Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill

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Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill

Volume 4

New tax rules for portfolio investment entities

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Prepared by the Policy Advice Division of the Inland Revenue Department and the Treasury

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New tax rules for portfolio investment entities

OVERVIEW

The bill introduces new tax rules for collective investment vehicles that meet the definition of a "portfolio investment entity". Under these optional rules, collective investment vehicles that satisfy certain criteria will not be taxable on realised share gains made on New Zealand and Australian companies. Portfolio investment entities will pay tax on investment income based on the tax rates of their investors (capped at 33%). Income earned via a portfolio investment entity will not affect investors' entitlements to family assistance or their student loan repayments and child support obligations.

The new rules will treat investment through portfolio investment entities in the same way as direct investment by individuals, thus removing long-standing disadvantages of saving through intermediaries like managed funds. They will also prevent over-taxation of lower income savers, and eliminate the taxation of capital gains on New Zealand and Australian shares held through a fund. These changes are particularly important given the implementation of KiwiSaver next year.

There were over 120 submissions on the proposed tax rules for portfolio investment entities. Submissions generally welcomed the proposals and, in particular, supported the objective of aligning the tax treatment of investors in managed funds with that of direct savers.

Submissions sought a number of technical amendments to ensure that the proposed rules would achieve their intended policy effect. One concern was that the rules were overly prescriptive – in particular, in the area of the eligibility criteria for becoming a portfolio investment entity. Another concern was that the rules, as introduced, were overly complex and did not reflect the current commercial practice of certain funds.

Officials, taking into account the technical concerns raised, have recommended a number of amendments to the proposed portfolio investment entity tax rules, including:

- Deferring the application date of the portfolio investment entity tax rules to 1 October 2007, to align with KiwiSaver.
- Making it easier for entities that satisfy current definitions of a widely held investment vehicle to qualify as a portfolio investment entity.
- Allowing portfolio investment entities to recognise income, for tax purposes, in the same manner the entity allocates income to investors.
- Allowing portfolio investment entities to generally apply a zero percent tax rate in relation to investors that exit the fund.
- Providing refunds for tax losses and excess tax credits directly to portfolio investment entities, who will apply the refunds for the benefit of investors, instead of these amounts being rebated directly to investors.
- Allowing simplified tax calculation methods for portfolio investment entities that are listed companies and superannuation funds.

TIMING OF THE INTRODUCTION OF THE NEW RULES

Clause 85

Issue: Deferral to 1 October 2007

Submissions
(597a – PricewaterhouseCoopers, 12a – NZ Funds, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 598 – Trustees Executors, 582 – National Provident Fund, 556 – AMP, 568 – Corporate Taxpayers Group, 881 & 1138 – Perpetual Trust Limited, 1141 – MCA NZ Limited, 613W – Phillips Fox)

The commencement date of the PIE tax rules should be deferred until 1 October 2007, to enable PIEs to be ready to accept the first flows of KiwiSaver funds and to allow entities wishing to elect further time to develop systems fully and inform investors about their new products.

Furthermore, there should be a process of speedy and binding resolution of issues in advance of the enactment of the legislation.

Any requests made by the savings industry for a deferral of the implementation date of the new rules would be supported.

Some changes could be made for 1 April 2007 to allow KiwiSaver to be launched and to level the playing field between direct investment and investment via collective investment vehicles, with more comprehensive changes introduced in 2008.

Consider extending the 1 April 2007 deadline.

Comment

The timing of the PIE tax rules is inherently linked with the application date of the KiwiSaver work-based savings initiative. The government has decided to defer the application date for KiwiSaver to 1 July, to take into account provider concerns. More importantly, employee contributions will not be transferred to KiwiSaver providers until 1 October 2007. As this is when the appropriate tax rules need to be in place, we agree with submissions recommending that the application date of the portfolio investment entity tax rules should be deferred to 1 October 2007. This should give fund providers (including KiwiSaver default funds) an extra six months to ensure that their systems are fully tested and operational.

Recommendation

That the application date of the portfolio investment entity tax rules be deferred to 1 October 2007.

Issue: Deferring attribution requirement to 1 April 2008

Submissions
(592 – Tower, 734W – Todd Corporation)

To allow sufficient time for systems development, PIEs should be able to defer application of the requirement to attribute income to investors to 1 April 2008. However, the 1 April 2007 application date should continue to apply for the purposes of the exclusion of trading gains on Australasian equities.

Comment

Allowing further time for systems development will be addressed by the preceding recommendation to defer application date of the entire PIE rules to 1 October 2007. It is not appropriate that the primary benefits of the regime (the exclusion of the trading gains on Australasian shares) should apply earlier than the requirement to attribute income to investors. The regime is intended to operate as a whole.

Recommendation

That the submissions be declined.

Issue: The bill should be split into two parts

Submission
(558 – Christopher Milne (Business Builders Group) on behalf of several NZ Exchange listed UK Investment Trust Companies)

The bill should be split into two. The parts relating to the removal of capital gains taxes for managed funds investing in NZ and Australia and the taxation of individual investors in managed funds at their personal marginal tax rate should come into force on 1 April 2007. The parts relating to investments outside NZ and Australia coming into force on 1 April 2008 or later.

Comment

Deferring the offshore tax changes until 1 April 2008 or later would adversely affect PIEs. If the current offshore tax rules were retained, PIEs would generally be taxable on realised gains on offshore shares. As the proposed rules require PIEs to allocate income to investors on a regular basis and pay tax on this income at investors' tax rates, having assets that are taxable on realisation would create difficulties for funds in determining how unrealised gains should be allocated to investors. Equally, retaining the current "grey list" exemption would mean that investment in the grey list via PIEs would continue to be tax-disadvantaged relative to direct investment in these countries. This would be undesirable, particularly given the 2007 start-date for KiwiSaver. We therefore recommend that the submission suggesting separating the PIE tax rules from the offshore tax changes be rejected.

Recommendation

That the submission be declined.

Issue: Deferral to at least 1 April 2008

Submission
(567 – Mercer Human Resource Consulting)

The implementation date needs to be set back, with the effective date being no sooner than 1 April 2008. As an alternative, changes could be elective from 1 April 2007, with compliance required from 1 April 2008.

Comment

The deferral of the PIE rules until 1 October 2007 should allow sufficient time for entities to adopt the necessary procedures.

Recommendation

That the submission be declined.

SUPPORT FOR PIE PROPOSALS

Submissions

(592 – Tower, 594 – New Zealand Law Society, 558 – Christopher Milne (Business Builders Group) on behalf of several NZ Exchange listed UK Investment Trust Companies, 560 – Institute of Financial Advisers, 568 – Corporate Taxpayers Group, 570 – Richard Entwistle, 577 & 577a – ASB Group, 604W – Meat Industry Superannuation Scheme, 615W – Business NZ, 734W – Todd Corporation, 611 – New Zealand Assets Management Limited, 467W – M D Macfarlane)

"We strongly support the PIE regime, which will assist in levelling the playing field between direct and indirect investment (subject to our concerns in relation to international investment)." *(Tower)*

"The society supports the proposed PIE regime in principle, as leading to a closer alignment between the tax imposed on direct investment and the tax imposed on investment though a New Zealand managed fund. However, it must be recognised that the proposed tax regime is unique, and poses some unique problems." *(594 – New Zealand Law Society)*

"The Institute supports the proposed qualifying PIE regime, permitting alignment of taxation with a lower income individuals' marginal tax rate and capping tax at the rate of 33% for other investors. The Institute supports the proposal to exempt New Zealand resident shares and Australian resident listed companies from the unrealised capital gains tax." *(Institute of Financial Advisers)*

Comment

Officials welcome this support for the PIE proposals.

Recommendation

That the submissions be noted.

Submissions
(881 & 1138 – Perpetual Trust Limited, 1141 – MCA NZ Limited, 1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan, 1382W – Equity Investment Advisers & Sharebrokers Limited, 1478 – Mercer Investment Consulting, 657W – Sothertons Chartered Accountants, 393W – Fair Home, Graeme Martin James Hall, Gerald Gibbard, Stuart + Carlyon, Bruce Fraser)

The tax disadvantages of New Zealand-based collective investment vehicles should be removed. However, the proposed PIE rules will lead to higher administration and compliance costs. The problems in the legislation cannot be solved in time for fund managers to implement the necessary systems changes or alter prospectuses and trust deeds before 1 April 2007.

Group investment funds and qualifying unit trusts investing in New Zealand or in Australian listed securities should be able to elect to be taxed as a trust, rather than as a company, with investments held to be on capital account. This will mean that they are not subject to capital gains tax, and that income distributions have resident withholding tax deducted at the investor's marginal rate.

The following solution allows the Inland Revenue to differentiate between 19.5% and 33% taxpayers but does not create the administrative strain on providers:

- Do not differentiate between taxable and non-taxable gross income at a CIV level.
- Maintain unit pricing on a net basis.
- Require each provider to submit each individual's proxy gross income as (net income)/(1 – tax rate).
- Require the calculation on an annual basis. For 19.5% taxpayers, quarterly calculations are not warranted given the dollars involved at this level.

The current PIE proposals do not meet any cost benefit test. As such, most employer schemes will not become PIE compliant or may wind up because of overall increased costs, which is not the intention of the legislation. Therefore the PIE regime should not proceed.

The general intent in relation to PIEs is supported but the objectives could be much simpler by adopting a similar approach to Australia, where vehicles "pass-through" income and tax credits to the investor.

It appears it may be better to design a system whereby each year's tax liability is an issue between the Inland Revenue and each individual, if a proper flow-through principle is to be applied to investment income generated through a pooled vehicle such as a PIE. It may be too much to expect that a PIE can perform this task efficiently and fairly and at a reasonable cost to the PIE.

The bill gives undue weight to the desires of the collective investment vehicle sector, which is only a part of the larger total investment market. The proposed measure in the taxation bill that will see the collective investment vehicle sector granted significant tax concessions not available to other investors is opposed. Also opposed is the general public being offered substantial incentives to invest exclusively in these vehicles in New Zealand.

There is agreement in theory with the general concept of the tax treatment of investments in PIEs being more closely aligned with the tax rates of the underlying investors but the proposed method is opposed on a cost benefit basis. It would be cheaper and easier to administer the tax implications through the already well-understood method of filing individual tax returns on an annual basis and claiming back any overpayment of tax. New Zealand investors should also be able to continue investing in passive index funds as these funds provide relatively risk-free access into the share markets in both New Zealand and Australia and are a low cost alternative to a trading unit trust.

To remove the bias against New Zealand unit trusts, there should be no tax on capital gains for unit trusts investing in any listed securities (including Australia, New Zealand and foreign exchanges) and income should be taxed at a flat 33% rate with physical distributions taxed at marginal rates (with an imputation credit for tax paid by the fund). To cater for low-income earners and to encourage true retirement savings, KiwiSaver funds and all superannuation schemes should have lock-in to age 55 or 65 and not be taxed on capital gains, with income taxed to the fund at 15% or 19.5%.

Comment

The benefits of PIE status (such as the Australasian share trading exemption) should not be separated from the other policy objectives of:

- taxing investors at their correct tax rates;
- not affecting their social assistance requirements; and
- not requiring taxpayers to file a tax return when they currently do not have to.

The submissions listed above do not meet these policy objectives, as they either require investors to file returns to get their correct tax rate (which will affect social assistance entitlements and may create tax compliance obligations that currently do not exist) or that funds be taxed at a concessionary tax rate (for example, 15%, which would be lower than investors' marginal rates). For these reasons, we do not consider that these submissions should be accepted.

Officials also note that, as explained below, a new, simplified method of attribution will be available for entities such as superannuation funds that will achieve these objectives with fewer compliance costs. This new method should broadly allow superannuation funds to operate as at present, while undertaking a single tax calculation at the end of the year in respect of their investors (instead of requiring quarterly tax calculations).

Recommendation

That the submissions be declined.

Issue: General concerns

Submissions

(578 – NZICA, 558 – Christopher Milne (Business Builders Group) on behalf of several NZ Exchange listed UK Investment Trust Companies, 613W – Phillips Fox)

The New Zealand Institute of Chartered Accountants has submitted that while supporting the overall thrust of the PIE proposals, it has reservations about the method of implementation and strong reservations about the drafting. It has commented that significant changes to the bill are required to successfully achieve the policy objectives.

Other submissions have recommended that:

- The Finance and Expenditure Committee should request further information, both from officials and large and small tax advisors, regarding the extent of compliance costs resulting from this bill; and
- A review of the areas of tax law in question should be started again, using a process that does not have the restrictions and flaws inherent in the process that has been adopted to date. (They suggest that this does not mean that the work undertaken to date will be ignored or wasted; rather, its conclusions should be reassessed in light of the wider issues).

Comment

Officials recognise that the draft legislation on the PIE tax rules is highly technical and complex. This reflects the nature of the subject matter, which involves putting investors in managed funds in a similar position to direct investors. In particular, ensuring that managed fund investors receive their tax rate on investment income derived via a PIE requires a "flow-through" concept to be incorporated in the draft legislation. This is a significantly different approach from entity taxation than has previously been considered and, as a result, a degree of legislative complexity is unavoidable.

The Committee process of the bill has afforded an opportunity to review and streamline the PIE tax rules. This should reduce compliance costs for taxpayers and advisers. For example, the PIE tax provisions have been re-ordered more logically. The PIE tax rules also contain a legislative overview, or roadmap, of the different provisions to guide users.

On the issue of the compliance cost of the changes, the proposals in the bill will impose some additional compliance costs on individual investors (mostly currently investing in "grey list" countries outside Australia) and managed funds (from having to implement the new PIE tax rules). The proposed "fair dividend rate" for taxing individuals' offshore share investments is, however, significantly simpler than the current offshore tax proposals in the bill. The PIE tax rules may impose some additional systems costs (from taxing PIE income at investors' tax rates) but there would be clear benefits for investors in PIEs – namely, being taxed at their correct tax rate and receiving capital gains on New Zealand and Australian equities tax-free.

The proposals in the bill have been the culmination of a number of reviews into the taxation of investment income. These range from the 2001 Tax Review and its recommendations for taxing offshore portfolio share investments to issues papers released by Inland Revenue and the Treasury, a 2004 review of the investment tax rules by Mr Craig Stobo and the release of a government discussion document outlining reform proposals last year. A number of different stakeholders were consulted as part of these reviews, and officials consider that the problems with the current tax rules and options for reform were exhaustively canvassed. We do not consider that abandoning the reform proposals in the bill, especially the proposed PIE tax rules, for a fresh review of the tax rules for investment income is likely to result in a better outcome. It would simply delay the correction of the tax disadvantages facing investors in New Zealand managed funds, which would not be desirable given the imminent application of KiwiSaver.

Recommendation

That the submissions be noted; however, the submission that the current proposals be abandoned and a fresh review of the investment tax rules be commenced should be declined.

Issue: Opportunities to review draft legislation

Submission
(594 – New Zealand Law Society, 578 – NZICA)

The PIE legislation highlights a weakness in New Zealand's tax policy process, which is that there is insufficient consultation on the actual drafting of legislation. The bill should not be enacted until there has been the opportunity for the release of a further draft, and the opportunity for public submission on that draft.

Officials should be instructed to consult on the changes to the legislative detail to ensure that the legislation is free from anomalies, omissions and errors.

Comment

This bill has followed normal Parliamentary practice, which requires that Parliament refer draft legislation to a sub-committee for detailed consideration and report-back with recommendations for change. There does not seem to be a special case for departing from this normal practice.

The Finance and Expenditure Committee has given officials permission to consult with submitters. This is designed to ensure that, where concerns have been raised in relation to the legislative drafting, these concerns are able to be reflected to the Committee for consideration. Officials have consulted extensively with submitters on a number of issues, including concerns regarding the drafting.

Recommendation

The submission be noted.

Issue: Purpose provision in section HL 1

Submission
(578 – NZICA)

Section HL 1 would benefit from a purpose provision as an aid to interpretation. This section would also benefit from the use of flow charts to show the linkages in the rules and how income, losses and tax credits flow through the PIE.

Section HL 1(2) should be omitted as it repeats what is in section HL 12. It should be replaced with a flow-chart.

Section HL 1(3) should be clarified.

Section HL 1(4)(a) should refer to section CP 1 so that there is a clear link to income, and section HL 1(4)(b) should refer to section DB 43 (deductions).

The rules for determining class income, class losses and credits should be set out diagrammatically in a flow-chart or similar aid.

Comment

Section HL 1 has been redrafted and should now meet the concerns raised in submissions. Re-drafted section HL 1 should provide a useful roadmap to the PIE tax rules.

Recommendation

That the submission be noted.

Issue: General legislative framework

Submission
(598 – Trustees Executors)

Anti-avoidance measures should be removed from the substantive provisions that have general application and be limited to transactions that have the intention and effect of avoiding tax.

Comment

It is preferable from a certainty perspective to have objective rules to counter avoidance concerns rather than subjective rules based on the intention of avoiding tax. Examples of such objective rules include those to prevent PIEs converting taxable income (for example, dividends from New Zealand and Australian companies) to non-taxable amounts (under the PIE trading exemption on Australasian shares). This approach should reduce taxpayer compliance costs, uncertainty and administrative costs.

Recommendation

That the submission be declined.

Submission
(578 – NZICA)

Direct savers should be allowed to designate some or all of their portfolio as a PIE. This would provide direct savers with similar protection on their New Zealand and Australian share gains as is afforded to a PIE. The current PIE tax rules introduce a bias in favour of investment in New Zealand and Australian shares via a PIE rather than directly. This is because a direct investor can be subject to revenue account treatment (that is, be taxable on realised share gains).

Comment

The PIE tax rules aim to put investors in New Zealand managed funds (that elect to be PIEs) on a similar footing to direct investors. At present, direct investors are more able to achieve capital account treatment for their share investments than institutional investors. Therefore, there is no need to provide a separate exemption for direct investors. Doing so would also result in certain types of labour income – trading in shares – not being taxable. This could create an incentive for individuals to substitute away from (taxed) employment to trading in shares (un-taxed).

The case law in this area has resulted in managed funds typically applying revenue account treatment (unless they have a ruling from Inland Revenue that they are a passive index tracker). This is to maintain equity between current and future investors if Inland Revenue challenges a capital account election on a particular investment, made today, at some future date. This conservatism amongst trustees of managed funds has resulted in the need to provide certainty to managed funds that their New Zealand and Australian share investments made on behalf of investors, the vast majority of whom would be on capital account, would not be subject to tax on capital gains.

Recommendation

That the submission be declined.

Clause 85

Issue: Commissioner discretion

Submissions
(597a – PricewaterhouseCoopers, 592 – Tower, 582 – National Provident Fund, 567 – Mercer Human Resource Consulting, 925W – ASFONZ)

Inland Revenue should have the discretion to allow an entity that does not meet one or more of the PIE eligibility requirements to elect into the regime if the Commissioner is satisfied that the entity is of a type that from a policy perspective should be treated as a PIE.

There needs to be discretion for the Commissioner to grant dispensation from the eligibility requirements contained in section HL 6.

Comment

Officials consider that such a discretion for the Commissioner would be inconsistent with self-assessment. It is also preferable that the PIE eligibility criteria are objective in nature rather than dependent on the exercise of an official discretion (which could give rise to challenges).

Recommendation

That the submissions be declined.

Issue: Generic eligibility criteria (including "safe harbour" approaches)

Submissions
(578 – NZICA, 593 – Westpac NZ/BT Funds Management NZ, 556 – AMP, 12a – NZ Funds, 569 & 608 – ING, 597a – PricewaterhouseCoopers, 596 – ISI, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 598 – Trustees Executors, 586 – Promina Group Ltd, 585 – NZX, 568 – Corporate Taxpayers Group, 577 & 577a – ASB Group, 1221 – Ernst & Young)

A PIE should be a vehicle that:

- is principally an investor in savings and investment instruments;
- is either a portfolio or non-portfolio investor;
- is widely held;
- not able to be controlled by any group of investors (unless when starting up or winding down);

- has a prospectus on issue or is listed on the main board of the New Zealand Exchange;
- has an entity responsible for its management (except for qualifying listed companies); and
- is a wholesale fund or subsidiary of a PIE if it is reasonably regarded as a vehicle for investment by a PIE.

An entity that is or has been offered to the public under the Securities Act 1978 should be able to elect to be a PIE without the need to comply with:

- the independent management requirement (if this is retained);
- the entity history requirement;
- the investor class requirement;
- the investor size requirement; and
- the investor interest repurchase requirement.

A "safe harbour" should be introduced for fund managers by changing the criteria so that the PIE must:

- be a public issuer for the purposes of the Securities Act;
- have established principally for the purposes of investment and savings;
- be widely held (20 or more investors); and
- have fewer than 20 investors where available for widely held investments (such as start up funds).

or

- have investors that meet the above rules.

Publicly listed entities and unlisted entities that issue a prospectus in relation to equity interests in the entity should be deemed to meet the investment size requirement under the investor test.

PIE eligibility could be based on the "qualifying unit trust" definition (modified for entities that are not unit trusts). Entities that meet the "qualifying unit trust" definition should be treated as satisfying the investor eligibility requirements (that is, a safe harbour). If this is not accepted (for example, if there is a concern a PIE could be used as a means of replacing or substituting for direct investment), there could be tiered eligibility requirements depending on whether the fund is widely held or not. Alternatively, there could be a safe harbour for widely held vehicles.

The ongoing costs of monitoring and compliance with the eligibility criteria are contrary to the government's aim of low cost intermediary services.

PIE definitional requirements should be extended to include property entities and cater for the unique investment characteristics surrounding property investment.

Comment

The PIE eligibility criteria are designed to distinguish genuine savings and investment vehicles from other entities. This distinction is important as PIEs will not generally be taxable on their realised New Zealand and Australian share gains. Among these requirements is that investors in the PIE are portfolio investors (the investor requirements) and the PIE itself is a portfolio investor in companies it invests into (the investment size requirements). It is also important that the PIE has the majority of its assets employed in deriving what is typically known as passive income (such as income from trading shares, dividends, land and rents). These criteria are broadly designed to replicate the situation of the vast majority of individuals who invest directly (the alternative to investing via a managed fund). If these tests were not present, then direct investors who are share traders would be able to manipulate the PIE rules to gain the advantages of being a PIE, while maintaining control of their trading activities. This would not be desirable for reasons explained earlier.

Submissions have commented that instead of the preceding bright-line tests, a more appropriate qualification requirement is to require an eligible entity to be an issuer of securities to the public under the Securities Act or an entity that is a qualifying unit trust. A "qualifying unit trust" is a defined term in the Income Tax Act and, broadly, describes a widely held investment vehicle.

In the bill, as introduced, a PIE can have investors that are themselves PIEs or entities that qualify as a foreign investment vehicle (under the definition in the bill) without breaching the investor requirements. These investors can currently hold up to 100% of a PIE, and a PIE does not need 20 other investors if it has either a PIE or a foreign investment vehicle as an investor. Officials are recommending a number of amendments to further simplify the investor requirements.

We agree with submissions that entities that meet the "qualifying unit trust" definition in section OB 1 of the Income Tax Act 2004 should be safe harboured from the investor requirements. We consider this safe harbour should be available to entities that meet paragraphs (a), (c) to (e) of the qualifying unit trust definition or that would meet the definition if the entity were it a unit trust. We do not consider that entities that meet paragraph (b) of the definition – which largely describes wholesale managed funds – should be included in the safe harbour, as officials consider that the investor requirements for wholesale funds can be adequately dealt with under the amendments being proposed below. We also consider that amendments are needed to accommodate the National Provident Fund and Government Superannuation Fund (if these entities elect to become PIEs). We understand that these entities would meet the "qualifying unit trust" definition if not for the requirement to offer securities to the public. As these funds are widely held entities (and are operated under statute), we do not see any concerns in relation to providing the safe harbour from the investor tests under the PIE rules to these entities.

We consider that entities that would meet the PIE eligibility criteria but do not elect to be PIEs should be allowed to hold up to 100% of a PIE without the PIE breaching its PIE status. Similarly, life insurance companies (which are not eligible to become PIEs under the rules as currently drafted) should also be allowed to hold up to 100% of a PIE. We also understand that the New Zealand Superannuation Fund and funds operated by the Earthquake Commission and the ACC can hold large interests in other investment vehicles. These investors have similar characteristics to other collective vehicles and should be allowed to hold up to 100% of a PIE.

If a PIE has one or more of these types of investors, the 20 investor test would not need to be met. The amendments above should mean that a wholesale managed fund would be able to have, as investors, other funds that are PIEs, entities eligible to be PIEs but which do not elect to be, life insurance companies, foreign investment vehicles, and certain specified funds (such as the New Zealand Superannuation Fund) without breaching the investor requirements.

Further, investors other than those listed above should be allowed to hold up to 20% of a PIE (the current limit in the bill is 10%). Officials understand that this should assist the majority of listed investment entities, such as listed property funds and listed investment companies, that wish to become PIEs to comply with the investor size requirement. We understand that shareholders in a listed company cannot generally increase their holding to 20% or more of the voting rights without triggering certain provisions of the Takeovers Code. This should provide a signal to prospective PIEs that are listed entities that a breach of the investor size requirement is imminent. Officials are also aware of certain listed entities, who have legacy investors holding more than 20% of the entity (and therefore would breach the investor size requirement). We consider that there is scope for grandfathering such legacy investments, to the extent that such investors hold 40% or less of the PIE. This would mean that a listed PIE would be able to have legacy investors, who held an interest in the PIE of greater than 20% without breaching the investor interest size requirement. Rules would be needed to ensure that the entity does not retain PIE status if these legacy investors increase their interests to interests greater than 40%.

We do not consider that being a qualifying unit trust or an issuer of securities to the public should be the sole criteria for being a PIE, as there are a number of additional criteria (such as the investment requirements and investment-type requirements) which are necessary to distinguish genuine savings and investment vehicles from other entities. In particular, the investment size requirement (which requires a PIE to hold not more than 20% of an underlying company) is important in re-enforcing the portfolio investor concept as there is no such requirement under the qualifying unit trust definition.

Officials consider that monitoring of compliance with the PIE eligibility criteria – required quarterly – would be no different from compliance with existing tax rules (such as the qualifying unit trust definition).

Recommendation

That submissions recommending a generic eligibility criteria (that is, automatic qualification for certain entities) be declined. However, officials recommend a number of amendments to make compliance with the investor requirements:

- Entities that meet paragraphs (a), (c) to (e) of the "qualifying unit trust" definition in section OB 1 of the Income Tax Act 2004 should not be required to separately meet the investor requirements under the proposed PIE definition (known as the "investor requirement safe harbour").
- Allowing the National Provident Fund and Government Superannuation Fund, also to get the benefit of the safe harbour in relation to the investor requirements.

- Allowing entities that are eligible to be PIEs but do not elect to be and life insurance companies to hold up to 100% of a PIE without the PIE breaching its PIE status. (This should address the concerns raised in relation to wholesale funds.)
- Allowing the New Zealand Superannuation Fund and funds operated by the Earthquake Commission and ACC to hold up to 100% of a PIE without the PIE breaching its PIE status.
- Allowing investors in a PIE generally to hold up to 20% of the PIE, with rules to accommodate legacy investors holding interests greater than 20%. (This should address the concerns raised in relation to listed entities.)

Issue: Locating eligibility requirements in a single section

Submission
(578 – NZICA)

The eligibility requirements for entities to be a PIE (new sections HL 5 and 6) should be in one section.

Comment

The reasons for the eligibility requirements being contained in two sections is that the temporary breach rules apply only to the requirements in the second provision (section HL 6 – for example, the investor and investment tests) and not to the requirements in the first provision (HL 5 – for example, the requirement for a PIE to be a New Zealand resident). The requirements in the first provision are of a strict liability nature. Therefore, there is a reason for the eligibility requirements to be a PIE being in separate sections of the Act.

Recommendation

That the submission be declined.

Issue: Relationship between investor and investment requirements

Submissions

(578 – NZICA, 589 – KPMG, 551 – Macquarie Goodman, 590 – Property Council, 582 – National Provident Fund, 552 – Kiwi Income Property Trust, 577 & 577a – ASB Group)

The circularity in the investor and investment requirements in sections HL 6(4), HL 6(6) and HL 6(7) should be corrected.

Alternatively, if a property fund meets the eligibility requirements of section HL 5 and HL 6, other than subsections (6) and (7) of HL 6, it should be deemed to meet the investment value requirement in section HL 6(7) in certain group situations – for example, if its wholly owned subsidiaries meet the definition of a wholly owned group in the Income Tax Act 2004 and 90% or more of the assets of each of the subsidiaries are land.

Comment

Officials do not agree that the provisions in section HL 6 of the bill are circular. In any event, the re-drafting and reordering of this provision should substantially address the concerns raised.

Amendments are recommended to allow land PIEs to hold interests of greater than 20% in land or in companies whose assets are 90% or more in land.

Recommendation

That the first submission be declined. It be noted that amendments are recommended to address the concerns raised in the second submission.

Issue: Inclusion of wrap accounts in PIE rules

Submission

(997W – Grosvenor Financial Group)

The definition of what constitutes a PIE should be widened to include individually managed accounts (IMAs). The current bill promotes managed funds at the expense of IMAs. The bill risks stagnation in the New Zealand investment climate whilst the rest of the world adopts more efficient vehicles.

Comment

The aim of the PIE tax rules is to put investors in managed funds on broadly the same tax footing as direct investors. Our understanding is that individuals investing via IMAs are currently able to structure their investments to get the benefit of the exclusion from tax for Australasian share gains. Therefore, we do not consider that investors in IMAs should get a safe harbour from tax for their Australasian share gains. If such an exemption were provided, individual share traders would be able to use IMAs to mitigate the tax on trading gains on New Zealand and Australian shares, which would

be undesirable from a policy perspective, for reasons outlined earlier. It would be possible for IMAs to become PIEs if they meet the relevant eligibility criteria.

Recommendation

That the submission be declined.

Issue: Australian unit trusts should be allowed in the PIE regime

Submission
(614W – Plan B Financial Services Limited)

An Australian unit trust, while meeting every other criteria, will fail the New Zealand tax residency requirement and therefore cannot elect into the regime. An Australian unit trust should be able to elect into the PIE regime, when it could be subject to the requirement that it has a New Zealand representative who would be liable for the obligations of the Australian unit trust.

Comment

The PIE tax rules have been designed for New Zealand-resident managed funds as a New Zealand resident investor has the choice to invest directly or via such a vehicle. As noted in response to an earlier submission, investment through New Zealand managed funds is currently tax disadvantaged relative to investing directly (including in an Australian unit trust). The PIE tax rules aim to correct these anomalies. Furthermore, an Australian unit trust would be subject to the Australian tax rules and would therefore be outside New Zealand's taxing jurisdiction. It is therefore unclear how New Zealand's tax rules could apply to tax the underlying income of an Australian unit trust.

Recommendation

That the submission be declined.

Clause 85

Issue: Category B GIFs

Submission
(597a – PricewaterhouseCoopers)

Certain trusts, including category B GIFs, should be excluded from the income interest requirement in section HL 5(3).

Comment

Officials understand that group investment funds deriving category B income are typically trusts administering the estates of deceased taxpayers. These trusts can allocate income to certain beneficiaries and capital to other beneficiaries. Officials are satisfied that group investment funds deriving category B income are genuine commercial arrangements and should therefore be eligible to become PIEs. We therefore consider that the income interest requirement in the PIE tax rules should not apply to group investment funds that derive only category B income. Providing this exclusion to other trusts could undermine the intent of the PIE rules.

Recommendation

That group investment funds deriving category B income be exempt from the income interest requirement.

Clause 85

Issue: Investor class requirement

Submissions

(594 – New Zealand Law Society, 552 – Kiwi Income Property Trust, 479W – Walker Capital Management, 613W – Phillips Fox, 567 – Mercer Human Resource Consulting, 925W – ASFONZ, 618W – The Retire Fund, 674W – Waterfront Industry Superannuation Fund)

Listed entities should automatically meet the investor class requirement in section HL 6(2). Bona fide investment management firms, where more than 90% of the firm's total funds under management are from third party sources, should be exempt from the investor class requirement in HL 6(2).

There should be no minimum number of investors in an investor class.

The investor class requirement may be problematic for schemes offering investment choice facilities if each investment choice is considered to be a separate portfolio investor class and fewer than 20 members use a particular option. The investor class requirement should not preclude schemes offering investment choice, and the bill should be clearly worded accordingly.

Comment

The PIE investor class requirements recognise that managed funds may have different investment options (investor classes), such as conservative, balanced and growth portfolios, within the same fund. The investor class requirement is designed to ensure that for each investor class offered by a PIE, there are a minimum number of investors (20). This is important as otherwise an investor class could be set up that has only one investor, who owns 100% of the underlying investments in the class (but less than 20% of the PIE) and is able to effectively control the investment decisions of that particular investor class. We therefore do not agree that the investor class requirement should be removed from the PIE tax rules.

However, as noted earlier, officials are recommending that entities which meet paragraphs (a), (c) to (e) of the qualifying unit trust definition in the Income Tax Act 2004 (or would meet the definition if they were a unit trust) would not need to meet the investor class requirement. The 20 investor requirement would not need to be met if the PIE has at least one investor that is:

- another PIE;
- a foreign investment vehicle (as defined in the rules);
- an entity that would meet the PIE eligibility rules, but does not elect to be a PIE;

- a life insurance company; or
- the New Zealand Superannuation Fund, the Earthquake Commission or ACC.

Officials also agree that an exception to the investor class requirement for 20 or more investors is justified in certain circumstances, such as when a boutique investment option is on offer and fewer than 20 investors take it up. The requirements for this exception should be as follows:

- The PIE entity has another class with at least 20 members.
- No investor, other than the fund's manager or trustee, in a class with fewer than 20 members can control the investment decisions relating to that class.
- Less than 10% of the PIE's total assets belong to all classes of the PIE with fewer than 20 members.

The definition of "portfolio investor class" in the bill effectively requires each investor in the class to have an interest in the investments of that class, in the same proportion to the other investors in that class. Officials understand that when new investors enter a class, the interests of the new investors in the assets of the class may not match those of existing investors (as the entity would need time to purchase more of the underlying investments). The legislation therefore needs to provide a tolerance for new investors in a class to temporarily have interests in the investments of that class that differ in proportion from the interests held by existing investors.

In our view, new investors should be able to have interests in the investments of the class that are different in proportion to those of existing investors for up to five days, from entry. We also consider that investors should generally be able to have interests in the underlying investments that are different in proportion from those of other investors, if this difference is largely immaterial (if the interest in the underlying assets differs by less than 5%). This recognises that, owing to normal commercial arrangements, it is unlikely that an investor in a class will have an interest in the investments of that class that is, at all times, in the exact proportion as the other investors in that class.

Recommendation

That submissions recommending the investor class requirement be removed be declined. Exceptions to the 20 member investor class requirement, consistent with officials' comments above, should be available in certain circumstances. We also recommend that the PIE tax legislation provide tolerance for new investors in a class to have interests in the investments of that class that differ in proportion from the interests held by existing investors.

Issue: Measuring compliance with investor test

Submission
(578 – NZICA)

The investor tests in section HL 6(4) should be measured quarterly.

Comment

Officials consider that the draft legislation already requires compliance with the investor tests in HL 6(4) on a quarterly basis. A further amendment is therefore not required.

Recommendation

That the submission be noted.

Issue: Associated investors

Submissions
(597a – PricewaterhouseCoopers, 595 – AXA, 556 – AMP, 567 – Mercer Human Resource Consulting)

Widely held retail funds should not be required to determine whether their investors are associated.

The 20 person requirement should be amended to refer to 20 natural persons ultimately holding units.

Comment

We consider that associated investors should be taken into account for the purposes of the 20 investor requirements as otherwise it could be possible for a group of associated investors to effectively control a PIE. However, we consider that PIEs should be required for the purposes of the association rule to take into account only investors who hold more than 5% of the PIE. This would mean that PIEs should not have to incur the compliance cost of establishing association between investors who have very small holdings. Also, the proposal to safe harbour entities that meet paragraphs (a), (c) to (e) of the qualifying unit trust definition from the investor requirements (including the associated investor requirements), or that would meet the definition if they were a unit trust, should mean that a majority of investment vehicles would not need to be concerned with this requirement.

We do not consider that the 20-investor requirement under the investor test should refer to natural persons only, as associated entities such as trusts and companies may be used to gain control of the underlying investments of a PIE. The submission's main concern is in relation to entity investors in a wholesale fund (of which there may be fewer than 20). As noted in response to earlier submissions, there would be an exception from the 20 investor requirement if the investors in a PIE are, for example, another PIE, an entity that could be a PIE (but does not elect to be one), a foreign

investment vehicle or a life insurance company. This should address the concerns raised in the submission.

Recommendation

That the first submission be accepted, subject to officials' comments – PIEs should not have to take into account associated investors who hold less than 5% of a PIE. The second submission should be declined (and it should be noted that the concerns expressed in the submission will be addressed under the general exceptions to the 20 investor test).

Issue: PIE status for wholesale funds

Submissions
(597a – PricewaterhouseCoopers, 556 – AMP, 557 – AllianceBernstein)

Wholesale funds should be able to "look through" certain entities to determine whether the investor criteria are met.

Comment

We agree with the key principle underlying these submissions. In response to previous submissions, we have supported allowing the following widely held entities to hold up to 100% of a PIE (including wholesale PIEs):

- other PIEs;
- foreign investment vehicles (as defined in the draft legislation);
- a vehicle that is eligible to be a PIE but does not elect to be one;
- life insurance companies; and
- the New Zealand Superannuation Fund and funds operated by the Earthquake Commission and the Accident Compensation Commission.

Recommendation

That the submission be accepted consistent with officials' comments.

Issue: Investor size requirement

Submissions

(12a – NZ Funds, 578 – NZICA, 569 – ING, 588 – Trustee Corporation Association of NZ, 592 – Tower, 579 – Macquarie New Zealand Limited, 594 – New Zealand Law Society, 595 – AXA, 590 – Property Council, 582 – National Provident Fund, 585 – NZX, 584 – Smartshares Limited, 552 – Kiwi Income Property Trust, 595 – Brook Asset Management, 574 & 574a – Staples Rodway, 577 & 577a – ASB Group, 1167 – New Zealand Investment Trust, 1221 – Ernst & Young, 479W – Walker Capital Management, 608 – ING Property Trust, 613W – Phillips Fox, 734W – Todd Corporation)

The investor interest size requirement is too low and should be increased to 20%. PIEs that are listed on the New Zealand stock exchange should have the investor interest size requirement increased to 20%. Non-resident life insurers should be allowed to hold up to 20% of a PIE.

The maximum total percentage an investor can hold of a PIE should be increased to 25%. Section 32D of the Tax Administration Act 1994, which requires a unit holder of a qualifying unit trust to provide the trustee with a statement of the persons associated with the unit holder, should be extended to cover the associated persons information necessary to comply with section HL 6(4).

Qualifying unit trusts, group investment funds, New Zealand-resident life insurers, superannuation funds and PIEs should be allowed to hold up to 100% of a PIE. Other investors or associated investors should be allowed to hold up to 25% of a PIE. The associated persons criteria should not apply to investors in a widely held vehicle. Investors other than PIEs should be able to hold up to 49% in a portfolio investor class, provided the investment vehicle either has one or more PIE investors or 20 or more non-associated investors.

There should be no limit on the size of investments in PIEs. For publicly listed entities there should be no investor interest size requirement as such entities will necessarily be widely held. One submission does not necessarily agree that to be a PIE the investors in it must be, in effect, portfolio investors. It comments that, given that many people do not discuss their business/investments with anyone other than their spouse, the inclusion of the associated persons requirement seems unworkable.

Bona fide investment management firms, where more than 90% of the firm's total funds under management are from third party sources, should be exempt from the investor size requirement in section HL 6(4).

The investor size requirement should be amended to exclude entities which are eligible to be a PIE but have not elected to be one.

Guidelines should be developed to measure an investor's interest in a PIE.

Comment

The investor size requirement (along with the investor class requirement) is designed to ensure that no single investor or an investor combined with associated parties can control the underlying investments of a PIE. These two tests are meant to reflect the fact that investors in PIEs should be portfolio investors. We therefore do not agree with removing this requirement altogether, as some submissions have suggested.

As noted in response to an earlier submission, officials are recommending that a number of entities investing in PIEs be safe harboured from the investor requirements (both the investor class and size requirements) under the PIE tax rules. These include other PIEs and foreign investment vehicles, as wells as entities that are eligible to be PIEs but do not elect to be PIEs, life insurance companies and the New Zealand Superannuation Fund, EQC and ACC. These entities will not need to meet the investor size requirement when investing in a PIE. Entities that meet paragraphs (a), (c) to (e) of the qualifying unit trust definition would also not need to worry about the investor requirements (with respect to entities investing in them). For investors other than those covered by the proposed exceptions, we have recommended that the investor size threshold be raised from 10% to 20%.

Officials consider that the suggestion to have a provision similar to section 32D of the Tax Administration Act is unnecessary given the proposed changes to the associated persons tests for PIEs (meaning the association rule should only take into account investors who hold 5% or more) and the proposed safe harbour for entities meeting paragraphs (a), (c) to (e) of the qualifying unit trust definition.

In terms of measuring an investor's interest in a PIE, this should be calculated with reference to the ownership of the underlying assets held (in the case of an entity such as a unit trust or superannuation fund that elects to become a PIE). In the case of a listed entity that elects to be a PIE, the investor size requirement would be calculated in relation to the investor's shareholding.

Recommendation

That the submissions recommending that the investor size requirement be removed be declined. It should be noted, however, that, in response to earlier submissions, officials have recommended that a number of widely held entities be allowed to hold up to 100% of a PIE and that other investors be allowed to hold up to 20% (versus the 10% currently in the bill). The submissions recommending that section 32D of the Tax Administration Act apply for the purposes of determining association should also be declined.

Issue: Collective investment vehicles investing into PIEs

Submissions
(567 – Mercer Human Resource Consulting, 881 & 1138 – Perpetual Trust Limited)

An exemption should be included to allow small collective vehicles to invest into a widely held PIE. This exemption would need to be similar to section HL 6(4), which allows a PIE to invest into another PIE.

There should be no restrictions on PIEs, unit trusts, group investment funds, or other CIVs investing in each other. The ability to invest on a wholesale basis gives managers efficiency options and aids diversification, while limiting this ability serves no purpose.

Comment

We consider that the proposed exemptions from the investor size requirements for a number of widely held entities (such as entities that are eligible to be PIEs but don't elect to do so) and increasing the investor size requirement for other investors to 20% should largely address the concerns raised.

Recommendation

That the submissions be noted.

Issue: Allowing New Zealand Superannuation Fund, EQC, and ACC to invest into a PIE

Submission
(Matter raised by officials)

Under the current bill a large investment into a PIE by the New Zealand Superannuation Fund, the Earthquake Commission or the Accident Compensation Commission could result in a loss of PIE status. This should not be the case.

Comment

Officials consider that an exception to the investor interest size requirement in section HL 6(4) as currently drafted should be made to allow the New Zealand Superannuation Fund, ACC, or EQC to make an investment of any size into a PIE without jeopardising that PIE's status. This is because these investors share certain characteristics with collective investment vehicles which will also be allowed to make investments of any size in a PIE.

Recommendation

That the submission be accepted.

Issue: Employer sponsored super schemes investing into a PIE

Submission
(567 – Mercer Human Resource Consulting)

Employer-sponsored registered superannuation schemes should be permitted to invest into an Australasian shares PIE with a portfolio investor rate of 33% to obtain the PIE treatment for capital gains on such holdings, but to otherwise continue to operate as at present and without the need to apply look-through.

Comment

Simpler PIE tax rules are being recommended for superannuation funds (which should address many of the compliance cost concerns of being a PIE). Further, under the proposed safe harbour from the investor requirements, superannuation schemes that are eligible to be PIEs but do not elect to be a PIE can hold up to 100% of another PIE. This should allow these schemes to invest in a PIE and get the benefit of the exclusion from tax for Australasian share gains, without having to be a PIE themselves.

Recommendation

That the submission be accepted.

Clause 85

Issue: Investment value requirement

Submissions

(597a – PricewaterhouseCoopers, 12a – NZ Funds, 578 – NZICA, 569 & 608 – ING, 589 – KPMG, 594 – New Zealand Law Society, 595 – AXA, 679W – Goldman Sachs JBWere, 613W – Phillips Fox, 734W – Todd Corporation)

The investment value requirement should apply only in relation to equity investments in companies and should be measured in terms of the PIE's voting interest in the underlying company. These requirements should not apply to debt investments or investments in land.

"Value" in section HL 6(6)(b) should be defined to mean "fair value" as adopted for accounting purposes. The way the investment size test is expressed, by reference to the "value of the entity's assets", is ambiguous. The commentary to the bill indicates that this is an "ownership interest" (equity) and, if that is the case, then the fact it refers to equity interests (and does not apply to investments in debt securities) should be clarified in the legislation.

The investment value requirement should be removed or relaxed for PIEs that qualify under the proposed "safe harbour" or as long as the PIE does not exert control over the investment. A single investment must not exceed 49% of the PIE's total assets.

The investment value requirement should be amended to allow a PIE to hold all of the shares in a New Zealand resident single asset company and still qualify for PIE treatment even if the special purpose company makes up more than 10% of the total portfolio.

It appears more appropriate that the proposed 10% maximum investment size requirement, to the extent to which one asset can dominate a portfolio, should be increased to 25%.

Comment

Officials agree that the investment value requirement should apply only to equity held in a company (that is, a PIE would be allowed to hold up to 100% of non-equity investments such as debt or land). Our understanding is that property funds, for example, typically hold greater than 20% interests in land and buildings, either directly or through a holding company (defined as a company whose assets are 90% or more and, in substance, in the form of land). We consider that this should continue to be allowed under the PIE rules, as the tax status of property investments (unlike Australasian equities) would not change.

We also agree that investment value requirement should be measured by reference to the percentage of the total voting interests in the company held by a PIE. Officials do not agree that the references in section HL 6(6)(b) should be to "fair value" as the Income Tax Act 2004 does not employ this concept.

We agree with submissions recommending that the investment size requirement should be raised to 20% for investments in companies, without the need for a PIE to offer a facility for investors to redeem their interest in the PIE at an estimated market value. We understand that such a "buy-back" requirement is of significant concern to listed entities who currently do not offer such a mechanism (the investment can only be redeemed in a secondary market) as well as superannuation schemes. Removing the "buy-back" requirement and raising the investment size threshold from 10% to 20% (the level at which the Takeovers Code generally applies) should address many of the concerns raised.

Officials do not consider that the investment size requirement should be abandoned altogether for equity investments, as suggested in some submissions. Along with the investor requirements, the investment size requirement is necessary to ensure that the benefits of the PIE tax rules are available only to genuine widely held investment vehicles. These vehicles should be portfolio investors, which the maximum investment size requirement of 20% for interests in companies would achieve.

Recommendation

That the submissions recommending that the investment size requirement only be applied to equity held in a company and be measured by reference to the percentage of the total voting interests in the company held by a PIE be accepted. We also recommend that the investment size requirement be raised to 20% (from 10%) without the need to offer a buy-back mechanism to investors.

Issue: Buy back requirement

Submissions
(12a – NZ Funds, 578 – NZICA, 569 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 551 – Macquarie Goodman, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 590 – Property Council, 552 – Kiwi Income Property Trust, 577 & 577a – ASB Group, 608 – ING Property Trust, 674W – Waterfront Industry Superannuation Fund)

The investor repurchase requirement for PIEs should be removed or a safe harbour from this requirement should be implemented for unit trusts, superannuation schemes, GIFs, listed property trusts and life insurance companies.

Comment

As noted in response to the previous submission, officials agree with submissions to remove the investor repurchase requirement for PIEs, as it would not be possible for superannuation funds (including those offering KiwiSaver) and listed entities to meet this requirement. Officials consider that the other eligibility criteria are sufficient to ensure that only genuine collective investment vehicles are able to qualify as PIEs.

Recommendation

That the submissions be accepted.

Issue: Type of investments

Submissions
(597a – PricewaterhouseCoopers, 12a – NZ Funds, 578 – NZICA, 569 & 608 – ING, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group)

An investment in a life insurance policy should be added to the list of eligible investments in section HL 6(5)(b).

It is not appropriate to adopt a detailed list approach for the allowable investments for a PIE. Instead the list of eligible investments should provide that 90% or more of a PIE's assets should comprise:

- an interest in land;
- a financial arrangement or excepted financial arrangement;
- rights or options relating to land, financial arrangements and excepted financial arrangements; and
- any derivative investment approved by the International Swap Dealers Association.

The list of things that an entity can invest into in section HL 6(5) should be able to be updated and amended, perhaps through Order in Council. Life insurance, securitisations, and finance leases and derivatives based on commodity prices are four further investment products that should be on the list in section HL 6(5).

An indirect investment in land should come within the scope of the investment-type requirement.

Consideration should be given to how deferred tax assets fit within the financial arrangement rules. As it stands, an entity with a significant deferred tax asset could be precluded from satisfying the PIE rules.

Comment

Officials agree that the investment-type requirement under the PIE tax rules is too prescriptive. We consider that the list of eligible investments for PIEs should encompass investments in land, financial arrangements and excepted financial arrangements, rather than attempting to provide an exhaustive list. Both financial arrangements and excepted financial arrangements are currently defined terms.

We also consider that a requirement that at least 90% of the taxable income derived by a PIE be from investments in land (rents only), financial arrangements (such as interest), excepted financial arrangements (such as dividends from New Zealand companies) and foreign investment fund income (under the fair dividend rate) should be included in the eligibility criteria. Together with the investment-type requirement, this "income-type" requirement is designed to ensure that PIEs are set up primarily for the purpose of investment and savings.

Recommendation

That the current prescriptive list of eligible investments (under the investment-type requirement in the PIE tax rules) be replaced with a requirement that at least 90% of the PIEs assets are in land, financial arrangements or excepted financial arrangements. We further recommend that the investment-type test be further buttressed by a requirement that at least 90% of the taxable income derived by a PIE be rents from investments in land, income from financial arrangements, excepted financial arrangements and FIF income.

Issue: Private equity funds electing to be PIEs

Submission
(593 – Westpac NZ/BT Funds Management NZ)

A private equity fund with a fixed term should be able to elect to be a PIE without being restricted to having only 10% of its investments in 25% or greater interests in New Zealand companies, and without being required to offer to repurchase units.

Comment

Officials consider that the portfolio-into-portfolio concept of the PIE tax rules is important. Private equity does not typically fit into such a framework. Investors in private equity, typically take a controlling interest in the companies they invest into (often being involved in their management). The PIE tax rules are not specifically designed to apply in these cases (although PIE would be able to hold up to 100% of an underlying company if the total of all such investments does not exceed 10% of the total assets of the PIE). We do not consider that a special exception should be made for private equity funds to become PIEs where the fund takes ownership interests of greater than 20% in underlying companies (and these investments comprise more than 10% of the total value of the fund).

Recommendation

That the submission be declined.

Clause 85

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 12a – NZ Funds, 578 – NZICA, 569 – ING, 551 – Macquarie Goodman, 593 – Westpac NZ/BT Funds Management NZ, 590 – Property Council, 585 – NZX, 552 – Kiwi Income Property Trust, 914W – Dominion Funds Group, 608 – ING Property Trust)

It is not realistic to require a PIE to determine whether a foreign entity which invests in it is a foreign investment vehicle. The definition of a foreign investment vehicle in the bill should therefore be relaxed. An option could be for the foreign investment vehicle requirement to be determined by reference to a simpler test which is in line with the present definition of "qualifying unit trust" in the Income Tax Act 2004.

A foreign investment vehicle should not be required to comply with the investor interest size requirement (under the PIE rules) and should be allowed to have fewer than 20 investors, if the vehicle can be regarded as a vehicle for collective investment either directly or indirectly despite the lesser number of investors.

The definition of foreign investment vehicle (as defined in section HL 6(10)) should be similar to NZICA's proposed definition of a PIE.

The following requirements should be removed from the foreign investment vehicle criteria:

- the investor size requirement;
- the investment-type requirement;
- the investment value requirement;
- the investor interest repurchase requirement;
- the independent management requirement;
- The investor interest adjustment requirement.

The foreign investment vehicle definition should only impose the investor class requirement and the investment-type requirement.

It would be appropriate to extend foreign PIE equivalents that are part of the investor class requirement to wholesale foreign PIE equivalents.

Comment

The foreign investor vehicle definition is designed to allow PIEs to hold up to 100% of a foreign investment vehicle and to describe foreign savings vehicles which can hold up to 100% of a PIE. As the PIE rules confer certain benefits to investors in PIEs, it is important that the ability to wholly own a PIE and for a PIE to hold 100% of another entity be restricted to genuine widely held savings vehicles. The mechanism for doing this, in the case of non-resident entities, is applying a subset of the PIE eligibility requirements to these foreign vehicles.

We recognise that some of the criteria may be difficult to apply as the PIE may not be able to source this information from the foreign vehicle. The information that a PIE may not be able to access will typically relate to other investors in the foreign vehicle. Therefore, for the purposes of the eligibility requirements to be a foreign investment vehicle, we consider that the investor size requirement should apply only to New Zealand resident investors in the foreign investment vehicle. That is, non-resident investors would be able to hold more than 20% of the foreign vehicle without breaching the foreign investment vehicle definition under the PIE rules. A PIE would be able hold any ownership interest in a foreign investment vehicle as long as no other New Zealand resident investor (for example, that is not a PIE, or an entity that would otherwise be allowed to hold 100% of a foreign investment vehicle) holds an ownership interest of 20% or greater.

In the case of foreign investment in PIEs, we consider that a rule is necessary to ensure that the foreign entity is a widely held vehicle. That is, a single non-resident investor should not be able to hold 100% of a PIE and gain access to New Zealand and Australian share trading gains tax free (as they would not gain the safe harbour if they had invested directly in New Zealand companies). Also, in many cases these investors would hold less than 20% of the New Zealand PIE and therefore would not jeopardise the New Zealand entity's PIE status.

Recommendation

That the submissions be declined. However, for the purposes of applying the investor size test to foreign investment vehicles, the investor size requirement should only apply in respect of New Zealand resident investors.

PIE INVESTMENTS IN PIES – QUALIFICATION CRITERIA

Clause 85

Submissions

(597a – PricewaterhouseCoopers, 588 – Trustee Corporation Association of NZ, 569 & 608 – ING Property Trust)

The eligibility criteria need to be amended to allow a PIE to hold 100% of another PIE. The circularity in the PIE eligibility criteria in proposed section HL 6(2), (6) and (8) means this outcome is not achieved.

Comment

Officials consider that the legislation already allows a PIE to hold up to 100% of another PIE. Therefore, no further amendment is required.

Recommendation

That the submission be declined.

Clause 85

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 12a – NZ Funds, 578 – NZICA, 569 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ,592 – Tower, 551 – Macquarie Goodman, 594 – New Zealand Law Society, 595 – AXA, 590 – Property Council, 586 – Promina Group Ltd, 585 – NZX, 552 – Kiwi Income Property Trust, 595 – Brook Asset Management, 556 – AMP, 557 – AllianceBernstein, 567 – Mercer Human Resource Consulting, 574 & 574a – Staples Rodway, 577 & 577a – ASB Group, 925W – ASFONZ, 1221 – Ernst & Young, 314 – Aspiring Asset Management, 479W – Walker Capital Management, 604W – Meat Industry Superannuation Scheme, 608 – ING Property Trust, 734W – Todd Corporation, 618W – The Retire Fund, 674W – Waterfront Industry Superannuation Fund, 1131 – David Patterson)

The independent management requirement should be removed. If not, clarification is needed as to the applicable test for association in section HL 5(4).

The independent management requirement should be amended to allow investors that also manage the PIE to hold a 20% interest in the PIE.

The independent management requirement should be amended to accommodate common structures within the savings industry, including the fund manager or associates having an interest in the fund.

The independent management requirements in HL 5(4) should be amended to include an exception for other investment vehicles where no underlying investor can influence investment decisions. Alternatively, a provision could be drafted that allowed investment decisions made under a delegated independent investment mandate, to be deemed to be operated under independent investment management.

Often fund managers have a vested interest in their property fund. This should not preclude them from becoming a PIE.

Comment

Officials agree with submissions that the independent management requirement creates uncertainty as to what level of ownership interest in a PIE the fund manager can maintain. The current wording of this requirement has been interpreted as precluding any investment in the PIE by management; this was not intended. Officials also consider that the other PIE eligibility requirements (such as the investor and investment requirements) are sufficient to ensure that only genuine widely held investment vehicles can qualify as a PIE. As with any other general investment in a PIE, the manager / trustee would be able to hold up to a 20% interest.

Recommendation

That the submissions that the independent management requirement be removed from the PIE eligibility criteria be accepted.

Clause 85

Issue: Inadvertent breaches

Submission
(596 – ISI)

If an entity elects to be a PIE and sets up systems to meet the requirements discussed below, it should remain a PIE unless it elects out or winds up. The permanent loss of PIE status because of an inadvertent breach or a breach outside the control of a manager is unreasonable.

Comment

The PIE tax rules contain comprehensive temporary breach rules for PIEs. Under these comprehensive rules, PIEs would have up to six months to correct temporary breaches. It is also worth noting that the proposed safe harbour from the investor tests in the PIE tax rules for entities that meet paragraphs (a), (c) to (e) of the qualifying unit trust definition should also mean that qualifying unit trust status would need to be lost before this safe harbour is breached. Even if qualifying unit trust status is lost, the entity would still be able to rely on the temporary breach provisions in the PIE rules.

Officials have earlier recommended a number of amendments to both the investor requirement (investor class and size requirements) and investment size requirements which should reduce the scope for breach of these criteria and therefore loss of PIE status. These include a number of exemptions from the investor requirements for certain widely held entities, and raising the investor size requirement and investment size requirement to 20%.

Recommendation

That the submission be declined.

Issue: Loss of PIE status on a prospective basis

Submissions

(597a – PricewaterhouseCoopers, 569 & 608 – ING, 593 – Westpac NZ/BT Funds Management NZ, 595 – AXA, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 585 – NZX, 595 – Brook Asset Management, 1221 – Ernst & Young)

If PIEs have to lose their PIE status, it should only be on a prospective basis. A PIE should lose its PIE status from the end of the next quarter (six months after the initial breach is notified) or the following 1 April.

Where a breach occurs, a PIE should have two quarters from the earlier of when it is notified of the breach or should reasonably have known of the breach before triggering the loss of PIE status.

Comment

Officials agree with the principle of submissions that loss of PIE status should be prospective. We consider that PIE status should be lost if a PIE fails to meet the relevant eligibility criteria on the last day of two consecutive quarters (that is, a period of 6 months). PIE status would be lost from the start of the third quarter.

Recommendation

That submissions be accepted, subject to officials' comments.

Issue: Consequences of breach

Submissions

(596 – ISI, 597a – PricewaterhouseCoopers, 556 – AMP, 568 – Corporate Taxpayers Group, 577 & 577a – ASB Group, 914W – Dominion Funds Group)

If an investor's investment in a PIE gives rise to a breach of the investor eligibility requirements for a PIE, the consequences of the breach should fall on the investor instead of the PIE losing its PIE status. This would likely involve Australasian equity gains and losses otherwise not taxable being taxable at the investor level. The investor who breached the threshold should become subject to a prescribed investor rate of 0% and become taxable at his or her own marginal rate.

Comment

We consider that imposing the consequences of a breach on the investor – whose share of Australasian share gains would no longer be excluded income – for exceeding the investor size requirement could lead to uncertainty over how PIE tax should be calculated for that investor. (For example, what if the breach is only temporary?)

Furthermore, the use of the provisions in the qualifying unit trust definition as a safe harbour from the investor tests (and increasing the PIE ownership threshold generally to 20%) should significantly reduce the likelihood of a PIE breaching the investor requirements. Therefore, the suggested change of imposing the consequences of breaching the investor tests, under the PIE tax rules, is unnecessary.

Recommendation

That the submissions be declined.

Issue: Deliberate breaches

Submission
(578 – NZICA)

In addition to the temporary breach rules, a PIE should be given a reasonable opportunity to explain and correct a deliberate breach. If no action is taken by the PIE, the Commissioner should be given the power to revoke the PIE's status.

Comment

Officials consider that there should be no genuine reason for entities to deliberately breach the PIE rules. Breaches that are outside the control of the PIE will be dealt with under the temporary breach rules. Therefore, the suggested change is unnecessary.

Recommendation

That the submission be declined.

Issue: Removing temporary breach provisions

Submission
(578 – NZICA)

The temporary breach provisions in section HL 6(9) should be removed. The appropriate place to deal with eligibility is at the entry stage. Unless there is a material change in circumstance, such as a change of residence or complete change in the nature of activity, then PIE status should be uninterrupted.

Comment

We do not consider that it is desirable for the eligibility criteria to be applied only when an entity first enters the PIE tax rules, as this would negate their usefulness if the entity is subsequently used to circumvent the policy intent of the PIE tax rules. With regard to the temporary breach rules in section HL 6(9), these rules allow entities to maintain their PIE status if breaches of certain eligibility requirements are

temporary (and result from factors outside the entity's control) and are fixed within prescribed timeframes. In other words, this provision can only be of benefit to taxpayers and should therefore remain available.

Recommendation

That the submission be declined.

Issue: Notification of compliance with PIE rules/breaches

Submission
(569 & 608 – ING, 599 – Kingfish Limited, 585 – NZX)

PIEs should provide quarterly certificates to the Inland Revenue as to their status (whether they have breached or not). If a PIE breaches its status it will notify the Inland Revenue as part of its quarterly certificate and resolve the breach by the end of the following quarter. If it fails to resolve the breach, it will notify all investors that it will lose its PIE status within 60 days of notification by the Inland Revenue.

Comment

Officials consider that PIEs should not need to provide compliance certificates to Inland Revenue on a quarterly basis. Currently, entities that are qualifying unit trusts, for example, do not need to provide such certification unless they fail to meet the relevant criteria. We therefore consider that PIEs should be required to notify Inland Revenue only if they fail to meet the eligibility criteria (and in the case of temporary breaches, where the breach is not rectified within the prescribed timeframe).

Recommendation

That the submission be declined.

Issue: Length of temporary breach period

Submissions
(589 – KPMG, 593 – Westpac NZ/BT Funds Management NZ, 314 – Aspiring Asset Management)

The allowed temporary breach period for new PIEs should be longer than six months. A two-year time frame would be more workable.

The breach criteria, like existing qualifying unit trust criteria, should not be time bounded.

New investment funds can take time to gain traction as prospective investors wait for a track record to be established. Therefore the six-month grace period for PIEs to comply with eligibility requirements should be lengthened to 12 months to allow for new products to gain wide acceptance.

Comment

As noted earlier, the safe harbour from the investor tests for entities that meet the paragraphs (a), (c) to (e) of the qualifying unit trust definition and other proposed amendments to the investor size test means the likelihood of a PIE breaching these tests should be significantly reduced. Officials also consider that the current six-month period in the bill provides a sufficient grace period for any temporary breaches to be resolved. To have a period longer than this could provide opportunities for abuse of the PIE tax rules.

Recommendation

That the submissions be declined.

Issue: Clarification of factors within a PIE's control

Submission
(594 – New Zealand Law Society)

The reference in section HL 6(9)(b) to the entity's failure being "due to factors within (its) control" is ambiguous.

Comment

The temporary breach rules under the PIE eligibility criteria are designed to apply where one or more of the relevant eligibility criteria (such as the investor size or investment size requirements) are not met, the breach is of a temporary nature, and the reason for the breach is outside the control of the entity.

In relation to the breach being due to factors outside the PIE's control, this is where the breach has not arisen owing to actions of the PIE. An example of this is where the 20 investor requirement is not met because a large number of investors exit the PIE (which may also result in the 20% investor size requirement being breached as remaining investors may hold more than 20% of the underlying assets). Similarly, the proposed investment size requirement of 20% could be breached for no fault of the manager, because the PIE's holding in an underlying company increases as a result of other investors in the company exiting.

The temporary breach rules are designed to provide adequate time to undertake remedial measures to ensure compliance with the relevant PIE eligibility criteria is restored.

Recommendation

That the submission be noted.

Issue: Application of grace period to foreign investment vehicles

Submission
(594 – New Zealand Law Society)

Foreign investment vehicles should be given the benefit of the same grace periods as applied to a PIE in section HL 6(9).

Comment

Officials agree with the submission.

Recommendation

The submission be accepted.

Issue: Consequences of loss of PIE status

Submissions
(584 – Smartshares Limited, 567 – Mercer Human Resource Consulting, 568 – Corporate Taxpayers Group, 604W – Meat Industry Superannuation Scheme)

A permanent breach of the PIE rules causing a PIE to lose its PIE status should not constitute a permanent exclusion from PIE status, particularly in view of the fact that entities will likely incur high compliance costs.

Comment

The restriction on entities re-entering the PIE tax rules post-breach is designed to prevent entities from manipulating the rules. If entities were allowed to deliberately breach the PIE tax rules with no consequences (that is, if they were able to re-enter the rules in the following year), these entities would effectively be able to pick the years in which they were PIEs, according to the relative tax benefits. This could create undesirable incentives for PIEs to deliberately breach the PIE rules when Australian and New Zealand share markets are making losses (as doing so would remove the safe harbour on Australasian share gains, allowing capital losses to be claimed as a deduction) and re-enter the rules when the market increased in value. Officials therefore consider that if a PIE deliberately breaches the PIE eligibility criteria, there should be no opportunity for it to become a PIE in future. It should be noted that PIEs would be able to voluntarily cease to be a PIE (by giving notice to the Commissioner). However, the entity would not be eligible to re-enter the PIE tax rules for a period of five years, to prevent gaming.

It should also be noted that PIEs would have comprehensive temporary breach rules for factors outside their control (and the amendments proposed to safe harbour entities that meet certain provisions of the qualifying unit trust definition and to raise the investor size requirement should also reduce the risk of breach).

Recommendation

That submissions be declined.

Issue: Breach of portfolio-in requirements

Submission
(556 – AMP)

The submission questions the need for there to be any adverse consequences from breaching the portfolio-in (investor class and size) requirements.

Comment

The rationale for the investor class (minimum of 20 investors) and size (no single investor holding more than 20% of a PIE) requirements is to ensure that no single investor in the PIE (or group of associated investors) can control the investment decisions of the PIE. Exceptions to the investor tests are proposed for investments by other PIEs and vehicles which can broadly be described as widely held (and not controlled by any single investor). As outlined earlier, the PIE tax rules are designed to apply to vehicles that are genuine widely held savings vehicles.

Recommendation

That it be noted that the PIE tax rules are designed to apply to genuine widely held savings vehicles. Such vehicles, by definition, have investors that hold portfolio interests in the vehicle and are themselves portfolio investors in the companies they invest into.

Clause 85

Issue: Replace PIE entity tax with a final withholding tax

Submissions
(596 – ISI, 569 & 608 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 592 – Tower, 594 – New Zealand Law Society, 595 – AXA, 600 – Fisher Funds Management Limited, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group)

The bill should be amended to replace the PIE entity tax with a final withholding tax liability.

A flow-through regime similar to the current designated group investment fund rules provides a better result for both the industry and officials.

The PIE tax rules should be redrafted so that all investors are taxable on their share of PIE income; the PIE should withhold RWT from such income; and if desired PIE income could be excluded for social assistance calculation purposes.

Comment

The PIE entity tax approach has been adopted because it is considered to be the simplest approach, especially in relation to how the new rules interact with other provisions in the Act. We do not consider that an entity tax approach would result in a different tax outcome for investors (in relation to the application of their elected tax rates on portfolio investment entity income) than a withholding tax model.

Recommendation

That submissions be declined.

Issue: Financial reporting

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 593 – Westpac NZ/BT Funds Management NZ, 582 – National Provident Fund, 556 – AMP, 577 & 577a – ASB Group)

The legislation should be amended to provide that PIE tax is a tax paid by PIEs on behalf of investors. Financial reporting standards require a reporting entity to recognise as income tax any tax levied on the income of the entity. There remains a possibility that PIEs may have to show PIE tax in their financial statements. This would have implications for unit trusts, which would need to quote different unit prices, net of tax, for zero-rated, 19.5% and 33% investors. This would be impractical for these funds.

The PIE tax rules need to be re-written to better reflect that the tax liability is not the entity's. (The entity only calculates and withholds the tax on behalf of investors.)

Amendments should be made to the bill that deal with the situation where the outcome is not consistent with the principle of investor liability on attributed income and withholding tax, including a statement in the bill as to what is the substance of the regime and why it takes the entity-liability approach as a matter of form.

Comment

As noted above, the entity model for calculating PIE income tax has been adopted as it is considered the simplest method of taxing investors on their share of the PIE's income at the correct rate while ensuring that this income does not affect investors' other liabilities or entitlements. However, it is acknowledged that PIE income is, in economic substance, the investors' income. Officials therefore agree that the PIE tax rules would benefit from a purpose provision in order to clarify that the tax levied on behalf of an investor at the PIE level is intended to resemble the tax that an investor would pay on the income if the investor had made the investment directly. A purpose provision of this nature should reduce the risk that entities would be required, for financial reporting purposes, to recognise as income tax any tax levied on the income of the PIE.

Recommendation

That those submissions requesting the inclusion in the PIE rules of a purpose provision relating to financial reporting be accepted.

Clause 85

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 592 – Tower, 556 – AMP, 572 – New Zealand Fire Service Superannuation Scheme, 577 & 577a – ASB Group, 1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan, 604W – Meat Industry Superannuation Scheme, 679W – Goldman Sachs JBWere Transtasman Unit Trust, 966 – New Zealand Harbours Superannuation Plan, 618W – The Retire Fund, 674W – Waterfront Industry Superannuation Fund, 569 & 608 – ING, 593 – Westpac NZ/BT Funds Management NZ, 586 – Promina Group Ltd)

A PIE should have the option of attributing income to investors annually and be able to attribute income and account for tax on behalf of withdrawing investors quarterly.

Comment

The bill as currently drafted does not provide PIEs with the ability to attribute income to investors annually. The bill provides that PIEs must allocate income to investors at least quarterly and pay PIE tax on that income at least quarterly (or more often at the election of the PIE). The quarterly attribution and payment of tax ensures that tax receipts from PIEs are not deferred.

The bill also provides that the PIE will be liable for tax on all the income that they earn during the quarter – even if an investor exits during the quarter. Officials recognise that this approach could result in significant investor equity issues for some PIEs. This is because the tax liability on the PIE income for the quarter – including the income that was attributed to exiting investors – would be borne by those investors that remained in the PIE at the end of the quarter. The only way PIEs could address this issue would be to approximate an amount of tax to withhold on exiting investors. Such an approximation would inevitably be inaccurate and would result in investor inequity.

It is therefore recommended that PIEs have the ability to pay tax on income earned in a period at 0% for those investors that have exited the PIE during the quarter and within five days after the end of the quarter. Under this approach, the PIE would inform Inland Revenue of investors that had exited during the year and how much taxable income had been allocated to each exiting investor. The outstanding PIE tax liability would then be a matter for Inland Revenue to follow up with the investor concerned.

Officials also consider that an annual attribution and payment of PIE tax should be permitted, provided that a fund accurately withholds tax when investors exit during the year. Under this approach, the fund would deduct an accurate amount of tax from the exiting investor’s proceeds and would return this to Inland Revenue in the month following the exit. While this would delay the tax receipts from those PIEs that adopted this approach, it would result in the most accurate and least administratively expensive method for collecting tax from PIEs.

Recommendation

That the submissions be accepted in part. That is, PIEs who calculate and pay PIE tax each quarter should be able to apply a 0% tax rate for investors who exit in a quarter. PIE should also be provided with the option of attributing and calculating PIE tax annually provided that they withhold tax accurately from investors exiting the PIE during the tax year and pay that tax to Inland Revenue in the month following the month in which the investor exists the PIE.

Clause 85

Issue: Allocation of income to PIE investors

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 12a – NZ Funds, 569 & 608 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 592 – Tower, 594 – New Zealand Law Society, 598 – Trustees Executors, 582 – National Provident Fund, 556 – AMP, 577 & 577a – ASB Group, 925W – ASFONZ)

PIEs should be able to use any attribution method that meets the overriding requirement that all taxable income is attributed and the attribution results in investors being allocated income that reflects their actual economic interest in the PIE. Inland Revenue should have the discretion to accept the methods adopted, subject to meeting these requirements. Clear guidance on the attribution methods that PIEs will be required or allowed to use should be made public as soon as possible as this information is fundamental to the design and development of systems required to undertake flow-through.

The legislation should provide a framework for a calculation and attribution mechanism, but with sufficient flexibility for a particular manager's circumstances. Therefore the bill should cater for fund managers who are able to accommodate more accurate taxable income and tax credit calculations, while retaining the rules currently in the bill for those who cannot. For example, where a fund manager spreads items in a manner that is acceptable for unit pricing and accounting purposes, and such spreading accords with the trust deed, then the spreading should also be acceptable for PIE tax calculation purposes.

All PIEs should perform taxable income calculations based on taxable income and tax credits attributable to each investor to ensure fair and equitable results.

The methodology for attributing income should be made more flexible so that the different methods actually applied by funds can be used to allocate income for tax purposes as well.

The legislation should explicitly recognise the strict fiduciary responsibilities of fund trustees to treat investors equitably and the effect this may have on the PIE's ability to return the exact amount of tax payable. In some cases, it may not be possible to strictly apply the tax rules and collect every cent of tax due, while discharging its fiduciary responsibilities. This requires that the new regime sensibly balances the trustee's fiduciary responsibilities with the complexity of the regime and compliance costs associated with collecting the exact amount of tax.

The Commissioner should have the ability to agree to the particulars of any given approach.

Comment

Officials acknowledge that the current bill does not provide sufficient flexibility to PIEs in calculating PIE tax. The current drafting does not recognise that different PIEs may adopt different methods for attributing income to their investors.

Officials agree with the general principle that the PIE tax rules should recognise income in the same manner that the PIE allocates that income to investors. In other words, as a general rule, the tax liability of the PIE should equal the aggregate of all amounts attributed to investors, multiplied by each investor's tax rate for the tax calculation period.

Officials therefore agree that the PIE tax calculation methodologies should be redrafted to provide PIEs with additional flexibility to ensure that a calculation methodology is available that reflects the way that the particular PIE attributes income to its investors.

Additional flexibility can be achieved by generally allowing PIEs to choose the period that income is allocated to investors for tax purposes. As a general rule, this would allow PIEs to ensure that the allocation period for tax purposes matches their allocation period for commercial purposes. For example, a unit trust that calculates unit prices daily (and therefore allocates income to investors daily) will be able to choose a daily allocation period for tax purposes.

In addition, the rules can be made even more flexible by ensuring that the period that the PIE recognises income and expenditure for commercial purposes is mirrored by the period the amounts are recognised for tax purposes. A good example of this is expenditure on audit fees. While these fees are often formally incurred for tax purposes at the end of the tax year, a PIE will often recognise these fees for commercial purposes from the beginning of the year to which the expenditure relates.

It is also recognised that the current rules do not accommodate non-unitised superannuation funds adequately. The recommendations outlined later in this report should allow such funds to calculate their PIE tax in a manner that more closely reflects the way they currently pay tax.

Recommendation

Officials agree with submissions that, in general, allocation of income under the PIE tax rules should mirror the allocation that the PIE performs for accounting or unit pricing purposes.

Issue: Definition of income to follow IFRS

Submissions
(596 – ISI, 569 & 608 – ING, 589 – KPMG, 593 – Westpac NZ/BT Funds Management NZ, 598 – Trustees Executors, 586 – Promina Group Ltd)

The bill should provide that taxable income calculated under generally accepted accounting principles or IFRS (for unit pricing) should be acceptable, notwithstanding other provisions of the Income Tax Act 2004.

The tax timing rules should be aligned with the rules for recognising income and expenses for accounting and unit pricing.

The calculation of PIE taxable income should be able to be based on the calculation of investor returns. An allocation of income and expenses that is applied for unit pricing and/or financial reporting should be acceptable for tax purposes, provided any differences that arise are merely timing differences, and the allocation is not done with the intention and effect of avoiding tax.

Comment

As noted above, officials agree that additional flexibility can be achieved by ensuring that the timing of income and expenditure under the PIE tax calculation follows the timing of that income and expenditure for accounting and unit pricing purposes.

Recommendation

That the timing of income and expenditure under the PIE tax calculation should follow the timing of that income and expenditure for accounting and unit pricing purposes.

Clauses 144, 145, 148, 154 and 155

Issue: Disclosure requirements

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 569 & 608 – ING, 594 – New Zealand Law Society, 582 – National Provident Fund, 567 – Mercer Human Resource Consulting)

Likely disclosure requirements (such as quarterly returns and the annual reconciliation) should be conveyed in a timely manner (that is, before enactment of legislation) as this information is essential for systems development. This includes the form of any prescribed information required to be provided by PIEs to their investors.

The bill should contain a provision similar to section 29 (shareholder dividend statements) of the Tax Administration Act 1994 requiring PIEs to provide investors with information such as:

- Their amount of income or loss from the PIE for the year. This is necessary for zero-rated investors so they can complete their tax returns, and for others so they can determine whether or not they are over the $48,000 threshold for the first quarter of the next year.
- For zero-rated investors, the amount of PIE tax credits they are entitled to and, in relation to foreign tax credits, the amount of foreign source income attributable to them from the PIE (since their ability to claim a credit is limited to the tax on their foreign source income).

Comment

Inland Revenue officials are consulting on the form and content of information that prospective PIEs will need to provide to Inland Revenue.

Officials consider that PIEs should be required at the end of each year to provide to their investors information that the Commissioner of Inland Revenue prescribes. This information would include details of the investor's share of the PIE's taxable income and the rate that the PIE has used on behalf of that investor. This should ensure that all categories of PIE investors are provided with the necessary information to comply with their tax obligations.

Officials consider that this can be achieved with a general provision that requires PIEs to furnish information to investors in a form prescribed by the Commissioner of Inland Revenue.

Recommendation

That PIEs be required to provide their investors with the information prescribed by the Commissioner of Inland Revenue (such as their share of the PIE's income and the tax rate used on behalf of the investor).

Issue: Payment of tax and provision of returns

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 12a – NZ Funds, 569 & 608 – ING, 595 – AXA, 582 – National Provident Fund)

Tax payments and returns for PIE attributions should be due on the 15th of the second month following the end of the month that the attribution is undertaken.

The annual reconciliation showing PIE tax paid for the year should be due on 30 June each year (instead of 20 May as the bill currently provides).

A PIE should only be required to submit a return quarterly regardless of the PIE's portfolio entity period.

An annual return should only be used to collect information, not as a reconciliation or wash-up.

Section 57B of the Tax Administration Act 1994 should be amended to specify the information required to be submitted to the Commissioner of Inland Revenue.

Comment

The current bill requires that tax payments and PIE returns are due by the end of the month immediately following the end of the PIE's calculation period. This effectively gives PIEs one month to calculate and pay their PIE tax. Officials consider that this one-month period is sufficient and should not be extended.

Officials agree that the date by which the annual reconciliation statement must be filed should be extended to 30 June.

The current bill contemplates and provides for PIEs that choose to allocate income to investors more regularly than quarterly (for example, daily). The relevant submission concerns how often such PIEs would be required to pay PIE tax. The issue has been superseded given our recommendations later in this report that PIEs generally not be permitted to calculate PIE tax for investors (remaining in the PIE) more often than quarterly.

The current annual return requirement only requires information to be provided and does not require a tax reconciliation or wash-up. Therefore no amendment is required.

Officials consider that it would not be desirable to closely prescribe in section 57B of the Tax Administration Act 1994 the information required to be included in PIE returns because this would be too inflexible. It may be necessary to change returns at short notice to take account of changing circumstances, and this would take much longer if the legislation had to be periodically amended to allow this. Such a non-prescriptive approach is consistent with other return-filing requirements.

Officials further consider that PIEs that wind up or permanently breach the PIE eligibility rules should be required to complete all return and payment obligations within two months of the date of cessation.

Recommendation

That the submission recommending that the annual reconciliation showing PIE tax paid for the year should be due on 30 June each year (instead of 20 May as the bill currently provides) be accepted, and PIEs that wind up or permanently breach the PIE eligibility rules be required to complete all return and payment obligations within two months of the date of cessation. It is further recommended that the remaining submissions be declined.

Issue: Matching income year to tax year

Submissions
(567 – Mercer Human Resource Consulting, 925W – ASFONZ)

Section HL 2(3)(d) has the effect of making all PIEs have income years coinciding with the tax year. For practical reasons this is likely to move all PIEs to balance dates of 31 March. This will create significant resourcing issues in the managed funds industry.

The bill proposes that all PIEs have an income year ending 31 March. A significant number of current schemes have balance dates other than 1 April, and it is not clear that an additional workload at that date can be managed.

Comment

PIEs that are required to attribute income regularly to their investors should be required to have the same tax year as the majority of their investors – namely the standard tax year ending on 31 March. This is important as a number of PIE investors will need to know in a timely manner how much PIE income they have earned for a tax year.

In addition, Inland Revenue will be issuing refunds to certain PIEs that have incurred tax losses during the year or have excess tax credits. This process would be better facilitated if the end of the PIE's tax year matched the end of the standard tax year.

However, certain PIEs (such as listed company PIEs and PIEs that elect to remain as provisional taxpayers) will not attribute income regularly to their investors and will not receive refunds for tax losses incurred during the year or excess tax credits. There is less necessity for these types of PIEs to match their tax year with the standard tax year. It is therefore recommended that these PIEs be permitted to have an income year that does not end on 31 March.

Recommendation

That the submissions be accepted in part. That is, PIEs that are not required under the PIE tax rules to calculate PIE tax regularly should be permitted to have an income year that does not end on 31 March.

Issue: Income year aligned with PIE tax period

Submission
(595 – AXA)

A new section should be introduced for the purposes of subpart CX defining the income year as being a period consistent with a PIE period. For example, the market value and smoothed market value methods under the proposed international tax regime would need to apply based on a PIE tax period.

Comment

Officials agree with the submission's general point that the PIE tax calculation period should function appropriately with the proposed international tax rules. Under the fair dividend rate method this should be achieved by ensuring that the fair dividend rate reflects the PIE's tax calculation and allocation periods.

Recommendation

That the submission be accepted subject to officials' comments.

Issue: Treatment of losses and excess credits

Submissions
(595 – AXA, 556 – AMP)

New section HL 11 should be amended to allow yearly attribution.

PIEs should be given the option (but it should not be mandatory) to be allowed to adjust PIE tax so that quarterly losses can be used over the income year.

Comment

Officials accept the submissions' argument that not providing PIE investors value for losses incurred in one calculation period to offset income derived in later calculation periods is problematic. One option would be to allow PIEs that incur losses in one calculation period to offset those losses against profits in later calculation periods. Officials have considered this option but have concluded that it would add significant complexity to the mechanics of the PIE tax calculation.

Officials consider that the issue can be more appropriately addressed by providing a refund of tax to PIEs that calculate PIE tax quarterly to compensate for any losses or any excess tax credits in a quarter. These PIEs would then be required to allocate the benefit of these losses and credits appropriately among their investors. Providing refunds to PIEs in this way would remove the need to rebate these amounts directly to investors.

Recommendation

That, although the concern raised by the submission is valid, the issue be dealt with by providing refunds to PIEs that calculate PIE tax quarterly, for losses and excess tax credits.

Issue: Requiring equitable income calculations

Submissions
(598 – Trustees Executors, 567 – Mercer Human Resource Consulting)

PIEs should be able to perform taxable income calculations based on the frequency on which investors can enter and exit the PIE to ensure fair and equitable results for all investors. Such calculations will ensure that investors coming into a fund or exiting during a calculation period will be taxed correctly on income they actually derive. It would allow investors to enter and exit PIEs as they currently do and all investors will be treated equitably. Any potential for abuse should also be removed.

PIEs should be able to determine PIE tax on a daily basis without averaging class income over the portfolio entity period.

Comment

Officials agree with the submissions. It is recommended that the bill be amended to allow PIEs to choose the frequency that income is allocated to investors.

Recommendation

That submissions be accepted.

Issue: Legislating multiple unit pricing model

Submission
(598 – Trustees Executors)

A multiple unit pricing model should be specifically legislated for in order to calculate and return PIE tax at the investor's correct marginal tax rate.

Comment

Officials consider that it is unnecessary to legislate specifically for a multiple unit pricing, as suggested by the submission. The current rules would allow PIEs to run a single gross unit price for investors that have elected different tax rates. Investors' individual tax rates would be reflected when the PIE adjusts investors' interests at the end of the PIE's calculation period (as the proposals would require for most PIEs).

Recommendation

That the submission be declined.

Issue: Alternative method: separate PIEs for different rate investors

Submission
(598 – Trustees Executors)

An alternative model would involve funds setting up three PIEs to cater for 33%, 19.5% and 0% rate taxpayers respectively. This model ensures that investors are taxed at their correct marginal rate.

Comment

There is nothing in the proposed rules that would prevent the establishment of separate PIEs for investors with different tax rates.

Recommendation

That the submission be noted.

Issue: Aggregation of losses, credits and net income for the year

Submission
(600 – Fisher Funds Management Limited)

Losses, credits and net income for each quarter should be accumulated until the end of the year and the payment made to Inland Revenue in the month following the end of the year. This achieves a fairer treatment for the investor and involves less administration for PIEs and Inland Revenue.

Comment

This issue has been superseded by the recommendation to allow PIEs that calculate PIE tax quarterly to receive a refund for losses incurred during a quarter, as well as for excess credits.

Recommendation

That the submission be noted.

Issue: Alternative method: rebate for 19.5% and 0% investors

Submission
(1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan)

Inland Revenue should investigate a process under which a scheme pays tax at 33% and individuals claim back a rebate similar to the charitable donation rebate regime based on the attribution certification given.

Comment

The submission would result in increased compliance costs for investors and significantly increased administrative costs for Inland Revenue. To prevent 19.5% investors from being overtaxed under the system suggested by the submission, each 19.5% investor would be required to claim a rebate, and Inland Revenue would be required to process each individual claim.

Recommendation

That the submission be declined.

Issue: Alternative method: PIE tax rate of 19.5%

Submission
(1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan)

Instead of attribution, the tax rate for genuine long-term superannuation schemes should be reduced to 19.5%. Not only would this solve the complexity, it would also stimulate genuine retirement savings much like other developed countries where retirement savings have a concessionary tax treatment.

Comment

The suggestion would amount to a significant tax concession for investment through managed funds. This is inconsistent with the policy underlying the proposals, which is to level the playing field between direct investment and investment through managed funds.

Recommendation

That the submission be declined.

Issue: Inappropriate marginal investor tax rates

Submissions
(1143 – Retirement Policy & Research Centre, 1347W – Northplan Financial Services/Swain Investment Services/Colin Strang Financial Planning, 657W – Sothertons Chartered Accountants)

There appears to be no real justification for using anything other than the contributor's marginal tax rate. Accordingly, it is difficult to understand why the top rate applied by the PIE should be other than 39%.

For members earning more than $38,000, including PIE income, but less than $48,000, the appropriate rate that the PIE should apply to this group should be 33% because that is what the member would have paid on this income if it had been earned directly.

The 19.5% tax rate for those earning less than $38,000 a year will be inappropriate for almost every contributor. The rate for this group should be 21%. The bill provides an ideal time to remove the "under $38,000 rebate" and to formalise four statutory tax rates of 15%, 21%, 33% and 39%.

An alternative solution is to formalise the 19.5% tax rate for investment income for those under a total income of $38,000. This could be achieved by making the resident withholding rate applied by banks a final rate of 19.5%. It would also be necessary to gross up benefits and New Zealand Superannuation so that they are taxed at 19.5% and not give New Zealand superannuitants the under $38,000 rebate.

Comment

Officials acknowledge that arguments can be made for taxing income relating to 39% PIE investors at 39%. It should be noted, however, that the 33% tax rate cap applying to PIEs was chosen to remove the dilemma that trustees of certain funds would otherwise face. That is, if the top PIE tax rate were 39% the trustee of a superannuation fund that is currently taxed at a final rate of 33% would face a dilemma of whether to elect into the PIE rules, as such an election would advantage the fund's 19.5% investors but could disadvantage the fund's 39% investors. This would be a significant practical concern facing funds and, on this basis, officials recommend retaining a top PIE tax rate of 33%.

Officials acknowledge that arguments can be made to retain the boundary between the 19.5% rate and the 33% rate at $38,000. The proposal to set the boundary at $48,000 was to ensure that, in situations where someone's PIE income from the previous year causes total income to exceed $38,000, they would not be overtaxed on their PIE income. Such over-taxation could otherwise occur as investors would be required to elect a 33% PIE tax rate and have all their PIE income taxed at 33% – even though a portion of the PIE income for the previous year would have been below the $38,000 threshold. The proposed $48,000 boundary would solve this issue in most cases.

As discussed earlier, we are recommending that the proposed rules for investors selecting a PIE tax rate be amended so that investors would be required to elect a 33% rate if their income, other than PIE income, from the relevant previous year exceeded $38,000. The exclusion of PIE investment income would also address the over-taxation issue discussed in the previous paragraph. However, a rule is needed to ensure that investors with very little non-PIE income (for example, employment income) but significant levels of PIE income are unable to get the 19.5% tax rate on their income from PIEs. We therefore consider a further rule, which would require investors whose combined income in the relevant previous year from PIEs and other sources exceeds $60,000 to elect the 33% tax rate on their PIE income, is warranted. This $60,000 threshold should balance the potential over-taxation of PIE income with the need to ensure the PIE rules do not create opportunities to reduce tax inappropriately.

Officials accept that in many cases an investor's marginal tax rate on income earned below $38,000 is 21%. This is because investors earning below $38,000 are likely to be earning salary and wage income, and this income receives the benefit of the low income rebate that is clawed back by applying a 21% rate for income earned between $9,500 and $38,000. The low income rebate does not, however, apply for investment income. For investment income a simple 19.5% RWT rate applies. Given that PIE income is investment income, officials consider that it is appropriate to retain the current proposal with the 19.5% rate rather than have a 21% rate applying for PIE income.

It is acknowledged that other methods, such as the one suggested by the submission, may be available for effectively making the 19.5% statutory rate more transparent for investment income. Consideration of such methods is, however, beyond the scope of this project.

Recommendation

That the submission concerning the $48,000 boundary for electing a 33% rate be accepted in part. That is, the boundary for investors electing a 33% rate should be set at $38,000 without the need for investors to include PIE income from the relevant previous year (unless combined PIE income and other income exceeds $60,000).

Clause 85

Issue: Applying the provisional tax rules to PIEs

Submission
(578 – NZICA)

For the purposes of accounting for PIE tax, a PIE should pay provisional tax as it does currently and offset this against any liability for PIE tax on behalf of investors that arises under section HL 10.

Comment

PIEs will generally pay income tax regularly and accurately on their income for the calculation period. There is, therefore, no need to require these PIEs to pay provisional tax.

PIEs will, however, have the option of continuing as a provisional taxpayer – provided they meet a number of criteria (discussed later). It is envisaged that a number of superannuation funds and listed companies will elect this option.

Recommendation

That the submission be declined.

Issue: Extension of time for payment of PIE tax for listed entities

Submissions
(551 – Macquarie Goodman, 590 – Property Council, 552 – Kiwi Income Property Trust, 569 & 608 – ING Property Trust)

Under the NZX listing rules, the minimum period between announcing dividends and making the actual payment is three weeks. It is therefore unworkable for listed property trusts to pay the PIE tax by the last day of the month following the date on which the quarterly calculation would take place. Accordingly, listed entities should have an additional month to pay PIE tax.

Comment

Officials acknowledge the problem outlined by the submissions. It is noted, however, that the problem would not arise under the recommended PIE tax calculation method for listed companies.

Recommendation

That the submission be noted.

Issue: Payment dates for end of year PIE tax

Submission
(572 – New Zealand Fire Service Superannuation Scheme)

The timeframe for the fourth quarter attribution and payment should be extended to at least 31 May – that is, two months after the end of the fourth quarter. This approach is consistent with fringe benefit tax.

Comment

There is no justification for providing a longer period to calculate and pay PIE tax for the fourth quarter than is provided for the other quarters. The calculation for the fourth quarter should be no more difficult than the calculations for the first three quarters as there is no reconciliation or wash-up required in the attribution and payment for the fourth quarter.

It should be noted that a superannuation scheme (such as the submitter's) that elected to pay PIE tax as a provisional taxpayer would continue to file returns as it currently does.

Recommendation

That the submission be declined.

INTRA-YEAR GAINS/LOSSES

Clause 85

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 582 – National Provident Fund, 586 – Promina Group Ltd, 567 – Mercer Human Resource Consulting, 925W – ASFONZ)

Under the quarterly attribution option, PIEs should have the option to offset gains and losses for an investor between quarters within the tax year, including (as a minimum) the ability to "carry forward" losses derived in one quarter to offset against gains in subsequent quarters of the same income year. Where a PIE tax liability arises in one quarter and a loss arises in a subsequent quarter, the PIE tax paid should be refunded to the PIE to the extent of the lesser of the PIE tax previously paid or the tax effect of the loss for the quarter using investors' tax rates.

The quarterly attribution approach should allow for timely refunds of PIE tax which has been paid in quarters which were followed by quarters in which losses were made.

Comment

This issue has been superseded by the recommendation to allow PIEs that attribute quarterly to receive a refund for losses incurred during a quarter, as well as for excess credits.

Recommendation

That the submission be noted.

Clause 85

Issue: Separate section for investor interest adjustment requirement

Submission
(12a – NZ Funds)

The investor interest adjustment requirement should be in a separate section of the Act as it is a pivotal provision with regard to the interaction between PIE tax and the adjustment to investor interests.

Comment

Officials agree that the investor interest adjustment requirement in section HL 6(3) is a key provision in the PIE tax rules. The PIE rules will be restructured, which should aid understanding of the rules and ensure that the investor interest adjustment provision is given appropriate prominence.

Recommendation

That the submission be noted.

Issue: Increasing flexibility for adjusting investors' interests

Submissions
(578 – NZICA, 594 – New Zealand Law Society, 589 – KPMG)

The requirement for a PIE to adjust investors' interests (in section HL 6(3)) should not form part of the eligibility criteria. PIEs should be afforded flexibility such that adjusting investors' interests is not the only permitted method for ensuring that investors receive the appropriate after-tax return from a PIE. (For example, a PIE could make a cash distribution to achieve this outcome.)

Comment

Officials agree that PIEs should be permitted to use methods other than adjusting investors' interests in order to ensure that investors receive their appropriate after-tax return from their PIE investment. While the legislation should generally require that investors are given their correct after-tax return, there is no need to prescribe the method by which this should occur.

Recommendation

That the submissions be accepted.

Issue: Consistency in investor interest adjustment methodology

Submission

(588 – Trustee Corporation Association of NZ, 598 – Trustees Executors)

Legislation should be drafted to ensure all PIEs use a consistent approach when performing the investor interest adjustment.

Consistency of application of the investor interest adjustment would be achieved by the legislation containing clear and specific rules.

Comment

As noted above, while the legislation should generally require that investors are given their correct after-tax return, there is no need to prescribe the method by which this should occur. For example, a correct after-tax return could be achieved by distributing differential cash amounts to investors.

Recommendation

That the submission be declined.

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 589 – KPMG, 592 – Tower, 595 – AXA, 556 – AMP, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group)

The legislation should permit the consolidation of existing managed fund vehicles without triggering adverse tax consequences. It should allow losses and imputation credits to transfer from one entity to another where those funds are consolidated into one fund. The government should also explore other areas where regulatory relaxation would facilitate the rationalisation of funds.

Comment

To facilitate consolidation by allowing imputation credits and losses to transfer between funds would require significant additions and amendments to the bill. There has been insufficient time to consider: (i) whether this would be desirable and (ii) the method by which this could be achieved. Officials, therefore, do not support the submission.

Recommendation

That the submission be declined.

Clause 85

Issue: Section HL 2(2) – Requirement for effective PIE election

Submissions
(12a – NZ Funds, 567 – Mercer Human Resource Consulting)

Section HL 2(2) should be deleted. This provision provides that if a PIE breaches the eligibility criteria within twelve months of electing to be a PIE it is treated as having never been a PIE. If this submission is not accepted, the bill needs to clarify the treatment of portfolio investment attributed income and portfolio investor rebates previously passed to investors if section HL 2(2) applies to deem the entity to never have been a PIE.

If there is to be some form of quarterly test that the entity has met the eligibility requirements over the first 12 months then the wording of section HL 2(2)(b) needs amending. As it stands, a breach will only occur if there is a failure in each quarter not in any quarter.

Comment

The changes recommended to the PIE definition (discussed earlier) and, in particular the recommended introduction of a safe harbour from the investor requirements for entities that would meet paragraphs (a), (c) to (e) of the definition of "qualifying unit trust" (if the entity were a unit trust), should reduce significantly the risk of a fund breaching the PIE rules. These changes would substantially address the concerns of submitters.

The intent of section HL 2(2)(b) is to provide a newly established PIE with 12 months to meet the PIE eligibility criteria. The words in the proposed section HL 2(2)(b) achieve this by providing that a PIE fails to make an effective PIE election by failing to meet the relevant eligibility criteria in each of the quarters during the 12-month period.

Recommendation

That the submissions be declined.

Issue: Election to become a PIE

Submissions

(12a – NZ Funds, 569 & 608 – ING, 594 – New Zealand Law Society, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 914W – Dominion Funds Group, 613W – Phillips Fox)

A special provision is required to allow entities to elect to be PIEs before 1 April 2007 and for the election to be effective from 1 April 2007.

Quarterly elections into the PIE regime should continue after the 2007 year.

Elections to be a PIE (for a newly established entity) should be effective from the start of the quarter in which the entity is first established provided the Commissioner receives the election within 20 working days of the entity's establishment date.

A new vehicle should be able to elect into the PIE rules from the date of establishment provided an election notice is sent before the end of its first quarter

PIE status should begin from any date stated by the applicant. The entity will be responsible to pay PIE tax at the end of the quarter following election.

It should be clearly stated that the PIE regime will remain elective, and will not become mandatory in the future.

Comment

To allow PIEs more time to make necessary changes it is recommended that the PIE rules apply from 1 October 2007. Officials agree that PIEs should have the ability from 1 April 2007 – six months before the 1 October 2007 application date – to indicate to Inland Revenue their ability to meet the PIE requirements by 1 October 2007.

Officials consider that from 1 April 2008 only new entities should be able to elect to be PIEs at any time. For existing entities that want to elect to be PIEs from 1 April 2008, this election should be required to be made before the start of the relevant year. This requirement will facilitate the entity's transition from the current tax rules to the PIE tax rules.

Officials disagree with the submission that the legislation, once enacted, should provide that the PIE tax rules will always remain optional. Even if desirable, it is difficult to see how such a provision could ever be effective.

Recommendation

That the submissions be accepted in part, subject to officials' comments.

Issue: Rationalisation of election provisions

Submission
(578 – NZICA)

The rules for electing to be a PIE (or ceasing to be a PIE) should all be contained in one provision. In the alternative, sections HL 2 and HL 7 should be located next to each other.

Comment

The restructuring of the PIE tax rules should aid comprehension and will ensure that provisions are more logically ordered.

Recommendation

That the submission be noted.

Issue: Relationship between election provisions

Submission
(578 – NZICA)

The relationships between section HL 2, HL 5 and HL 6 should be clarified.

The rule in section HL 2(3)(a) needs to cater for the rule in section HL 2(2)(b).

Comment

The PIE tax provisions will be re-ordered and restructured to meet general concerns about the relationships between the different provisions.

Recommendation

That the submission be noted.

Issue: Period before an entity can re-elect to be a PIE

Submission

(594 – New Zealand Law Society)

Where a PIE has ceased to be eligible by election it should be able to re-elect to be a PIE after three years. The Commissioner of Inland Revenue should also have the power to reduce this three-year period.

Comment

The appropriate "stand down" period for a PIE that has elected out of the PIE rules is a judgment that balances, on the one hand, the problems of an entity electing in and out of the PIE rules to gain a tax advantage and, on the other hand, not raising unnecessary barriers to re-entry into the rules. We consider that the current five-year "stand down" period achieves this balance appropriately.

Recommendation

That the submission be declined.

Clauses 85 and 124

Issue: Non-residents able to claim tax credits

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 551 – Macquarie Goodman, 595 – AXA, 590 – Property Council, 552 – Kiwi Income Property Trust, 556 – AMP, 568 – Corporate Taxpayers Group, 569 & 608 – ING Property Trust)

The legislation should be amended to clarify which tax rate applies when PIE income is attributed to a non-resident investor.

The legislation should be amended to allow a PIE that is attributing income to non-residents to apply the non-resident's NRWT rate under the applicable double tax agreement.

The legislation should be amended to specifically allow non-residents to offset any losses attributed to them by a PIE against their future PIE income.

When PIE tax is paid on behalf of non-resident investors, those investors should be treated in a way that will allow them to claim foreign tax credits in their country of residence to the extent of the PIE tax paid by them. This includes allowing the foreign investor tax credit (FITC) regime to apply to distributions from PIEs to non-resident investors.

To enable non-resident investors to have a tax credit that they can claim in their home jurisdiction, the PIE could be deemed to pay a fully imputed dividend equal to 67/33 of the PIE tax attributable to the non-resident investor for the quarter. This would then feed into the FITC regime and would allow the payment of a supplementary dividend, the payment of non resident withholding tax and the claiming of a FITC.

Alternatively, a regime similar in nature to the foreign investor tax credit regime could be introduced for distributions of PIE taxable income made from a PIE to non-resident investors. This would effectively achieve the same result as using the FITC regime but would specifically apply to distributions from PIEs.

Non-residents should be allowed to file tax returns to allow a refund of the difference between the correct tax rate and 33%.

Comment

The bill is clear that the tax rate that applies to a non-resident investor in a PIE is 33%. Compared to the NRWT approach suggested by some submissions this will reduce significantly the costs for PIEs in complying with the rules. That is, under the NRWT approach, a PIE would be required to track different tax rates for the same investor, depending on the type of income derived by the PIE. (For example, interest income would generally have a different rate to dividend income.) In addition, under the change suggested in submission, a PIE would be required to separately take

account of the residence of each investor and, if the investor is non-resident, the particular rate that would apply under the relevant tax treaty.

A listed PIE will be treated as a company and will therefore gain the benefit of the FITC regime through the normal rules. Officials do not consider it necessary or desirable to enact a separate FITC regime for ordinary PIEs as it would significantly increase complexity.

Recommendation

That the submissions be declined.

Issue: Conduit regime

Submission
(568 – Corporate Taxpayers Group)

The original proposals to allow a conduit regime for all non-resident investors into PIEs should be enacted as originally proposed. New Zealand fund managers will be competitively disadvantaged without a comprehensive conduit regime for PIEs.

Comment

This approach would allow PIE income that is sourced outside New Zealand and attributed to a non-resident to be relieved of New Zealand tax. Because there has been insufficient time to adequately consider this issue, and given its complexity, officials do not support this submission.

Recommendation

That the submission be declined.

Clause 126

Issue: Over-taxation of investors investing through PIEs

Submissions
(596 – ISI, 12a – NZ Funds, 569 & 608 – ING, 589 – KPMG, 593 – Westpac NZ/BT Funds Management NZ, 556 – AMP, 567 – Mercer Human Resource Consulting, 674W – Waterfront Industry Superannuation Fund)

As the bill is currently drafted, some PIE investors may not obtain the benefit of the 19.5% rate if their total income (including PIE investment income) in the previous year exceeds $48,000. This would arise, for example, where an investor derives only PIE income and this breaches the $48,000 threshold. In this case, every dollar of their PIE income would be taxable at 33% (when some of it should get the benefit of the 19.5% rate). This could adversely affect investors with very little non-PIE investment income, such as retirees. Approaches to dealing with this issue include reducing the 19.5% threshold to $38,000 (and exclude PIE income from the calculation of this threshold) or allowing PIE tax to be refunded to investors to the extent it results in a tax liability in excess of that if the investor had invested directly.

If officials are concerned about the ability of individuals to avoid tax by having all their income generated through a PIE, there could be a high threshold of PIE income above which investors are required to file a return.

Investors may not be in a position to determine the correct investor rate when the election is required. The bill requires this election to be based on the income of the investor in the preceding income year. However, investors in PIEs that elect into the new rules on 1 April 2007 will not have determined their 2007 taxable income. *(KPMG)*

Comment

Officials consider that this potential over-taxation issue should be dealt with by allowing PIE investors to elect a 19.5% rate only if their total income (other than PIE investment income) in the previous year is $38,000 or less (or, if the information is not available for that year, the preceding year). Investors must elect the 33% tax rate if their combined PIE and non-PIE income in the previous year is greater than $60,000. This latter requirement is necessary to ensure that investors that derive significant amounts of PIE investment income (but very little other income) are not able to get the benefit of the 19.5% tax rate. Allowing the election to be based on the income in up to two previous years addresses the transitional issue referred to in the KPMG submission.

Recommendation

That the submission be accepted to the extent outlined in officials' comments.

Issue: Electing higher rates

Submissions
(597a – PricewaterhouseCoopers, 578 – NZICA, 569 & 608 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 593 – Westpac NZ/BT Funds Management NZ, 600 – Fisher Funds Management Limited, 586 – Promina Group Ltd, 572 – New Zealand Fire Service Superannuation Scheme, 1347W – Northplan Financial Services/Swain Investment Services/Colin Strang Financial Planning, 880 – First NZ Capital, 966 – New Zealand Harbours Superannuation Scheme, 674W – Waterfront Industry Superannuation Fund, 267a – The Wealthcare Group)

Investors with a prescribed rate of 0% (that is, zero-rated investors, such as trustees) should be able to elect for PIE tax to be paid on their behalf at 33%, but not as a final tax.

Trustees (zero-rated investors) should have the option of electing a "prescribed investor rate" of greater than 0%. This would be a final tax.

Trustees should also be able to elect a 19.5% rate if they can demonstrate that the beneficiaries of the trust are 19.5% marginal taxpayers.

PIE income should be treated in the same way as distributions to minors who are beneficiaries. The trustee would pay tax at a rate of 33% and the income, when distributed, would not form part of the minor's taxable income.

The option should be available for trusts and companies investing in PIEs to have tax deducted at a rate other than 0%, if they so elect.

Comment

Officials agree that trusts should be allowed to elect 33% as a final tax. This approach will suit trusts that currently have their investment income taxed at the fund level. This would mean income attributed to the trustee would be excluded income and also would not be taxable to the beneficiary (including a beneficiary on a 39% marginal tax rate).

The trust rules require that for income of the trust to be beneficiary income there are certain requirements that need to be met. Allowing trustees to elect the 19.5% rate would allow them to circumvent these requirements. It would also be very difficult to prove that all the potential discretionary beneficiaries of a trust had a 19.5% rate.

Recommendation

That trust be allowed to elect 33% as a final tax rate on PIE income

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Issue: Electing lower rates

Submission
(557 – Alliance Bernstein)

The list of entities able to elect a prescribed rate of 0% should be extended to include:

- any entity with a valid certificate of exemption;
- a portfolio investment entity;
- a superannuation fund;
- a revenue account holder;
- a custodian.

Comment

Officials agree that portfolio investment entities, custodians and superannuation funds should also be able to elect 0%. Any other entity that is not a natural person should come within the definition of "company" and therefore a certificate of exemption process would not be required. The PIE rules do not distinguish between investors who hold PIE interests on revenue or capital account. Consequently, the ability to elect a 0% tax rate on PIE income should not be based on the capital or revenue account status of investors.

Officials consider the correct result is achieved if an individual investor who holds an interest in a PIE on revenue account is required to elect 19.5% or 33% and pay tax on any trading gain when the interest is disposed of.

Recommendation

That the submission be accepted subject to officials' comments.

Issue: Joint investors

Submissions
(12a – NZ Funds, 593 – Westpac NZ/BT Funds Management NZ, 1347W – Northplan Financial Services/Swain Investment Services/Colin Strang Financial Planning)

Investors should be given the opportunity to obtain a refund where too much tax has been paid on their portfolio investor attributed income from a joint investment. This problem could arise where investors have a joint investment in a PIE and the elected rate of the joint investment is 33%, whereas one of the investors is a 19.5% taxpayer.

Joint investors should be given the option to elect 33%, 19.5% or 0%, together with an obligation to file a tax return at the end of the year.

It is not clear how joint holders with different marginal rates can be accommodated in the currently proposed legislation.

Comment

PIEs would be required to deduct tax on individual investors' interests at either 19.5% or 33%. Where joint holders of the investment each qualify to elect the reduced rate they can elect 19.5%. Where more than one rate may apply to an investor interest the PIE would be required to deduct tax at the highest applicable rate.

Recommendation

That the submissions be declined.

Issue: Allowing individual investors in tax loss to elect 0%

Submissions
(596 – ISI, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 593 – Westpac NZ/BT Funds Management NZ, 595 – AXA, 577 & 577a – ASB Group)

Individual investors with tax losses in the previous year should be able to elect to be a zero-rated investor in a PIE.

Investors with a prescribed investor rate of 19.5% or 33% should be able to elect for PIE tax to be paid at 0%, but not as a final tax. For example, this would allow individuals who are not entitled to a rebate because they do not have any non-PIE income on which they have paid tax to offset PIE losses against PIE income from another PIE. However, this treatment should be legislated so as not to affect social assistance entitlements.

An investor who has a loss should be able to elect a rate of 0% with an exemption certificate.

Comment

Individual investors in PIEs are required to pay tax on this income, with the minimum rate being 19.5%. Allowing individual investors to choose to flow through or not could lead to gaming around an investor's taxable income, flow through occurring when they have a loss in their tax return and not when their other taxable income is high.

The submissions' proposal would also increase the complexity of the rules which would not be desirable.

Recommendation

That the submissions be declined.

Issue: Allowing wholesale PIEs to pay tax on behalf of retail PIEs

Submission
(596 – ISI)

A wholesale PIE should have the option, if elected by a retail PIE, to deduct PIE tax at a rate elected by the retail PIE. The rate available for election would be a weighted average rate of the retail PIE's tax deduction obligations. The retail PIE and its investors would then receive credit for PIE tax deducted at the wholesale PIE level. This would mean the retail PIE would not have to find the cash to pay the tax.

Comment

Officials note that this would add further complexity to the proposals and, as a final tax, would see individual investors in the retail PIE on the 19.5% rate not receive the full benefit of the lower tax rate.

Recommendation

That the submission be declined.

Issue: Default rate for entities

Submission
(12a – NZ Funds)

The default rate for investors in PIEs that are charities, trusts or companies that fail to provide their prescribed investor tax rate should be zero.

Comment

In order to ensure that investors are entitled to take advantage of a reduced rate (19.5% or 0%) they will be required to provide their Inland Revenue tax number as part of electing their prescribed investor rate.

Officials consider that having different default rates for individual and non-individual PIE investors would not be feasible. In particular, it would be difficult for PIEs to establish whether an individual holds an investment in a trustee or personal capacity (whether a person holds an investment on trust is generally not notified on registers).

Recommendation

That the submission be declined.

Issue: Prescribed rate based on current year income

Submissions

(12a – NZ Funds, 613W – Phillips Fox, 674W – Waterfront Industry Superannuation Fund)

The bill should allow investors to choose a prescribed investor rate based on a reasonable estimate of current year income.

A preferred approach would be to adopt the previous year's tax rate as an indicative rate on which to base a withholding (not final) tax, and the taxpayer to return the PIE income along with other income in the period and applying the correct marginal tax rate for that period.

The prescribed investor rate should be set using a similar method to the withholding tax system currently applied by banks.

Comment

The use of an estimation process would bring about the need for investors who under-estimate their rate to file a return and would leave them potentially liable to penalties. This would add further compliance costs for investors.

Under a withholding tax model there is a potential for many people to be brought back into the tax return filing system, which could affect their social assistance entitlements. Both of these outcomes are inconsistent with the key objectives of the proposed legislation.

Recommendation

That the submissions be declined.

Issue: Investors who elect the wrong rate should not be double taxed

Submissions
(594 – New Zealand Law Society, 567 – Mercer Human Resource Consulting, 925W – ASFONZ, 674W – Waterfront Industry Superannuation Fund)

The exclusion in section CX 44D for an individual's share of a PIEs income does not apply if the person has elected a 19.5% rate when he or she is in fact a 33% rate taxpayer. This means that such a person suffers a combined tax burden of 52.5% (19.5% paid by the PIE and 33% paid by the person). This double taxation would be prevented by allowing the individual a credit for the tax paid by the PIE. The submission accepts that there should be some penalty for a person who either deliberately provides the wrong rate to a PIE or else fails to update an election within a reasonable period (for example, within a year).

Investors selecting the wrong rate should not be penalised arbitrarily, other than where there is reason to believe that a lower rate has been selected deliberately.

Comment

If investors incorrectly elect for PIE tax to be paid at 19.5%, but their prescribed tax rate is actually 33%, the bill provides that all of the attributed PIE income would be taxable to them at their personal tax rate (which could be 33% or 39%). No relief is given for the 19.5% tax already paid by the PIE on the income.

This treatment was provided to act as a disincentive for those who deliberately provide the PIE with an incorrect tax rate. There is no specific provision in the tax penalties regime to penalise investors for providing the wrong tax rate. The treatment in the bill should, therefore, provide an effective penalty for deliberately choosing too low a tax rate. Tax payer should be able to elect the appropriate tax rate on their PIE income as they can look back up to two years.

Recommendation

That the submissions be declined.

Issue: Timing of notification of investor rate

Submissions
(595 – AXA, 1141 – MCA NZ Limited)

The prescribed investor rate should be able to be selected with reference to the year prior to the last completed tax year in order to give investors certainty on this issue.

Providers should be allowed one month at the beginning of each tax year to determine if an investor is to pay 19.5% or 33% tax based on their 31 March tax assessment.

Comment

Officials consider that the rate to be notified to the PIE by the investor should be based on the income of the two previous years. Furthermore, the time available to investors to provide their prescribed investor rate should be extended until the end of the PIE's tax calculation period.

Recommendation

That the submissions be accepted subject to officials' comments.

Issue: Achieving greater certainty of prescribed investor rates

Submissions
(600 – Fisher Funds Management Limited, 1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan)

A fund manger should be able to provide a list of Inland Revenue numbers in relation to investors on a default rate. Inland Revenue could then provide to the fund manager more accurate tax codes.

Inland Revenue should be required to provide scheme trustees with details of members' tax rates to avoid the need to collect them individually from the members.

Comment

Secrecy obligations would prevent Inland Revenue from supplying fund managers with taxpayer-specific information.

Recommendation

That the submission be declined.

Issue: Clarification over frequency of prescribed rate election

Submissions
(567 – Mercer Human Resource Consulting, 925W – ASFONZ)

Clarification is needed over the frequency with which investors are expected to advise their portfolio investor rate. It should be clarified whether new advice must be given for each portfolio entity period, whether is it only required for each tax year, or whether the advised rate remains in force until the investor advises a new portfolio investor rate.

It is not practical for investors to be required to advise their applicable tax rate every year. This should only be required on commencement and whenever a different rate becomes applicable. The balancing payment arrangements applied for bank deposits should be applied in respect of PIE income (that is, balances or refunds should be dealt with through Inland Revenue at the end of each year).

Comment

Officials agree investors should advise their PIE only of any changes to their prescribed investor rate. If the investors do not advise the PIE of a change in their prescribed investor rate, the PIE should continue to use the last notified elected rate.

Recommendation

That the submissions be accepted.

Issue: Prescribed rates for non-resident investors

Submissions
(577 & 577a – ASB Group, 1347W – Northplan Financial Services/Swain Investment Services/Colin Strang Financial Planning, 880 – First NZ Capital, 618W – The Retire Fund, 674W – Waterfront Industry Superannuation Fund)

For non-residents the prescribed investor rate should be set at 10% or 15% to reflect the current non-resident withholding tax rate for non-residents of treaty countries.

In relation to gains on foreign equities, the correct policy perspective is that this income should not be within the tax base of non-residents, and therefore gains (and losses) on foreign equities should have a zero rate of tax. Likewise, foreign dividend income should not be subject to New Zealand tax.

Comment

Non-resident investors in PIEs will have income which is subject to tax in New Zealand significantly reduced by virtue of both the Australasian trading gains exclusion and only being subject to tax on offshore shares under the fair dividend rate method.

It is not desirable for PIEs to be required to track the residence of each investor and also tax different sources of income at various rates for a particular group of investors.

Recommendation

That the submissions be declined.

Issue: Restriction of income caught under $48,000 threshold

Submission
(1141 – MCA NZ Limited)

The $48,000 threshold could be applied just to taxable income received from the participating employer and contributions paid by that employer (and not include the PIE's investment income). This would avoid the providers having to keep records of taxable income for each individual investor.

Comment

An investor may have more than one source of income, so basing the prescribed investor rate on just one employer's income details or on the income from one scheme provider will not necessarily result in the correct rate selection. Officials also note that investors may have income tax losses that would reduce their taxable income and allow them to take advantage of the 19.5% rate.

Recommendation

That the submission be declined.

Clauses 99, 100, 101, 102 and 104

Issue: Separately identifying foreign tax credits (PIEs)

Submission
(596 – ISI, 569 & 608 – ING, 593 – Westpac NZ/BT Funds Management NZ, 586 – Promina Group Ltd)

The bill should be amended to remove the requirement for a PIE to separately identify different tax credits (such as foreign tax credits, imputation credits and resident withholding tax).

Income and tax should be grouped as follows: taxable income, resident withholding tax, imputation credits and foreign tax credits. Taxable income should be reduced in the following order: foreign tax credits (with any excess forfeited); imputation credits; and resident withholding tax.

All foreign tax credits should be available to be applied against all foreign income in calculating PIE tax.

Comment

Officials consider that while foreign tax credits need to be separately identified from other credits, for compliance cost reasons, these credits should be able to be offset against tax on all PIE income (irrespective of the source of the income, be it New Zealand or foreign). Therefore only a single pool of foreign tax credits would need to be maintained. Any foreign tax credits that cannot be offset against PIE tax would be forfeited and would not be refunded to investors (which is consistent with the current law). This proposed treatment is a significant simplification, as the current rules for use of foreign tax credits require that credits be separated according to income-type and source.

Recommendation

That PIEs be allowed to pool foreign tax credits and offset these credits against tax on all PIE income (irrespective of income-type or source).

Issue: Separately identifying foreign tax credits (investors)

Submission
(12a – NZ Funds, 567 – Mercer Human Resource Consulting)

There should be no requirement for zero-rated PIE investors to distinguish between non-refundable, convertible or refundable credits. The words "of the type received by the entity" under section HL 18(4) and (6) should be removed.

Comment

PIEs are required to track each tax credit by its type so that the correct income tax treatment is applied when calculating their PIE tax liability. These details will be passed on to zero rate investors to ensure that they too apply the correct tax treatment.

Recommendation

That the submission be declined.

Issue: Identifying credits covered by section HL 18

Submission
(589 – KPMG, 588 – Trustee Corporation Association of NZ)

The definition of credit under subsection HL 18(4) should be clarified to include the relevant credits – imputation, foreign tax, resident withholding tax and dividend withholding payment. It is currently not clear what the term "credit" in the formula in this section includes.

Comment

Section HL 18(1) applies to credits for tax paid or withheld; this would cover the credits referred to in the submission with the possible exceptions of imputation and dividend withholding payment credits attached to dividends received by PIEs. Officials therefore consider it should be clarified that these types of credits are covered by this provision.

Recommendation

That the submission be accepted in part subject to officials' comments.

Clauses 85 and 86

Submission
(596 – ISI)

The bill should specify that otherwise taxable income can be attributed to an investor without deduction of PIE tax where the income is sourced from a lower-tier PIE (such as a wholesale fund) and pre-PIE tax losses in the lower-tier PIE (formation losses) have been offset against the income.

Comment

Wholesale PIEs can deduct their formation losses to the extent of the income in a return period. The wholesale PIE's formation losses are used to offset income at the wholesale level and cannot form part of any flow-through to a retail PIE. The income that has been offset would not be taxable income at the retail PIE level. Any subsequent distribution by the wholesale PIE would also not be taxable to the retail PIE.

Any income that is allocated to a retail PIE will be zero-rated and the income would form part of the retail PIE's assessable income. Losses that the retail PIE has would be offset against any income it is allocated from a wholesale PIE.

Officials therefore believe the bill does not produce the result suggested by the submission.

Recommendation

That the submission be declined.

Clause 98

Issue: Rebate for overpaid PIE tax

Submissions
(12a – NZ Funds, 569 & 608 – ING, 595 – AXA)

PIE investors should be able to claim a refundable rebate for any overpaid tax where the investor has incorrectly elected a portfolio investor rate that is higher than their prescribed investor rate. Also, the rebate should not be restricted to the amount of other tax paid by the investors (that is, it should be refunded in full).

Under a quarterly attribution approach, any excess PIE tax (arising from a combination of gains and losses during quarters) should be refunded by Inland Revenue. If the total for the year is still a net loss, this should then be applied to investors' other income. If the investor has insufficient income to offset the loss, it should be carried forward.

Comment

Officials consider that PIEs that allocate losses and tax credits to investors for a calculation period should be able to provide value for losses and excess tax credits that cannot be utilised on behalf of the investor in the period. The balance of any losses allocated at the end of the calculation period would be converted to a tax credit at the investor's prescribed investor rate, as currently proposed in the bill. The tax credit arising from losses would be added to any excess tax credit arising from the PIE tax calculation on the income and associated tax credits allocated to the investor. The value of these combined credits would be paid by Inland Revenue to the PIEs.

The PIE would then adjust the level of the investor's interest in the PIE to provide the investor with the benefit of these combined credits.

This would remove the need for the credit types other than foreign tax credits to be separately treated for investors other than those using the zero rate. The current rebate process in the bill involves the value of losses and credits being refunded directly to investors, forming part of the investor's discretionary income, which may be spent on consumption instead of being reinvested. This new approach leaves the credits within the fund, thereby promoting saving, which is consistent with KiwiSaver concepts.

Recommendation

That the submission be declined but note that some of the points raised in the submission are addressed by changes outlined above in officials' comments.

Issue: Expenses by PIE investors available as a rebate

Submission
(569 & 608 – ING)

Instead of filing a tax return to claim expenses, investors should be able to file a rebate claim for a refund (which could be done by amending the existing rebate claim form used by taxpayers to claim rebates on charitable donations).

Comment

Investors currently can claim these expenses by filing a tax return. Officials consider that the PIE amendments should not affect the current process for individual investors making a claim for deductible expenditure.

Recommendation

That the submission be declined.

Issue: Quarterly PIE tax rebates

Submission
(595 – AXA)

The tax rebate period should be aligned with the portfolio entity period (that is, rebates should be paid quarterly instead of once a year).

Comment

Officials consider that this issue will be superseded by the proposal for the value of any unutilised losses and excess tax credits to be paid by Inland Revenue to PIEs, which will then provide the benefit of this payment to investors (for example, by adjusting investors' interests).

Recommendation

That the submission be declined.

Issue: Industry consultation for rebate process

Submission
(577 & 577a – ASB Group)

Inland Revenue should continue to consult regularly with the industry during the Select Committee process on the specific return and rebate process design, including the expected timeframe for rebates to be available to investors. This will enable the industry to prepare appropriately.

Comment

Officials consider that industry involvement will increase the likelihood of successful implementation of the changes introduced in the bill.

Recommendation

That the submission be noted.

Clause 85

Submissions

(597a – PricewaterhouseCoopers, 12a – NZ Funds, 596 – ISI, 578 – NZICA, 569 & 608 – ING, 593 – Westpac NZ/BT Funds Management NZ, 594 – New Zealand Law Society, 598 – Trustees Executors, 600 – Fisher Funds Management Limited, 556 – AMP)

If a PIE attributes income and pays tax quarterly, it should determine the attribution based on the tax rates of investors that have a remaining interest. If an investor partially exits, the PIE would cancel units only to the extent that there are remaining units that are able to be redeemed. Any balance of tax not able to be funded by remaining interests would become payable by the investor and not the PIE. In other words, exiting investors are treated as zero-rate investors to the extent they do not have sufficient units to cancel to meet the PIE tax liability.

Investors that have exited between the end of an attribution period but before PIE tax is calculated should be treated as zero-rated provided the PIE calculates PIE tax within ten working days following the end of the period.

Alternatively, a PIE should be authorised to deduct an estimated amount of tax from the proceeds of the investor's interest based on earnings to date of exit.

Comment

PIEs should be able to use their current methods for allocating income, expenditure and tax credits in calculating their PIE tax liability. Where this does not enable a sufficiently accurate assessment of the taxable income for an investor who exits during a quarter, the PIE should be allowed to treat the investor as zero-rated. Officials also agree that investors who exit within five working days following the end of a return calculation period should be treated as zero-rated. At the end of the quarter the PIE will calculate the investor's allocated income and advise the investor accordingly. The investor would be responsible for squaring up the tax with Inland Revenue.

Recommendation

That the submissions be accepted subject to officials' comments.

Clause 85

Issue: Making attribution to investors optional

Submission
(592 – Tower, 595 – AXA)

Entities that elect into the PIE regime must attribute income of the PIE to investors and account for PIE tax. This requirement to attribute income of the PIE to investors should be optional – for example, at the discretion of trustees. The main effect of the flow-through mechanism is to reduce the tax paid by low marginal tax rate investors. In the case of a fund with virtually all investors on higher marginal tax rates there will be very little reduction in tax because of the flow-through mechanism. Therefore, it does not seem worth the compliance costs of operating the flow-through mechanism to require attribution to investors in such cases.

Comment

The requirement to have income attributed to investors at their marginal tax rates is an inherent feature of the PIE rules as it ensures that lower income savers are taxed at their correct rate. It is not the policy intention that the fiscal benefits of the PIE rules such as the exclusion for trading gains on Australasian equities should be accessed without the concomitant requirement to attribute income to investors at their personal rates.

Officials note that a number of the recommended amendments – such as the proposals for listed companies and superannuation funds – will reduce compliance costs for funds.

Recommendation

That the submission be declined.

Issue: PIE income attributed to a trust

Submission
(597a – PricewaterhouseCoopers)

Legislation should be introduced that permits trustees of a qualifying trust to deem PIE income attributed to the trust to vest absolutely in one or more beneficiaries (for tax purposes) and therefore qualify as “beneficiary income”.

Comment

Officials understand the background to this issue is whether income derived but not received in cash (such as attributed PIE income) can constitute beneficiary income for purposes of trust taxation. We note that this issue is broader than PIE taxation but applies to any taxable income not received in cash, such as accrual income. We consider that this issue should not be addressed in this bill but be considered in a wider context.

Officials consider that the policy intent is that PIE income attributed to qualifying trusts can vest absolutely in one or more beneficiaries (for tax purposes) and therefore qualify as "beneficiary income".

Recommendation

That the submission be noted.

Issue: Trusts and 33% cap

Submissions
(597a – PricewaterhouseCoopers, 589 – KPMG, 588 – Trustee Corporation Association of NZ)

Where income is allocated by a PIE to a trust, the legislation should provide that PIE income that is to be passed out by the trust as beneficiary income to a beneficiary on the 39% tax rate is taxable as trustee income at 33%.

Resident investors on 33% or 19.5% tax rates should be taxed at each investor's applicable rate as beneficiary income.

A distribution to a non-resident beneficiary should be taxable as trustee income at 33%, unless the income is subject to double tax agreement relief (such as NRWT rates for dividend and interest income) and the non-resident has submitted such rates to the PIE.

Comment

Officials consider that PIE income derived by a trustee and paid to a beneficiary would be taxed at the beneficiary's tax rate as beneficiary income. Under section HH 3(2) a trustee must satisfy the income tax liability for beneficiary income as agent of the beneficiary. Tax paid in this manner is taken into account to determine "residual income tax" and therefore should not result in provisional tax obligations for beneficiaries receiving PIE income.

Officials recommend that a trustee may choose to have PIE tax apply at 33% (rather than have the PIE income attributed to the trustee as assessable income). This will have the effect of capping the tax rate at 33% even when the income is paid to a beneficiary on the 39% tax rate.

Recommendation

That trustees investing in PIEs may choose to have PIE tax apply at 33% instead of having the PIE income attributed to the trustee.

Issue: Allowing trust income to be taxed at beneficiaries' rate

Submission
(589 – KPMG)

Trustee income retained in the trust for the benefit of beneficiaries on the 19.5% marginal tax rate should not be taxed at 33%.

Comment

Trust income is taxed as either trustee income at a 33% rate or as beneficiary income at the beneficiaries' rate. Distributions of trustee income are not taxed in the beneficiaries' hands. Beneficiary income is income of a trust that is paid or applied for beneficiaries or vests absolutely in beneficiaries in the income year it is derived or within six months of the end of that year. A general feature of the trust regime is that income derived by a trustee and not paid to a beneficiary within six months of the end of the income year is taxed to the trustee at 33%, even if the beneficiaries who will ultimately receive the income are subject to a lower tax rate. This is a general feature of the trust tax regime. This submission seeks a major change to the trust tax regime which is beyond the scope of this bill.

Recommendation

That the submission be declined.

Issue: Portfolio investor attributed income

Submission
(578 – NZICA)

New section CP 1 should refer to an amount of attributed rather than derived income.

Comment

Section CP 1 does not refer to a person "deriving" portfolio investor attributed income. This is the correct approach as derivation is a timing concept, whereas Part C of the Act is simply concerned with ascertaining what is income (and not with its timing).

Recommendation

That the submission be declined.

Issue: Making PIE periods shorter than 3 months

Submission
(567 – Mercer Human Resource Consulting)

It may be problematic for a PIE to elect a period that is shorter than three months because investors may not be in a position in the first period of a tax year to determine a correct portfolio investor rate.

Comment

Officials note it will be possible for investors to elect their prescribed investor rate based on either of the previous two years' income. Therefore officials consider this issue should no longer pose a problem. It should also be noted that PIEs will no longer be able to choose a calculation period shorter than three months (this is discussed previously).

Recommendation

That the submission be declined.

Issue: Attribution to 19.5% investors only

Submission
(1142 – Carter Holt Harvey Employee Benefits Plan and Retirement Plan)

Schemes should only be required to attribute income to 19.5% taxpayers. For the majority of investors the extra costs of attribution will provide no potential benefit.

Comment

Officials note that the recommendation to allow a superannuation scheme which is eligible to be a PIE but does not elect to be one to own 100% of the PIE will allow such schemes some of the key benefits of PIE status (tax free Australasian share gains) without incurring the compliance costs of attribution. In addition, the recommended simplified method for superannuation schemes that want to become PIEs should ensure that compliance costs are minimised.

Recommendation

That the submission be declined.

Issue: Clarifying meaning of distribution

Submissions

(596 – ISI, 12a – NZ Funds, 578 – NZICA, 582 – National Provident Fund)

The application of section CX 44D(2) – which provides that distributions by PIEs are excluded income of investors – should be clarified to ensure that any distributions of pre-PIE retained earnings are also excluded income. All distributions from a PIE should be deemed to be fully imputed.

It should also be clarified that any amounts received by an investor on redemption of units are a distribution from a PIE and therefore excluded income.

For a PIE that is a company, distributions from the PIE are still dividends for the purposes of the Act. The possible consequences of this should be considered – for example, an amendment has been made to the RWT rules to exclude dividends from companies that are PIEs but an equivalent amendment has not been made to the NRWT rules.

Comment

Officials agree that an equivalent amendment to clause 120 (excluding dividends from companies that are PIEs from the RWT rules) should also be made to the NRWT rules (in section NG 1(2)).

Officials consider that the other submissions seeking to clarify that distributions of pre-PIE retained earnings are excluded income are unnecessary as this effect is already achieved under the current provisions in the bill.

Recommendation

That the submissions be accepted subject to officials' comments.

Clause 85

Submissions

(582 – National Provident Fund, 572 – New Zealand Fire Service Super Scheme, 925W – ASFONZ, 604W – Meat Industry Superannuation Scheme, 679W – Goldman Sachs JBWere Transtasman Unit Trust, 966 – New Zealand Harbours Superannuation Plan, 618W – The Retire Fund, 674W – Waterfront Industry Superannuation Fund)

An existing entity that is closed to new members and elects to be a PIE should have the option of adopting flow-through, rather than this being a mandatory requirement.

The Australasian exemption should be decoupled from the requirement to undertake flow-through. The requirement for a PIE to flow through income to investors and be taxed at the investors' marginal tax rates should not be mandatory. Potentially the compliance costs associated with flow through could outweigh any benefit to those members that have a marginal tax rate of 19.5%. The legislation already allows this for defined benefit superannuation schemes, and this should be expanded to include any other entity that does not consider it cost effective to elect flow through.

The decision on whether or not to adopt a flow-through basis for taxing investors should be made by the product provider, taking into account the costs involved and the likely benefit to that product's investors, if any. To suggest that investors can have the over-taxation removed only if both measures are adopted is unreasonable.

The proposals to reduce the tax burden on low income savers (the PIE regime) and the proposals for the taxation of equity investments are unrelated and should not be linked. The weakness in linking the two is that the tax rules for equities are of concern to a much wider constituency, and therefore subject to other pressures. The changes to the taxation of equities, in the current review process or by subsequent governments should not erode the benefits that could accrue under the PIE regime.

Comment

Officials consider that the use of investors' prescribed tax rates is a key feature of the new PIE rules. This ensures that investors are taxed on their PIE income at their correct tax rate. Investment vehicles that are prepared to adopt this feature should be allowed the benefit of the Australasian share trading exclusion. As noted in response to previous submissions, a superannuation scheme which is eligible to be a PIE but does not elect to be one will be able to own 100% of a PIE. This will allow such schemes some of the key benefits of PIE status (tax free Australasian share gains) without incurring the compliance costs of attribution.

Recommendation

That the submissions be declined.

Issue: Taxation of revenue account investors

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 569 & 608 – ING, 592 – Tower, 586 – Promina Group Ltd, 556 – AMP, 557 – AllianceBernstein, 577 & 577a – ASB Group)

The legislation should be amended to ensure that the taxable gain or loss arising on disposal of an interest in a PIE by a revenue account investor does not include attributed income or losses nor any amounts that are not otherwise taxable to them (realised share gains on New Zealand companies and Australian-resident listed company). Revenue account holders should be allowed to increase their cost base by the new amount of attributed taxable income.

Previously attributed income should be either deducted in calculating any taxable gain or loss on realisation of an investment in PIE, or added to the cost price of the investment. Alternatively, PIEs should be given the option of notionally "passing out" to investors' imputation credit balances (including any tax payable under the notional wind-up calculation), with these credits only being able to be used by revenue account investors in satisfaction of any tax liability on sale of the investment in the PIE (with the credits reduced for any distributions made by the PIE). ICs resulting from deferral of tax payments should be provided to revenue account holders if necessary.

If a PIE holds an interest in another PIE on revenue account, there is also potential for double taxation.

Revenue account holders of a PIE should be able to elect a 0% rate.

Comment

Officials do not consider that there is a policy basis for giving a separate exemption for investors who hold their PIE investments on revenue account. It is an inherent feature of the Income Tax Act that the tax treatment of each person is considered separately.

Officials do not think it is possible for a PIE to hold an interest in another PIE on revenue account, owing to the proposed exclusion from tax for New Zealand share gains. This would mean that if the investor PIE disposed of its interest in the other PIE, these gains would not be taxable, and therefore there would be no double taxation.

Recommendation

That the submission be noted.

Issue: Determining capital/revenue account status

Submission
(597a – PricewaterhouseCoopers)

PIE income could be deemed to be assessable income for the purpose of determining whether an investor is a capital or revenue account investor. Because a PIE pays PIE tax on attributed income of individual investors, and distributions from a PIE are excluded income, individual investors will not derive any assessable income. This may affect their ability to argue that they hold their PIE investment on capital account.

Comment

Officials consider that an amendment deeming distributions to be assessable income, for the purposes of determining capital/revenue account status, is not necessary. Such an amendment would unnecessarily complicate the law. Following enactment, officials will include a statement in the *Tax Information Bulletin* article on the new rules, clarifying that the exclusion for distributions from a PIE does not affect the capital account status of investors.

Recommendation

That the submission be noted.

Issue: Effect of PIE income on social assistance

Submissions
(1143 – Retirement Policy & Research Centre, 613W – Phillips Fox, 657W – Sothertons Chartered Accountants)

If an individual is potentially entitled to any state-provided benefit (such as income from Working for Families) or has an obligation to the state (such as a student loan) that, in either case, might be affected by the amount of the individual's income, the investment income should affect those entitlements or obligations.

This concession is manifestly inequitable and gives the impression that New Zealand investors are being bribed to invest in one particular investment structure. If implemented, this concession should apply to all investors regardless of the investment vehicle used.

Comment

The government decided that PIE income should not affect social assistance entitlements in order to encourage New Zealanders to save and participate in KiwiSaver. As investments in KiwiSaver funds would be locked in until retirement, it would not considered appropriate to abate savers' family assistance entitlements or trigger student loan and child support repayment obligations for investment income that cannot be accessed until retirement. Officials note that, currently, those who save by investing in superannuation schemes do not have their social assistance affected by the scheme's income since the income is deemed to be derived by the superannuation

scheme and not by the individual investors. The proposed PIE treatment is therefore consistent with this current treatment.

Recommendation

That the submission be declined.

Issue: PIE investors should have to file tax returns

Submission
(613W – Phillips Fox)

The number of taxpayers that would be required to file tax returns solely because of PIE income is expected to be small, and there is no justifiable tax policy reason for such persons not to file returns.

Comment

The PIE tax rules are designed so that the PIE performs the tax compliance and pays the tax attributable to individual investors. This provides assurance that tax liabilities will be satisfied and minimises compliance costs of the investors. It also ensures that PIE income does not affect individuals' social assistance entitlements. Officials also note that while, currently, there may not be many individuals who invest in managed funds and do not file tax returns, the number of individuals in that position is likely to grow with the advent of Kiwisaver.

Recommendation

That the submission be declined.

Issue: Confirmation that PIE investors are not automatically revenue account traders

Submission
(734W – Todd Corporation)

The bill should be amended to expressly confirm that if an investor buys and sells an interest in a PIE then that activity does not influence the capital/revenue account status of other investments held directly by that investor.

Comment

The PIE rules were intended to provide that investors who have capital account treatment for their own share trading receive the same treatment when they invest through a PIE, by providing a tax exemption for Australasian share trading income of the PIE. The rules were not intended to allow individuals who are share traders and therefore on revenue account to get the benefit of capital account treatment. We

therefore consider that individuals who actively trade in PIE interests should continue to be on revenue account.

Recommendation

That the submission be declined.

Issue: Tax incentives for low income savers

Submission
(618W – The Retire Fund)

Individuals with incomes over $60,000 or between $38,000 and $48,000 will pay PIE tax at a lower rate than their marginal tax rates. A similar concession should be introduced to encourage low income earners to undertake long-term savings commitments.

Comment

The PIE tax reform is significantly reducing the tax on low income savers who invest through managed funds by:

- reducing the tax rate to the individual's marginal rate (capped at 33%);
- providing a tax exemption on Australasian share trading income derived by the PIE; and
- if the Committee accepts officials' recommendation regarding the fair dividend rate, reducing the tax on investing in offshore companies through active managed funds from a realised gains basis to a 5% deemed return basis.

Officials do not consider that further tax concessions are necessary or advisable given the fiscal cost.

Recommendation

That the submission be declined.

Clause 85

Issue: Custodial investors in PIEs

Submissions
(596 – ISI, 578 – NZICA, 569 – ING, 551 – Macquarie Goodman, 593 – Westpac NZ/BT Funds Management NZ, 600 – Fisher Funds Management Limited, 590 – Property Council, 584 – Smartshares Limited, 552 – Kiwi Income Property Trust, 557 – AllianceBernstein, 577 & 577a – ASB Group, 608 – ING Property Trust, 880 – First NZ Capital)

Nominee holdings in PIEs should be treated as zero-rated investors, with the nominee receiving the gross amount and withholding the tax (on behalf of its investors). This could be implemented by extending the existing RWT proxy rules for income from AUTs to include PIE attributed income through a custodian. The PIE tax liability would likely need to be settled out of cash distributions from the PIE, or other cash held on account of the investor where no cash distribution is made.

Custodial/nominee unit holders should be allowed to be set up with zero tax so that the tax reporting responsibility is held at their level as the tax status of its underlying investors is unknown.

Comment

Officials agree that nominees and wrap account providers should perform the PIE tax compliance obligations with respect to their clients. This is necessary as only these custodians, rather than the PIEs themselves, will have the necessary information about the individual investors.

Recommendation

That the submissions be accepted subject to officials' comments.

Clause 85

Issue: Clarification of available options

Submission
(567 – Mercer Human Resource Consulting)

Greater clarity is needed in the legislation or provided in a *Tax Information Bulletin* at the earliest opportunity to explain the options available to defined benefit schemes and for steps to be taken to ensure the options are viable.

Comment

Officials will provide more information on compliance for defined benefit schemes in consultation with providers and publications such as the *Tax Information Bulletin*.

Recommendation

That the submission be noted.

Issue: Unallocated amounts in defined benefit schemes

Submissions
(578 – NZICA, 582 – National Provident Fund, 577 & 577a – ASB Group, 925W – ASFONZ)

Section HL 12(1)(c) deals with defined benefit schemes. A better solution may be to treat all unvested interests as interests of a notional person and taxed at the average rate of investors within the fund.

The formula could be the sum of ((individual members' liability/total liabilities) x individual members' marginal tax rate x unallocated income)

Comment

The legislation provides that unallocated income of defined benefit schemes be subject to tax at 33%. Officials consider that this is better than the suggested weighted average tax rate as it is simpler. Further, the suggested solution could be subject to some manipulation because it would encourage the practice of keeping income unallocated if the weighted average tax rate is low.

Recommendation

That the submission be declined.

Issue: Allowing defined benefit schemes to carry forward losses

Submission
(594 – New Zealand Law Society)

Section HL 14 should be amended to allow a loss incurred by a defined benefit scheme to be carried forward for offset against PIE income of the scheme. (Such losses cannot be attributed to investors.)

Comment

Officials agree with this submission.

Recommendation

That the submission be accepted.

Issue: Allowing hybrid schemes to become PIEs

Submission
(734W – Todd Corporation)

Trustees of hybrid superannuation schemes should be able to elect to become a PIE, taking into consideration the relative mix of defined benefit and contribution members. If the trustees resolve to deem the whole scheme as comprising defined benefit members they should be able to do so with the default 33% rate applying.

Comment

Officials agree that the allocated income of defined contribution members should be taxed at the members' tax rates, and the unallocated income of defined benefit members should be taxed at the 33% rate.

Recommendation

That the submission be accepted.

Clause 12

Issue: Extending the trading exemption to individuals/entities other than PIEs

Submissions
(569 & 608 – ING, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 585 – NZX, 568 – Corporate Taxpayers Group, 575 – Direct Broking Limited, 1142 – Carter Holt Harvey Employee Benefit Plan and Retirement Plan, 602 – ANZ National Bank, 734W – Todd Corporation, 880 – First NZ Capital, 674W – Waterfront Industry Superannuation Fund, 63W – Shaun Evans, 630 – Lockie & Associates)

Extend the capital gains exemption on New Zealand and Australian equities to all unit trusts, superannuation funds, New Zealand life insurance companies and GIFs.

If the preceding submission is accepted, redemptions from unit trusts that arise as result of off market share cancellations should not be taxed as a dividend.

The sale of interests in certain entities that are not companies, such as partnerships and Australian listed property trusts, should be covered by the Australasian trading exemption.

The exemption from tax on capital gains on the sale of domestic and Australian listed shares should be extended to all New Zealand taxpayers that are not in the business of share dealing.

The bill creates a new distortion by allowing PIEs to "short-term trade" Australasian stocks without paying tax on gains – something the private investor cannot do. There is no logic to this radical shifting of the long-established revenue/capital boundary.

Comment

The PIE rules are intended to ensure that investors who get capital account treatment on their direct Australasian investments receive the same treatment when they invest through a PIE, by providing a tax exclusion for Australasian share gains made by the PIE. The rules were not intended to allow individuals who are share traders and on revenue account themselves to get the benefit of capital account treatment. Therefore the Australasian trading income exclusion should be available only to PIEs that are earning income on behalf of their (generally) capital account investors.

Recommendation

That the submissions be declined.

Issue: Definition of Australian resident company

Submissions
(12a – NZ Funds, 595 – AXA)

The residence requirement for an Australian resident listed company in new section CX 44C(a)(ii) should be clarified.

The requirement for an Australian listed company to be an Australian tax-resident should be removed and replaced with an active income test.

Comment

The requirement that an Australian listed company be tax-resident in Australia is important to justify the tax exclusion for PIEs on their Australian shares gains. The reason for the exclusion is that Australian tax resident companies generally have a high dividend rate, with these dividends taxable to New Zealand shareholders. The high dividend payout rate is encouraged by incentives in the Australian tax system (for example, the franking system). Companies that are not tax-resident in Australia do not always have the same incentives to pay a high dividend.

Recommendation

That the submissions be declined.

Issue: No deduction for cost of investment

Submissions
(597a – PricewaterhouseCoopers, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 577 & 577a – 577 & 577a – ASB Group)

No deduction should be given for the cost of shares in New Zealand companies and Australian-resident listed companies that are subject to the realised share gains exclusion for PIEs. To achieve this, the legislation should be amended to prevent a deduction for opening stock (which would normally be allowed under section DB 40(4) of the Income Tax Act 2004) if the opening stock was used to derive excluded income under new section CX 44C. The legislation should also be amended to prevent a realised loss incurred from the sale of New Zealand and Australian-resident listed companies from being deductible to a PIE.

Comment

Officials agree with submissions.

Recommendation

That the submissions be accepted.

Issue: Anti-avoidance rules

Submissions

(597a – PricewaterhouseCoopers, 596 – ISI, 12a – NZ Funds, 578 – NZICA, 569 & 608 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 592 – Tower, 593 – Westpac NZ/BT Funds Management NZ, 594 – New Zealand Law Society, 595 – AXA, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 582 – National Provident Fund, 586 – Promina Group Ltd, 585 – NZX, 552 – Kiwi Income Property Trust, 556 – AMP, 557 – AllianceBernstein, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group, 479W – Walker Capital Management, 679W – Goldman Sachs JBWere, 674W – Waterfront Industry Superannuation Fund)

The sale and purchase of the same New Zealand or Australian share within 30 days, or where shares are sold cum-dividend, should result in only the dividend being taxable to the PIE under a targeted anti-avoidance provision. This rule should only apply when the shares are sold after declaration of the dividends and before the dividend is paid. Such an occurrence should also not give rise to taxable income on the disposal of the underlying investment itself. Alternatively, the existing dividend-stripping rules in section GB 1(3) should apply.

Alternatively, a "safe harbour" provision should be introduced allowing fund managers to sell down up to 20% of an equity that is cum-dividend before the dividend portion is taxable.

New section CX 44C(c), (d) and (e) – the wash-sale anti-avoidance rules in the Australasian trading exemption – should be removed and replaced by specific anti-avoidance provisions. Alternatively, new section CX 44C(d) should be redrafted so as not to catch normal commercial shares sales where settlement is at some future date.

The restrictions on the share trading exclusion in proposed section CX 44C are unworkable and should be modified. In particular, paragraph (c) operates too broadly and should be omitted. Paragraph (d) is also unworkable because it adversely affects normal commercial arrangements and, accordingly, should be omitted or substantially modified.

There should be exemptions from the anti-avoidance rules applying to Australian shares for trading in the normal course of business or if the sale transaction is out of the control of the PIE. The anti-avoidance rules in section CX 44C should not apply to New Zealand shares. The rule in section CX 44C(d) should be amended to focus on the time of acquisition. The 30-day re-purchase period anti-avoidance rule in section CX 44C(e) should be removed.

Structured products specifically designed to remove equity risk should be taxed on any gains. However, the use of lock-up agreements (which are commonly conditional on the success of a takeover bid) should be allowed.

The anti-avoidance rules, such as the "wash sale" provision could be included in the legislation for non-PIE investors. It is not appropriate to have a "wash sale" provision for PIE investors, as there are already rules covering the sale and repurchase of investments in New Zealand equities by PIEs.

Comment

Officials agree that the anti-avoidance rule in new section CX 44C(c) should be amended so that the dividend amount in the arrangement is taxed when New Zealand and Australian shares are sold after a dividend has been declared but before the dividend is paid. Section CX 44C(d) should be amended to focus on the time of acquisition of the relevant shares or commencement of the arrangement. Section CX 44C(e) should be removed.

Recommendation

That the anti-avoidance rules in section CX 44C be amended in accordance with officials' comments.

Issue: Assessable income rules should be applied to Australian capital gains

Submission
(1478 – Mercer Investment Consulting)

Under the Australasian trading gains exemption for PIEs, the effective tax rate on Australian shares more than halves and is less than New Zealand shares. If the intent is to level the playing field, then tax should be applied to at least 25% of the capital gains of Australian shares.

Comment

The suggested change is complicated and is inconsistent with the policy of not taxing PIEs on their trading income from selling Australian shares.

Recommendation

That the submission be declined.

Issue: Removal of the capital/revenue distinction for PIEs

Submission
(613W – Phillips Fox)

Where a PIE is clearly a trader in shares/ investments such PIEs should be required to recognise, at the PIE level, those share gains as being on revenue account. Failure to maintain this distinction puts the PIE at an advantage to other types of investors, and gives indirect investors an advantage over direct investors.

Comment

The intent of the PIE reforms is to remove the current disadvantage for individual capital account investors to invest through a managed fund that holds its investments on revenue account.

Recommendation

That the submission be declined.

Clause 85

Issue: Grouping situations

Submissions
(578 – NZICA, 551 – Macquarie Goodman, 590 – Property Council, 585 – NZX, 552 – Kiwi Income Property Trust, 569 & 608 – ING Property Trust)

When a property fund owns property through subsidiary companies, the PIE tax should be calculated at the "parent" PIE level. This would allow a loss making PIE subsidiary to offset land losses with the income of a profit making PIE.

Comment

Officials are recommending a simpler PIE tax regime for listed companies. It will use existing tax principles to a greater extent and include group loss offsets for companies in the same group of companies. This should address the concern raised in submissions.

Recommendation

That the submissions be noted.

Issue: Indirect investment in land

Submissions
(551 – Macquarie Goodman, 590 – Property Council, 585 – NZX, 552 – Kiwi Income Property Trust, 569 & 608 – ING Property Trust, 734W – Todd Corporation)

Investments in land by way of an incorporated joint venture or a 100% subsidiary that only owns land should be treated as a direct investment in that land for the purposes of the PIE rules. The loss offset rules in subpart IG of the Income Tax Act should apply to allow the offset of net losses against net income where a PIE has an investment of 66% or greater in a company that was incorporated for the purpose of owning land as a passive investment.

Comment

Officials agree that an interest in a company of which 90% or more of its assets constitute land should be treated as an interest in land for the PIE rules.

Recommendation

That the submissions be accepted.

Issue: Land losses

Submission

(Matter raised by officials)

The bill currently restricts net land losses from offsetting other PIE income in calculating PIE tax. This was done in order to prevent PIEs holding real property being used as tax shelters.

The proposed treatment of land losses in the bill is complex. Given that most managed funds either invest very little in land, or, on the other hand, invest predominantly in land, officials recommend a simpler approach. For PIEs of which less than 50% of their assets is land, there would be no special treatment of losses. Losses could effectively flow through for the benefit of PIE investors. For PIEs of which 50% or more of their value is land, no losses would be allowed to flow through for the benefit of investors. Officials consider that this is a much simpler approach to address the base maintenance concern.

Recommendation

That the submission be accepted.

Clause 85

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 551 – Macquarie Goodman, 594 – New Zealand Law Society, 599 – Kingfish Limited, 600 – Fisher Funds Management Limited, 590 – Property Council, 585 – NZX, 584 – Smartshares Limited, 552 – Kiwi Income Property Trust, 556 – AMP, 569 & 608 – ING Property Trust)

Listed PIEs should have an option of attributing income using a "last man standing" option (as per the discussion document). That is, the taxable income calculation for listed entities should be done quarterly and a distribution equal to the value of the taxable income be made after the end of the quarter. Those investors who hold shares on the dividend payment date will derive the distribution. Tax should be deducted in the share registry of the listed entity from these distributions in accordance with investors' elected tax rates. As the minimum period between announcing dividends and payment is three weeks (under NZX listing rules), listed PIEs should have an additional month to pay the tax to Inland Revenue.

The commercial reality of listed entities means that they cannot be expected to allocate their income between investors on an average daily basis. The only practical method for them is to allocate income to persons who hold shares on specified record dates.

A listed company should be eligible to become a PIE if they meet criteria equivalent to that for a qualifying unit trust under the Income Tax Act 2004 (amended to include all relevant vehicles including companies, group investment funds and superannuation schemes); or be a listed vehicle and:

- is resident in New Zealand; and
- meets the income interest requirement; and
- meets the investment-type requirement; and
- meets the investment value requirement.

Listed PIEs should continue to pay provisional tax on their income on a quarterly basis, with the exception that gains on New Zealand and Australian shares will not be assessable. The current dividend rules would continue to apply (that is, the PIE attribution rules would not apply to investors). Any imputation credits should be able to be used by the investor, with any excess imputation credits being refundable. Although this approach means that investors would not benefit from losses which would be retained at the PIE level and not flowed through, this is a small price to pay for inclusion in the PIE rules and lower compliance costs.

For listed entities, the PIE tax should be calculated on a six-monthly basis based on the marginal tax rates of the investors in the entity on the distribution record date. A six-monthly basis should be used as that is the frequency with which listed vehicles generally distribute dividends to shareholders and prepare their accounts for public release.

Comment

Officials consider that the attribution problems for listed companies can be addressed by giving them similar treatment to qualifying companies. Listed PIEs would be subject to 33% company tax on their taxable income. They would be allowed to exclude income from trading Australasian shares. They would be subject to provisional tax and have to maintain an imputation credit account.

When a listed PIE paid a dividend it would have to impute the dividend to the extent imputation credits are available. The dividend would be excluded income to the shareholder, with any attached imputation credits not able to be used; this means that the dividend would be subject to a maximum tax rate of 33%. However, a taxpayer would be able to elect to include the dividend in their assessable income, and use any attached imputation credit, by returning the dividend in a tax return; this means that shareholders on a 19.5% rate would be able to receive the benefit of excess imputation credits.

Recommendation

That the submissions be accepted subject to officials' comments.

Clause 85

Issue: Simplified method for superannuation funds

Submission
(Matter raised by officials)

After consultation with representatives from the superannuation funds industry, officials have developed a simplified system for superannuation funds that would allow them the benefits of being a PIE – primarily the Australasian share trading exclusion – without requiring some of the complexities of the attribution requirements of the normal PIE rules. Such a simplified system is desirable for superannuation funds which do not have some of the systems which make attribution more practicable.

Comment

A superannuation fund which meets the PIE eligibility criteria and elects into the simplified system would:

- Pay provisional tax using a weighted average tax rate of its members.
- Be required to do an accurate tax calculation for its tax year based on its actual income and the weighted average tax rate of its members.
- Be required to make an annual investor interest adjustment within three months of the end of the tax year to ensure that 19.5% rate taxpayers receive an additional entitlement to reflect their lower tax rate.
- Would be liable for the tax on the share of the current year's income that is paid out to investors that exit the fund during a year. This would typically be the "interim interest rate" that superannuation funds pay out to exiting investors. It is expected that superannuation funds would fund a provision for this tax liability by making a deduction from the amount paid out to their exiting members.

Losses and tax credits (such as imputation credits) would not pass through to members. Instead, they would be able to be used only to offset the tax liability of the superannuation fund.

The tax rate applying to superannuation funds that are defined benefit schemes would be 33%.

Recommendation

That the submission be accepted.

Issue: Treatment of unvested amounts

Submissions

(596 – ISI, 569 & 608 – ING, 582 – National Provident Fund, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group, 674W – Waterfront Industry Superannuation Fund)

Where unvested amounts are held in an individual account in an investor's name, taxation should be at an individual's elected rate, as otherwise the unvested amounts will be over-taxed.

To the extent a scheme does not allocate all of its income, and unallocated amounts vest in members, such amounts should be taxed at the weighted average marginal tax rate of its members.

Comment

Officials understand that the background to this issue relates to the complexity surrounding identification of taxable income relating to vested and unvested contributions to member accounts, as superannuation administration systems record the total vested and unvested account balance as a single record associated with each individual member.

We consider that prescribed investor rates should be used to tax income arising on unvested employer contributions subject to certain conditions. The recommended conditions are:

- For schemes established before the bill was introduced, the vesting period cannot be increased over its current level.
- New schemes established after the bill was introduced must have vesting periods equal to or less than three years, and for schemes meeting this condition, the contributions should vest in the employee within that vesting period.

Recommendation

That the submission be accepted subject to officials' comments.

Issue: Treatment of reserves

Submission

(674W – Waterfront Industry Superannuation Fund)

Presumably, reserves will be treated as an entity interest. In particular, if there is an attributed loss for the full year (which will happen occasionally), what is the mechanism for a scheme to obtain a refund for that loss, as carry forward of losses appears to be precluded under clause HL 14 and there is no provision for paying rebates to an entity?

Comment

Income that is retained by PIEs in reserve accounts should attract PIE tax at the 33% prescribed investor rate.

Officials consider that the legislation should be amended to allow losses that cannot be refunded under the PIE rules to be carried forward.

Recommendation

That the submission be accepted.

Clause 85

Issue: Inclusion of life insurance in PIE rules

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 592 – Tower, 595 – AXA, 586 – Promina Group Ltd, 557 – AllianceBernstein, 568 – Corporate Taxpayers Group, 577 & 577a – ASB Group)

Life insurance companies should not be specifically excluded from being a PIE, or should at least be allowed to treat their investment-linked products under the PIE rules. It should be possible to remove these products from the life insurance tax regime.

If life insurance companies are included in the PIE rules, the policyholder tax rate should be the average tax rate of the policy holders; share gains on New Zealand and Australian companies should be excluded income to the extent they support savings products; and a rebate for excluded income (NZ and Australian share gains) should be available against policyholder income.

Where it is not possible or appropriate to remove savings products from the life insurance tax regime (that is, non-unitised products), it should still be possible to provide policyholders with the benefit of the exclusion from tax on New Zealand and Australian shares gains and for the rate of tax on policyholders' income to be a blended rate based on their marginal tax rates.

The policyholder base for life insurance companies should be eligible to become a PIE but be taxed at a flat rate of 33% rather than flow through at investors' rates.

Life insurers should either be able to apply a blended tax rate to take account of their 19.5% policyholders or be only required to collect Inland Revenue numbers and return PIE attributions allocated to those Inland Revenue numbers for those policyholders who are entitled to the 19.5% marginal tax rate.

Comment

On 17 August 2006 the government announced that it is to carry out a comprehensive review of the life insurance tax rules.

The current rules have been operating in a largely unmodified form since 1990, even though the commercial, regulatory and savings environment has changed significantly in the intervening period.

In particular, this review will look at whether life insurance should be included in the rules for taxing PIEs, to prevent life insurance being disadvantaged relative to other savings vehicles. The review will be conducted in full consultation with the industry.

It is expected that any changes emerging from the review will be included in a tax bill to be introduced next year.

Recommendation

That the submission be declined. However, the government's review of the life insurance tax rules, which will consider including life insurance savings products in the PIE tax rules, should be noted.

Issue: Policyholders to get benefit of PIE and FIF reforms

Submissions
(596 – ISI, 592 – Tower, 586 – Promina Group Ltd, 556 – AMP, 577 & 577a – ASB Group)

The life insurance tax regime should be amended to ensure that the discount available under the proposed FIF rules (taxing 85% of offshore share gains instead of 100%) is also available to investors in life insurance savings products.

To the extent that assets are held on behalf of policyholders, life insurers should be permitted to derive exempt capital gains from New Zealand and listed Australian equities. The calculation of tax under the policyholder base would need to be amended to ensure that this concession was not removed in the policyholder base tax return. As only 85% of FIF income will be taxable to individuals and PIEs a measure is required to prevent over-taxation of policyholders when these gains are distributed.

The life insurance tax regime should also be amended to ensure that the benefits of investing into a PIE (the exclusion from tax for PIEs on their New Zealand and Australian share gains) are made available to investors in life insurance based savings products where the life insurer invests into a PIE.

Comment

As noted above, the government has announced it is undertaking a review of the life insurance rules. The review will include considering whether life insurers should be able to be PIEs.

Recommendation

That the submissions be declined. However, the government's review of the life insurance tax rules, which will consider including life insurance savings products in the PIE tax rules, should be noted.

Issue: Life insurance company allowed to hold 100% of a PIE

Submissions
(596 – ISI, 592 – Tower, 586 – Promina Group Ltd, 577 & 577a – ASB Group)

The PIE rules should allow a life insurance company to hold up to 100% of a PIE. The qualifying unit trust rules should be replicated to allow this.

Comment

Officials agree that a life insurance company should be allowed to hold up to 100% of a PIE. We do not consider, however, that it is necessary to replicate the qualifying unit trust rules to achieve this.

Recommendation

That the submissions be accepted subject to officials' comments above.

Issue: Interaction with other tax rules

Submissions
(596 – ISI, 577 & 577a – ASB Group)

Any PIE income attributed to life insurance companies should replace any taxable income or deduction under any other provision in the Income Tax Act 2004.

Comment

Officials consider it is not necessary to have a special rule for PIE income derived by life insurers. Such income should be treated like any other income derived by a life insurer.

Recommendation

That the submissions be declined.

Issue: Life insurer should be able to elect part of its business to become a PIE

Submissions

(586 – Promina Group Ltd, 577 & 577a – ASB Group)

Where a life insurer has the ability to segregate a part of its business through having both separate accounting and investment records and that business only relates to investment policies held for the benefit of policyholders, that segregated part can elect to become a PIE. This segregated part would become a notional tax entity within the life company.

Comment

As noted above, the government has announced it is undertaking a review of the life insurance rules. The review will include considering whether life insurers should be able to be PIEs.

Recommendation

That the submissions be declined. However, the government's review of the life insurance tax rules, which will consider including life insurance savings products in the PIE tax rules, should be noted.

Issue: Non-resident life insurer to own up to 20% of a PIE

Submission

(552 – Kiwi Income Property Trust)

There is no reason for excluding non-resident life insurers from the investor interest size requirement. Section HL 6(4)(a)(iii) should be amended by removing the words: "that is a New Zealand resident".

Comment

This issue has been superseded by the recommendation to raise the general investor interest size requirement to 20 percent.

Recommendation

That the submission be noted.

Issue: Allowing non-resident life insurer with a New Zealand branch to own all of a PIE

Submission
(Matter raised by officials)

A non-resident life insurer with a branch in New Zealand should be able to own up to 100% of a PIE if it would have satisfied the foreign investment vehicle definition without its New Zealand branch.

Comment

The New Zealand branch business of a non-resident life insurer may be treated under section EY 48 as being carried on by a separate company resident in New Zealand. This deeming provision could restrict the level of ownership in a PIE held by a non-resident life insurer. This restriction is inappropriate if the non-resident life insurer would have satisfied the foreign investment vehicle definition in proposed section HL 6(10) in the absence of this deeming provision. A non-resident life insurer with a New Zealand branch should continue to be treated as a non-resident for the purposes of the PIE rules, despite section EY 48. A foreign investment vehicle may own up to 100% of a PIE.

Recommendation

That the submission be accepted.

Issue: Life insurers to attribute income at investors' marginal tax rates

Submission
(556 – AMP)

Life companies should be permitted to elect to attribute income to individual investors in respect of investment-linked products. This would enable investors on the 19.5% marginal tax rate to achieve a consistent treatment with investors in PIEs.

Income attributed from PIEs should be taxed in the life company, with no withholding at the PIE level. This is necessary to ensure that the life company generates imputation credits, which it will need to meet the liability in the policyholder base tax return.

Comment

Officials note that a life insurance company that invests in a PIE will receive income attributed at a 0% rate. The life insurance company will be responsible for paying the tax.

Recommendation

That the submission be declined. However, the government's review of the life insurance tax rules, which will consider including life insurance savings products in the PIE tax rules, should be noted.

Issue: Relationship between PIE rules and other income tax provisions

Submissions
(589 – KPMG, 588 – Trustee Corporation Association of NZ, 593 – Westpac NZ/BT Funds Management NZ)

The bill needs to clarify which parts of the Income Tax Act are to remain operative in relation to PIEs to provide certainty regarding the tax treatment.

A PIE should not have to comply with the following regimes: ASC, Supplementary ASC, ICA and loss continuity.

Comment

Officials consider that a number of current provisions in the bill and further amendments will clarify which parts of the Income Tax Act remain applicable to PIEs. For example, because section ME 1 will specifically provide that a PIE cannot be an imputation credit account company, the various imputation provision will not be applicable to PIEs. The general rule is that unless a general provision is specifically "switched off" in relation to a PIE it should be treated as applying to a PIE.

Recommendation

That the submissions be noted.

Issue: Relationship between PIE rules and core provisions

Submission
(594 – New Zealand Law Society)

The determination of PIE income should be simplified and made more consistent with the core provisions approach in the Act. There is no good reason for core provisions not to be applied to the calculation of income subject to PIE taxation. If it is not, the benefits of the rewrite process of the past 15 years will be significantly weakened.

Comment

Various drafting changes made to the PIE provisions in the bill since its introduction have made the PIE rules more consistent with the core provisions in the Income Tax Act.

Recommendation

That the submission be noted.

Issue: Making subpart HL a code

Submission
(12a – NZ Funds)

The PIE regime should be drafted as a legislative code. Subpart HL should be drafted as a stand-alone legislative code so there is no doubt about the possible application of other tax regimes.

Comment

Having the PIE rules drafted as a stand-alone legislative code would be inconsistent with the general structure of the Income Tax Act and, in particular, core provisions. The rewrite of the Income Tax Act has involved, in part, replacing stand-alone legislative codes with more integrated provisions.

Recommendation

That the submission be declined.

Issue: Exemption from income tax for PIEs

Submission
(597a – PricewaterhouseCoopers)

The legislation should specifically state that a PIE is exempt from income tax on its portfolio investment income.

Comment

The submission incorrectly assumes that PIE tax is not income tax and is a separate tax. This is not the case. PIE tax is income tax. It would therefore not be correct to exempt PIEs from income tax. The relationship between the PIE provisions and other Income Tax Act provisions will be made clearer, as a result of amendments made at the Committee stage of the bill.

Recommendation

That the submission be declined.

Issue: Treatment of income distributed by a former PIE

Submission
(597a – PricewaterhouseCoopers)

If a PIE exits the PIE rules, income derived up to the time of exit should be able to be subsequently distributed without the recipient having a tax liability in respect of that income (provided it has been taxed as attributed income).

Comment

Under proposed section CX 44D(2), income distributed by a PIE is excluded income to the investor. This exclusion should apply only for the period the entity qualifies as a PIE. It is within the control of a PIE to make a tax free distribution at any time up to when the entity ceases to be a PIE. The submission's proposal would also significantly increase the complexity of the PIE rules as it would require amounts earned by an entity before and after it was a PIE to be separately tracked.

Recommendation

That the submission be declined.

Issue: Relationship between PIE tax and dividend rules

Submission
(569 & 608 – ING)

Amend sections CD 14, CD 32 and CZ 13 of the Income Tax Act 2004 so that these rules no longer apply to unit trusts and group investment funds that have elected into the PIE rules.

Comment

Under the PIE tax rules, all distributions from PIEs will be excluded income of investors, meaning that investors will not be taxable on any dividends. Officials do not consider it is necessary to make any further amendments to the dividend rules as suggested by the submission.

Recommendation

That the submission be declined.

Issue: CFC rules not to apply to PIEs

Submission
(12a – NZ Funds)

The CFC rules should not apply to PIEs. If a PIE holds an interest in a CFC and that CFC has FIF interests, then the PIE would have to return the underlying FIF income. As the intention of the PIE rules is that all investments of a PIE are portfolio investments, the new FIF rules (and not the CFC rules) should apply.

Comment

Officials do not consider there is a policy basis for not applying the CFC rules to PIEs. If the offshore interests of PIEs come within the current CFC rules then it is appropriate that those rules rather than the new FIF rules apply to these interests. All interests coming within the current CFC rules should be treated the same. The proposal to apply the FIF rules instead of the normal CFC rules to interests in CFCs held by PIEs would also increase the overall complexity of the offshore tax rules.

Recommendation

That the submission be declined.

Issue: Relationship between PIE tax and DWP rules

Submissions
(596 – ISI, 578 – NZICA, 569 & 608 – ING, 589 – KPMG, 593 – Westpac NZ/BT Funds Management NZ, 914W – Dominion Funds Group)

PIE tax should override the dividend withholding payment obligations under the Income Tax Act 2004. Another option is to cap the DWP liability for PIEs at 15%, which will mean less tax is overpaid in the case of non-residents.

Comment

Officials consider it is appropriate to replace DWP with PIE income tax as this will simplify the operation of the PIE tax rules. Consequently, clause 104 of the bill, which relates to underlying foreign tax credits and is only relevant to DWP, should be omitted. Section MG 2 should also be amended to prevent a PIE being a dividend withholding payment account company (similar to how section ME 1 is being amended to prevent a PIE being an imputation credit account company).

Recommendation

That the submissions be accepted subject to officials' comments.

Issue: Interaction with consolidation regime

Submission
(578 – NZICA)

The effect of the PIE tax rules on a consolidated group should be clarified.

Comment

Officials do not consider that an amendment is necessary to clarify the relationship between the PIE tax rules and the consolidation rules. The normal consolidation rules should apply.

Recommendation

That the submission be declined.

Issue: Application of section FC 3

Submission
(578 – NZICA)

Section FC 3 of the Income Tax Act 2004, an anti-avoidance rule relating to share dealing, should not apply to PIEs.

Comment

Officials do not consider it is necessary to amend section FC 3 to provide that it does not apply to PIEs. In certain circumstances, section FC 3 treats a dividend as consideration received on the sale of shares. Because income derived from the sale of Australasian shares will be excluded income of PIEs, it is not possible for section FC 3 to have an adverse effect on PIEs. It is therefore not necessary to expressly exclude the application of the section to PIEs.

Recommendation

That the submission be declined.

Issue: Status of imputation credit accounts

Submission
(578 – NZICA)

Where a fund had an imputation credit account prior to electing to be a PIE, it should be allowed to retain this. However, no further entries to the account should be allowed unless it ceases to be a PIE.

Comment

Under the PIE tax rules all distributions from a PIE – including distributions of income earned by an entity before it becomes a PIE – will be excluded income of investors. It is therefore not necessary for PIEs to maintain imputation credit accounts, which is why the legislation prevents PIEs from maintaining them. Officials do not consider it is necessary to make any further changes to the imputation rules.

Recommendation

That the submission be declined.

Issue: Relationship with double tax agreements

Submissions
(589 – KPMG, TCA, 591 – Duncan Cotterill)

Officials need to review the position to ensure that New Zealand's network of double tax agreements is not put at risk. Because becoming a PIE is currently limited to New Zealand-resident entities, a foreign investment vehicle that invests in New Zealand will not be able to benefit from the capital gain exemption in the PIE rules. This difference in treatment could be a breach of New Zealand's DTAs, in particular, non-discrimination clauses.

Comment

Officials consider that the PIE tax rules are consistent with New Zealand's double tax agreements.

Recommendation

That the submission be noted.

Issue: Approach to legislating avoidance concerns

Submission
(12a – NZ Funds)

Anti-avoidance measures (such as the PIE eligibility rules and the wash-sale rules for Australasian equities) should be removed from the substantive provisions in the bill. Where necessary, anti-avoidance matters should be addressed by specific provisions that have their application limited to transactions that have the intention and effect of avoiding tax.

Comment

Officials consider that the suggested approach of using "intention and effect" type anti-avoidance provisions would result in more uncertainty than the current objective rules (such as the wash-sale rules for Australasian equities). We therefore do not favour this approach.

Recommendation

That the submission be declined.

Issue: Relationship between PIE quarters and tax year

Submission
(594 – New Zealand Law Society)

There may not be the necessary linkage between the change in the PIE taxable period from a tax year to a quarter and the other provisions in the Income Tax Act. For example, it is not clear whether the deferral of a deduction under section EA 3 (pre-payments) is taken in the first quarter of the next year or is spread on a pro-rata basis over all the quarters of the next year.

Comment

The proposed amendment has been superseded by the recommended restructuring of the PIE tax rules, which will now provide the necessary linkage between PIE periods and income years. PIE periods will not be treated as separate income years and instead will fit within the existing income year structure of the Income Tax Act. This means that provisions like section EA 3 (prepayments) will continue to apply as they do currently.

Recommendation

That the submission be noted.

Issue: Definition of investor in section OB 1

Submission
(567 – Mercer Human Resource Consulting)

Clause 126(20)(c) amended the definition of "investor" in section OB 1. The new definition includes subsections for group investment funds, PIEs that are companies and PIEs that are not companies. It may be useful to have particular definitions to cover members and trustees of registered superannuation schemes.

Comment

The definition of "investor" for PIEs that are not companies will apply to registered superannuation schemes. Therefore, the suggested amendment is not necessary.

Recommendation

That the submission be declined.

Issue: Non-PIE investment income tax rate capped at 33%

Submissions
(568 – Corporate Taxpayers Group, 880 – First NZ Capital)

The tax rate cap of 33% on income earned through PIEs should be extended to all individual taxpayers for all forms of income from investment. That is, the maximum tax rate for individuals on interest and dividends should be capped at 33%.

Comment

These submissions, which seek to have the tax rate of all investment income earned by individuals capped at 33%, is outside the scope of the bill.

Recommendation

That the submissions be declined.

Clauses 166 to 171

Issue: Trust deed/company constitution overrides for investor interest adjustment

Submissions
(597a – PricewaterhouseCoopers, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 582 – National Provident Fund, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group, 925W – ASFONZ, 613W – Phillips Fox, 618W – The Retire Fund)

Proposed sections 42E of the Trustee Act 1956 and proposed section 12A of the Unit Trusts Act 1960 should provide the ability for the manager or trustee to adjust the interests of investors as required under section HL 6(3), notwithstanding any provision in the relevant trust deed or applicable governing legislation. An additional provision along the lines of proposed section 42E of the Trustee Act 1956 should be introduced for the benefit of managers or trustees of a GIF.

The Trustee Companies Act 1967 should also be amended to ensure that trustees of group investment funds that elect to be PIEs are able to adjust investors' interests.

Is it necessary to provide a similar provision to that contained in clause 168 (power to adjust interests of investors in PIE despite any provision in the Superannuation Schemes Act 1989)? That would enable trustees to adjust the interests of members of non-PIE entities to allow for implications of the deemed disposal provisions in the FIF rules.

To ensure clarity and simplicity of process, where a deed amendment is required to enable the PIE legislation to be implemented, relief should be granted under all related legislation including the Superannuation Schemes Act. For superannuation schemes, any deed amendments should be approved by the Government Actuary in lieu of member consent.

Comment

Officials agree that a provision similar to clause 168 in the bill should be included to amend the Trustee Companies Act, to authorise the trustee or manager (in the case of an externally managed fund) of a group investment fund to adjust the interests of investors as required under proposed section HL 6(3), despite any provision in the Trustee Companies Act or the relevant trust deed. For consistency, clause 168 should also be amended to authorise adjustments, despite any provision in the relevant trust deed.

Given that group investment funds can also be established under the Public Trust Act 2001 or the Public Trust Office Act 1957, a similar amendment allowing the interests of investors in these funds to be adjusted despite any provision in these Acts or the relevant trust deed, should also be made.

Officials do not consider it necessary to provide a provision similar to clause 168 to enable trustees to adjust the interests of members of non-PIE entities to allow for implications of the deemed disposal provisions in the FIF rules. Deemed disposal provisions have been a feature of the FIF rules for many years, and it has not been considered necessary to have a provision overriding other trustee obligations.

Recommendation

That the submission to include a provision similar to clause 168 in relation to the Trustee Companies Act 1967 be accepted, subject to officials' comments, and that a similar amendment also be made to legislation governing the Public Trust.

Issue: Trust deed override for imputation credits

Submission
(569 & 608 – ING)

The changes to section 12A of the Unit Trusts Act 1960 should be extended to cover changes arising as a result of the PIE tax rules to taxation of distributions and gains from redemption and the treatment of imputation credits.

Comment

The bill provides that all distributions from PIEs will be excluded income to investors. It is therefore not necessary for PIEs to maintain imputation credit accounts. Given this treatment of distribution, officials do not consider it is necessary to extend the current amendment in the bill to section 12A of the Unit Trusts Act 1960.

Recommendation

That the submission be declined.

Issue: Amendments to Companies Act 1993 to allow differential treatment

Submission
(594 – New Zealand Law Society)

To avoid the requirement for a special resolution, a company which has made an election to be a PIE should also be empowered under the Companies Act 1993 to make differential adjustments to its shareholdings or to make differential distributions.

Comment

The requirements to adjust the interests of investors under section HL 6(3) will not apply to PIEs that are listed companies incorporated under the Companies Act 1993. It is therefore not necessary to amend the Companies Act 1993 to provide for this requirement.

Recommendation

That the submission be declined.

Issue: Reference to property employed in a business

Submissions
(578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ)

The amendments in clauses 168 and 171, which allow trustees to adjust investors' interests, should not refer to property that is employed in a business (as this could narrow the ambit of these changes).

Comment

Officials agree that the amount of the relevant provisions should not be limited by referring to a business.

Recommendation

That the submissions be accepted.

Clause 85

Issue: Limiting notional wind-up to assets whose tax treatment changes

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 592 – Tower, 551 – Macquarie Goodman, 590 – Property Council, 582 – National Provident Fund, 585 – NZX, 552 – Kiwi Income Property Trust, 574 & 574a – Staples Rodway, 573 & 573a – Guinness Peat Group (supplementary submission), 569 & 608 – ING Property Trust)

The transitional rules should focus on situations where revenue account assets change their status to become capital account assets. In particular, section HL 2 should apply either only to New Zealand and Australian equity investments or where investments move from revenue to capital account as a result of entry into the PIE rules. The deemed disposal and reacquisition on notional windup (that is, entry into the PIE tax rules) should not apply to depreciable property as the tax treatment of this asset class will not change.

Section HL 2(3) should exclude from its scope investments in qualifying unit trusts, superannuation funds, and GIFs.

The effect of HL 2(3), if retained in its current form, would mean that managed funds would not have a five-year holiday from the new rules at all in respect of their GPG shares. Proposed section HL 2(3) should be amended to provide that assets which will retain their existing tax character after the introduction of the new rules will not be deemed to be realised at the time a managed fund elects to be a PIE.

Comment

Officials agree that the deemed disposal and reacquisition of the property of entities becoming PIEs, under section HL 2(3), should apply only to New Zealand and Australian shares which will be subject to the proposed exclusion in section CX 44C for PIEs from tax on realised gains on Australasian shares. This is because it is only these assets whose status changes from revenue account to capital account, and it is appropriate that only accrued change in value is brought to tax.

This more limited deemed disposition and reacquisition should apply to all shares in Australasian companies referred to in section CX 44C.

Recommendation

That the submissions to limit the application of section HL 2(3) to Australasian shares whose proceeds of sale will be excluded income be accepted.

Issue: Formation loss

Submissions
(12a – NZ Funds, 578 – NZICA)

The references to "subparts IE and IF" in section HL13 should be removed on the basis that the PIE rules under subpart HL are a legislative code.

The continuity of ownership rules in "subpart IE" should not apply to PIEs or to the rules in section HL 13 as the underlying policy objective is to preserve these losses.

Comment

Officials consider that it is not consistent with the scheme and structure of the Income Tax Act for losses to be carried forward other than under subparts IE and IF. Subpart HL cannot be a complete code unto itself as it is part of the Income Tax Act 1994. The normal rules in subpart IE and IF for carrying forward losses, including continuity of ownership requirements, should continue to apply to PIE formation losses where applicable.

Recommendation

That the submissions be declined.

Issue: Three-year spread of transition liability

Submissions
(597a – PricewaterhouseCoopers, 596 – ISI, 578 – NZICA, 595 – AXA, 567 – Mercer Human Resource Consulting, 577 & 577a – ASB Group, 925W – ASFONZ, 674W – Waterfront Industry Superannuation Fund)

The due date for payment of the transitional tax liability, under section HL 2(3), in each of the three spread years should be specified in legislation.

The tax payment crystallised on movement into the new FIF rules should be payable in three equal instalments over the next three years.

The ability to spread under section HL 3(2) should be made elective so that entities can settle their tax obligations arising from notional wind-up earlier than the three-year period if so wished.

The three-year deferral should be extended to all tax payments incurred as result of this bill, including those faced by non-PIE entities with significant offshore portfolio investments.

Tax arising at 1 April 2007 should be spread for all entities and that the spread should be over a longer period, and suggest that at least five years is required.

Comment

Officials consider it is reasonable for tax payments owing as a result of the entry of non-Australasian shares into the FIF rules to be spread in equal instalments over the three tax years starting from 1 April 2007. (This tax could be paid sooner if the taxpayer wishes to.) This spread should be for no longer than three years. The due date for payment will be the end of each of the three tax years.

Recommendation

That the submissions to spread the tax payable on movement into the new FIF rules over the next three years in equal instalments be accepted.

Issue: Imposition of penalties and interest upon 3-year spread

Submission
(597a – PricewaterhouseCoopers)

The legislation should be amended to stipulate that no penalties or interest will arise as a result of the PIE spreading the tax liability arising upon election to the PIE regime equally over a three-year period, as allowed under new section HL 3(2).

Comment

Officials consider it is already the effect of current section HL 3(2) that no penalties or interest will arise solely as a result of a PIE spreading its transitional tax liability equally over a three-year period.

Recommendation

That the submission be noted.

Issue: Double taxation issue (retail and wholesale PIEs)

Submissions
(569 & 608 – ING, 593 – Westpac NZ/BT Funds Management NZ, 595 – AXA)

Notional windup should not be required on assets held in an underlying vehicle (such as a wholesale fund) where the underlying vehicle also converts to a PIE.

Alternatively, funds should be able to credit their imputation credit accounts with a deemed amount equivalent to the deferred tax liability created on transition and undertake a distribution with those deemed credits attached on 31 March 2007.

Comment

Officials agree that the deemed disposition and reacquisition in proposed section HL 2(3) should not apply for shares held by a PIE in another entity that becomes a PIE because this otherwise could result in double taxation.

Recommendation

That the primary submission be accepted.

Issue: Treatment of supplementary available subscribed capital account credit balances upon election to be a PIE

Submissions
(597a – PricewaterhouseCoopers, 569 & 608 – ING)

Section MD 2A of the Income Tax Act 2004 should be amended to allow overpaid income tax to be refunded to a qualifying unit trust or group investment fund upon electing to be a PIE.

It should be made clear in section MJ 1 that a PIE will no longer maintain a supplementary available subscribed capital account.

Comment

Officials agree that amendments should be made to allow overpaid income tax for a qualifying unit trust or group investment fund to be refunded to the extent provided in section MD 2A when it elects to be a PIE. The rationale for this proposed amendment is based on the ability of qualifying unit trusts and group investment funds to liquidate and obtain a refund of pre-paid tax in the same manner under current legislation.

Officials agree that amendments should be made to provide that a PIE does not maintain a supplementary available subscribed capital account.

Recommendation

That the submissions be accepted subject to officials' comments.

Issue: Distribution of income derived prior to PIE election

Submissions
(597a – PricewaterhouseCoopers, 569 & 608 – ING, 592 – Tower, 556 – AMP, 577 & 577a – ASB Group)

The bill should be amended to specifically state that section CX 44D(2) will apply to income earned by a PIE both before and after election into the PIE rules.

The proportion of retained earnings (pre-PIE income) not sheltered by imputation credits should be distributed by a PIE as excluded income.

Comment

Officials consider that the legislation already provides that the exclusion from tax for distributions from a PIE applies to income earned both before and after the entity elects into the PIE tax rules. A statement confirming this effect will be included in the *Tax Information Bulletin* article on the new rules (once enacted).

Recommendation

That the submissions be declined.

Issue: Imputation credits attributed to revenue account investors

Submissions
(597a – PricewaterhouseCoopers, 592 – Tower)

Immediately prior to the entry by a company (including a unit trust) into the PIE regime there should be a deemed distribution of imputation credits to revenue account investors, including deemed imputation credits in respect of tax payable on transition into the PIE regime.

Comment

Given that distributions from PIEs – including income earned before an entity becomes a PIE – will be excluded income to all investors, officials do not consider there is a case for transferring imputation credits to a revenue account investor. In any event, it would be inappropriate to stream imputation credits to revenue account investors only.

Recommendation

That the submissions be declined.

Issue: Amnesty for initial period

Submissions
(12a – NZ Funds, 578 – NZICA, 584 – Smartshares Limited)

A 12-month amnesty period should be provided (for one year from the date of application) for timing errors in taxable income and breaches of the qualification criteria. The amnesty should allow any incorrect tax position to remain unadjusted provided the position taken is consistent with the allocation of income to investors and unit pricing, and the difference is a timing difference.

If the preceding submission is not accepted, at the very least there should be a 100% reduction in shortfall penalties if voluntary disclosure is made before the due date for filing the first annual reconciliation statement.

There should be no application of penalties during the first year of the new regime.

Comment

Officials consider that amnesties are generally not desirable as they can be regarded as undermining the rule of law. Officials will be monitoring the new legislation and, where appropriate, will recommend remedial amendments with retrospective effect.

Recommendation

That the submissions be declined.

Issue: Transition into the new FIF rules

Submission
(597a – PricewaterhouseCoopers, 569 & 608 – ING, 592 – Tower, 582 – National Provident Fund)

Income that arises on the deemed disposal of offshore equities by PIEs, on notional windup, should be determined under the new FIF rules for offshore equities that will apply from 1 April 2007 (that is, tax 100% of share gains on Australian resident listed companies and 85% of other gains).

If Inland Revenue is concerned about the revenue impact of taxing revenue account share gains of PIEs at 85%, an option could be for funds to pay tax arising on the notional wind-up (on Australasian shares) in the first year, instead of spreading this liability over three years.

Comment

Officials consider that the deemed disposition and reacquisition (notional wind-up for PIEs) should apply only to Australian and New Zealand equities that would be subject to the trading exclusion as these are the only class of asset whose tax treatment would change. This means that offshore shares (outside Australia) would not be affected by the notional wind-up and would be subject to the transitional rules proposed under the new FIF rules. The submissions have therefore been superseded by the amendment recommended by officials.

Recommendation

That the submissions be noted.

Issue: Treatment of income arising under HL 2(3)

Submission
(578 – NZICA)

The legislation in section HL 2(3), relating to the deemed disposition of an entity's property prior to becoming a PIE, needs to be clear as to how the income arising upon the deemed disposition is dealt with. In particular, it needs to be made explicit that this income arises under the existing (pre-PIE) tax rules.

Imputation credits arising from tax paid on the deemed disposition should be able to be used under the FITC rules and thereby generate foreign tax credits for non-resident investors.

Comment

Officials consider the legislation is already clear that income arising from the deemed disposition under section HL 2(3) is dealt with under the existing tax rules.

We consider that allowing distributions from PIEs of pre-PIE income, such as that arising under section HL 2(3), to be excluded income to all investors is an appropriate tax treatment. Applying FITC to distributions of pre-PIE income would unnecessarily complicate the PIE tax rules. Entities would be able to utilise any imputation credits under the FITC rules up until the time they become PIEs.

Recommendation

That the submissions be declined.

Issue: Correcting tax references in HL 3(2)

Submissions
(596 – ISI, 12a – NZ Funds, 578 – NZICA, 569 & 608 – ING, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 582 – National Provident Fund)

The nature of the payment of tax arising on transition should be clarified to refer to provisional tax and terminal tax liabilities. Currently, section HL 3(2) refers only to liabilities under the resident withholding tax and non-resident withholding tax rules.

Comment

Officials agree with the submission.

Recommendation

That the submissions be accepted.

Clauses 85 and 126

Issue: Ordering of PIE tax calculation provisions

Submission
(578 – NZICA)

Section HL 8, which further refines section HL 9, should follow the rules in section HL 9 and not precede them. Section HL 8 also needs clarification. Further, the interaction between sections HL 8, HL 9 and HL 12 to HL 16 is far from clear and requires clarification.

Comment

The PIE tax calculation provisions will be re-ordered to improve their comprehensibility.

Recommendation

That the submission be noted.

Issue: Market value references in subpart HL

Submission
(12a – NZ Funds)

Where market value is not available for the purposes of complying with provisions in the PIE tax rules for becoming or ceasing to be a PIE, "fair value" adopted for accounting should be sufficient.

Comment

Officials note that "market value" is a general concept used in the Income Tax Act 2004 and should be sufficient for the purposes of the provisions for becoming or ceasing to be a PIE. The tax rules do not currently contain a "fair value" concept, and officials consider that introducing such a concept would create uncertainty.

Recommendation

That the submission be declined.

Issue: Correcting PIE company references

Submissions
(597a – PricewaterhouseCoopers, 12a – NZ Funds, 589 – KPMG, 588 – Trustee Corporation Association of NZ, 594 – New Zealand Law Society, 567 – Mercer Human Resource Consulting)

A number of provisions incorrectly assume that a PIE is a company: sections HL 6(9) and HL 17(4) of the Income Tax Act 2004 and section 57B(1)(b) and (2)(b) of the Tax Administration Act 1994. These references should be changed to refer to an entity. The reference to "shareholders" in section HL 6(9) should be replaced with "investors".

Comment

Officials agree.

Recommendation

That the submissions be accepted.

Issue: Definition of portfolio investor class taxable income

Submission
(567 – Mercer Human Resource Consulting)

The definition of portfolio investor class taxable income in section HL 8 seems to contain a drafting error. In particular, as currently drafted, for the amount of portfolio investor class taxable income to be other than zero the portfolio investor class must have a portfolio investor class land loss. Presumably this was not intended.

Comment

Officials agree that section HL 8 contains a drafting error. This error should be corrected to ensure the provision caters correctly for situations where PIEs do not have a portfolio investor class net loss.

Recommendation

That the submission be accepted.

Issue: Minor drafting issues

Submissions

(596 – ISI, 12a – NZ Funds, 578 – NZICA, 569 – ING, 551 – Macquarie Goodman, 594 – New Zealand Law Society, 590 – Property Council, 552 – Kiwi Income Property Trust, 567 – Mercer Human Resource Consulting, 914W – Dominion Funds Group, 608 – ING Property Trust)

Replace "net income" with taxable income in new section HL 18(6).

Replace "liquidation and formation" with re-acquisition of equity investments and land and buildings held on revenue account in new section HL 13.

In the definition of "prescribed investor rate" in section OB 1, replace "attributed investment entity income" with "portfolio investor attributed income".

The words "the income year of the entity ends before the day on which the election is effective" under new section HL 2(3)(a) should be replaced with "the income year of the entity ends immediately before the day on which the election is effective".

The words "the total of the following amounts" under new section HL 9(1) should be replaced with "either of the following amounts".

The words "class net income" under new section HL 12 (5) and (7)(b) should be replaced with "class taxable income".

The words "from a period ending before" under new section HL 13(1) should be replaced with "from a period ending immediately before".

In the definition of portfolio investor interest fraction in section OB 1, "means the fraction which the investor is entitled to an amount of proceeds from a portfolio entity investment distributed by the entity to the investors in the portfolio interest class" should be replaced with "means the fraction to which the investor is distributed an amount from the portfolio entity investment of the entity".

The drafting of section CX 44C(a)(i) and HL 5(2)(b) should be the same as section ME 1(2)(b) in clause 113 of the bill.

In section HL 2, the reference to "(entity)" after "person" is not standard drafting practice in the Income Tax Act, adds nothing, and should be deleted.

Section HL 2(1) talks about "choose" whereas section HL 2(2) talks about "election". The language should be standardised.

The deemed disposal rules in section Hl 2(3) and HL 4(2) should be made consistent with other deemed disposal rules in the Act.

Language referring to percentages "of the total interest", percentages "of value of the entity's assets", and percentages "of value of the company" should be standardised as much as possible.

The references to value to the term “value” in section HL 6(6) and (7) should be replaced with the term “market value”.

In the definition of portfolio investor rate individuals should only be required to notify the PIE if their tax rate is not 33%.

In HL 18(6), the reference to “net income” should be replaced with “taxable income”.

In section HL 13, “liquidation” and “formation” should be replaced with notional disposal and reacquisition of equity investments and land and buildings held on revenue account if not held by listed entities.

An amendment is needed to section NG 1(2) of the Act to clarify that a distribution from a listed PIE will not be subject to NRWT.

Section CX 44D(1) should be redrafted. On the basis of the current wording, an investor who provides a portfolio investor rate at the beginning of the portfolio entity period that is lower than his or her prescribed investor rate but who amends this to the correct rate before the end of the portfolio entity period does not satisfy part (1)(b). Any portfolio investor attributed income for this investor will not be excluded income.

For clarity, section HL 2(3)(a) should read “..the income year of the entity ends on the day before the election is effective” and not “…the income year of the entity ends before the day on which…”

Section HL 6(9) states, “An entity is not eligible to be a portfolio investment entity if…”. This would be better stated as, “An entity will cease to be eligible to continue to be a portfolio investment entity…”

The formula for calculating PIE tax contained in section HL 12 is incorrect. The definition of “class income” needs to refer to the portfolio investor class net income for the portfolio entity period.

In section HL 18(4) the definition of “credit” should refer to the amount of credit received for the portfolio entity period.

Comment

As part of the recommended amendments to the bill, the PIE tax rules in the bill will be restructured to make them clearer and ensure that they achieve their intended effect. Officials consider that the minor remedial amendments listed above should be taken into account as part of the amendments restructuring the PIE tax rules.

Recommendation

That the proposed minor remedial amendments be taken into account in amending the PIE tax rules.