Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill

Commentary on the Bill

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Minister of Revenue

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SIMPLIFYING FILING REQUIREMENTS

OVERVIEW

(Clauses 15, 60, 74, 87, 88(11) and (12), 100(2), (5) and (6), 101, 102, 103(2) and (3), 104, 106, 107, 108, 109, 110, 111, 112, 114, 115, 116, 117, 120, 121, 123, 124, 125, 126, 127, 128 and 129)

In June 2010, the Government released the discussion document and online consultation forum *Making tax easier*. The intention of the proposed changes was to support the Government's goal of a tax system that supports innovation and growth, without imposing unnecessary compliance costs upon taxpayers. With this in mind, the discussion document and forum outlined several proposals to reform the way tax is administered. The key proposals were to:

- reduce the use of paper forms in administering the tax system and increase online services and technology, including a proposal to mandate the use of electronic services;
- reform the PAYE and personal tax summary process, including a proposal to make PAYE a final tax for many taxpayers; and
- introduce a new framework for sharing information, where appropriate and with safeguards, with other government agencies.

While generally supportive of the overall objective to make tax administration more efficient by making greater use of online services, submissions were not supportive of the proposals to mandate their use, or of the proposal to make PAYE a final tax.

The proposed changes in the bill take into account the views expressed by submitters, while still aiming to achieve the Government's goals for an efficient, innovative tax system. The proposals include:

- requiring taxpayers who choose to file a tax return to file tax returns for the previous four years as well as for the current year;
- removing the requirement for taxpayers to file an income tax return merely because they receive Working for Families;
- amalgamating the two main income tax return forms (the PTS and the IR 3 forms);
- allowing the Commissioner of Inland Revenue to authorise data storage providers to store their clients' tax records offshore, and being able to revoke any such authorisation; and
- allowing taxpayers who submit their returns electronically to store them electronically.

Overall, these proposals should reduce compliance costs for businesses and individuals, while helping Inland Revenue to achieve its goal of delivering the bulk of its services online in the future. The proposals will also be supplemented by an internal strategy aimed at moving taxpayers to electronic services.

As part of Inland Revenue's drive for greater efficiency across Government, the new information-sharing framework raised in the discussion document *Making tax easier* was included in the recently enacted Taxation (Tax Administration and Remedial Matters) Act 2011.

AMALGAMATING INCOME TAX RETURN FORMS

(Clauses 15, 60, 74, 87, 88(11) and (12)(a)(i), 100(2), (5) and (6), 101, 102, 106, 107, 108, 109, 112, 114, 115−117, 121 and 123−129)

Summary of proposed amendment

The bill contains several clauses which will remove the distinctions between the two major income tax returns currently available for individual taxpayers to file – either a personal tax summary or an IR 3 income tax return. The result will be that the forms are effectively "amalgamated" and replaced with one income tax return form making the process simpler for taxpayers and Inland Revenue to deal with.

Application date

This amendment will apply for the 2014−15 and later tax years.

Key features

The two forms currently used by individual taxpayers will be replaced with a customised, web-based income tax return form. This will operate over a secure connection and will require taxpayers to answer questions about their income and expenses. Where possible, details will be pre-populated with information already held by Inland Revenue. Paper forms will be available only in limited circumstances.

In order to deliver a simpler income tax return for individual taxpayers, the distinction between the two income tax returns will be removed.

The proposed change is a significant step towards achieving Inland Revenue's goal of delivering the major part of its services to taxpayers online.

Background

Tax simplification changes made in the 1999−2000 tax year introduced income statements into the tax Acts and the administration of individual filing requirements. Commonly referred to as personal tax summaries, they were designed for taxpayers who received the majority of their income from sources that had tax withheld, such as salaries and wages. They are pre-populated with any salary and wage information that Inland Revenue has about the individual.

In addition to income statements, taxpayers with additional income that is not taxed at source must file an IR 3 income tax return, which is longer and more detailed than a personal tax summary.

Many taxpayers have found the distinction between the two forms confusing, and identifying which form a taxpayer should file has, in the past, been resource-intensive for Inland Revenue.

Delivering tax returns through online services provides an opportunity for Inland Revenue to ask taxpayers about all of their income, instead of restricting it to the types of income information it has on record. In this way, tax returns can be tailored to individual requirements, and be as comprehensive or as simple as necessary.

This policy change requires the repeal of Part 3A of the Tax Administration Act 1994. This part was originally inserted in 1998 and is specific to the income statement process of tax filing. With the proposed amalgamation of the tax return forms, the rules in Part 3A around the issuing, receipt, details and processes of income statements are no longer necessary.

References to income statements throughout the Tax Administration Act 1994 and the Income Tax Act 2007 will also be removed.

To retain flexibility, the Commissioner will have the power under new section 92AC to make an income tax assessment for any person.

The application date of the 2014–15 and later tax years has been chosen to allow sufficient time for implementation of the changes in Inland Revenue systems.

Officials have taken this as an opportunity to re-write section 33A of the Tax Administration Act 1994 – as new section 33AA. This provision is based on the premise in section 33 that all taxpayers must file, and sets out who is not required to file. It has been substantially altered since it was first enacted, so it has been re-written to make it more comprehensible.

REQUIRING TAXPAYERS WHO ELECT TO FILE TAX RETURNS TO FILE ACROSS THE PREVIOUS FOUR YEARS

(Clauses 88(12)(a)(ii), 106 and 108)

Summary of proposed amendment

The proposed amendment will require taxpayers who are not required to file tax returns, but who choose to do so anyway, to file for the previous four tax years, in addition to the year in which they have chosen to file.

Application date

The "four year rule" proposal will have a phased application. It will apply for the 2014−15 and later tax years. Under this phased approach, taxpayers covered by the proposed amendment who elect to file on or after 1 April 2015 would file for the 2014−15 tax year and would square up only for that year.

However, taxpayers covered by the proposed rule who choose to file for the 2015−16 tax year would also be required to file for the 2014−15 tax year if they had not already done so.

It is proposed that the application would continue in this manner until it is fully phased in by 2019. For the 2018−19 tax year, taxpayers covered by the proposed policy who choose to file for that year, would be required to also file for the previous four tax years (2014−15, 2015−16, 2016−17 and 2017−18), if they have not already filed for those years.

Key features

The four-year rule is intended to apply to taxpayers who are not required to file a return of income under the proposed new section 33AA of the Tax Administration Act 1994. Under the proposed rule, when taxpayers in this category of non-compulsory filers choose to file a return, they will be required to file returns for the previous four years, in addition to the year in which they have chosen to file. Taxpayers will still be able to check their overall tax position for the back years before filing their returns, as is the current practice.

This rule is also intended to be phased into application over four years.

Background

Currently, taxpayers who are not required to file a tax return, or be issued one by the Commissioner, can choose to have an assessment anyway.

Over recent years, there has been a significant increase in the number of taxpayers in this category choosing to have an assessment. For the 2004 tax year, approximately 200,000 taxpayers chose to submit a return, spread over 60 months. By 2007, the

volume of taxpayer-requested tax filing reached 200,000 tax returns in just seven months.

This increase has been driven in part by an increased awareness of the ability for taxpayers to “cherry pick” the years in which they are due a refund of over-deducted PAYE withholding payments and then file in those years only. In the majority of cases they choose to not file in years when PAYE has been under-deducted.

The net result to the Crown revenue is that Inland Revenue is paying out significant amounts of over-deducted PAYE, without collecting amounts of under-paid PAYE.

The policy proposal to address this problem is to require taxpayers who are in the category of non-compulsory filers, and who choose to have an assessment, to file across the previous four tax years, with any over-deductions of PAYE potentially being offset by any under-deductions.

The proposal does not prevent taxpayers from seeking refunds of overpaid tax, but introduces more fairness into the system than currently exists.

REMOVING THE REQUIREMENT TO FILE A TAX RETURN FOR TAXPAYERS WHO RECEIVE WORKING FOR FAMILIES TAX CREDITS

(Clauses 88(12)(a)(i), 106, 108, 109, 111 and 120)

Summary of proposed amendment

Currently, taxpayers who receive Working for Families tax credits are required to file an income tax return or receive a personal tax summary. This requirement also extends to a recipient's spouse or civil union or de facto partner. The proposed amendment will remove this requirement for Working for Families recipients who are not otherwise required by law to file an income tax return.

Application date

This amendment will apply for the 2014−15 and later tax years.

Key features

Under the proposed amendment, a Working for Families recipient (and their spouse, civil union or de facto partner) will no longer be required to file an annual tax return, if they are not otherwise required by law to file. They will, however, still be required to provide family scheme income information and family details to square up their Working for Families entitlement against their actual circumstances each year.

It is estimated that the proposed amendment will remove the compliance cost of annual income tax return filing for 260,000 taxpayers.

Background

The key information that Inland Revenue needs to determine a family's entitlement to Working for Families tax credits is a recipient's family scheme income, and family details (such as the details of the children in their care). In the past, some of this information has been obtained by requiring recipients to file tax returns or receive a personal tax summary. This in turn has contributed to large numbers of taxpayers filing or receiving annual tax returns.

Requiring this group to file an annual tax return to assess their annual income tax liability merely because they receive Working for Families is unnecessary. The amount of PAYE that has been withheld from recipients' salary and wages is not needed to determine their entitlement to the tax credits.

Depending on the source of their family income, some taxpayers will still be required to file an annual income tax return. Others will be able to file if they choose to. However, if they are not otherwise required by law to file a tax return, they will be subject to the new four-year rule.

SIMPLIFYING RECORD-KEEPING REQUIREMENTS FOR BUSINESSES

(Clauses 103(2) and (3), 104 and 110)

Summary of proposed amendments

The bill contains amendments to modernise the record-keeping requirements of businesses by making it easier for taxpayers to store records offshore through applications from their data storage providers, and by allowing taxpayers who submit returns electronically to store them electronically.

Application date

The amendments will apply from the date of enactment.

Key features

Generally, taxpayers are required to store their records in New Zealand. As taxpayers are increasingly managing their tax obligations through their payroll or accounting software, the use of offshore data storage for information, records and returns is growing. While the Commissioner of Inland Revenue can authorise taxpayers to store their records offshore, applications can only be made individually. A proposed amendment will change who can apply, so that Inland Revenue-approved data storage providers can apply on behalf of their clients. This will make it easier for taxpayers to store their data offshore, if they choose. The Commissioner will also be able to revoke an authorisation.

A further amendment proposes to allow taxpayers to submit and store tax returns electronically, thereby removing the current requirement to retain a hard copy.

Background

The proposed amendments have been developed to make it easier for taxpayers to conduct their tax compliance activities electronically, and to help Inland Revenue deliver the bulk of its services online.

Inland Revenue will provide administrative criteria for the authorisation, which will outline the standards required of data storage providers. The principle for these proposals and for the criteria is that there should be no greater obligation on data storage providers than currently exists for the storing of business records in any other format, so long as the Commissioner’s access to those records is not unnecessarily compromised.

TAX TREATMENT OF PROFIT DISTRIBUTION PLANS

TAX TREATMENT OF PROFIT DISTRIBUTION PLANS

(Clauses 6−10, 82, 83, 85, 88 and 108)

Summary of proposed amendment

The tax treatment of profit distribution plans (PDPs) is being amended so that shares issued under a PDP will be treated as a taxable dividend. This will mean PDPs are given the same tax treatment as other similar arrangements.

Application date

The amendments will apply to shares that are issued under PDPs from 1 July 2012.

Background

A PDP is a scheme used by companies to retain capital. Under a PDP a company issues bonus shares to all shareholders and offers to repurchase the shares immediately after the shareholder receives them. If the shareholder does not elect for the company to repurchase some or all of their bonus shares, the default option is for the shareholder to retain the bonus shares.

The current tax treatment of PDPs was the subject of a specific Inland Revenue product ruling in 2005 (BR PRD 05/08). The ruling held that, subject to certain conditions, a distribution of shares under a PDP is treated as a non-taxable bonus issue and consequently does not constitute a dividend in the hands of the shareholder. If shareholders elect for their shares to be repurchased, the cash amount they receive is treated as a taxable dividend and imputation credits can be attached.

In April 2009, the Government announced its intention to amend the law to ensure that bonus issues of shares distributed under PDPs are taxed in the same way as shares issued under other dividend reinvestment plans.

In June 2009, officials released the consultative issues paper, *The taxation of distributions from profit distribution plans*. The issues paper proposed that a distribution of shares under a PDP should be treated as a taxable dividend.

The key concerns that the Government has with the tax treatment of PDPs are:

Inconsistent tax treatment with other arrangements

There are other arrangements that are substantially similar to PDPs. For example, under both a dividend reinvestment plan and a bonus issue in lieu, shareholders are effectively given the choice of whether to receive shares or a cash dividend. Under these plans, regardless of whether shareholders receive shares or a cash dividend, they are treated as

receiving a taxable dividend. To ensure consistency and coherence in the tax system, a similar tax treatment should be afforded to PDPs. While accepting that the legal form of each plan differs, in substance they are the same and can be used as a means to retain capital in a company.

Potential for imputation credit streaming

The current tax treatment of PDPs effectively allows for streaming of imputation credits through a shareholder self-selection process. This can occur when shareholders elect for the company to repurchase their bonus shares depending on whether or not they can utilise imputation credits that would be attached to a cash dividend. Shareholders that are unable to utilise imputation credits (for example, exempt or non-resident taxpayers) may elect to receive bonus shares that are non-taxable. As the bonus shares are non-taxable, imputation credits will not be attached, preserving the credits for shareholders who can best use them. This defeats the current policy settings that are in place for the imputation system.

Shareholders may not be taxed at their correct tax rate

PDPs are attractive to shareholders on high personal tax rates, relative to alternative share reinvestment plans. This is because high-rate shareholders are able to choose to receive the non-taxable bonus issue of shares, meaning they are effectively taxed at the company tax rate, rather than at their personal tax rates. By contrast, New Zealand taxpayers on personal tax rates below the company tax rate will tend to prefer the cash dividend because the imputation credits attached to it will generally reduce their tax liabilities.

The Government deferred its final decisions on the taxation of distributions from PDPs until after the Victoria University Tax Working Group (TWG) and the Capital Market Development Taskforce (the Taskforce) reported.

While the TWG did not comment on PDPs, the Taskforce stated that it:

> *…considers it important that the tax system treats substitutable transactions neutrally. If PDPs are substitutable for ordinary dividend payments with optional reinvestment, the tax treatment should ideally be identical in both cases. The same goes for other close substitutes. Otherwise, there is a danger that investment decisions will be biased towards companies that offer PDPs, and that there could be significant loss of tax revenue from normal dividend taxation.*
>
> *At the same time, the Taskforce considers it desirable that the tax system does not impede the supply of capital. A decision on the tax treatment of PDPs should, therefore, take into account the fact that PDPs are an effective way for companies to raise capital.*
>
> <u>*Recommendation:*</u> *We recommend that changes to the tax treatment of PDPs should be made as part of a broader review of tax settings and take into account any adverse impacts on capital-raising costs.*

Following the Taskforce's report, the Government decided that the tax treatment of PDPs should be amended as originally proposed. Consultative draft provisions were

sent to interested parties in May 2011, and the feedback received on the drafting has been taken into account in determining the changes made in this bill.

Detailed analysis

A definition of "profit distribution plan" is being inserted into the Income Tax Act 2007. In addition, amendments are being made to ensure that, for tax purposes, bonus shares issued under a PDP are treated in the same way as a bonus issue in lieu. These amendments include changes to the rules for available subscribed capital, resident withholding tax and non-resident withholding tax.

If a shareholder elects, as part of the PDP, for the company to repurchase their shares, the cash amount they receive will not be treated as a taxable dividend, but rather the receipt of the bonus shares will be treated as a taxable bonus issue. This is to prevent double taxation.

Amendment to the tax treatment of bonus issues in lieu

The tax treatment of bonus issues in lieu is being amended so that the amount of a dividend is the money or money's worth offered as an alternative. Previously, resident withholding tax was required to be deducted from the alternative amount. The new tax treatment is not expected to have any significant effects to the tax treatment of bonus issues in lieu, but is intended to make the tax treatment simpler.

For the purposes of a PDP, the amount of the dividend will similarly be the amount offered by the company for the repurchase of the share.

Remedial amendment to filing requirements

A minor amendment is being made to the current filing requirements for natural person taxpayers. This change is necessary to reflect changes in the personal tax rates.

TAX TREATMENT OF UNSUCCESSFUL SOFTWARE DEVELOPMENT

TAX TREATMENT OF EXPENDITURE ON UNSUCCESSFUL SOFTWARE DEVELOPMENT

(Clauses 17 and 163)

Summary of proposed amendment

The proposed amendment allows an immediate deduction for expenditure incurred on unsuccessful software development projects in the year that the development is abandoned.

Application date

The amendment applies for the 2007−08 and later income years. The application date is retrospective to give certainty to taxpayers who have previously relied upon a 1993 Inland Revenue policy statement to claim a deduction for the costs of unsuccessful software development.

Key features

The amendments allow a deduction when a person incurs expenditure on developing software for use in their business and the development of this software is abandoned.

The person is allowed a deduction for the expenditure incurred in the development of the software if no other deduction has been allowed for the expenditure under New Zealand legislation.

The deduction will be allowed in the income year that the software development project is abandoned.

Background

On 4 April 2011 the Commissioner of Inland Revenue issued a general notice advising taxpayers that they should not rely on certain parts of a 1993 policy statement, "Income tax treatment of computer software". The statement indicated that capital expenditure incurred on developing unsuccessful software qualifies for an immediate tax deduction. The 2011 general notice indicated that this is no longer the Commissioner's view of the law and it should not be relied upon. It advised, therefore, that this part of the 1993 statement should be treated as being withdrawn from the beginning of the 2011−12 income year.

As a consequence of the Commissioner's revised view of the law, it is possible that some expenditure on unsuccessful software development may never be deductible (either immediately or over time). The non-deductibility of unsuccessful capital expenditure would be an example of so-called "blackhole" expenditure. This raises a policy concern because disallowing a deduction for such expenditure could discourage firms from undertaking otherwise sensible investment.

The changes proposed in the bill will give taxpayers greater certainty over the tax treatment of the costs of unsuccessful software development.

KiwiSaver measures

KIWISAVER EMPLOYEE AND EMPLOYER CONTRIBUTION RATES

(Clauses 96, 154, 157 and 159)

Summary of proposed amendment

The bill amends the KiwiSaver Act 2006 and the Income Tax Act 2007 to increase the default and minimum employee contribution rates for KiwiSaver and complying superannuation funds from 2% to 3% of an employee's gross salary or wages.

The bill also increases the compulsory employer contribution rate from 2% to 3% of gross salary or wages.

Application date

The new employee and employer contribution rates will apply from 1 April 2013.

Key features

The minimum employee contribution rate is being increased from 2% to 3% of gross salary or wages from 1 April 2013. The increased rate automatically applies to all employees who have been contributing at a 2% rate to a KiwiSaver scheme or a complying superannuation fund.

The default contribution rate for KiwiSaver members who do not select a rate also increases from 2% to 3% of gross salary or wages from 1 April 2013.

The rate at which compulsory employer contributions are made will increase from 2% to 3% of gross salary or wages, from 1 April 2013.

A provision is included in the bill to protect providers from potential non-compliance with securities enactments in relation to their prospectuses and investment statements following these contribution rate changes. This gives providers time to revise their prospectuses and investment statements to reflect the new rates.

Background

The Government announced changes in Budget 2011 that will see KiwiSaver funds continue to grow, but with a larger share of contributions coming from members and employers, through increased contribution rates, and a lower share from the Government.

Employees who are enrolled in KiwiSaver must pay employee contributions, unless they have taken a contributions holiday. Currently, employee contributions are deducted from salary or wages at a rate of 2%, 4% or 8% of gross salary or wages.

The minimum deduction rate of 2% is increasing to 3% from 1 April 2013. Employees contributing at higher rates (4% or 8%) will be unaffected by the change.

The default contribution rate applies to employees who are automatically enrolled into KiwiSaver when they start new employment, unless they select their own contribution rate. This is the same as the minimum contribution rate, and so will increase to 3% from 1 April 2013.

An employer must pay KiwiSaver employer superannuation contributions for an employee for whom they are required to deduct personal contributions from the employee's salary or wages. This contribution rate will increase from 2% to 3% of gross salary or wages, from 1 April 2013.

The new contribution rates apply to employer contributions made for, or employee contributions deducted from, an employee's first payment of salary of wages for a pay period that starts on or after 1 April 2013.

CONSOLIDATION OF INTEREST PAYMENTS FOR KIWISAVER CONTRIBUTIONS HELD BY INLAND REVENUE

(Clause 156)

Summary of proposed amendment

The bill amends the KiwiSaver Act 2006 to enable the Commissioner of Inland Revenue to consolidate and pay interest due on employee and employer contributions for the period they are in the KiwiSaver holding account, on a periodic basis.

Application date

The amendment will apply from the date of enactment.

Key features

The amendment will allow the Commissioner to consolidate interest due on employee and employer contributions for the period they are in the KiwiSaver holding account, and credit it to members on a periodic basis − for example, weekly, monthly or quarterly. The maximum period over which interest may be consolidated is three months.

The amendment applies from the date of enactment. However, it is likely to take a few months following enactment for Inland Revenue to make the necessary IT changes to credit this interest on a periodic basis.

The amendment does not affect the method of calculation of interest due; this will still be computed on a daily basis.

Background

Section 72 of the KiwiSaver Act 2006 requires the Commissioner to establish the Inland Revenue KiwiSaver Holding Account into which employee and employer contributions are received before being passed on to the provider. The Commissioner pays interest on contributions that are held by Inland Revenue until they are forwarded to the member's KiwiSaver scheme.

For the purposes of computing the interest due, employee contributions are treated as received by Inland Revenue on the 15th day of the month in which the deduction is made by the employer. Employer contributions are treated as received on the first day of the month in which the money is actually received by Inland Revenue.

Section 88 of the KiwiSaver Act 2006 provides that interest must be credited to the member's account and then on-paid to their provider at the same time as the amount of the employee or employer contribution is on-paid. This can create lots of small regular credits, many for a few cents, especially if contributions are credited to members'

accounts in several stages. This creates a large volume of low-value transactions, using IT functional and storage capacity and lots of small entries on members' statements.

CROWN GUARANTEE OF EMPLOYEE CONTRIBUTIONS TO KIWISAVER

(Clause 155)

Summary of proposed amendment

The bill amends the KiwiSaver Act 2006 to enable the Commissioner to operate the Crown guarantee of employee contributions in cases where he has sufficient evidence that the employee has incurred a deduction from their salary or wages, but the employer has not filed an employer monthly schedule (EMS).

Application date

The amendment will apply from the date of enactment.

Key features

The amendment will allow the Commissioner to use the Crown guarantee to pay an employee's contributions to their KiwiSaver provider when the employer has not filed an EMS, but there is other evidence that the contributions were deducted from their salary or wages.

The employer's obligation to file an EMS showing these contributions, or to pay the amounts due to the Commissioner, is unaffected by this amendment.

Background

Section 78 of the KiwiSaver Act provides that an employee's KiwiSaver deductions are guaranteed by the Crown, if the Commissioner is satisfied that the employer has taken the deduction from the employee's salary or wages and the employer has filed an EMS.

The purpose of the Crown guarantee is to ensure that the full amount of the employee's deduction is always forwarded to their provider, even when their employer has not forwarded the money to Inland Revenue.

Under the current legislation, the Commissioner can only use the Crown guarantee when the deduction is shown on the employer monthly schedule (EMS). This leads to difficulties and delays if the employer does not file an EMS. Even if an employee is able to provide satisfactory evidence that the contributions were deducted from their wages − for example, a payslip or payroll printout − without the EMS the Crown guarantee technically cannot be used. This is not consistent with the original policy intent.

WORKING FOR FAMILIES

FAMILY SCHEME INCOME AND WITHDRAWALS FROM KIWISAVER

(Clause 61)

Summary of proposed amendment

The bill amends the Income Tax Act 2007 to ensure that a withdrawal made from KiwiSaver after the member has reached the date of entitlement to withdraw is not regarded as family scheme income of the individual under the Working for Families (WFF) tax credits rules.

The amendment also applies to earlier withdrawals made under the KiwiSaver first home purchase, significant financial hardship and serious illness rules, and to withdrawals from complying superannuation funds.

Application date

The amendment will apply from 1 July 2007, the date when KiwiSaver started.

Key features

Section MB 5 of the Income Tax Act 2007 is being amended to ensure that if an individual makes a withdrawal from their KiwiSaver fund under first home purchase, significant financial hardship and serious illness rules, or after the "end payment date", this will not be counted as family scheme income.

The amendment will also apply to withdrawals made from complying superannuation funds.

Background

Section MB 5 of the Income Tax Act 2007 contains a provision to address situations when a person's income for WFF tax credit entitlement purposes is apparently reduced by channelling income through a superannuation scheme. This rule means that the distributions received are counted as the individual's family scheme income (to the extent that the distribution does not consist of amounts that the individual contributed themselves).

Section MB 5 applies if an individual receives a distribution from the superannuation scheme in an income year and:

- the employer of the individual has made contributions to that superannuation scheme, either in the current income year or in either of the previous two income years; and
- the individual continues to work for that employer for at least one month after receiving the distribution; and

- the distribution was not a result of their retirement from employment with that employer.

The KiwiSaver rules in Schedule 1 of the KiwiSaver Act 2006 govern when members may withdraw their funds. The general rule permits withdrawal on or after the KiwiSaver "end payment date", which is the later of the date that the member reaches the NZ superannuation qualification age (currently 65) or five years from the date of joining KiwiSaver (or a complying superannuation fund).

KiwiSaver schemes must allow withdrawals before the "end payment date" for certain purposes; including:

- first home purchase;
- significant financial hardship; and
- serious illness.

A withdrawal from KiwiSaver (or a complying superannuation fund) is regarded as a distribution from a superannuation scheme. This means that the amounts withdrawn under these KiwiSaver provisions could be included as part of an individual's family scheme income if the individual continues to work for their employer after making the withdrawal, and their employer has made employer contributions to KiwiSaver in the current or previous two income years. This outcome is inconsistent with the original policy intention.

IN-WORK TAX CREDIT AND MAJOR SHAREHOLDER EMPLOYEES OF A CLOSE COMPANY

(Clauses 65(2) and (3) and 66)

Summary of proposed amendment

The bill amends the requirements for the in-work tax credit to allow a major shareholder employed by their close company to meet the requirement of a full-time earner, regardless of whether they receive wages or a shareholder salary. A major shareholder employed full-time in a close company will qualify for the in-work tax credit if:

- they meet all other requirements for the in-work tax credit such as age, residence and care of a dependent child;
- they meet the work hours requirement of the definition of a full-time earner in relation to the close company; and
- the company derives gross income in the income year.

Application date

The amendment will apply from 1 April 2012.

Key features

Section MD 9 of the Income Tax Act 2007 is being amended to allow a major shareholder employed in a close company to meet the full-time earner requirement for the in-work tax credit. A major shareholder who is a full-time earner in relation to a close company will not have to meet the requirement to derive income as set out in section MD 9(2). Instead, the close company they are a major shareholder in and work for must derive gross income in the income year.

The person will still be required to meet all the other requirements for the in-work tax credit as set out in sections MD 5 to MD 8 relating to age, care of a dependent child, residence and not receiving a benefit. The person will also be required to meet the required hours of full-time earner as set out in section MA 7. A full-time earner is a person who is normally employed for at least 20 hours a week, if they are a sole parent, or at least 30 hours a week in combination with a spouse, civil union or de facto partner.

The terms "major shareholder" and "close company" are defined in section YA 1. A major shareholder is a person who owns, or has the right to acquire, or power to control, at least 10 percent of the ordinary shares or voting rights, or control of the company. A close company means a company in which five or fewer natural persons hold more than 50 percent of the interests; or if a market value circumstance exists, five or fewer natural persons hold more than 50 percent of the market value interests. All natural persons associated at the time are treated as one natural person.

Consequential amendments are being made to section MD 10, which relates to the calculation of the in-work tax credit.

Background

Some shareholder-employees work full-time for their company but are unpaid for their work effort because, for example, the company has made a loss for that year and has restricted cashflow. This could occur in start-up companies, for example. Under the current full-time earner requirements, the shareholder employee would not qualify for the in-work tax credit as they did not derive income as set out in subsection MD 9(2). Other business owners, such as partners in a partnership or a sole trader, in the same situation do qualify for the in-work tax credit as they earn income from a business, even if the business makes an overall loss, as long as the business derives gross income.

The Income Tax Act 2007 contains a provision to restrict opportunities for major shareholders in a close company to inflate their entitlement to Working for Families tax credits. The net income of the close company (less any dividends paid to the major shareholder) is attributed to a major shareholder in proportion to their interest in the close company under section MB 4. This attributed income counts towards the person's family scheme income used for abating any Working for Family tax credits. In contrast, the attributed income does not apply for the purposes of the full-time earner requirement for the in-work tax credit under section MD 9.

IN-WORK TAX CREDIT AND ACC SURVIVOR SPOUSE PAYMENTS

(Clauses 59 and 65(1))

Summary of proposed amendment

This remedial amendment removes the requirement for a person to be receiving income from a work activity from the requirements of a full-time earner in section MD 9 of the Income Tax Act 2007. This amendment will clarify that a person who is receiving ACC payments as a surviving spouse or partner of a deceased claimant is entitled to receive the in-work tax credit if the deceased claimant would have qualified before the accident causing death.

Application date

The amendment will apply from 1 April 2008.

Key features

Section MA 7, which defines "a full-time earner", is being amended to provide that a person receiving ACC weekly compensation as a surviving spouse or partner of a deceased claimant is treated as being employed, during the week in which compensation is paid, for the number of hours that the deceased claimant would have been employed previously but for their accident causing death.

Section MD 9, which contains the full-time earner requirements to qualify for an in-work tax credit, is being amended to remove the requirement for the full-time earner to be receiving income directly from a "work activity". This will allow a surviving spouse to meet the requirements of the section if they derive income as set out in section MD 9(2), which includes ACC weekly compensation payments.

These changes are consistent with the intended policy outcome. The regulation on this issue was clearer before the Income Tax Act 2007, which is why the clarifying amendment applies from 1 April 2008, being the commencement date of that Act. A person receiving ACC weekly compensation, including a surviving spouse of a deceased claimant, should continue to receive the in-work tax credit the family previously qualified for, when the person or their spouse is no longer able to work due to incapacity.

Background

A person can receive weekly compensation as a surviving spouse or partner of a deceased claimant under clause 66 of schedule 1 of the Accident Compensation Act 2001. While there is a provision in section MA 7(2)(b) for a person who is incapacitated to be deemed to still be employed, it is not clear that it applies when a person is a surviving spouse.

Furthermore, the wording in section MD 9 requires a person to be receiving income from a work activity and deriving income or compensation as set out in section MD 9(2), (3) and (4). While an injured person receiving weekly compensation would meet this requirement, it is unclear that a surviving spouse would qualify as the weekly compensation they receive is not from their work activity but from the deceased spouse's work activity.

FOSTER CARE ALLOWANCES AND FAMILY SCHEME INCOME "OTHER PAYMENTS" CATEGORY

(Clause 62)

Summary of proposed amendment

The bill amends the "other payments" category in the definition of "family scheme income" so that foster care allowances made under the Children, Young Persons and Their Families Act 1989 are excluded from family scheme income. This definition of income is used for Working for Families (WFF) tax credits and some community services card purposes, and will be used for the parental income test for student allowance purposes from next year.

Application date

The amendment will apply from 1 April 2011.

Key features

Foster care allowances made under the Children, Young Persons and Their Families Act 1989 will be excluded from the "other payments" category in the family scheme income definition. Excluding foster care allowances from family scheme income is consistent with the treatment of orphans and unsupported child benefits, and reflects current policy.

Background

Caregivers who receive orphans and unsupported child benefits and foster care allowances are not entitled to claim the family tax credit relating to the child for whom the benefit is received, but are eligible for the in-work tax credit relating to that child. Both benefits and allowances are exempt from income tax.

Foster care allowances from Child, Youth and Family help to reimburse caregivers for the day-to-day costs of fostering a child. These allowances are intended to cover the costs of board, personal items such as clothes and pocket money. The amounts vary according to the child's age and specific special needs. Foster care allowances are made under the Children, Young Persons and Their Families Act 1989 and fall under the "other payments" definition, as a payment to the caregiver used to meet usual family living expenses.

In contrast, orphans and unsupported child benefits from Work and Income, which are similar to the foster care allowances, are specifically excluded from the "other payments" category, as these payments are made under the Social Security Act 1964.

GST CHANGES

GST-APPLICATION OF THE DEFINITION OF "LAND" TO LEASES

(Clause 135)

Summary of proposed amendment

The GST legislation is to be amended to clarify the application of the exclusion of "commercial leases" from the definition of "land" so that an assignment of a commercial lease will not be covered by the exclusion.

Application date

The amendment will apply from 1 April 2011.

Key features

Under the current GST legislation, the definition of "land" excludes commercial leases which do not involve a large proportion (more than 25%) of consideration being paid at any one time.

There has been some uncertainty about whether assignments of leases are covered by the exclusion. Consequently, the bill clarifies that a transfer of a lease does not exclude the lease from the definition of "land" for GST purposes.

Background

To prevent "phoenix" fraud transactions, the Taxation (GST and Remedial Matters) Act 2010 introduced rules that require supplies between registered persons that involve land to be charged at the rate of 0%. To reduce any uncertainty regarding which transactions must be treated as involving "land", and to ensure that most land-related supplies that could give rise to "phoenix" fraud concerns are zero-rated, the Goods and Services Tax Act 1985 was amended to include a new definition of "land".

An assignment of a lease involves an assignee paying for the right to take over the lease. Therefore, this type of transaction could potentially be used for "phoenix" fraud purposes. As such, it is important that assignments of leases are covered by the definition of "land" and are subject to the zero-rating rules.

TREATMENT OF SERVICES ACQUIRED BY A PURCHASER

(Clause 141(2))

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to clarify that the purchaser of goods and services zero-rated under section 11(1)(mb) must account for output tax on any non-taxable use of the services acquired as part of the wider supply.

Application date

The amendment will apply from 1 April 2011.

Key features

Section 20(3J)(iii) of the GST Act is being amended to require purchasers to account for output tax on any non-taxable use of services.

Background

The Taxation (GST and Remedial Matters) Act 2010 made a number of changes to the GST Act, strengthening the rules in order to prevent "phoenix" fraud schemes by requiring vendors to zero-rate certain transactions that involve land. If land forms part of a wider supply and the zero-rating rules apply, the whole supply rather than just the land component of the supply is zero-rated.

To ensure that any non-taxable use of a zero-rated acquisition is accounted for by the purchaser, section 20(3J) requires the purchaser of zero-rated goods to account for output tax on any non-taxable use of the goods. The legislation, however, fails to state that the purchaser must also account for output tax on any non-taxable use of the services acquired as part of a wider supply.

INFORMATION REQUIREMENTS IN SECTION 78F

(Clause 152(1) and (2))

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to clarify that when a contractual purchaser in a land transaction nominates another person to receive the land, the contractual purchaser may provide information to the supplier as required by section 78F in relation to the nominated person. The supplier will be able to rely on the information provided when determining the GST treatment of the supply.

Application date

The amendment will apply from 1 April 2011.

Key features

Since a supply of land may involve a contractual purchaser nominating another person to become a recipient of the supply, the wording of section 78F is being clarified to ensure that the contractual purchaser may provide the information to suppliers in respect of the ultimate recipient's circumstances. The section is also being amended to ensure that the supplier may rely on that information in determining the appropriate GST treatment of the supply.

Background

Section 78F of the GST Act requires the recipient of a supply that involves land to provide information to the supplier about their registration status and intentions in relation to the land. This information may then be used by the supplier to determine whether the supply is zero-rated or standard-rated. When the ultimate recipient is a person nominated by the contractual purchaser to the agreement for sale and purchase (a nominee), it is the nominee's registration status and intentions in relation to the land that must be used to determine the GST treatment of the supply.

Since section 78F refers to the "recipient" as the person that is required to provide information, the section may be interpreted as not allowing the contractual purchaser to provide the information on the nominee's (recipient's) behalf and, as a result, not permitting the supplier to rely on that information. To avoid any doubt, the wording of the section is being clarified to ensure that the contractual purchaser may provide the information and the supplier may rely on it.

CLARIFYING THE APPLICATION OF THE "CONCURRENT USE OF LAND" PROVISION

(Clause 146)

Summary of proposed amendment

An amendment is being made to clarify the application of the "concurrent use of land" provision in section 21E of the Goods and Services Tax Act 1985. The proposed change provides that "concurrent" means the same part of the land is simultaneously ("concurrently") used for both taxable and non-taxable purposes.

Application date

The amendment will apply from the date of enactment.

Key features

Section 21E of the GST Act provides a formula that must be used to apportion the taxable and non-taxable use of land in situations when the mixed use occurs "concurrently". The provision was intended to apply when the same area of land is equally and simultaneously is used for both taxable and non-taxable purposes.

The wording of the provision is being amended to ensure that it applies as intended.

Background

Section 21E of the GST Act provides guidance when a person rents out land (exempt use) or uses land for private purposes while simultaneously using it for making taxable supplies, such as taking steps to sell it. This type of mixed use is most likely to affect property developers.

The provision is not intended to apply when land is used for both taxable and non-taxable purposes, but that use either relates to different parts of the land or is not simultaneous. Concerns have been raised, however, that the provision as currently drafted may be interpreted too broadly and may, in some situations, produce unintended results.

ADJUSTMENTS ON DISPOSALS BEFORE THE END OF AN ADJUSTMENT PERIOD

(Clause 147)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to clarify that a person must make a final apportionment of input tax when goods or services are disposed of during an adjustment period.

Application date

The amendment will apply from the date of enactment.

Key features

On the acquisition of goods or services a purchaser may only claim input tax deductions to the extent that they intend to use the goods or services for making taxable supplies. However, if the actual taxable use of goods or services differs from the intended taxable use and no exclusions apply, the purchaser may be required to adjust the input tax deduction previously claimed to reflect the actual taxable use (sections 21 and 21A). Adjustments for any differences between the actual taxable use and the intended taxable use are done at the end of an adjustment period, which is usually a period of one year.

Section 21G(4) sets out the maximum number of adjustment periods for apportioning goods and services. The legislation does not, however, provide guidance on whether a section 21 and 21A adjustment is required if goods or services are disposed of before the end of an adjustment period.

The proposed amendment provides that when goods or services are disposed of before the end of the last adjustment period, the current adjustment period is treated as the final adjustment period ending immediately before the date of disposal. As a consequence, a person would be required to make their last adjustment under sections 21 and 21A in the final adjustment period. This final adjustment will ensure that the input tax deducted by the person in relation to the taxable use of the asset throughout the ownership of the asset, reflects the actual taxable use of the asset.

Background

From a tax policy perspective, a person who acquires goods or services should only be able to claim input tax deductions to the extent that the goods or services are used for taxable purposes. The new apportionment rules achieve this result by requiring a person to estimate their intended taxable use of goods and services on acquisition, and by making subsequent adjustments to the input tax deduction if the estimate proves to be incorrect. These subsequent adjustments are made at the end of relevant adjustment periods. For assets other than land, the number of adjustment periods is capped.

It has been noted that the rules do not expressly stipulate whether a person is required to make a final adjustment when a disposal occurs before the end of an adjustment period. Moreover, it has also been contended that the legislation may be interpreted as requiring the person to make adjustments after the disposal of goods or services until they reach the end of their last adjustment period.

TAXABLE USE OF MOTOR VEHICLES

(Clause 143)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended so it expressly allows the taxable use of motor vehicles to be identified by using a three-month logbook period.

Application date

The amendment will apply from 1 April 2011.

Key features

Under the apportionment rules that came into force on 1 April 2011, a person can claim an input tax deduction by reference to the actual taxable use of goods or services, subject to certain exclusions.

The bill will amend the GST apportionment rules by inserting a cross-reference to the Income Tax Act 2007 to allow the actual taxable use of a motor vehicle to be identified by using the three-month logbook period. This method of identifying taxable and non-taxable use may also be used for identifying the intended taxable use of the motor vehicle as estimated on acquisition of the vehicle – which may be useful if the vehicle is purchased as a replacement for another motor vehicle for which usage has been determined by the logbook method.

Background

Before the introduction of the apportionment rules, Inland Revenue issued guidelines which allowed a person to identify the taxable use of a motor vehicle by reference to a three-month logbook method. Under that method, a logbook could be kept for a minimum of three months to work out the taxable and private use of the motor vehicle. The taxpayer could then use the result of the three-month record as the approximation of their taxable and private use over the next three years, unless the use of the vehicle changed by more than 20 percent.

As the new apportionment rules require taxpayers to be able to identify the actual taxable use of a motor vehicle, the rules arguably have the effect of overriding the logbook guidelines.

Expressly allowing taxpayers to use the three-month logbook method for GST and income tax purposes should decrease compliance costs for affected taxpayers.

APPLICATION OF SECTION 21B

(Clauses 136(2) and 145)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to allow a registered person to claim input tax deductions in respect of imported and second-hand goods acquired before registration and to remove the $5,000 minimum requirement for apportioning goods and services acquired before registration.

Application date

The amendment will apply from 1 April 2011.

Key features

Section 21B of the GST Act allows a registered person to claim input tax deductions for goods or services acquired before registration. As currently drafted, the provision allows input tax deductions only when GST has been charged by the vendor under section 8(1) of the GST Act. Moreover, section 21B does not apply if the original cost of goods or services, excluding GST, was $5,000 or less.

Since GST may be charged on the importation of goods or be imbedded in second-hand goods purchased from an unregistered person, section 21B will be amended to allow a registered person to claim input tax deductions for imported and second-hand goods acquired before registration.

In addition, it is proposed to repeal the $5,000 minimum threshold in section 21B(4). This will allow GST-registered taxpayers to claim input tax deductions for all goods and services acquired before registration.

Background

Section 21B was enacted as part of the Taxation (GST and Remedial Matters) Act 2010, with effect from 1 April 2011, and allows a registered person to make an adjustment in order to claim input tax deductions for goods or services acquired before registration. The purpose of the provision is to ensure that GST imposed on goods or services purchased by a person before their registration is not a cost on the business when those goods or services are used in the business after the person registers for GST.

Specifically, section 21B operates by requiring a person to treat the period that starts on the date of acquisition and ends on the first balance date that falls after either the time of registration or at a later time when the person uses the goods or services for making taxable supplies as the person's first adjustment period for the purposes of the GST apportionment rules.

As the legislation operates on the assumption that the person is making a "subsequent" adjustment of the input tax, like the general apportionment rule, the adjustment is allowed only if the original cost of the goods or services was more than $5,000 (section 21B(4)).

As an unregistered person is unable to claim any input tax on the acquisition of goods or services, the effect of the minimum threshold is to preclude them from being able to claim any input tax on goods or services purchased for $5,000 or less.

Furthermore, as currently drafted, section 21B allows input tax deductions only when GST has been charged by the vendor under section 8(1) and not in respect of second-hand or imported goods. This is not an appropriate outcome as the GST component should be recoverable by a purchaser if the acquired goods are used for making taxable supplies.

INPUT TAX AVAILABLE FOR IMPORTED GOODS

(Clauses 136(3) and 141(1))

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to prevent a registered person from claiming input tax deductions in respect of goods entered for home consumption (imported goods), when they deliver or arrange the delivery of the goods to a person in New Zealand.

Application date

The amendment will apply from 1 April 2011.

Key features

The proposed amendment will prevent a person from claiming input tax deductions in respect of imported goods, when they merely deliver, arrange the delivery or make the delivery of the goods more easily achieved to a person in New Zealand.

Background

The GST Act defines "input tax", in relation to a registered person, as including GST paid on goods entered for home consumption (imported goods) by the person.

Before the introduction of the new apportionment rules, the definition did not apply to the delivery of goods to a person in New Zealand. This ensured that, for example, a courier firm was not able to claim input tax in respect of imported goods when they merely arranged delivery of the goods in New Zealand.

As a result of the changes to the wording of the definition of "input tax" to accommodate the new apportionment rules, the restriction on the ability to claim input tax has been removed. A registered person could arguably claim input tax deductions in respect of GST paid in the process of delivering the goods to a person in New Zealand.

ADJUSTMENTS FOR GOODS AND SERVICES ACQUIRED BEFORE 1 APRIL 2011

(Clause 148)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to clarify the treatment of goods and services acquired before 1 April 2011 but which have not been subject to either the change-in-use rules or apportionment rules until after 1 April 2011.

Application date

The amendment will apply from 1 April 2011.

Key features

Section 21H is a transitional provision that specifies which rules – the former change-in-use adjustment rules or the new apportionment rules – should be used for goods and services acquired before the date of introduction of the new apportionment rules (1 April 2011).

To clarify the treatment of goods and services acquired before 1 April 2011 but which have not been subject to either the change-in-use rules or the apportionment rules until after 1 April 2011, section 21H is being amended so that:

- if the taxpayer has already claimed an input tax deduction for the goods or services, they should apply the old change-in-use adjustment rules; or
- if the person has not deducted any input tax for the goods or services, they should apply the new apportionment rules. For the purpose of the new apportionment rules, the first adjustment period is treated as starting on the date of acquisition of the goods or services and ending on the date that is the later of the first balance date falling after the date on which they were first used for making taxable supplies, or the date on which the person becomes a registered person.

A "savings" provision will also be introduced to allow taxpayers who have already applied either the old change-in-use adjustment rules or the new apportionment rules before the amendment is introduced to continue with their chosen treatment.

Background

The new apportionment rules apply to supplies made on or after 1 April 2011. In accordance with the transitional provision (section 21H) as currently drafted, goods and services acquired before 1 April 2011 which are used for both taxable and non-taxable purposes remain subject to the old change-in-use adjustment rules.

Section 21H leaves some uncertainty around the treatment of goods and services acquired before 1 April 2011 but which have not been subject to either the change-in-use rules or apportionment rules until after 1 April 2011. This may occur, for example, if the goods or services were exclusively used for either taxable or non-taxable purposes or because the person was not registered for GST before 1 April 2011.

GST REGISTRATION REQUIREMENTS IN UNDISCLOSED AGENCIES

(Clause 152(3))

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to modify the information requirements relating to transactions that involve land to allow unregistered agents for undisclosed principals to provide the agents' IRD numbers to suppliers.

Application date

The amendment will apply from 1 April 2011.

Key features

The proposed amendment will modify section 78F which requires a recipient of a supply that involves land to provide certain information to the supplier and allow an unregistered agent for an undisclosed principal to provide the agent's IRD number to the supplier.

Background

The Taxation (Tax Administration and Remedial Matters) Act 2011 amended the information requirements in section 78F of the GST Act for transactions that involve land to allow an agent for an undisclosed principal to make limited representations to the supplier for the purposes of the GST zero-rating rules. This may be done, however, only if an agent is registered for GST and provides their registration number to the supplier.

In some situations, an agent may be not registered for GST. Law firms, for example, often use "solicitor's nominee companies" as agents for undisclosed principals. These companies may not have a taxable activity and may not therefore be registered for GST. Requiring these companies to carry on a taxable activity and register for GST so they can act as agents for undisclosed principals would introduce an unnecessary compliance burden.

TRANSACTIONS INVOLVING NOMINATIONS

(Clauses 149 and 151)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to repeal the rule that deems a supply to be made to the nominee when the contractual purchaser and the nominee have a different registration status.

Application date

The amendment will apply from 1 April 2011.

Key features

When a supply of goods or services is made to a person nominated by a contractual purchaser, section 60B of the GST Act determines whether the supply is treated as being made to the contractual purchaser or the nominated person.

The proposed amendment will repeal section 60(5) which states that when the contractual purchaser and the nominated person have a different GST registration status, the supply must be treated as made between the supplier and the nominated person.

A "savings" provision will be introduced to protect taxpayers who may have already claimed input tax deductions in reliance on section 60(5).

Background

The Taxation (GST and Remedial Matters) Act 2010 enacted a number of changes to the Goods and Services Tax Act 1985, including clarification of the GST treatment of transactions that involve nominations. The nomination rules adopt an "economic substance" approach so that the GST consequences of a transaction involving a nomination (such as the entitlement to an input tax deduction) reflect the commercial reality of the transaction. The new rules apply from 1 April 2011.

Nominee transactions ordinarily involve a purchaser nominating another person (a nominee) to receive the goods or services in question and/or settle the transaction. Under the new default "economic substance" nomination rule, a single GST supply is deemed to exist between the supplier and the person who provides the consideration relating to the supply. Depending on the facts, the latter could be either the contractual purchaser or the nominee.

To prevent "phoenix" fraud, the 2010 Act also introduced rules that require supplies of land to be zero-rated in certain circumstances. To ensure that the new zero-rating of land rules (which were also enacted in the 2010 Act) could not be bypassed by parties using nominations, the default "economic substance" rule was modified in respect of

transactions that involve land to deem a supply as always occurring between the supplier and the nominee.

As a result of an oversight, a similar supplementary rule also applies to transactions that do not involve land when the contractual purchaser and the nominee have a different registration status. Application of the rule in these situations may give rise to inappropriate GST outcomes, such as the denial of input tax deductions to the contractual purchaser. For this reason, the legislation should be amended to ensure that the default "economic substance" approach applies without the modifying provision to all transactions that do not involve land.

Minor drafting changes

The following changes are being made to correct minor errors in the GST ACT:

- Section 21A(c) is being amended to also refer to section 21(2)(d).
- The reference to "principal purpose" in section 20A(2) is being deleted.
- A cross-reference in section 21H(1) is being amended to refer to "21 to 21H".

REVERSE CHARGE RULES

(Clauses 138 and 139)

Summary of proposed amendments

Changes are being made to the reverse charge rules in the Goods and Services Tax Act 1985 to ensure that they operate as intended and with minimal compliance costs to business. They will:

- amend section 8(4B)(b)(ii) of the GST Act to change the reverse charge threshold from 90 percent to 95 percent; and
- amend section 9(2)(h) to change the time of supply from the first day of the relevant adjustment period to the last day of that period.

Application date

The new rules will apply from 1 April 2011, being the date the amendments to the reverse charge rules took effect.

Key features

The reverse charge rules in section 8(4B)(b) are in two parts. The main rule applies on acquisition if the intended taxable use of the service is less than 95 percent. The second rule applies if the original acquisition estimate was higher than 95 percent, but the actual taxable use of the services drops below 90 percent. It is this second rule that is at issue. The 90 percent figure was set to tie in with the rule in section 21(2)(c) that only requires adjustments to be made when the percentage of taxable use deviates by more than 10 percent. In other words, the 90 percent "built in" the difference between 100 percent and 90 percent when no adjustment is generally required.

However, the 90 percent figure does not take into account the other limb of section 21(2)(c), which requires an adjustment if the difference in GST is greater than $1,000. It may therefore be possible for a taxpayer to avoid making an adjustment if it was less than 10 percent, even if the GST at stake was considerably more than $1,000. To address this concern, the second reverse charge threshold in section 8(4B)(b)(ii) is being changed to 95 percent. This will mean that, once the percentage of non-taxable use of the service exceeds 5 percent, the reverse charge rules will apply and the change-in-use adjustments will automatically follow in appropriate circumstances. This will also make the secondary rule consistent with the threshold applied to the main reverse charge rule.

Time of supply for reverse charge

Under sections 8(4B)(b)(ii) and 9(2)(h), a registered person that imports services for a taxable purpose, but later applies those services for a non-taxable purpose, is treated as supplying those services to themselves on the first day of the adjustment period that their non-taxable use becomes greater than 10 percent (soon to be 5 percent, as above). However, an "adjustment period" is always approximately a year in length. The rule may therefore produce difficulties for a registered person that returns GST on, for example, a monthly basis. This would occur because the first day of the adjustment period would be in a different GST filing period − meaning that previous returns may need to be adjusted.

Section 9(2)(h) is therefore being amended so that the supply is treated as occurring on the last day of the relevant adjustment period. This should prevent the taxpayer having to incur compliance costs through amending previous returns.

GST AND LATE PAYMENT FEES

(Clause 137)

Summary of proposed amendment

The Goods and Services Tax Act 1985 is to be amended to clarify that late payment fees charged by businesses to customers are subject to GST. The proposed amendment is a result of a recent interpretation of the law which concluded that no GST is chargeable on late payment fees. This interpretation is inconsistent with the policy of a broad-based tax, and with Inland Revenue's public interpretation which has been that late payment fees are subject to GST whereas penalty interest is not.

Application date

The amendment will apply for taxable periods ending on or after 1 April 2003. As the purpose of the amendment is to clarify the current law, the application date has been aligned, as closely as possible, with the statutory time-bar for claiming GST refunds – specifically, with the last possible year in which taxpayers could possibly seek a refund of overpaid GST.

The amendment also contains a "savings" clause which preserves the past GST treatment of late payment fees by taxpayers who have, before the date of introduction of this bill, adopted a regular practice of not charging GST on the fees. For these taxpayers, the amendment will apply from 1 April 2012.

Key features

A new provision is being inserted into section 5 of the GST Act to clarify that GST is chargeable on late payment fees. The provision will apply retrospectively for taxable periods ending on or after 1 April 2003.

The new provision contains a savings clause which will preserve, up until 1 April 2012, the past GST treatment of late payment fees by some taxpayers. The purpose of the savings clause is to ensure that the retrospective amendment does not penalise taxpayers who have, in good faith, taken an interpretation of the law that was open to them at the time. It would apply to taxpayers who, before the date of introduction of this bill, relied on the provisions of the GST Act as they were before this amendment, and who adopted a regular practice of not charging GST on late payment fees. Taxpayers who fall within the savings clause will have until 1 April 2012 to make any necessary systems changes in order to comply with the amendment.

Background

Under the GST Act, GST is only charged on taxable supplies of goods and services. The term "supply" is defined very broadly in keeping with the policy of GST having the broadest base as is practically possible.

Late payment fees are fixed fees charged by a business to customers who are late in paying their accounts. These fees are common across a range of sectors and charging GST on these fees is common practice. The fees are different from penalty and default interest payments which are specifically GST-exempt in the same way as other financial

transactions. A recent interpretation of the law, however, has concluded that no GST should be imposed on late payment fees as there is an insufficient connection between the fee and the underlying supply of goods and services, even though the fee may represent the cost of administering the late payment. This is inconsistent with the policy of a broad-based tax, and with Inland Revenue's public interpretation which has been that late payment fees are subject to GST but penalty interest is not.

The interpretation may create scope for businesses to restructure similar fees and charges to take advantage of this interpretation, thereby raising base maintenance concerns. Late payment fees should be treated in the same manner as prompt payment discounts, for example, where the intention of the legislation is that amounts with or without discount are fully subject to GST. The lack of clarity around application of the rules also gives rise to an ongoing fiscal risk, as a result of taxpayers, many of whom currently charge GST on late fees, no longer charging it.

Applying the measure retrospectively will avoid the possibility of refunds being claimed to take advantage of the recent interpretation, with potential windfall gains to the supplier.

LIQUIDATORS AND RECEIVERS CHANGING GST ACCOUNTING BASIS

(Clause 140)

Summary of proposed amendment

An amendment is being made to the Goods and Services Tax Act 1985 to preclude liquidators, receivers and voluntary administrators switching from the payments basis to the invoice basis when accounting for GST.

Application date

The amendment will apply from the date of enactment.

Key feature

New section 19(3B) of the GST Act 1985 will prevent a liquidator, receiver, or administrator (as defined in section 239B of the Companies Act 1993) of a registered person who accounts for tax payable on a payments basis applying to change the registered person's accounting basis to an invoice basis.

Background

If a registered person meets certain conditions, for example, when the total value of taxable supplies for a 12-month period has not, or is not likely to exceed $2 million, the registered person may account for GST on a payments basis. The majority of registered persons (approximately 80 percent) account for GST using the payments basis. The GST Act 1985 allows registered persons who are accounting for GST on a payments basis to change to the invoice basis by applying to the Commissioner of Inland Revenue. There are currently no restrictions on registered persons making this accounting basis change.

It has become standard practice for liquidators and receivers to adopt the invoice basis for accounting for GST, immediately upon becoming a liquidator or receiver of a registered person that accounts for GST on a payments basis. Moving to an invoice basis allows the liquidator or receiver to claim input tax credits for supplies received for which no payment has been made. Changing the accounting basis often results in refunds being made to the liquidator or receiver despite in many cases there being no realistic prospect that the debt, to which the input credit relates, will ever be paid. The current practice does not seem to have a commercial purpose other than to generate GST refunds.

SECOND-HAND GOODS INPUT TAX CREDIT

(Clause 136(1))

Summary of proposed amendment

The bill amends the definition of "input tax" in the Goods and Services Tax Act 1985 as it relates to second-hand goods, as a remedial base maintenance measure. It prevents a situation where GST is paid once but input tax credits can be claimed twice on the same goods.

Application date

The amendment applies from the date of the introduction of the bill.

Key features

Section 3A(2)(b) is being replaced to deny a second-hand input tax credit when the goods:

- are supplied by a non-resident; and
- have previously been supplied to a registered person who has entered them for home consumption under the Customs and Excise Act 1996.

It does not matter if the person who enters the goods was registered for GST purposes at the time the goods were entered or was registered at a later date.

Background

In 1995, an amendment was made to the GST Act 1985 to counter the situation where input tax credits were being claimed twice on the same goods: once when the goods were imported under a lease, and again through the second-hand goods input tax credit, when goods situated in New Zealand were purchased from the non-resident owner. The 1995 amendment ensured that a second-hand goods credit could not be claimed when the sale of goods is a non-taxable supply by a non-resident, and any GST originally charged at the border on the goods has already been claimed.

Detailed analysis

Both the 1995 amendment and the amendment in this bill concern the following situation. Goods are leased from a non-resident to a resident. The resident lessee, who is registered for GST, enters the goods for home consumption under the Customs and Excise Act 1996. The New Zealand Customs Service charges GST on the value of the assets, and the registered lessee would claim an input tax credit. At a later point, the non-resident owner would sell the goods, now situated in New Zealand, to a GST registered person. As the seller is a non-resident, the supply is not a taxable supply and GST output tax is not charged. However, as the goods are already situated in New Zealand, the registered purchaser is potentially able to claim a second-hand goods

credit. This could lead to GST input credits being claimed twice, while GST is paid only once.

The 1995 amendment denied a second-hand goods credit if the non-resident selling the goods is the same non-resident who has previously supplied (i.e. leased) the goods to the registered person (the lessee) who had entered the goods for home consumption.

The amendment in this bill extends the section to also deny a second-hand tax credit in situations where the non-resident owner who sells the goods to a registered person in New Zealand is not the same person who originally leased the goods to a registered person in New Zealand. It also covers the situation when the lessee who entered the goods for home consumption was not registered for GST at the time of entry, but registers after the event and claims a GST input credit under section 21B.

GST AND THE CREDIT CARD SERVICE FEE

(Clause 131)

Summary of proposed amendment

Section 226C of the Tax Administration Act 1994 is being amended to clarify that fees charged under that section are GST-exclusive.

Application date

The amendment will apply from the date of enactment.

Key features

Clause 131 amends section 226C of the Tax Administration Act 1994 to clarify that GST does not apply to the amount of fees charged under that section.

Background

Section 226C of the Tax Administration Act 1994 allows the Commissioner to charge taxpayers a fee, if they choose to pay their tax and social liabilities by credit card. The current fee is set at 1.42 percent of the total transaction and may be changed by Order in Council. The change proposed in the bill makes it clear that if GST is payable on a particular service fee, the amount set in legislation is exclusive of GST.

The fee is passed on to domestic-based student loan borrowers and child support parents by Inland Revenue because the cost of absorbing the fee is too high. These individuals also have other practical ways in which they are able to comply with their repayment obligations, such as via internet banking. Inland Revenue will, however, continue to absorb the fee for credit card payments made by overseas liable parents and overseas student loan borrowers to help reduce their compliance costs.

BANKING GROUP'S EQUITY THRESHOLD

BANKING GROUP'S EQUITY THRESHOLD

(Clause 31)

Summary of proposed amendment

The bill increases the minimum equity threshold of a reporting bank's New Zealand banking group for a tax year from 4 percent of risk-weighted exposures (RWEs) to 6 percent of RWEs.

Application date

The amendment will apply from 1 April 2012.

Key features

Section FE 19(1) of the Income Tax Act 2007 contains a formula which a reporting bank must use to calculate the minimum equity threshold of its New Zealand banking group for a tax year. The formula contains a multiplier to be applied to the value of RWEs less deductions from equity value. This formula is to be amended by increasing the multiplier from 0.04 to 0.06.

The new formula will apply only for measurement dates under section FE 8(3) for periods beginning on or after 1 April 2012.

Background

Since 2005, a special form of thin capitalisation rule has applied for foreign-owned banks. The rule requires a New Zealand banking group to hold equity equal to at least 4 percent of its New Zealand assets − specifically, 4 percent of its RWEs (less deductions from equity value). The rule has the effect of limiting the interest deductions foreign-owned banks may take against their New Zealand sourced income for tax purposes.

It is proposed that the minimum equity threshold for tax purposes be increased from 4 percent to 6 percent of RWEs from 1 April 2012. The proposed increase for tax purposes is consistent with recent changes in the commercial and regulatory environment facing banks, which has seen average regulatory capital ratios steadily increase, while the average tax capital ratio has remained near the prescribed minimum.

REMEDIAL MATTERS

APPLICATIONS FOR OVERSEAS DONEE STATUS

(Clause 98)

Summary of proposed amendments

The bill adds four 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.

- Aotearoa Development Cooperative
- Deepavali Charitable Trust
- Orphans of Nepal
- School Aid: Global Partnerships Through Schools

Application date

The amendments will apply from 1 April 2013.

Background

Donations to listed organisations entitle individual taxpayers to a tax credit of 33⅓% 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.

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.

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

- Aotearoa Development Cooperative (ADC) works with poor communities in Burma to establish community-owned microfinance institutions that provide small loans for business development.
- The Deepavali Charitable Trust provides funds to schools and hospitals in India and developing parts of Asia and, when necessary, provides support to those in need in India and developing parts of Asia in cases of natural disaster (such as the 2004 Boxing Day Tsunami) and famine.
- Orphans of Nepal provides basic necessities for orphaned children in need in the Kathmandu Valley, including food, accommodation, clothing, health care and education.

School Aid aims to assist schools and children in developing countries. The organisation has set up an investment fund, the profits from which go to schools in poor countries.

NON-RESIDENT FILM RENTERS' TAX

(Clauses 5, 12, 19, 56, 68, 72, 84, 88, 91, 92 and 93)

Summary of proposed amendment

The rules for taxing non-resident film renters in the Income Tax Act 2007 are being replaced with non-resident withholding tax (NRWT) to rationalise and simplify the New Zealand income tax rules applying to non-residents.

Application date

NRWT will apply to amounts derived by non-residents from renting films in New Zealand from the date of enactment.

Key features

Currently, the Income Tax Act 2007 treats 10 percent of gross receipts derived by a non-resident company from renting films in New Zealand as income with no deductions, giving an effective tax rate of 2.8%. The bill will replace the current tax of 2.8% on gross film rentals with NRWT.

Practically all amounts currently subject to the non-resident film renters' tax come within the "royalty" definitions in the Income Tax Act 2007 and in New Zealand's double tax agreements (DTAs). Such amounts will therefore be subject to NRWT once provisions relating to non-resident film renters are repealed. Although the standard NRWT rate on royalties is 15%, the rate applying to most non-resident film renters would be 5% or 10% under New Zealand's DTAs.

Background

The current rules for taxing non-resident film renters have existed in various forms since 1928. They were originally enacted because of the difficulties in accurately determining the net profit derived by non-residents from renting films in New Zealand.

The current rules are an historical anachronism for which there is no longer a sound policy rationale. It appears that the non-resident film renters' tax was not replaced in 1964 when NRWT was introduced because of the 1948 DTA between the United States and New Zealand. That DTA prevented New Zealand taxing the income of United States film renters except to the extent allowed under the existing rules. The 1982 DTA between New Zealand and the United States (which replaced the 1948 DTA) and the current DTA (in force from November 2010) contain no similar restriction on New Zealand's ability to tax income derived from New Zealand by the United States-resident film renters.

TIMING OF DETERMINING SERIOUS HARDSHIP

(Clause 131)

Summary of proposed amendment

The Tax Administration Act 1994 is being clarified to ensure that when a serious hardship application is made, the financial position considered by Inland Revenue is the financial position at the date the application for relief is made.

Application date

The amendment will apply from the date of enactment.

Key feature

New section 177(1B) of the Tax Administration Act 1994 will provide that when determining whether recovery would place a taxpayer in serious hardship, Inland Revenue will consider the taxpayer's financial position at the date on which the application for relief is made.

Background

The Tax Administration Act 1994 prevents Inland Revenue from recovering outstanding tax to the extent to which recovery would place a taxpayer, being a natural person, in serious hardship. The Act defines "serious hardship".

Under the debt rules, late payment penalties stop being imposed when a taxpayer contacts Inland Revenue seeking relief. This provision is aimed at encouraging taxpayers to contact Inland Revenue when they are having problems paying their tax. It was intended Inland Revenue would consider the taxpayer's financial position at the time the taxpayer contacts Inland Revenue.

A recent Court of Appeal decision, *Larmer*[1], found that serious hardship could be determined at the time of application or, alternatively, at the time the tax became due. Determining serious hardship at the time tax becomes due is not consistent with the policy intent and could lead to inconsistent application of the provision.

The debt rules provide incentives for taxpayers to contact Inland Revenue if they cannot pay their tax. In such cases Inland Revenue can enter an instalment arrangement and if necessary write off part, or all, of the outstanding amount − for example, when payment would place a taxpayer in serious hardship. To determine if an individual will be placed in serious hardship, Inland Revenue will request relevant details of the person's financial position − for example, details of bank accounts and assets held.

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[1] *CA61/2010*

It could in practice be very difficult, and in some cases impossible, for Inland Revenue to determine whether a taxpayer was in serious hardship when the tax became due. This is because this could be a date years before the application for relief is made and it could be difficult to reconstruct a person's affairs. It would also remove the incentive on taxpayers to contact Inland Revenue when they cannot pay their tax.

RATE FOR EXTINGUISHING TAX LOSSES WHEN TAX IS WRITTEN OFF

(Clause 132)

Summary of proposed amendment

The Tax Administration Act 1994 is being amended to reduce the rate used to extinguish the tax losses of companies when their tax is written off.

Application date

The amendment will apply from the date of enactment.

Key feature

The rate used for extinguishing losses of companies who have tax written off is being reduced to 28%. The rate for other taxpayers will remain at 33%.

Background

The Tax Administration Act 1994 allows Inland Revenue to write off tax which cannot be recovered in certain cases.

If Inland Revenue writes off tax for a taxpayer who has a tax loss, it must extinguish all or part of the taxpayer's tax loss in proportion to the amount written off by dividing the amount written off by 33% and reducing the tax loss by that amount. Currently, the legislation provides a single rate of 33% for extinguishing tax losses.

When the provision was introduced, the company tax rate was 33% and the top marginal tax rate for individuals was 39%. Submissions on the provision, when it was introduced in 2002, noted that the rate used for extinguishing tax losses should be the taxpayer's marginal tax rate. Officials' response was that a single rate was preferred for simplicity reasons, and the 33% rate would generally either be accurate or taxpayer-friendly.

Since the provision was introduced in 2002, tax rates have reduced. The top marginal rate for individuals is now 33% and the company tax rate has been lowered from 33% to 28%.

Given these changes to rates, the 33% rate for extinguishing losses is too generous in all cases for companies because they are taxed at a flat rate of 28%; in other words, insufficient company losses are extinguished under the current 33% rate. The rate for

other taxpayers should remain at 33% to ensure individuals on the top marginal tax rate do not have their losses over-reduced.

EMISSIONS TRADING SCHEME AND CERTAIN TREATY OF WAITANGI SETTLEMENTS

(Clause 88)

Summary of proposed amendment

Legislation is being amended to ensure that transactions in emissions units which are transferred through certain entities as part of Treaty settlements still give rise to exempt income.

Application date

The amendment will apply from 9 June 2009 which is just prior to the date any pre-1990 forest land emissions units were allocated to any relevant entities.

Key features

When pre-1990 forest land emissions units are disposed of, the income which arises is treated as exempt income under section CX 51B of the Income Tax Act 2007. This amendment extends the definition of pre-1990 forest land emissions units in section YA 1 so that units which are received by an iwi from a representative entity as part of a Treaty settlement process fall within the definition. This will ensure that the disposal proceeds received by that iwi are also treated as exempt income.

Background

A one-off allocation of emissions units is made by the government to owners of pre-1990 forestry land to compensate them for the additional costs that will arise as a result of the Emissions Trading Scheme if they change the use of their land. For owners who hold the land on capital account, the disposal of these units is treated as giving rise to exempt income. Ordinary rules apply to any subsequent transactions in those units.

Some Treaty of Waitangi settlements which involve forestry land are being implemented in two stages. The land and other assets are initially transferred by the Crown to an entity which represents a number of iwi, and that representative entity will subsequently transfer those assets to the iwi it represents.

EMISSIONS TRADING SCHEME AND NEGOTIATED GREENHOUSE AGREEMENTS

(Clause 21)

Summary of proposed amendment

Legislation is being amended so that the accrual income rules apply when a party to a Negotiated Greenhouse Agreement (NGA) receives emissions units in relation to the impact of the Emissions Trading Scheme (ETS) on the price of inputs.

Application date

The amendment will apply from 1 July 2010.

Key features

Section ED 1B of the Income Tax Act 2007 treats the entitlement to receive emissions units from the Crown under the ETS industrial allocation process as giving rise to income on an accrual basis. This amendment completes the extension of that accrual basis to parties to a NGA who receive emissions units in recognition of the impact of the ETS on the price of their inputs.

Background

NGAs were entered into between the Government and two businesses some years before the introduction of the ETS. Arrangements have subsequently been agreed between these emitters and the Crown under which the Crown will transfer emissions units to these businesses in recognition of the impact of the ETS on the price of their inputs.

An earlier amendment was made to section ED 1B to deal with this issue, but was not wide enough to cover the procedure subsequently negotiated with another of the NGA parties.

ANNUAL CONFIRMATION OF INCOME TAX RATES

(Clause 3)

Summary of proposed amendment

The bill sets the annual income tax rates that will apply for the 2012–13 tax year. The annual rates to be confirmed are the same rates that applied for the 2011–12 tax year.

Application date

The provision will apply for the 2012–13 tax year.

Key features

The annual income tax rates for the 2012–13 tax year will be set at the rates specified in Schedule 1 of the Income Tax Act 2007.

MAKING RWT CERTIFICATES AVAILABLE ELECTRONICALLY

(Clause 105)

Summary of proposed amendment

Interest payers are required to send depositors resident withholding tax (RWT) withholding certificates at the end of the tax year. Interest payers can provide RWT withholding certificates electronically, provided that the recipient agrees to receive the certificate in that way.

In accordance with the original policy intention, this amendment clarifies that interest payers can meet this requirement by making RWT withholding certificates available on their websites, as long as the recipient agrees to receive the certificate in that way.

Application date

The amendment will apply to RWT withholding certificates provided on or after 1 April 2002 that relate to interest or specified dividends paid in the 2001–02 and subsequent income years to align with the application date of the provision when it was originally introduced.

EMPLOYER SUPERANNUATION CONTRIBUTION TAX AND PAST EMPLOYEES

(Clauses 75 to 81, 103, 113, 112 and 130)

Summary of proposed amendment

The bill amends the Income Tax Act 2007 and the Tax Administration Act 1994 to codify the long-established practice of deducting employer superannuation contribution tax (ESCT) from superannuation contributions made on behalf of past employees.

It also provides that a 33% rate of ESCT applies to these contributions.

Application date

The amendments apply from 1 April 2008, unless a return was filed before the introduction of this bill on a different basis.

The Taxation (Budget Measures) Act 2011 contained some other changes to the ESCT rules, which apply from 1 April 2012. This necessitated the amendments being drafted in two stages, but the overall outcome is the same.

Key features

The definition of an "employer's superannuation cash contribution" is being clarified to include superannuation contributions paid by a person for the benefit of their past employees − that is, even when there is no current "employer" and "employee" relationship.

This means that the person paying the superannuation contribution, although no longer technically "an employer" of these past employees, must still deduct ESCT from these superannuation contributions.

The rate at which ESCT must be deducted from these contributions is set at 33%. The variable rates that employers must apply to contributions on behalf of current employees from 1 April 2012 are not used because the variable rates rely on recent salary or wage information that is not applicable in the case of a past employee.

A provision is being included so that the amendments do not apply to people who filed a return before the date of introduction of the bill on a different basis. Instead Inland Revenue will consider the basis on which they have filed their return in light of the current legislation.

DEDUCTIBLE OUTPUT TAX

(Clause 88(3))

Summary of proposed amendments

The definition of "deductible output tax" in section YA 1 of the Income Tax Act 2007 is being amended to correct an oversight that occurred when the definition was introduced in 2011. The definition is relevant (in this context) to section DB 2 of the Act. Under the previous version of section DB 2, output tax payable in respect of a supply of fringe benefits under section 21I of the Goods and Services Tax Act 1985 was explicitly available as a deduction for income tax purposes. In expanding the provision to provide for the new apportionment rules in the GST Act, the reference to section 21I was inadvertently removed. There is no policy reason why such output tax should not be available as a deduction because it represents a real cost to the taxpayer.

Application date

The amendment will apply from 1 April 2011, to clarify that output tax charged under section 21I has always been available as a deduction.

HARDCOPY RETURNS

(Clause 110)

Summary of proposed amendments

Section 36(3) of the Tax Administration Act 1994 provides that, when a return is transmitted electronically, a hardcopy of that return must be signed and retained. Although section 36 generally gives approval for electronic returns to be transmitted by a "taxpayer, registered person, or agent of a taxpayer or registered person", section 36(3)(b) provides that the hardcopy return "shall be signed by the taxpayer or registered person".

This has led to some confusion over whether these hardcopy returns can be signed by agents. An amendment is proposed to section 36(3)(b) to clarify that an agent of a taxpayer or registered person can sign the hardcopy of the transmitted return. This accords with the policy behind the provision and with current practice accepted by Inland Revenue.

Application date

This amendment will take effect from the date of enactment.

COMMISSIONER GIVEN DISCRETION NOT TO RULE ON RECONSTRUCTION PROVISION

(Clause 118)

Summary of proposed amendment

Section GA 1 of the Income Tax Act 2007 gives the Commissioner of Inland Revenue the power to reconstruct a tax avoidance arrangement to counteract the tax advantage gained. An amendment is proposed that will give the Commissioner a discretion whether to make a private ruling to the extent to which it would be a ruling on how section GA 1 applies or would apply.

Application date

The amendment will apply from the date of enactment.

Key features

The discretion to make a ruling is only in relation the application of section GA 1, and is not a general widening of the Commissioner's general discretion to make a ruling.

Background

Currently, the Commissioner is required to rule on how section GA 1 applies, or would apply when a taxpayer requests such a ruling. This occurs in some instances where the Commissioner has determined that the taxpayer's arrangement constitutes tax avoidance. Requiring the Commissioner to make a ruling on exactly how the Commissioner would apply the reconstruction provision is not ideal, and can be difficult to do without an investigation. Giving the Commissioner a discretion to make a ruling will allow the Commissioner to provide a ruling when its position regarding reconstruction is clear, and will allow the Commissioner to refrain from making a ruling if the position is uncertain.

PRIVATE RULINGS FOR ADVANCE PRICING AGREEMENTS

(Clause 119)

Summary of proposed amendment

The amendment will require those making an application for a private ruling relating to transfer pricing to examine the application and confirm, in a notice submitted at the same time as their application for a ruling is submitted, that to the best of their knowledge, the information disclosed in the application is comprehensive.

Application date

The amendment will apply from the date of enactment.

Key features

Applicants for private rulings relating to advance pricing agreements will be required to be more involved in the application process. The amendment will require them to examine the application personally and make a declaration as to the comprehensiveness of the information provided in support of their application.

Background

Inland Revenue has some concerns about the completeness of some advance pricing agreement applications and documentation packages. As transfer pricing is driven by the facts available, problems can arise if the key facts are not provided, or if information provided is not comprehensive.

Currently, tax agents can make an application of behalf of an applicant, and can sign the declaration on the application form that "the details contained in this application are true and correct".

The new requirement will be in addition to the requirement in section 91ED(1)(b) of the Tax Administration Act 1994 that the application must disclose all relevant facts and documents relating to the arrangement for which the ruling is sought. Its inclusion is to ensure that the applicant has personally examined the application and stated that to the best of their knowledge, the information disclosed for the application is comprehensive.

CHANGES TO THE INCOME TAX (DETERMINATIONS) REGULATIONS 1987

(Clauses 176 to 178)

Summary of proposed amendments

Regulation 10 of the Income Tax (Determinations) Regulations 1987 is being amended to change the reference to "the Gazette" to "a publication chosen by the Commissioner" following a similar change in respect of binding rulings made in 2010. The current fee-waiver provision will also be amended to make it more flexible.

Application date

The amendment will apply from the date of enactment.

Key features

The current fee-waiver provision only permits the fees for a financial arrangement determination to be waived in whole or in part in "exceptional circumstances". The new fee-waiver provision will allow greater flexibility based on what the Commissioner considers is fair and reasonable.

Background

The proposed removal of the reference to "the Gazette" follows changes which were made to the Tax Administration Act in 2010, where the requirement to publish the making and withdrawal of public and product rulings in the Gazette was replaced with a requirement to publish in a publication chosen by the Commissioner. As with the previous change, this is aimed at streamlining the process and avoiding the duplicate publishing of the determinations (which are published in Tax Information Bulletins and available on Inland Revenue's website).

The fee-waiver provision in the Tax Administration (Binding Rulings) Regulations 1999 was similarly amended in 2010 to provide the Commissioner with greater flexibility to waive fees in circumstances where it is considered to be fair and reasonable to do so.

CHANGES TO THE TAX ADMINISTRATION (BINDING RULINGS) REGULATIONS 1999

(Clauses 179 to 181)

Summary of proposed amendment

The bill proposes that the fees charged for binding rulings be increased to take into account increasing costs of providing a ruling and be expressed as "plus GST (if any)" to give greater clarity for taxpayers.

Application date

The amendment will apply from the date of enactment.

Key features

Fees payable for a binding ruling made by Inland Revenue are set out in Regulation 3 of the Tax Administration (Binding Rulings) Regulations 1999. The fees currently comprise an application fee of $310 and a further fee of $155 an hour (or part-hour), beyond the first two hours, spent in consideration of the application by the Commissioner.

Regulation 7 currently provides that the fees include GST. It also provides that for a supply which is zero-rated under the Goods and Services Tax Act 1985, the fee prescribed by the regulations is reduced by an amount equal to the GST portion of the fee.

The new fees will be $280 plus GST (if any) for the application fee, and $140 plus GST (if any) for the further fee.

The reference in Regulation 3(1)(b)(ii) to the fees payable for applications received before 1999 will be revoked as it is no longer relevant. Regulation 7 will also be revoked.

Background

The change to a "plus GST (if any)" basis stems from the GST rate increase on 1 October 2010 from 12.5% to 15%. The change to a "plus GST (if any)" basis expresses the fees which are payable for supplies which are zero-rated in a less complex manner.

The fees have not been increased since 1999. The increases proposed are minor, and will help to meet costs involved in providing rulings.

CHANGES TO THE INCOME TAX (DEPRECIATION DETERMINATIONS) REGULATIONS 1993

(Clauses 171 to 175)

Summary of proposed amendment

The bill proposes that the fees payable for depreciation determinations made by Inland Revenue be increased to take into account the increased costs of providing determinations, and be expressed as plus any GST. The bill also proposes that a new additional consultation reimbursement fee be added, which relates to applications for determinations of provisional rates under section 91AAG of the Tax Administration Act 1994. The initial fee and processing fee will both be increased, and the $300 cap on the departmental consultation reimbursement fee will be removed. The fees will be expressed as "plus GST (if any)".

Cross-references in the regulations will be updated to include reference to the new additional consultation reimbursement fee.

The fee waiver provision will be amended to provide the Commissioner with greater flexibility to waive fees in circumstances where it is considered fair and reasonable to do so.

Application date

The amendment will apply from the date of enactment.

Key features

The fees which are payable for depreciation determinations made by Inland Revenue are set out in Regulation 9 of the Income Tax (Depreciation Determinations) Regulations 1993. The fees currently comprise an initial fee of $50, a processing fee of $30 per hour (or part-hour) beyond the first two hours spent in processing of the application, a departmental consultation reimbursement fee, and an additional consultation reimbursement fee.

The initial fee will be increased to $150 plus any GST and the processing fee will be increased to $75 plus any GST per hour (or part hour) beyond the first two hours.

The consultation reimbursement fee which an applicant is liable to pay Inland Revenue is currently capped at $300. This $300 cap will be removed, so the departmental consultation fee will be equal to the amount of fees paid by the Commissioner to consultants. The wording will also change from "paid by the Department" to "paid by the Commissioner".

The bill also proposes that an additional consultation reimbursement fee be added. An applicant for a determination of a provisional rate will be liable to pay this fee if the Commissioner has declined to issue a determination, or has issued a determination which is unfavourable to the applicant and the applicant requests further work.

Similarly, an additional consultation reimbursement fee will apply following a conference if the applicant requests further work and the extra work or the conference do not cause the Commissioner to issue a determination which is favourable to the applicant.

Regulation 12 currently provides that the fees prescribed in the regulations include goods and services tax. This will be revoked as the GST treatment of the fees will be addressed in Regulation 9.

The cross-references in Regulation 10(1) and 10(2) of the Income Tax (Depreciation Determinations) Regulations 1993 will be updated to include a reference to the new additional consultation reimbursement fee.

The current fee-waiver provision only permits the fees for a depreciation determination to be waived in whole or in part in "exceptional circumstances". The new fee-waiver provision will allow more flexibility based on what the Commissioner considers is fair and reasonable.

Background

Fees for determinations made by Inland Revenue were set on the basis of full-cost recovery when they were introduced in 1993. The fees have not increased since the regulations came into force, although the costs involved in providing depreciation determinations have increased substantially. Increasing the fees and removing the cap on the departmental consultation reimbursement fee will better reflect the costs to Inland Revenue of providing the service.

Taxpayers can apply for determinations on provisional rates, special rates and a higher maximum pooling value. Fees are currently not payable on determinations of provisional rates. The proposed new additional consultation reimbursement fee will mean that some fees may be payable for determinations of provisional rates. Currently, a taxpayer who has had their application for a provisional rate determination declined, or who has received a determination which is unfavourable to their position, can request further work, even when there is little chance of their application being successful. Fees may be payable in these instances to reflect the costs to Inland Revenue of any further work undertaken.

The fee-waiver provision in the Income Tax (Depreciation Determinations) Regulations 1993 is not currently used as the fees do not come close to recovering the costs to Inland Revenue in providing determinations. As the fees are being increased to a level which will better reflect the costs to Inland Revenue in providing determinations, the fee-waiver provision is being amended to offer greater flexibility to the Commission to waive fees in circumstances where it is considered to be fair and reasonable to do so.

The current fee-waiver mirrors the former fee-waiver provision in the Tax Administration (Binding Rulings) Regulations 1999 which was amended in 2010 to provide greater flexibility based on what the Commissioner considers is fair and reasonable. It is proposed in this bill to similarly amend the fee-waiver provision in the Income Tax (Determinations) Regulations 1987.

AMENDMENTS TO THE PIE RULES

(Clauses 16, 29, 40 to 55, 95 and 167)

Summary of proposed amendment

The bill contains several remedial amendments to the portfolio investment entity (PIE) rules, including some amendments to the recently enacted rules for foreign investment PIEs. Some amendments are to correct minor anomalies in how the rules operate while others are to correct minor technical errors.

Application date

The amendments will apply from the date of enactment unless otherwise stated.

Key features

The amendments will:

- narrow the capital gains exemption that applies to PIEs investing in New Zealand and Australian listed shares, to ensure that it applies only to shares that provide an equity interest;
- amend section HM 17 of the Income Tax Act 2007 which requires all investors to have the same rights to investment proceeds to clarify that it should not apply when a PIE invests in financial arrangements only;
- add Quayside Holdings Limited, the investment arm of the Bay of Plenty Regional Council, to schedule 29, which will mean its investments will be exempt from some of the requirements of the PIE rules;
- amend the flow-through rule to ensure expenses are treated appropriately in all situations; and
- correct minor drafting errors.

Detailed analysis

Tax exclusion for non-participating shares

Section CX 55 of the Income Tax Act 2007 provides that income from a PIE's share-trading gains from New Zealand and certain Australian shares is generally excluded. When this rule was developed, it was only intended that it would apply to shares that provide a true equity interest in the underlying company. Reflecting this intention, the share-trading exclusion does not apply to *non-participating redeemable shares* at present.

Nevertheless, some types of share do not provide a true equity interest yet do not fall within the definition of a *non-participating redeemable share*. Further, some elements

of the definition are of no concern from a policy perspective – for example, it is irrelevant whether or not a share carries voting rights.

Accordingly, the bill will modify the share-trading exclusion to more closely reflect the original policy intent. Specifically, the share-trading exclusion will not apply to shares that are:

- a fixed-rate share; or
- a share to which the amount payable on its cancellation is no more than the original subscription amount of the share.

Application of anti-streaming rule for cash PIEs

Section HM 17 of the Income Tax Act 2007 sets out a specific rule to prevent the streaming of different types of investment proceeds to different investors. This rule is designed to combat tax minimisation strategies and generally operates as intended. It can, however, be read in a way that causes difficulties for so-called "cash PIEs" (i.e. term deposits that have been structured as PIEs) because of the way these PIEs are often structured.

The bill amends section HM 17 to clarify that it does not apply to PIEs that invest only in financial arrangements, such as cash PIEs. The clarification will ensure that cash PIEs can continue to structure themselves in the most commercially sensible manner. As all amounts received under a financial arrangement, whether capital or revenue in nature, are taxable, allowing such streaming does not provide any tax advantage.

Flow-through rule for foreign investment PIEs

To facilitate the use of inter-PIE investment of foreign investment PIEs, a flow-through rule was created. The rule allows one PIE (PIE A) to treat its share of the gross income derived by another PIE (PIE B) as if the income had been derived directly. Say, for example, PIE B derived $100 of gross income and wishes to charge PIE A $10 in fees (leaving $90 net). Under the flow-through rule, PIE A would be treated as deriving $100 of income. However, for the flow-through rule to work effectively, the treatment of expenses also needs to be considered.

If PIE B attributes the full $100 of income to PIE A and sends a separate bill for $10, it is clear that PIE A will have incurred $10 of expenditure. However, say instead PIE B deducts the $10 from the amount it pays to PIE A, so only $90 is attributed. In this case it is unclear whether PIE A has incurred the $10 of expenditure, even though it will be deemed to have earned the full $100 under the flow-through.

To ensure the appropriate result is achieved, the bill introduces new subsection HM 6B(4). The subsection clarifies that a PIE using the flow-through rule is deemed to have incurred expenditure equal to the difference between the amount of income deemed to have been derived under the flow-through and the amount actually attributed to the PIE. In the example above, PIE A is treated as deriving $100 of income under the flow-through mechanism but has only been attributed $90 of income. Accordingly, subsection HM 6B(4) will deem PIE A to have incurred a $10 expense.

This clarification applies from the beginning of the 2012−13 income year.

Adding Quayside Holdings to schedule 29

Normally an entity can only own up to 20 percent of a PIE and there must be at least 20 investors in a PIE. The rationale for these restrictions is to ensure that PIEs are widely held, so a single investor cannot dominate the actions of a PIE. Entities listed in schedule 29, however, can hold up to 100 percent of a PIE and can be a PIE's sole investor. This is on the basis that such entities are themselves widely held. The PIE will therefore, in effect, still be widely held even if one such entity has a significant interest in it.

The bill adds Quayside Holdings to schedule 29. Quayside's investments are held for the benefit of the Bay of Plenty Regional Council's ratepayers. As such, it is effectively widely held. In addition, Quayside is similar in function to other entities already listed on schedule 29, such as Auckland Council, EQC and the New Zealand Superannuation Fund. All these entities invest for the benefit of a significant sector of the public.

Minor drafting errors

Amendments in the bill correct the following minor drafting errors:

- section HL 21(13) is being replaced by new section HL 21(9B), which will correctly modify an investor's *prescribed* investor rate as opposed to their *portfolio* investor rate with application from 1 April 2008. A similar amendment is being made to section HL 20 of the Income Tax Act 2004 with application from 1 October 2007;
- the erroneous reference to "an exiting investor referred to in section HM 61" will be removed from the definition of zero-rated investor;
- the rule that provides how a PIE should allocate tax credits will be amended to correctly apply to all types of credit, other than PIE-specific credits;
- references to "tax year" and "income year" in section HM 34 will be corrected, with application from the beginning of the 2011−11 income year;
- references to defined terms in sections HM 35B and EZ 63 will be corrected, with application from the beginning of the 2010−11 income year and 30 June 2010, respectively;
- sections HM 51(1)(b) and HM 53(1)(b)(ii) are being amended to provide that transitional residents that have elected a 0% tax rate cannot benefit from certain tax credits;
- section HM 32(3) is being re-worded (with effect from the date of enactment), while sections 64(3) and 65(5) will be amended (with effect from the date of enactment of the Taxation (Tax Administration and Remedial Matters) Act 2011) to clarify the policy intent; and
- cross-referencing errors will be corrected in sections HM 11(2) and (3), HM 12(2) and HM 19C(2), with effect from the date of enactment of the Taxation (Tax Administration and Remedial Matters) Act 2011.

FDP ACCOUNT

(Clauses 69 and 70)

Summary of proposed amendment

The bill includes two remedial amendments to the foreign dividend payment (FDP) account rules so that when a company pays further income tax as a result of having a FDP debit balance, a FDP credit arises that eliminates the FDP debit balance.

In the absence of the remedial amendments, the FDP account would remain in debit for the following year, triggering an additional tax liability, even though the correct amount of further income tax has already been paid.

Application date

The amendments apply from income years beginning on or after 1 July 2009, as this is consistent with earlier FDP changes that created the issue.

Key features

Under the existing law, a company that has an FDP debit balance at the end of the tax year, or at the time that the company stops being resident in New Zealand, is required to pay a further income tax equal to the FDP debit balance.

New sections OC 30(4) and OC 31(3) create an FDP credit for an amount of further income tax paid in these circumstances.

Background

As part of the 2009 international tax changes, an exemption was implemented for foreign dividends paid to companies. This meant that a special tax on foreign dividends, called a foreign dividend payment (FDP), was repealed.

FDP credit accounts were retained for five years to allow companies to distribute FDP credits to shareholders.

Previously, if a FDP account had a debit balance at the end of the year (for example, because excess credits were distributed), an additional FDP liability would be payable. In 2009 this liability was replaced with a further income tax liability to reflect the fact that FDP was repealed.

An unforeseen consequence of this change is that once a FDP account went into debit, the account would remain in debit for the following year, triggering an additional tax liability, even though the correct amount of further income tax has already been paid.

NRWT AND PARTLY IMPUTED DIVIDENDS

(Clause 86)

Summary of proposed amendment

The bill includes a remedial amendment to the non-resident withholding tax (NRWT) rules to ensure that some partly imputed dividends are not overtaxed compared with the rate that would apply to an equivalent unimputed dividend under a double tax agreement (DTA).

Application date

The amendment applies from 1 February 2010, being the date that the NRWT rate on imputed non-portfolio dividends was reduced to nil.

Key features

The bill clarifies how New Zealand's domestic law and double tax agreements should interact when a company pays a partly-imputed dividend to a non-resident who would qualify for relief under a double tax agreement.

Under the proposed new rules, taxpayers will calculate the post-treaty tax rate that would apply to an equivalent unimputed dividend. This rate will apply to the unimputed portion of the dividend (section RF 11B(b) of the Income Tax Act 2007). Subject to certain conditions being met, the imputed portion of the dividend may then qualify for the 0% NRWT rate under section RF 11B(a), or failing that, the 15% rate under section RF 7.

This approach is likely to be consistent with how taxpayers have been applying the existing law.

Background

The rate of NRWT that applies to dividends depends on whether the dividend is imputed or unimputed, and whether the shareholder is from a country which has a DTA with New Zealand.

The problem for partly imputed dividends is that DTAs reduce the NRWT that applies to the total dividend (the average rate of NRWT) as opposed to the rate that applies to the unimputed portion (the marginal rate). This means there may be little or no relief of NRWT in respect of the unimputed portion of the dividend.

For example, if a dividend was half imputed and half unimputed, the average NRWT rate would be 15% which would not be reduced further by the DTA. In contrast, if the same amount could be paid as two separate dividends, an imputed dividend and an unimputed dividend, there would be DTA relief on the unimputed dividend so that the average rate on both dividends would be 7.5%.

To correct this inconsistency, the bill provides for a lower rate of NRWT on the unimputed portion of a dividend when a DTA would have provided for a lower rate if the entire dividend had been unimputed.

Detailed analysis

Clause 86 of the bill replaces section RF 11B of the Income Tax Act 2007. The new section RF 11B is described below.

Section RF 11B(a) applies to the extent that a dividend is fully-imputed. It provides a 0% rate of NRWT to the fully-imputed portion of a dividend if the conditions of section RF 11B(a)(i) or RF 11(a)(ii) are met.

Section RF 11B(a)(i) requires that the shares be directly held by a non-resident and which have a 10% or greater voting interest in the company paying the dividend.

Section RF 11B(a)(ii) requires the dividend to be held by a non-resident who does not have a 10% or greater voting interest but who would nonetheless receive a less than 15% rate under a double tax agreement. Currently, New Zealand has no DTAs that provide for this.

Section RF 11B(b) applies to the extent to which the dividend is not fully-imputed. It requires the taxpayer to calculate a post-treaty tax rate by assuming that no imputation credits are attached to the dividend (including any portion of the dividend that is in fact imputed). This tax rate is then applied to the unimputed portion of the dividend.

DEFINITION OF "HIRE PURCHASE AGREEMENT"

(Clauses 88 and 168)

Summary of proposed amendment

The bill amends the definition of "hire purchase agreement" in section OB 1 of the Income Tax Act 2004 and section YA 1 of the Income Tax Act 2007 to correct a drafting error.

Application date

The amendment will apply from the commencement of the Income Tax Act 2004, with a "savings" provision for people who filed returns before the date of introduction of the bill.

Key features

The definition of "hire purchase agreement" in the Income Tax Act 2004 and the Income Tax Act 2007 will be amended to clarify that an agreement where the goods are let or hired to a person with an option to purchase does not require that option to be actually exercised.

Background

The definition of "hire purchase agreement", which originates from the Hire Purchase Act 1971, is intended to cover two types of hire purchase agreement recognised by long-standing case law. The first is one where the goods are let or hired to a person with an option to purchase (the "option to purchase agreement").[2] The second is one when a person has agreed to purchase the goods with a condition (a "conditional contract of sale").[3] The main difference between the two is whether or not the person has agreed to purchase the goods at the time the relevant contract is entered into.

The rewrite of the hire purchase agreement definition in the Income Tax Act 1994 contained a drafting error. The option to purchase agreement in the definition imports the conditional contract of sale element – it is not intended that the person's actual agreement to purchase the goods is also required.

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[2] *Helby v Matthews* [1895] AC 471 (HL).
[3] *Lee v Butler* [1893] 2 QB 318 (CA).

LIMITED PARTNERSHIPS – LOSS LIMITATION RULES

(Clause 39)

Summary of proposed amendment

The bill amends the Income Tax Act 2007 to clarify that a loan by a limited partner to their limited partnership is counted when calculating their basis for the purposes of the loss limitation rules.

Application date

The amendment will apply from 1 April 2008, being the date the limited partnership rules started.

Key features

The limited partnership rules contain loss limitation provisions to ensure that the amount of tax deductions a limited partner may claim in a year is restricted if the amount of the deductions exceeds the tax book value of their investment (the partner's basis).

The definition of "capital contribution" in the "investments" item of the loss limitation formula is being amended to clarify that it includes a loan made by a limited partner to a limited partnership, and a credit balance in the limited partner's current account with the partnership.

LOOK-THROUGH COMPANIES − MISCELLANEOUS AMENDMENTS

(Clauses 33 to 36, 88 and 150)

Summary of proposed amendments

The bill contains several remedial amendments to the look-through company (LTC) rules in the Income Tax Act 2007 and the Goods and Services Tax Act 1985 to ensure the rules are consistent with the original policy intent.

The amendments cover:

- Qualifying company amalgamations
- Tax elections, and valuation and timing methods
- Disposal of financial arrangements
- Fringe benefits provided to working owners
- Flat-owning companies
- Look-through counted owner test
- GST group-filing rules

Except where indicated otherwise, these amendments will apply from 1 April 2011, when the LTC rules became effective.

Qualifying company amalgamations (Clause 33)

When the LTC rules were introduced, the qualifying company (QC) rules were grandparented. The intention was that no new companies could use the QC rules after 1 April 2011; only companies that were already QCs (including loss attributing qualifying companies before that date could continue to use the QC rules.

This amendment ensures that a new company cannot enter into the QC rules through an amalgamation that is not a resident's amalgamation. The amendment provides that following an amalgamation between a non-QC company and a QC, the resulting amalgamated company cannot use the QC rules.

The amendment will apply to amalgamations on or after the date of enactment.

Tax elections, and valuation and timing methods (Clause 34)

This amendment provides that elections concerning the tax treatment of an LTC's income or property, or any valuation or timing methods adopted in relation to an LTC's income or property, are made or established by the LTC, not each owner. The elections made, or valuation and timing methods adopted, by the LTC are then binding on the owners in respect of their look-through interests in the LTC's property.

The amendment will apply from 1 April 2011.

Disposal of financial arrangements (Clause 35)

When an owner disposes of some or all of their interests, and those interests include a financial arrangement or an excepted financial arrangement, the owner is not required to perform a base price adjustment for their interest in a financial arrangement if, among other things, the LTC is not in the business of holding financial arrangements.

This amendment clarifies that is not necessary to consider whether any of the owners of the LTC have a business of holding financial arrangements in a capacity other than as an owner. It is only the LTC's business that is relevant.

The amendment will apply from 1 April 2011.

Fringe benefits provided to working owners (Clause 88)

A shareholder of an LTC who personally and actively performs duties for the LTC under a contract of employment may, if certain conditions are met, be treated as an employee and be referred to as a "working owner".

Fringe benefit tax (FBT) does not apply to fringe benefits received by working owners. Instead the cost of providing the benefit is a distribution of profit to that owner, to the extent of the private use element. The "private" costs are non-deductible to the other owners.

This amendment clarifies that a "working owner" is not treated as an employee for FBT purposes, by re-drafting the rule for "working owners" so that it is written in a similar style as the same, longer-standing, rule for "working partners" in a partnership.

The amendment will apply from 1 April 2011.

Flat-owning companies (Clause 88)

This amendment ensures that the definition of "flat-owning company" applies when that term is used in the definition of "look-through company".

The amendment will apply from 1 April 2011.

Look-through "counted owner" test (Clause 88)

An LTC must have five or fewer "look-through counted owners". The shareholdings of look-through owners who are relatives are aggregated, and they are treated as one look-through counted owner.

The definition of "relative" includes, among other things, a person connected with another person by being the trustee of a trust under which a relative has benefited or is eligible to benefit. This was not the intended policy outcome in relation to trustee owners of LTCs, who should be treated as separate look-through owners.

This amendment limits the meaning of "relative" for the purposes of aggregating interests in an LTC, by excluding a person connected with another person by being the trustee of a trust under which a relative has benefited or is eligible to benefit.

The amendment will apply from an LTC's first income year starting on or after the date of enactment.

GST group registration rules (Clause 150)

An LTC is not generally regarded as a company for income tax purposes. However, for GST purposes, an LTC is a company and is the GST registered entity. The LTC is responsible for complying with any GST requirements, not each individual owner. Therefore LTCs should be able to use the GST group registration rules.

This amendment provides that the income tax rules for defining a "group of companies" will include an LTC to the extent that these rules are used to define a group of companies within the GST group registration rules only. This will allow LTCs to meet the requirements for GST group registration.

The amendment will apply from 1 April 2011.

MEASUREMENT OF COST – FIF RULES

(Clauses 24 and 25)

Summary of proposed amendment

When the new foreign investment fund (FIF) rules were introduced, a temporary 5-year exemption was provided for investments in grey list companies with significant New Zealand shareholdings. Investments in Guinness Peat Group plc (GPG) qualified for this exemption. This exemption will expire from the beginning of the 2012−13 income year. This will mean that many shareholders in GPG will calculate tax under the FIF rules from 1 April 2012 using the fair dividend rate (FDR) method.

Because of the expiry of the exemption, a minor remedial amendment is required to define how "cost" is measured for the FIF rules.

The FIF rules do not apply to natural persons (or to certain trusts) if the cost of their FIF investments is equal to or less than $50,000. For the purposes of determining cost, section EX 68 of the Income Tax Act 2007 provides that a taxpayer can use half an investment's 1 April 2007 value in place of its cost if it was purchased before 1 January 2000. This is because such an investment's cost may not be readily available.

For investments to which the temporary 5-year exemption applied, this modification to "cost" is not appropriate. It may be difficult to obtain price data for long-held investments purchased after 1 January 2000.

Accordingly, it is proposed that a taxpayer be able to elect to treat the cost of an investment in a FIF as its market value at 1 April 2013 if that investment was previously covered by the 5-year temporary exemption and the investment was entered into before 1 January 2005. The investment's market value, as opposed to half its market value (as in the existing rule), will be used because share prices are historically very low.

Application date

The amendment will apply from the beginning of the 2012−13 income year.

FIF REMEDIAL

(Clause 23)

Summary of proposed amendment

The provision in the Income Tax Act 2007 that provides an exemption from the foreign investment fund rules for shares held in certain Australian companies is being updated to reflect the updated ASX Operating Rules.

Application date

The change will apply from the introduction of the updated rules (1 August 2010).

TECHNICAL CHANGES TO THE LIFE INSURANCE TRANSITIONAL RULES

(Clauses 2(16), 26 and 27)

Summary of proposed amendments

Technical changes are proposed to the application and effect of the transitional rules for life insurance policies sold before the commencement date of the reforms to the taxation of life insurance in 2010.

The changes affect both profit participation policies and life risk policies.

Application date

The proposed changes apply from 1 July 2010, or earlier at the life insurer's election for an income year that includes 1 July 2010.

Key features

The changes:

- Clarify that a simplified method for taxing profit participation policies (sold before 30 June 2009) continues to apply if those policies are later transferred or sold to another life insurer and certain conditions continue to be met. Consequential changes are also proposed to preserve transitional relief available to life risk policies in the event those policies are sold or transferred to another life insurer.
- Clarify that transitional relief continues to apply to life risk policies that are cancelled by the policyholder but later restored by the life insurer on the same terms and conditions. The restoration would need to occur within 90 days from when the life insurer receives notice of the cancellation.
- Remove ambiguities about how the transitional rules apply to life reinsurance contracts.

Background

Changes to the taxation of life insurance business, enacted by the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009, included a set of transitional rules designed to grandparent life insurance policies sold before the date the new rules started. Grandparented life policies are eligible for relief that preserves, for a limited period, the application of the previous life taxation rules.

Ongoing consultation with life insurers about the effect of the taxation reform has continued to identify a number of remedial, and often technical, issues with the operation of the transitional rules. Many of these issues are connected with the range and variation of life products on offer and the legal nature of the policies sold.

The following amendments reflect the recommendations of the Rewrite Advisory Panel's consideration of submissions on the rewritten Income Tax Acts. The Panel monitors the working of the Income Tax Act 2007 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 date

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

Valuation of livestock

(Clause 20)

As part of the rewrite of the trading stock rules in subpart EE of the Income Tax Act 1994 into the Income Tax Act 2004, the livestock valuation rules were separated from the general trading stock rules (subpart EB). The livestock valuation rules were placed in a separate subpart (subpart EC). Subpart EC was re-enacted in the Income Tax Act 2007.

However, under section EE 1 of the 1994 Act, the trading stock valuation rules in subpart EE of the Income Tax Act 1994 applied to a person carrying on a business. Therefore in the 1994 Act, the livestock valuation rules applied only to a person carrying on a business and to their livestock held as part of the normal incident of carrying on that business. This aspect of section EE 1 was rewritten into subpart EB but was inadvertently not included in the provisions of subpart EC.

This amendment restores the business nexus to subpart EC in both the 2004 and 2007 Acts. This requirement extends to all livestock for which there is a purpose of sale. The business nexus will normally be satisfied for livestock held over several years, such as dairy cattle, sheep, goats and the like, which are held for their fleece or their progeny (or both). The business nexus would normally be satisfied for this type of livestock because the disposal of these animals beyond their useful life is a normal incident of a farming business.

Application date

The amendment to the livestock valuation rules to restore the business nexus apply from the beginning of the 2005–06 income year. However, a savings provision applies for tax positions taken before 31 May 2011.

Trustee income

(Clause 38)

If income derived by at trustee for an income year is not distributed as beneficiary income, that income is included in the trustee's taxable income as trustee income. In most circumstances, trustees are taxed on income derived if it is either sourced from New Zealand or derived by a trust having a resident settlor.

Section HC 25 provides support to the settlor basis for taxing trusts by ensuring that a non-resident trustee of a trust having a resident settlor (and certain other trusts) is taxable on income derived from sources outside New Zealand.

The Rewrite Advisory Panel noted that section HC 25(1) contains an ambiguity and could be read as applying to income derived from a source outside Zealand by a non-resident trustee of a trust having a resident settlor even if that income is distributed as beneficiary income.

The Panel also identified that as the Interpretation Act 1999 provided for headings to sections to be relevant indicators for statutory interpretation, there is no unintended change in outcome. Therefore, the Panel concluded it is unnecessary to provide for a retrospective amendment.

This amendment clarifies that section HC 25 applies to income derived by a trustee in an income year that is not also beneficiary income. The Panel considered this amendment will assist the reader in understanding the effect of the provision.

Employment income

(Clause 88(7))

The amendment resolves an ambiguity in the definition of "employment income" and ensures that the definition applies to shareholder-employees.

Employment income is defined in the 2007 Act as income referred to in section CE 1. Under this provision, for shareholder-employees to derive employment income, the income they derive must come within the meaning of salary or wages.

However the definition of "salary and wages" in section RD 5 might not include income of a shareholder-employee who has elected to opt out of the PAYE rules. The election to opt out of the PAYE rules is permitted in relation to drawings taken from the company in anticipation of a salary being subsequently declared.

This amendment ensures that the income of a shareholder-employee who has elected that employment income is not subject to the PAYE rules, remains treated as employment income for the purpose of non-PAYE provisions. Examples of employment income provisions that apply to shareholder-employees are sections CE 1, EA 4 and EI 9.

Minor maintenance items

The bill also contains a series of amendments for minor maintenance items arising from the rewrite of income tax legislation that have been referred to the Rewrite Advisory Panel. These may include any of the following:

- ambiguities;
- compilation errors;
- cross-references;
- drafting consistency, including readers' aids − for example, the defined terms lists;
- grammar;
- punctuation;
- spelling;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

The following minor maintenance items are included in this bill.

Clause	Section	Amendment	Application date
Income Tax Act 2007			From beginning of 2008−09 income year
11	CE 5(1)	Improving the consistency of terminology	
13	CW 15	Correction to defined terms list	
14	CW 17(1)	Improving the consistency of terminology	
18	DC 15(1) "employee" (a), (b)	Improving the consistency of terminology	
22	EJ 2(1)	Correction to cross-reference	
30	FE 8(4)	Improving the consistency of terminology	
32	FM 8(3)(b)(ii)	Improving the consistency of terminology	
37	HC 18	Correction to cross-reference	
57	LD 3	Correction to defined terms list	
58	LJ 7(3)	Improving the consistency of terminology	
88(4)	YA 1 "dividend", para (b)	Correction to cross-reference	
89	YC 18(6)	Improving the consistency of terminology	
90	YC 18B(2)(c)	Correction of spelling	

Clause	**Section**	**Amendment**	**Application date**
Income Tax Act 2004			From beginning of 2005−06 income year
161	CE 5(1)	Improving the consistency of terminology	
162	CW 13(1)	Improving the consistency of terminology	
164	DC 14(1) “employee” (a), (b)	Improving the consistency of terminology	
166	EJ 2(1)	Correction to cross-reference	
Income Tax Act 1994			
170	DO 2(1)	Correction to cross-reference	
Tax Administration Act 1994			From beginning of 2005−06 income year
100(3), (4)	Section 3 “petroleum permit”	Correction to cross-reference	