
Rewriting the Income Tax Act

Exposure Draft

Part H

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

Rewrite Project Team

First published in March 2005 by the Policy Advice Division of the Inland Revenue Department, P O
Box 2198, Wellington.

Rewriting the Income Tax Act: Exposure Draft - Part H
ISBN 0-478-27124-7

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 H of the Income Tax Act 2004, which relates to special rules that modify the way in which Parts B to E operate for certain persons and entities.

Rewritten Parts A to E of the Act were enacted in May 2004, with effect from the 2005-06 tax year.

The key objective of rewriting the Act is to produce tax legislation that is clear, uses plain language and is structurally consistent. This it is intended to make it easier for taxpayers to identify and comply with their income tax obligations, ultimately saving 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 30 April 2005. Submissions should be made to:

The Rewrite Project
Policy Advice Division
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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 H OF THE INCOME TAX ACT 2004

Introduction

Part H of the Income Tax Act 2004 contains groups of rules that modify the calculation of taxable income for a tax year for certain persons and entities. Some provisions within Part H also affect provisions in Parts F to N of the Act.

This commentary outlines the drafting changes proposed in rewriting Part H. No policy changes are proposed.

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 redundant material and relocating some provisions, as appropriate.

Benefits of the proposed structure

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

Future readers may come to the legislation without knowledge of how the various rules in Part H interact with the core provisions and Parts C to E. In identifying these interrelationships, the draft legislation assists readers in their understanding of the operation of core provisions when applied to the various persons and entities addressed in Part H.

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

Draft subpart HB: Attributing companies

Terminology

The draft legislation uses the terms “attributing company” and “loss attributing company” in place, respectively, of “qualifying company” and “loss attributing qualifying company”.

The policy is to treat dividends distributed from this type of company as a non-taxable transaction, similar to the way in which the Act applies to drawings made from a partnership. For loss companies, the policy is to attribute the net loss of the company in a manner similar to the way partners share in losses of the partnership.

This results in an attributing company satisfying its income tax obligations in relation to its taxable income. The company is then able to pay dividends to its shareholders without any further income tax liability for the shareholders. If the company elects to attribute its losses, the company’s net losses are attributed to the shareholders in proportion to their effective interest in the company.

The term “attributing” is already used in this set of rules for a “loss attributing company” and is considered to better reflect their nature. In contrast, the word “qualifying” that is currently in use is not very meaningful. Also, it is used in a variety of ways in the Act, which can be confusing to readers.

Reorganisation of material

The requirements set out in section OB 3 of the 2004 Act are relocated within draft subpart HB, primarily in draft sections HB 5 and HB 6. This draws important provisions of these rules closer together, making it easier for readers to find the relevant detail.

Relationship with Part C

Distributions from an attributing company are either treated as fully imputed dividends or as exempt income. This effect is reflected in a draft provision for subpart CW.

The reference to “transitional capital amount” in section HG 13(1)(a)(i) of the 2004 Act has been removed. This reference is redundant as it related to unexpired, ten year bonus issues, which terminated in 1998.

Relationship with Part D

Section HG 9(3) of the 2004 Act provides a restriction on the amount of deduction a person is allowed for interest incurred. This restriction is proposed to be included in subpart DB as a limitation on the deduction, although it continues to be detailed in draft section HB 24. As interest is allowed as a deduction under the general permission, the limiting effect of draft section DB 8A requires an override of the general permission.

Timing of attribution of attributed CFC loss and FIF loss

Draft section HB 29 clarifies that the time at which the shareholder incurs the attributed loss is subject to the differing balance date rule in draft section HB 31.

Draft subpart HC: Trusts

Terminology and definitions

Complying and non-complying trusts

The word “qualifying” is not very meaningful. Because it is used in a variety of ways in the Act, to continue to use the term in association with trusts is not consistent with the goal of achieving clear and unambiguous legislation. Therefore the defined terms “qualifying trust” and “non-qualifying trust” are replaced with “complying trust” and “non-complying trust”, to better reflect the underlying policy.

Trust rules

The definition of “trust rules” is simplified to refer to those provisions that have general application, rather than including provisions that are narrowly focused.

Beneficiary income

A beneficiary is taxable on the basis of residence and source. The draft definition of “beneficiary income” clarifies this by removing paragraphs (a)(iii) and (iv) (section OB 1 2004 Act) as they are no longer necessary. The treatment of income derived by a non-resident trustee and the relationship of that income to beneficiary income is now more clearly set out in draft section HC 22(5)

Transfer of value and terms “distribution”, “settlor” and “settlement”

The defined terms “distribution”, “settlor” and “settlement” rely on the common law but also extend the common law concepts for certain classes of transaction or event. In reviewing the effect of these two terms, it seems that both a “distribution” and a “settlement” involve a transfer of value in a very similar way to the concept used in subpart CD of the 2004 Act.

In rewriting the dividend rules in subpart CD, a transfer of value is a transaction or event that leads to a value passing from one person to another for an unequal consideration (if any) in return.

These two concepts have been re-drafted on the basis they are a transfer of value which is intended to simplify and harmonise concepts that have similar effect throughout the Act.

Charitable trust

The concept of “charitable trust” is defined for the purpose of the trust rules in section HH 1 of the 2004 Act, even though the definition is virtually the same as the concept of “charitable trust” used in subpart CW. The draft section HC 10 therefore rationalises the legislation because it is not necessary to retain a separate definition of “charitable trust” for the trust rules.

Relocated provisions

The income aspects of sections HH 1(7), HH 3(1), HH 3(3), HH 4(3), HH 5A, and HH 8 of the 2004 Act are relocated to draft subpart CV, to ensure structural consistency with sections BD 1, CA 1, and CA 2 (2004 Act).

The exempt income provisions in sections HH 3(1), HH 3(3B), HH 4(6) and HH 3A to HH 3F (2004 Act) are now located in subpart CX, also to ensure structural consistency with sections BD 1, CA 1, and CA 2 (2004 Act).

The agency placed on trustees and settlors is signalled also in the agency provisions in draft subpart HD, for completeness.

Section HH 1(9) (2004 Act) is relocated to subpart FC, as this rule re-characterises the nature of the trust on the date referred to in that section.

Non-resident trustee treated as New Zealand resident

Draft section HC 22 introduces a link to section BD 1(4) in the core provisions of the 2004 Act.

The link is intended to assist the reader identify that this rule overrides a core concept of the Act: taxation on the basis of both source and residence. This link is an illustration of the underlying theme of Part H, being to modify the operation of Parts B to E in relation to certain type of person or entity.

Draft subpart HD: Agency

Reorganisation

The main feature of the draft subpart HD is a consolidation into a single section of the obligations (draft section HD 3) that a person declared to be an agent must satisfy. The rewritten provisions also draw together other agency provisions (by way of cross-reference) that are located in other parts of the 2004 Act.

Possible relocation

Section HK 18 of the 2004 Act places an obligation on Customs officials to comply with a valid request of the Commissioner of Inland Revenue. It is proposed that this provision be relocated within the Tax Administration Act 1994.

Section HK 11 of 2004 Act

Section HK 11 of the 2004 Act contains sets of rules to assist the recovery of tax in situations where an arrangement leaves a company with insufficient assets to meet its income tax obligations. This rule is also the basis for recovery under section 61 of the Goods and Services Tax Act 1985.

The section is included as draft section HD 14 on the basis that an agency is created for the purpose of satisfying tax obligations under the core provisions. Equally, the recovery aspects could be relocated or repeated in the Tax Administration Act because it has many characteristics of a recovery provision.

We invite comment on whether the recovery aspects of section HK 11 should be relocated to the Tax Administration Act, since this may have wider policy implications for other revenue Acts.

Draft subpart HE: Mutual associations

Income provisions relocated

Section HF 1(1) and HF 1(5) (2004 Act), relating to income derived by, respectively, a mutual association and a member of a mutual association, are relocated to sections CB 29 and CB 30 respectively. This is signalled at the beginning of draft subpart HE. This relocation ensures that provisions making a transaction income are placed within Part C, as required by sections BD 1, CA 1, and CA 2 (2004 Act).

Deduction provision relocated

Section HF 1(2) of the 2004 Act is relocated to draft subpart DV, again to provide structural consistency within the Act for the treatment of deductions. This relocation is signalled at the draft section HE 1.

Section HF 1(6) of the 2004 Act

This rule is absorbed into draft section CB 30(4).

Draft subpart HF: Maori authorities

Draft section HF 3(3)

The redrafting of section HI 1(2)(b) of the 2004 Act is intended to provide consistency with the redrafted loss rules. (See Exposure Draft Part I.) Under those rules, the Act permits or restricts the use of loss balances or tax loss components, rather than restricting the offsetting of net income.

The effect is the same, and no policy change is intended.

Draft subpart HG: Joint activities

Section HD 1 of the 2004 Act

Subsection (1) is relocated to draft subpart HC (Trusts).

Subsections (2) and (3) are rationalised into one section in draft subpart HG as there is little practical difference in the effect of the two subsections. The Tax Administration Act 2004 also addresses the obligations to file an income tax return which leaves draft section HG 1 as identifying who must satisfy tax obligations imposed under Part B of the Income Tax Act.

Consolidated companies

Subpart HB 2004 Act

We propose relocating subpart HB of the 2004 Act to Part F, drawing together many of the consolidated company rules. This is to be addressed in the rewriting of Part F.