

Taxation (GST and Remedial Matters) Bill

Commentary on the Bill

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Minister of Revenue

First published in August 2010 by the Policy Advice Division of Inland Revenue, PO Box 2198,
Wellington 6140.

Taxation (GST and Remedial Matters) Bill; Commentary on the Bill.
ISBN 978-0-478-27185-0

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GST

ZERO-RATING TRANSACTIONS INVOLVING LAND

(Clauses 4, 6, 9, 10, 13(4), 17, 18, 19 and 20)

Summary of proposed amendments

The GST legislation is being amended to require GST-registered vendors to charge, subject to certain conditions, GST at the rate of 0% on any supply to a registered person involving land or in which land is a component. This measure is intended to prevent “phoenix” fraud schemes that involve Inland Revenue refunding GST to the purchaser with no corresponding payment being made by the vendor because the supplying company deliberately winds up before making payment.

Application date

The amendments will apply from 1 April 2011.

Key features

Application

The Goods and Services Tax Act 1985 (GST Act) will be amended by new section 11(1)(mb) which will require a GST-registered vendor to charge GST at the rate of 0% on any supply involving land or in which land is a component to a registered person who acquires the goods with the intention of using them for making taxable supplies.

The new rules will not apply when the supply is a supply of land intended to be used as a principal place of residence of the purchaser or their relative (section 11(1)(mb)(ii)). This exclusion will prevent registered persons such as sole traders from using their GST-registered status to zero-rate the purchase of their family home. In circumstances when a principal place of residence forms part of a larger supply of land, the supply of the residence will be deemed to be a separate supply from the supply of the other land (section 5(15)).

A new definition of “land” will be added to section 2(1) of the GST Act to include an estate or interest in land, a right that gives rise to an interest in land, or an option to acquire land or an interest in land. The definition will not apply to mortgages or supplies of accommodation in a dwelling.

The new zero-rating rules will apply to any supply that involves land, irrespective of whether land is a predominant component of the supply. This will affect most supplies of “going concerns”, which often involve transfers of land, and in turn reduce the need to determine whether a going concern is being supplied.

New section 5(22) also extends the application of the zero-rating rules to certain supplies of land to which section 5(2) applies. For example, if a mortgagee sells a mortgaged property, subject to the obligation to account for GST under section 5(2), the mortgagee will be required to zero-rate the supply if the mortgagor would be required to zero-rate the transaction were they selling the property themselves.

Vendor's obligations

Since the new rules apply to transactions between two registered persons, new section 78F(2) requires the vendor to obtain the purchaser's registration details.

The proposed zero-rating rules will not apply if the registered purchaser does not intend to use the goods for making taxable supplies or if the property is being purchased as the principal place of residence of the purchaser or their relative. Vendors will therefore be required to confirm with the purchaser their intentions in relation to the supply.

If, in the circumstances relating to the supply, the vendor is unable to obtain the details described above, the vendor must make sufficient inquiries into the purchaser's registration status and otherwise obtain all the information required (new section 78F(3)).

Having obtained the necessary information about the purchaser's registration status or the purchaser's intentions regarding the use of the land, the vendor will not be liable for tax on the supply in a case of mistake or misrepresentation by the purchaser (new section 78F(4)).

If the vendor fails to fully comply with their information-gathering obligations in section 78F(2) and (3), the vendor may be liable to account for tax even if it is also the case that the purchaser has provided incorrect information to them (new section 78F(5)).

Although the vendor will not be required to account for any output tax for a zero-rated supply, they will need to disclose the zero-rated transaction on their GST return or an attachment to the GST return to be prescribed by Inland Revenue. This information will help Inland Revenue to identify the transaction and ensure that the purchaser complies with their apportionment obligations.

Purchaser's obligations

New section 5(23) states that if an unregistered purchaser provides incorrect information to the vendor, the purchaser will be deemed to supply the goods and services to themselves and be liable to pay GST on the supply at the standard rate. For the purposes of this section, the unregistered purchaser will be required to register for GST (new section 51B(4)) and will not be able to claim a deduction in respect of the deemed supply (new section 20(4B)).

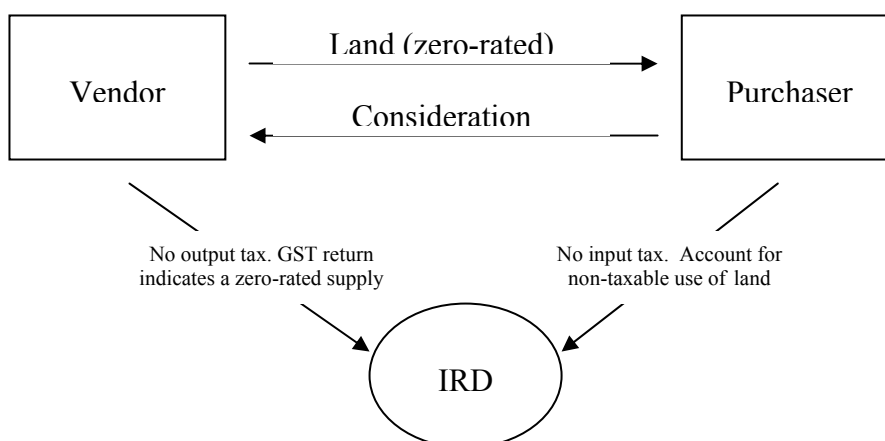
In circumstances when the purchaser fails to provide the correct information to the vendor, the purchaser may be liable to account for tax even if the vendor has failed to fully comply with their information-gathering requirements in section 78F(2) and (3) (new section 78F(5)).

This obligation on the purchaser to account for tax will only apply if the vendor has not accounted for the GST at the standard rate.

Under the rules for apportionment of input tax and change-in-use adjustments also proposed in this bill, any input tax deduction that can be claimed by a purchaser will be based on the GST paid by the purchaser and the intended taxable use of the goods and services. Since the amount of input tax in a zero-rated supply is zero, special rules will be required to ensure that any non-taxable use of acquired land is accounted for.

New section 20(3I) will require the purchaser to account for tax on the acquisition of a zero-rated asset when they do not intend to use the asset solely for the purpose of making taxable supplies – that is, the asset is also used privately or in making exempt supplies. This will be done by the purchaser having to calculate, on acquisition, the amount of GST that would have been paid by the vendor if the supply was subject to the standard rate of GST (the nominal GST component), and account to Inland Revenue for the proportion of the nominal GST component that relates to the non-taxable use of the acquired supply. The nominal GST component will also be used by the purchaser to make adjustments for any subsequent change in use.

Example of a zero-rated transaction



Nominations

Nominations are often used in transactions that involve transfers of land. For example, although a contract for a transfer of land may be between a vendor and a purchaser, the transaction may instead be settled and the title in land received by a third party nominated by the purchaser (the nominee).

The bill includes the introduction of new rules that would govern the GST treatment of transactions involving nominations. The purpose of the rules is to ensure that the GST treatment of a nominee transaction follows its economic substance. How the economic substance is determined depends on which party (the nominee or the purchaser) pays the consideration.

The new nomination rules will particularly affect land transactions when a contractual purchaser and a nominated person have a different GST registration status. For example, registered vendor A may agree to sell land to an unregistered purchaser B. Because of B's unregistered status, A may have initially treated the transaction as

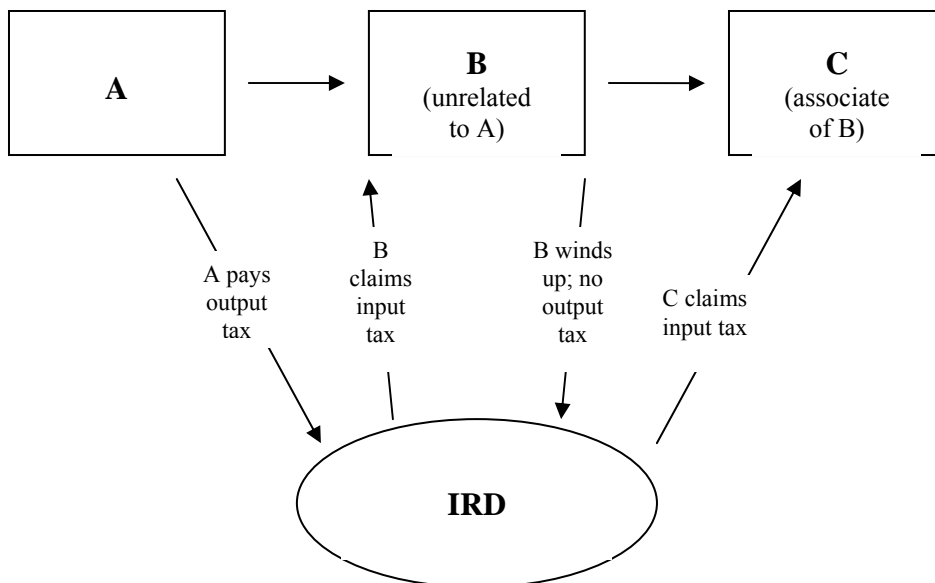
subject to the standard GST rules. However, if purchaser B has nominated a registered person C to settle the transaction, the new nomination rules will treat the transaction as between A and C (new section 60B(5)). Therefore, the supply will need to be zero-rated by the vendor (and they will be able to claim back any output tax already paid in relation to the supply).

Conversely, registered vendor A may agree to sell land to a registered purchaser B. Because of B's registered status, A may have initially treated the transaction as subject to the zero-rating rules. However, if B nominates an unregistered person C to settle the transaction, the new nomination rules will again treat the transaction as between A and C. As a result, A would be required to charge GST on the supply at the standard rate.

Background

In November 2009, the Government released the discussion document *GST: Accounting for land and other high-value assets*, which proposed a number of changes to the GST Act 1985 that would address certain GST base risks and improve the operation of the GST system more generally. The main risk to the tax base identified in the discussion document was "phoenix" fraud schemes that often occur between associated entities and involve Inland Revenue refunding GST to one party with no corresponding payment being made by the vendor because the vendor deliberately winds up the business before making payment.

Example of a phoenix fraud transaction



In considering this concern, the discussion document proposed a domestic reverse charge to transactions principally involving land, “going concerns” and assets with a value of \$50 million or more. The zero-rating option was mentioned in the discussion document, but was not preferred. The preference for the domestic reverse charge largely resulted from concerns that zero-rating would not deal well with situations when an unregistered purchaser purports to be registered or when parties mistakenly zero-rate a transaction. However, most submitters expressed a preference for zero-rating as it would give rise to fewer compliance costs.

While both mechanisms would be effective, the domestic reverse-charge would introduce a new method of accounting for GST under which the obligations of parties to a transactions would significantly differ from those under the normal GST rules. Under the zero-rating mechanism, the accounting obligations of the parties would remain virtually unchanged. Accordingly, zero-rating the relevant transactions to the GST base risk is likely to be an easier mechanism for businesses to deal with.

Any remaining concerns regarding zero-rating are intended to be resolved by anti-avoidance provisions.

Submissions on the discussion document considered that for large-value non-land transactions, current Inland Revenue processes to allow an offset of the output and input tax between registered parties in order to avoid carrying costs and other risks are working effectively. The \$50m threshold for zero-rating outlined in the discussion document was considered by most to be unnecessary and is not therefore included in this bill.

TRANSACTIONS INVOLVING NOMINATIONS

(Clauses 15 and 18)

Summary of proposed amendments

The GST legislation is to be amended to clarify that, in transactions involving nominations, when a contractual purchaser nominates another person to receive the goods or services from the contractual vendor, the GST treatment should be determined on the basis of the transaction's economic substance. The amendment will ensure that the GST Act 1985 provides guidance regarding the GST treatment of transactions that involve more than two parties.

Application date

The amendment will apply from 1 April 2011.

Key features

New section 60B will be added to the GST Act 1985 to clarify the GST treatment of transactions involving nominations – that is, when a contractual purchaser nominates another person (a nominee) to receive the goods or services from the contractual vendor.

In these circumstances, the GST treatment will depend on which party provides payment for the supply of goods or services:

- In transactions when the contractual purchaser provides the full payment for the supply, there will be only one supply from the vendor to the purchaser. The purchaser will be the only party entitled to an input tax deduction (section 60B(2)).
- When a nominee settles the transaction by paying the full purchase price to the vendor, the proposed rules will treat the arrangement as involving one transaction – from the vendor to the nominee (section 60B(3)).
- When both a contractual purchaser and the nominee contribute to the payment for the supply, the proposed new rules will treat the transaction as involving a single supply between the vendor and the purchaser, with the purchaser being entitled to the input tax deduction (section 60B(4)). However, the purchaser and the nominee will be able to override this default rule by explicitly agreeing that the supply of the property be treated as a supply by the vendor to the nominee. No such agreement can, however, be made if the purchaser has already claimed input tax in relation to the supply.
- Notwithstanding the above, when a contractual purchaser and the nominee have a different registration status, the transaction will be always treated as involving a single supply between the vendor and the nominee, with the nominee being entitled to the input tax deduction, if any (new section 60B(5)).

- Under other changes proposed in the bill (clause 10), GST-registered vendors will be required to charge GST at the rate of 0% on any supply to a registered person involving land or in which land is a component. The proposed nomination rule for situations when a purchaser and the nominee have a different registration status may potentially affect whether such a transaction is zero-rated.

The proposed nomination rules will also affect the tax invoice requirements. In normal circumstances, a taxpayer must have a tax invoice to claim an input tax deduction. In transactions involving nominations, a nominee may not have the tax invoice as it may have been issued to the purchaser. In these circumstances, new section 24(7B) will require a nominee to maintain records that would allow information such as the name and address of the supply, the date of the payment for the supply, a description of the goods supplied, and the payment for the supply to be ascertained.

Background

GST is often described as a tax on transactions. Most transactions involve only two parties – a contractual vendor and a purchaser – and much of the GST Act operates on that assumption. The GST Act is not generally designed to cater for transactions involving nominees. Nominee transactions would ordinarily involve a purchaser nominating another person (a nominee) to receive the goods and/or settle the transaction.

In the absence of appropriate guidance, taxpayers have sometimes been uncertain about the GST treatment of nominee transactions, especially in relation to claiming input tax deductions.

The Government consulted on the proposed legislative clarification of the nomination rules as part of the 2009 discussion document, *GST: Accounting for land and other high-value assets*. Submitters on the discussion document generally supported the proposed approach to determine the GST treatment of transactions involving nominations on the basis of the transaction's economic substance. The bill reflects this approach and gives taxpayers greater certainty when entering transactions involving nominees.

SUPPLIES OF ACCOMMODATION

(Clause 4(3) and (4))

Summary of proposed amendment

The GST legislation is to be amended to clarify the boundaries of the definitions of “dwelling” and “commercial dwelling” as the current legislative framework does not give taxpayers enough certainty about when the supply of accommodation should be treated as a taxable or exempt supply.

Application date

The amendment will apply from 1 April 2011.

Key features

Under the current rules, accommodation provided by GST-registered persons in a “commercial dwelling” is taxable whereas accommodation provided in a “dwelling” is treated as an exempt supply.

The definitions of “dwelling” and “commercial dwelling” in section 2(1) of the GST Act 1985 are being amended to give suppliers more certainty on whether they supply accommodation in a “dwelling” or a “commercial dwelling”. This will be mainly achieved by narrowing the definition of “dwelling” and updating the list of accommodations that should be treated as “commercial dwelling”.

The definition of “dwelling”

When the GST Act 1985 was introduced, the exemption for accommodation in a “dwelling” was intended to apply to situations when there is a reasonable level of substitutability between renting and owning a home. Arguably, this goal is not currently being achieved because of the wide interpretation of the definition. To achieve the purpose behind exempting supplies of accommodation in “dwelling”, the definition will be amended to be construed more narrowly.

Under the current definition of “dwelling”, the application of GST is based on the functional nature of the premises in which the accommodation is provided, rather than on the intention of the supplier and the recipient for the use of the property. The definition of “dwelling” will therefore be amended to refer to the nature of the occupation of the accommodation by the recipient of the supply.

Under the proposed changes, for accommodation to be a “dwelling” it must be occupied by the recipient as their principal place of residence. Moreover, an important characteristic of home ownership is that the owner enjoys an exclusive possession of their property. For an accommodation to be a “dwelling”, the definition will also be amended to require that a tenant possesses an exclusive possession of their accommodation. Thus, for example, supplies of accommodation in a typical rental property by way of lease will continue to be treated as exempt for GST purposes.

The definition of “commercial dwelling”

The current definition of “commercial dwelling” provides a list of types of accommodation that should be treated as commercial dwellings for GST purposes. This list will be amended by expressly including homestays, farmstays, bed and breakfast establishments, and serviced apartments as these types of accommodation are supplied as an alternative to hotels and motels and therefore should be subject to the same GST treatment. The express inclusion of these types of accommodation within the definition of “commercial dwelling” will ensure that there is no uncertainty about their GST treatment.

Since it is difficult to identify and specifically list in the legislation all possible current and future types of accommodation that should be treated as commercial dwellings, it is necessary to have a comprehensive catch-all provision. The catch-all” provision is being added to the definition of “commercial dwelling” to cover all types of accommodation that are not “dwellings”. The provision ensures that if a supply of accommodation neither satisfies the definition of “dwelling” and is not expressly or explicitly covered by the definition of “commercial dwelling”, the supply should be treated as a supply of a commercial dwelling.

Background

In October 2006, Inland Revenue released a draft interpretation statement about the exemption from GST for accommodation provided in a dwelling. Inland Revenue received a number of comprehensive submissions on the draft, many requesting that the policy underlying the GST treatment of accommodation be reviewed. Most submissions were concerned that the current legislative framework did not give taxpayers enough certainty about when the supply of accommodation should be treated as a taxable or exempt supply.

Accommodation provided by GST-registered persons is generally taxable unless it is expressly treated as an exempt supply. The GST Act 1985 expressly exempts the supply of accommodation in a “dwelling”, but not accommodation that is a “commercial dwelling”. The main reason for exempting the supply of accommodation in a dwelling from GST, as described in the 1985 *White Paper Proposals for the Administration of the Goods and Services Tax*, was to ensure that owner-occupiers of residential dwellings were not placed in an advantageous position compared with those who rent. For this reason, the definition was intended to apply to situations where there was a reasonable level of substitutability between renting and owning a home. This goal has not been achieved because of the wide interpretation of the definition of “dwelling”.

Current uncertainty around the boundary between the definitions of “dwelling” and “commercial dwelling” may create difficulties for suppliers of accommodation in identifying whether they are making taxable or exempt supplies. This can result in different suppliers of essentially the same type of accommodation treating their supplies differently for GST purposes, because of their differing interpretations of what constitutes a “dwelling” or “commercial dwelling”. This uncertainty can result in compliance costs to taxpayers and revenue loss to the Government as a result of some commercially provided accommodation being treated as exempt from GST.

INPUT TAX AND CHANGE-IN-USE ADJUSTMENTS

(Clauses 4, 5, 13, and 14)

Summary of proposed amendments

The GST legislation is to be amended to replace the existing change-in-use adjustment provisions that deal with the mixed use of goods and services with an approach that reflects their relative use and apportions related input tax deductions. The proposed approach is expected to be easier to use and understand than the current rules.

Application date

The amendments will apply to goods and services acquired after 1 April 2011 with a transitional rule to allow goods and services held before 1 April 2011 also to be subject to the new rules.

Key features

Apportionment of input tax on acquisition

It is proposed that the GST Act 1985 be amended by a new section 20(3A) that will allow a GST-registered recipient to apportion GST incurred on the acquisition of goods and services and claim an input tax deduction for goods or services that are used for making taxable supplies.

In determining the extent to which goods or services are used for making taxable supplies, a person must estimate how they intend to use the goods or services, and choose a determination method that provides a fair and reasonable result (new section 20(3F)). The estimated intended taxable use of the goods or services will then be used by the person to claim the proportion of the input tax that corresponds with the estimated intended taxable use (new section 20(3G)).

New section 20(3I) will also require an apportionment of input tax when a supply that includes land is zero-rated under the zero-rating rules proposed in clause 10. Since, technically, the input tax under a zero-rated transaction is zero, the provision will require the purchaser to identify the nominal amount of tax that would be chargeable under section 8(1) in relation to the supply if the zero-rating rules did not apply. The purchaser will then be required to estimate the intended non-taxable use of the goods or services and account for this amount as output tax.

As a consequence of the proposed input tax regime not relying on the “principal purpose” test as the current regime does, the definition of “input tax” in section 3A will be amended to exclude references to the “principal purpose” test.

When apportionment on acquisition is not required

New section 20(3D) will relieve recipients from the obligation to apportion the input tax on acquisition of goods or services if a recipient makes mainly taxable supplies. These recipients will not be required to apportion input tax if they make both taxable and exempt supplies and have reasonable grounds to believe that the total value of their exempt supplies will be no more than the lesser of \$90,000 or 5% of the total payment for all taxable and exempt supplies for the period beginning at least 12 months from acquisition and ending on the date that corresponds to the person's balance date.

Subsequent adjustments of input tax deductions

In an "adjustment period" following the initial input tax deduction claim on acquisition, taxpayers may be required to make further adjustments if the *actual* taxable use of an asset is different from its *intended* taxable use.

"Adjustment period"

An "adjustment period" will be a period at the end of which a person is required to estimate whether an adjustment for a subsequent change in use is required. The first adjustment period will start on the date of acquisition and end at least 12 months after the acquisition on the date that corresponds to the person's balance date. All subsequent adjustment periods will be annual and start the day after the end of the previous adjustment period (new section 21F(2)).

There will be a maximum number of adjustment periods during which adjustments will be required to be made. The default method for identifying the maximum number of adjustment periods is in new section 21F(3)(a) and requires the taxpayer to refer to the following GST-exclusive bands of goods and services:

- \$5,001 to \$10,000 – two adjustments;
- \$10,001 to \$500,000 – five adjustments;
- \$500,001 or more – ten adjustments.

Alternatively, taxpayers will be able to select the maximum number of adjustments by reference to the estimated useful life of the asset as specified in the Commissioners Table of Depreciation Rates (new section 21F(3)(b)).

There will be no limit to adjustment periods in relation to land (new section 21F(4)).

When subsequent change-in-use adjustments will not be required

No subsequent change-in-use adjustment will be required for goods and services that fall under a minimum threshold of \$5,000 (new section 21(2)(b)).

For assets with a value of more than \$5,000, no adjustment will be required in the relevant adjustment period if the recipient makes both taxable and exempt supplies and has reasonable grounds to believe that the total value of their exempt supplies will be no more than the lesser of \$90,000 or 5% of the total amount payable for all taxable and exempt supplies for that adjustment period (new section 21(2)(a)).

If none of the above exclusions apply, new sections 21A and 21B provide that, at the end of an adjustment period, a person must compare the percentage of the actual taxable use of goods or services with:

- the percentage of the intended taxable use of the goods or services (if no previous adjustment has been made); or
- the previous actual use (if the goods or services have been subject to a previous adjustment).

The “percentage actual use” is defined in new section 21F(1)(a) as the extent to which the goods or services are *actually* used by the person for making taxable supplies. It is calculated from the date of acquisition to the end of the relevant adjustment period. The estimates must be expressed in percentages.

The “percentage intended use” is defined in new section 21F(1)(b) as the extent to which the goods or services are *intended* to be used by the person for making taxable supplies, estimated at the time of acquisition. The estimates must be expressed in percentages.

The “previous actual use” is defined in new section 21B(b)(i) as the percentage actual use in an earlier period that is the most recent period in which an adjustment has been made.

If the percentage of intended taxable use or previous actual use of goods or services is equal to the percentage actual use, the person will not be required to make an adjustment in the relevant adjustment period.

If the actual taxable use of goods or services differs from the intended taxable use of goods or services as estimated on acquisition, the person will still not be required to make the adjustment in an adjustment period if the difference between the amounts is less than 10% and the monetary value of the adjustment is less than \$1,000 (new section 21(2)(c)). If, however, the actual taxable use of goods or services exceeds either of these thresholds, the person will be required to make an adjustment and will not be able to use the exclusion in section 21(2)(c) in any of their subsequent adjustment periods (new section 21(3)).

Calculating adjustments

If none of the exclusions mentioned above apply, the person will need to account for a change in use.

New section 21C sets out how to calculate the amount of a change-in-use adjustment for the adjustment period. The formula provided in this section will identify the amount of the adjustment by applying the difference between the actual and intended taxable uses or the previous actual use of goods or services to the amount of the full input tax deduction. The resulting amount will be then either accounted for by the person as output tax (if there has been a decrease in taxable use) or claimed as input tax (if there has been an increase in taxable use).

Special rule for concurrent use of land

A special rule will be introduced to deal with situations when land is used concurrently for a taxable purpose and a non-taxable purpose, such as when land is simultaneously advertised for sale (taxable use) and rented out as a dwelling (non-taxable use). In these circumstances, a question may arise over what the taxable use of the land is. To remove doubt, new section 21D provides formulas to enable taxpayers to calculate the extent to which land is used for making taxable supplies.

Section 21D(3) requires a registered person to calculate the extent to which the land is used for making taxable supplies by using the formula:

$$\frac{\text{Consideration for taxable supply}}{\text{Total consideration for supply}} \times 100\%$$

The “consideration for taxable supply” will be defined as either the amount derived on a disposal of the land or, if the land has not been disposed of, the market value of the land at the time of the adjustment.

The “total consideration for supply” will be defined as the sum of the “consideration for the taxable supply” and the amount of all rental income derived from the land since the land was acquired or the market value of rental income that would have been derived if the land had been used for this purpose.

New section 21D(5) specifies that the market value must be used in determining “consideration for the taxable supply” and/or “total consideration for supply” if amounts derived under those definitions are not arm’s-length amounts.

The amount resulting from the use of the formula in section 21D(3) represents the proportion of the land used for taxable purposes.

An additional formula (section 21D(6)) estimates the extent of taxable use of the land if the land has, at any time, been used solely for making non-taxable supplies. By taking into account the solely non-taxable use of the land, the formula will reduce the extent of the taxable use of the land calculated under the formula in section 21D(3).

Section 21D will not apply if the Commissioner of Inland Revenue agrees that the registered person may use another calculation method (section 21D(2)).

Adjustment on disposal

If a registered person disposes of, or is treated as disposing of, goods or services in the course of a taxable activity and has not claimed a full input tax deduction, they may be able to claim an additional amount of input tax (new section 21E). The amount that can be claimed on disposal cannot exceed the total amount of input tax to which the person would be entitled if they had acquired the goods or services solely for making taxable supplies.

Consequential amendments

Clauses 25, 29(2) and 35 are consequential amendments to the Income Tax Act 2007. They ensure that input and output tax calculated under the apportionment rules are taken into account in the relevant income tax and depreciation calculations.

Transitional provision

New section 21G provides transitional relief for taxpayers who may wish to apply the new approach to their existing assets rather than have them grandfathered. To transition into the new rules, registered persons will have to treat themselves as disposing of the relevant goods or services at market value (and account for output tax on the disposal) and then acquiring the goods or services for the same market value under the new rules.

To ensure that transitional provisions do not result in any windfall payments, subsection (4) specifies that the person will not be entitled to recover any amounts of an adjustment made under the current adjustment rules.

Background

New Zealand's current approach to accounting for the taxable and non-taxable use of assets on which GST is paid involves deeming a supply to occur when an asset which is used for business purposes is subsequently used for private or exempt purposes, or vice versa. This approach has been described by commentators and taxpayers as complex and confusing. The lack of relationship between the initial input tax deduction claimed and the change-in-use adjustments, means that the concepts behind imposing GST on mixed use and changes in the use of assets may not be sufficiently transparent for many taxpayers and that adjustments may be required for an indefinite period. This can result in unforeseen tax and compliance costs. The possibility of making adjustments on either the cost basis or the open market value basis can also leave the regime open to manipulation.

In the 2009 discussion document, *GST: Accounting for land and other high-value assets*, the Government proposed to replace the existing change-in-use adjustment approach with one that would apportion input tax deductions in line with the actual use of the goods and services. Submitters on the discussion document in general supported the proposed changes.

GST REVERSE CHARGE RULES

(Clauses 7 and 8)

Summary of proposed amendments

The GST reverse charge rules for imported services are being amended as a consequence of the introduction of the apportionment rules. The amendment will tie the use of imported services to the defined terms “percentage intended use” and “percentage actual use” to ensure that appropriate apportionment of imported services takes place following the introduction of the new rules.

Application date

The amendments will apply to services imported after 1 April 2011.

Key features

It is proposed that section 8(4B) of the GST Act 1985 be amended to apply to imported services when the recipient of the supply:

- estimates at the time of acquisition that the percentage intended use of the services is less than 95%; or
- determines that the percentage actual use is less than 90%.

Background

The apportionment rules set out in clauses 13 to 14 of this bill apply to apportion input tax on a particular supply to ensure that only the appropriate amount of input tax can be claimed. A fundamental feature of these rules is for there to be an amount of input tax for the rules to “attach” to.

Under the existing rules, if a registered person makes taxable supplies 95% or more of which are taxable supplies, the person does not need to apply the reverse charge rules. However, if the person then applies those services for a non-taxable use, they are required to “self-supply” the relevant portion of the services under the change-in-use rules – thereby creating an output tax liability.

If the same situation occurred under the proposed apportionment rules, the person would not be liable to apply the reverse charge (as is currently the case). However, the starting premise of the apportionment rules is that there is an original amount of input tax on the supply that is used as the benchmark for future adjustments. Therefore, when it comes to accounting for any non-taxable use, the apportionment rules would arguably not apply because there was no original amount of input tax to refer back to.

The amendment seeks to remedy the problem by deeming there to be a supply when either the percentage intended use is less than 95% or the percentage actual use falls below 90%. The 90% threshold is used to effectively factor in the 10% minimum change in use allowed under the proposed apportionment rules. Where the 90% percentage actual use test is the trigger for the liability, clause 8 treats the adjustment period in which the percentage actual drops below 90% as the time of supply, so the registered person does not have to revisit previous returns to account for the supply.

Once the supply has taken place for GST purposes, the apportionment rules set out in clauses 13 to 14 should operate in the usual manner to apportion the input tax on that supply.

It is not anticipated that these changes will have a great impact on the primary users of the reverse charge rules. Although the rules have changed from a “type of business” test to a focus on supply by supply, most users of these rules already apply change-in-use adjustments to supplies where some of the supply was used for taxable supplies. Application of the rules proposed here should therefore mean that the apportionment rules produce the same overall result as the current rules.

APPLICATION OF SECTION 19D TO NON-PROFIT BODIES

(Clause 92, 93, 94 and 95)

Summary of proposed amendments

The GST legislation will be amended to exclude non-profit bodies from the application of section 19D when the risk of tax avoidance is low, therefore allowing them to operate without the additional cost of having to fund the full cost of GST upfront.

Application date

The amendment will apply from the date of enactment.

Key features

New section 19D(2B) will be introduced to exclude supplies made by a non-profit body from the application of section 19D(1) in the following circumstances:

- when the recipient is not GST-registered; and
- when the recipient is either not intending to use the goods and services for the purposes of carrying on a taxable activity or intending to use the goods and services for the purposes of carrying on a taxable activity, only after the full payment for the supply is paid to the supplier.

Background

Differences in the accounting practices for GST can result in timing advantages being deliberately created when a registered person who accounts for GST on a payment basis makes a supply to another registered person who accounts on an invoice basis. In these situations, the payments-basis supplier accounts for GST when payment is received, while the purchaser may claim an input tax deduction following receipt of the tax invoice.

The aim of section 19D is to limit taxpayers' choices of accounting bases when the application of GST accounting principles could give rise to tax-base risks. Specifically, section 19D requires GST-registered suppliers accounting for GST using the payments basis to use the invoice basis when the amount payable for a supply of goods and services is \$225,000 or more (including GST) and payment by the customer is deferred.

Section 19D applies to all taxpayers. The universal application of section 19D may have an unintended detrimental effect on some non-profit bodies. Thus, a non-profit body may agree to supply an asset, such as a house, to an individual in need. Often the agreement will stipulate that the recipient of the asset will make a number of payments over a period of time and will receive the title in the asset when the asset has been paid for in full.

These types of arrangements may trigger section 19D, and require the non-profit body to account for GST on an invoice basis. This would result in the non-profit body having to account for the GST on the entire purchase price at the outset, creating a significant cost to the non-profit body. Consequently, the operation of the rule may discourage non-profit bodies from providing goods and services over a certain value.

SECTION DB 2 – REVERSE CHARGE RULES

(Clauses 29(1), 90 and 104)

Summary of proposed amendment

A technical change is being made to section DB 2 of the Income Tax Act 2007 (and the corresponding provisions in the Income Tax Acts 1994 and 2004) to ensure that GST output tax on services that are subject to the reverse charge rules for imported services is available as a deduction for income tax purposes (provided the underlying services were also deductible). This amendment corrects an anomaly for taxpayers who arguably are not able to deduct this GST at present, despite it representing a real economic cost to business.

Application date

The change applies from 1 January 2005, the date the reverse charge rules were introduced.

Key features

Section DB 2 is being amended to ensure that output tax, to the extent that it is not offset by input tax credits attributable to the supply, is deductible in the following circumstances:

- the output tax arises under the rules related to the reverse charge for imported services; and
- the underlying services are themselves able to be deducted.

Background

Currently, section DB 2(1) of the Income Tax Act 2007 denies an income tax deduction for both input tax and GST paid by the taxpayer to the Commissioner. The economic effect of this provision is that a taxpayer is denied a deduction for all output tax it receives as a supplier, less any input tax able to be claimed for its own expenses. Although this economic effect is generally desirable, it does not work when a GST-registered person is deemed to supply goods or services to themselves. Until recently, the only example of this enforced “self-supply” was when a taxpayer who acquired goods or services for the principal purpose of making taxable supplies used the goods or service for non-taxable purposes (known as a “change in use adjustment”). To recognise that the output tax on these supplies is a real cost to the taxpayer (that is, it cannot be offset by input tax), section DB 2(2) specifically allows it as a deduction.

Since 1 January 2005, when certain services are imported into New Zealand, the GST Act 1985 requires the New Zealand resident to treat itself as the supplier of those services (as well as being the recipient) and account for GST accordingly. This is another example of “self-supply” and is conceptually identical to the change in use adjustments. However, unlike the change in use rules, there is no specific provision in the Income Tax Act 2007 to allow any irrecoverable output tax incurred on the self-supply to be allowed as an income tax deduction. As a result, arguably, the general rule in section DB 2(1) applies and the taxpayer is denied a deduction, despite the fact that the expenditure is “real” in an economic sense.

This anomaly potentially creates a discrepancy in income tax treatment between services that are sourced in New Zealand (and therefore not subject to the reverse charge) and those that are sourced offshore.

The amendment will apply from 1 January 2005 (the application date of the reverse charge rules that are the root of the problem), to provide certainty going forward and provide taxpayers with comfort that Inland Revenue will not adopt a strict interpretation of section DB 2 for the intervening periods.

MISCELLANEOUS TECHNICAL AMENDMENT: GST – FILING DATES FOR “SPECIAL RETURNS”

(Clause 11)

Summary of proposed amendment

A technical change is being made to section 17(1B) of the GST Act 1985. Section was amended in 2007 to confirm the filing dates for “special returns” (being the return that a creditor must file when selling goods in satisfaction of a debt owing). An unintended consequence of this amendment is that the due date for the actual payment of tax related to the return was removed. Section 17 is being amended to clarify that the relevant tax is payable not later than the due date for the return.

Application date

The change applies from 30 November 2007, the date the 2007 amendment took effect to ensure that there are no periods for which the relevant output tax is arguably not payable.

Key features

Section 17 of the GST Act 1985 is being amended to ensure that output tax charged on a supply that is a sale in satisfaction of debt under section 5(2) is payable to the Commissioner not later than the due date for the relevant return.

Background

Section 17 requires a person selling any goods that are being sold in satisfaction of a debt under section 5(2) – for example, a mortgagee sale – to file a special return in relation to that supply. Prior to an amendment in 2007, section 17 provided that this return was to be filed, and the relevant tax paid, on or before the 28th of the month following the month in which the sale took place. The 2007 amendment was introduced to confirm that the filing date for these special returns was the “standard” filing date for GST returns (which is not always the 28th of the following month). A consequence of this amendment was that the payment date for the relevant tax was removed.

The proposed amendment confirms that the person responsible for filing the special return must complete all of the obligations imposed on them under section 17(1)(a) to (c) on or before the due date for filing the special return. This includes the obligation to pay the amount of tax charged on the supply.

KiwiSaver remedials

SHARING OF KIWISAVER MEMBER INFORMATION

(Clauses 81 and 100)

Summary of proposed amendments

The bill amends the KiwiSaver Act 2006 and Tax Administration Act 1994 to allow the sharing of information about a KiwiSaver member between their scheme provider and Inland Revenue. This information is limited to a member's address, date of birth and IRD number (tax file number).

This amendment will help to ensure that both the scheme providers and Inland Revenue hold accurate contact details, allowing the communication of vital KiwiSaver information to members.

Currently, if a member updates their information they are required to advise both their scheme provider and Inland Revenue, as both send out different items of KiwiSaver correspondence. This amendment removes impediments that may occur if only one party gets updated.

The sharing of information is to be completed electronically.

Application date

The new rules will apply from the date of enactment.

Key features

- New section 220B of the KiwiSaver Act 2006 will allow Inland Revenue and a scheme provider to communicate information about a member's name, address (including their email address), date of birth and IRD number (tax file number) to each other.
- Section 81(4) of the Tax Administration Act 1994 will be amended to provide an exception to the secrecy requirements for information disclosed by Inland Revenue to scheme providers under new section 220B of the KiwiSaver Act.
- The information must be communicated through electronic means ensuring accuracy, timeliness and adherence to e-government standards.

Background

A newly registered KiwiSaver member's details are provided to Inland Revenue by their employer.

Under section 51(3) of the KiwiSaver Act, Inland Revenue is required to provide address details as part of the default allocation process. This is necessary because the provider has no prior direct contact with the member as the allocation is completed by Inland Revenue.

Under the default allocation process a KiwiSaver member should only be allocated to a default provider in the case of new membership or in the event of an involuntary transfer due to a scheme wind-up. At any other time Inland Revenue is unable to pass on address details, even in the event of the address being updated with Inland Revenue, because of the secrecy provisions in the Tax Administration Act 1994.

Given that the current provision to share a person's address applies only on joining KiwiSaver, the member is required to update both Inland Revenue and their scheme provider, if their details change, as they often do, throughout their membership. Generally if a KiwiSaver member updates their address, they are likely to contact one but not both parties. For example, if a scheme provider gets an updated address from their member, they have no obligation to pass that information on to Inland Revenue. This can result in Inland Revenue holding an invalid address for the member while the scheme provider holds a valid address or vice-versa. Currently both parties have a number of invalid or unknown addresses for members, and the non-sharing of member information is one of the reasons for this.

The proposed amendments will improve the delivery to members of vital information about KiwiSaver, such as investment statements, annual reports and contribution holiday letters.

It also allows both Inland Revenue and scheme providers to proactively contact KiwiSaver members when needed and will lower the volume of returned mail for both parties.

REFINEMENTS TO SCHEME WIND-UP PROVISIONS

(Clauses 94 to 99)

Summary of proposed amendments

If a KiwiSaver scheme provider winds up their operation and ceases to exist, Inland Revenue manages the transfer of members to a new scheme, following notification by the scheme trustees or the Government Actuary.

Several remedial amendments to the scheme wind-up provisions within the KiwiSaver Act 2006 will fine-tune the current provisions, ensuring they give full effect to the scheme wind-up policy intent. These amendments clarify the date a member is allocated to a new scheme, add a requirement for scheme providers to supply the IRD number (tax file number) they hold for transferring members, and remove the requirement to send additional information packs to existing members.

Application date

The new rules will apply from the date of enactment.

Key features

Allocation to a new scheme

Once scheme trustees resolve to wind up their scheme and nominate an effective date of closure, they have 14 days to lodge a copy of the notice with both the Government Actuary and the Commissioner of Inland Revenue.

Currently, section 50(3) of the KiwiSaver Act 2006 determines that when the Commissioner receives notice from a provider of the impending wind-up, the member must be default-allocated to another scheme as soon as practicable. Section 51(4)(b) determines that the final date of allocation to the new scheme should be three months after the date on which the notice was received.

These sections do not take into account the effective date of closure nominated by the winding-up scheme in the notice. This is likely to be the date that transfer of membership has been arranged for.

Having the final allocation set at three months after the date that notification was received can cause an early transfer of members. This affects the scheme provider's obligations to continue to meet the provisions of their trust deed until the scheme is wound up.

To allow the winding up scheme to retain its members and their contributions until its date of closure, sections 50(4), 51(1) and 57(1) are being amended so that the allocation will occur on whichever is later, the date notification of wind-up is received or the date on which the winding up takes effect. It will no longer impose the requirement to have a three-month provisional period for these members.

Supply of tax file number

Within 14 days of the wind-up resolution being made, section 173(1) of the KiwiSaver Act 2006 requires the trustees of the winding-up scheme to supply the Commissioner of Inland Revenue, the names and addresses of the scheme members.

Inland Revenue uses this information to verify the identity of the member. To ensure more robust identification, an amendment is being made to section 173(1)(b) requiring trustees to also supply the tax file numbers that they hold for these members.

Issuing of information packs

A KiwiSaver information pack contains general introductory information explaining the savings initiative. It is primarily targeted at new or prospective members.

Section 59(a) currently provides that KiwiSaver information packs should be sent to members when their scheme is winding up, so that they are aware of the default allocation rules and how to access information about KiwiSaver schemes. Section 59(a) requires the packs to be sent to all members of the winding-up scheme including existing members who have already made an active choice about their new scheme. However, all of the members would have already received this information pack when they joined KiwiSaver. Members are therefore receiving unnecessary or duplicate information, which can be confusing and irrelevant to their current situation.

Additionally, Inland Revenue sends a letter to affected members advising them of the wind-up and the required actions. These letters are tailored to suit the member's situation. For example, those who have not chosen a scheme are given information about the default allocation rules and how to access information about KiwiSaver schemes.

Section 59(a) will be amended to remove the requirement to send an information pack to members whose scheme is being wound up.

Other remedial matters

ON PREMISES FRINGE BENEFIT TAX EXEMPTION

(Clauses 28 and 89)

Summary of proposed amendment

An amendment is being made to clarify the scope of the exemption from fringe benefit tax (FBT) for benefits provided on the premises of an employer (or a member of an employer's group of companies). The amendment is necessary because the wording used by the rewritten Income Tax Act 2004 has resulted in some confusion regarding the scope of the exemption. To reaffirm the policy behind the provision, the amendment confirms that only benefits "used or consumed" on the relevant premises are exempt from FBT.

Application date

The change applies from 1 April 2005, the date the Income Tax Act 2004 took effect.

Key features

Section CX 20 of the Income Tax Act 2004 and section CX 23 of the Income Tax Act 2007 are being amended to ensure that the scope of the "on premises" exemption from FBT remains consistent with the policy intent of their corresponding provision in the Income Tax Act 1994.

Background

The "on premises" exemption contained in the Income Tax Act 1994 excluded from the definition of "fringe benefit" a benefit that is provided by an employer on the employer's premises "where the benefit is enjoyed by the employee on those premises". The equivalent provisions in the 2004 Income Tax Act, provide that a benefit is not a fringe benefit if it is provided by an employer to an employee and is "received or used by the employee on the premises of the employer".

Some taxpayers have argued that providing employees with vouchers for future use (such as grocery vouchers) means the exemption applies – on the basis that the voucher was "received" by the employee on the employer's premises. This interpretation could logically extend to any expensive and mobile goods given to the employee at the employer's premises that can be taken away for the employee's benefit.

There was no intention to extend the scope of the relevant definition as part of the rewrite process. Although the effect of the 1994 Act wording was initially "saved" by a provision in the 2004 Act, that saving stopped applying when an unrelated amendment was made to the provision in 2006. The 2006 amendment was directed at a separate point, and no widening of the exemption was intended.

The current amendment will clarify that the policy intent of the exemption remains consistent with the provision in the 1994 Act. Benefits will be exempt when they are “used or consumed” on the relevant premises – wording more closely aligned with the “enjoyed” concept used in the 1994 Act. The amendment will therefore be effective from 1 April 2005, the date on which the 2004 Act took effect, to remove any confusion over the correct treatment of benefits provided on premises for the intervening periods.

JOINT BANK ACCOUNTS

(Clauses 16, 86 ad 105)

Summary of proposed amendments

The provisions of some Inland Revenue Acts which allow deductions of tax from payments due to a defaulting taxpayer are being amended to allow the Commissioner of Inland Revenue to make deductions of tax from joint bank accounts. The amendments will allow deductions from a joint bank account if the defaulting taxpayer can make withdrawals from that account without the signature of the other person. The changes will ensure consistency of treatment for deductions from joint bank accounts.

Application date

The amendments will apply from the date of enactment.

Key features

Section 12L of the Gaming Duties Act 1971, section 43 of the Goods and Services Tax Act 1985 and section 157 of the Tax Administration Act 1994 are being amended to allow the Commissioner to make deductions from joint bank accounts if the defaulting taxpayer can make withdrawals from that account without the signature of the other person. This is consistent with the existing deduction power in the Child Support Act 1991 and will ensure a consistent approach to joint bank accounts.

Background

When a taxpayer fails to pay any income tax, interest or civil penalty the Commissioner may issue a written notice to any third party, for example, a bank, requiring the third party to deduct and pay to the Commissioner funds from any amounts payable to the defaulting taxpayer. The deductions may be in the form of a lump sum or instalments.

Currently, section 157 of the Tax Administration Act 1994 does not refer to joint bank accounts. The courts have held that the Commissioner cannot issue a deduction notice to obtain funds from a joint account for an income tax debt owed by one of the joint bank account holders, because there is no authority to do so under section 157.¹ The High Court noted that the Social Security Act 1964 and the Child Support Act 1991 both contain deduction provisions that expressly refer to money held in joint bank accounts, whereas the Tax Administration Act 1994 does not. This raised an inference that a tax deduction provision like section 157 needed to contain an express reference to joint bank accounts for it to apply to such accounts.

¹ *ANZ Banking Group (New Zealand) Limited v CIR* (1998) 18 NZTC 13,643

The Child Support Act 1991 allows the Commissioner to require deductions from money payable to a liable parent to meet a child support debt. This deduction power extends to money held in joint bank accounts in the name of the liable parent and one or more other persons, when the liable parent can draw from that account without the signature of the other person.

CAP ON SHORTFALL PENALTIES

(Clause 84)

Summary of proposed amendment

Section 141JAA of the Tax Administration Act 1994 (the TAA) which caps some shortfall penalties is being clarified so that it does not apply if the taxpayer makes a disclosure at the time the tax position is taken (under section 141H). If the cap applied to disclosures made at the time of filing taxpayers could take tax positions that did not meet the standard of being “about as likely as not to be correct” knowing the maximum penalty they would face would be a penalty of \$50,000.

Application date

The amendment will apply from the date of enactment.

Background

Shortfall penalties can be reduced for different reasons. Under section 141G of the TAA a shortfall penalty is reduced by between 40% and 100% if it is voluntarily disclosed before the beginning of an audit. Under section 141H of the TAA a shortfall penalty for an unacceptable tax position or an abusive tax position is reduced by 75% if the taxpayer makes adequate disclosure of their tax position at the time they take their tax position.

Under section 141JAA of the TAA a shortfall penalty for not taking reasonable care or an unacceptable tax position can be limited to \$50,000 if the taxpayer voluntarily discloses their tax position or the Commissioner determines the shortfall, no later than the date that is the later of –

- the date that is three months after the due date of the return to which the shortfall relates; and
- the date that follows the due date of the return to which the shortfall relates by the lesser of –
 - one return period; and
 - six months.

It is not clear that the limit in section 141JAA applies only to voluntary disclosures under section 141G and not to disclosures made under section 141H. It was never intended that section 141JAA apply to disclosures made at the time the tax position is taken (under section 141H), because if it applied to these disclosures taxpayers could take tax positions that did not meet the standard of being “about as likely as not to be correct” knowing the maximum penalty they would face would be a penalty of \$50,000.

PIE CREDIT IMPAIRMENT PROVISIONS

(Clauses 43, 51 and 91)

Summary of proposed amendment

Amendments are being made to the portfolio investment entity (PIE) rules to ensure that multi-rate PIEs are able to claim deductions for credit impairment provisions. The amendments will also ensure that multi-rate PIEs have sufficient authority to claim deductions for expenses and pay tax for income when these are reflected in the PIE's unit price or in its financial statements. The changes are intended to clarify uncertainty in the timing rules over when deductions can be made or income declared.

Application date

The amendments will apply from 1 October 2007.

Key features

The bill adds new sections HM 35B and HL 19B to the Income Tax Act 2007, and section HL 19B to the Income Tax Act 2004. These sections will clarify that multi-rate PIEs can claim deductions for expenses and pay tax for income at the point when they are reflected in the PIE's unit price or its financial statements, even if this is before the PIE has legally incurred or derived the expenditure or income. The purpose of this timing rule is to maintain investor equity over time by ensuring that investors exiting a PIE are attributed their correct share of the PIE's tax.

Under this new timing rule, any future change in an expense or income that has already been deducted or taxed will also be picked up for tax purposes at the point when the change is reflected in the PIE's unit price or financial accounts.

These new sections also ensure that multi-rate PIEs are able to claim deductions for credit impairment provisions when they are reflected in the PIE's unit price or its financial statements. Credit impairment provisions are created to reflect the decline in a financial asset's value due to past events.

A PIE will only be able to claim deductions for credit impairment provisions if it has objective evidence of a loss in an asset's value because of events that have already occurred. Specifically, the criteria set out in NZ IAS 39 will need to be met in order for the PIE to make such a deduction.

These amendments apply retrospectively from 1 October 2007. However, the bill includes transitional measures to confirm the tax positions already taken by multi-rate PIEs on the timing of income and expenses, as well as credit impairment provisions. These transitional measures prevent PIEs from making retrospective adjustments to their tax returns following these clarifications.

TECHNICAL AMENDMENTS CONCERNING THE APPROVED ISSUER LEVY

(Clauses 79, 102 and 103)

Summary of proposed amendments

The bill introduces a number of amendments to the rules for the approved issuer levy (AIL) in the Tax Administration Act 1994 and the Stamp and Cheque Duties Act 1971. The purpose of these amendments is to clarify the relationship between domestic law and treaty law for interest derived from New Zealand by foreign banks. The amendments will make clear that a borrower can pay AIL in order to qualify for an exemption under a double tax agreement. They will also ensure a better fit between terminology used in the relevant tax treaties and the arrangements whereby a borrower chooses to pay AIL under domestic law.

Application date

The amendments will apply from 1 August 2010.

Key features

A number of changes are being made to section 32M of the Tax Administration Act 1994:

- As amended, subsection (1) will make clear that a borrower is eligible to elect to pay AIL for the purposes of an exemption under a double tax agreement, as well as for the purposes of the non-resident withholding tax (NRWT) rules. Subsection (2) will set out how the borrower elects to pay AIL in relation to a particular security, by either being or becoming an approved issuer, by applying to register the security, and by paying the levy for the security.
- A person will become an approved issuer by giving notice to the Commissioner of Inland Revenue (the Commissioner) under subsection (2B). The Commissioner may revoke a person's approved issuer status under subsection (3). By virtue of subsection (4B), such revocation applies from the date of notification under subsection (2B) if given with 20 working days of that date. This replaces the existing arrangements whereby a person must apply for approved issuer status but is deemed to have been granted such status unless notified by the Commissioner within 20 working days that their application has been declined.
- Subsection (5) is being amended to introduce a reference to an exemption under a double tax agreement.

Sections 86I and 86L of the Stamp and Cheque Duties Act 1971 are also amended to introduce references to an exemption under a double tax agreement.

Background

Recently concluded tax treaties with Australia and the United States include a new exemption from source-country tax for interest derived by banks. For interest derived from New Zealand, the availability of this exemption depends on the borrower paying AIL, unless the borrower is not eligible to elect to pay the levy, or there is no such levy, or the rate of the levy exceeds 2 percent of gross payments.

The proposed amendments clarify the circumstances in which a person is eligible to pay AIL. They make clear that a borrower can pay AIL in order to qualify for an exemption under a double tax agreement, even if paying the levy makes no difference to the way the transaction is dealt with under domestic law. This will address uncertainty around the treatment of interest paid to foreign banks operating through a branch in New Zealand. Such interest is not subject to NRWT so the AIL mechanism is not relevant domestically, but the new treaty exemption could still apply if the loan was made from offshore instead of through the New Zealand branch.

More generally, the amendments ensure a better fit between terminology used in the relevant tax treaties and the arrangements whereby a borrower chooses to pay AIL under domestic law. The new treaty provisions ask specifically whether the borrower is “eligible to elect to pay” AIL. The amendments will ensure that domestic law directly addresses this question.

The amendments are intended to make the existing law more transparent, rather than substantively to alter its effect. It is therefore not considered necessary for the amendments to apply retrospectively.

APPLICATIONS FOR OVERSEAS DONEE STATUS

(Clause 2 and 75)

Summary of proposed amendment

The bill amends the Income Tax Act 2007 to add the following three organisations to schedule 32:

- The Branch Foundation.
- The Mutima Charitable Trust.
- The Bougainville Library Trust.

This will enable donors to obtain tax credits on their donations to these overseas-focussed organisations.

The Mutima Charitable Trust is to be granted donee status until the end of the 2016–17 tax year and the Bougainville Library Trust is to be granted donee status until the end of the 2018–19 tax year.

The Income Tax Act 2007 is also being amended to reflect the name change of the Volunteer Service Abroad (Incorporated) to Te Tuao Tawahi: Volunteer Service Abroad Incorporated.

Application date

The application date is 1 April 2011 for the three organisations to be added to schedule 32. This means that donations made to these organisations after this date will be eligible for a tax credit.

The approval of overseas donee status for The Mutima Charitable Trust and The Bougainville Library Trust is subject to a sunset clause as these organisations operate projects of a limited duration. At the end of this period these organisations will be removed from the schedule. The Mutima Charitable Trust is to be granted donee status until the end of the 2016–17 tax year and the Bougainville Library Trust until the end of the 2018–19 tax year.

The application date for the name change of Volunteer Service Abroad will be from the date of enactment.

Background

Charities that apply some or all of their funds outside New Zealand must be approved for charitable donee status by Parliament. These organisations are listed in schedule 32 to the Income Tax Act 2007.

Donations to listed organisations entitle individual taxpayers to a tax credit of 33 $\frac{1}{3}$ % of the amount donated, up to the level of their taxable income, and for companies and Māori authorities, to a deduction for donations up to the level of their net income.

The Branch Foundation is a fundraising body working for grassroots organisations on the Thai/Burma border. The Foundation enables local organisations, particularly in Thailand, to provide aid for those who have fled ethnic conflict in Burma. The main focus of the Foundation is to provide financial and logistical support to organisations working primarily with children displaced due to conflict.

The Mutima Charitable Trust was established by a team of cardio-thoracic specialists from Christchurch Public Hospital. The aim of the Trust is to perform life-saving heart surgery on young adult Zambians who suffer from rheumatic heart disease. The Trust aims to have established a sustainable Zambian-based specialist cardio-thoracic unit after five years of operations, once local funding is in place and local staff have been trained.

The Bougainville Library Trust was established to support the work of the Bougainville Heritage Foundation. The Trust's aim is to act as a vehicle through which New Zealanders and the international community can contribute to, and support, the building and stocking of a library in Bougainville.

TREATMENT OF SUPERANNUATION SCHEMES ADMINISTERED BY THE NATIONAL PROVIDENT FUND

(Clauses 2(9) and 37)

Summary of proposed amendment

A technical change is being made to section EY 11(5) of the Income Tax Act 2007 to clarify that the taxation rules for life insurance do not apply to superannuation schemes administered by the Board of Trustees of the National Provident Fund. The change ensures that the schemes administered by the Board and constituted under the various National Provident Fund Acts are not subject to the life insurance rules in the Income Tax Act.

Application date

The change will apply from 1 April 2010.

Key features

Section EY 11(5) is being clarified to ensure that superannuation schemes administered by the Board and constituted under various National Provident Fund Acts are not subject to the taxation rules for life insurance.

Background

Superannuation schemes administered by the Board are closed to new members and the benefits payable are subject to a government guarantee. The life insurance rules have application in the first instance to these schemes because they generally pay benefits that are contingent on the continuance of human life. The policy intent is that these schemes should be taxed as superannuation schemes.

Most of the superannuation schemes administered by the Board are specifically removed from the scope of the life insurance taxation rules through the operation of sections EY 11(2) to (9). Section EY 11(5) has specific application to the schemes administered by the Board. Some National Provident Fund schemes are, however, excluded from the scope of section EY 11(5) on a legislative technicality based on whether the scheme received employer contributions. As a result, the life insurance rules have application to the affected schemes unless section EY 10(2) otherwise applies.

The proposed amendment clarifies the operation of section EY 11(5) so that it does not distinguish between the different superannuation schemes that are administered by the Board.

AUCKLAND COUNCIL RESTRUCTURING

(Clause 106)

Summary of proposed amendment

The bill amends section 83 of the Local Government (Auckland Transitional Provisions) Act 2010 which provides transitional tax relief on the amalgamation of Auckland local authorities into one Council. It provides that for the purposes of the financial arrangement rules in the Income Tax Act 2007, when the new Auckland Council enters into an acknowledgement of debt with a council-controlled organisation (CCO) without paying the principal to the CCO, the Auckland Council is deemed to have advanced the amount of the principal to the CCO.

Application date

The amendment will apply from 31 October 2010.

Background

On 1 November 2010, the existing Auckland local authorities will cease to exist and be replaced by the Auckland Council. As part of this restructuring, certain assets owned by existing local authorities will vest in CCOs owned by the new Auckland Council.

For commercial reasons, the debt relating to those assets will not be transferred to the CCOs but will be assumed by the Auckland Council. In turn, the CCOs will enter into an acknowledgement of debt to the Council for the amount of the debt attributable to the assets.

Under the process proposed, there will be no funds or other consideration actually flowing from the Auckland Council to the CCO in relation to the acknowledgement of debt.

Detailed analysis

The absence of consideration flowing from the Auckland Council to the CCO in relation to the acknowledgement of debt creates a problem under the financial arrangement rules in the Income Tax Act 2007.

The general definition of “financial arrangement” in section EW 3(2) does not apply to the acknowledgement of debt because there is no consideration paid by the Council to the CCO. However, the debt is a financial arrangement because section EW 3(3)(a) applies. This provision captures all debts, regardless of whether the borrower receives consideration.

Under the financial arrangement provisions, the difference between the amount received and the amount paid under a debt (generally the interest component) is deductible to the borrower and assessable income to the lender. Because there is no flow of funds from

the Auckland Council to the CCO under the acknowledgment of debt, the CCO will have a tax deduction for all amounts (interest and principal) paid under the debt and the Auckland Council will have assessable income of the same amount.

To ensure that only interest (and not the principal) is deductible to the CCO and assessable to Auckland Council, the bill provides that Auckland Council will be deemed to have advanced the amount of the principal to the CCO. The amendment applies for the purposes of the financial arrangement rules in the Income Tax Act 2007.

TAX TREATMENT OF EMISSIONS TRADING UNITS

(Clauses 22, 33 and 34)

Summary of proposed amendments

Amendments are being made to the way that income is recognised following the free allocation of emissions units to the industrial and agricultural sectors under the emissions trading scheme. The new provisions require businesses to recognise income according to the business's entitlement to receive emissions units for the income year. Previously, the rules would have required businesses to look at units they actually held, and recognised income on the basis of the units which were properly attributable to the current year.

Application date

The amendments apply from 1 July 2010, the date on which the industrial sector became subject to the ETS.

Key features

Section ED 1B is being extensively rewritten to provide new valuation rules for free units (zero-value units) that have been allocated and which the business holds at the end of the income year. Under the proposed rules, income arises from valuing an appropriate number of zero-value units at market value, and if necessary, supplementing that amount with the difference between the entitlement and the number of units held (see example 2).

The starting point for the valuation of zero-value units is the entitlement to units which the business has for the income year. This is determined in accordance with the formulas in sections 83 and 84 of the Climate Change Response Act 2002. This calculation is made independently of the number of zero-value units which the business has been allocated for the relevant period, or which it actually holds at the end of it.

The business may have already sold or surrendered some of the units it received for free. This number of units is deducted from the number of units required to be given a market value, as the sale and surrender processes give rise to income in their own right. The number of units remaining is the number of zero-value units held which are to be assigned a market value at the end of the year.

In some instances the entitlement which the business is required to recognise will exceed the number of zero-value units which the business has on hand at the end of the year. If this happens, an additional sum of income will be recognised (see example 2) and be carried forward to apply against zero-value units received in the following year.

In other instances the business may hold more zero-value units at the end of the year than it is required to recognise. If this happens, the surplus units will be carried forward at a zero value (see example 1).

Background

Under the Climate Change Reform Act 2002, certain trade-exposed businesses are entitled to an allocation of emissions units. The basis of allocation was changed in 2009, and allocations are now calculated by reference to:

- the level of assistance which applies to the business in the relevant emissions year; and
- the business's production output for the emissions year.

Businesses will be allocated free emissions units, with an interim allocation being made early in the calendar year, and a square-up early in the following calendar year.

The changes to the basis of allocation in 2009 required changes to the provisions in the Income Tax Act 2007 which deal with the taxation consequences of the receipt of free emissions units.

There are two basic issues which the current amendments deal with:

- What is the appropriate amount of income for the business to recognise in the income year as a result of its entitlement to receive free units?
- What value should the free units be recorded at in the business's tax accounts?

The following examples illustrate how the amended rules would work.

Examples

1. *Excess emissions units held*

A Ltd has a 31 December year-end. In February the Government transfers 150 emissions units to A Ltd. However, because of falling production, its entitlement for the year is only 100 units. It values 100 units at market value at year-end, and continues to hold the remaining 50 at a nil value.

2. *Insufficient emissions units held*

B Ltd also has a 31 December year-end. In February the Government transfers 100 emissions units to B Ltd. However, because of increasing production, its entitlement for the year is 150 units. It values all 100 units at market value, and records an additional amount of income equal to 50 units x market value.

REWRITE ADVISORY PANEL AMENDMENTS

The following amendments arise from recommendations of the Rewrite Advisory Panel's following its consideration of submissions on the rewritten Income Tax Acts.

The Panel monitors the working of the Income Tax Act 2007 (2007 Act) and the Income Tax Act 2004 (2004 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 appropriate, to correct any unintended changes in law.

Application date

The following rewrite-related amendments apply from the beginning of the 2008–09 income year, unless otherwise stated.

Key features

Clause 23: Section CD 24(2)(a)(i): Returns of capital: on-market share cancellations (rewrite remedial item)

The amendment corrects the cross-reference to section CD 29, to cross-refer instead to section CD 40.

Clauses 24 and 88: Section CE 1 (2007 and 2004 Acts): Market value of benefit of accommodation (rewrite remedial item)

The amendment to section CE 1 clarifies that:

- for the market value of the benefit arising from accommodation to be income, it must arise in relation to an office or a position;
- the amount of income is the measured by the market value of the benefit of accommodation; and
- the market value of the benefit of accommodation allowances is included within the meaning of “accommodation”.

This amendment applies from the beginning of the 2005-06 income year.

Clause 40: Section FF 4(1)(a): Threshold for application of interest apportionment rule (rewrite remedial item)

This provision contains an unintended change in law, which results in section FF 4(1)(a) of the 2007 Act incorrectly providing that a conduit tax relief company is required to perform a “thin-cap” interest allocation (deductible/non-deductible interest) if its conduit tax credits exceed \$50,000, even if the relevant debt percentage in the foreign group is less than or equal to 66 percent.

The amendment corrects this unintended change to ensure that a conduit tax relief company is not required to make this “thin-cap” interest allocation if the company’s debt percentage in the foreign group is less than or equal to 66 percent.

Clause 41: Section FO 18: Discharge of a financial arrangement on an amalgamation

Section FO 18 applies, on an amalgamation of companies, to determine that financial arrangements are deemed to be discharged by the lender immediately prior to the amalgamation. However, section FO 18 contains an unintended change in law, which incorrectly results in the value treated as being given by an insolvent borrower to be at market value in all cases.

The amendment ensures that, if an insolvent borrowing company is likely able to meet its financial obligations (for example, because property of the company fully secures the debt), the accrued value of the discharged financial arrangement is treated as being the amount of consideration given immediately prior to the amalgamation.

Clauses 31, 32, 44–45, 47–50, 52–56, and 62: Subpart HM: Portfolio investment entities (rewrite remedial item)

The amendments to sections HM 3, HM 5, HM 15, HM 23, HM 31, HM 35, HM 43, HM 47, HM 48, HM 61, HM 62, and consequential changes to sections DV 2, DV 5, and LS 4, clarify the circumstances in which the term “interests” is a reference to the defined term “investor interest”.

Clause 46: Section HM 6(2)(b): Intended effects for multi-rate PIEs and investors (rewrite remedial item)

The amendment corrects an unintended change in law in which section HM 6(2)(b) incorrectly provides that a portfolio investment entity (PIE) is liable for the income tax on investment returns for an investor who has elected to be “zero-rated” under the PIE rules.

The amendment clarifies that a PIE does not have an income tax liability in relation to an investor who has elected to be “zero-rated” under the PIE rules.

Clause 58: Section LC 4(1): Tax credits for transitional circumstances (rewrite remedial item)

The amendment corrects the cross-reference to subpart MB, to cross-refer instead to subparts MD, ME, and MZ.

Clause 60: Section LF 8(1): Credits for persons who are non-resident or receive exempt income (rewrite remedial item)

An unintended change in law results in section LF 8(1) of the Income Tax Act 2007 incorrectly preventing FDP credits from being refundable to tax-exempt shareholders (despite the heading to the provision referring to tax-exempt shareholders).

The amendment ensures that FDP credits are refundable to exempt shareholders.

Clause 63: Section ME 1(2): Minimum Family Tax Credit (rewrite remedial item)

This amendment corrects a printing error in section ME 1(2) of the 2007 Act, which inadvertently omitted the brackets around the expression “prescribed amount – net family scheme income”. The amendment reinserts the brackets.

Clause 67: Sections OZ 7 to OZ 17: Memorandum accounts in a transitional period

The amendment omits the references (following the text of the sections) to comparative provisions in the 2004 Act. Sections OZ 7 to OZ 17 provide transitional treatment for memorandum accounts in the transition of the company tax rate from 33% to 30%, effective from the commencement of the 2007 Act, and have no comparative provisions in the 2004 Act.

Clause 68: Section RD 4(2): PAYE obligations when employer fails to withhold

The amendment corrects an intended change in law that potentially results in an employee being liable for PAYE on their PAYE income payments (that is, salary or wages, extra pay or a schedular payment) if the employer had withheld PAYE from the PAYE income payment but not remitted the PAYE to Inland Revenue.

The amendment ensures that an employee is liable to account for PAYE only if the employer has failed to withhold PAYE (in full or in part) at the time of paying a PAYE income payment.

Clause 70: Section RD 22(2, (2B)): Returns for amounts of tax paid to Commissioner (rewrite remedial item)

Section RD 22(2) contains an unintended change in law, which incorrectly requires an employer who remits PAYE to the Commissioner once a month to complete a form for the payment on both the 5th and 20th of the month.

The amendment ensures that an employer who remits PAYE to the Commissioner once a month, need only complete the PAYE form on one occasion each month.

Clauses 26, 27, 36, 38, 39, 42, 57, 59, 61, 72, 73, 74(3), 74(7): Section YA 1: Definition of “derived from New Zealand”

The definition of “derived from New Zealand” is repealed because it has substantively the same effect as the term “source in New Zealand”. Provisions referring to the term “derived from New Zealand” are consequentially amended to refer to the term “source in New Zealand”.

Clause 74(8): Section YA 1: Definition of “transfer of value” (rewrite remedial item)

In paragraph (b)(ii) of the definition of “transfer of value”, the cross-reference to paragraph (a) is replaced by a cross-reference to paragraph (b)(i). This amendment ensures the 2007 Act definition of “transfer of value” is consistent with the definition of “transfer of value” in the 2004 Act.

Clauses 76 and 93: Schedule 51 (2007 Act) and Schedule 22A (2004 Act)

The amendment relates to dividend and fringe benefit tax provisions which apply to low or nil interest loans applied to shareholder-employees. Under the Income Tax Act 1994, a shareholder-employee of a company could offset dividends derived from the company against the balance of a low or nil-interest loan if the dividend was assessable income but was not resident withholding income. In the 1994 Act, this offset was permitted by section CF 2(12)(b) (low interest loan was provided in the shareholder capacity) or by section CI 3(3)(b) (low interest loan provided in the employee capacity).

The Rewrite Advisory Panel concluded that sections CD 28(9)(b) and NE 1E(2) of the 2004 Act contain an unintended change in law in that they permit fully imputed dividends and exempt dividends to be offset against the balance of low or nil interest loans provided to a shareholder-employee, if the dividend was an exempt dividend paid to a shareholder of a qualifying company or if the dividend was a fully imputed dividend. Those changes were re-enacted in the 2007 Act as sections CD 39(9)(b) and RD 36(2) respectively.

However, the Panel referred the matter to Policy Advice to consider retaining these drafting changes, on the basis that the outcomes are consistent with the policy. The policy intention is that shareholder-employees are able to reduce the balance of their low or nil-interest loans by applying their own funds in a reduction of the loan balance.

This amendment confirms the drafting changes as intended changes, by amending the respective “intended changes in legislation” schedules in both of the 2004 and 2007 Acts. The amendment applies from the beginning of the 2005-06 income year.

Tax Administration Act

Clause 78(3): Section 3(1): Definition of “tax payable”

The amendment places the definition of “tax payable” in the correct alphabetical order.

Clause 80: Section 39(5): Consequential adjustments on change in balance date (rewrite remedial item)

Section 39(5) of the Tax Administration Act 1994 contains an unintended change in law arising because, in the rewrite of Parts C, D, and E of the 2004 Act, the brackets in the formula were placed incorrectly.

The amendment ensures that the average tax rate for the taxpayer is determined by reference to the taxable income the person would have by adjusting that income by the ratio of the number of days in the “change period” to the number of days in a normal tax year (365 days).

Clause 82: Section 85F(3): Definition of “company”

In the definition of company in section 85F(3), the cross-reference to the definition of “large budget screen production grant” is corrected to refer to the definition of “government screen production payment”.

Other legislation and regulations

Clause 108: Health Entitlement Cards Regulations 1993

In the definition of “net income” in regulation 2, the cross-reference to section EX 37(2) and (3) of the Income Tax Act 2007 is corrected to refer to section EX 43(2) and (3) of the Income Tax Act 2007.