

# **Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill**

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*Commentary on the Bill*

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Minister of Revenue

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# Trans-Tasman portability of retirement savings

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## **TRANS-TASMAN PORTABILITY OF RETIREMENT SAVINGS**

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*(Clauses 8, 32(2) and (6), 72(1) and (3), 75, 76, 79, 80(1) to (3), (5) and (6))*

### **Summary of proposed amendments**

The bill amends the KiwiSaver Act 2006 and the Income Tax Act 2007 to give effect to trans-Tasman portability of retirement savings. The portability arrangements will allow a person who has retirement savings in both Australia and New Zealand to consolidate them in one account in their current country of residence. The amendments remove an impediment to labour movement between the two countries, as retirement savings are currently unable to be transferred if a person permanently emigrates to the other country.

### **Application date**

The portability arrangements will come into effect up to two months after New Zealand and Australia have exchanged notes informing each other that the necessary legislation has been enacted. This is expected to be during the second half of 2010.

### **Key features**

The key features of the new portability arrangements are:

- Participation will be voluntary for KiwiSaver members and scheme providers.
- Retirement savings may only be transferred between a KiwiSaver scheme and an Australian complying superannuation fund regulated by the Australian Prudential Regulation Authority.
- A KiwiSaver member must permanently emigrate to Australia to be able to transfer his or her retirement savings. The requirements for proof of permanent emigration, to be supplied to the member's provider before the savings can be transferred, will be the same as for permanent emigration to other countries. These requirements are contained in clause 14, schedule 1 of the KiwiSaver Act 2006.
- A KiwiSaver member will not be able to withdraw any retirement savings in cash after one year if the member permanently emigrates to Australia, as can be done if the person emigrates to a country other than Australia.
- Any member tax credits may be transferred to Australia. Under the current rules, a person's member tax credits are recovered by the Crown if the person withdraws his or her savings in cash after permanent emigration.
- New section CW 29B of the Income Tax Act 2007 provides that an amount of Australian-sourced retirement savings transferred to a KiwiSaver scheme under the portability arrangements will be treated as exempt from tax at the point of entry.

- Some policy differences (for example, relating to withdrawals for retirement and purchasing a first home) will apply to Australian-sourced retirement savings that have been transferred to a KiwiSaver scheme. However, any New Zealand-sourced earnings on those retirement savings will be subject to normal KiwiSaver policies.
- New rules will govern the treatment of KiwiSaver balances after a member permanently emigrates to Australia. For permanent emigration to any other country, the current rules in clause 14(1) and (2), schedule 1 will continue to apply.

## **Background**

The retirement savings portability arrangements were developed by a working group established to investigate options for improving the portability of retirement savings between New Zealand and Australia.

The trans-Tasman portability arrangements recognise the high degree of integration between New Zealand and Australia, and are intended to make it easier to transfer retirement savings across the Tasman to improve labour mobility between the two countries.

The portability details are contained in an Arrangement between the governments of New Zealand and Australia which was signed by the Minister of Finance and the Australian Treasurer on 16 July 2009. The Arrangement is available at <http://taxpolicy.ird.govt.nz/>.

## **Detailed analysis**

### ***Tax treatment of transfers***

One of the principles of the portability arrangements is that transferring retirement savings across the Tasman should not lead to an unnecessary loss in value of those savings. To protect the value of retirement savings, such transfers between New Zealand and Australia will be exempt from entry or exit taxes.

Generally, a transfer from a foreign superannuation scheme to a registered superannuation scheme in New Zealand involves:

- a distribution from the source superannuation scheme to the member; and
- the member reinvesting the proceeds in the host country's superannuation scheme.

Consequently, a transfer of retirement savings from Australia to New Zealand may give rise to a taxable dividend. New section CW 29B of the Income Tax Act 2007 will ensure that an amount of Australian-sourced retirement savings transferred to a KiwiSaver scheme under the portability arrangements becomes exempt income at the point of entry.

For transfers from a KiwiSaver scheme to an Australian scheme, the only possible tax impost is non-resident withholding tax (NRWT), which is levied on dividends, interest and royalties paid to non-residents. Distributions from a KiwiSaver scheme to non-residents are not treated as dividends and so are not subject to NRWT. Therefore, no specific exemption for transfers of savings from a KiwiSaver scheme to an Australian scheme is necessary.

### ***Australia's excess non-concessional contributions tax***

Australia imposes a tax-free limit (a “non-concessional contributions cap”) of A\$150,000 on the amount of superannuation contributions that an individual can make from non-wage sources in a particular year. Contributions that exceed this cap are taxed at a rate of 46.5 percent. The tax is intended as a disincentive for people to accumulate excessive contributions in superannuation funds, as Australian superannuation funds are taxed on their earnings at concessional rates (15 percent) and pensions paid out of such funds are typically tax-free after 60.

Transfers from KiwiSaver to an Australian superannuation scheme will be subject to the non-concessional contributions cap on initial entry into the Australian system. This is intended to maintain the integrity of the Australian superannuation system. The cap will not apply to New Zealand-sourced or Australian-sourced superannuation contributions re-entering Australia.

An individual under 65 can bring forward the next two years' worth of contributions, so can contribute up to A\$450,000 in any particular year without breaching the contributions cap. The cap will be indexed to inflation from 2010–11.

### ***New rules for permanent emigration to Australia***

Under the current rules, clause 14, schedule 1 of the KiwiSaver Act 2006 allows members who permanently emigrate overseas to withdraw their savings in cash one year after emigration. Any member tax credits that the person has accumulated cannot be withdrawn, and will be recovered by the Crown. The amendments contained in the bill replace these rules for KiwiSaver members who permanently emigrate to Australia.

Under new clause 14B, schedule 1, a KiwiSaver member can transfer his or her retirement savings from their participating KiwiSaver scheme to an Australian complying superannuation fund regulated by the Australian Prudential Regulation Authority. Members can request the transfer of their savings at any time after they supply their provider with proof of their permanent emigration to Australia. The requirements for proof of permanent emigration to Australia will be the same as those contained in clause 14(3), schedule 1 of the KiwiSaver Act 2006.

KiwiSaver members transferring their retirement savings to Australia will be able to take their accumulated member tax credits and \$1,000 Crown contribution with them. Currently, member tax credits are recovered by the Crown if a member withdraws his or her savings following permanent emigration from New Zealand.

Under Australian law, retirement savings transferred from KiwiSaver to Australia will remain locked in until the member reaches the age of entitlement to New Zealand Superannuation (currently 65).

Under Australian law, any New Zealand-sourced retirement savings that are transferred to Australia will not be able to be transferred from Australia to a third country.

The portability arrangements will be the only way for KiwiSaver members to take their accumulated savings with them when they permanently emigrate to Australia. Consequently, KiwiSaver members who emigrate to Australia will not be able to withdraw their accumulated savings in cash. This reflects the policy intent of KiwiSaver, which is to encourage a long-term savings habit and asset accumulation.

The portability arrangements will apply only to transfers of retirement savings between New Zealand KiwiSaver schemes and Australian complying superannuation funds. For KiwiSaver members who permanently emigrate to a country other than Australia, the current rules in clause 14, schedule 1 of the KiwiSaver Act will continue to apply, except that the amount withdrawn will be reduced by the amount of Australian-sourced retirement savings (as well as any member tax credits), as provided by clause 14(1) and (2), schedule 1.

Members of complying superannuation funds in New Zealand will not be eligible for the portability arrangements, but are covered by the existing rules after permanent emigration, described in clause 14, and amended by this bill.

### ***Policy differences for Australian-sourced retirement savings***

Differences between the Australian and New Zealand superannuation schemes mean that transferred savings will remain subject to a number of source-country rules. These rules will apply only to the principal amount of savings that is transferred to the host country. Once transferred, earnings on those savings and any subsequent contributions will be subject to the rules of the host country. Applying these policy differences will ensure that portability supports labour market mobility, rather than being used to take advantage of regulatory and policy differences between New Zealand and Australia.

Members can completely withdraw their retirement savings on the later of five years of membership or on reaching the age of entitlement to New Zealand Superannuation (currently 65). Despite this, new clause 4B, schedule 1 will allow Australian-sourced retirement savings which are held in KiwiSaver to be withdrawn at age 60 if the member is retired. This is consistent with the Australian rules on the withdrawal of retirement savings, and ensures that an individual is not disadvantaged by moving from Australia to New Zealand. These individuals could otherwise have accessed the savings tax-free at 60 if they had remained in Australia.

The government provides members of a KiwiSaver scheme with a member tax credit that matches their personal contributions at a rate of 100 percent, up to a maximum of \$1,042.86 a year. To be eligible, members must reside mainly in New Zealand in the year for which the tax credit applies. As Australian savings relate to contributions made while the member was not residing in New Zealand, the member tax credit will not be paid on such savings after they are transferred to KiwiSaver. The definition of “member credit contribution” in section YA 1 of the Income Tax Act 2007 is being amended to achieve this.

Australian-sourced savings held in KiwiSaver will not be able to be used for any of the KiwiSaver housing-related initiatives. The Arrangement between the two countries prescribes that transferred savings cannot be withdrawn to assist with the purchase of a first home, under clause 8, schedule 1 of the KiwiSaver Act 2006. This is because Australia's home ownership scheme is separate from its retirement savings scheme. However, any earnings on Australian-sourced savings may be withdrawn for the purchase a first home.

The mortgage diversion facility is a feature of KiwiSaver which allows a member to divert up to half of their contributions to their mortgage repayments. It was closed to new applicants from 1 June 2009. To fulfil the intent behind the portability arrangements, and to ensure consistency between the first home withdrawal initiative and the mortgage diversion facility, Australian-sourced retirement savings will not be able to be diverted to a member's mortgage repayments under new section 229(2)(jb) of the KiwiSaver Act.

The KiwiSaver deposit subsidy provides a member with a lump sum payment of \$1,000 for each year of contribution, up to a maximum of \$5,000, to use for a deposit on the member's first home. To be eligible for the subsidy, a member must contribute at least two percent of his or her salary or wages for at least three years. To align the deposit subsidy rules with the residence requirements for other benefits of KiwiSaver, contributions made to an Australian complying superannuation fund and subsequently transferred to New Zealand will not count towards eligibility for the subsidy. This will be contained in the deposit subsidy administrative rules which are administered by the Housing New Zealand Corporation.

If a person's membership in KiwiSaver is invalidated after retirement savings are transferred from Australia to New Zealand, the net value of any such savings will be returned to the member's Australian superannuation account instead of being refunded in cash to the member.

As previously noted, KiwiSaver members who permanently emigrate from New Zealand to a country other than Australia will not be able to withdraw any Australian-sourced retirement savings in cash after one year.



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# KiwiSaver

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## ENROLMENT OF UNDER 18-YEAR-OLDS

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*(Clauses 72(2), 73 and 74)*

### **Summary of proposed amendments**

The bill amends the KiwiSaver Act 2006 to create a new set of rules governing the enrolment of under 18-year-olds in KiwiSaver. These rules will provide that children under 16 can only be enrolled by their legal guardian, and children aged 16 to 17 will be subject to a transitional rule which recognises their growing intellectual maturity. The proposed new rules will provide clarity and certainty around the enrolment of under 18-year-olds in KiwiSaver.

### **Application date**

The new rules will apply from 1 July 2010 or the date of enactment of the legislation, whichever is later.

### **Key features**

To provide certainty and clarity, the bill creates a new set of rules in section 35 of the KiwiSaver Act to prescribe how those aged under 18 can enrol in KiwiSaver. The proposed new rules are:

- Children under 16 years old may only be enrolled by their legal guardian(s), and may not enrol themselves in KiwiSaver.
- Children aged 16 to 17, with a legal guardian, must co-sign with their legal guardian(s) in order to enrol in KiwiSaver. They may not enrol themselves, and a legal guardian will not be able to enrol a child aged 16 to 17 in KiwiSaver without the child's consent.
- Children aged 16 to 17 without a legal guardian may opt into KiwiSaver by contracting directly with a scheme provider. This means that children aged 16 to 17 who are married, in a civil union, or living with a de facto partner, will not need to co-sign in order to opt into KiwiSaver.

A contract properly entered into on behalf of an under 18-year-old will be treated as if the child is 18 – that is, the contract will be binding. The proposed amendments will mean that a purported enrolment will be invalid if, for example, an under 16-year-old is enrolled by someone other than their legal guardian, or if a 16 to 17-year-old with a legal guardian is not a co-signatory.

If an under 18-year-old has more than one legal guardian, all guardians must act jointly in order to enrol the child in KiwiSaver. This is consistent with the rules around the exercise of guardianship in the Care of Children Act 2004.

## **Background**

The KiwiSaver Act 2006 provides that children under 18 years old are not subject to automatic enrolment, and can only opt into KiwiSaver by contracting directly with a provider. The KiwiSaver Act does not prescribe who can contract with a scheme provider on behalf of a child under 18 years old. It is at the discretion of the provider whether an application is accepted.

The lack of clarity about who can enrol children in KiwiSaver has led to complaints and disputes from parents and guardians, as well as from children who have been enrolled without their consent. Children and their parents can currently contest an enrolment on the grounds that the contract was non-binding.

## **CONSISTENCY BETWEEN THE PAYE RULES AND KIWISAVER RULES FOR SCHOOL CHILDREN**

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*(Clause 77)*

### **Summary of proposed amendment**

The KiwiSaver rules are being amended to ensure that, if PAYE is not required to be deducted from a child's salary or wage if they receive the tax credit for children, no KiwiSaver deductions are required to be made.

### **Application date**

The amendment will apply from 1 July 2010 or the date of enactment of the legislation, whichever is later.

### **Key features**

If a child has the tax credit for children under section LC 3 of the Income Tax Act 2007, Inland Revenue can reduce the amount of tax for a PAYE income payment. This can be done if the tax credit fully covers the child's PAYE liability (if their annual earnings are less than \$2,340).

If a child has validly opted into KiwiSaver and is employed, the child is required to have KiwiSaver deductions made from his or her wages. It is the policy intent that, if no tax deduction is required to be made from the payment of salary or wages at the time the payment is made, in accordance with the PAYE rules, then there is no requirement for KiwiSaver contributions to be made. However, section 67 of the KiwiSaver Act 2006 prevents this from happening.

The proposed amendment will mean that a child does not need to make regular contributions to KiwiSaver from their salary or wages if PAYE is not required to be deducted. A child may still choose to contribute to KiwiSaver by giving his or her employer a deduction notice.

## PROVISION OF ANNUAL REPORTS VIA HYPERLINK

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*(Clause 78)*

### **Summary of proposed amendment**

A change to the KiwiSaver rules will allow scheme providers to send their members a copy of their annual report via hyperlink, if the member has agreed to this in writing. This will reduce compliance costs for providers.

### **Application date**

The amendment will apply from 1 July 2010 or the date of enactment of the legislation, whichever is later.

### **Key features**

Section 122 of the KiwiSaver Act 2006 (which incorporates section 17 of the Superannuation Schemes Act 1989) requires the trustees of a KiwiSaver scheme to provide an annual report to all KiwiSaver members in their scheme. If an email address is provided, the annual report can be delivered in an electronic format through an email attachment.

However, the annual report requirement cannot be satisfied by providing a hyperlink to the report in an email, as a hyperlink provides a “point of access” to the information rather than providing the information itself. If the provider is unable to deliver the report via email, for example, because of firewalls or a lack of capacity in the recipient’s email account, a hardcopy of the annual report must be supplied. This imposes additional compliance costs.

An amendment to section 122 of the KiwiSaver Act 2006 will allow scheme providers to satisfy the requirements to provide an annual report by sending a hyperlink in an email which links to the annual report, if the member has agreed to this in writing.

## **“LEASEHOLD ESTATE” – FIRST HOME WITHDRAWAL AND DEPOSIT SUBSIDY**

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*(Clause 80(4))*

### **Summary of proposed amendment**

An amendment to the KiwiSaver rules will ensure that members with an interest or past interest in a leasehold estate, such as a residential tenancy, will not be excluded from being eligible for the first home withdrawal or deposit subsidy provisions in KiwiSaver.

### **Application date**

The amendment will apply from 1 July 2010.

### **Key features**

Clause 8, schedule 1 of the KiwiSaver Act 2006 allows members of KiwiSaver to withdraw their accumulated savings, less the one-off \$1,000 Crown contribution and any member tax credits, to use for the purchase of a first home. A KiwiSaver member cannot withdraw his or her savings for a first home if they have previously held an estate in land, unless their financial position is what would be expected of a first home buyer.

In clause 8, the definition of an estate includes a “leasehold estate”. A leasehold estate includes leasehold residential tenancies where a property owner rents the property to another party. Using that definition, if a member has ever been party to a rental lease agreement, the person may not be eligible for first home withdrawal. These people should not be excluded from meeting the eligibility requirements for this reason only.

The amendment to clause 8, schedule 1 will ensure that individuals with an interest or past interest in a leasehold estate, such as a residential tenancy, will not be excluded from first home withdrawal.

The amendment will also ensure that individuals with an interest in a leasehold estate may be eligible to receive the KiwiSaver deposit subsidy. The deposit subsidy is provided for in the administrative rules of the Housing New Zealand Corporation rather than legislation. The administrative rules for the deposit subsidy are aligned with the first home withdrawal rules in clause 8, schedule 1 of the KiwiSaver Act 2006.



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## Distributions to cooperative company members

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## **DISTRIBUTIONS TO COOPERATIVE COMPANY MEMBERS**

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*(Clauses 6, 7, 12 and 32)*

### **Summary of proposed amendments**

The bill in effect extends the scope of sections DV 11 and CD 34 of the Income Tax Act 2007, which allow a cooperative company to deduct a distribution to a member if the distribution is in proportion to the sale and purchase of trading stock between the member and the cooperative. Amendments to section DV 11, and new section CD 34B, remove the requirement for strict proportionality by permitting a 20 percent differential.

This flexibility is being introduced to reduce compliance costs for cooperative companies that pay dividends on a limited number of shares in excess of those held to match trading stock transactions. There will be a general review of the tax treatment of dividends paid by cooperatives within the next year.

### **Application date**

The amendments will apply to distributions made on or after 1 April 2010.

### **Key features**

- Section CD 34 will be repealed and replaced by section CD 34B, which is slightly broader in scope.
- Section CD 34B provides that a distribution on certain types of shares by a cooperative company to a member is not a dividend. This applies to shares held in proportion to actual or expected trading stock transactions between the member and the cooperative, and also to a limited number (20 percent) of other shares.
- Section CD 34B(9) provides an exception to section 125 of the Companies Act 1993 for cooperatives that elect deductible dividend treatment for tax purposes, and that provide a copy of the election to the Registrar of Companies. Subsection (9) gives such companies some flexibility in fixing the date of entitlement which establishes members' right to receive dividends.
- Section DV 11, which currently provides for a cooperative company to deduct distributions to which section CD 34 applies, now refers to section CD 34B.

### **Background**

Cooperative companies can require members to hold shares in proportion to trading stock transactions between the member and the cooperative. Shares linked to supply in this way are described as "supply-backed shares". Sections DV 11 and CD 34 provide that, subject to certain limitations, cooperatives with these types of shares may deduct distributions paid to members if the payments are in proportion to trading stock transactions. This would enable a cooperative to deduct a distribution paid on a supply-backed share.

A cooperative company with such a capital structure can make distributions in relation to non-transaction shares as well as supply-backed shares. Non-transaction shares are shares that enable the member to supply trading stock to the company in a season but in relation to which the member does not actually supply or expect to supply trading stock.

The boundary between supply-backed and non-transaction shares is not clear during a trading season. To avoid increased compliance costs for these cooperatives, which would arise from treating these shares differently for income tax purposes, the government has decided in the shorter term to extend the existing treatment for distributions on supply-backed shares to distributions on a limited number of non-transaction shares.

It is satisfied that, provided the number of non-transaction shares held by a member does not exceed 20 percent of the number of other shares, there is still a close enough link between a member's overall shareholding and the member's trading stock transactions with the cooperative to warrant the same treatment for distributions on both types of share.

However, the government intends to review the tax treatment of distributions paid on shares held in cooperative companies within the next year as part of its general review of mutual transactions.

### **Detailed analysis**

New section CD 34B will generally apply in the same circumstances as the existing section CD 34, which will be repealed.

The new section describes four types of shares – transaction shares, projected transactions shareholding, limited non-transaction shares and other shares that entitle members to enter into trading stock transactions. The distinction exists only for the purposes of tax rules relating to deductibility and dividends – the shares may be of the same, or a different class, for company law purposes.

#### ***Distributions in proportion to actual or estimated trading stock transactions***

Under new section CD 34B, transaction shares are those that are held in proportion to trading stock transactions in a season. Projected transactions shareholding are shares held in proportion to estimated trading stock transactions in a season.

Under the proposed changes, distributions paid by a cooperative company on such shares will be deductible to the cooperative (section DV 11) and are not a dividend (new section CD 34B(2)(a) and (b)).

#### ***Distributions on limited non-transaction shares***

Non-transaction shares are shares that are not held in proportion to actual or estimated trading stock transactions but that entitle the member to enter into trading transactions with the cooperative.

A distribution paid by a cooperative to a member on such a share is deductible to the cooperative, and is not a dividend, only if the member does not hold, and the constitution of the cooperative does not allow any other member to hold, more non-transaction shares than 20 percent of the greater of the number of their transaction shares or projected transactions shares.

If the constitution allows any member to hold more non-transaction shares than the 20 percent level, only distributions on transaction and projected transactions shareholding will be deductible to the cooperative and will not be a dividend. Distributions to any member on other shares will not be eligible for this tax treatment.

### **Example**

A is a member of a farmers' meat cooperative company. The company requires a member to hold one share for each 10 kilograms of meat the member sells to the cooperative in a season. Members can also hold additional shares up to a maximum of 20 percent of shares held by the member to back their recent or estimated sale of meat to the cooperative. Shares held in excess of this are redeemed by the cooperative at the end of the season.

A estimates that he will supply 1,000kg of meat in the 2010–11 season so he purchases 120 shares. He only supplies 800kg of meat in the season. After the end of the season, the cooperative company distributes \$1 per share to members for that season so A receives \$120.

A holds 100 projected transactions shares (80 of which are transaction shares) and 20 limited non-transaction shares for the 2010–11 season. The distribution of \$120 is not a dividend under new section CD 34B and is deductible to the cooperative under section DV 11.

### ***Variation***

The cooperative company changes its constitution so that an individual member may hold any number of non-transaction shares. A estimates that he will supply 1,000kg of meat in the current season, and actually supplies 900kg. He holds 200 shares. The company pays a \$200 dividend on the shares.

A holds 100 projected transactions shares and 100 other shares. The \$100 paid on the projected transaction shares is deductible to the cooperative and excluded as a dividend. The remaining \$100 is non-deductible and may be a dividend.

In this case, section CD 34B(3)(b) applies so that distributions on shares other than transaction shares or projected transactions shareholding held by any member (not just A) are not deductible and may be a dividend.

### ***Review***

As noted earlier, the government proposes to review the tax treatment of distributions from cooperative companies to shareholders within the next year. This will enable full consultation on the appropriate treatment of such distributions.

### ***Section 125(2) Companies Act 1993***

A problem arises for cooperative companies with a particular capital structure that pay dividends to shareholders and have different financial years and trading seasons (for example, a trading year ending 31 March and a financial year ending 31 May).

Under section 125 of the Companies Act 1993, there is a maximum 20 working-day period between the time shareholders' entitlements to receive a dividend are determined (the "record date") and the date the company's board resolves to pay the dividend.

This creates a problem for cooperative companies that require shares to be held in proportion to trading stock transactions, that pay dividends to shareholders and that have a different financial year and trading season. If such companies pay a dividend in respect of a trading season after the end of the equivalent financial year, the record date can be in the new trading season. The appropriate record date should be in the trading season for which the dividend is paid.

Proposed subsection CD 34B(9) therefore provides an exception to the 20 working-day rule for cooperative companies that have elected the tax treatment in section CD 34B. However, the exception applies in relation to all shares of the cooperative that entitle a member to enter into trading stock transactions. That is, the 20 percent limitation that applies for tax purposes does not apply for the purposes of the exception to the Companies Act 1993.

#### **Example**

A Co is a cooperative company whose members hold 1 share for each \$10kg of meat they supply to the cooperative. It has a trading season of 1 April to 31 March and a financial year of 1 June to 31 May. It intends to pay a dividend based on its 2010–11 trading season on 1 August 2011, after the end of its 2010–11 financial year. It wants to pay that dividend to members in relation to their shareholding in the 2010–11 trading season.

It elects, under section CD 34B, to deduct the dividends paid on its shares and also gives a copy of the election notice to the Registrar of Companies. It resolves to fix a record date for all future distributions of 31 March, being the last day of its trading season. As this resolution was made before the end of the 2010–11 trading season, the board can resolve to pay a dividend on 1 August 2011, in respect of the 2010–11 trading season, based on shareholding on 31 March 2011.

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## Cancellation of BETA debits from conduit-relieved dividends

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# CANCELLATION OF BETA DEBITS FROM CONDUIT-RELIEVED DIVIDENDS

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*(Clauses 29 and 30)*

## **Summary of proposed amendment**

Following reforms of the international tax rules, there are concerns that some companies may be able to use their branch equivalent tax accounts (BETA) debit balances to effectively continue conduit tax relief. This is contrary to the intention of the reforms. The proposed amendments therefore cancel those BETA debits that arose from conduit-relieved dividends. Cancellation of these BETA debits will not lead to double taxation because conduit-relieved dividends would not have been taxed in the first place.

## **Application date**

The amendment applies from all income years beginning on or after 1 July 2009.

## **Key features**

A new provision (section OE 11B) generates a BETA credit equal to any BETA debits generated in respect of foreign dividend payment (FDP) liabilities that have been reduced under section RG 7.

The bill also removes subsection OE 7(1)(c)(iii). This is intended to clarify that section OE 7 (which allows companies to use BETA debits to satisfy an income tax liability in relation to attributed controlled foreign company (CFC) does not apply to BETA debits that have been generated on dividends that have been conduit-relieved under section RG 7.

## **Background**

Recent reforms to the international tax rules included the repeal of conduit tax relief and a two-year phase-out period for companies with debit balances in their branch equivalent tax accounts (BETAs).

### ***Repeal of conduit tax relief***

Conduit tax relief was a mechanism that relieved tax on income earned in foreign subsidiaries to the extent that the New Zealand parent company was owned by non-residents. The new rules introduced an active income exemption for controlled foreign companies and an exemption for most foreign dividends received by companies, making conduit tax relief largely redundant. Consequently, conduit tax relief was repealed, with application from all income years beginning on or after 1 July 2009.

### ***Phase-out of branch equivalent tax accounts***

Under the old international tax rules controlled foreign company (CFC) income was taxed twice: when the income was earned by the CFC and attributed back to its New Zealand shareholders and when the CFC paid a dividend to those shareholders. Branch equivalent tax accounts (BETA) were the mechanism for relieving the double taxation that could otherwise occur from having these two layers of tax.

As part of the international tax reforms, an exemption has been introduced for most types of foreign dividends received by companies. This removes the potential for double taxation and makes it possible to phase out BETA accounts held by companies.

In February 2008 the government announced that once the international tax changes took effect, companies would be able to carry forward and use any existing BETA debit balances for a further two years. This two-year transitional period for BETA debits was intended to relieve the double taxation that could occur when a dividend was taxed under the old rules ahead of the underlying income being taxed again under the new international tax rules.

### ***The problem***

Officials have since become aware of a small number of companies with very large BETA debit balances. There is a concern that these BETA debit balances could be used to effectively prolong conduit tax relief for a further two years. This is a particular concern in respect of dividends that have been conduit-relieved as such dividends generate a BETA debit even though no tax has been paid on the dividend. This means that these BETA debits are not needed to relieve double taxation, but can be used to offset tax on some other attributed foreign income.

To address this concern, the proposed amendments cancel those BETA debits that arose from conduit-relieved dividends. Other BETA debits will still be available for use during the two-year transitional period.

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# Gift duty exemptions

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## GIFT DUTY EXEMPTIONS

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*(Clause 82)*

### Summary of proposed amendments

The bill introduces a number of amendments to the Estate and Gift Duties Act 1968 to exempt the following gifts from gift duty:

- Transfers of assets by, and gifts made to, local or central government. The change removes an impediment to donors who want to give property (monetary and non-monetary) to local or central government and will reduce the associated compliance costs for those donors.
- Gifts made to donee organisations.<sup>1</sup> The change will align the gift duty treatment of gifts made to donee organisations with the policy for encouraging greater giving to charitable and philanthropic causes.
- Distributions of property made in accordance with a Court order under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955. The change will ensure that the original policy intention that such distributions of property are exempt from gift duty is maintained.

### Application dates

The exemption for distributions of property made in accordance with a Court order under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 will apply retrospectively to 24 May 1999, the date when Part 1 of the Estate and Gift Duties Act 1968 was repealed.

The other amendments will apply from the date of enactment.

### Key features

New section 73(2)(aa) of the Estate and Gift Duties Act 1968 exempts any gift required by an order of a Court under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 from gift duty.

New sections 73(2)(jd) and 73(2)(kb) introduce exemptions from gift duty for gifts made to central government and local authorities, provided these organisations are not carried on for the private pecuniary benefit of any individual.

New section 73(2)(o) introduces an exemption from gift duty for gifts made to donee organisations.

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<sup>1</sup> A donee organisation is an organisation that is approved by Inland Revenue and listed at [www.ird.govt.nz/donee-organisations](http://www.ird.govt.nz/donee-organisations), or that is approved by Parliament and listed in schedule 32 of the Income Tax Act 2007.

## Background

Gift duty was introduced in New Zealand in 1885.<sup>2</sup> The original purpose of gift duty was to protect the estate duty base (by discouraging the gifting of assets before death) and to raise revenue. However, when estate duty was abolished in 1992, the government of the day decided to retain gift duty to protect against income tax avoidance, social assistance targeting and defeating creditors, until measures to restrict avoidance were considered and announced.

The way the Estate and Gift Duties Act 1968 is currently structured means that gift duty has a wide ambit. This is because gift duty is imposed on any gift of property in New Zealand, or outside New Zealand if the donor's permanent home is in New Zealand, or the donor is a company incorporated in New Zealand. A number of exemptions from gift duty are provided in section 73 of the Act. The exemptions are, however, ad hoc and there does not appear to be a coherent framework for determining whether exemptions should be granted. Consequently, the Minister of Revenue receives frequent requests for legislative change to exempt certain gifts.

Instead of continuing to determine exemptions on a case-by-case basis, a review of gift duty, focusing on options for targeting the application of gift duty, will be undertaken in the coming year. The review will seek to ensure that the government's intention for gift duty as a means of protecting against income tax avoidance, defeating creditors and social assistance targeting is met, and to ensure that the integrity of the tax system is maintained.

Given that further work on reviewing gift duty is likely to take time, current requests for exemptions are being included in this bill. These relate to: transfers of assets by, and gifts made to, local or central government agencies; gifts of money made to donee organisations; and distributions of property made by a Court order under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955.

## Detailed analysis

### *Transfers of assets by, and gifts made to, local or central government*

Requests for exemptions for transfers of assets by, and gifts made to, local and central government fall into the following four categories:

- *Transfers of assets by local authorities* – local authorities often transfer assets as part of local council restructurings which can give rise to gift duty. Restructuring transactions to deal with the actual or potential imposition of gift duty is inefficient for local authorities.
- *Gifts made to local authority trusts* – the general characteristics of local authority trusts are that the sole trustee is a local authority and trust funds are held for charitable (or public) purposes benefiting all or a significant portion of the public within the territory of the local authority. Gifts made to these trusts may give rise to gift duty because of the legal uncertainty of such trusts registering with the Charities Commission.

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<sup>2</sup> The legislative provisions at that time were contained in the Deceased Persons' Estates Duties Act 1885 and are now contained in the Estate and Gift Duties Act 1968.

- *Gifts made to local or central government* – uncertainty arose for a donor who proposed to gift a number of parcels of land to both local and central government agencies, and wished to ensure that such gifts were not subject to gift duty.
- *Gifts made to district health boards (DHBs)* – DHBs are Crown entities owned by the Crown.<sup>3</sup> For income tax purposes, Crown entities are treated as public authorities and are therefore exempt from income tax.<sup>4</sup> However, gifts to DHBs may be liable for gift duty. For example, a donor who wishes to gift a dialysis machine to a DHB may face potential gift duty.

Granting specific legislative exemptions for transfers of assets by, and gifts made to, local or central government agencies can be justified on the grounds that the proposed exemptions would:

- be consistent with the government’s intention in retaining gift duty for protecting against income tax avoidance, social assistance targeting or defeating creditors;
- remove impediments to donors to give property (monetary and non-monetary) to local or central government. Currently, donors making such gifts are subject to gift duty. The Crown is therefore the recipient of both the gift and the duty;
- be consistent with other exemptions contained in the Estate and Gift Duties Act 1968. For example, of the 12 named organisations listed in section 73 of the Estate and Gift Duties Act, three are Crown entities (New Zealand Antarctic Institute, Te Papa and the Historic Places Trust);
- reduce compliance costs for donors wishing to make gifts to local or central government as restructuring such gifts to ensure that they do not incur gift duty is currently resource-intensive and inefficient.

To ensure that the proposed exemptions are properly targeted, there will be a requirement that no person should be able to derive a private pecuniary benefit from a local or central government agency, over and above what would normally be permitted, and no person should be able to influence the amount of any benefit they themselves would receive.

### ***Gifts made to donee organisations***

Individuals, companies and Māori authorities qualify for tax relief on gifts of money made for charitable, benevolent, philanthropic or cultural purposes within New Zealand, or for certain purposes overseas. However, the exemption from gift duty applies only to gifts that are made to organisations registered with the Charities Commission. Consequently, donors may be entitled to a tax benefit for their gifts to donee organisations but are then subject to gift duty. This outcome has been criticised as being inconsistent with the policy for encouraging greater giving to charitable and philanthropic causes.

To ensure that the proposed exemption is not subject to abuse, there will be a requirement that no person should be able to derive a private pecuniary benefit, over and above what would normally be permitted, and no person should be able to influence the amount of any benefit they would receive.

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<sup>3</sup> Crown Entities Act 2004, section 7.

<sup>4</sup> Income Tax Act 2007, section CW 38.

### ***Distributions of property made by a Court order under certain Acts***

In 1993, estate duty was abolished for deaths occurring after 17 December 1992. Legislation affecting this matter was passed under the Estate Duty Repeal Act 1999, which provided for the repeals of parts 1, 2 and 3 of the Estate and Gift Duties Act 1968.

Under repealed section 7(2) of the Act, it was clear that the distribution of any property in accordance with a Court order under the Law Reform (Testamentary Promises) Act 1949 or the Family Protection Act 1955 was exempt from gift duty. Since the repeal of that section, the gift duty treatment of such distributions has become unclear.

Since such distributions have previously been treated as exempt from gift duty, it was an unintended consequence of repealing section 7(2) of the Estate and Gift Duties Act 1968 that the treatment of such distributions has become unclear. Given that the original policy intention of the Act was that such distributions be exempt from gift duty, the amendment will be made retrospectively to 24 May 1999, the date when Part 1 of the Estate and Gift Duties Act 1968 was repealed.

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# Binding rulings

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## QUESTIONS OF FACT

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*(Clauses 36(4), 52(2) and (4), 55, 56, 57, 58(2) and (3), 63, 64(1) and 66)*

### **Summary of proposed amendments**

The bill contains amendments to replace the current general prohibition on determinations of fact with a provision that the Commissioner can rule only on the basis of the facts as provided by the applicant. The purpose of the amendment is to clarify that the Commissioner can rule on questions of tax avoidance and in doing so retain certainty for taxpayers.

### **Application date**

The amendments will apply from the date of enactment.

### **Key features**

The amendments introduce the following changes:

- The rule that the Commissioner cannot rule on questions of fact (sections 91E(4)(a) and 91F(4)(a)) will be replaced with a rule that the Commissioner cannot rule on “proscribed questions” which include the existence or correctness of facts.
- Specific exclusions from ruling in relation to the taxpayer’s intention, the value of anything and what constitutes “commercially acceptable practice” will also be included as proscribed questions on the basis that they are likely to require the Commissioner to rule on the existence or correctness of facts.
- The Commissioner may make a ruling based on the facts provided by the applicant. The Commissioner may also inquire as to the correctness or existence of the facts provided by the applicant, but is not required to do so.

### **Background**

An underlying principle of the binding rulings legislation is that the Commissioner should not have to determine whether facts provided by an applicant for a ruling are correct. Under sections 91E(4)(a) and 91F(4)(a) the Commissioner is therefore prohibited from ruling on questions of fact. On a literal interpretation of this provision it could be argued that the Commissioner is prohibited from making a ruling when doing so would expressly or implicitly require particular facts to be found to exist. In that case, the Commissioner may be unable to rule on fact-dependent issues such as the application of the general anti-avoidance provision or specific anti-avoidance provisions. Such a broad interpretation would, however, be inconsistent with the understanding and application of the binding rulings provisions by taxpayers, tax practitioners and Inland Revenue since the binding rulings regime was introduced in 1994. The inability to obtain a binding ruling on questions of avoidance would reduce certainty for businesses.

To ensure that the Commissioner can rule on tax avoidance, the relevant legislation is being replaced with a rule that the Commissioner cannot rule on proscribed questions, including the existence or correctness of facts. The Commissioner can, however, rule on the basis of facts that are assumed to exist from the application for the ruling. Proscribed questions also include the taxpayer's intention, the value of anything and what constitutes commercially acceptable practice.

To remove any inference that the Commissioner is unable to rule on tax avoidance (which would defeat the main purpose of the proposed change) the exclusion for commercially acceptable practice will be limited to where that term is used in the tax legislation.

## **ABILITY TO RULE WHEN THE MATTER IS SUBJECT TO A CASE BEFORE THE COURTS**

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*(Clauses 52(1) and 58(1))*

### **Summary of proposed amendment**

The Commissioner's discretion not to rule on matters before the courts is being clarified by limiting its application to cases involving substantially similar arrangements. The purpose of the amendment is to clarify when the Commissioner will exercise the discretion.

### **Application date**

The amendment will apply from the date of enactment.

### **Key features**

Sections 91E(3)(b) and 91F(3)(b) are being amended to clarify the Commissioner's discretion not to rule on matters which are the subject of a dispute with the applicant or another person. The application of the discretion is being limited to an arrangement on which the ruling is sought, or a separately identifiable part of that arrangement, which is substantially the same as an arrangement which is before the courts.

### **Background**

The Commissioner has a discretion under which he can decline to rule "if the matter on which the ruling is sought is subject to an objection, challenge or appeal, whether in relation to the applicant or to any other person". The provision is expressed in general terms and the scope of the provision, particularly the term "matter" is unclear. The provision does not allow for an unduly narrow interpretation such as requiring an identical transaction and the same or associated taxpayer. At the other extreme, it would be inappropriate to apply it to all instances where an issue arises that is commonly determined in a transaction – for example, the application of the general anti-avoidance provision – as that would allow the Commissioner to turn down any ruling application on that issue. This lack of clarity does not give businesses certainty.

## **MASS MARKETED AND PUBLICLY PROMOTED SCHEME RULINGS**

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*(Clauses 36(3), 58(1), 61, 62 and 70)*

### **Summary of proposed amendment**

An amendment is being made to allow promoters of arrangements, or those with an interest similar to that of a promoter, to apply for a product ruling for prospective arrangements. Currently a promoter cannot request a binding ruling on an arrangement if the promoter is not a party to the arrangement. Allowing promoters of schemes to apply for product rulings could enhance overall tax compliance if such applications became standard practice.

### **Application date**

The amendment will apply from the date of enactment.

### **Key features**

New section 91FC(1A) of the Tax Administration Act 1994 allows promoters of arrangements to apply for product rulings for prospective arrangements.

To deal with the possible incentive for promoters of arrangements to omit relevant information or misrepresent the arrangement to obtain a favourable binding ruling, the promoter of the scheme will be required to make a statutory declaration that the relevant facts and documents provided in the application are correct. The Commissioner is also being given a discretion not to rule if the promoter has previously applied for such a ruling and omitted relevant information or provided false information.

### **Background**

A product ruling sets out Inland Revenue's interpretation of how the tax law applies to an arrangement that is likely to be entered into with a number of people on identical terms. One of the conditions when applying for a product ruling is that the applicant must intend to be a party to the proposed arrangement (section 91FC(1A)).

This means that the promoter of an arrangement may not be able to apply for a product ruling. This position followed a legislative clarification in 1999 intended, among other things, to ensure that rulings applications were limited to "seriously contemplated" arrangements.

There are advantages to investors and promoters in Inland Revenue issuing binding rulings on schemes. Prospective investors could make their investment decision in full knowledge of the tax effects of the arrangement and this would assist with compliance with their tax obligations. The promoter of the scheme could use the binding ruling to market the scheme as a means of demonstrating that the scheme is sound from a tax perspective. For Inland Revenue there are also benefits in such rulings being made available. Inland Revenue will become aware of the arrangement at an early stage and administrative costs in auditing the scheme will be reduced or eliminated.

## **DECLINING TO RULE WHEN AN ARRANGEMENT IS THE SUBJECT OF A DISPUTE**

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*(Clauses 52(3) and (5))*

### **Summary of proposed amendment**

Section 91E(4)(ga) is being clarified to allow the Commissioner to make a binding ruling if the arrangement is the subject of a dispute by way of notice of proposed adjustment (NOPA) but the application for the ruling relates to a different tax type from that in the NOPA. Currently the Commissioner cannot make a ruling if the application relates to an arrangement that is the subject of a NOPA. Allowing the Commissioner to make a ruling that relates to a different tax type to that being disputed will give taxpayers greater certainty.

### **Application date**

The amendment will apply from the date of enactment.

### **Key features**

Section 91E(4)(ga) is being amended to provide an exception to the prohibition on ruling on disputed arrangements that are the subject of a NOPA. The exception will apply if the application for the ruling relates to a different tax type from that being disputed.

### **Background**

Under section 91E(4)(ga) the Commissioner may not make a private ruling if the application relates to an arrangement that is being disputed by way of a NOPA. This criterion was added in 1999 to clarify the policy intent that there should be no overlap between the disputes resolution process and the binding rulings regime. This is necessary to ensure that certainty for the taxpayer about the Commissioner's position is maintained.

If a NOPA relates to only one aspect of the arrangement, the Commissioner cannot rule on other aspects which may not be related to the issue being disputed. This could occur, for example, if an arrangement has both income tax consequences and GST consequences. Even if the NOPA relates only to the GST aspects of the arrangement, the taxpayer cannot obtain a ruling in relation to the income tax aspects of the arrangement.

A further qualification on the ability to rule would therefore be necessary to ensure that the matter in dispute, and that for which the ruling was sought, were sufficiently separate.

## **A RULING WHICH FAILS IN PART**

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*(Clauses 53, 54, 59 and 60)*

### **Summary of proposed amendment**

Amendment are being made to sections 91EB and 91FB so that a ruling can be made invalid in part rather than in full only. This is when not all tax types ought to be affected by the invalidity. The amendment is aimed at providing greater flexibility in the rulings process.

### **Application date**

The amendments will apply to new rulings made on or after the date of enactment.

### **Key features**

Sections 91EB and 91FB are being amended to provide that if a ruling is no longer valid but the reason for the invalidity applies only to a certain tax type or types involved in the ruling, the other parts of the ruling relating to other tax types should continue to apply.

### **Background**

Currently under section 91EB(2) a binding ruling involving material differences with the arrangement actually undertaken is treated as fully invalid even if those differences are material only to certain aspects of the ruling. An example is when a ruling relates to both GST and income tax and the material differences relate only to the GST issues.

## **PUBLICATION OF NOTIFICATION OF BINDING RULINGS IN THE GAZETTE**

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*(Clauses 40 to 45, 47 to 51, 64(2) to (4) and 65)*

### **Summary of proposed amendments**

The requirement to publish the making and withdrawal of public and product rulings in the *Gazette* is being replaced with a requirement that the Commissioner publish the making and withdrawal of public and product rulings in a publication chosen by the Commissioner such as the *Tax Information Bulletin*. Similar amendments are being made to the Commissioner's determination-making powers. The amendments are aimed at streamlining the process for making and withdrawing rulings and determinations.

### **Application date**

The amendments will apply from the date of enactment.

### **Key features**

The amendments replace the requirements that the Commissioner publish the making and withdrawal of public and product rulings in the *Gazette* with requirements that the Commissioner publish this information in a publication chosen by the Commissioner.

Similar amendments are being made to the Commissioner's determination-making powers.

### **Background**

The binding rulings legislation requires Inland Revenue to notify the making and withdrawal of public and product rulings in the *Gazette*. Public and product binding rulings are also published in full in Inland Revenue's *Tax Information Bulletin* (TIB). The TIB is available on Inland Revenue's website and a paper copy can be requested. The TIB will continue to be the main vehicle for publication.

## **UNACCEPTABLE TAX POSITION PENALTIES AND USE-OF-MONEY INTEREST**

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*(Clauses 36(2), 67, 68 and 69)*

### **Summary of proposed amendments**

New sections 120W and 141B(1D) are being added to ensure that taxpayers who rely on official Inland Revenue advice will not be subject to use-of-money interest or to the unacceptable tax position penalty.

### **Application date**

The amendments will apply to new rulings made from the date of enactment.

### **Key features**

New sections 120W and 141B(1D) and a definition of “Commissioner’s official opinion” are being introduced to ensure that taxpayers who rely on official Inland Revenue advice will not be subject to use-of-money interest or to the unacceptable tax position penalty. The advice relied on will be that provided orally or in writing by the Commissioner as the official position of Inland Revenue and applicable specifically to the taxpayer (with all the relevant facts having been provided by the taxpayer).

The amendment will not apply to advice that is in the form of a private binding ruling. As the ruling is binding on the Commissioner, the taxpayer, in following the ruling, will not be subject to interest or the unacceptable tax position penalty.

### **Background**

A shortfall penalty for taking an unacceptable tax position can be imposed when a taxpayer’s tax position fails to meet the standard of being “about as likely as not to be correct”. The penalty applies when the tax position involves a significant amount of tax.

Use-of-money interest imposed on a taxpayer is charged when tax is underpaid and compensates the Crown for not having the use of its money.

It is possible that an unacceptable tax position penalty and/or use-of-money interest may apply if the taxpayer has underpaid their tax, even if this is as a result of having relied on advice provided by Inland Revenue.

## **CHARGING FOR BINDING RULINGS AND GST AND FEES FOR NON-RESIDENT APPLICATIONS**

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*(Clauses 88 and 89)*

### **Summary of proposed amendments**

The bill introduces a more flexible fee waiver provision and a reduction of 1/9th of the fee for zero-rated supplies of binding rulings by amending the Tax Administration (Binding Rulings) Regulations 1999. The amendments will allow such factors as the nature of the issue and the skill and experience applied by Inland Revenue staff in providing the rulings to be taken into account in charging for binding rulings. The amendments also bring the Regulations in line with existing GST policy.

### **Application date**

The amendments will apply new rulings made from the date of enactment.

### **Key features**

The Tax Administration (Binding Rulings) Regulations 1999 will be amended to provide for a more flexible fee-waiver provision based on what the Commissioner considers is fair and reasonable. The fees for zero-rated supplies of binding rulings will be reduced by the tax fraction of the fee.

### **Background**

Private, product and status binding rulings all incur fees that are based on recovering the cost of providing the ruling. Currently, Inland Revenue may in exceptional circumstances, at the Commissioner's discretion, waive in whole or in part any fee payable by an applicant. More flexibility is required for the exercise of the waiver. The Regulations will therefore change the requirement to one based on what is fair and reasonable having regard to such factors as the nature of the issue and the skill and experience applied by Inland Revenue staff.

The fees for zero-rated supplies of binding rulings will be reduced by the tax fraction of the fee. Currently, the fees assume a GST rate of 12.5% and do not take into account the fact that binding rulings issued to non-residents outside New Zealand may be zero-rated under the Goods and Services Tax Act 1985. Therefore, any binding ruling issued to a New Zealand resident is in effect cheaper than if that same ruling were supplied to a non-resident. This is because the New Zealand resident, if registered for GST, can generally claim an input tax credit for the GST cost of acquiring the binding ruling. The non-resident, on the other hand, is unlikely to meet the requirements for registration or input tax credit entitlement.



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## Other policy matters

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## INCOME TAX RATES

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*(Clause 3)*

### **Summary of proposed amendment**

The bill sets the annual income tax rates that will apply for the 2010–11 tax year.

### **Application date**

The amendment will apply for the 2010–11 tax year.

### **Key features**

The annual income tax rates for the 2010–11 tax year will be set at the rates specified in schedule 1 of the Income Tax Act 2007.

The rates in schedule 1 that apply for the 2010–11 year are those that applied for the 2009–10 year.

## **CONTINUING THE TAX EXEMPTION FOR NON-RESIDENT RIG OPERATORS FOR A FURTHER FIVE YEARS**

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*(Clause 9)*

### **Summary of proposed amendment**

Section CW 57 of the Act provides a tax exemption for income derived by a non-resident company from oil and gas exploration in an offshore permit area. The current exemption expires on 31 December 2009. The bill extends the exemption for a further five years, until 31 December 2014 to mitigate the additional costs and delays that could occur in the absence of the exemption and to provide companies with a degree of long-term certainty.

### **Application date**

The amendment applies retrospectively. This means the tax exemption will apply to income derived from oil and gas exploration in an offshore permit area between the beginning of the non-resident company's 2005–06 income year and the 31 December 2014.

### **Background**

In May 2009 the Minister of Revenue and the Minister of Energy and Resources announced that as part of Budget 2009 the existing tax exemption for offshore oil and gas exploration due to expire on 31 December 2009 would be extended for five more years until 31 December 2014.

The exemption was introduced in 2004 because the 183-day rule for having a permanent establishment was having a negative impact on longer-term exploration programmes in New Zealand waters.

Before the exemption, non-resident offshore rig operators and seismic vessels had tended to stay in New Zealand for a period of less than 183 days (so as to not create a permanent establishment), even if further exploration had been desirable beyond the 183-day window. In some cases a different rig was mobilised to complete the exploration programme. This added to the costs of exploration and introduced delays to exploration drilling and any subsequent discovery of new oil or gas.

Extending the exemption for a further five years will provide companies planning exploration programmes with the certainty they require to commit to further long-term exploration.

## CHARITABLE DONEE ORGANISATION

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*(Clause 34)*

### **Summary of proposed amendment**

Cure Kids is to be recognised as a charitable donee organisation by being added to the list of charitable donee organisations in schedule 32. This will enable donors to obtain tax relief on their donations to Cure Kids.

### **Application date**

The amendment will apply from the 2010–11 tax year.

### **Background**

For an overseas-focussed charitable organisation to be a charitable donee organisation, it must be added to schedule 32 of the Income Tax Act 2007.

Individuals who donate to charitable donee organisations are entitled to a donations tax credit of 33½ percent of the amount they have donated up to the level of their taxable income. Companies and Māori authorities who donate to charitable donee organisations are entitled to a deduction for donations up to the level of their net income.

The decision to recognise an organisation as a charitable donee organisation is a specific policy decision by the government. This means the government's decision to recognise an organisation as a donee organisation involves various considerations including wider government overseas aid objectives and fiscal implications, as well as the credibility and internal controls and management of the organisation.

Cure Kids was established in 1971 to conduct, support and fund research into the health of children, and to make the best use of the knowledge so gained for the furtherance of health and the cure, prevention and treatment of disease in children. Cure Kids now wishes to extend its work initially to Fiji and later to other countries.

The amendment will allow Cure Kids to be recognised as a charitable donee organisation and allow donors to claim tax relief on their donations to Cure Kids.

## **PERMANENT FOREST SINK INITIATIVE – EMISSIONS UNIT TRANSACTIONS**

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*(Clauses 5, 10, 11, 13, 20, 32(4) and (9))*

### **Summary of proposed amendments**

Amendments are being made to the Income Tax Act 2007 to align the income tax treatment of transactions in emissions units received under the Permanent Forest Sink Initiative (PFSI) with the income tax treatment of transactions in emissions units received in relation to post-1989 forestry under the Emissions Trading Scheme (ETS). The two schemes are very similar and the nature of emissions units transactions under the two schemes is virtually identical, so it makes sense for the tax treatment to be the same.

### **Application date**

The amendments apply from 1 January 2009.

### **Key features**

The subject of these amendments is the income tax treatment of the receipt of emissions units from government, and the surrender of emissions units to government, by PFSI participants. These amendments make the tax treatment of these transactions the same as the treatment of those transactions for post-1989 foresters under the ETS, which is that the receipt of emissions units gives rise to income and the surrender is deductible, both on a cash basis.

### **Background**

Foresters who choose to participate under the ETS for post-1989 forests receive emissions units from government reflecting the carbon capture in their growing forests. If the forest is harvested or otherwise lost, an equivalent number of emissions units to those received must be repaid to government. The tax treatment of transactions in emissions units for post-1989 foresters was discussed in the issues paper, *Emissions Trading Tax Issues*, released in September 2007 and enacted as part of the Climate Change Response Act 2002. Those amendments recognise that transactions in emissions units are part of the ordinary business of post-1989 foresters under the ETS, and so are on revenue account. So, the receipt of emissions units gives rise to income, and the surrender of emissions units is deductible. The amendments also recognise that forestry is generally taxable on a cash basis, unlike other businesses which are generally taxable on an accruals basis.

Under PFSI, foresters may choose to enter into covenants with government. Those covenants limit their ability to harvest the forest, but entitle them to receive emissions units for the carbon captured in the growing forest. If the forest is harvested or otherwise lost, an equivalent number of emissions units to those received must be “repaid” to government.

PFSI and post-1989 forestry under ETS have very similar transactions in emissions units, both in frequency and nature. Accordingly, it makes sense for their tax treatment to be the same, which is the effect of the amendments in this bill.

## AMENDMENTS TO CURRENCY CONVERSION RULES – SECTION YF 1

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*(Clause 33)*

### **Summary of proposed amendment**

The drafting of section YF 1 in the 2007 Act incorporated the effect of the decision of the Privy Council in *Payne v The Deputy Federal Commissioner of Taxation* [1936] AC 497; [1936] 2 All ER 793. The effect of that decision is that, in calculating taxable income, amounts derived in a foreign currency should be converted at the rate of exchange applying at the time of the transaction, unless the legislation otherwise provided.

The amendment to section YF 1 codifies the Commissioner's practice of permitting alternative currency conversion methods and alternative rates to the actual exchange rates at the time a transaction occurs. This practice was adopted to reduce compliance costs for taxpayers, given the Privy Council's decision in *Payne* that currency conversions should be made at the actual exchange rate at the time of the transaction, unless otherwise provided by statute.

### **Application date**

The amendment is to apply from the 2008–09 income year.

### **Key features**

Under the 2004 Income Tax Act and earlier legislation, some provisions of the Act had explicit currency conversion rules (in particular the controlled foreign company and foreign investment fund rules). However, apart from those specific rules, the Act was silent on methods of conversion.

The common law approach adopted by the courts (*Payne*) requires conversion at the actual exchange rate applying at the date of the transaction, unless otherwise provided by statute. To reduce compliance costs for taxpayers, the Commissioner adopted an extra-statutory practice of permitting alternative rates or currency conversion methods to that stipulated in *Payne*.

The currency conversion rules from the 2004 Act have been rewritten into section YF 1 of the Income Tax Act 2007. However, the drafting of that section reflects the effect of the decision in *Payne*, and arguably prevents the Commissioner from continuing the extra-statutory practice of permitting alternative rates or currency conversion methods.

The amendment legislates for the previous practice of the Commissioner, and now allows the Commissioner to approve taxpayer-specific methods or rates, as well as general methods or rates.

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# Remedial matters

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## **GST INCURRED IN MAKING CERTAIN SUPPLIES OF FINANCIAL SERVICES**

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*(Clauses 2(2) and 81)*

### **Summary of proposed amendment**

A technical change is being made to section 20C of the Goods and Services Tax Act 1985. The proposed change ensures that the formula in section 20C, which calculates a deduction for GST incurred in making certain supplies of financial services, produces the correct amount. The formula applies in connection with supplies of financial services between financial services providers.

The current formula has the effect of diluting the value of supplies made to other financial services providers and correspondingly reduces the amount that should otherwise be deductible. This outcome is inconsistent with the policy intent.

### **Application date**

The change applies from 1 January 2005, the date that section 20C first had effect.

### **Key features**

Section 20C is being changed by defining element “c” of the formula so that it refers to exempt supplies of financial services, rather than to total supplies, made by the supplier.

### **Background**

In 2005, changes were made to the GST Act which zero-rated certain business-to-business supplies of financial services by introducing new sections 11A(1)(q) and (r). The changes allowed suppliers of financial services to claim input tax deductions when previously such supplies were treated as exempt from GST (and no input tax deductions were allowed). The 2005 changes were designed to remove economic distortions such as “tax cascades”, a phenomenon that occurs when irrecoverable GST connected with making exempt supplies is passed on by a supplier to another GST-registered person who makes taxable supplies and so on.

Financial services supplied between financial services providers (such as banks) cannot generally be zero-rated because most recipient financial services providers (“the direct supplier” in section 20C) will not satisfy the requirements under sections 11A(1)(q) and (r). Financial services providers are therefore unable to deduct input tax in connection with these transactions because they are exempt from GST.

The deduction calculated by the formula in section 20C replaces the denied input tax deduction, to the extent that the direct supplier makes supplies to taxable businesses. It therefore reduces the possibility of tax cascades arising if the financial services are on-supplied by the direct supplier to taxable businesses.

The amount deductible is the product of the formula:

$$a \times \frac{b}{c} \times \frac{d}{e} \quad ^5$$

The formula is based on two fractions which measure the mix of taxable and exempt supplies made by the supplier and the direct supplier in a taxable period. The product of the two fractions is applied to the amount of input tax that is unclaimed by the supplier for the taxable period.

The proposed amendment to the formula ensures that it produces a result that is consistent with the original policy intent. The amendment changes the denominator in the first fraction (element “c”) so that it is defined by reference to the amount of total exempt supplies of financial services made by the supplier rather than its current reference to total supplies, which has the effect of reducing the amount that should otherwise be deducted.

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<sup>5</sup> Where:

a is the total amount in respect of the taxable period that the registered person—

(a) would not be able to deduct under section 20(3); and

(b) would be able to deduct under section 20(3), other than under section 20(3)(h), if all supplies of financial services by the financial services provider were taxable supplies:

b is the total value of exempt supplies of financial services made to the direct supplier in respect of the taxable period:

c is the total value of supplies made in respect of the taxable period:

d is the total value of taxable supplies made by the direct supplier in respect of the taxable period as determined under section 20D:

e is the total value of supplies made by the direct supplier in respect of the taxable period as determined under section 20D

## PORTFOLIO CLASS LAND LOSS

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*(Clauses 19 and 20)*

### **Summary of proposed amendment**

An amendment is being made to the definition of “portfolio class land loss”. This will clarify that portfolio investment entities (PIEs) that own land offshore can allocate tax losses arising from foreign exchange contracts to investors.

### **Application date**

The amendment to section HL 32 will apply from 1 October 2007, the date the PIE rules were introduced.

The amendment to section HM 65 will apply from 1 April 2010, the date the rewritten PIE rules apply from.

### **Key features**

Amendments to section HL 32, and to rewritten section HM 65 of the Income Tax Act 2007 change the definition of “portfolio land class loss” to clarify that land-owning portfolio investment entities (PIEs) that invest offshore can allocate tax losses that arise from foreign exchange contracts to their investors. This is consistent with the policy intent of the PIE rules when they were enacted.

### **Background**

At the end of the year, a PIE usually receives a cash rebate from Inland Revenue for any tax losses it has made, which it then allocates to its investors. However, PIEs that invest predominantly in land or land-owning companies (“land PIEs”) cannot receive a cash rebate for their tax losses at the end of the year. Instead, when a land PIE makes a tax loss on its investments it carries the loss forward to offset income in future years. This is to prevent excessive tax losses arising from heavily geared land investments.

Under the current rules, a problem arises for land PIEs with portfolio investments in foreign land-owning companies. As these investments are often denominated in foreign currency, these PIEs typically enter into foreign exchange hedging contracts to remove or reduce the currency risk associated with the investment. These hedging contracts result in a loss if the foreign currency in which the investment is held appreciates against the New Zealand dollar. Under the current rules, the PIE must carry forward these losses that arise as a result of the hedging contract rather than allocate the losses to its investors.

The PIE's investment in the foreign land-owning company is generally subject to fair dividend rate (FDR) taxation at 5% and always generates income for tax purposes. In some years, the land PIE's FDR income will not be sufficient to offset the foreign exchange loss and an overall tax loss may arise. Under current legislation, a land PIE will be required to carry this loss forward. This is the wrong policy outcome because the loss arises from the foreign exchange hedging contract. The loss does not arise from the underlying land investment. The proposal provides that foreign exchange losses associated with portfolio investments in foreign land-owning companies are allocated to investors as they arise.

## REWRITE ADVISORY PANEL AMENDMENTS

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*(Clauses 18, 21, 25, 26, 27, 28, 32(10)-(11) 37, 38, 85 and 86)*

The following amendments reflect the recommendations of the Rewrite Advisory Panel's consideration of submissions on the rewritten Income Tax Acts. The Panel monitors the working of the 2007 Income Tax Act and reviews submissions on what may be unintended changes in the law as a result of its having been rewritten. The Panel recommends legislative action, when necessary, to correct any problems.

### **Definition of a “controlled foreign company” – sections EX 1(1)(b) of the Income Tax Acts 2004 and 2007**

*(Clauses 18 and 85)*

The Rewrite Advisory Panel agreed with a submission that section EX 1(1)(b) of the 2004 and 2007 Acts did not correctly reflect the outcome given in section CG 4(2)(b) of the 1994 Act. Under the 1994 Act, a foreign company was not a controlled foreign company if a non-resident shareholders control interests were:

- at least equal to or greater than 40 percent; and
- there was no single New Zealand-resident shareholder having control interests greater than the control interests of the non-resident.

The amendment restores the effect of section CG 4(2)(B) of the 1994 Act to section EX 1 in both the 2004 and 2007 Acts. As the provision is retrospective, it will have the effect of validating taxpayers who have continued to:

- disclose their interests in a foreign company as an interest in a controlled foreign company; and
- return their attributed CFC income from controlled foreign companies.

In addition, retrospectivity potentially exposes taxpayers to penalties in relation to:

- non-disclosure of interests in a controlled foreign company; or
- non-inclusion of attributed CFC income in their return of income.

Therefore, the amendment includes a savings provision to protect taxpayers from adverse affects of the retrospective amendment. The savings provision applies to a taxpayer who has taken a tax position in relation to whether the person has an interest in a controlled foreign company:

- in a return of income filed before (the last date of the period to which the savings provision applies); or
- for the purpose of a disclosure requirement occurring before (the last date of the period to which the savings provision applies).

The savings provision applies only if the tax position is based on the wording in section EX 1 of the 2004 or 2007 Acts (as appropriate) before this amendment.

The amendments apply from the beginning of the 2005–06 income year with both the 2004 and 2007 Acts being amended to give effect to this application, subject to the savings provisions described above.

**Tax credits of trustees – section HC 24(2)**  
*(Clause 21)*

An amendment ensures that a trustee may use tax credits, such as imputation credits, to satisfy the trustee’s income tax liability in relation to trustee income. The amendment clarifies that the provision prevents a trustee from having a tax credit referred to in either subpart LC or subpart LD.

In the 2007 Act, section HC 24(2) prevents a trustee from using any tax credits to satisfy its income tax obligations. The Rewrite Advisory Panel agreed with a submission that this was an unintended change in law, as the 2004 Act did not prevent a trustee from using imputation credits (or other credits under Part L of the 2004 Act) to satisfy its income tax liability in relation to trustee income. The restriction in the 2004 Act was to prevent the trustee from obtaining personal tax credits, such as the low income earner rebate and the rebate for charitable donations.

The amendment applies from the beginning of the 2008–09 income year.

**Formula for calculating the maximum amount for the total deduction of a supplementary dividend holding company – section LP 10(1)**  
*(Clause 27)*

The amendment corrects the formula in section LP 10(1) to restore the effect of the formula given in the corresponding provision of the 2004 Act (section LE 4(2)). This formula is used to calculate the annual total deduction for an income year of a supplementary dividend holding company.

The Panel also noted that the outcome given by the formula in section LP 10(1) of the 2007 Act may give a total deduction greater than that given by the formula in section LE 4(2) of the 2004 Act. The Panel noted that the recommended retrospective amendment limiting the amount of the total deduction can adversely affect a taxpayer who has filed a 2008–09 return of income for the 2008–09 tax year, applying section LP 10(1) as drafted. Therefore, a savings provisions applies to protect a taxpayer from being adversely affected by the retrospective change, if the taxpayer has relied on the wording of the formula in section LP 10(1) of the 2007 Act in taking a tax position in a return of income filed before the last date of the period for which the savings provision applies.

The amendment applies from the beginning of the 2008–09 income year. However, a savings provision applies, as described above.

**Tax pooling – section OB 6**  
***(Clause 28)***

An amendment to section OB 6 clarifies that an imputation credit arises for an imputation credit account (ICA) company that receives an entitlement to funds held in a tax pooling account by way of transfer of that entitlement from another ICA company. The amendment provides that the time of the credit occurs at the time of the transfer of the entitlement.

The Rewrite Advisory Panel agreed with a submission that section OB 6 produced a different outcome from section ME 4(2)(ad) of the 2004 Act, in that a credit to the ICA does not arise for the transferee on the transfer of an amount that is an entitlement to funds in a tax pooling account.

The amendment applies from the beginning of the 2008–09 income year.

**Definition of “revenue account property” – section YA 1 of the Income Tax Act 2007, section OB 1 of the Income Tax Act 2004**  
***(Clauses 32(10)-(11) and 86(1))***

The amendment clarifies the definition of “revenue account property” in both the 2004 and 2007 Acts to ensure that that if “revenue account property” becomes valueless, it does not cease to be revenue account property. This amendment ensures that the cost of revenue account property that becomes valueless may still be deductible under the general permission and allocated to the appropriate income year under section EA 1 (Trading stock) or section EA 2 (Other revenue account property).

The Rewrite Advisory Panel considered the drafting of the definition of “revenue account property” in the 2004 and 2007 Acts could be read as requiring a factual test to be applied. The consequence of that interpretation is that property that becomes valueless, despite initially coming within the meaning of “revenue account property”, would no longer be “revenue account property”. The Panel was concerned that the cost of the property might then not be deductible as a result of the property’s loss in value.

The amendment applies from the beginning of the 2005–06 income year (both the 2004 and 2007 Acts being amended to give effect to this application).

**Sections 24M(5) and 24N(5) of the Tax Administration Act 1994**  
***(Clauses 37 and 38)***

The amendment corrects wording in section 24M(5), as recommended by the Rewrite Advisory Panel. The Panel’s concern was that section 24M(5) could be read as being in conflict with section 24M(1), effectively negating the use of an exemption certificate issued under section 24M(1). This exemption certificate relieves the payer of schedular payments to withhold tax from the payment.

The same concern as raised in this submission to the Panel for sections 24M(5) also relates to section 24N(5) in relation to a special tax rate certificate issued under section 24N(1).

The amendments to both sections 24M and 24N therefore ensure that:

- subsection (5) does not override the effect of subsection (1), to prevent a zero rate of withholding being applied to schedular payments; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act, if the person alters an exemption certificate or special rate certificate issued by the Commissioner in relation to schedular payments; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act, if the person uses or attempts to use an exemption certificate, that has expired or been cancelled by the Commissioner, to obtain a zero rate of withholding from schedular payments made to the person; and
- a person commits a knowledge offence, under section 143A of the Tax Administration Act, if the person uses or attempts to use a special tax rate certificate, that has expired or been cancelled by the Commissioner, to obtain a rate of withholding for schedular payments less than the rate set out in Schedule 4, Part C, clause 1(b) of the 2007 Act.

The amendments apply from the 2008–09 income year.

**Tax credits and a person who is an absentee – sections LC 3 and LC 6**  
***(Clauses 25 and 26)***

Sections LC 3(1) and LC 6(1) are being amended to make clear, in the text of the provisions, that neither the child’s income tax credit (section LC 3) nor the housekeeping tax credit (LC 6) are available for a person who is an absentee for income tax purposes.

The requirements to obtain the child income tax credit include attendance at school for the tax year, and so this tax credit is inherently not available for an absentee. Section 41A of the Tax Administration Act prevents an absentee from receiving the housekeeper tax credit.

The amendments apply from the 2008–09 income year.

## **CROSS-REFERENCES FOR DEPRECIATION RULES**

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### *(Clauses 14 and 46)*

Changes are being made to update cross-references to schedules for the tax depreciation rules that take into account the changes that came into effect from 1 April 2005.

The reference to schedule 12 in section EE 30(3)(b) of the Income Tax Act 2007 is being replaced with schedule 11, which is the correct schedule for assets acquired after 1 April 2005. A reference to schedule 11 of the Income Tax Act 2007 is being added to sections 91AAH(2)(a) and 91AAH(3)(ab) of the Tax Administration Act 1994.

These changes ensure that the Commissioner is able to select the appropriate banded rates schedule when considering a special or provisional depreciation rate application. These changes are consistent with the original policy intent of having different banded rates applying to assets acquired on or after 1 April 2005.

### **Application date**

The change applies from the 2008–09 and later income years.

## **IFRS – FINANCIAL ARRANGEMENTS – ANTI-ARBITRAGE PROVISIONS**

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*(Clauses 15, 16, 17, 83 and 84)*

### **Summary of proposed amendment**

An amendment is being made to the anti-arbitrage rules for IFRS taxpayers. Each of sections EW 15E, EW 15F and EW 15G of the Income Tax Act 2007 and sections EW 15D and EW 15E of the Income Tax Act 2004 will have a new subparagraph added to ensure they fully implement the original policy for use of the relevant tax methods.

### **Application date**

The changes are effective from 1 April 2008 for the Income Tax Act 2007 and 1 April 2007 for the Income Tax Act 2004.

### **Key features**

The changes ensure that the relevant methods can be used for financial arrangements which are treated under IFRS as hedges of non-financial arrangements.

### **Background**

The original anti-arbitrage rules in these sections did not achieve the intended effect and subsequent amendment in 2008 also did not remedy this aspect of the rules.