Taxation (Tax Administration and Remedial Matters) Bill

Commentary on the Bill

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GIFT DUTY

GIFT DUTY ABOLITION

(Clause 110)

Summary of proposed amendments

Gift duty will be abolished with effect from 1 October 2011. The change follows a review of gift duty which revealed that the compliance costs far outweigh the revenue it collects and the limited protections it has provided to creditors and to social assistance integrity.

Application date

The amendments will apply from 1 October 2011.

Key features

The definition of a "gift" in section 2 of the Estate and Gift Duties Act 1968 is being amended so that the term refers only to dispositions of property before 1 October 2011. The bill also amends section 61 of the Estate and Gift Duties Act 1968 to ensure that gift duty is payable only for gifts made from the Act's commencement until 1 October 2011.

The effect is that the Estate and Gift Duties Act 1968 will no longer apply to gifting of property on or after 1 October 2011. The Act remains effective with respect to dispositions of property before this date.

Background

Gift duty has existed in New Zealand since 1885.[1] Its purpose 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 and social assistance targeting until alternative protection measures could be introduced.

In light of the increasing number of requests for exemptions from gift duty, a review was initiated. Options considered included:

- narrowing the scope of gift duty to apply only to gifts between individuals, trusts and closely held companies;
- raising the thresholds at which gift duty applies;

[1] 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.

- removing the requirement to file gift statements for non-liable gifts;
- introducing electronic systems for the filing of gift statements and payment of gift duty; and
- updating life-expectancy tables for valuing annuities under the Estate and Gift Duties Act 1968.

As the review progressed, a strong case for outright abolition emerged. Some of the concerns which existed in 1992 have been addressed or reduced by the strengthening of existing legislative provisions. Remaining areas of concern were scrutinised in consultation with the Treasury, the Ministry of Economic Development, Ministry of Justice, Ministry of Health, New Zealand Police, the Ministry of Social Development, and Housing New Zealand Corporation. None of these agencies opposed gift duty abolition.

The review concluded that gift duty no longer raises any significant revenue and imposes a high level of compliance costs on the private sector. The protections offered by gift duty in the areas of income tax, creditors and social assistance have been incidental rather than intended policy goals. The analysis undertaken across government revealed that the protection gift duty offers is inefficient and limited and is outweighed by the significant compliance costs it imposes on the private sector.

The bill abolishes gift duty with effect from 1 October 2011. The government agencies mentioned above will monitor the effects of gift duty abolition and Inland Revenue will initiate a post-implementation review to ensure there are no unintended consequences.

TAX ADMINISTRATION MATTERS

Changes to the secrecy and information-sharing rules

OVERVIEW

In June 2010, the discussion document, *Making Tax Easier*, was released for consultation, alongside an online forum seeking feedback on a range of proposals aimed at making the tax system easier and more efficient for taxpayers to interact with. Included were proposals concerning the operation of Inland Revenue's tax secrecy rules.

Inland Revenue is subject to a strict obligation of secrecy in relation to the information it collects and holds. The general rule, contained in section 81 of the Tax Administration Act, requires all employees of Inland Revenue to keep secret all matters that come to their knowledge relating to the Acts administered by Inland Revenue. This is subject to a number of exceptions, for purposes both related, and unrelated, to the administration of the tax system.

The New Zealand tax system relies heavily on taxpayers voluntarily complying with their obligations. For taxpayers to be willing to comply with their obligations, it is critical that they trust Inland Revenue. Appropriate treatment of taxpayer information is an important aspect of building and maintaining this trust.

Inland Revenue does, however, need to be able to disclose information to taxpayers and third parties in certain circumstances, in order to efficiently operate the tax system. There are also some situations when disclosure, while not directly related to the operation of the tax system, has been considered important enough by Government that a specific exception to the secrecy rule has had to be enacted.

The changes proposed in the bill will help to overcome problems caused by the very narrow circumstances in which Inland Revenue can currently share information with other government agencies, thereby improving the quality of information across government. The bill also extends the ability of the Commissioner to release taxpayer-specific information for the purposes of administering the tax system, subject to certain criteria.

RELAXING THE TAXPAYER SECRECY RULES FOR TAX ADMINISTRATION PURPOSES

(Clause 58)

Summary of proposed amendment

The secrecy rules contained in Part 4 of the Tax Administration Act 1994 are being amended to give the Commissioner of Inland Revenue greater discretion to release taxpayer information for the purpose of administering the tax system more efficiently. This information may include, for example, releasing information to a friend or family member a taxpayer has nominated to deal with their personal tax affairs.

Application date

The amendments will apply from the date of enactment. Inland Revenue will issue a Standard Practice Statement setting out how the new rules will apply.

Key features

The current rule allowing the Commissioner to release taxpayer information under the Inland Revenue Acts is being repealed. The rule is being replaced with the discretion to release taxpayer information in executing or performing (or supporting executing or performing) the powers, duties and responsibilities of the Commissioner to administer, implement, improve, research and reform the tax system. The change is intended to allow the Commissioner more flexibility to release taxpayer information.

In deciding whether to exercise the discretion to release, the Commissioner must consider the integrity of the tax system, the importance of promoting voluntary compliance, the resources available to him, the personal or commercial interest or sensitivity of the taxpayer concerned, and whether the information is currently in the public domain. Following consideration of these factors, the Commissioner may release information if the communication is considered reasonable, whether or not it is also necessary. This is intended to relax the current “reasonably necessary” threshold for disclosure.

A Standard Practice Statement will be developed, setting out how the new rules will be administered in different situations. The Statement will categorise disclosures according to the type of information and the recipient of the information. It will outline the process for disclosure and the level at which different types of disclosure are signed off. The Statement will be published on the date the new rules come into effect.

The requirement to obtain Ministerial authorisation for the release of aggregate or process information will be removed. The release of this information will be at the discretion of the Commissioner while weighing the criteria set out above.

Background

Inland Revenue can currently only release taxpayer information to a third party when it is "reasonably necessary" to administer the tax laws. This does not provide Inland Revenue with sufficient flexibility to administer the tax system in the most efficient way.

The conservative interpretation currently taken can prevent Inland Revenue from making disclosures in the course of administering the tax legislation, even when disclosures would provide benefits such as greater efficiency or compliance that would outweigh the costs. There is a range of potential initiatives involving disclosure of taxpayer information related to administering the tax system that would have benefits, but which may not be necessary to administer the tax system, and therefore cannot be progressed without legislative amendment.

In the past, when the benefits of disclosure for a particular initiative have been sufficiently high, legislative uncertainty has been resolved by adding a specific disclosure exception to the legislation. This is inflexible, administratively inefficient and will potentially hamper or delay future initiatives to administer the tax system more efficiently.

The proposed new rules are intended to increase the Commissioner's ability to disclose taxpayer information for purposes relating to administering, improving and reforming the tax system. The criteria the Commissioner must consider in deciding whether to make a disclosure will include those already set out in section 6 and 6A of the Tax Administration Act.

For example, under the new rules information would be able to be released under the following conditions:

- it is already in the public domain and not subject to criminal sanctions;
- it is generic information using generic statistical data (and does not identify an individual taxpayer); or
- in some circumstances it is information the taxpayer has consented to being released – for example, when a deaf or non-English speaking taxpayer authorises a friend or family member to make telephone queries about their tax affairs, or a constituent asks a Member of Parliament to make enquiries of Inland Revenue about an issue in relation to that constituent.

It is not clear under the current rules whether these disclosures would be permitted.

The new rules also allow the Commissioner to respond when taxpayers make incorrect statements to the media about Inland Revenue, or about their dealings with Inland Revenue. Such statements can be highly damaging to the integrity of the tax system, and in particular to other taxpayers' perceptions of that integrity.

A further type of disclosure to be permitted under the new rules is the provision of information to The Treasury for the purposes of tax policy development. Currently there is an express exemption to the secrecy rules which allows Inland Revenue to disclose information to The Treasury for the purposes of tax revenue forecasting. The Treasury has requested that it also has access to information for the development of tax policy. Disclosure of information for this purpose falls within the Commissioner's discretion under the new rules and does not therefore require an extension to the specific forecasting exception. Allowing Treasury employees access to Inland Revenue information for the purposes of tax policy development will improve the quality of policy advice available to the Government. Naturally, appropriate secrecy conditions will apply.

SHARING TAX INFORMATION WITH OTHER GOVERNMENT AGENCIES

(Clause 59)

Summary of proposed amendments

The bill introduces changes to facilitate the sharing of tax information between Inland Revenue and other government agencies. This will allow more efficient use of information collected by Inland Revenue and reduce the need for individuals to provide duplicated information to multiple government agencies.

Application date

The amendments will apply from the date of enactment. No information sharing will occur until an agreement has been entered between Inland Revenue and the requesting agency, Cabinet approval has been obtained, and an Order in Council has been made, authorising the disclosure.

Key features

The changes will allow an Order in Council to be made, authorising the sharing of Inland Revenue information with another government agency, provided certain criteria are met. The government agency seeking access to the information must have the ability and authority to collect the information in its own right, and the information must be available and already collected by Inland Revenue. Information will only be shared if it is not so sensitive that it would inhibit individuals from providing accurate information in the future. Finally, it must be economically inefficient for the agency seeking access to collect the information itself, or there must be clear compliance benefits to individuals for the information to be shared rather than collected separately.

The final decision on whether information should be shared with another agency will be made by Cabinet. Before recommending a sharing arrangement to Cabinet the Minister must consult with the Privacy Commissioner, the agencies that may be affected by the proposed order, and any organisations considered by the Minister to represent the interests of those likely to be substantially affected by the proposed information-sharing arrangement.

The changes include provision for a review after five years of operation to consider any impact on the privacy of individuals, the impact on the tax system, and whether any further amendments to the law are necessary.

Background

Government agencies currently exchange information with other government agencies using the information-matching rules set out in the Privacy Act 1993. Information-matching is often used by agencies as an auditing and verification function. Generally, this involves comparing personal information from one set of records against another set of records to produce or verify information (usually a name) about an individual, with the aim of finding records in both sets that belong to the same person.

The information matches to which Inland Revenue is currently a party only allow for the transfer of particular information for the specific purposes set out in the relevant legislative provision. Any information exchanged under these provisions must be provided for in a written agreement between Inland Revenue and the other agency. For Inland Revenue, these agreements are generally prescriptive and focussed on enforcement matters.

Inland Revenue currently has eight information-matching agreements with the Ministry of Social Development. In several of these matches Inland Revenue cannot provide any information until the Ministry of Social Development has sent information to Inland Revenue on selected individuals and a match has been found for that individual by Inland Revenue.

The changes will enable wider use of Inland Revenue's information and provide better value for money across the public service with improved speed, accuracy and certainty of information.

The changes seek to strike an appropriate balance between individuals' privacy rights and a more efficient and effective government service. Several privacy safeguards are built into the legislative framework, such as the requirement that information shared must be information that the requesting agency is authorised and able to collect in its own right. Before information is shared with another agency, the specific purposes for which it will be shared will be stated publicly, and individuals will be advised of these when information is collected from them. The purposes will also be listed in the Order in Council authorising the particular sharing agreement. The purpose for which Inland Revenue collects information that will subsequently be shared will become a joint agency purpose. When it is possible that an adverse outcome may arise for an individual, information-sharing will be limited to information collected after the joint purposes are set.

Over time, it is likely that information-sharing agreements will supersede many, if not all, of Inland Revenue's existing information-matching agreements. However, these existing arrangements will continue to operate for some time as the new arrangements are negotiated and come into force, and therefore the provisions authorising Inland Revenue's existing information-matching and information exchange arrangements will remain in place.

Disputes

OVERVIEW

The current tax disputes system, which involves a number of communications on disputed matters between a taxpayer and Inland Revenue before a case may go to court, has been in effect from 1996 and results from the *Organisational Review of the Inland Revenue Department* by the Richardson Committee. The objective of the process as recommended by the Committee is that there should be an "all cards on the table" approach to disputes resolution so that if Inland Revenue issues an amended assessment it will have the best possible opportunity to be right first time. The recommendations of the Richardson Committee were subject to a post-implementation review in 2003.

In August 2008 the Minister of Revenue and the Commissioner of Inland Revenue received a joint submission from the New Zealand Institute of Chartered Accountants (NZICA) and the New Zealand Law Society summarising their members' concerns about the disputes process. The submission did not advocate a fundamental shift from the Richardson objectives.

The submission opened a dialogue between the submitting organisations and Inland Revenue. Discussions resolved a number of concerns about the administration of the process. However, differences of opinion remained around exactly which phases of the disputes process should be governed by legislation and, where it is so governed, to what extent.

In July 2010, Inland Revenue released an officials' issues paper and two draft standard practice statements (SPSs) on the disputes process. The SPSs set out a series of important changes to the way that Inland Revenue administers certain parts of the disputes process. In particular:

- The Commissioner's notice of proposed adjustment (NOPA), which is the first document of the disputes process, should be proportionate in size to the dispute and subject to a more rigorous quality-control process to ensure that only the best arguments are put forward.
- A taxpayer entering the conference phase of the process is now offered the opportunity for the conference to be facilitated by a senior Inland Revenue employee who has not previously been involved in the dispute.
- Guidelines have been provided on when the Commissioner would be prepared to agree with the taxpayer to opt out of the disputes process (the opt-out guidelines). After the conference phase, the Commissioner will generally agree to opt out if the core tax in dispute is $75,000 or less, the dispute turns on its facts, the same issue is being considered by the courts, or the Commissioner has previously considered the issue and will not be altering that view.

The issues paper set out a number of areas in which legislative change was considered to be warranted. Legislative changes sought by NZICA and the Law Society, but which are not proposed in this bill include:

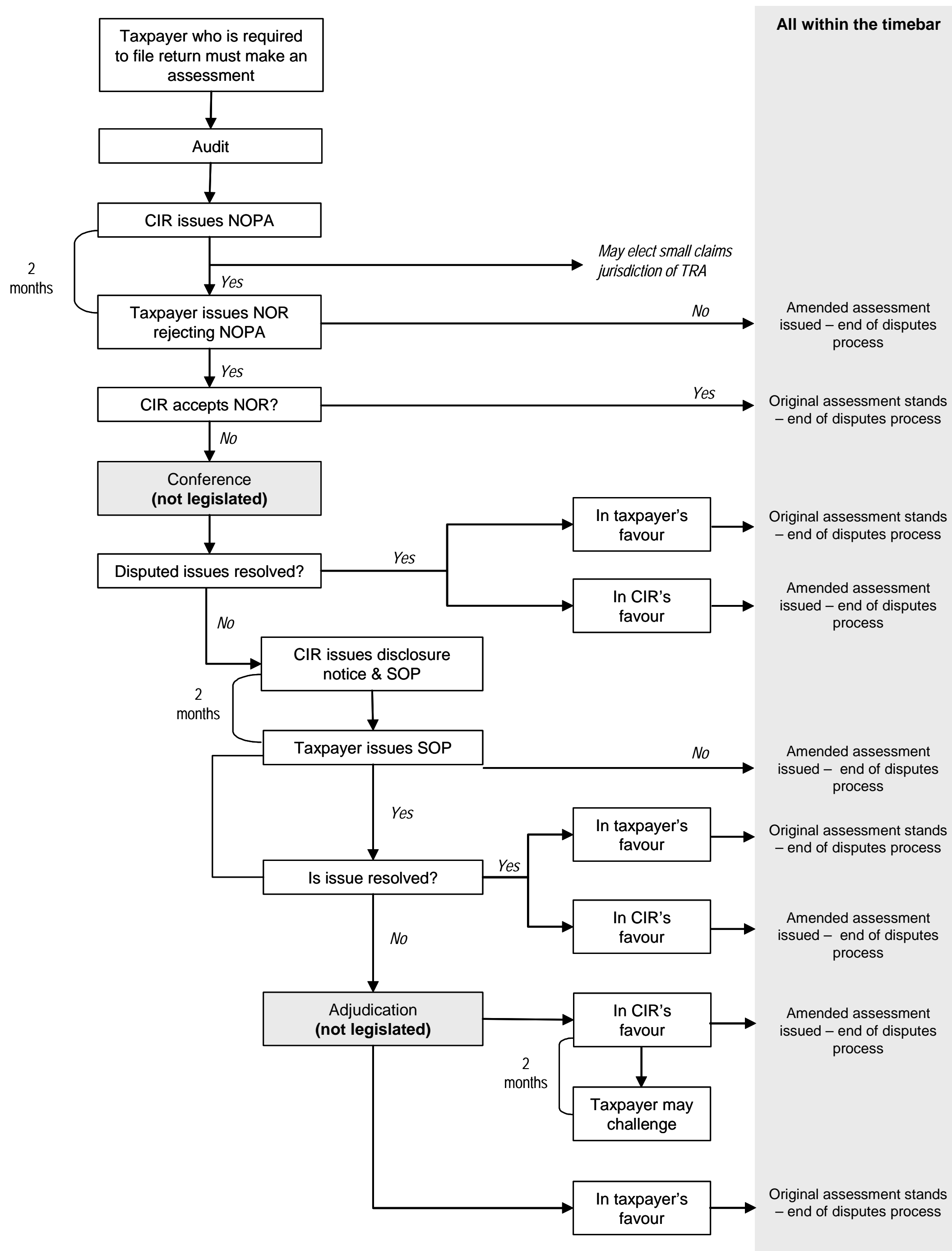
- a statutory right for taxpayers to unilaterally opt out of the disputes process after the conference phase; and
- imposing statutory timeframes on the Commissioner for various phases of the disputes process.

Legislation is not considered necessary to cover these points as it is anticipated that the administrative changes set out in the SPSs, and currently being implemented by Inland Revenue, will address the main concerns expressed by NZICA and the Law Society. However, the Minister of Revenue has agreed to a review of the position in approximately two years time. If significant taxpayer concerns remain, legislative solutions could be considered at that time.

The process

The current disputes process for a dispute initiated by the Commissioner is shown in Figure 1.

Figure 1: the disputes process



There is a corresponding process for disputes initiated by taxpayers that is broadly similar. However, in that process, the Commissioner has a two-month timeframe in which to issue a notice of response (NOR) and the taxpayer currently has the right to effectively opt out of the process and proceed straight to court at any time after the Commissioner has issued the NOR.

REMOVAL OF THE SMALL CLAIMS JURISDICTION OF THE TAXATION REVIEW AUTHORITY

(Clauses 43(6), 63, 73, 74, 90–92, 94, 98, 99 and 101–108)

Summary of proposed amendments

The small claims jurisdiction of the Taxation Review Authority (TRA) has been used infrequently and is not adequately fulfilling its policy intention, most probably because it does not provide a right of appeal. The general jurisdiction of the TRA is suitably flexible to deal with the any specific requirements of a dispute related to a small amount of tax. As a result, the small claims jurisdiction is being removed.

Application date

The amendments will apply for disputes when no election to the small claims jurisdiction has been made before the date of enactment.

Key features

The small claims jurisdiction of the TRA was established in 1996. A taxpayer can elect to have a dispute heard in the TRA acting in its small claims jurisdiction if certain criteria are met (including that the proposed adjustment is $30,000 or less). This election can be made in the taxpayer's Notice of Proposed Adjustment (NOPA) (for a taxpayer-initiated dispute) or their Notice of Response (NOR) (for a Commissioner-initiated dispute). If the taxpayer makes this election, it is irrevocable. The election effectively circumvents the remainder of the disputes process and allows the dispute to progress straight to the TRA acting in its small claims jurisdiction.

Because a dispute has to exhibit certain characteristics before a taxpayer can elect to use the small claims jurisdiction, and there is no right of appeal from the TRA acting in that capacity, fewer than 10 cases have been heard since its establishment.

Under new administrative changes to the disputes process, if the core tax in dispute is less than $75,000, the taxpayer will generally be given the right to opt out of the disputes process after the conference phase. This ability to truncate the process eliminates the need for a specific taxpayer election to the small claims jurisdiction, because they will be able to begin a dispute at the earlier stage in the general jurisdiction of the TRA.

The TRA acting in its general jurisdiction is able to deal with small claims. Disputants can represent themselves and the TRA, as a commission of enquiry, has a large degree of flexibility in the formality or otherwise of hearings.

This bill therefore proposes to remove the small claims jurisdiction.

EVIDENCE EXCLUSION RULE

(Clause 72)

Summary of proposed amendments

The evidence exclusion rule (EER) is to be relaxed so that it limits the parties only to the issues and propositions of law disclosed in their Statement of Position (SOP).

Application date

The amendments will apply to disputes for which the disclosure notice is issued after the date of enactment.

Key features

In the event that a dispute reaches court, section 138G of the Tax Administration Act 1994 (known as the EER) applies. The EER currently limits the Commissioner and the taxpayer to the facts, evidence, issues and propositions of law that are disclosed in their respective SOPs.

The EER aims to ensure that the SOP contains all of the best arguments for each party to eliminate the possibility of "trial by ambush". It also helps to make sure that all relevant information is brought forward at the SOP stage (at the latest) to increase the possibility that the Commissioner's assessment will be correct.

The EER has been criticised for encouraging a "kitchen sink" approach to SOP preparation, meaning that it encourages disputants to include every fact, piece of evidence, issue and proposition of law to avoid the risk of something being deemed to be inadmissible in court. Overly long documents can have the effect both of unnecessarily increasing compliance costs for disputants and also of obscuring the real issue to be resolved.

The EER is to be amended so that it limits the parties only to the issues and propositions of law contained in the SOP and not the facts and evidence. This change should mean that the parties still have considerable certainty on the scope of the dispute, while eliminating the pressure to include every fact and piece of evidence in the SOP for fear of not being able to raise them at a later date. The SOP will still need to contain "an outline" of the facts and evidence to be relied upon.

The amended EER, as with the current version, applies to both taxpayer- and Commissioner-initiated disputes when a disclosure notice has been issued (and, therefore, SOPs have been exchanged). No exclusion rule will apply for truncated disputes, such as when the parties agree to opt out of the process.

EXCEPTIONAL CIRCUMSTANCES

(Clauses 43(3), 64, 65, 68 and 69)

Summary of proposed amendments

A late notice from a taxpayer can be accepted by the Commissioner if exceptional circumstances exist. This rule is being expanded to allow the Commissioner to accept late documents if the taxpayer has a demonstrable intention to enter into or continue the disputes process. If the Commissioner does not exercise the discretion to accept late documents, that decision will be able to be challenged in the Taxation Review Authority.

Application date

The amendments will apply from the date of enactment.

Key features

Although statutory timeframes are considered essential to ensure that the disputes process is navigated in a timely and efficient manner, there will be situations when a late response is justified and the party to the dispute should not be unduly penalised for failing to meet a deadline. This is particularly the case for tax disputes, when it is considered that the consequence of late filing is that the party is deemed to accept the position of the other disputant.

A new rule will allow the Commissioner a discretion to accept disputes documents delivered outside of the statutory response period if the Commissioner considers that the disputant has a demonstrable intention to enter into or continue the disputes process. This new rule is based on a previous common law notion of an "intention to dispute". [2]

In order to avoid a situation where taxpayers can extend the process indefinitely by continually asserting an intention to dispute without actually acting on that intention, the existing requirements in section 89K(1)(b) of the Tax Administration Act 1994 will remain. That section requires the disputant to send the relevant notice to the Commissioner as soon as practicable after becoming aware of their failure to respond in time.

Therefore, if the Commissioner considers that the taxpayer has either been subject to exceptional circumstances (under the current legislation) or has a demonstrable intention to dispute (and the other requirements of section 89K are met), a late notice will be treated as having been received on time. If neither of those features are present, the late submission of documents will not have met the statutory requirements and the taxpayer will be deemed to accept the Commissioner's position.

[2] *Gisborne Mills Ltd v CIR* (1989) 13 TRNZ 405.

In the event that the Commissioner decides not to accept late documents, and the taxpayer disagrees with that decision, the taxpayer will be able to challenge that decision in the Taxation Review Authority.

To avoid a situation when a procedural matter jeopardises a substantive dispute, a new provision is being added to sections 108 and 108A so that the timebar for the substantive dispute is suspended while the appropriateness or otherwise of the Commissioner's exercise of his discretion is considered by the courts.

TAXPAYER OPT-OUT RIGHT AND COMPLETING THE PROCESS

(Clauses 43(4), 66, 67 and 70)

Summary of proposed amendments

A new rule is being introduced to remove the current right taxpayers have to opt out of the disputes process during disputes they have initiated. This change is to ensure there is consistency in the process between disputes initiated by the Commissioner and those initiated by taxpayers.

Complementary changes are being introduced to ensure that the full process is followed by both parties unless a truncated process is agreed upon.

Application date

The amendments will apply from the date of enactment.

Key features

Under section 138B(3) of the Tax Administration Act 1994, taxpayers have a right to take a dispute they have initiated to court at any time after the Commissioner has issued the NOR. This ability means that a dispute can be fast-tracked to court without having the benefit of a conference between the parties. There is also a significant information deficit in taxpayer-initiated disputes. These disputes, by their nature, often come as a surprise to the Commissioner. The Commissioner has two months to issue the NOR after which the challenge can commence.

The period between the receipt of the NOPA and the issuing of the NOR will not always be long enough for the Commissioner to form a definitive view on the issues raised, particularly in the limited cases where the taxpayer is uncooperative. This process has the potential for disputes to reach court without the issues being properly defined and debated between the parties – therefore defeating a key objective of the disputes process.

The proposed new rule will retain the taxpayer's challenge right, but only in circumstances when the Commissioner has issued a "challenge notice" (as introduced in the bill) in respect of the dispute. This notice is the Commissioner's final view that the assessment will not be amended in the way proposed by the taxpayer. It is anticipated that these notices will generally be issued by Inland Revenue once the dispute has been fully considered in the adjudication process.

Changes are also being made to sections 89M and 89N of the Tax Administration Act 1994 to clarify that the SOPs must be exchanged before the Commissioner issues an amended assessment or challenge notice. These changes ensure that, unless an exception applies (such as when the parties agree to opt out), the full process must be followed in both taxpayer- and Commissioner-initiated disputes. They also resolve an existing technical argument that the Commissioner does not have to issue a SOP in a taxpayer-initiated dispute.

Finally, a rule is being added to section 138B of the Tax Administration Act 1994 to allow a fast-track procedure for taxpayer-initiated disputes that are ancillary to other substantive disputes. The disputes in question are those when the taxpayer has adopted a position across numerous tax periods or when a taxpayer is affected by a position taken by another taxpayer (such as when a loss-making company transfers its losses to a profitable company in the same group). In these circumstances, the Commissioner can issue a challenge notice immediately and the taxpayer can challenge the assessment in court.

TAXATION REVIEW AUTHORITY REGULATIONS

(Clauses 100 and 103)

Summary of proposed amendments

The Taxation Review Authority Regulations are being updated to make them consistent with the District Court and High Court Rules.

Application date

The amendments will apply from the date of enactment.

Key features

In addition to the changes necessary to remove the small claims jurisdiction, two changes are being made to the TRA regulations.

The District Court Rules, through Regulation 4 of the Taxation Review Authority Regulations, operate when they are not directly over-ridden by the Taxation Review Authority Act or Tax Administration Act 1994. Currently the regulations refer to the District Court Rules 1992. This reference is being updated so that the revised District Court Rules 2009 apply instead.

There is currently an inconsistency between the time the Commissioner has to file a notice of response in the TRA and the filing times for a standard track hearing of the High Court. As both the TRA and the High Court can be the initial hearing authority for tax disputes, this distinction is being removed. The timing for filing a notice of defence in the TRA is therefore being reduced from 40 to 25 days.

MINOR REMEDIAL CHANGES

(Clauses 43(7), 62 and 71)

Summary of proposed amendments

Changes are being made to:

- ensure that the Commissioner can make a consequential adjustment to a taxpayer’s assessment when all or part of the taxpayer’s loss has been extinguished under section 177C(5) of the Taxation Administration Act 1994; and
- clarify that the issue of a dispute document by the Commissioner, or decisions surrounding the bilateral opt-out are not “disputable”. This is because the disputes process itself already provides taxpayers with an opportunity to respond to these decisions.

Application date

The new rules will apply from the date of enactment.

Changes to the tax pooling rules

CHANGES TO THE TAX POOLING RULES

(Clauses 33, 34, 35 and 79)

Summary of proposed amendments

Amendments are being made to the provisional tax pooling rules to ensure the legislation is simpler, fairer and is consistent in its application to different tax types. A number of these amendments either legislate operational concessions that previously applied to the provisional tax pooling rules or more correctly reflect the policy intent of the rules than they do currently.

Application date

The amendments will apply from the date of enactment.

Key features

New 75- day time limit to meet provisional or terminal tax liabilities

Taxpayers who want to access funds held by a tax pooling intermediary to meet their provisional or terminal tax liabilities must do so within 60 days of their terminal tax date to use the funds at backdated credit dates. For some taxpayers the 60-day time limit means that the last day to use tax credits from a tax pooling account falls before the date when the tax returns are due to be filed, and potentially before tax liabilities have been determined by the taxpayer. This is particularly a problem for those with a December balance date.

New section RP 17B(4)(a) provides that all taxpayers using a provisional tax pooling facility will have 75 days from the terminal tax date to access funds held by a tax pooling intermediary to meet their provisional or terminal tax liabilities at backdated effective dates. This will provide more time for taxpayers with a December balance date to request a transfer from a pool before filing a return, in order to access pooling funds with a backdated effective date.

Time limit to no longer apply to own funds

New section RP 17B(4)(b) provides that the time limit will no longer apply for “own funds” provided the taxpayer is not overdue in filing their return for the tax year.

New section RP 17B(7) will provide limits to the amount a taxpayer may request an intermediary to transfer. This restriction will not apply to taxpayers who use their own funds, except when the funds are used to meet an increased obligation or deferred tax.

Clarification of effective date of transfer where section 157 Tax Administration notice applied

An amendment is being made to section 157 of the Tax Administration Act which allows the Commissioner to seize tax pooling deposits by way of a deduction notice. The amendment clarifies that when a taxpayer has made a deposit and fails to instruct their tax pooling intermediary to transfer the deposit to meet their tax obligations, the concessions available for using tax pooling funds voluntarily will not apply. The amendment will provide that when a deduction notice is applied the effective date is the date the tax pooling intermediary pays the funds to the Commissioner. Previously it could have been argued that the deposit date of the funds was the effective date.

Use of purchased funds when obligations cannot be quantified

Currently the tax pooling rules only permit tax pooling funds to be used to meet an actual tax obligation. Consistent with the policy intent the funds transferred from the pool to a taxpayer's own account is limited to the amount of tax actually owing. However, sometimes a taxpayer may wish to purchase tax pooling funds before they file their return for the relevant year because they expect to have an obligation that they cannot quantify at that time. New section RP19B allows taxpayers to use funds in a tax pooling account towards the payment of a future tax liability if certain criteria are met. This section only limits the use of acquired funds; taxpayers who use their own deposited funds will not be subject to this limit.

Extending the use of pooling funds to voluntary disclosures where there has been no previous assessment

The provisional tax pooling rules were extended to taxpayers who have additional tax to pay following a reassessment (including those resulting from voluntary disclosures, and the resolution of a dispute). However, the use of tax pooling funds is currently limited to situations when there has been a previous assessment. In addition, the use of tax pooling funds does not extend to such cases where a tax liability exists without the need for an assessment (because the amount due is an obligation not assessed taxes) such as for resident withholding tax and fringe benefit tax. New section RP 17B(3)(ab) will allow pooling funds to be used for a voluntary disclosure when there has not been a previous assessment, provided the relevant return has previously been filed for that year. Because not all adjustments will arise from a voluntary disclosure, new section RP 17B(3)(ac) will allow pooling funds to be used when the Commissioner makes an assessment or adjustment increasing an amount previously payable, provided the relevant return has previously been filed for that year or period.

Any original amounts payable will not be able to be paid with tax pooling funds. Tax pooling funds can only be used for the adjustment resulting from the difference between the return filed and the increased amount owing. This is consistent with the treatment of additional amounts owing resulting from amended assessments. If second or subsequent adjustments are made that result in more tax to pay, this amendment will also allow tax pooling to be used, provided each subsequent adjustment results in an increased amount of tax to pay than the immediately preceding adjustment.

Correcting the use of tax pooling to eliminate imputation account debit closing balances

The provisional tax pooling rules currently include an unintended ability to use tax pooling funds to eliminate imputation account debit closing balances. This occurs when a taxpayer purchases or otherwise acquires pooling funds at an effective date that falls before the tax year in which the tax pooling funds are to be used to meet an income tax obligation. This effectively allows a company to receive a backdated effective date for imputation purposes while paying a current provisional or terminal tax obligation. This circumvents the imputation rules, and does not reflect the original policy intent. The bill introduces an amendment to section RP19(3) so that all taxpayers purchasing funds must nominate an effective date that is no earlier than the original due date (or the first provisional tax due date, in income tax cases) of the applicable year or period in which the tax pooling funds are used.

Extending the definition of increased "amount of tax" to reflect the policy intent

Currently tax pooling can be used to pay an increased amount of tax only when there has been a prior assessment. It does not allow tax pooling to be used when an increased amount of tax results from an increase in an obligation that does not result from an assessment. Additionally, "amount of tax" is a defined term in section YA 1 of the Income Tax Act which has resulted in an unintended limiting of tax pooling to withholding taxes as defined in "amount of tax" following an amended assessment.

New section RP 17B(8) is intended to achieve two policy outcomes. First, to extend the revenue types that tax pooling can be used for, so it also includes income tax, FBT, GST and imputation tax. Secondly, it will also bring the withholding taxes defined in "amount of tax" in the section YA 1 definition into the tax pooling rules. These measures better reflect the policy intent of which revenues and in what circumstances tax pooling can be used. The 10% imputation penalty tax can also be met using tax pooling to the extent that this relates to an increased amount of further income tax payable following an assessment by the Commissioner. This concession is a pragmatic way to deal with this unique penalty provision for imputation.

Background

A review of the legislation applying to tax pooling intermediaries was undertaken to ensure the rules were working as intended. As a result a number of amendments were made to tax pooling legislation in 2009 including removal of a number of Inland Revenue's administrative practices. The tax pooling rules are now perceived by some intermediaries and stakeholders as being less flexible than previously. The proposed amendments aim to address this problem while still reflecting the original policy intent of the tax pooling rules.

Authority for the Commissioner to impose fees for credit card payments

AUTHORITY FOR THE COMMISSIONER TO IMPOSE FEES FOR CREDIT CARD PAYMENTS

(Clause 80)

Summary of proposed amendment

The bill introduces changes that will allow Inland Revenue to offer a credit card facility for payment of all tax and social liabilities subject to an appropriate credit card transaction fee if taxpayers choose to use this facility. The bill establishes the Commissioner's authority to apply a transaction fee to offset the current bank fee Inland Revenue is charged for this facility.

Application date

The amendment will apply from 1 July 2011.

Key features

Section 226B of the Tax Administration Act 1994 will allow the Commissioner to charge taxpayers a fee, if they choose to pay their tax and social liabilities by credit card. The fee will be set at 1.42% of the total transaction and can be changed by Order in Council in the future.

This fee will not apply to overseas-based student loan borrowers and overseas-based child support liable parents who choose to make their payments by credit card.

Background

Since 2004, the Commissioner has accepted credit card payments from student loan borrowers and child support liable parents who are based overseas. The bill extends this facility to all payments of tax and social liabilities. For this to be practical, a legislative change is required to give the Commissioner authority to charge taxpayers a credit card transaction fee. The overall benefit of extending this facility is that it will provide taxpayers with another payment option to meet their tax and social liabilities.

Inland Revenue will continue to absorb the fee for credit payments made by overseas liable parents and overseas-based student loan borrowers to encourage compliance.

OTHER POLICY MATTERS

APPLICATIONS FOR OVERSEAS DONEE STATUS

(Clause 41)

Summary of proposed amendments

The bill adds seven new charitable organisations to Schedule 32 of the Income Tax Act 2007.

This will allow donors to obtain tax credits on their donations to the following organisations whose activities are largely focussed overseas.

- Jasmine Charitable Trust No.2
- New Zealand Good Samaritan Heart Mission to Samoa Trust
- NZ-Iraqi Relief Charitable Trust
- RNZWCS Limited
- Ruel Foundation
- The Cambodia Charitable Trust
- The Unions Aotearoa International Development Trust

Application date

The amendments will apply from 1 April 2012.

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 of the Income Tax Act 2007.

Donations to listed organisations entitle individual taxpayers to a tax credit of $33^{1/3}$% of the amount donated, up to their taxable income. Companies and Māori Authorities may claim a deduction for donations up to the level of their net income.

The seven charitable organisations being added to Schedule 32 are engaged in the following activities:

- Jasmine Charitable Trust No.2 funds experienced social entrepreneurs developing sustainable models to provide healthcare, education and improved livelihoods to the world’s most disadvantaged.
- New Zealand Good Samaritan Heart Mission to Samoa Trust performs voluntary heart surgery in Samoa for patients with life-threatening heart disease who otherwise cannot afford treatment.

- NZ-Iraqi Relief Charitable Trust works for the relief of needy people in Iraq. The Trust works together with TEAR Fund New Zealand to help sick Iraqi children. Projects have included building a new Thalassemia unit for blood disorders in Basra and providing medical consumables and New Zealand doctors to educate local doctors working in hospitals in Basra and Baghdad.
- RNZWCS Limited (Rotary New Zealand) is the international humanitarian arm of the New Zealand Rotary club network whose aim is to encourage, assist and foster projects worldwide by Rotarians, Rotary Clubs and Districts in New Zealand and the South Pacific. This includes emergency response activities in the Pacific and elsewhere. Rotary already has a related organisation listed in Schedule 32 – The New Zealand Rotary Clubs Charitable Trust.
- Ruel Foundation provides assistance and support for children living in poverty in developing nations within the Pacific Basin. The Foundation provides free medical aid, including surgery for children with deformities such as cleft lip and palate. It also runs a crisis centre in the Philippine Islands for children living in poverty and local government-approved courses in mid-wifery and child care for poor communities.
- The Cambodia Charitable Trust aims to raise educational standards, strengthen economic community development, improve social accountability and uphold human rights and improve health in Cambodia.
- The Unions Aotearoa International Development Trust is an independent international aid and development Trust established by the New Zealand Council of Trade Unions – Te Kauae Kaimahi. It provides a channel for New Zealand workers to contribute to international development through support for programmes which help unions, workers and their families in developing countries.

DIVIDENDS PAID WITHIN A WHOLLY OWNED GROUP

(Clause 4)

Summary of proposed amendment

Section CW 10 of the Income Tax Act 2007 treats as exempt income, dividends paid between New Zealand-resident companies that are in the same wholly owned group. However, this exemption does not apply if common balance date requirements are not satisfied. This distorts the original purpose of the rules, which is to allow the movement of capital within a wholly owned group of companies, and imposes an unnecessary compliance cost upon those companies.

The amendment therefore removes the common balance date requirements from section CW 10.

Application date

The amendment will apply to dividends derived by a company on or after the first day of that company's 2010–11 income year.

Key features

The repeal of the common balance date requirement removes an inappropriate restriction on the dividend exemption for New Zealand-resident wholly owned companies.

Background

The purpose of the wholly owned group intra-group dividend exemption is to facilitate the movement of capital around a wholly owned group, without taxation being a distortionary or inhibiting factor.

At present, if the paying and receiving companies do not have a common balance date, and the differences in the balance dates are not supported by commercial reasons, the dividend is not exempt.

In practice, the provision will normally not apply because companies in a wholly owned group not meeting the common balance date requirement will use non-dividend methods to move capital around the wholly owned group company. This effect unnecessarily increases compliance costs for taxpayers, which is inconsistent with the purpose of the rule.

REMEDIAL MATTERS

SHAREHOLDER CONTINUITY: DIRECTORS' KNOWLEDGE PROVISION

(Clauses 38 and 87)

Summary of proposed amendment

Section YC 15 of the Income Tax Act 2007 is being amended to exclude from its scope minor "off-market" share transactions. The amendment will remove current uncertainty about how the section applies to off-market transactions and should reduce compliance costs.

Application date

The amendment will apply for income years beginning on or after 1 April 2005.

Key features

The bill amends section YC 15 to exclude the following transactions from its scope:

- off-market transactions between a company and its shareholders which in aggregate are less than 5 percent of the shareholding in a company in the income year; and
- off-market transactions between shareholders who have a less than 5 percent shareholding in a company in the income year.

"Off-market transactions" are share transactions that occur outside of a recognised stock exchange and include employee share schemes, dividend reinvestment plans and small private sales between shareholders.

Background

The shareholder continuity and tracing rules govern the carry-forward of tax losses and imputation credits to ensure that the benefits from these are returned, in general, to the same shareholders when they were incurred or derived. The standard tracing rules require tracing the ownership of shares in a company through to underlying shareholders who are "natural persons".

There are a few concessions that simplify the standard tracing rules particularly in relation to listed companies. These concessionary rules are subject to section YC 15, under which shareholder continuity is considered to be breached if the directors of a company know or could reasonably be expected to know, that the requirements of any continuity provision would not have been satisfied.

The issue is that the current section can be interpreted to mean that directors are presumed to be aware of all off-market transactions for the purposes of applying the provision.

The frequency with which some minor off-market transactions occur (for example, employee share schemes) means the application of section YC 15 under this interpretation may limit access to tracing concessions for at least some listed companies. The effect is that these companies may be required to undertake full tracing of all transactions, which would be onerous.

Given that section YC 15 is an anti-avoidance rule, when applying the provision, companies should only have to include in their continuity calculation transactions which their directors would know of or that it would be reasonable to expect them to know of. Since it is unlikely that company directors would have knowledge of minor off-market transactions, these transactions should not be taken into account when applying section YC 15.

The amendment will apply retrospectively (from income years beginning on or after 1 April 2005) as it reflects the way officials understand the law is currently being applied by the majority of taxpayers.

REMEDIAL AMENDMENTS TO TAX STATUS OF NEW ZEALAND SUPERANNUATION FUND

(Clauses 21, 39, 40 and 88)

Summary of proposed amendments

The New Zealand Superannuation Fund (NZSF) is a Government investment fund that was set up in 2001 to pre-fund a portion of New Zealand's future superannuation requirements. The NZSF is not a separate legal entity, but a pool of funds owned by the New Zealand Government.

Amendments to the Income Tax Act 2007 and the New Zealand Superannuation and Retirement Income Act 2001 (NZSRIA 2001) will better reflect that the NZSF is an integral part of the Crown, and not a separate entity. Under the new legislation tax on income derived by the Crown through the NZSF will continue to be calculated in the same way that it is now.

Amendments will also clarify that the NZSF, as part of the New Zealand Government, is a resident of New Zealand for tax purposes.

Application date

The amendments will apply from 1 April 2011.

Key features

Section 76 of the NZSRIA 2001 will be repealed. A transitional provision in the bill will ensure that the effect of this amendment does not result in the liquidation or creation of any entity or person.

Section HR 4B will clarify that, although the NZSF is part of the Crown, the amount of tax on the Crown's income relating to the New Zealand Superannuation Fund will be calculated using the company tax rules. Because the provision specifies that the company tax rules apply to the amount of income to be calculated, this means that rules such as the basic tax rate that applies to companies applies to Crown income derived through the NZSF. It will also apply to provisions such as section DB 7, which provides that no nexus with income is needed for interest incurred by most companies to be deductible.

Because the fund is not deemed to be a body corporate, the obligations that are specifically imposed on companies, such as the obligation to maintain an imputation credit account, do not apply.

Schedule 1 is being amended to ensure that the tax rate applicable to the fund is the same as the company tax rate.

Section YD 3B clarifies, for the avoidance of doubt, that the Crown is a resident of New Zealand.

Background

The New Zealand Superannuation Fund was set up in 2001 to pre-fund a portion of New Zealand's future superannuation requirements. The NZSF is intended to smooth the future amount spent on New Zealand superannuation on a 40-year rolling horizon.

Part 2 of the NZSRIA 2001 governs the operation of the NZSF.

The NZSF is not (and never has been) a separate legal entity. Rather, it is a pool of funds that remains the property of the Crown (section 40 of the NZSRIA 2001). Earnings from the NZSF are taxed using the company tax rate. The NZSRIA 2001 is generally clear on this point.

The Guardians of the NZSF are charged with managing and administering the NZSF, in accordance with the New Zealand Superannuation and Retirement Income Act 2001. However, the Guardians are not a trustee of the NZSF (section 51(2) of the NZSRIA 2001), and the legal owner of the NZSF is the Crown, not the Guardians of the Fund or any other entity.

The NZSRIA 2001 and the Income Tax Act 2007 are being amended to better reflect the status of the NZSF – that the NZSF is a pool of funds owned by the Crown and is not a separate legal entity.

An amendment will also clarify that the Crown is a resident of New Zealand. This will ensure that domestic law is consistent with the position under New Zealand's tax treaties. Double tax agreements (DTAs) usually specify that the Government is to be treated as a resident for the purposes of the DTAs. This ensures the Crown, including its various pools of funds (such as NZSF) obtain the benefits of these DTAs, including lower withholding rates.

REMEDIAL AMENDMENTS TO THE PIE RULES

(Clauses 15–20, 36(3) and 86)

Summary of proposed amendments

The bill makes five remedial amendments to the portfolio investment entity (PIE) rules to ensure the rules operate as they were intended.

Application date

The amendment to allow a PIE to derive significant amounts of income from life insurance policies will apply from the beginning of the PIE regime, 1 October 2007.

The other amendments will apply from 1 April 2012.

Key features

The amendments will have the following effect:

- allow a PIE to derive more than 10 percent of its income from life insurance policies;
- for a person who has recently become a New Zealand tax resident, require that they take their worldwide income into account when calculating their prescribed investor rate (PIR). This should result in rates that better reflect the person’s actual income and marginal personal tax rate;
- ensure that a person’s taxable income is not double-counted in certain situations when calculating their prescribed investor rate;
- provide that income from conditional employer contributions to superannuation funds on behalf of an employee are to be taxed at the employee’s tax rate if the employee will become entitled to the contribution within five years; and
- clarify that, when calculating the income to be attributed to an investor, a PIE is able to deduct fees for the ongoing management or ongoing administration of the fund.

Detailed analysis

Life insurance income

PIEs are restricted to earning 90 percent or more of their income from the types of income listed in section HM 12 of the Income Tax Act 2007. The purpose of this restriction is to ensure that PIEs generally earn only passive income, as PIEs are intended to be passive investment vehicles. Income from life insurance policies was inadvertently not included in this list. Accordingly, the bill amends section HM 12 to include income derived from life insurance policies, with effect from the beginning of the PIE regime.

Prescribed investor rates for recent migrants

Prescribed investor rates are the tax rates that should apply to investors in a PIE. As a result of the way these are currently defined, it is possible for individuals who have recently become New Zealand tax residents to use the lowest available PIR (10.5%) for the first three income years that they are a resident, regardless of their actual income. To remedy this, the bill introduces new section HM 57B which will require the PIRs for recent migrants to be calculated using their worldwide income, not their New Zealand taxable income. The change will ensure that PIRs more closely reflect a new resident's actual income and marginal personal tax rate.

Double counting of income

In certain situations, it is currently possible for some of an individual's taxable income to be counted twice when calculating their PIR. This occurs if a person has informed a PIE of a rate that is too low, and can result in inappropriately high PIRs. Accordingly, the bill amends section HM 56 to ensure that this does not occur.

Conditional entitlements

Section HM 38 sets out the appropriate tax treatment of conditional employer contributions to superannuation funds. These are contributions made on behalf of employees, but where the employee only becomes entitled to them after a vesting period, which is normally a minimum period of employment. At present, the interest earned on a conditional employer contribution is taxed at the employee's rate if the vesting period is no longer than five years. If it is longer, the interest is taxed at the PIE's tax rate until the vesting period is over.

The bill amends section HM 38 so that, if a vesting period is within the five-year period, the interest earned on conditional employer contributions is taxed at the employee's tax rate. This removes the current tax disadvantage of having a vesting period longer than five years.

Fees for management and administration

Section HM 36 currently provides that, when calculating the income that should be attributed to an investor, a PIE can deduct fees for the "ongoing management and administration" of the fund. This wording has caused some confusion amongst taxpayers. The bill re-words this section to clarify that fees for the ongoing management or the ongoing administration of the fund should be able to be deducted.

LISTED PIES – GROUPING OF TAX LOSSES

(Clause 22)

Summary of proposed amendment

The bill amends the loss grouping tax rules in order to close off a potential loophole that could allow New Zealand companies with tax losses to avoid paying tax by setting up structures using listed PIEs. To counter this practice the change will restrict a listed PIE (a type of portfolio investment entity that is a listed company) to grouping only with its own wholly owned subsidiaries.

Application date

The amendment will apply from the date of enactment.

Key features

Section IC 3(1) is being amended to exclude a listed PIE from the phrase "a group of companies". New section IC 3(2C) will provide that a listed PIE can only group with its own wholly owned subsidiaries.

Background

Under the tax rules for grouping tax losses and credits, a listed PIE is currently allowed to use its parent company's tax losses to offset its taxable income.

There is concern about the potential for New Zealand companies with tax losses that would otherwise be difficult to use, to establish structures involving the use of listed PIEs in order to use these losses. For example, a loss-making New Zealand company that wanted to raise capital from the retail sector could establish a listed PIE that would raise funds, in the form of preference shares, from retail investors. It would then lend these funds to its loss-making parent – with the parent paying interest to the listed PIE.

This structure raises policy concerns as it undermines the company tax and imputation system. Under the current tax grouping rules, the listed PIE would be able to offset the interest income it received against its parent's losses and thereby eliminate its tax liability. Under the PIE rules, this would provide the PIE investors with a tax-free return and would provide the parent with a mechanism to use its tax losses.

The amendment ensures that listed PIEs will be treated in a similar manner to multi-rate PIEs under the loss grouping rules, which are confined to grouping tax losses with land-owning subsidiaries or other multi-rate PIEs.

IFRS FINANCIAL ARRANGEMENTS

(Clauses 8, 9 and 10)

Summary of proposed amendments

The bill introduces several technical changes to clarify the International Financial Reporting Standards (IFRS) financial arrangement rules in relation to integral fees when the modified fair value method applies, the timing of the base price adjustment when changing from the fair value method to another method, and anti-arbitrage rules around the use of the fair value method.

Application date

The amendments will apply retrospectively from 1 April 2008.

Key features

- *Integral fees where the modified fair value method applies*: The modified fair value spreading method is based on the fair value method. The consideration of the fair value method is defined to ignore non-integral fees (which is an accountant's term). The consideration for the modified fair value method should also ignore non-integral fees, but this was inadvertently not specified in the original legislation. The amendment corrects the omission.
- *Timing of base price adjustment when changing from fair value method to another method*: When taxpayers change from the fair value method to another spreading method they are required to perform a base price adjustment (BPA). The current rules state that this BPA is to be performed when the change of method occurs. The intended meaning of this is for taxpayers to perform the BPA at the end of the relevant income year; however, the current wording does not make this clear. Accordingly, the rule is being clarified by explicitly stating that the BPA calculation is to be performed at the end of the income year in which the change of method occurs.
- *Anti-arbitrage rules for the use of the fair value method*: Several amendments were made last year to the anti-arbitrage rules. These rules are intended to prevent income and expenditure from being deferred or advanced on two financial arrangements which are in a designated hedging relationship. However, in amending the rules the ability to use the fair value method for financial arrangements that are used to hedge other financial arrangements (being agreements for the sale and purchase of property in foreign currency subject to a determination method) was inadvertently denied. The amendment allows the fair value method to be used in such circumstances.

FAIR DIVIDEND RATE METHOD: QUICK SALE GAIN AMOUNT

(Clauses 11 and 12)

Summary of proposed amendments

The bill amends the fair dividend rate (FDR) rules to ensure that an adjusted formula for "average cost" can be used when calculating the "quick sale gain amount" under section EX 52(12) following a share reorganisation. This is to ensure that the "average cost" calculation is accurate following a share reorganisation.

Application date

The amendments will apply to income years beginning on or after 1 April 2008.

Key features

The fair dividend rate (FDR) rules will be amended to ensure that an adjusted formula for average cost can be used when calculating the "quick sale gain amount" under section EX 52(12) following a share reorganisation.

Detailed analysis

Under section EX 52(7) of the FDR rules, a quick sale adjustment is the lesser of two amounts – the "peak holding method amount" and the "quick sale gain amount".

The formulas for each use "average cost" as a component.

For the peak holding method, an adjusted calculation of "average cost" is used if a share reorganisation occurs. In such cases, average cost is calculated under section EX 54.

However, the rules do not currently provide an equivalent adjusted calculation of "average cost" when determining the quick sale gain amount in the event of a share reorganisation. This means that the calculation of "average cost" under the quick sale gain amount formula may not be accurate following a share reorganisation.

The bill amends section EX 52(13) so the adjusted "average cost" definition available under section EX 54 can be used to determine the quick sale gain amount, if a share reorganisation occurs.

Additionally, section EX 54(1)(b) is being amended to cross-reference with section EX 52(12).

UPDATING THE DEFINITION OF "BOOK AND DOCUMENT"

(Clauses 43(2), 43(5), 44 to 57, 58(3)(b), 58(4)(b) and (d), 60, 61, 75 to 78, 93 and 109)

Summary of proposed amendment

The definition of "book and document" in section 3 of the Tax Administration Act 1994 is being updated to remove references to redundant technology and future-proof the definition.

Application date

The amendment will apply from the date of enactment.

Key features

The definition of "book and document" in section 3 of the Tax Administration Act 1994 is being updated. The new definition of "document" covers the medium on which information is stored, the information itself and any device associated with the medium which allows the information to be communicated.

The words "book and document" throughout the Inland Revenue Acts are being replaced with the new term "document".

Background

Section 3 of the Tax Administration Act 1994 defines "book and document" and "book or document" as including:

> "all books, accounts, rolls, records, registers, papers, and other documents and all photographic plates, microfilms, photostatic negatives, prints, tapes, discs, computer reels, perforated rolls, or any other type of record whatever"

The current definition has not been updated since 1974 and therefore does not reflect changes in technology since then. For example, some of the terminology refers to out-of-date technology such as computer reels and perforated rolls.

In a recent Court of Appeal decision it was decided that computer hard drives are a "book or document" under the Tax Administration Act 1994, as the definition already includes "or any type of record whatever".[3] Therefore, the new definition does not extend the current definition but instead updates it – for example, by removing references to redundant technology.

[3] *Avowal Administrative Attorneys Ltd & Ors v The District Court at North Shore & the Commissioner of Inland Revenue*.

Updating the definition will not affect departmental practice because it is Inland Revenue's view that the current definition includes any records in electronic form. Inland Revenue's practice is to use cloning technology to copy computer records on site whenever practicable rather than remove computers from premises, thereby minimising any impact on taxpayers' activities.

DEDUCTIBILITY OF USE-OF-MONEY INTEREST

(Clauses 5, 6, 82, 83, 96 and 97)

Summary of proposed amendment

The amendment clarifies that use-of-money interest (UOMI) payable to Inland Revenue is deductible for tax purposes.

Application date

The amendment will apply retrospectively from the 1997–98 income year (the start of the UOMI rules) to taxpayers for deductions that have been claimed in returns filed before the date of introduction of the amending legislation.

Key features

The amendment clarifies that UOMI is deductible for tax purposes. The amendment will ensure consistency, in particular between companies (for whom interest is frequently deductible) and individuals. The amendment also ensures symmetry in treatment for tax purposes so that UOMI is both taxable and deductible.

Background

The current penalty and interest rules have applied since the 1997–98 income year. The policy intention of the interest rules was that interest paid on overpayments of tax would be taxable, and interest charged on underpayments of tax would be deductible under the normal income tax rules. This approach provided consistency with the treatment of interest generally, removed the need to convert rates to after-tax rates and distinguished between penalties and interest. Furthermore, the discussion documents released before the introduction of the rules noted interest would be deemed to be interest on money lent for the purposes of determining whether a deduction was available under the Income Tax Act. This was, however, never specified in the legislation.

Over time questions have been raised over whether UOMI is in fact deductible. This has led to a number of taxpayers seeking case-specific rulings from Inland Revenue on this issue. There appears to be some inconsistency over whether interest is deductible for companies and individuals. Generally companies are automatically entitled to deduct interest, but other taxpayers (specifically individuals) must satisfy a nexus requirement – meaning that interest may not be deductible. This inconsistency has arisen as a result of a lack of clarity over what Parliament’s intention was on the nexus requirement and has resulted in calls for legislative clarity on the deductibility of UOMI.

REFUNDS FROM INLAND REVENUE KIWISAVER HOLDING ACCOUNT

(Clause 89)

Summary of proposed amendment

The bill amends the KiwiSaver Act 2006 to give the Commissioner of Inland Revenue discretion to reallocate or make necessary refunds to members or employers from the KiwiSaver holding account, in circumstances when the monies cannot be passed on to the designated KiwiSaver scheme provider. It will apply in circumstances where the monies cannot be forwarded to the provider, because the member's account has closed.

Application date

The amendment will apply from the date of enactment.

Key features

The amendment will create a discretionary power for the Commissioner to efficiently refund a member's contributions to members, or to reallocate or refund overpayments of compulsory employer contributions to employers from the holding account.

Background

Section 72 of the KiwiSaver Act 2006 requires the Commissioner to establish the Inland Revenue KiwiSaver Holding Account into which contributions are received before being passed on to the designated KiwiSaver provider.

The KiwiSaver Act prescribes specific circumstances in which the Commissioner can refund monies in the holding account back to the member – for example, a refund can be made when:

- there is an invalid enrolment, which is not later validated (section 59D);
- the individual opts out following automatic enrolment (section 80); and
- the member makes an application on grounds of serious illness or significant financial hardship (section 113).

As KiwiSaver has become more established, the Commissioner is identifying other circumstances when funds should be repaid from the holding account.

Members’ refunds predominantly involve refunds following the member’s death. Upon notification of death the provider pays out to the estate and closes down the member’s account. This means that Inland Revenue cannot forward the funds from the holding account to the member’s provider. Other examples include administrative error or delays such as credits or interest appearing late in the holding account after a member has withdrawn funds following their emigration, and the provider has closed their account.

A further example is when overpayments of compulsory employer contributions occur, usually following a reassessment of an employer’s monthly return. Section 81(2) of the KiwiSaver Act specifically requires Inland Revenue to refund overpaid compulsory employer contributions (CECs) which are returned from the provider. However there is no specific provision for when the CECs have not been passed to the provider, but are still in the holding account. So the employer could face a delay in obtaining a refund or reallocation while the CECs are sent to, and then returned by, the provider.

PAYMENT OF MEMBER TAX CREDITS TO KIWISAVER PROVIDER WHEN MEMBER CHANGES PROVIDER

(Clause 26)

Summary of proposed amendment

The bill amends the Income Tax Act 2007 to clarify that the Commissioner of Inland Revenue may pay a member's tax credits directly to the member's new provider when the member is in the process of transferring or has recently transferred to the new provider. This ensures that the credits are available to the new fund for the member's benefit as quickly as possible.

Application date

The amendment will apply from the date of enactment.

Key features

When a member chooses to transfer to another KiwiSaver provider, the Commissioner receives an electronic transfer notice from the new provider. The amendment will ensure that any member tax credit amount that is due can be paid to the new provider, rather than to the member's previous provider who would then be obliged to transfer it to the member's new provider.

The amendment clarifies the present system of automatic electronic transfers between the Commissioner and providers to allow a more efficient process for both providers and members.

REWRITE ADVISORY PANEL AMENDMENTS

The following amendments reflect the recommendations of the Rewrite Advisory Panel following its consideration of submissions on the rewritten Income Tax Act. 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.

Application dates

Unless otherwise stated all the amendments will apply retrospectively, with effect from the beginning of the 2008–09 income year.

Disposal of petroleum mining assets to related parties

(Clauses 7 and 84)

Summary of proposed amendment

This amendment to section DT 9 of the Income Tax Act 2007 and the Income Tax Act 2004 addresses two drafting matters identified by the Rewrite Advisory Panel:

- an ambiguity, which under one interpretation would be an unintended change in outcome from the corresponding provisions of the 2004 Act; and
- an incorrect cross-reference.

Detailed analysis

Section DT 9 applies when a petroleum mining asset is disposed of by a petroleum miner to a related party, and unamortised development expenditure forms a part of the cost of the asset.

Under the petroleum mining rules, the full amount of development expenditure that is an allowable deduction is taken into account in calculating taxable income over a seven-year period, under an amortisation rule. However, if a petroleum mining asset is disposed of before the end of that seven-year amortisation period, the balance of the unamortised deduction for the development expenditure forming part of the cost of the asset is allocated to the year of sale.

However, if a petroleum mining asset is disposed of to a related party within the seven-year amortisation period, section DT 9 limits how much of the unamortised deduction for development expenditure can be allocated to the year of sale. That amount is limited to no more than the profit on the sale of the asset, to prevent a group of companies creating a deductible loss from the disposal of a petroleum mining asset to a related party.

The Panel concluded that the provisions of section DT 9 in the 2007 Act contained an ambiguity that could result in the petroleum miner selling the petroleum mining asset having a lower amount of deduction allocated to the year of disposal than would have occurred under the corresponding provisions of the Income Tax Act 1994.

Section DT 9 is being amended to restore the effect of the corresponding provisions in the 1994 Act.

As this amendment relates to both the 2007 and 2004 Acts, the amendment has retrospective effect to the beginning of the 2005–06 income year.

Thin capitalisation debt-equity ratio and concession for on-lending

(Clause 14)

Summary of proposed amendment

Section FE 12(1) of the Income Tax Act 2007 is being amended to ensure that a financial institution is able to utilise the on-lending concession in determining whether the thin capitalisation rules apply.

Detailed analysis

The Rewrite Advisory Panel considered that the on-lending concession in the thin capitalisation rules in the 2007 Act relating to the statutory debt equity ratio incorrectly applies only to natural persons.

Under the thin capitalisation rules, a company controlled by non-residents has its interest deductions reduced if the group debt levels exceed 75% of total group assets. However, a concession applies to allow financial institutions to borrow beyond the 75% threshold if borrowings are on-lent to either:

- a person who is not associated with the taxpayer; or
- a non-resident who also does not operate a business through a fixed establishment in New Zealand.

The concession treats borrowings by the entity as being first used in making advances to other entities. The effect of the rule is that the debt ratio is calculated against mainly fixed assets. In the 2004 Act, the on-lending concession applied to all classes of taxpayers, not just natural persons, as intimated in section FE 12(1).

Foreign tax credits and income with multiple sources

(Clause 23)

Summary of proposed amendment

Section LJ 1(2)(a) is being amended to permit a foreign tax credit to be available for foreign tax paid on income sourced outside New Zealand.

Detailed analysis

The Panel concluded that, in the 2007 Act, the foreign tax credit rule in section LJ 1(2) incorrectly prevents the New Zealand resident receiving a foreign tax credit for withholding tax paid in the country from which the dividends are paid.

Under section LC 1 of the 2004 Act, it was possible for one stream of income to be sourced in New Zealand and outside New Zealand, and if foreign tax was paid on that income, a foreign tax credit would be allowed.

An example where this may arise is in relation to a New Zealand resident with an investment business in New Zealand that receives dividends paid from a foreign company (as part of that investment business). Under the source rules (and associated case law) this dividend is:

- sourced in the country in which the company paying the dividend is resident; and
- sourced in New Zealand as the country in which the business is carried on.

Under the 2004 Act, despite the source rules providing that the dividend is sourced in two different countries, the foreign tax credit rules allowed a foreign tax credit for foreign tax paid on income derived from a country or territory outside New Zealand.

Section LJ 1(2)(a) will be amended to restore the effect of section LC 1 of the 2004 Act.

Foreign tax credits – calculation of New Zealand tax payable on foreign income

(Clause 24)

Summary of proposed amendment

Section LJ 5 of the 2007 Act is being amended to ensure that if the total of the maximum foreign tax credits calculated under section LJ 5(2) for each segment of foreign-sourced income exceeds a person's notional income tax liability:

- a pro-rating down of the maximum amount of foreign tax credit is required; and
- the pro-rating down ensures that deductions for expenditure incurred in deriving income in excess of that income are spread across all segments of income, wherever that income is sourced.

Detailed analysis

The Rewrite Advisory Panel agreed with a submission that the formula in section LJ 5(4) of the 2007 Act incorrectly takes into account deductions that are not attributable to any particular income source, resulting in an incorrect adjustment. However, the Panel considered this arose from a drafting error in a remedial amendment to section LJ 5(4), in 2009.

Section LJ 5(4), (4B) adjusts a person's foreign tax credit if the aggregate of New Zealand tax payable calculated under section LJ 5(2) for each amount of foreign income exceeds the taxpayer's notional income tax liability. This ensures that foreign tax credits cannot exceed the notional income tax liability and also that excess deductions incurred in deriving income are spread across all foreign tax credit calculations.

The amendments to section LJ 5 ensure that:

- The calculation, under section LJ 5(2), of the maximum foreign tax credit allowed for each segment of foreign-sourced income is explicitly placed on an income year approach.
- The result of the calculation in section LJ 5(2) cannot be a negative result.
- If the maximum amount of foreign tax credit calculated under section LJ 5(2) exceeds a person's notional income tax liability, the person must apply section LJ 5(4B) to adjust downward each maximum amount of foreign tax credit calculated.
- In the adjustment formula in section LJ 5(4B), the meaning of the parameter "New Zealand tax" is being amended in section LJ 5(4C) to:
  - include all segments of income, wherever sourced; and
  - exclude expenditure that does not satisfy the nexus test under section DA 1, for each segment of income (for example, a deduction under section DB 3 for expenditure incurred in preparing an income tax return).

Residence requirement for family scheme
(Clause 25)

Summary of proposed amendment

Section MC 5(2)(a) and (3) is being amended to clarify that the residence requirement is determined by the defined term "New Zealand resident".

Overpaid provisional tax transferred within a group and imputation
(Clause 27)

Summary of proposed amendment

Section OB 4 is being amended to clarify that an imputation credit arises for a company on the transfer of overpaid provisional tax by one company within a wholly owned group of companies to another company in the same group on the date the transfer is notified to the Commissioner.

Detailed analysis

Section MB 33 of the 2004 Act provided that when a company transfers the benefit of its overpaid provisional tax to another company in the same wholly owned group of companies, the transferring company receives a debit to its imputation credit account for the amount of the transferred tax, and the recipient company is treated as having paid the tax and receives a credit for the same amount.

Under the 2004 Act, the date of the debit and credit for this transfer of overpaid provisional tax within a wholly owned group of companies was the date the notice of the transfer was given to the Commissioner.

Section OB 4 is being amended to restore the effect of the 2004 Act in relation to the timing of an imputation credit arising for a company receiving the benefit of the transfer of overpaid provisional tax from another company in the same wholly owned group of companies.

Further income tax payable for debit balance in imputation credit account

(Clause 28)

Summary of proposed amendment

Section OB 67 is being amended to ensure that a debit balance of a company's imputation credit account at the end of one tax year, on which further income tax has already been paid, does not give rise to double taxation if the imputation credit account (ICA) also has a debit balance at the end of the next tax year.

Detailed analysis

The Rewrite Advisory Panel considered that section OB 67 of the 2007 Act contains an unintended change to the imputation rules, by allowing a company to incorrectly reduce the amount of the debit balance in the company ICA at the end of a tax year. This can result in a lower amount of further income tax being charged than under the corresponding provisions in the 2004 Act.

Under sections OB 65 and OB 66, further income tax is charged on the debit balance of a company's ICA at 31 March. If the ICA remains in debit throughout the next year, section ME 9(7)–(9) of the 2004 Act (which corresponds to section OB 67 of the 2007 Act) ensured that the first year's debit balance is not counted again at the end of the second year, resulting in double taxation through further income tax being paid on the same amount of debit balance.

The amendment restores the effect of section ME 9(7)–(9) of the 2004 Act.

BETA debit rules: sections OE 7, OE 8, OP 101 and OP 102

(Clauses 29 to 32)

Summary of proposed amendments

The amendments correct an unintended change in law in sections OE 8 and OP 102 of the Income Tax Act 2007 and clarify sections OE 7 and OP 101.

Application date

The amendments will apply from the beginning of the 2008–09 income year.

Key features

The amendments correct an unintended change in law relating to sections OE 7, OE 8, OP 101 and OP 102 of the Income Tax Act 2007 that apply to a company that elects to use branch equivalent tax account (BETA) debits to satisfy its income tax liability in relation to attributed controlled foreign company (CFC) income.

These provisions convert to a tax loss component, the amount of any unused portion of those BETA debits the company has elected to use to satisfy the income tax liability relating to attributed CFC income. This would occur where the company's actual income tax liability is less than the income tax liability calculated for that attributed CFC income because of, for example, domestic losses from current year transactions.

Minor drafting improvements are also being made to sections OE 7 and OP 101.

Background

An unintended change in law in sections OE 8 and OP 102 incorrectly provides for an automatic conversion to a tax loss component of the entire debit balance in a company's branch equivalent tax account.

Under the 2004 Act (section MF 5), a conversion of BETA debits to a tax loss component occurred only if all of the following requirements were met:

- a company has BETA debits available in its BETA account;
- that company (or a group company) has attributed income (CFC income) under the controlled foreign company rules;
- that taxpayer has elected for their BETA debits to be applied against the income tax liability of the company (or the group company's income tax liability); and
- the amount of the income tax liability relating to the CFC income is less than the amount of the BETA debits elected to be applied against that income tax liability.

Tracing of shareholder interests

(Clause 37)

Summary of proposed amendment

Section YC 11(3) is being amended to clarify that the market value interest referred to is the market value interest in the issuing company.

Detailed analysis

In the 2007 Act, a number of rules for two or more companies depend on whether there are the same ultimate shareholders of those companies. Examples of these rules include the loss carry-forward provisions and the loss grouping provisions, among many others. To determine who the ultimate shareholders of a company are, tracing rules look through a chain of companies interposed between the company of interest and the ultimate shareholders.

However, if the company holding the shares is a limited attribution company, that company is treated as the ultimate shareholder if:

- the shareholder company's voting interest or market value interest (without tracing to its shareholders) in the underlying company is less than 50%; or
- the shareholder company is not associated with the issuing company and has an interest of less than 10%.

As it is possible that section YC 11(3) may refer to more than one limited attribution company, the provision is being amended to clarify that the market value interest referred to in the section are the interests of the issuing company.

REMEDIAL AMENDMENT TO THIN CAPITALISATION RULES

(Clause 13(2))

Summary of proposed amendments

A remedial amendment is being made to a minimum threshold exemption in the thin capitalisation rules to ensure it operates as originally intended.

Application date

The amendment will apply from the date of introduction of the bill.

Key features

The proposed rule provides relief from interest denial when the total interest deductions of the New Zealand group, in the absence of the thin capitalisation rules, would be less than $2 million in the year. If the deductions would be less than $1 million, relief is total. If not, relief is only partial.

Example

There are two members in the New Zealand group, X Co and Y Co. X Co has a "total deduction" amount under section FE 6(3)(a) of $0.7 million and Y Co has a total deduction amount of $0.5 million.

The group finance cost is $1.2 million. Since this is between $1 million and $2 million, proposed subparagraph (iii) applies. $800,000 is the amount by which $2 million exceeds the group finance cost.

For XCo, the ratio of the member finance cost to the group finance cost is $0.7m ÷ $1.2m = 7/12. The amount "adjust" in the formula in section FE 6(2) is therefore 7/12 × $800,000 = $466,667. For YCo, "adjust" is $333,333.

Background

The exemption, enacted in 2009, applies to taxpayers with less than $2 million of interest deductions. It replaced another, less generous exemption that was proposed in 2008 (and never enacted). The originally proposed exemption was to apply to the entire group of a New Zealand-based multinational, with a hard limit – groups below the limit would have no interest denial, while groups above would have no relief from denial.

The enacted exemption, in contrast, had a soft limit. Taxpayers with less than $1 million of deductions would have no interest denied under the thin capitalisation rules, but taxpayers with deductions between $1 million and $2 million would have partial relief from denial. This abating treatment required a different legislative approach, and in particular required incorporating the relief into the core thin capitalisation calculation.

An unintended consequence of this different approach was that the threshold applied to individual taxpayers rather than entire groups. This poses significant risks to the tax base, prompting the proposed change in this bill.