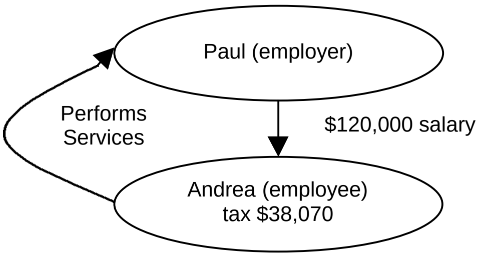
The attribution rule addresses the need to protect the PAYE tax base following the increase in the top personal tax rate, from 1 April 2000, to 39 percent. Anecdotal evidence suggests that simple avoidance schemes are being targeted at employees.

Income tax legislation already contains general anti-avoidance rules that can be used to counter such avoidance activity. Experience has shown, however, that they are time-consuming and costly to apply. Relying on these rules to counter the expected rise in cases of alienation of income by employees would mean that the results would most likely not become public through the courts for several years.

Such delays could seriously erode the additional tax revenue intended by raising the top personal tax rate to 39 percent. The proposed legislation addresses this problem by providing explicit rules. This legislation closely follows the detail of the proposal announced by the Government on 30 March 2000.

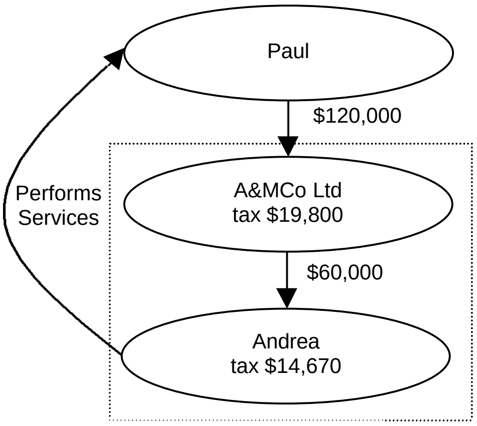
HOW THE AVOIDANCE SCHEMES WORK

In this simple example, Andrea is employed by Paul. Paul pays Andrea an annual salary of $120,000. Before 1 April 2000, Andrea's annual tax liability would be $34,470. However, with the top tax rate increasing to 39%, her annual tax liability after 1 April 2000 would increase to $38,070:


Paul (employer)
Performs Services
$120,000 salary
Andrea (employee) tax $38,070

$38,000 @ 19.5%	=	$7,410
$22,000 @ 33%	=	$7,260
$60,000 @ 39%	=	$23,400
		$38,070

Andrea, therefore, now has a greater incentive to structure her employment arrangement to reduce her tax liability. By forming and interposing a company, A&MCo Ltd, between herself and Paul, and drawing only $60,000 income from the company, the 39% tax rate could be avoided, and the total tax levied on the $120,000 income would remain at $34,470:


Paul
$120,000
Performs Services
A&MCo Ltd tax $19,800
$60,000
Andrea tax $14,670

Andrea:		
$38,000 @ 19.5%	=	$7,410
$22,000 @ 33%	=	$7,260
		$14,670
A&MCo Ltd:		
$60,000 @ 33%	=	$19,800
Total:		$34,470

The attribution rule will operate to ensure that the full $120,000 income is attributed to Andrea, as the person who has performed the personal services giving rise to the income.

Key features

The main legislation proposed is new sections GC 14B to GC 14D of the Income Tax Act 1994.

The attribution rule is generally intended to apply when:

- an employee (person C) has structured his or her employment relationship;
- to interpose an entity (person B) between themselves;

- and their employer (person A);

if the result is that income is diverted, or alienated, to an associated person to take advantage of the associated person's lower marginal tax rate. The effect of the attribution rule will be to attribute person B's net income from services to person C, the one who personally provided the services. The use of net income means that any deductible expenses incurred by person B will still be deductible.

The rule will apply only when four key criteria are met:

- The "employee", person C, and the interposed entity, person B, must be associated persons.
- Eighty percent of the gross income from the services of person B must be derived from a single source, person A, or persons associated with A.
- Eighty percent of the gross income from the services of person B must relate to the services personally provided by person C, and related persons.
- Substantial business assets are not a necessary part of the business structure that is used to derive the income from services.

Substantial business assets are defined as being depreciable assets whose cost is the lesser of $75,000 or 25 percent or more of gross income from services. Generally, the assets must not be privately used, although if the asset is a vehicle, up to 20 percent private use is allowed.

The amount to be attributed is the lesser of the net income from services or the net income of person B, with allowance being made to reduce the amount by income distributed by person B to person C in the form of beneficiary or partner income or as dividends.

If the amount that would otherwise be attributed under this rule is less than $5,000, the rule does not apply.

The amount attributed will be deemed to be gross income of person C and a deductible expense of person B.

Detailed analysis

The main provisions are new sections GC 14B to GC 14D:

- Section GC 14B defines the circumstances in which the rule will apply.
- Section GC 14C quantifies the amount to be attributed.
- Section GC 14D provides for the $5,000 minimum threshold.

Section GC 14B – the application

Subsection (1) sets out the general proposition that when person B provides services personally performed by person C and persons B and C are associated, the attribution rule could apply.

The words “services personally performed” indicate that a natural person performs the services.

Criteria to apply the rule

Subsection (2) sets out the criteria to be met before the rule applies:

- Eighty percent of the gross income from services of person B must be derived from a single source, person A, or persons associated with A.
- Eighty percent of the gross income from services of person B must relate to the services personally provided by the “employee”, person C, and related persons.
- Substantial business assets are not a necessary part of the business structure that is used to derive the income from services.

The 80 percent level is arbitrary, but has been set to provide a suitable balance between what might or might not otherwise be a genuine employer/employee situation.

Subsection (3) provides that persons are associated for the purposes of the attribution rule if they meet the criteria of sections OD 7 or OD 8(3).

Substantial business assets

Subsections (4) to (6) provide a definition of “substantial business assets” as being depreciable property whose cost is the lesser of:

- $75,000; or
- 25 percent or more of gross income from services;

so long as the property is not used privately. Vehicles are excepted from this private use prohibition if their private use is 20 percent or less of total use. This recognises that in most small enterprises there will usually be some private use of vehicles. Private use is measured as appropriate, as either:

- days in which fringe benefit tax is payable as a percentage of days the vehicle is leased or owned; or
- the proportion of expenditure that is non-deductible in relation to the total expenditure on the vehicle.

The substantial business assets test is designed to recognise that when substantial business assets are used there should also be a return on capital that does not relate to the services personally performed by person C. For example, the owner/driver of a petrol tanker should receive a return based on both assets employed and on labour provided.

Structures involving multiple entities

In relation to one person C there may be more than one person B. In this case the rule still works, however, because it considers each person B separately and focuses on those persons B that have net income. Each such person B will have to consider the rule to see whether it needs to attribute income.

Section CG 14C – the calculations

Person B may have more than one source of income. For example, the one entity may have a share dealing business and, as well, be providing professional accounting services to one user. On the assumption that the qualifying criteria are met in relation to the accounting services income, the issue then becomes a question of how much to attribute.

Clearly, one of the relevant amounts is the determination of the net income from services. Equally clearly, it is appropriate to ignore any net income from the share dealing activity. However, if the share dealing activity makes a loss for any one year, it seems reasonable to allow the loss to reduce the services income for that year as in many cases this loss would be accessed and used anyway.

Therefore section GC 14C(1) requires that the amount to be attributed is the lesser of:

- person B’s net income from services; or
- person B’s net income.

Subsection (2) qualifies this when person B is the trustee of a trust or a partnership. If person B is a trust, the calculations for person B are required to be completed as if it had not distributed any of its income to beneficiaries. If it is a partnership, person B is to be regarded as a taxpayer – ordinarily partnerships do not have net income; rather their income and expenditure are attributed to the partners.

It is intended that the “net income from services” is after allowing for what are loosely termed “head office expenses” – the expenses of running the business, such as accounting and company office fees.

Furthermore, person B’s net income from services allows that the monetary remuneration package paid to or on behalf of person C is an expense of deriving its “net income from services”. This package includes wages and salary, directors fees, attributable fringe benefits provided and fringe benefit tax. So long as person C receives the net service income as gross income, the rule does not seek to attribute anything more.

Subsection (3) provides that any salary paid or fringe benefits provided by person B to person C will, for the purposes of determining person B’s net income from services, be regarded as an expense.

In a similar fashion, subsection (4) provides any amount to be attributed by person B is reduced if:

- person B is a trust, the amount of any beneficiary income distributed to person C;
- person B is a partnership, the amount of any partnership income received by person C;
- person B is a company, the amount of dividends paid to person C during the year, or within six months afterwards, in respect of the year's income.

Although it is not possible to trace income through a company to a dividend paid to its owners, it will be acceptable, so long as the facts do not otherwise indicate, that the resolution declaring the dividend refers to the year's income to which it relates.

Any dividends paid by person B to persons other than person C from the income before it was attributed will not be "reversed" as a result of applying this attribution rule, since it would be difficult to deal with the myriad of situations that could arise.

Subsection (5) provides that if the amount paid by person B to person C by way of beneficiary or partnership income or by dividend is greater than the subsection (1) amount to be attributed, the attribution rule does not apply.

Subsection (6) provides that if there is more than one person C in relation to a person B (for example, husband and wife have both provided services) the amount to be attributed must be fairly divided between them, based on the relative value of work they have performed. Although this is not likely to apply very often, any reasonable basis of apportionment will be acceptable.

Section GC 14D

This section provides the $5,000 minimum threshold. If the amount calculated under section GC 14C is less than $5,000, no attribution need be made. Where, in relation to any one service provider (person C) there is more than one person B, the $5,000 threshold applies only once.

Other changes

Sections CD 8 and DJ 19 are inserted to provide that any amount attributed is gross income of person C and an allowable deduction to person B respectively. This has the effect of reducing person B's income by the amount attributed and should generally prevent double taxation of the one amount of income.

The section OB 2 definition of "source deduction payment" is being amended to ensure that amounts attributed are not source deductions, so they will not be subject to tax at source. Rather, person C will have to account for the income tax.

Section CF 6(1) is being amended to require that dividend amounts for ascertaining the amount to be attributed include imputation credits.

TAX SIMPLIFICATION FOR WAGE AND SALARY EARNERS

Summary of proposed amendments

The bill makes a number of small policy changes and remedial amendments aimed at supporting the tax simplification measures enacted in 1998. The policy changes include removing the need for certain applicants for family support to provide tax file numbers or evidence of employment, and allowing some taxpayers to claim rebates early.

Application date

The amendments support processes that began with the start of the 1999-2000 income year, and apply from that time.

Background

Major tax simplification initiatives were enacted by the Taxation (Simplification and Other Remedial Matters) Act 1998, which removed the need for wage and salary taxpayers to file IR 5 returns. A number of minor amendments in this bill either improve the processes that underlie those reforms or are remedial in nature.

Key features

Amendments to the Income Tax Act 1994 and the Tax Administration Act 1994:

- remove the need for applicants for family assistance to provide tax file numbers or evidence of employment in certain circumstances;
- extend the time tax agents have to return income statements;
- allow rebates to be claimed early in certain circumstances; and
- give taxpayers who receive an income statement issued after terminal tax date two months to review it before it becomes an assessment.

Detailed analysis

Family assistance
(Clauses 22, 23 and 24)

Families with low employment income are entitled to tax credits. Three amendments will make it simpler for families to apply for the credits and increase the efficiency with which the credits are administered.

Children for whom family assistance is claimed must have tax file numbers. This is a compliance measure designed to reduce the amount of information that taxpayers need to provide and to mitigate the risk of multiple claims being made for the same child. In circumstances where the child has been given up for adoption or has died, those compliance issues may be outweighed by the stress of payments being delayed until tax file numbers are provided. In those situations other methods of identification may be more appropriate, such as the child's birth certificate. Birth certificates and similar documentation are used as identification in the administration of the child support rules.

Sections KD 4 (2A) and KD 5 (2)(c) of the Income Tax Act 1994 are being replaced and a new section KD 5 (2AB) is inserted to allow evidence other than tax file numbers to verify the existence of a child for whom family assistance is being claimed.

Applicants for interim instalments of family assistance are required to provide evidence of their income from employment for a specified period. This information is necessary to verify their entitlement. Changes to the way wage and salary information is collected by Inland Revenue have made it unnecessary for applicants with only wage and salary income to provide this information.

A new section KD 5(2)(2AA) is being inserted into the Income Tax Act 1994 to provide an exemption to subsection (2)(a) of the same section if an applicant for family assistance has income only from employment.

Inland Revenue is required to provide a certificate showing the amount of interim payments of family assistance paid to IR 3 taxpayers by 20 April following the end of the year in which the payments are made. The information is intended to help taxpayers self-assess their tax liability. Administrative processes have been designed to provide that information to taxpayers, with other related documents within a month of the certificate being due. Delaying the requirement on Inland Revenue to provide information about the interim payments until 20 May will make administering the system more efficient, prevent confusion that may result from duplicating the information and give taxpayers the information at an appropriate time to help them meet their tax obligations.

The requirement in section KD 7(2A)(a) of the Income Tax Act 1994 that Inland Revenue provide a summary of interim payments by 20 April is being amended to 20 May following the year in which the payments are made.

Terminal tax date

(Clauses 37, 50, 51, 53 and 54)

The terminal tax date for taxpayers with agents is generally two months later than for other taxpayers. When the tax simplification reforms were legislated, this extended terminal tax date was inadvertently omitted for taxpayers who receive an income statement.

Section NC 17(2)(b) is being replaced with a provision that includes taxpayers who receive an income statement and who also have a tax agent within the group entitled to an extended terminal tax date, to restore consistency of treatment for all taxpayers with agents. Consequential amendments are made to sections 80B, 80C, 80F and 80H of the Tax Administration Act 1994 to ensure that processes supporting income statements are consistent with the extended terminal tax date.

Procedure to claim rebates
(Clauses 39, 41 and 64)

Section 41A of the Tax Administration Act 1994 allows rebates to be claimed only after 1 April following the end of the income year in which donations or housekeeper and childcare expenses are incurred. Standard balance date taxpayers must claim these rebates by 30 September. Not allowing rebates to be claimed before the end of the income year may significantly disadvantage certain taxpayers, such as those who intend to leave the country before the end of the year, or a trustee of an estate who is unable to wind up the estate until a rebate is claimed.

New sections 41A (6AA) and (6AB) in the Tax Administration Act 1994 are being inserted to allow rebates to be claimed early in prescribed circumstances.

A redundant reference is being removed from the definition of “refundable rebate” in section OB 1 of the Income Tax Act 1994.

Section 184A (5) of the Tax Administration Act 1994 is being replaced with a new definition of tax that includes refunds allowed under section 41A. This means that rebates, like refunds of tax, levies, and duties will be direct credited.

Income statements
(Clause 54)

Income statements are expected to be issued well before the terminal tax date, at which time they become assessments of tax liability. An unintended exception to this rule is an income statement issued after the terminal tax date. Because these income statements are deemed to be assessments from the terminal tax date, taxpayers lose the ability to review and correct them before they become assessments.

A new section 80H (6) in the Tax Administration Act 1994 deems income statements issued on or after terminal tax date to be assessments two months after they are issued. The two-month period gives taxpayers time to review and correct the statement before it becomes an assessment and, therefore, increases the certainty with which taxpayers self-assess.

RWT ON INTEREST PAID BY INLAND REVENUE

(Clause 38)

Summary of proposed amendment

The amendment prevents over-deduction of resident withholding tax on interest paid by Inland Revenue.

Application date

The amendment will apply from the 1999-2000 income year.

Background

Resident withholding tax must be deducted from interest paid by Inland Revenue. If the underlying overpayment of tax is revised upwards, interest paid with respect to that overpayment is recalculated. At present, it is uncertain whether the resident withholding tax rules require tax to be deducted from both interest payments. Deduction from both interest payments can lead to over-deduction of resident withholding tax.

Key feature

A new section NF1(3A) requires Inland Revenue to take into account interest that has previously been calculated in relation to the same underlying overpayment.

INCOME TAX RATES

(Clause 113)

Summary of proposed amendment

The bill confirms the annual income tax rates that will apply for the 2000-2001 income year.

The annual rates to be confirmed include:

- The 39 percent rate applying to individuals and unincorporated bodies with income exceeding $60,000; and
- The proposed specified superannuation contribution withholding tax (SSCWT) rate of 39 percent that will apply to employer's contributions to a superannuation fund if the employer elects to pay specified superannuation contribution withholding tax at this rate.

Application date

The amendment will apply for the 2000-2001 income year.

Background

The Income Tax Act 1994 provides for the rates of income tax specified in the First Schedule of the Act to be confirmed each year. The new 39 percent income tax rate was enacted in December 1999. The proposed 39 percent SSCWT rate is part of the Taxation (FBT, SSCWT and Remedial Matters) Bill, currently before Parliament.

Key features

The rates listed in Schedule 1 of the Income Tax Act 1994 will be confirmed for the 2000-2001 income year.

INCREMENTAL PENALTY FOR LATE PAYMENT OF TAX

(Clause 57)

Summary of proposed amendment

The incremental penalty for late payment of tax is to be reduced from 2 percent to 1 percent each month that tax is overdue. This is a simplification measure designed to support penalties without creating a preference for paying trade creditors.

Application date

The amendment applies from the 2001-2002 income year.

Background

The discussion document *Less Taxing Tax,* released in September last year, considered a number of tax simplification proposals aimed at small businesses. Measures it proposed to increase the leniency and flexibility of treatment given to those with overdue tax received wide support. Those measures also had earlier formed part of the recommendations made by the Finance and Expenditure Committee’s inquiry into the powers and operations of the Inland Revenue Department.

The incremental late payment penalty is designed to provide a clear, continuing incentive to pay overdue tax. Although the penalty must be significant enough to create a preference for paying Inland Revenue over trade creditors, and so that complying taxpayers can see that non-compliance is punished, reducing it to one percent achieves those objectives while increasing the fairness and integrity of the tax system. Penalties should not exceed the levels necessary to achieve their objectives. The reduction will also prevent penalties accumulating to the extent they are perceived to be out of proportion to the underlying overdue tax and reduce pressure on processes used to mitigate imposition of the penalty. The measure is, therefore, expected to reduce both compliance and administrative costs.

Key feature

Section 139B(2)(b) of the Tax Administration Act 1994, which sets the rate of the penalty, is being amended to reduce that rate to 1 percent a month.

GRACE PERIOD FOR USE-OF-MONEY INTEREST

(Clause 63)

Summary of proposed amendment

The grace period from use-of-money interest given to taxpayers who receive a statement of account for overdue tax is being increased from fifteen days to thirty days. This is a simplification measure designed to make it easier for taxpayers to meet their obligations to pay overdue tax.

Application date

The amendment applies from the 2001-2002 income year.

Background

This simplification measure also arises from the Finance and Expenditure Committee inquiry and is discussed in *Less Taxing Tax.*

Use-of-money interest is applied on overdue tax payments to compensate the Government for the tax deferral. However, interest applicable to the period between the issue of a statement of account and when the payment is made is eligible to be cancelled if the payment is made within fifteen days of the statement being issued. This is a measure designed to provide certainty by creating a period for payment in which daily interest calculations do not need to be made to determine the total amount of tax and interest payable.

In practice, the grace period has proved too short to be effective, particularly for taxpayers with agents. By extending the grace period to thirty days, taxpayers and their agents will have considerably longer in which to make payments without the need to make additional interest calculations. The extended period of certainty reduces the cost of meeting tax obligations.

Key feature

Section 183C (4)(b) of the Tax Administration Act 1994, which sets the grace period, is being amended to increase that period to thirty days.

SERIOUS HARDSHIP AND FINANCIAL DIFFICULTY

(Clauses 48, 60, 61 and 62)

Summary of proposed amendments

The types of taxes that are eligible to be cancelled, remitted or the subject of an instalment arrangement will be extended from income tax and fringe benefit tax to include all taxes.

It will be unnecessary for Inland Revenue to obtain the approval of the Minister of Finance to remit tax, refund it or enter instalment arrangements for amounts in excess of $50,000.

These are simplification measures designed to reduce the costs and stress associated with overdue tax payments by increasing certainty in, and the speed, of the processes that grant relief in relation to that debt.

Applications to Inland Revenue to pay overdue tax by instalments no longer need to be in writing.

Application date

The extension of the relief provisions to all tax types applies to tax that is payable on or after the 2001-2002 income year. The requirement that applicants for instalment arrangements be in writing is removed from the date of enactment.

Background

This is a further initiative arising from the Finance and Expenditure Committee inquiry and is discussed in *Less Taxing Tax.*

The serious hardship and financial difficulty provisions in the Tax Administration Act 1994 apply only to income tax and fringe benefit tax. In practice, however, taxpayers can face serious hardship and financial difficulties in meeting other tax obligations. In such cases Inland Revenue has been using care and management authority to provide a measure of relief.

Extending the relief provisions to all tax types is expected to provide greater clarity and transparency of processes that deal with taxpayers whose circumstances are stressful. Applying the extension to the instalment arrangement provisions creates a more coherent package of relief provisions.

Awaiting ministerial approval of relief arrangements can be a time-consuming procedure that causes stress and anxiety for taxpayers. The delay may often affect the taxpayer's economic circumstances and may act to reduce revenue collection. The need for approval is also inconsistent with the separation of the Commissioner's statutory role of day-to-day tax administration from the Minister's role of political oversight.

Removing both that requirement and the requirement that applications for instalment arrangements in cases of financial difficulty be in writing have the advantage of streamlining the relief process. It will result in administrative cost savings for Inland Revenue and reduce compliance costs for taxpayers, particularly by reducing the stress associated with waiting for approval.

Key features

Four key amendments are being made to the remission and relief rules in the Tax Administration Act 1994:

- A new definition of "tax" for the purposes of sections 176 and 177 is inserted into section 3.
- The subsections in section 176 that impose the requirement for ministerial approval and define the taxes eligible for relief are repealed.
- Section 177 is amended for the current year, making it clear that applications for remission still need to be in writing.
- Section 177 is replaced from the 2001-2002 income year.

Remedial amendments

FINANCIAL ARRANGEMENT TERMINOLOGY

(Clause 14)

Summary of proposed amendment

Section EH 18 of the Income Tax Act 1994 is being amended to clarify its intended effect.

The amendment to section EH 18(1) will ensure that provisions of the Income Tax Act 1994 that were amended by the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 to reflect terminology changes in the accrual rules continue to apply to Division 1 financial arrangements.

Section EH 18(2) and (3) is being amended to provide that where there is duplication of provisions in Division 1 and elsewhere in the Act, the Division 1 provisions apply to Division 1 financial arrangements.

Application date

These amendments will apply from 20 May 1999, the date that section EH 18 came into effect. Inland Revenue indicated to taxpayers in a *Tax Information Bulletin* in October 1999 that it would recommend to the Government that the section be clarified, with retrospective effect.

CONSOLIDATED GROUPS AND FINANCIAL ARRANGEMENTS

(Clauses 16 and 19)

Summary of proposed amendment

The consolidated filing rules are being amended to ensure that dividends resulting from the remission of certain debt between members of a consolidated group are not inappropriately excluded from the gross income of the consolidated group. The concern arises from the remission of debt that was in place before the election to form the consolidated group became effective.

This remission can, depending on the facts, be dealt with as a base price adjustment or as a dividend. If it is a base price adjustment it is currently brought to account. If it is a dividend, however, it is currently excluded from income.

Application date

The amendment applies from the date of introduction of the bill.

Background

The recent reform of the accrual rules identified a deficiency concerning debt remission within a consolidated group. This concerns the situation where debt is remitted by a member of a consolidated group to another member of the consolidated group. If the debt was in place before the companies became members of the consolidated group, any remission is intended to result in gross income being derived.

If a remission results in income under the accrual rules, the outcome is appropriate. However, frequently the result will be a dividend under section CF 2(1)(b) and, depending on the corporate structure, section CF 2(1)(k). Such a dividend would generally not qualify for the wholly owned group companies intra-group dividend exemption. Section HB 2(1)(a)(i) and (ii) results in such dividends not being gross income.

Key features

New sub-paragraph HB 2(1)(a)(vi) of the Income Tax Act 1994 now includes dividends resulting from the remission of debt between members of a consolidated group if that debt was in place before the consolidation became effective in the gross income of the consolidated group.

As well, the interaction of sub-paragraphs HB 2(1)(a)(iv) and HB 2(1)(a)(v) is clarified so that they act independently, not conjunctively.

PARENTAL TAX CREDIT

(Clause 23)

Summary of proposed amendment

A new section, KB 5(1BA), is being introduced into the Income Tax Act 1994. It ensures that when the three-month application period for the parental tax credit spans two income years and the family chooses to apply for the credit in the second income year, the credit will be abated against income earned in the second year.

This is in keeping with the original policy intent and merely legislates for current administrative practice.

Application date

The amendment will be backdated to apply from 1 October 1999, the date from which the parental tax credit first applied.

FOREIGN INVESTOR TAX CREDIT RULES

(Clause 33)

Summary of proposed amendment

Section LE 3 of the Income Tax Act 1994 will be amended to address an anomaly in the foreign investor tax credit (FITC) rules. Section LE 3 allows the FITC rules to be used when a New Zealand holding company is interposed between the paying company and the non-resident shareholder. The rules were amended in 1998 to prevent section LE 3 applying when the holding company is a member of a consolidated group. That amendment, however, was too broadly worded, and inadvertently prevents the mechanism applying in some cases when the FITC rules should legitimately apply.

Application date

The amendment will apply to dividends paid on or after 12 December 1995, to match the date on which the 1998 amendment took effect.

HOUSING NEW ZEALAND

(Clauses 46 and 110)

Summary of proposed amendment

The amendments to Schedule 18 of the Income Tax Act 1994 and Schedule 14 of the Income Tax Act 1976 confirm that Housing New Zealand Ltd (HNZ) is to be taxed as if it were a state enterprise from the date of its inception in 1992 to 4 June 1999. The policy intention was for HNZ to be taxed as if it were a state enterprise, but an Order in Council providing for that status was overlooked until 4 June 1999.

Application date

The amendment applies for the period 1 July 1992 to 4 June 1999.

DEFINITION OF “TAX”

(Clause 48)

Summary of proposed amendment

This remedial amendment will have the effect of restoring the scope of the definition of “tax” for the purpose of the care and management provisions of the Tax Administration Act 1994. When those provisions were originally enacted they applied to all revenues and entitlements covered by the Inland Revenue Acts.

Application date

Because the earlier amendment that limited the scope was effective from 1 0ctober 1996, the amendment will be retrospective to that date.

Background

The Commissioner is expressly charged with the care and management of the taxes covered by the Inland Revenue Acts and with any other functions conferred on him or her.

A 1995 amendment, however, inadvertently excluded particular references such as the approved issuer levy, use-of-money interest, student loan repayments and financial support from the scope of the care and management provisions.

Key feature

A new paragraph is included in the definition of “tax” in section 3 of the Tax Administration Act 1994. The effect is that for the purposes of the care and management provisions (sections 6 and 6A of the Tax Administration Act 1994) “tax” will include all revenues, repayments and entitlements covered by the Inland Revenue Acts.

PROVISIONAL TAX FOR THOSE CHANGING BALANCE DATES

Minor remedial amendments are required to the rules introduced in the Taxation (Remedial Provisions) Act 1997, which established provisional tax rules for those who change their balance date. The complexity of these rules and their interaction with subsequent legislation has raised potential for uncertainty in their application. All the amendments in the bill act to confirm the policy underlying the rules that came into effect from the 1998-1999 income year.

Calculation of residual income tax in a transitional year

(Clause 34)

Summary of proposed amendment

Residual income tax of the preceding year is used to calculate the provisional tax liability for the current year. If the preceding year was a transitional year, residual income tax for that year needs to be adjusted to take into account the length of the transitional year. An amendment to section MB 2(6) and (7) of the Income Tax Act 1994 is being made to ensure that it does so. The amendment also clarifies that the relevant base year is the year before the immediately preceding income year.

Application date

The amendment applies to payments of provisional tax for the 1998-1999 income year that are due on or after 7 July 1998.

Election to become a provisional taxpayer

(Clause 35)

Summary of proposed amendment

Taxpayers can elect to become provisional taxpayers if they have paid $2,500 of provisional tax by the third instalment date for provisional tax. Taxpayers with a transitional year may have their tax payments spread over six instalment dates, with only half being paid by the third instalment date, and therefore find that they are ineligible to elect to become provisional taxpayers. An amendment to section MB 2A(1) in the Income Tax Act 1994 will allow taxpayers who have paid provisional tax of $2,500 by their final instalment date to elect to become provisional taxpayers.

Application date

The amendment applies from the beginning of the 1998-1999 income year.

Provisional tax obligations during the transitional year

(Clause 36)

Summary of proposed amendment

Applications for non-standard balance dates can be approved in the period after the end of the income year in which the application is made, but before the end of the transitional year. An amendment is being made to section MB 5A(1) of the Income Tax Act 1994 to confirm that the transitional provisional tax rules apply in that period.

Application date

The amendment applies from the beginning of the 1998-1999 income year.

Calculation of transitional year provisional tax

(Clause 36)

Summary of proposed amendments

A new section MB 5A(1A) of the Income Tax Act 1994 clarifies that the total amount of provisional tax that is payable is the total of all instalments due in the transitional year. It removes inconsistencies that can arise in the calculations undertaken to monitor and inform taxpayers of their liability. Consequential changes are made to sections MB 5A(5), MB 5A(6) and MB 5A(7), which calculate the amount of individual instalments due in a transitional year.

Application date

The amendments apply from the beginning of the 1998-1999 income year.

Interest on transitional year provisional tax

(Clauses 36 and 56)

Summary of proposed amendments

Use-of-money interest is charged on underpaid provisional tax. The provisional tax rules are prevented from applying before a new provisional taxpayer starts up a business. Amendments to sections MB 5A(4) of the Income Tax Act 1994 and 120K of the Tax Administration Act 1994 are being made to prevent use-of-money interest from applying before the business starts up.

Application date

The amendments apply from the beginning of the 1998-1999 income year.

Definition of “provisional taxpayer” in section OB 1

(Clause 39)

Summary of proposed amendment

The provisional tax rules inappropriately apply to all taxpayers entitled to become provisional taxpayers. An amendment is being made to the definition of “provisional taxpayer” in section OB 1 of the Income Tax Act 1994 to exclude taxpayers from the application of the provisional tax rules if they have not elected to become provisional taxpayers.

Application date

The amendment applies from the beginning of the 1999-2000 income year.

Definition of “new provisional taxpayer”

(Clauses 39 and 48)

Summary of proposed amendment

The existence of separate definitions of “new provisional taxpayer” in the Income Tax Act 1994 and Tax Administration Act 1994 have the potential to create confusion. The definition in section 3(1) of Tax Administration Act 1994 is being repealed, leaving the broader definition in section OB 1 of the Income Tax Act 1994 to apply to both Acts. Because the Income Tax Act 1994 definition covers natural persons, a number of consequential amendments are being made to rules that apply use-of-money interest to new provisional taxpayers who are natural persons. The definition of “new provisional taxpayer” in section OB 1 of the Income Tax Act 1994 is being amended at the same time to correct a previous omission that excludes natural persons acting in their capacity as a trustee.

Application date

The amendment applies from the beginning of the 2000-2001 income year.

Payments due after new provisional taxpayer starts business

(Clause 45)

Summary of proposed amendment

The method of calculating the number of provisional tax instalments in a transitional year can result in a provisional tax liability for new taxpayers before they start up business. An amendment is proposed to Schedule 13 Part B of the Income Tax Act 1994 to prevent such a liability from arising.

Application date

The amendment applies from the beginning of the 1998-1999 income year.

Late payment penalty for unpaid provisional tax during a transitional year

(Clause 58)

Summary of proposed amendment

Late payment penalties are payable on unpaid provisional tax during a transitional year. Section 139C(2) of the Tax Administration Act 1994 is being re-enacted to confirm that that the penalty should be calculated on a basis that includes provisional tax payable during a transitional year.

Application date

The amendment applies from the beginning of the 1998-1999 income year.