
Rewriting the Income Tax Act

Exposure Draft

Part G

Land and Income Assessment Act 1891
Land and Income Assessment Act 1900
Land and Income Assessment Act 1908
Land and Income Tax Act 1916
Land and Income Tax Act 1923
Land and Income Tax Act 1954
Income Tax Act 1976
Income Tax Act 1994
Income Tax 2004

Rewrite Project Team

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Rewriting the Income Tax Act: Exposure Draft – Part G
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Introduction

This exposure draft has been prepared by the project team responsible for rewriting New Zealand's income tax legislation. It contains draft legislation for the rewrite of Part G of the Income Tax Act 2004, which relates to special rules that modify the way other Parts of the Act operate when tax avoidance occurs or when specific valuation rules are provided for certain transactions.

The key objective of rewriting the Act is to produce tax legislation that is clear, uses plain language and is structurally consistent. This should make it easier for taxpayers to identify and comply with their income tax obligations, and ultimately save them time and money.

We are rewriting the law as it currently stands. Changes to the law, other than minor ones in the interests of clarity or simplicity, will continue to be handled through the normal legislative programme. The presence or absence of provisions in the rewritten draft legislation does not necessarily indicate any future change in tax policy.

We invite submissions on any aspect of this work, including the points raised in this commentary. The closing date for submissions is 31 October 2005. Submissions should be made to:

The Rewrite Project
Policy Advice Division
Inland Revenue Department
PO Box 2198
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Electronic submissions should be sent to: policy.webmaster@ird.govt.nz.

Please note submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with the Act. If you feel any part of your submission could be properly withheld under the Act (for example, for reasons of privacy), please indicate this clearly in your submission.

COMMENTARY ON REWRITTEN PART G OF THE INCOME TAX ACT 2004

Introduction

Part G came into being during the reorganisation of the Income Tax Act 1976 as the Income Tax 1994. It contains two types of provisions:

- those dealing with avoidance; and
- those dealing with certain transactions treated as taking place at market value.

This Part therefore has wide impact across the Act because of the scope of its provisions.

Two structural issues were identified in rewriting Part G:

- It was not entirely clear in what circumstances a provision's anti-avoidance nature merited locating it in Part G. This point arises because, in many cases, technical base-maintenance remedial provisions could be viewed as dealing with matters of avoidance.
- As other Parts of the Act also contain many provisions treating transactions as occurring at market value, the rationale for having valuation provisions in Part G was unclear. As a result, the provisions proposed to be retained in Part G are those which do not have a suitable alternative location or have an anti-avoidance element.

The exposure draft adopts a structural approach of locating in subparts GA and GB only those provisions that, in broad terms, apply to arrangements having a purpose or effect of generally defeating the purpose the Act or specific provisions in other Parts of the Act.

This commentary also outlines the drafting changes proposed in rewriting Part G.

The drafting changes relate mainly to structural relationships, are relatively minor, and are intended to improve the legislation. They fall into four main types:

- modernising the style and language;
- ordering the subparts from the most generally applicable to the more specific sets of rules;
- improving the clarity of the law; and
- removing of redundant material and relocating some provisions, as appropriate.

Some minor policy changes are proposed for the rewrite of Part G. These policy changes are mainly concerned with:

- replacing some discretions given to the Commissioner of Inland Revenue with objective tests to provide consistency with the law and practice relating to self-assessment, and are identified individually; and
- technical corrections relating to drafting errors or when there is a lack of clarity.

Benefits of the proposed structure

Although current readers may be familiar with the concepts contained in Part G, the rewriting of this Part must also take into account the needs of future readers.

Future readers will come to the legislation without knowledge of how the various rules in Part G interact with the core provisions and other Parts of the Act. In identifying these interrelationships, the draft legislation assists readers in their understanding the relationship between provisions in other Parts of the Act and the transactions and situations dealt with in Part G. In particular, provisions in other Parts of the Act which relate to Part G provisions are identified and their relationships to the anti-avoidance rules are noted or clarified.

The ordering of the subparts and provisions in the subparts reflects the drafting policy that more generally applicable provisions should appear earliest in each Part.

Cross-references in this exposure draft to Parts H or I relate to the 2004 Act, not to the recently released exposure drafts of those rewritten Parts. This is because further intensive specialist reviews of these Exposure Drafts are planned and may lead to changes in draft Parts H and I.

Specific feedback

Questions for specific consideration by readers of the exposure draft are set out in the commentary under the relevant sections.

Minor policy changes and technical corrections

Replacing some discretions given to the Commissioner with objective tests

Draft sections containing this change are GB 4, GB 6, GB 33, GB 36(1), GZ 1, Schedule 2A, Part A, Clause 2.

Commentary on technical corrections and clarifications in individual draft sections

GA 1: Commissioner's power to adjust

Draft section GA 1(2) is simplified to refer to an adjustment in any way to taxable income.

This is consistent with the law as set out in section 99 of the 1976 Act and section BG 11 of the 1994 Act (before enactment of the Taxation (Core Provisions) Act 1996). The amendments to section BG 11 by the Taxation (Core Provisions) Act 1996 were intended to complement the global/gross approach adopted in the core provisions, rather than change the outcomes under the law.

The elements of taxable income that can be taken into account in this adjustment remain as set out in section GA 1(4).

Question for comment on GA 1

Does the proposal to simplify the wording of the reconstruction provision and allow for an adjustment to taxable income give rise to a change in outcome?

Other comments on GA 1

Section GB 1(1)(b) of the 2004 Act has been removed in rewriting section GB 1 because its role is performed by the draft section GA 1(1) and (4).

The words “without limiting the generality of the preceding subsections... section GA 1(1)-(3)” have been removed. Examination of the 2004 Act provision in section GB 1(2A) indicates that these words have no effect on the operation of section GB 1(2A).

Section GB 1(1)-(2) of the 2004 Act is concerned with the reconstruction of taxable income, as calculated under sections BC 1 to BC 7.

The use of credits to satisfy an income tax liability is dealt with in section BC 9 (and possibly section BC 8 if rebates are considered to be credits) of the 2004 Act. Use of credits occurs after taxable income has been determined.

Therefore, an adjustment of credits under section GB 1(2A) of the 2004 Act has no effect on the determination of taxable income and so cannot affect section GB 1(1) and (2) of the 2004 Act.

GB 14: Combination of changes increases loss

Section GC 9(5) of the 2004 Act has been removed because its effect is duplicated in the rewritten structure and cross-referencing elsewhere.

GB 26: Commercial bill repatriation arrangements

Under section GC 14A(2), the New Zealand transferee is treated for the purpose of this rule as redeeming the bill, even if the actual redemption is delayed. It is implicit in this rule that the time of the “deemed” redemption is the time at which the actual redemption was originally provided for under the commercial bill. The rewritten provision makes explicit this timing.

This timing rule overrides the financial arrangement rules provided by the reference to “necessary implication” in section EW 2(1)(b).

GB 27(3): Attribution rule for income from personal services

The attribution rule does not apply to an associated entity that is a natural person and is not a partner of a partnership. What is not clear is the relationship between this rule and how the attribution rule applies to a trustee.

Draft section GB 24(2) makes it clear that the attribution rule is intended to apply to a trustee. This means that the exclusion for natural persons in section GB 22(3) is not intended to apply to a natural person that is a trustee when acting as a trustee, and this relationship is made explicit in the rewritten section. The rewritten draft provision relies on the definition of “trustee” in section OB 1 of the 2004 Act for this effect.

Draft section GB 27 now refers to the “income year” of the associated entity to give consistency to the value of “substantial business assets” in section GC 14C(6) which was measured at the end of that entity’s “accounting year”.

GB 35: Imputation arrangements to obtain a tax advantage

GB 36: Reconstruction of arrangements to obtain a tax advantage

The language of the corresponding provision in the 2004 Act (section GC 22) refers to an arrangement which has “the purpose (not being an incidental purpose)” that a party will obtain a tax advantage for a party to the arrangement.

The words “the purpose” have been changed to “a purpose” on the basis that 2004 Act provision clearly contemplates multiple purposes.

GB 43: Reconstruction of arrangements to obtain a tax advantage

The words “or refund” which appears in section GC 27A(5)(c) of the 2004 Act has been removed as it seems unnecessary to refer to a refund.

Relationship of Part G to other Parts

The relationship between Part G provisions and provisions in other Parts of the Act has been signalled with new draft linkage provisions in Parts C, D, E, H, K, L, M and N.

Moving 2004 Act Part G provisions to subpart GZ

Section GC 6 is now largely spent (although a new provision may be needed if legislation in the Taxation (Depreciation, Payment Dates Alignment, FBT and Miscellaneous Provisions) Bill 2005 is enacted. This provision is moved to draft section GZ 1.

The references in section GC 12 to transactions occurring before 1992 or 1991 are likely now to be largely spent. This provision is moved to draft section GZ 2.

Moving 2004 Act provisions from Part G to other Parts

Part C

Section GD 6(1), (2) has been moved to draft section CS 18.

Section GD 6(3) has been moved to draft section CZ 20.

Section GD 15(3), (4) has been moved to draft section CX 16A. The treatment of the associate as an employee has been removed as it is considered to conflict with the operation of draft section GB 27 (2004 Act provision section GC 15(1), (2)) which treats the benefit as being received by the actual employee.

Part D

Section GD 4 has been moved to draft sections DB 45 and DC 4A.

Part E

Section GD 8 has been moved to draft section EY 10A.

Part O

Section GC 9(6) has been moved to draft section OE 2(2A).

Schedules

Section GC 16(a) and (b) have been moved to Schedule 2, Part A, Clause 2.

2004 Act provisions to be removed from Part G

Section GC 14D(6)

This subsection has been removed as the draft section GB 29(4) incorporates its effect.

Section GC 14F(2)

This subsection has been removed as its effect is dealt with in the definition of “arrangement” in section OB 1.

GC 19

Section GC 19 has been removed on the basis that it duplicates the effect of section NF 13 and is therefore unnecessary.

Its existence as a general anti-avoidance provision directed at one type of tax (other than income tax) is also inconsistent with the approaches to anti-avoidance of other taxes.

GC 18, GC 20

Public policy law operates to void any agreement not to comply with New Zealand legislation. These two provisions are therefore unnecessary.

GC 27A(6)(d)

This paragraph is removed as it is unnecessary. The Commissioner chooses which of subsection (5) or (6) applies and so both subsections cannot apply at the same time.

GD 3(3)

Subsection GD 3(3) has been removed as its effect is taken up in draft section GB 23(1), (2) and (3).

GD 10(3)

This subsection's effect is incorporated in draft subsections GC 5(1) and (2).

GE 1, GZ 1

These two provisions have been removed on the basis they are spent provisions.

GC 17(a)

The reference to vehicles acquired before 23 September 1985 has been removed on the basis it is a spent provision.