

Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill

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

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Business tax package

OVERVIEW

The bill contains 16 measures to make tax simpler for businesses.

The main change in the package is the introduction of the Accounting Income Method (AIM). AIM allows businesses to pay their provisional tax based on a calculation prepared by their accounting software.

Submitters were highly supportive of AIM and believed it would ease the burden of provisional tax and make tax simpler for small businesses. Submitters considered that the success of AIM depends on ensuring that its final design is simple and submitted that Inland Revenue will need to sacrifice accuracy to achieve this.

The other measures in the package:

- extend the safe harbour for use-of-money interest (UOMI);
- remove UOMI from the first two instalments for standard uplift taxpayers;
- enable companies to make tax payments on behalf of shareholder-employees;
- allow contractors subject to the schedular payment rules to elect their own withholding rate and expand the rules to labour-hire firms and enable voluntary withholding agreements;
- reform the late payment penalty by no longer imposing the 1% incremental late payment penalty from new GST, income tax, and Working for Families tax credit debt;
- enable Inland Revenue to share tax for significant debts with credit reporting agencies and share information with the Registrar of Companies about certain offences; and
- provide a number of supplementary simplification measures to make the tax rules simpler.

Submitters were generally supportive of these measures. In particular there was strong support for the extension of the safe harbour and the removal of the incremental late payment penalty.

Submissions focused on the technical detail of all the measures in the package. In response to these submissions we are recommending a number of changes to the detail of the proposals, with the majority of the changes intended to provide greater certainty about how the proposals are intended to apply.

The main four changes proposed are to:

- clarify the ability of taxpayers using the standard uplift method to “square up” their provisional tax at the third payment date;
- simplify the design of the provisional tax attribution rule;
- provide an extension of time for labour-hire firms to implement the withholding tax changes; and
- make changes to the drafting of the threshold for reportable unpaid tax to address “Henry VIII” concerns raised by the Regulations Review Committee.

Provisional tax: accounting income method

ACCOUNTING INCOME METHOD (AIM)

Clauses 27-54

Issue: Support for the amendment

Submission

(Deloitte, Rightway, EY, TaxLab, AIM Working Group Software Providers (MYOB, XERO, CCH and Reckon), Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, PwC)

All submitters supported the amendments proposed in the bill to introduce a new provisional tax method based on accounting income as calculated by accounting software. As the amendments proposed will ease the burden of provisional tax they are encouraged and supported by submitters.

Recommendation

That the submission be noted.

Issue: Design and introduction of AIM method

Submissions

(PwC, Chartered Accountants Australia and New Zealand, KPMG, TaxLab)

All submitters agreed that the successful introduction and implementation of the accounting income method (AIM) depends on ensuring its final design is simple. The submitters maintain that Inland Revenue will need to acknowledge it will have to sacrifice a certain level of accuracy to achieve this. The introduction of AIM needs to be well publicised with clear guidance given, in line with the user-friendly nature of the software. It must also acknowledge the important role the accounting industry has in assisting their clients with the use of accounting software.

Inland Revenue should also be careful in communications regarding AIM not to create the impression of actual cost reductions to taxpayers when they use AIM as these may not actually eventuate.

Comment

Officials agree that the design of AIM must be based on simplicity. It is accepted that there will be an accuracy trade-off to achieve this. To ensure the design of AIM is kept simple and effective for those using it, Inland Revenue has a working group made up of software providers and accounting industry representatives to assist Inland Revenue in designing industry-led solutions. There is also a strategic input group made up of members of the business and accounting professions to provide oversight and a practical perspective on the design of AIM and its use in business.

Recommendation

That the submissions be noted.

Issue: Implementation date of AIM

Submission

(TaxLab, AIM Working Group Software Providers)

Submitters supported the later implementation date of 1 April 2018 for AIM.

One submitter wanted to note that while it would be achievable, it is still ambitious. *(TaxLab)* Tax functionality is complex, time consuming and expensive to develop and there is need for constant communication between software developers and Inland Revenue.

Comment

Officials have committed to working with software providers through the use of its AIM software providers working group, and provide regular communication through that group.

Recommendation

That the submission be noted.

Issue: Date of election to use AIM

Submission

(Chartered Accountants Australia and New Zealand)

The proposals require a person to have chosen to use the method before the first instalment date. The submission proposes this be extended to be “on or before” the first instalment date.

Comment

Officials agree that adding “on or before” to the wording would enable taxpayers to select to use the AIM on the first instalment date. An amendment to address this has been proposed.

Recommendation

That the submission be accepted.

Issue: Self-certification process

Submissions

(Chartered Accountants Australia and New Zealand, KPMG, AIM Working Group Software Providers, TaxLab)

Some submitters expressed concern with regard to the risks to the integrity of the tax system through the possibility of incorrect calculation of provisional tax by an AIM-capable accounting system that incorrectly self-certifies. It was also suggested that the Commissioner should take responsibility for ensuring AIM-capable providers meet the criteria rather than a self-certification process as this would improve certainty and reliability. *(Chartered Accountants Australia and New Zealand, KPMG)*

The Commissioner should publish a comprehensive register of approved AIM providers on its website that a taxpayer can access. *(KPMG)*

Other submitters supported self-certification as a method of certifying software providers as it is the most efficient method of certification for their industry and is consistent with the current e-filing approval processes. *(AIM Working Group Software Providers, TaxLab)*

Self-certification does require some level of auditing to be effective and Inland Revenue will need to ensure it has the skills and capability to audit given the reliance that small taxpayers place on certified systems. *(TaxLab)*

AIM can be used successfully by larger businesses however the certification process described for businesses with a turnover of under \$5 million will not be suitable for larger taxpayers. If the Government considers extending AIM to larger taxpayers, basing the approval on the software itself is not going to be a suitable basis. Approving the process by which the provisional tax payments are calculated should be used instead. *(Corporate Taxpayers Group)*

Comment

Officials consider the process of self-certification through statutory declaration to be the most effective and efficient way to certify software providers. It is consistent with other approval processes. The alternative is for Inland Revenue to audit each system, which places an undue burden on resourcing and may result in delays in certification that can cause bias to the delayed providers and taxpayers who wish to use those products.

The use of a statutory declaration and the resulting criminal implications of falsifying or misleading Inland Revenue about the certified status of a software provider will ensure there an incentive to maintain their certified status.

Inland Revenue is engaged in consultation with interested parties on how it might extend AIM to larger taxpayers and continues to engage with that submitter on a modified process.

Recommendation

That the submissions be noted.

Issue: AIM-capable accounting system definition

Submission

(AIM Working Group Software Providers, TaxLab)

The submitter supported the definition of what an AIM-capable accounting system must be before it can offer AIM to its customers. *(AIM Working Group Software Providers)*

The requirement to have an up-to-date software package should not force a package to update if that update has no impact on AIM calculations themselves. Many software products are made up of a system of connected products. As drafted, the tax calculation functionality required must be part of a core software accounting *package* so separate tax calculation products will not qualify. *(TaxLab)*

Comment

Officials note the comments regarding the update of accounting software and will review the legislation to consider clarifying that a failure to perform an update that does not relate to the AIM calculation will not mean the software ceases to be AIM-capable.

With regard to the meaning of the term “core accounting package”, it was intended that the term “package” be broad enough to include a system of connected products. Officials will review the drafting and consider clarifying that a core accounting package can include one or more connected software products.

Recommendation

That the submission regarding the update of software be accepted.

That the submission referring to the term “package” be referred to the drafters for consideration for clarification.

Issue: Removal from AIM during an income year

Submissions

(Chartered Accountants Australia and New Zealand, KPMG)

Use of the estimation model in revocation

When a taxpayer is disqualified from using AIM, the proposals is that they are shifted into the estimate provisional tax method. Submitters suggest they should be able to use the uplift method in the instance that their amounts already paid under AIM are sufficient to cover their uplift liabilities. *(Chartered Accountants Australia and New Zealand)*

In the instance a taxpayer is placed into the estimation provisional tax method, the UOMI implications of that should be limited to a prospective basis, rather than applying retrospectively to the whole year. *(KPMG)*

The Commissioner should not have the ability to recalculate liabilities where the Commissioner determines the amount of provisional tax as calculated under AIM is not reasonably accurate. It is unfair to put in place a provisional tax methodology which is designed to be simple, and yet penalise taxpayers when they fail to consider complex tax obligations. If a taxpayer has not acted in good faith, gross carelessness penalties provide sufficient penalties. (*KPMG*)

Revocation due to lack of provision of statement of activity

When a taxpayer has not provided the required statement of activity twice in the year they should not be excluded from AIM if the reason for the failure was out of the taxpayer's control. (*Chartered Accountants Australia and New Zealand*)

Comment

Use of the estimation model in revocation

The use of AIM removes the exposure to UOMI. A taxpayer would, however, be disqualified from using AIM in a year when they have failed to meet the requirements for AIM. Being able to transfer into the standard uplift method would effectively allow taxpayers to switch methods mid-year and use this opportunity to reduce their tax liability. Being transferred into the estimation method would place this UOMI exposure back onto the business and is an effective deterrent from switching between methods by intentionally failing to meet the requirements of AIM.

Revocation for failing to provide a statement of activity

Providing a statement of activity is an important requirement of AIM and will be hard coded into the accounting software. The mapping and collection of the information contained in the statement of activity will be processed by the software. The user will then submit the information to Inland Revenue.

A statement of activity is required each period. There will be instances when no actual payment of provisional tax is required or a refund is requested and the statement of activity is required to support these circumstances, which are why it is required each period. Failure to provide the first statement will cause Inland Revenue to consult with the taxpayer and failure to provide the second statement will result in removal from the AIM method. A taxpayer would not be held to account for a software failure that caused a statement of activity error.

The revocation from AIM into estimate is intended to only apply in the worst cases.

Recommendation

That the submissions be declined.

Issue: Disqualification from AIM due to consistently inaccurate assessment

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The proposals are that a person is disqualified from using AIM when they have consistently and systematically returned inaccurate assessments of their tax liabilities. This is inappropriate and should be removed. If the purpose of this section is to apply to situations when the taxpayer has deliberately misused AIM, then this would be better dealt with under the gross carelessness provisions and associated penalties.

Comment

Officials consider that there is a possibility for an inaccurate provisional tax payment amount to be produced despite the business in question using AIM correctly. AIM is designed to match the cashflow of the business and assist business to pay the right amount of tax at the right time. However, some businesses by their very nature may result in inaccurate payments of tax using AIM, despite using AIM correctly. This clause enables Inland Revenue to engage with taxpayers in this situation when their payments result in regular inaccurate payments of tax and steer them towards another provisional tax payment that works better for their business. This is not an immediate response and will instead take into account variances that arise over several income years. Therefore it is not intended to be used to revoke eligibility due to a simple arithmetic error.

Recommendation

That the submission be declined.

Issue: Revocation of AIM eligibility for taxpayer

Submission

(KPMG)

The bill should be amended to include a process for revoking AIM eligibility due to the taxpayer ceasing to meet eligibility requirements part-way through a year. The bill is currently silent on this and a provision will help provide certainty. Such a provision should involve requirements on the Commissioner to consult with the taxpayer to rectify any failures.

Comment

Officials agree clarity is required on the process of revocation during the year however disagree that legislative change is required to confirm this. Consultation with taxpayers is important in this situation and it is standard Inland Revenue procedure to do so in these circumstances. Officials note the concern and requirement for clarity and will ensure consultation is built into the practices and procedures for AIM internally.

Recommendation

That the submission be declined.

Issue: AIM technical determinations process

Submission

(Deloitte, Chartered Accountants Australia and New Zealand, KPMG, AIM Working Group Software Providers, TaxLab)

Submitters support the Commissioner's process for making determinations but want public consultation on the content of the determination. They are concerned that commercial software providers may be seen to have too much power or influence over tax policy, which should be driven by the Government and not software providers.

Comment

The process of developing the technical determination for AIM will engage with the AIM software providers group and Strategic Input Group for consultation on content. The Strategic Input Group comprises leading tax practitioners and members of relevant industry bodies.

Officials are happy to discuss the content of these determinations with submitters and have made contact with them.

Inland Revenue has not included software providers in the Strategic Input Group to ensure that software providers do not have undue influence over the design of the determination.

Recommendation

That the submission be noted, and officials discuss the content of the draft determination with submitters as it is developed.

Issue: Proposed adjustments within AIM technical determination

Submission

(PwC, KPMG, TaxLab)

The *Commentary* to the legislation included a summary on the proposed Inland Revenue process for developing the content of the AIM technical determination. Officials must continue to balance the need for absolute accuracy with the benefits of having a simple and easy to apply method.

Inland Revenue should only require adjustments shown to generally cause significant differences between accounting and taxable income and not be too pedantic in what it requires from taxpayers during the year.

Comment

Officials have made contact with the submitters to discuss their comments in more detail as they prepare the technical determination.

Recommendation

That the submission be noted.

Issue: Notice of changes to AIM technical determination

Submission

(TaxLab)

The submitter supports the 120-day lead time built into the determination process. It considers this to be acceptable when it relates to a minor change but Inland Revenue must understand how software development processes work, including business case requirements. For wholesale policy changes, Inland Revenue should ensure software developers are involved from the beginning.

Comment

Officials appreciate that the software development processes are distinct from its own design processes and that they hold their own challenges with regard to timing and implementation. The quality of the policy design to date has benefited from early engagement with software providers and it is considered this engagement with software providers will continue, especially with regard to any large scale reviews of AIM processes as standard practice.

Recommendation

That the submission be noted.

Issue: Adjustments not covered by the AIM technical determination

Submission

(Chartered Accountants Australia and New Zealand)

The amendments allow an AIM-capable accounting system to make adjustments for amounts not included in the Inland Revenue determination relating to tax adjustments for AIM. This is not practical for off-the-shelf accounting systems as reasonable accuracy will depend on the individual circumstances of the business.

Comment

The determination contained in the proposals will outline the key tax adjustments officials consider necessary for the implementation of AIM. These adjustments are coded into the AIM-capable software packages used by taxpayers. There will possibly be adjustments that would not be compulsory but the user of the software may want to make as part of their provisional tax process. It is at the software provider's discretion whether they offer this additional capability within their software.

The "reasonable accuracy" referred to in this clause is intended to apply when a software provider chooses to code any additional adjustments. It ensures they code these to take the taxpayer closer towards reasonably accurate assessments of tax. This clause applies to the software providers coding and not the use of the software by the taxpayer themselves. It is intended to protect the integrity of the tax system to ensure that the development and coding of AIM-capable accounting software works towards a reasonable accurate tax assessment.

Recommendation

That the submission be declined.

Issue: Tax pooling be allowed for provisional tax payments under AIM

Submission

(Chartered Accountants Australia and New Zealand, Tax Pooling Intermediary Association)

The taxpayers using AIM should be able to use tax pooling as it will assist with cashflow management in the instance where a business has insufficient cash to make their payments. In particular taxpayers should be able to use tax finance products marketed by the pooling providers.

Comment

The use of tax pooling for provisional tax payments throughout the income year provides certainty to taxpayers when payments are uncertain. It also assists in situations when provisional tax payments made under the estimate or uplift methods are not matched to the income flows of the business.

Provisional tax payments made under AIM would have certainty, would more closely match the income flows of the business and have no UOMI exposure to the taxpayer. AIM aligns the payment of provisional tax with other tax payments like GST and PAYE, for which tax pooling does not apply.

Officials therefore believe that AIM effectively removes any benefit to a business from using tax pooling *during* the income year.

The issues of mismatched cashflow to tax payments occur when tax adjustments move the taxable profit further away from accounting profit. Most small businesses keep tax adjusted accounts for simplicity reasons and the adjustments required under the proposed determination have intentionally been kept simple and matched to accounting income to ensure there is minimal movement away from accounting profit to keep AIM payments in line with cashflow.

In the instance where a business does have cashflow concerns during the year, they may be able to use their standard banking facilities or when it is a continued issue, choose to use a provisional tax method that better aligns to their cashflow.

Pooling itself does not operate as a pure financial institution with regard to short-term loans, rather it facilitates the sale and purchase of tax paid at different dates.

Recommendation

That the submission be declined.

Issue: Tax pooling be allowed for tax disputes giving rise to an additional liability

Submission

(Deloitte, Corporate Taxpayers Group, KPMG)

Tax pooling should be permitted to be used for reassessments of year-end residual income tax liability.

Comment

The proposed legislation is intended to remove AIM taxpayers from using tax pooling for AIM *provisional tax payments* only and does not exclude those using it for *year-end tax disputes* or a taxpayer's year-end *terminal tax payment*.

Officials agree that in both these situations because the amounts are uncertain due to the application of UOMI, a taxpayer can continue to use tax pooling in these occasions.

Recommendation

That the submission be accepted, and referred to the drafters for review.

Issue: Use-of-money interest, and penalties in AIM

Submissions

(TaxLab, EY, KPMG, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand)

Use-of-money interest

Inland Revenue should consider making AIM payments subject to use-of-money interest (UOMI) as it has a low administrative cost for Inland Revenue to administer and has the benefit of providing an incentive to taxpayers to take reasonable care.

Another supported the removal of UOMI from AIM. *(Corporate Taxpayers Group)*

Reasonable care penalty clarification

An AIM taxpayer should not be penalised because an AIM provider's approval is subsequently revoked. Reasonable care penalties should not be imposed in these circumstances. *(Chartered Accountants Australia and New Zealand)*

Clarification is sought on what "reasonable care" means for AIM. The Commissioner should take a lenient approach in the first few years of AIM. *(Corporate Taxpayers Group)*

Comment

UOMI

Officials consider the removal of UOMI to be a positive step in the development of AIM. It reflects the likely increased number of payments under AIM and gives taxpayers certainty in the amounts they are paying for AIM. The administrative costs to Inland Revenue administering UOMI are irrelevant when compared with the reduction in compliance costs for taxpayers

“Reasonable care” penalty clarification

Reasonable care in relation to AIM applies to the taxpayer in their use of the software, not in the software itself. The current test for “reasonable care” is whether another taxpayer in similar circumstances would have made the same error. In the first few years it is likely that this comparison will take into account the learning curve that many taxpayers may have in relation to a new method. However, the Commissioner will develop and publish guidance on what would be considered reasonable care under AIM. This penalty is likely to be used rather than loss of AIM eligibility as a sanction against taxpayers who fail to treat items correctly or whose adjustments are not sufficiently accurate.

Reasonable care penalties would not be imposed in the situation where an AIM provider’s approval is subsequently revoked. It refers to the use of the software and not the software itself.

Recommendation

That the submission on making AIM payments subject to UOMI be declined.

That the submission on clarification of what “reasonable care” means be accepted in part, subject to officials’ comments.

Issue: Statement of activity

Submission

(PwC, TaxLab, Chartered Accountants Australia and New Zealand, KPMG)

One submitter expressed concern about overreach in designing the statement of activity, as Inland Revenue does not bear the cost about possible development. The more cost imposed the less possibility there will be for innovation and competition by the software providers. *(PwC)*

Any statement of activity will not provide evidence of robustness of the system, and instead its main role is for statistical information for Inland Revenue. As such, any objective of robustness should be removed. *(TaxLab)*

The bill does not outline the process by which the Commissioner will determine the information required by taxpayers under the statement of activity. This information is sensitive for taxpayers and should have a consultation process prior to the setting, revocation or amendment of any information requirements. *(KPMG)*

Comment

Inland Revenue is working with software providers on the design and content of the statement of activity and has a strong relationship with the AIM providers working group and the strategic input group to ensure that any solution developed has a practical design component. The statement of activity will have purposes beyond statistical information in that it will provide the Commissioner with the information required to discharge her duties in relation to key ratio data, industry outliers, targeted services, further policy design and determining audit selection criteria.

As the drafting currently stands, there is no consultative process built into the development of the data to be provided to Inland Revenue by the software providers. Due to the interest shown in this data, officials propose that the scope of the determination be extended to cover the data made available to the Commissioner, and as such, its development will be included in the extensive process outlined for the other matters included in the determination.

Recommendation

That the submissions be:

- noted with regard to potential overreach of Inland Revenue;
- declined with regard to removing the objective of robustness from the statement of activity; and
- accepted with regard to the process for decisions on data included in the statement of activity and that the legislation be amended to alter the scope of the determination to include the development of the statement of activity.

Issue: Use of AIM by partnerships

Submission

(Chartered Accountants Australia and New Zealand)

AIM should be available to individual members of a partnership.

Comment

Officials agree that partnerships would benefit from the option of using AIM to make payments of provisional tax on behalf of their partners during the year. The implications and mechanisms required to extend AIM to partnership structures require detailed policy consideration and public consultation, and therefore officials propose it be included in a later tax bill.

Recommendation

The submission be accepted, subject to officials' comments.

Issue: Use of AIM by larger taxpayers

Submission

(KPMG, New Zealand Law Society, EY)

Submitters suggested that AIM be available for taxpayers with gross income greater than \$5 million and it could be set at \$10 million. It should be the complexity of adjustments required rather than turnover which is the appropriate eligibility criterion.

When considering the impact of extending AIM to a larger taxpayer, the net revenue over time referred to in these sections should be clarified so that it only refers to core tax rather than UOMI or penalties. *(EY)*

Comment

Ninety percent of small businesses in New Zealand have a turnover of under \$1 million and therefore the upper limit of \$5 million turnover will include the majority of small businesses within New Zealand. The next group of taxpayers who have turnover above \$5 million hold a far greater proportion of the income tax revenue and as such there is a much larger fiscal risk for extending AIM into this group.

Small businesses with simple structures are able to use the standardised “off the shelf” accounting software packages, however larger businesses with more complex business structures and transactions use more bespoke software tailored to their individual business needs. Officials are currently considering how AIM might apply to larger taxpayers in the future and are interested in continuing to expand the opportunity to pay provisional tax on a real time basis to all taxpayers.

The legislation does include the ability for businesses with turnover over \$5 million to use AIM in two instances. First, when they have been using AIM successfully and their business has grown over \$5 million they can apply to the department to continue using it, and secondly, in the instance when it is a member of a class of taxpayers using software that has been approved for large businesses. As an example, a software provider develops software suitable for the supermarket industry, which was approved by Inland Revenue as being AIM-capable. In this instance, any supermarket using the software with a turnover of over \$5 million would be able to use AIM for its provisional tax payments.

With regard to the submission related to the net revenue collected over time, the phrase “net revenue” is to be interpreted in light of section 6(A)(3), which refers to the duty of the Commissioner to collect the highest net revenue. Ensuring taxpayers are on the right provisional tax payment mechanism for them and paying an accurate amount of tax is the intention of the Commissioner. This does not include the ability to maximise revenue through collection of UOMI and penalties.

Recommendation

That the submission be declined.

Issue: Refunds

Submission

(Deloitte)

Section RM 13 of the Income Tax Act 2007 places requirements on companies before a refund of tax can be paid. It is unclear why it will not be necessary for companies using AIM to comply with section RM 13. This should be clarified.

Comment

It is intended that a refund of overpaid provisional tax under the AIM method does not require an AIM company to file an imputation credit account return but it will for all other cases of refunds of income tax. Section RM 13 will be updated to clarify this.

Recommendation

That the submission be accepted.

Issue: Defective software

Submission

(Chartered Accountants Australia and New Zealand)

The Commissioner may wish to consider including a provision that requires an AIM provider to fix defective software. Revocation does not apply till the following year after notification; if there is a defect it will need to be fixed quickly.

Comment

It is current practice to engage with software providers as soon as Inland Revenue is alerted to a defect in software which interacts with the department. At this time the approval for AIM software is able to be revoked but it is good practice for Inland Revenue to engage with the software provider to correct the error in order to maintain their approval status. It is officials' view that this standard practice is robust to ensure defective software is fixed in a timely manner and as such a separate provision is not required.

Recommendation

That the submission be declined.

Issue: Publication of notices

Submission

(KPMG)

The Commissioner should be *required* to publish notices regarding AIM eligibility approvals and revocation rather than it being discretionary.

Comment

The amendments currently propose that the Commissioner may publish notices regarding all approvals and revocations of AIM providers. Officials consider this be kept as a discretionary power to prevent the incidence of inadvertently releasing information that might be taxpayer-sensitive or hold commercial sensitivity for the taxpayers and software providers themselves. It is intended that the names of software providers who hold an AIM approval will be published on Inland Revenue's website and the Commissioner would also publish the name of the providers whose eligibility has been revoked. Having a blanket requirement to publish all information in these sections may have unintended consequences.

Recommendation

That the submission be declined.

Issue: Use of AIM in transitional years

Submission

(TaxLab)

Further consideration must be given to the impact of transitional and non-standard balance dates. The submitter wants clarity on how eligibility criteria and GST filing would apply in a transitional year.

Comment

Officials consider that AIM cannot be used effectively in a transitional year for a business as the complexity to make it work effectively would outweigh the benefits of AIM to the business. The decision to change balances dates is a conscious decision made by a business and therefore reverting to a more simplistic provisional tax method during that period of transition would be easier for the business.

AIM will utilise prior year figures during adjustments to accounting income and when it is used in a subsequent year to a transitional year, any prior year adjustments amounts would need to be annualised over a 12-month period.

Recommendation

That the submission be accepted, and legislation updated to reflect changes.

Issue: Tax rate on individuals in AIM

Submission

(Matters raised by officials)

The use of AIM is open to individual taxpayers, however, using the flat company rate may result in overpayments of provisional tax for individuals. Therefore officials consider that an alternative calculation method to allow for a more accurate determination of tax rate for individuals is required.

Comment

Officials' discussions with software providers have highlighted that the software has to develop calculations that will result in a more accurate figure for income and tax during the year. The software could also develop the capability to calculate a tax rate based on a rolling balance of figures; mixing the current year income with past year income while taking into account income from other sources and prior year rates. This option would result in the calculation of a tax rate that more accurately reflects the current year status of the business, which is the overall intention of AIM.

This issue needs consultation with the software industry to determine available calculation methods and undertake modelling to ensure they result in accurate results for the majority of taxpayers. This calculation would be embedded within the software itself and require little user intervention.

For this reason, officials propose extending the scope of the technical determinations from tax adjustments calculations to also include different ways of calculating the tax rate that applies to that taxpayer.

Using the determination provides more flexibility enabling officials and software developers to calculate a more accurate tax rate. Including this in the current determination means it would become subject to the consultation process with the AIM working group and strategic industry

Officials also propose that taxpayers have the option of choosing their own marginal rate in their first year of AIM. This ensures there is a simple option available to taxpayers should they require it. This rate choice would be subject to a requirement of reasonable care in choosing a rate (with a minimum of 10%) and the Commissioner would have the authority to override the rate when it was found to be deliberately set too low.

The principle of AIM is to ensure that businesses pay the right amount of tax at the right time; enabling the use of a marginal rate gives the taxpayer more flexibility to do this in the instance that complexity in their income year cannot be captured by a formula.

We also propose that taxpayers are able to approach Inland Revenue for a special tax code in the instance that no other option gives them accurate tax payment during the year.

Recommendation

That the drafting of the scope of the technical determination be extended to include the development of an individual's tax rate calculator.

Issue: Minor drafting issues

Submissions

(EY, KPMG, New Zealand Law Society)

Several minor drafting issues are described in the submissions. The suggested amendments relate to the following sections of the Tax Administration Act 1994:

- With regard to a failed instalment, there is a formula missing from proposed section 120KBC on how the UOMI will be calculated.
- Proposed section 91AAX(1) refers to determining adjustments for the purpose of proposed section RC 7B (3)(iv). It was suggested that the cross-reference should be to subparagraph (ii) instead of, or as well as, to subparagraph (iv).
- Proposed section 2C(b) changes the wording from “the amount of the shareholder’s tax credit under section LB 2 for the tax year less the shareholder’s residual income tax for the tax year, treating a negative amount as zero”. It was submitted that this should be changed to “the amount of the shareholder’s residual income tax under section LB 2 for the tax year less the shareholder’s residual income tax for the tax year, treating a negative amount as zero”.
- For proposed schedule 3, Part AB, insert the words “or section RC 9 (4B)(b)”.
- Proposed section 45C is currently placed within Part 3 – Information, Record Keeping and Returns and would be better situated in Part 2B – Intermediaries for PAYE, Provisional Tax and Resident Passive Income around section 15.
- The use of a statutory declaration in the eligibility process currently requires providers to declare that the product is updated regularly. A statutory declaration should not require a declaration to future actions. This should be changed to reflect their intent to keep it updated regularly.

Recommendation

That the submissions be noted and referred to drafters.

Other business tax

INCREASE AND EXTENSION OF THE CURRENT SAFE HARBOUR FROM UOMI FOR TAXPAYERS WHO USE THE STANDARD UPLIFT METHOD

Clause 110

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC)

Submitters expressed support for the proposal to increase and expand the current safe harbour from UOMI for those taxpayers who use the standard uplift method and have residual income tax of less than \$50,000.

Recommendation

That the submission be noted.

SAFE HARBOUR FOR ALL PROVISIONAL TAXPAYERS USING STANDARD UPLIFT METHOD

Clauses 80, 109 and 114

Issue: Support for the proposals

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC)

Submitters expressed support for the proposal to remove UOMI for all provisional taxpayers using the standard uplift method for the first two instalments.

Recommendation

That the submission be noted.

Issue: Estimating at the third instalment date

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, Corporate Taxpayers Group, EY, KPMG, PwC)

Six submitters believed taxpayers should be permitted to switch from the standard uplift method to the estimation method at or before the third instalment of provisional tax.

This would enable the policy intent where a person pays their entire residual income tax by the final instalment of provisional tax without the imposition of UOMI to be reflected in the legislation.

The current drafting of the legislation continues to require a person to make a final instalment of provisional tax based on the standard uplift amount, which could result in a taxpayer overpaying their tax for a particular income year.

Although the calculation of UOMI does reflect the policy intent it requires an assumption by taxpayers that they can pay less than the standard uplift amount. This should be specifically legislated.

Comment

Current rules allow a taxpayer to switch methods up until the last instalment date which is generally the third instalment. The bill proposes a rule that prohibits a taxpayer from switching from the standard uplift method to the estimate method after the payment of the second instalment of provisional tax. This restriction is designed to ensure that taxpayers who had paid the first two instalments and realised they were overpaid could not then switch to the estimation method and receive credit UOMI from the first instalment date.

The intention of the proposed changes is to permit taxpayers to pay whatever they want for the final instalment of provisional tax as this is when UOMI will apply to them. Officials thought this was clear in the wording of the calculation of UOMI and a practical way of dealing with this but submissions have suggested otherwise. Submissions have also suggested that policing action may be undertaken on the standard uplift amount on the final instalment when the taxpayer makes a payment that is less than the standard uplift amount required.

Officials recommend altering the wording in the legislation to make it clear that taxpayers who use the standard uplift method can either base their final instalment of provisional tax on the standard uplift amount or their estimate of their residual income tax for the year less payments made to date. Officials are currently considering the optimal way to reflect the policy intent in the legislation.

This will apply to all standard uplift provisional taxpayers with the exception of those who wish to use the safe harbour from UOMI when their residual income tax is less than \$60,000 who must pay all three instalments using the standard uplift amounts.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Inconsistency between sections RC 5 and RC 7

Submission

(Deloitte, EY)

The proposed changes to section RC 5, which limit a taxpayer's ability to use the estimation method after paying the first two instalments using the standard uplift method are inconsistent with section RC 7, which outlines the estimation method.

Comment

We consider that the issue outlined will be covered by the wording change proposed to enable taxpayers to use an estimate on their last instalment date (see "Issue: Estimating at the third instalment date"). As a result, we do not consider the proposed amendment is necessary.

Recommendation

That the submission be declined.

Issue: The overriding anti-avoidance section is unnecessary

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)

Two submitters raised concerns around the lack of detail about when the proposed definition of “provisional tax interest avoidance arrangement” would apply and therefore believed it should be removed. Submitters stated that if this submission was not accepted, more detailed explanation should be provided about when and how the rule would apply.

Comment

The removal of UOMI from some taxpayers creates opportunities to avoid UOMI and the payment of provisional tax in entirety by related parties switching income between them. As a result, a specific provision has been included in the legislation to deal with the most obvious gaming opportunity. However, officials consider it is prudent to retain a more general anti-avoidance mechanism to void transactions that have the primary motive of defeating the intent of the provisional tax rules that have not been contemplated by that more specific rule. This particularly applies to the under \$60,000 residual income tax safe harbour.

Officials do, however, agree that further guidance on the application of this provision should be supplied to taxpayers in a *Tax Information Bulletin* following enactment of the bill. It is intended that this provision is only applied when significant manipulation of income between related persons or entities has occurred to defeat the intention of the provisional tax rules.

Recommendation

That the submission be declined, subject to officials’ comments.

Issue: Two instalment and transitional year taxpayers

Submission

(Chartered Accountants Australia and New Zealand)

The current legislation does not deal with taxpayers who pay provisional tax in two instalments or those who are in a transitional year and may have more than three provisional tax instalments.

Comment

There are two situations where taxpayers do not have the usual three provisional tax instalments. In principle, there should be no reason to exclude these taxpayers from the safe harbour from UOMI.

Recommendation

That the submission be accepted.

Issue: An alternative anti-manipulation rule should be considered rather than the general anti-avoidance rule

Submission

(Chartered Accountants Australia and New Zealand)

Rather than the proposed anti-switching rule an alternative rule could be introduced that does not pay credit interest until the final instalment for those who start in the standard uplift and switch to the estimation regime. Alternatively, consideration could be given to providing UOMI relief to taxpayers who pay provisional tax using the estimation method.

Comment

As part of the review of the mechanism to allow taxpayers to use an estimated payment for their final instalment, officials will be considering if this is better achieved through the UOMI rules.

Recommendation

That the submission be noted, subject to officials' comments.

Issue: Pooling and standard uplift safe harbour

Submission

(PwC)

The bill does not comment on the use of tax pooling for those taxpayers using the standard uplift safe harbour although the issues paper issued by Inland Revenue clearly states that tax pooling will be able to be used.

Clarification is also required in relation to whether tax financed or purchased by a taxpayer when the amount equals or exceeds the standard uplift amount qualify for the proposal in relation to UOMI.

Comment

The tax pooling rules will apply to standard uplift taxpayers as they always have. Officials do not consider that any specific legislation is required to confirm that the current tax pooling rules continue to apply under these proposals.

Recommendation

That the submission be declined.

Issue: Reassessments – determination of method

Submission

(PwC)

A practical issue arises in relation to reassessments when attempting to determine the method elected by the taxpayer for the income year in question. Individuals involved in making the election may no longer work for the organisation or they may no longer recall which method they have elected.

Comment

The way UOMI applies to taxpayers who receive a reassessment will depend on which provisional tax method they have used for a particular tax year. For example, someone who used the standard uplift method and met all the conditions for UOMI to apply will have UOMI applied from the final provisional tax instalment date. Officials believe which provisional tax method taxpayers used in particular income years will be clearly indicated in the START system and the calculation of UOMI will be automatic on this basis. In addition, the record retention requirements placed on a taxpayer should ensure these records are available for reference.

Recommendation

That the submission be declined.

Issue: Standard method associate rule

Submissions

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC, New Zealand Law Society)

Five submitters believed that the proposed standard method associate rule is too widely targeted and should not be enacted. *(Chartered Accountants Australia and New Zealand, EY, KPMG, PwC, New Zealand Law Society)*

One submitter was supportive of the standard method associate rule as it is restricted to wholly owned companies. *(Corporate Taxpayers Group)*

The submitters who were not supportive of the rule considered that:

- it would be difficult for Inland Revenue and taxpayers to monitor their compliance with the rule;
- many associated entities are run as separate business units with provisional tax decisions made independently, and the provision will impinge on that; and
- the constraint may be too far-reaching even for companies in the same wholly owned group and may result in a wholly owned group paying too much provisional tax.

The rule should be restricted to companies and shareholders with at least 50 percent direct voting interests or market value interests or to close companies with shareholder employees who do not have PAYE deducted. (EY)

Concessionary UOMI treatment should apply where a standard method associate uses the estimation method and any concerns regarding the switching of income is more than adequately addressed by the anti-avoidance provision in the rules. (New Zealand Law Society)

Comment

The standard method associate rule is designed to deal with the situation when related taxpayers use differing provisional tax methods to circumvent the new UOMI rules by reducing exposure to UOMI and potentially also provisional tax. It complements the specific anti-avoidance provision that has also been introduced in these rules.

Officials have considered the submissions made in relation to the standard method associate rule. Officials believe that there is a requirement for such a provision to stop taxpayers from gaming the differences between the standard uplift and estimation regimes to reduce exposure to UOMI and provisional tax, and believe using a provision such as this is preferable to relying on a more general anti-avoidance provision.

However, officials consider that the scope of the definition may be too wide and may capture relationships which have a minimal ability to abuse the rules. Officials believe that the wholly owned group provision is correctly targeted but that the two provisions relating to individuals would benefit from being modified.

In particular officials recommend that proposed subsections 120KBB(4)(b)(ii) and (iii) relating to standard method associates be modified to include persons who are associated under section YB 3, treating section YB 3 as requiring 50 percent voting interests and market value interests rather than 25 percent and ignoring subsection YB 3(3). This will restrict the application of the provision significantly to capture only direct and indirect shareholders.

Recommendation

That the submissions be accepted, in part.

Issue: The formula for the calculation of failed instalments will mean a taxpayer could pay more UOMI on an instalment they have met than on a failed instalment

Submission

(EY)

The formula for determining the amount of residual income tax in proposed subsection 120KBB(3) will result in the payment of more UOMI than for a failed instalment because of the definition of “residual income tax”. To ensure that no UOMI is charged on instalments that are not failed instalments when a taxpayer does have another failed instalment during the year, the formula should be amended to reference section RC 10 in addition to section RC 9.

Comment

We agree that subsection 120KBB(3) should be altered to include section RC 10. This will mean when a taxpayer has, during an income year, instalments they pay on time and a failed instalment, the result will be that no UOMI will apply to the non-failed instalments but will apply to the failed instalments.

Recommendation

That the submission be accepted.

Issue: Correction to section 139C(1D)

Submission

(EY)

Clause 116(2) inserts new section 139C(1D). The word “the” is missing from the provision as follows “...for the tax year is *the* amount of unpaid tax given by section 120KBB(3)(b) for the date”.

Comment

We agree that the subsection should be altered to include the word “the” as outlined in the submission.

Recommendation

That the submission be accepted.

Issue: Minor drafting issues

Submission

(Matter raised by officials)

A number of small drafting points have been identified in relation to the wording in the legislation that should be remedied.

Comment

We recommend that the following minor drafting matters be remedied:

- the definition of “initial provisional taxpayer” in the Income Tax Act should reflect the change in the safe harbour threshold from \$50,000 to \$60,000;
- clause 110 should include a reference to section RC3(3) in the proposed amendment to section 120KE(1)(a) to ensure that those who are put into provisional tax for the current year can continue to use the safe harbour provisions;

- clause 110 should include the words “on or before” to ensure those taxpayers who pay their provisional tax instalments early can still use the safe harbour;
- clause 110 should also repeal section 120KE(1)(e) to align the treatment of taxpayers who have certificates of exemption from resident withholding tax; and
- clause 109 should amend proposed section 120KBB(3) to ensure that taxpayers will not be paid credit UOMI on failed instalments.

Recommendation

That the submission be accepted.

PROVISIONAL TAX ATTRIBUTION

Clauses 72, 73, 77, 78, 79, 82, 92(8)-(10), 96, 102 and 111

Issue: Support for the proposals

Submission

(Chartered Accountants Australia and New Zealand, KPMG, PwC, AIM software providers)

Submitters expressed support for the proposals.

Recommendation

That the submission be noted.

Issue: The proposal is overly complex and mechanical in nature

Submission

(Chartered Accountants Australia and New Zealand, KPMG, PwC)

All of the submitters stated that the proposal is overly complicated and complex and could be simplified.

The drafting results in unnecessary complexity. *(Chartered Accountants Australia and New Zealand)*

The UOMI calculations are extremely complicated and consideration should be given to simplifying these so they are easy to understand and apply. *(Chartered Accountants Australia and New Zealand)*

The mechanism used to transfer the tax credit to the shareholder-employee is complex and can be simplified. The submitter suggested that the existing trust-beneficiary mechanism be used. *(PwC)*

Consideration should be given to introducing two separate provisional tax attribution calculations, one for the shareholder-employee and one for the company. *(Chartered Accountants Australia and New Zealand)*

Comment

Although the concept of provisional tax attribution is simple the mechanism to implement a robust solution is, by nature, complex. Complexity arises in a number of areas including the attribution of provisional tax, the transfer of that tax and the overlay of use-of-money interest where shortfalls occur.

While acknowledging that the current mechanism does achieve the aims of the proposal officials have reviewed this in light of the submissions raised and agree some simplification can be made to make the proposal less complex for taxpayers.

Officials will continue to work with drafters and submitters to simplify the mechanism in the proposal with a view to providing a more simplified approach to the attribution in the reported back version of the bill.

Recommendation

That the submission be accepted, subject to official's comments.

Issue: Dividend and fringe benefit tax implications

Submission

(EY)

Explicit provisions should be included to address the dividend or FBT implications, if any, and the timing thereof, for transfers of provisional tax from the company to the shareholder-employee.

Comment

To the extent that any amount transferred to the shareholder-employee is not charged to a shareholder current account or otherwise reimbursed by the shareholder, it should be a dividend or a fringe benefit. In these circumstances it is more naturally a dividend so we agree that there should be no FBT.

The timing of any dividend should be on the last day of the company's income year.

Recommendation

That the submission be accepted.

Issue: Clarification of elections

Submission

(EY)

Clarification is required as to whether the provisional tax attribution agreements are intended to be made each year or whether they should continue from year to year unless cancelled.

Comment

It is intended that taxpayers should not have to make an annual election to use provisional tax attribution, however, once elected this will continue until the taxpayers cancel that election.

Officials will review the draft legislation with a view to clarifying this issue.

Recommendation

That the submission be accepted.

Issue: The provisional tax amount attributed to the company

Submission

(EY)

Proposed section RC 10(7) does not achieve the outcome asserted in the *Commentary*. Proposed section RC 10(7) should treat shareholder salary as the first part of their income.

Comment

As part of the simplification of the proposals, officials will review the drafting of this provision to ensure it meet the policy intent expressed in the *Commentary* to the bill.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Consequences of an insolvent liquidation

Submission

(KPMG)

It is not clear how the proposed rule would work in an insolvent liquidation of the company. The amounts paid would be treated as income tax of the company rather than an amount held in trust for another person. A shareholder employee may as a result find themselves with an end-of-year liability.

Comment

Officials note that in practice it would be unusual for a company in an insolvent liquidation to pay a shareholder-employee salary in the year of the liquidation, which is where the issue would arise. It is more likely that an amount has been advanced by the company to the shareholder employee during the year. This would seem to have commercial consequences but little tax implications. We do not consider the provisional tax attribution rules to be overly affected by this situation.

Recommendation

That the submission be declined.

Issue: Tax pooling

Submission

(Chartered Accountants Australia and New Zealand)

As an alternative to the proposed rules, companies and shareholder employees should be able to pool their provisional tax obligations and allocate at year end. This would simplify the process and achieve the desired objectives. This can be achieved through the transfer rules in subpart 10B of the Tax Administration Act 1994, however this approach should be formalised and sanctioned in the legislation.

Comment

As noted above, officials believe that some simplification of the proposals should be investigated with submitters and drafters and this potential alternative will be considered as part of that work.

Recommendation

That this submission be noted, subject to officials' comments.

Issue: Consideration of consequences of the shareholder-employee ceasing to receive a salary

Submission

(Chartered Accountants Australia and New Zealand)

Consideration should be given to whether the proposed rules address the situation of a shareholder-employee ceasing to receive a non-PAYE deducted salary.

Comment

Officials believe this issue can arise under current law and there are existing options to address this which can continue to be used under the provisional tax attribution.

Recommendation

That the submission be declined.

Issue: Date of election

Submission

(PwC)

The requirement to elect to use provisional tax attribution before the company's due date for the first instalment of provisional tax should be further considered.

Comment

The election to use provisional tax attribution prior to the first instalment is necessary to ensure that the obligations are correctly set and accounted for by taxpayers and Inland Revenue. Officials believe that an election is required prior to the first instalment of provisional tax.

Recommendation

That the submission be declined.

Issue: Company becoming a provisional taxpayer

Submission

(EY)

The current drafting refers to a company that is a provisional taxpayer. Where a company is currently not a provisional taxpayer but expects to be one for the tax year it should be able to use the proposed method.

Comment

In principle officials see no reason why a company who expects to pay provisional tax for the year could not use this mechanism and this issue will be reviewed as part of the simplification of the method.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Minor drafting issues

Submission

(EY)

A number of specific drafting points (cross-references and similar) should be reviewed.

Comment

As part of the simplification of the mechanism officials will review the drafting points raised by the submitter.

Recommendation

That the submission be accepted.

ALLOWING CONTRACTORS TO ELECT THEIR OWN WITHHOLDING RATE

Clauses 87, 88, 92(2)-(6), 93(1)-(18), 98, 99 and 114

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC)

Five submitters supported the proposed amendment to allow contractors subject to the schedular payment rules to elect their own withholding rate.

Some concerns about the technical detail of the proposal were raised, which are addressed below.

Recommendation

That the submission be noted.

Issue: Non-declaration rate for schedular payments

Submission

(Corporate Taxpayers Group, EY, KPMG, PwC)

The bill proposes to standardise the non-declaration rate for schedular payments to 45%.

One submitter supported the simplified approach to the non-declaration rate. *(PwC)*

Three submitters did not support the change to the non-declaration rate. They saw no strong justification for a non-declaration rate of 45% and believed that the non-declaration rate should attempt to match a contractor's final income tax liability.

The increase in non-declaration rate is contrary to the reduced non-declaration rate made for non-resident companies in 2004. *(EY)*

The current non-declaration rate should be retained and the non-declaration rate for employees should be decreased to 33%. *(EY)*

Comment

Non-declaration rates provide an important incentive for taxpayers to provide their IRD number. This information is important to ensure that the income information recorded in the employer monthly schedule can be matched against a taxpayer and therefore ensure the taxpayer pays the correct amount of tax and that their social policy obligations are correctly calculated.

We consider that a 45% rate is a simple rule that provides this incentive. The rate needs to be greater than 33% to ensure taxpayers on the top marginal tax rate who also have social policy entitlements or obligations have an incentive to provide their IRD number. It also aligns the rate with that for employees.

However, we agree that a 45% rate would be too high for non-resident companies. This is because these companies are likely to have deductions and no flow-on social policy obligations. Obtaining an IRD number for these companies may also be more difficult than for persons present in New Zealand. As a result, we recommend retaining the current 20% non-declaration rate for non-resident companies.

Recommendation

That the submission be declined, subject to officials' comments.

Issue: Minimum rate

Submission

(KPMG, PwC)

One submitter supported the proposed minimum withholding rate (*PwC*) and one did not. (*KPMG*)

The rate is too high and assumes a margin of approximately 30% on a contract payment. Most contractors will try to accurately pick a rate. (*KPMG*)

Comment

A minimum rate is necessary to reduce the risk that contractors may pick artificially low withholding rates to defer or avoid their tax obligations. Contractors that have genuine reasons for wanting a withholding rate below 10% will still be able to apply for a special tax rate.

Recommendation

That the submission be declined.

Issue: Repeatedly switching withholding rates

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, PwC)

Three submitters raised concern about the compliance costs for payers of contractors as a result of the proposed amendments. In particular, submitters commented on the proposed rule that contractors who have elected a withholding rate twice in the year must obtain the payer's consent to any further changes.

The number of changes allowed before consent should be decreased to one. (*Corporate Taxpayers Group*)

The contractor should require their consent for all changes to their withholding rate. (*PwC*)

The rule should be reviewed after two years to gauge the impact on compliance costs for payers of schedular payments. (*Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand*)

Comment

The proposed rule regarding repeatedly changing rates is intended to balance the competing objectives of reducing compliance costs for contractors and enabling them to get their withholding rate right, against the objectives of reducing the compliance cost for withholders having to repeatedly change withholding rates.

This trade-off is finely balanced. We consider that enabling a contractor to elect a rate twice within a year appropriately meets this balance. Enabling two elections without consent gives contractors an opportunity to correct genuine mistakes or adjust the rate if their circumstances change.

However, we agree with submitters that this should be reviewed after implementation, and believe it should be considered as part a wider review of schedular payments (see “Issue: Wider review of schedular payment rules”).

Recommendation

That the submission be declined, subject to officials’ comments.

Issue: Safeguards for prescribed rate

Submission

(*Chartered Accountants Australia and New Zealand*)

Taxpayers should be allowed a right of appeal or the Commissioner should be required to consult with the taxpayer regarding the prescribed rate before it is applied. It would be equitable to include these features.

Comment

The process for prescribed rates is intended to mirror the current process for deduction notices under section 157 of the Tax Administration Act 1994. Under section 157 the taxpayer can apply to have the deduction notice removed when they have paid all outstanding debt.

We consider that this process is appropriate for prescribed rates issued under section 24LC(2) (which relates to rates for outstanding debt). When a taxpayer has met all their obligations and the Commissioner considers it likely they will meet their future obligations we consider it appropriate that they also be able to apply to have any rate prescribed under section 24LC(1) changed.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Maximum prescribed rate

Submission

(Chartered Accountants Australia and New Zealand)

The maximum prescribed rate threshold of 60% appears too high and could put affected contractors into a difficult position. A rate of 50% would seem fairer.

Comment

We agree with the submitter that 60% appears to be too high. Reducing the rate to 50% would be more consistent with the maximum rate under deduction notices for salary and wages.

Recommendation

That the submission be accepted.

Issue: Published guidance on prescribed rate

Submission

(Chartered Accountants Australia and New Zealand)

The Commissioner should publish detailed guidance on the circumstances in which she would be likely to exercise her discretion to make a prescribed rate.

Comment

Under the proposed amendment, the Commissioner will only be able to use a prescribed rate when a contractor has not complied with their obligations under the Revenue Acts. This would generally be when the taxpayer has an overdue tax debt, but it could also include non-filing or evasion in some circumstances.

The Commissioner will prescribe a tax rate under section 24LC(2) (which relates to additional amounts to withhold to meet debts and other liabilities) when the taxpayer has an overdue debt. This rate will be used to repay the overdue debt and provides a more efficient means of collecting the amount outstanding compared with using a deduction notice.

The Commissioner will prescribe a rate under section 24LC(1) (which relates to adjusting the ordinary schedular withholding rate) to ensure the taxpayer's on-going compliance with their obligations. The Commissioner will use this when the taxpayer is non-compliant with their obligations and considers the taxpayer is at risk of future non-compliance with their obligations.

Inland Revenue will publish further guidance closer to the time of implementing this change.

Recommendation

That the submission be accepted.

Issue: Schedular notification

Submission

(EY, New Zealand Law Society)

Section 24L(2) should be reworded so it clearly applies only if a taxpayer has elected a withholding tax rate or if the Commissioner has prescribed a withholding tax rate.

Comment

A contractor can only notify their payer of their elected withholding rate if they have in fact made such an election. Officials agree that this should be clarified.

Recommendation

That the submission be accepted.

Issue: Services performed before 1 April 2017

Submission

(EY)

It should be clarified whether the changes will apply to all schedular payments made on or after 1 April 2017, regardless of whether they relate to services performed before or after that date.

Comment

The PAYE rules apply on a payments basis. The amendments are therefore intended to apply to payments beginning 1 April 2017, regardless of when the services relating to the payment were performed. Officials will make this clear in the *Tax Information Bulletin* following the bill's enactment.

Recommendation

That the submission be noted.

Issue: Recognition of incorrect rates

Submission

(Chartered Accountants Australia and New Zealand)

The legislation should recognise the possibility of tax being withheld at the incorrect rate due to administrative/coding errors. It would be difficult to verify errors of this nature and appropriate for the rules to recognise this.

Comment

If there is tax withheld at the wrong rate due to administrative or coding errors, Inland Revenue intends to focus more on education and future compliance with the rules. This is similar to how Inland Revenue addresses errors that occur for the PAYE rules generally. We consider that this flexible administrative approach works adequately for PAYE and is the better means of addressing any errors.

Recommendation

That the submission be declined.

Issue: Minor drafting issues

Submission

(Matter raised by officials)

Officials have identified a small number of minor drafting issues in relation to:

- whether there is a limit on how precise a contractor's withholding rate can be; and
- clarifying that as part of their notification requirements, a schedular payment contractor must provide their name and IRD number to their payer.

Comment

We recommend these issues be addressed by:

- providing that contractor's elected rate must be rounded to the nearest decimal place; and
- requiring schedular payment contractors to provide their name and IRD number to their payer as part of their notification requirements.

Recommendation

That the submission be accepted.

EXTENDING WITHHOLDING TO LABOUR-HIRE FIRM CONTRACTORS

Clauses 93(19) and 100(2)

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand, KPMG, PwC)

Three submitters supported the proposed amendment and rationale for the proposal.

Recommendation

That the submission be noted.

Issue: Wider review needed

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, PwC)

A wider review of the schedular payment rules should be undertaken. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)*

Consideration should be given to extending the schedular payment rules to all labour-only contracts. *(PwC)*

Comment

A review of the schedular payment rules is being considered as part of the Business transformation programme. This review will consider whether the schedular payment rules should be extended to all labour-only contracts.

Recommendation

That the submission be noted.

Issue: Need for greater clarity

Submission

(Corporate Taxpayers Group, Deloitte)

The definition of “labour-hire” is very brief and does not provide enough certainty for taxpayers. In particular, what is a “main activity” and when work is performed “directly for a client” is

unclear. There needs to be detailed commentary which explains how this rule is intended to apply.

Comment

The labour-hire firm provisions apply to a payment by an entity if “1 of the entity’s main activities is the business of arranging for a person or persons to perform work or services directly for clients of the entity”. This definition is based on rules that already exist in Australia.

“Arranging for a person to perform work or services directly for clients” means that there is an agreement to provide a worker to the client, who will then provide their services at the general direction of the client. This does not include a contract in which the parties agree to deliver a given result or outcome. For example, if a contract provided for Firm A to make available some painters to a building company to work for them for a period of time, and the painters work at the general instruction of the building company, then Firm A would be arranging for a person to perform work or services.

In contrast, if a contract providing for a painting company to paint houses for a building company, and the painting company contracted some labourers to work for it in completing the service, the contract between the painting company and building company would be a contract for a service to produce a given result (the painted houses) rather than a contract arranging for a person to “perform work or services directly for clients”.

For something to be one of the main activities of the business requires the activity to be more than incidental to other activities of the firm. For example, a wedding planner may arrange for persons to perform makeup, or other services directly for clients, but because this is incidental to the main activity of the planner it will not make the wedding planner a labour-hire firm.

A business can have more than one main activity. For example, a labour-hire firm may have main activities of providing workers directly, as well as providing direct contracting work. The key question to ask is whether arranging to provide workers directly is being done in a business of its own right, or whether it is merely a requirement or incidental activity of another activity of the business.

We will provide further guidance on this in the *Tax Information Bulletin* following the bill’s enactment.

Recommendation

That the submission be noted.

Issue: Alignment with attribution rule for personal services income

Submission

(PwC)

There is a risk that the current proposal could be too wide and may infringe on the application of the existing attribution rules for personal services income that already applies in cases when the contractor is associated with the labour-hire firm.

Therefore, the proposal to extend withholding tax to labour-hire firms should be limited to where the contractor and labour-hire firm are not associated.

Comment

The purpose behind the extension of the withholding rules to labour-hire firm contractors is to help contractors manage their tax payments throughout the year, and to address tax evasion concerns with some contractors in the industry.

In contrast, the personal services income attribution rules are intended to prevent higher income earners from diverting personal services income to associated entities to avoid the highest personal tax rates. It does this through attributing the income from the associated entity to the individual. The application of this rule does not affect the PAYE rules or remove provisional tax obligations, and relies on the taxpayer correctly self-assessing their income.

As a result, we do not believe that the application of the personal services income attribution rule would address the compliance cost and evasion concerns that the proposed labour-hire firm amendment addresses. In addition, when a labour-hire firm is associated with the contractor due to a shareholding relationship, the payment will usually be a shareholder-salary, which can be treated as exempt from the PAYE rules.

Recommendation

That the submission be declined.

Issue: Exemption certificates

Submission

(KPMG)

Clarification is needed as to whether non-resident contractors will still be able to apply for certificates of exemption.

The submitter strongly recommends that certificates of exemption be retained.

Comment

Certificates of exemption allow a contractor to be exempted from the schedular payment rules based on previous good behaviour. A contractor may wish to obtain a certificate of exemption when they would prefer paying provisional tax rather than paying their tax through withholding.

For New Zealand-resident contractors working for labour-hire firms, we consider that special tax rates of 0% provide a better mechanism for enabling this. This method still allows contractors to pay their income tax through the provisional tax system, but has the advantage over certificates of exemption in that it ensures that the contractor's income information is still provided to Inland Revenue and so minimises the risk of non-compliance.

However, for non-resident contractors we accept that there may still be a place for exemption certificates. This is because many non-resident contractors will be exempt from New Zealand tax and to obtain a special tax rate requires the contractor to obtain an IRD number. For non-

resident contractors, this may impose a compliance cost which exceeds the evasion risk. As a result, we recommend that non-resident contractors working for labour-hire firms be able to obtain certificates of exemption.

Recommendation

That the submission be accepted.

Issue: Clarifying special tax rates of 0%

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The *Commentary* to the bill states that contractors will be able to get special tax rates of 0%. However, this is not apparent in section 24N or 24F and it does not seem possible for a contractor to request this. This should be clarified and the IR 23BS form should be modified as necessary. *(Deloitte)*

The legislation should confirm that complying taxpayers who wish to remain in provisional tax should be able to obtain a special tax code certificate. *(Chartered Accountants Australia and New Zealand)*

Comment

The legislation enables the Commissioner to provide special tax rates without any constraints on what rate she is able to provide. Inland Revenue intends to update the relevant forms to enable contractors to specifically apply for special tax rates of 0%.

We consider that there should be a transitional provision for special tax rates so that contractors who have a certificate of exemption can, for the 2017–18 income year, have the certificate of exemption treated as a special tax rate of 0% if the certificate of exemption is not valid due to these amendments. This will help to ensure a smoother transition.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Company exemption for labour-hire firm contractors

Submission

(PwC)

The *Commentary* to the bill makes it clear that the general exemption from the schedular payment rules for companies will be overridden for labour-hire firm contractors. However, it is unclear in the draft legislation how the company exclusion is being overridden.

Comment

Clause 86(2) of the bill proposes to remove the company exemption for payments that are covered by the labour-hire firm withholding rules.

Recommendation

That the submission be noted.

Issue: Exemption for certain professional services firms

Submission

(Chartered Accountants Australia and New Zealand)

Payments made by a professional services person to its wholly owned professional services company should be excluded from the proposed rules. Extending the rules to these firms increases compliance costs for no benefit.

Comment

We agree that applying the withholding rules to payments between wholly owned companies would increase compliance costs for little benefit. These situations are also similar to payments of shareholder-salaries which are exempt from the PAYE rules. We recommend that payments to wholly owned companies be excluded from the labour-hire firm rule.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Minor drafting issues

Submission

(Matter raised by officials)

The proposed amendments currently refer to an "entity" when, for clarity, it should refer to a "person" instead.

The proposed amendment is intended to apply when a labour-hire firm arranges for a worker to perform services to a sub-client of a client of the labour-hire firm. However, the current drafting imposes an additional condition that the client of the labour-hire firm also be a labour-hire firm. This additional criterion is problematic, as it results in inconsistent treatment for contractors of labour-hire firms. It is also a criterion that is not present in the Australian legislation.

Comment

We recommend remedying this by replacing the word "entity" with "person".

We recommend that for the situation where there a chain of clients for a labour-hire firm, that the legislation not require the intermediary client be a labour-hire firm.

Recommendation

That the submission be accepted.

VOLUNTARY WITHHOLDING AGREEMENTS

Clause 93(19)

Issue: Support for the proposed amendment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, PwC)

Four submitters supported the proposed amendment to provide the option to enter into a voluntary withholding agreement.

For one submitter this support was contingent on the requirement of mutual consent remaining.
(Corporate Taxpayers Group)

Recommendation

That the submission be noted.

Issue: Company exemption for voluntary withholding agreements

Submission

(PwC)

It is unclear whether the company exception is overridden for voluntary withholding agreements.

Comment

Companies should be able to enter into voluntary withholding agreements if they have the consent of the payer. This is an oversight that should be fixed.

Recommendation

That the submission be accepted.

Issue: Requirement for valid agreement

Submission

(Chartered Accountants Australia and New Zealand)

The legislation should be redrafted to clarify what is required for a valid voluntary withholding agreement. The bill requires that the parties have “recorded their agreement in a document”. This is unclear and more guidance is needed.

Comment

For the voluntary withholding provision to apply there must be an agreement between the payer and contractor, and this agreement must be recorded in a document.

Determining whether there is a valid agreement is based on standard contract law principles and requires there to be offer and acceptance, objective evidence of agreement, and intention to create legal relations.

For this agreement to be recorded in a document, it can be through a memorandum, email, letter or formal contract between the parties so long as there is sufficient written evidence that there has been a required agreement between the parties (which can be either electronic or in hardcopy).

We will provide further guidance on this in the *Tax Information Bulletin*, as well as Inland Revenue’s employers’ guide.

Recommendation

That the submission be noted.

Issue: Other payments

Submission

(PwC)

It is unclear whether the voluntary withholding will apply to items which have previously not attracted withholding tax such as expense reimbursement. Clarification is needed in respect of these items.

Comment

Voluntary withholding applies when no other withholding provision applies and the parties agree to enter into a voluntary withholding agreement.

If the parties wish to enter into a voluntary withholding agreement for expense reimbursement, they may choose to do so.¹

¹ With the exception of amounts to which the Commissioner has made a determination under section RD 8(3).

Recommendation

That the submission be noted.

Issue: Placement of voluntary withholding provision

Submission

(Deloitte)

The voluntary withholding provision should be in Part K of schedule 4 rather than Part W.

Comment

Given the voluntary withholding provision is unique compared with the remaining schedular payment provisions, and only applies if the other schedular payment provisions do not apply, it is preferable to leave it in Part W. This would allow greater flexibility to add more parts to schedule 4 in the future.

Recommendation

That the submission be declined.

LATE PAYMENT PENALTIES

Clause 114

Issue: Support for the amendment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, PwC, R Saunders)

Submitters support the proposal to no longer impose the 1% incremental late payment penalty on certain tax types, with some submitters acknowledging that more work could be done in this area in the future.

The current penalty regime is excessive, particularly when combined with UOMI. *(KPMG)*

We would like to see further flexibility in the penalty rules, such as removing late payment penalties from provisional tax payments. *(Corporate Taxpayers Group)*

Recommendation

That the submission be noted.

Issue: Instalment arrangements credited against core tax

Submission

(Chartered Accountants Australia and New Zealand)

Instalment payments should be credited against core tax first, then late payment penalties and UOMI. Inland Revenue should concentrate on collecting core tax outstanding rather than collecting incremental penalties, many of which will have to be written off in the future.

Comment

The treatment and priority of payments made to Inland Revenue, and the calculation of UOMI on unpaid tax is outside the scope of the current bill. Officials may look at this issue in the future, depending on tax policy work programme priorities.

Recommendation

That the submission be noted.

Issue: Commissioner discretion to impose penalties and UOMI

Submission

(Chartered Accountants Australia and New Zealand)

A further discretion in the debt collection area should be given to the Commissioner so she can set different rates of late payment penalty and/or UOMI depending on the compliance history and circumstances of the taxpayer. UOMI rates for instalment arrangements could vary, so that one-off late payers are not penalised in the same way as serial defaulters.

Comment

Currently, when the taxpayer has a good compliance record for the preceding two years, the Tax Administration Act requires the Commissioner to grant a taxpayer additional time to pay before imposing late payment penalties. If the payment is not made by a certain date, the late payment penalty is imposed.

In giving the Commissioner discretion to impose late payment penalties and UOMI, the Commissioner would be required to design business rules to administer her discretion. These rules would require careful consideration and consultation and be robust enough to be fairly applied to all taxpayers.

Consideration would also need to be given to how these rules would be implemented, either by computer or by manual (human) processing. Given the time-sensitive nature of these decisions, the Commissioner would need to devote significant resources to ensure the efficient delivery of the discretionary rules.

There may be opportunity in the future for officials to further explore this issue as part of Inland Revenue's business transformation programme, by using the new IT capability (START) to administer and deliver greater discretion to some administrative financial penalties and UOMI rules.

Recommendation

That the submission be declined.

Issue: Imposition of late payment penalties on other civil penalties

Submission

(Matter raised by officials)

The current drafting of the proposed section requires the Commissioner to impose incremental late payment penalties on other unpaid civil penalties that have been imposed in the same tax period.

The outcome for the taxpayer is that while incremental late payment penalties will not be imposed on the unpaid tax in one of the prescribed periods, if a civil penalty such as a late filing penalty is imposed and remains unpaid, the Commissioner will be required to impose incremental late payment penalties on the unpaid late filing penalty amount.

Comment

The proposed section relies on the existing definition of “unpaid tax” in section 139B(6)(c) of the Tax Administration Act, which incorporates the definition of “tax” as defined in section (3)(1). This definition includes civil penalties in the definition of “tax”.

A potential interpretation of the current drafting is that the Commissioner is required to impose incremental late payment penalties on the unpaid civil penalty, but not the unpaid tax underlying the unpaid civil penalty.

This interpretation is against the policy intent, which is to no longer impose the incremental late payment penalty on the prescribed tax periods, regardless of whether a civil penalty is subsequently imposed on that particular tax period.

Recommendation

That the submission be accepted.

Issue: Minor drafting issue

Submission

(EY)

GST return periods

The proposed new subsection is drafted as:

(a) GST return period ending within 7 days of 31 March 2017 and (b) GST for a GST return period ending after 31 March 2017.

As the proposed new para (b) refers to GST returns for GST return periods ending after 31 March 2017, we assume para (a) is intended to cover return periods ending within the 7 days ending on 31 March 2017.

As phrases such as “within x days of” are often used for periods following the given date, we suggest it may be clearer for the proposed subsection to refer to a period ending within 7 days before or on 31 March 2017.

Comment

Officials acknowledge the minor drafting point raised by the submitter and have referred these points to the bill drafters for their consideration.

Recommendation

That the submission be noted.

GST returns: clarification of “within”

Submission

(Matter raised by officials)

Amending the number of days a GST return can be filed within 31 March 2017, to allow the provision to include all applicable taxpayers that may file their GST return early under section 15E(2) of the Goods and Services Tax Act 1985.

Comment

Proposed section 139B(2B)(a) prescribes that taxpayers that file GST returns that end within 7 days of 31 March 2017 will not be liable to pay an incremental late payment penalty.

Officials are concerned that taxpayers may read the definition of “within” to include the day of 31 March 2017, in effect only providing 6 days before the 31 March 2017 (25 March 2017). Due to section 15E of the Goods and Services Tax Act being worded as “not more than 7 days before or after the last day of the month”, officials recommend amendment to the provision, to include the 7th day before 31 March 2017 (24 March 2017).

Recommendation

That the submission be accepted.

DISCLOSING REPORTABLE UNPAID TAX TO CREDIT REPORTING AGENCIES

Clauses 95, 103 and 104

Issue: Support for the amendment

Submissions

(Deloitte, Office of the Privacy Commissioner, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Dun and Bradstreet, KPMG, PwC, R Saunders)

Almost all submitters supported the rationale of the proposal, but had concerns about the impact on the taxpayer in the event of misreporting or misidentification. Submitters supported the safeguards around the requirements the Commissioner had to meet in order to disclose the taxpayer's information.

One submitter was concerned about the commercial ramifications of misreporting and the lack of guidance on redress in such situations. *(KPMG)*

One submitter agreed that sharing information about outstanding tax debt with credit reporting agencies will provide some additional protection for the business community. *(Chartered Accountants Australia and New Zealand)*

One submitter disagreed with the proposed amendment, believing that it was unnecessary as the submitter expected the indebted taxpayer's tax agent to be proactive in resolving the tax debt. *(R Saunders)*

Recommendation

That the submissions be noted.

Issue: May limit commercial lending by banks

Submission

(R Saunders)

The proposal would inform retail banks that a taxpayer owes a significant amount of reportable unpaid tax debt, and consequently provide a bank with a reason to decline a taxpayer's request to any further lending.

In order to convince banks to lend to an indebted taxpayer, the taxpayer would occasionally have to set up certain business structures and other lending justifications that were otherwise not required, in order to facilitate the lending. This is not in the best interests of New Zealand.

Comment

This proposal will support businesses that unknowingly extend lending or trade credit to significantly indebted taxpayers. By disclosing tax information about significantly indebted taxpayers, the proposal provides other businesses with a more comprehensive view of the taxpayer's financial position at the time they are making important commercial decisions.

Recommendation

That the submission be noted.

Issue: Formal notification

Submission

(Deloitte)

The legislation does not specify how taxpayers will be notified. The *Commentary* indicates that if the taxpayer is a company, a notice will be sent to all registered directors. It is recommended that the notice should also be provided to the company itself at its registered address.

Comment

Proposed section 85N(2)(b) requires that the taxpayer will be formally notified prior to any disclosure. The definition of "formally notified" in section 14D of the Tax Administration Act must be in writing, delivered personally or by registered post, with communication not including communication by email, the internet or other electronic means. The *Commentary* further explains this notice will be served personally on the taxpayer.

A notice can also be easily be posted to the company's registered address. This address is accessible to the Commissioner from the Companies Office Register. This additional notification will be incorporated into operational guidelines.

Recommendation

That the submission be accepted.

Issue: Safeguards for disclosing taxpayer information

Submission

(Corporate Taxpayers Group)

The *Commentary* provides that this proposal will be phased in and the Commissioner will only credit report approximately 500 taxpayers per year, until robust processes can be established. In the submitter's view, no taxpayers should be reported on until such policies are established. Reporting on taxpayers when there are no robust policies in place increases the risk of errors and, the absence of reportable unpaid tax for an entity could give false impression that there is no outstanding tax debt when this may not be the case.

Comment

The *Commentary* outlines that the proposal would be implemented in a phased approach, and so the Commissioner would only disclose approximately 500 taxpayers a year. This would allow Inland Revenue to have firmly established robust processes and mechanisms in place while working with modest volumes.

The implementation of this proposal requires Inland Revenue to develop its own IT processes as well as interact with external third parties' IT databases. Officials agree that it is vital that those processes and policies are fit for purpose, before this proposal is launched. In the short-to-medium-term, Inland Revenue will disclose modest volumes to ensure those processes and policies are capable of handling larger volumes, if required.

This proposal will not "go live" until Inland Revenue has established processes and internal policies have been established.

Recommendation

That the submission be accepted.

Issue: Remedies for error

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The legislation should outline how the risk of errors will be mitigated (and corrected), and make provision for remedies when the taxpayer has suffered damage to their reputation or business as a result of this erroneous disclosure. *(Chartered Accountants Australia and New Zealand)*

There needs to be clear guidance on how these situations will be managed, including sanctions for the offender and redress for those affected. *(KPMG)*

Comment

The proposal contains a number of safeguards designed to minimise misreporting or misidentification.

This includes the 30-day notice being served on the taxpayer (or director) outlining the taxpayer's debt data. This allows the taxpayer to review this data and advise Inland Revenue of any errors, before the taxpayer's data is disclosed.

The Commissioner will disclose the taxpayer's identification information in order to match the taxpayer with the approved credit reporting agency's credit records. This will likely use a number of reliable identification sources, including the Company Office and New Zealand Business Number information. Only when there is a strong degree of confidence that an identification match has been successful, will the Commissioner subsequently disclose the taxpayer's debt information for the purposes of the data being included on the taxpayer's credit report.

In addition, the proposal intends to work with the approved credit reporting agency's processes and safeguards, to allow the approved credit reporting agency to perform a "common sense check".

If an error is identified, Inland Revenue will report that error to the approved credit reporting agency as soon as practicable, to allow the approved credit reporting agency to efficiently correct and update their records. This will include correcting any information that has been previously distributed to third parties.

The Commissioner will provide each taxpayer with information on how they can report any data errors as well as the complaints process.

Where an erroneous disclosure has occurred, the taxpayer can follow existing administrative law and ask the courts to judicially review the Commissioner's actions and decisions.

Recommendation

That the submission be declined.

Issue: Threshold for initial disclosure

Submission

(Chartered Accountants Australia and New Zealand, Dun and Bradstreet, PwC)

The \$150,000 threshold of reportable unpaid tax contained in proposed section 85N(2)(d) may not achieve the policy intent of the changes. The submitter supports the provision that allows the Governor-General to change by Order in Council, however it is uncertain whether the threshold proposed will be sufficient to protect the business community and help them to mitigate business risk. *(Chartered Accountants Australia and New Zealand)*

The use of a variable percentage of gross income to determine whether the tax debt is to be disclosed is inappropriate as it may expose businesses with materially small amounts of debt. *(PwC)*

The power to adjust the thresholds is important. The reduction of these thresholds in the future will provide a truer picture of a party's real liability position. *(Dun and Bradstreet)*

Comment

Officials acknowledge that the debt thresholds may not capture all significantly indebted businesses at the most appropriate time to disclose. These thresholds represent a balance between complexity and coverage across all significantly indebted taxpayers.

For the \$150,000 threshold, the ability to amend by Order in Council is important and provides the ability to amend the threshold when there is a sudden change in circumstances that may require Inland Revenue to take action.

The other threshold where the debt is more than a year old and is 30 percent or more of a taxpayer's gross income can be considered for indebted taxpayers that may owe less than the

\$150,000 threshold, but the tax debt is older, and significant compared with the turnover of the business.

Officials will monitor the effectiveness of the proposal's debt thresholds and consult with submitters if any further amendments are required.

As part of that oversight, officials will monitor the implementation of the new rules and report to the Minister of Revenue if concerns with the effectiveness of the rules are identified.

Recommendation

That the submission be noted.

Issue: Disclose where there is repeated non-compliance

Submission

(Dun and Bradstreet)

Where the taxpayer has shown repeated non-payment behaviour, the Commissioner should be able to disclose the taxpayer's information, despite the amounts outstanding being below the proposed debt thresholds.

Comment

The debt thresholds are designed for taxpayers that are significantly indebted. If the taxpayer is consistently and repeatedly filing tax returns without payment, the total debt amount will increase over time, until the amounts outstanding meet the prescribed debt thresholds.

Recommendation

That the submission be declined.

Issue: Amending the threshold amount using an Order in Council

Submission

(Regulations Review Committee)

Proposed section 85N(2)(d)(i) prescribes the threshold amount the taxpayer must owe in reportable unpaid tax, before the Commissioner can consider disclosing the taxpayer's information, with an accompanying empowering provision that would allow this amount to be amended by an Order in Council.

This provision is a technical "Henry VIII" power, as it authorises the statutory amount to be amended by Order in Council. There may be alternative ways of drafting this that would not create a technical Henry VIII provision. For example, the provision could state that the amount would be set by an Order in Council.

Comment

Officials agree with the submitter's suggested drafting of amending the empowering provision so the provision prescribes that the initial amount will be set by way of an Order in Council. This will resolve the submitter's concerns, while maintaining the flexibility to amend the amount in the future.

Recommendation

That the submission be accepted.

Issue: Commissioner's judgement

Submission

(Chartered Accountants Australia and New Zealand)

How is it proposed that the Commissioner determines a taxpayer's income if the taxpayer is not up to date with their return filing.

Comment

The *Commentary* notes that the Commissioner will use previously filed tax returns and other financial information to reasonably determine the taxpayer's gross income for the year.

If the tax returns are unavailable, the Commissioner would require a level of other suitable financial information to reasonably determine the taxpayer's income.

It is difficult for the legislation to effectively prescribe what can be a taxpayer-specific situation. The better option is to leave this to the judgement of the Commissioner to determine whether the requirement has been met.

Recommendation

That the submission be noted.

Issue: Require the Commissioner to disclose

Submission

(Deloitte, KPMG)

Once the Commissioner has notified the credit reporting agencies of a tax debt, the Commissioner must ensure the accuracy of the tax debt record from that point, especially when the taxpayer has cleared the tax debt. *(Deloitte)*

We note there may be a delay between the tax debt in Inland Revenue's system, the reporting of that debt to the credit reporting agencies, and the use of the information by lenders. There needs to be a process to ensure that any shared information is updated in a timely basis. This includes

a requirement for the credit reporting agencies to update their records and information communicated to any third parties. (*KPMG*)

Comment

The proposal relies on the Commissioner regularly disclosing data to external third parties (approved credit reporting agencies), with these agencies including the data in their databases, for the purposes of making that information available to selected third parties upon request.

However, officials recognise that when taxpayers have paid their reportable unpaid tax debt in full, they would then want this information updated on their credit report as soon as practicable, so their credit records show they no longer owe any reportable unpaid tax debt to Inland Revenue. As part of the proposal's implementation, Inland Revenue will design a separate method for communicating with the approved credit reporting agencies when applicable taxpayers have paid their debt in full.

Due to the tax debt balances changing daily, and because databases are being administered by the approved credit reporting agencies, the Commissioner would be providing regular, scheduled information updates to the approved credit reporting agencies.

Between these updates the data held by the approved credit reporting agency may become inaccurate, until the next data exchange has occurred and applied. The timing of these exchanges is yet to be determined, however they are likely to be on a fortnightly or monthly basis.

Officials will provide further guidance on how data exchanges will work in Inland Revenue's *Tax Information Bulletin* following enactment of the bill.

Recommendation

That the submission be accepted in principle, subject to practical limitations.

Issue: Disclosure of key elements of reportable unpaid tax

Submission

(*Deloitte*)

The *Commentary* indicates the Commissioner may disclose key elements about the taxpayer's reportable unpaid tax, including the amount of outstanding tax for each tax type expressed within a narrow band, and the age of each tax type. It is not clear where or how this is expressed in the legislation, however we expect this is intended to be in subsection 85N(4).

Comment

The drafting of proposed section 85N(4) provides the legislative discretion to the Commissioner to communicate *any* information relating to the taxpayer and any amount of reportable unpaid tax. This includes the elements outlined in the *Commentary*.

The legislation does not need to prescribe the elements, because as the legislation is currently drafted, that level of prescription is not required.

Officials will provide further information about the information that is disclosed under this provision in Inland Revenue's *Tax Information Bulletin* following enactment of the bill.

Recommendation

That the submission be noted.

Issue: Disclosure of default assessments

Submission

(R Saunders)

Inaccurate information may be disclosed to an approved credit reporting agency, in particular, when the taxpayer has incurred the tax debt by way of a Commissioner-issued default assessment. In some circumstances, these returns are inaccurate compared with the tax return later filed by the taxpayer and so had this data been released, it would have been wrong.

Comment

The proposed amendment has been developed with several safeguards in mind, in order to minimize any possible inaccuracies. This includes having the debt data being served on the taxpayer (or director) and allowing time for the taxpayer to raise any inaccuracies with the tax debt information contained in the formal notice.

The Commissioner would commonly raise a default assessment when a taxpayer had failed to file a required tax return. The default assessment is based on the best information available to the Commissioner at the time the default assessment was raised. A default assessment is usually raised when the tax return has been outstanding for some time (at least several months) and when the taxpayer had previously been informed that a default assessment may be raised if the return remains outstanding.

While the default assessment would be manually issued by an Inland Revenue officer or automatically issued by Inland Revenue's IT system, the default assessment fundamentally continues to represent a tax debt owed to the Commissioner. The Commissioner can take action (including legal proceedings) to recover the default assessment amount in the same way as any other tax debt. This would occur where the taxpayer has been issued with the default assessment and it remains unpaid. The quickest way for the taxpayer to resolve a default assessment is to file the outstanding return.

However, officials do note the submitter's concerns that some taxpayers may have outstanding returns or default assessments at the time they formally receive the notice.

When an amount contained in a previously issued default assessment meets the definition of "reportable unpaid tax", these amounts will be identified in the formal notice. The formal notice will also advise the taxpayer that if they wish for these amounts to best reflect their tax position at the time, they need to file their outstanding tax return as soon as possible. This notification will be incorporated into operational guidelines.

Recommendation

That the submission be declined.

Issue: Publication of credit reporting agency that has had approval revoked

Submission

(Chartered Accountants Australia and New Zealand)

The Commissioner should publish the number of credit reporting agencies that have had their approval revoked in the previous year. This would provide a check and balance on the proposal.

Comment

The *Commentary* states that any approval or revocation would be publicly notified. This is to ensure the general public is aware of who is authorised to receive the taxpayer's information.

Recommendation

That the submission be accepted.

Issue: Disclosing an individual's information

Submission

(Office of the Privacy Commissioner, Dun and Bradstreet, PwC)

Submitters are keen for officials to take a considered approach when contemplating extending the proposal to individuals.

Inland Revenue will need to do further work to determine the consistency of the proposal with the Credit Reporting Privacy Code 2004, which regulates credit reporting agencies use of individual information. The submitter's staff will work with Inland Revenue to help identify the best way to implement the policy for individuals in business, without unduly affecting their privacy. *(Office of the Privacy Commissioner)*

At a minimum, we submit that credit reporting of an individual's tax debt information should be the subject of further consultation. *(PwC)*

Comment

Officials acknowledge that further work is required when considering how best to extend the proposal to individuals. In due course, officials will welcome discussions with the Office of the Privacy Commissioner and other submitters.

Recommendation

That the submission be accepted.

Issue: Need for clarity

Submission

(Deloitte, Corporate Taxpayers Group)

The legislation should be updated and Inland Revenue should ensure there is clear guidance on the intended application of the rules (*Deloitte*).

The legislation relating to the proposals is unclear, and does not necessarily align with the description included in the *Commentary*. It does not appear to explicitly require the Commissioner to disclose the amount of debt owing, despite the *Commentary* to the bill suggesting this will occur. (*Corporate Taxpayers Group*)

Comment

Officials acknowledge the balance between legislative flexibility and specificity can be better achieved and have referred some items to the drafters for consideration.

Officials will issue guidance on the interaction and effect of this clause, including providing practical examples in Inland Revenue's *Tax Information Bulletin*.

The Commissioner will also prepare guidance on the practical use of the proposed section, so taxpayers and tax practitioners are made more aware of the provision.

Recommendation

That the submission be accepted.

Issue: Guidance on what constitutes “reasonable efforts”

Submission

(Chartered Accountants Australia and New Zealand)

The Commissioner should publish detailed guidance on what she considers to be “reasonable efforts to recover reportable unpaid tax”.

It will be critical to ensure trust and confidence in the system. It will therefore be fundamental for all parties involved, including the Commissioner, the taxpayer and the credit reporting agency, to understand the criteria that must be satisfied.

Comment

The *Commentary* notes that “reasonable efforts” includes when the Commissioner has engaged in recent, meaningful and sustained communication with the taxpayer.

This includes when the Commissioner and the taxpayer have explored various options to resolve the reportable unpaid tax, without success, or when the taxpayer is in the process of securing finance or conducting an ordinary windup of their business, and the Commissioner is confident of its success.

Officials will provide further guidance on this in Inland Revenue’s *Tax Information Bulletin*, with the Commissioner also issuing guidance, so taxpayers and tax practitioners are made aware of what constitutes “reasonable efforts”.

Recommendation

That the submission be accepted.

Issue: Definition of “income”

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

Proposed section 85N(2)(d)(ii) is unclear about what is the “taxpayer’s income”. Is it gross income, net income, taxable income, taxable and exempt income?

Comment

The term “income” is defined under section BD 1 of the Income Tax Act 2007. However, officials acknowledge that this definition of income is very broad, and may be broader than is required for this provision.

Officials recommend the proposed section be amended so the term “income” is replaced with *assessable income*. This definition is defined under the Income Tax Act 2007 and will include most of the usual forms of income received by New Zealand businesses. This figure can be determined from the tax returns and other financial information that taxpayers file with Inland Revenue.

This definition will also provide clarity to taxpayers and tax practitioners about what income is included for the purposes of determining if the taxpayer has met this portion of the debt threshold.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Inconsistency between the *Commentary* and the bill

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, Corporate Taxpayers Group)

There is an inconsistency between the officials’ *Commentary* on the bill and the bill itself, in relation to the reportable unpaid tax debt thresholds prescribed in section 85N(2)(d). This subsection prescribes the amount of reportable unpaid tax that must be owed before the Commissioner can disclose the taxpayer’s information. The drafting does not reflect the policy intent as described in the *Commentary* on the bill.

The threshold is an amount that is greater than \$150,000 or an amount that has been unpaid for a year and the amount is 30 percent or more of the taxpayer's income for the past year.

The drafting is expressed as a “:” meaning and/or, whereas the *Commentary* states that the threshold is part of a “greater than” test.

Comment

Officials confirm that the threshold contained in the bill is correct. The criteria in the *Commentary* is an error and officials propose to provide clarification in Inland Revenue's *Tax Information Bulletin*, which details the tax changes to the public once the legislation is enacted.

Recommendation

That the submission be accepted.

Issue: Minor drafting issues

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The submitters raise a number of drafting issues:

- i. Proposed section 85N(2)(d)(ii) is unclear as to what is “the year”, with the *Commentary* indicating this is the “previous” year.
- ii. Proposed section 85N(2)(7)(c) should be redrafted to improve clarity so that the number of taxpayers that have ceased having reportable unpaid tax in the previous year “having been previously” notified under this section.

Comment

Officials acknowledge the minor drafting points raised by the submitters.

In submission i), the term “year” is defined under Section YA 1 of the Income Tax Act 2007 as a 12-month period. The drafters have considered the submitter's issue and consider that amending the term to “previous year” would lead to ambiguity and confusion, as the term “previous year” is commonly used in a tax year context and it is not being used in that context in the proposed section.

In submission ii), the drafters have considered the submitters proposed drafting, and consider the difference in drafting to amount to different drafting style. As such, the drafters do not believe there is any added value in amending the current drafting.

Officials will consider whether the drafting could be improved in other areas of the proposed section.

Recommendation

That the submission be declined.

Submission

(Matter raised by officials)

Officials would like to raise a number of drafting issues:

- Proposed section 85N(8) and (9) could be redrafted to provide clarity on the interaction of (8) and (9).
- Proposed section 85N(11)(a)(i) that results from liability for or *refunds* of income tax. Officials believe that this drafting could be clarified as *excess refunds*.

Recommendation

That the submission be accepted.

DISCLOSURE OF INFORMATION RELATING TO SOME OFFENCES TO THE REGISTRAR OF COMPANIES

Clause 104

Issue: Support for proposal

Submission

(Office of the Privacy Commissioner, KPMG, Chartered Accountants Australia and New Zealand)

The thresholds for sharing information in clause 104 are consistent with the exceptions provided for under principle 11(e) of the Privacy Act (which provides for disclosure where it is considered necessary to avoid prejudice to the maintenance of the law). The provision is appropriately defined and will not unduly impact the privacy of affected individuals. *(Office of the Privacy Commissioner)*

Recommendation

That the submission be noted.

Issue: Proactive sharing with the Companies Office

Submission

(Chartered Accountants of Australia and New Zealand)

Detailed guidance should be issued to the public on which provisions under the Companies Act 1993 would trigger action by the Commissioner, and in particular, how Inland Revenue would be interpreting these provisions.

Comment

If enacted, the process for sharing information with the Companies Office will be outlined in a *Tax Information Bulletin* and it will detail which provisions under the Companies Act will trigger action.

Inland Revenue may proactively share information in certain limited circumstances where no interpretation of the Companies Act is required – if Inland Revenue discovers any persons still acting as director or promoter of a company when they are the subject of a prohibition order and/or if they are directing or acting in promotion of a phoenix company. The list of prohibited persons is a matter of public record. Inland Revenue may also proactively share information when it discovers a person making false statements about tax matters, as this may also mean false statements have been made under the Companies Act.

Recommendation

That the submission be noted.

Issue: Framework for information sharing with other agencies

Submission

(Corporate Taxpayers Group)

The submitter voices a general concern that information sharing between agencies is being developed on an ad hoc basis without a framework which balances the need for information sharing with the rights of individuals to have control over information or keep information private. The lack of framework against which to test each information sharing decision means the rights of individuals will be gradually eroded.

Through information sharing arrangements, agencies will be able to access data which it is not clear Parliament meant them to access. If Parliament did not give an agency the same powers to gather information as Inland Revenue, that agency was not meant to have that information, and should not access it through a sharing arrangement.

Comment

The Government is developing a framework for tax administration which includes the sharing of information gathered by Inland Revenue. In November 2015 the Government sought feedback from the public on a framework for tax administration through the release of the *Making Tax Simpler – Towards a New Tax Administration Act* discussion document. This document suggested changes to the tax secrecy provisions to allow information to be shared among government agencies, in order to provide better public services, and to be shared with foreign jurisdictions, to assist in taxpayer compliance.

The Government is considering the feedback it received from the public on the proposals and this will inform its work on any changes to the Tax Administration Act.

Recommendation

That the submission be noted.

MOTOR VEHICLE EXPENDITURE OF CLOSE COMPANIES

Clauses 56, 58, 59, 60, 61 and 63

Issue: Scope of proposals

Submission

(Chartered Accountants Australia and New Zealand, KPMG, PwC)

Three submitters supported the proposal to allow close companies the option of apportioning business and private use of motor vehicles instead of having to pay FBT on private use. *(Chartered Accountants Australia and New Zealand, KPMG, PwC)*

One submitter also acknowledged that while the proposal is a sensible and pragmatic simplification measure, it does contravene the concept of a company being a separate legal entity. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials agree that the proposal does ignore the close company's separate legal entity because the close company is operating like a sole trader and therefore is being treated the same as a sole trader for the purposes of this proposal only. This means that the company structure is set aside in order to use the motor vehicle expenditure rules if the close company elects to use this option.

Recommendation

That the submission be noted.

Issue: Interest allocation rule for motor vehicle expenditure for close companies

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The interest allocation rule adds unnecessary complexity to a proposal that is meant to be a simplification measure. It is accepted that not allocating interest costs to the apportionment of vehicle expenses is impure. However, simplification is a compromise between compliance costs and accuracy. "Close enough" should be accepted as good enough in these circumstances. *(Chartered Accountants Australia and New Zealand)*

The rationale for this rule is understood to be to prevent a close company obtaining a full interest deduction for a motor vehicle which is used 100% privately by the shareholder-employee. Addressing this concern is not straightforward given the fungibility of money. *(KPMG)*

Comment

This proposal provides an alternative to FBT on motor vehicles for close companies by providing methods to apportion the motor vehicle expenditure that includes interest. Motor vehicle expenditure includes interest that relates to the direct or indirect funding cost of motor vehicle expenditure – for example, interest on borrowings to purchase a motor vehicle. An interest allocation rule is required in order to limit the interest claimed on a motor vehicle used both privately and for business to ensure close companies using this option are treated the same way as sole traders. Without a specific interest allocation rule, close companies using this option would be able to claim all the interest on their motor vehicle funding costs under the automatic interest deduction rule for companies. For these reasons we recommend retaining the interest allocation rule.

Recommendation

That the submission be declined.

Issue: Alternatives to interest allocation rule

Submission

(KPMG)

The submitter provided alternatives to the interest allocation rule, as follows:

- Disallowing the taxpayer’s election into the subpart DE regime where there is an “interest allocation avoidance arrangement”. An “interest allocation avoidance arrangement” could be defined as an “arrangement that involves the manipulation of the private/business use ratio with the purpose or effect of defeating the intent and application of the motor vehicle expenditure rules in subpart DE”.
- A two-tiered objective test described as a prescribed private/business ratio that is complemented by a “brightline” threshold between when the motor vehicle is acquired by the close company and when the motor vehicle reaches the prescribed ratio of private/business use above. For example, if a motor vehicle is used for more than 50 percent private use during any income year within five years of acquisition by the close company, this could be deemed to be an interest allocation avoidance arrangement.
- A prescribed 50% deduction of interest regardless of the private/business use ratio. This represents a compromise between accuracy and simplicity, being the main objective of the proposals.

The submitter acknowledged that all of these require some element of tracing and are not therefore ideal and suggested further consideration is required.

Comment

As the submitter acknowledges, all of the above options involve a degree of tracing to establish the amount of interest attributable to amounts used to fund motor vehicle expenditure. The proposal also requires a degree of tracing of the interest amount but it is considered that this is appropriate given that this proposal allows a close company to be treated like a self-employed taxpayer and self-employed taxpayers would also be required to trace their relevant interest amount if they were using the motor vehicle expenditure rules. The advantage of the proposal

compared with a specific anti-avoidance rule is that it creates more upfront certainty for taxpayers as to what interest expenditure needs to be included.

A 50% prescribed deduction of interest rule is also not appropriate when there is minimal business use of a motor vehicle. Using actual expenditure as a basis for calculating the business expenditure is a much more appropriate basis that can take into account all levels of business/private use.

Recommendation

That the submission be declined.

INCREASED THRESHOLD FOR TAXPAYER SELF-CORRECTIONS OF MINOR ERRORS

Clause 105

Issue: Scope of proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, PwC)

Three submitters supported the proposal and all submitters recommended that the threshold be increased further.

Recommendation

That the submission be noted.

Issue: Changes to the threshold

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, PwC, EY)

All submitters recommended changes to the proposal including:

- increasing the statutory threshold;
- setting the threshold as a percentage of tax due; and
- having a threshold that applies to taxpayers with a residual income tax over a certain level.

The threshold should be raised to either \$2,000 or \$5,000, or \$10,000 for taxpayers with a residual income tax over a certain level. Increasing the threshold will decrease compliance costs. *(Chartered Accountants Australia and New Zealand, PwC, Corporate Taxpayers Group, EY)*

Alternatively the threshold should be a percentage of the total tax due or a mix of percentage and a threshold value depending on the type of taxpayer. *(Corporate Taxpayers Group, KPMG)*

Further self-corrected errors should be disclosed in the taxpayer's tax return. *(KPMG)*

Comment

Section 113A of the Tax Administration Act was introduced in 2009 as part of a wider package of measures to help reduce compliance costs for small and medium-sized enterprises (SMEs). The section was aimed at providing a greater level of comfort to taxpayers by having a provision that allowed minor errors that had been identified to be rectified by including them in current

returns. It was also considered that it would reduce the number of interactions taxpayers had with Inland Revenue.

The proposal increases the total discrepancy in an assessment threshold from \$500 to \$1,000. This increase in the threshold enables taxpayers to include more minor errors in their returns, which reduces compliance costs for taxpayers and administrative costs for Inland Revenue. Given that this provision was aimed at assisting SMEs, it is not recommended at this stage to increase the threshold beyond the proposed level because this is considered to be an appropriate threshold for non-disclosure of minor errors for SME taxpayers.

Also further work on changing the scope of section 113A is being considered as part of the broader review of the Tax Administration Act 1994.

Recommendation

That the submission be declined.

Issue: Review of self-correction rules

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

A fundamental re-think of the rules applying to self-correction should be undertaken with a view to further reducing restrictions on self-correction. *(Chartered Accountants Australia and New Zealand)*

There should be a broader review of the process for correction of errors. *(KPMG)*

Comment

Further work on reviewing the process for correction of errors should be considered as part of the broader review of the Tax Administration Act 1994.

Recommendation

That the submission be noted.

Issue: Widening the scope of section 113A

Submission

(EY)

The proposed increase in the threshold is too restrictive and the scope of section 113A should be widened to include PAYE and other withholding tax errors.

Comment

Further work on extending the scope of section 113A to other tax types should be considered as part of the broader review of the Tax Administration Act 1994.

Recommendation

That the submission be noted.

SIMPLIFIED CALCULATION OF DEDUCTIONS FOR DUAL USE VEHICLES AND PREMISES

Clauses 62, 64, 65, 66, 67, 68 and 71

Issue: Scope of proposal – vehicles

Submission

(Chartered Accountants Australia and New Zealand, KPMG, PwC)

The simplified method for calculating deductions for vehicles used for both business and personal purposes is supported.

Recommendation

That the submission be noted.

Issue: Scope of proposal – dual use premises

Submission

(Chartered Accountants Australia and New Zealand)

The proposal for expenditure on dual use premises is not supported because there is no real simplification as a result of having to do two calculations: one calculation for utilities using the Inland Revenue published rate and another calculation for rent, rates and mortgage interest. The second calculation is the calculation done now by taxpayers.

Comment

The proposal does provide simplification for taxpayers with dual use premises because it results in fewer calculation for taxpayers as they are able to use the Inland Revenue published rate for utilities per square metre. The second calculation that is related to actual costs is necessary because mortgage interest, rates and rent are fixed costs related to the dual use of the premises. These costs vary depending on a taxpayer's circumstances. It is therefore more appropriate to calculate the deduction for these costs based on a portion of the actual costs related to the area of the premises used primarily for business purposes.

Recommendation

That the submission be declined.

Issue: Standard deduction amount for dual use expenditure

Submission

(Chartered Accountants Australia and New Zealand)

The proposal should be replaced with one that allows the deduction of a standard amount for dual use expenditure with that amount being set by Inland Revenue; initially at say \$2,000. Taxpayers should be able to elect to use the standard amount or undertake their own calculation.

A standard sum would be a true simplification measure as it would remove the need for the calculation and gathering of information about a diverse range of costs.

According to the Regulatory Impact Statement, Officials consider that a flat rate would be too inaccurate, as it would not be proportionate to the size of the premises used for business purposes. The submitter's suggestion is a simplification measure and simplification is a compromise between accuracy and cost. In its present form the proposal is not a simplification measure.

Comment

A set deduction amount bears no relationship to actual expenditure incurred by taxpayers that relates to the dual use of the premises and would be viewed as a subsidy for taxpayers with home offices. The method proposed offers simplification and a reduction in compliance for taxpayers who use the method, while still maintaining the general principles of deductibility.

Recommendation

That the submission be declined.

Issue: Definition of “total premise costs”

Submission

(EY)

The proposed section DB 18AA(3)(a) definition of “total premise costs” should also include insurance or the Commissioner of Inland Revenue should clarify that insurance costs will be included in determining the “square metre rate”.

Comment

The suggestion to include insurance costs as part of the square metre rate has been forwarded to the Inland Revenue operational area that will be responsible for setting the rate.

Recommendation

That the submission be accepted.

REMOVE THE REQUIREMENT TO RENEW RWT EXEMPTION CERTIFICATES ANNUALLY

Clause 101

Issue: Scope of proposal

Submission

(Chartered Accountants Australia and New Zealand, KPMG, Corporate Taxpayers Group)

Three submitters supported the proposal with one submitter saying this was because the proposal will reduce compliance costs.

Recommendation

That the submission be noted.

Issue: Section 32I of the Tax Administration Act 1994

Submission

(Deloitte)

RWT exemption certificates for taxpayers with tax losses and RWT refunds are actually issued under section 32I of the Tax Administration Act 1994 and therefore the bill should also be modifying section 32I.

Comment

Officials agree that section 32I of the Tax Administration Act 1994 should be amended to confirm that a RWT exemption certificate issued in accordance with to section 32I can also be issued for an unlimited period.

Recommendation

That the submission be accepted.

Issue: Expanding the scope of the proposal to other types of exemption certificates

Submission

(Corporate Taxpayers Group)

Inland Revenue should consider expanding this proposal to other types of exemption certificates (for example, non-resident contractors' tax).

Comment

Extending the proposal to other types of exemption certificates goes beyond the scope of this proposal, and further investigation would be required to understand how and when this could be progressed.

Recommendation

That the submission be declined.

Issue: Listing holders of exemption certificates on website

Submission

(Corporate Taxpayers Group)

If a certificate is open-ended, it is important that a passive income payer is able to rely on this unless notified by the payee or Inland Revenue. This could be achieved by Inland Revenue maintaining a website page listing taxpayers with valid exemption certificates.

Comment

Inland Revenue currently maintains a list on its website of IRD numbers for reissued and cancelled RWT exemption certificates. The Government discussion document *Making Tax Simpler – investment income information*, released in July 2016, included a proposal for Inland Revenue to maintain such a database for payers to access.

The basis of this submission is therefore already being considered as part of that workstream.

Recommendation

That the submission be declined.

INCREASING THRESHOLD FOR ANNUAL FBT RETURNS FROM \$500,000 TO \$1 MILLION OF PAYE/ESCT

Clauses 90 and 91

Issue: Scope of proposal

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The proposal is supported as it will reduce compliance costs for some taxpayers.

Recommendation

That the submission be noted.

Issue: Inconsistency between wording in sections RD 60 and 61

Submission

(Deloitte)

There is inconsistency in wording between sections RD 60 and RD 61, which are being modified by clauses 90 and 91. We submit that the other wording in these section should be tidied up to ensure they are clear in their application.

In particular, section RD 60 refers to FBT returns being made on an income year basis (not on a 1 April – 31 March standard year if the employer has a non-standard balance date). Section RD 61 makes reference to both tax years (1 April – 31 March) and FBT being calculated on an “annual basis” (presumably based on a tax year). It is unclear why close companies who provide a fringe benefit to a shareholder-employee are able to pay FBT on an income year basis but a small business (which might also be a close company) who provides fringe benefits to an employee who is not a shareholder-employee is not. It is not clear from the legislation which of these sections takes precedence.

Comment

Officials note the issues raised by the submitter and recommend that that these be considered in the next available tax bill dealing with fringe benefit remedials.

Recommendation

That the submission be noted.

Issue: The use of the section RD 29 formulae for calculating motor vehicle benefits

Submission

(EY)

The proposed increases to the thresholds are welcomed but it is submitted that the section RD 29 formulae for calculating motor vehicle benefits on an income year and annual return basis be amended so that they are identical and consistent with the Commissioner's apparent practice and advice to taxpayers. Inland Revenue guidance suggests that the same formula is used for both annual and income year FBT returns. This guidance is inconsistent with the legislation and should be revised.

Comment

The points raised in the submission have been forwarded to the area in Inland Revenue responsible for the guidance on FBT to review Inland Revenue's guidance.

Recommendation

That the submission be noted.

MODIFYING THE 63-DAY RULE ON EMPLOYEE REMUNERATION

Clause 70

Issue: Scope of proposals

Submission

(Corporate Taxpayers Group, Deloitte, PwC, KPMG)

Three submitters supported the proposal including one submitter who supported the change in the interim. One submitter did not support the proposal.

Recommendation

That the submission be noted.

Issue: Not a simplification measure

Submission

(Chartered Accountants Australia and New Zealand)

The proposed modification of the 63-day rule for employee remuneration is not a true simplification measure. Employers who elect not to calculate the 63-day adjustment will save time but incur a tax cost.

Comment

The proposal is a simplification measure because employers who chose not to apply the existing 63-day adjustment rule will avoid having to track payments of employment remuneration paid within the 63-day period.

Recommendation

That the submission be declined.

Issue: Allowing deductions for accrued employee expenditure

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, Corporate Taxpayers Group)

The 63-day rule should be modified to allow the deduction of holiday pay incurred at balance date but still to be paid. This would match expenditure to the appropriate year by bringing to account a liability that an employer must meet. The 63-day rule could continue to apply to other remuneration provisions. *(Chartered Accountants Australia and New Zealand)*

The correct solution is to allow employers to take a deduction for accrued employee expenditure on the basis that such expenditure is incurred. (*Deloitte*)

If financial statements are audited, then accruals booked for items such as employment remuneration should be accepted as expenditure incurred for tax without any review of possible under- or over-accruals. A more targeted policy response which addresses the concerns regarding deferred bonuses could be:

- for statutory obligations such as holiday pay, a deduction should be able to be taken for expenditure incurred; and
- for contractual obligations such as payment of a bonus, a deduction should only be able to be taken for expenditure incurred if there is a legal obligation to pay within a certain timeframe (for instance, within a three to six month timeframe). (*Corporate Taxpayers Group*)

Given the 63-day adjustment is a temporary tax difference only (that is, a matter of timing as the deduction will ultimately be allowed), the better option is simply to allow the deduction. This would not apply to accrued shareholder-employee income, which is not recognised as taxable income in the same income year. This carve-out is necessary to ensure that deferral advantages are not sought due to a difference between deduction and income for related entities. (*KPMG*)

Comment

Submitters are suggesting a change to allow a deduction for accrued employee expenditure. Some submitters have suggested this modification be limited to holiday pay accruals while others have suggested it should apply to all accruals of employee expenditure apart from shareholder-employee accruals. One submitter has suggested an additional requirement for contractual obligations other than statutory obligations. The basis for these suggested changes is that these accrued amounts meet the general incurred test for deductibility because the employer has a legal obligation to pay the various amounts. However as these payments are accrued and not yet paid, these amounts need to be added back in the income year they are accrued. The proposal does not change this treatment.

The current 63-day rule was adopted because if the employer were able to claim all expenditure in relation to accrued employee expenditure there would be a mismatch between the year the employer recognises the expense and the year the employee recognises the income. This principle still applies and for this reason we do not support making any further changes in this area.

Recommendation

That the submission be declined.

Issue: Application date of the proposal

Submission (*EY*)

It should be clarified and expressly provided that the amended section EA 4(1) applies for the 2017–18 and subsequent income years. Taxpayers preparing and filing their 2016–17 returns

after 1 April 2017 would seem entitled to apply the amended provision for those returns on the basis the amendment was then in force. It is suggested that the application of the amendment should be clarified by specific provision in the legislation, preferably for returns for the 2016–17 and later income years, otherwise for the 2017–18 and later income years.

Comment

The proposed amendment comes into force on 1 April 2017. However, to ensure consistency about when the new rule applies for all taxpayers, it is recommended to clarify that the proposed amendment applies for the 2017–18 and subsequent income years.

Recommendation

That the submission be accepted, subject to officials' comments.

OTHER SUGGESTED CHANGES TO BUSINESS TAXATION

No clause

Submissions

(Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, EY, PwC)

Several submitters suggested additional items that could be considered to reduce compliance costs for businesses. They included:

- reviewing the timing of deductions for ACC levies, audit and accounting fees (*PwC*)
- reviewing the rules around entertainment, GST and the entertainment limitation rules (*PwC*)
- extending the \$10,000 threshold for legal fees to entertainment expenditure (*PwC*)
- increasing the residual income tax threshold for provisional tax liability to \$10,000 (*EY*)
- reducing the current standard uplift rates (*Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group*)
- excluding one-off fluctuations from uplift calculations (*Corporate Taxpayers Group*)
- removing the requirement to renew exemption certificates annually for other types of exemption certificates (*Corporate Taxpayers Group*)
- extending the early payment discount rules to all taxpayers regardless of business structure (*Chartered Accountants Australia and New Zealand*).

Comment

We consider that the items would need further investigation before being progressed. Officials will consider these suggestions in the context of the tax policy work programme.

Recommendation

That the submissions be noted.

Automatic exchange of information

GENERAL ISSUES

Clauses 3 to 26

Issue: General support and acknowledgement

Submissions

(BNZ, Chapman Tripp, Chartered Accountants Australia and New Zealand, Kensington Swan, New Zealand Bankers' Association, Office of the Privacy Commissioner, PwC, TGT Legal)

The submitters provided general expressions of support (albeit in many cases subject to concerns in relation to specific issues). *(BNZ, Chartered Accountants Australia and New Zealand, Kensington Swan, New Zealand Bankers' Association, Office of the Privacy Commissioner, PwC, TGT Legal)*

The submitters acknowledge Inland Revenue's engagement with financial institutions and their advisors. *(Chapman Tripp, PwC)*

Comment

Officials welcome the general expression of support from these submitters. Additional support for particular aspects of the bill is identified throughout this report. Submitters concerns over specific issues are also identified in this report.

Recommendation

That the submissions be noted.

Issue: Establishing general tax-based "know your client" rules

Submission

(KPMG)

The proposals establish "know your client" rules for non-residents only. Consideration should be given to implementing general tax-based "know your client" rules, which apply to residents and non-residents.

This is an opportunity to establish tax-based "know your client" rules, which establish a person's status and on which investors and New Zealand financial institutions can rely, for multiple tax purposes (that is, withholding and exchange of information).

Comment

The submitter has raised an issue that would require further analysis as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Efficacy of the Common Reporting Standard

Submission

(KPMG)

Inland Revenue appears to have concerns regarding the effectiveness of the Common Reporting Standard (CRS) regime.

In a draft internal memo provided to the *Government Inquiry on Foreign Trust Disclosure Rules*, Inland Revenue appears to advise the *Inquiry* that the CRS is easy to avoid (as well as not always applying).

We consider it important that, as a matter of public record, officials' concerns should be expressly addressed by the Select Committee.

Comment

The design of the CRS reflects OECD recognition that a comprehensive reporting regime that would apply to every investor in every circumstance would impose unreasonable compliance costs on jurisdictions.

The CRS therefore adopts a pragmatic and risk-based approach that targets structures and jurisdictions where offshore tax evasion is most likely to occur.²

Under this approach, the CRS therefore does not have a one-size-fits-all approach to trusts. A trust may be a financial institution or a non-financial entity, depending on its circumstances. This can affect whether information about the trust and persons connected with the trust are reported for CRS purposes. Trusts that are financial institutions will generally have CRS reporting obligations in respect of their non-resident settlors, trustees and beneficiaries. However, trusts that are non-financial entities will generally only be subject to CRS reporting to the extent that they satisfy "passive non-financial entity" criteria, hold accounts with financial institutions and have controlling persons that are non-resident.

A pragmatic approach is also adopted in respect of the due diligence procedures that apply to accounts. Stringent rules apply to new accounts. These generally require customers to provide self-certifications as to their residence status. However, for pre-existing accounts, the CRS often allows financial institutions to rely on information they already have on hand, and to identify relevant non-residents for reporting solely on the basis of "indicia of non-residence" that are evident from the information held.

These matters all contribute to whether an account holder (or controlling person of an account) is reported for CRS purposes. Inland Revenue's comments to the *Inquiry* reflect the reality of these points.

² The CRS also requires implementing jurisdictions to establish effective anti-avoidance rules. Consistent with this requirement, proposed section 185R in clause 24 of the bill contains a proposal for a broad anti-avoidance rule.

Recommendation

That the submission be noted.

INCORPORATING THE CRS INTO NEW ZEALAND LAW

Issue: Incorporation by reference

Submissions

(KPMG, Chapman Tripp, Chartered Accountants Australia and New Zealand, Westpac)

On balance, making the CRS part of New Zealand law is the best answer. *(KPMG)*

The proposal raises significant sovereignty issues which should be carefully considered. *(Chapman Tripp)*

We do not support the implementation of AEOI by incorporating the CRS into New Zealand law by direct reference to the CRS and OECD Commentary. Our preference is for the text to be redrafted using current legislative drafting practice and to be restated in the Tax Administration Act 1994. *(Chartered Accountants Australia and New Zealand, Westpac)*

Comment

Officials consider that making the CRS part of New Zealand law is appropriate. It is also broadly consistent with the approach adopted by Australia.³

The CRS is an international standard that New Zealand has committed to fully implement. Translating the rules, as set out in the CRS and as clarified and elaborated upon by the related OECD Commentary, into legislation would be feasible. Indeed, some countries have opted for that approach. However, translating the rules is unnecessary and, given the complexity inherent in the rules, would risk creating inaccuracies and ambiguities in the legislation.

New Zealand will be subject to comprehensive international peer review to ensure that the rules as set out in the CRS and OECD Commentary have been enacted correctly. Incorporating the CRS by reference removes any risk of inadvertent inaccuracies that would result in confusion or a failed peer review.

It may be noteworthy that only two submitters have indicated that they do not support this approach. Their specific arguments are addressed below as separate issues.

Only one submitter has expressly indicated support for the proposed approach. However, silence on the part of other submissions on this matter appears to indicate tacit support. Indeed, some submissions have made explicit suggestions to assist in making the approach more workable – for example, by publishing a New Zealand version of the CRS. These suggestions are dealt with below as separate issues.

Recommendation

That the submissions be noted, and that the submissions recommending against incorporate by reference be declined.

³ However, New Zealand's approach differs from Australia's in respect of the ambulatory approach, discussed in this report.

Issue: Lack of an express power to incorporate by reference

Submission

(Chartered Accountants Australia and New Zealand)

The Tax Administration Act 1994 does not expressly include a power to incorporate material by reference, which would be best practice.

Comment

The submitter's point is noted, but an Act cannot empower itself.

Recommendation

That the submission be declined.

Issue: Lack of plain language

Submission

(Chartered Accountants Australia and New Zealand, Westpac)

The drafting in the CRS and OECD Commentary is not expressed in terms that impose clear obligations. In addition, the CRS and OECD Commentary do not use plain language drafting that will be easily understood by taxpayers. For example, the CRS is amended by Schedule 2 of the bill. This, in turn, substitutes certain sections of an annex to the CRS for sections of the CRS itself. *(Chartered Accountants Australia and New Zealand)*

The CRS and OECD Commentary is not expressed in terms that impose clear obligations. Many commentators have noted that the language used in the CRS does not meet with the plain language drafting used in New Zealand tax legislation. Reliance is placed on guidance contained in the OECD Commentary which is not written using the New Zealand idiom. *(Westpac)*

Comment

The rules as set out in the CRS and OECD Commentary are inherently complex. Rather than improving clarity, translating the rules into legislation actually raises the risk of creating inconsistencies and ambiguities.

However, the concerns that have been raised are acknowledged. To address these concerns, officials note that Inland Revenue intends publishing a New Zealand version of the CRS that will include all New Zealand-specific modifications and dates. Approval is currently being sought from the OECD for this approach, given that the CRS and OECD Commentary are subject to copyright.

Inland Revenue will also publish guidance on the CRS due diligence and reporting requirements, which will provide further clarity about obligations.

Recommendation

That the submission be noted.

Issue: Lack of accessibility

Submission

(Chartered Accountants Australia and New Zealand, Westpac)

It is a fundamental principle that the law should be accessible to all. There should be one place to go to locate the regulatory framework and AEOI laws applicable to New Zealand individuals and entities. However the CRS and OECD Commentary are subject to copyright and it may not be possible for them to be made available on the New Zealand legislation website.

Comment

As noted, officials intend publishing a New Zealand version of the CRS that will include all New Zealand-specific modifications and dates. Approval is currently being sought from the OECD for this approach, given that the CRS and OECD Commentary are subject to copyright.

Recommendation

That the submission be declined.

Issue: Ambulatory approach

Submissions

(Chartered Accountants Australia and New Zealand, Westpac, Corporate Taxpayers Group)

The CRS and OECD Commentary are to be incorporated into New Zealand law as amended from time to time. This is referred to as an “ambulatory approach”. It means that any subsequent changes that may be made by the OECD to the CRS or OECD Commentary will automatically become New Zealand law. Such changes will therefore not be subject to consultation and the Parliamentary process. *(Chartered Accountants Australia and New Zealand, Westpac)*

Changes should not be automatic, but should be incorporated into New Zealand law by Order in Council. Changes without any approval of the Executive seem constitutionally inappropriate. An Order in Council mechanism would be consistent with FATCA, where changes to the IGA must be made by Order in Council. *(Corporate Taxpayers Group)*

Changes that automatically apply may result in inconsistencies with or be contrary to New Zealand law (for example, the Privacy Act 1993). *(Corporate Taxpayers Group, Westpac)*

Comment

Officials' reasons for proposing the ambulatory approach are as follows.

The CRS and OECD Commentary will be refined by the OECD over time to close loopholes and address deficiencies. New Zealand will have an opportunity to influence any future changes as decisions are being made and approved at the OECD. New Zealand officials participate in those decision-making sessions and have veto rights.

Once changes are approved by the OECD they become part of the international standard, which New Zealand has committed to implement. Failure by New Zealand to respond to the changes, particularly if it has failed to veto the changes at the OECD, would have international ramifications.

However, officials acknowledge the concern of stakeholders that decisions could be made that will have unreasonable or unintended implications for New Zealand financial institutions and other taxpayers.

Financial institutions and taxpayers would have the right to challenge particular changes through judicial review if applicable.

It also remains open to Parliament to act to prevent any future changes through explicit legislation, if it considers such an action necessary. This would need to be made in the full awareness and acceptance of the potential international ramifications.

However, the time it would take to enact explicit legislation to block changes would be problematic if a rapid response was required. To address that concern, Officials recommend inserting a regulation-making power into the bill by which the Government could, if it desired, act quickly to defer commencement of any particular change. That is, changes to the CRS would apply automatically unless the Government intervenes with an Order in Council setting terms around the application of the change, such as an effective start date.

With regard to the specific point raised by a submitter about consistency with FATCA, officials note that the FATCA rules are implemented by means of a different mechanism. The FATCA rules are enshrined in a bilateral treaty with the United States. Changes to the rules will therefore require an amendment to the treaty, which must then be given effect by Order in Council. A different mechanism applies for AEOI.

In response to the specific point raised by two submitters that changes could be contrary to New Zealand law, and in particular the Privacy Act, officials note that this is unlikely. Information obtained and provided by a financial institution in accordance with a legislative requirement (including a requirement arising from such a change) would take precedence over that Act, as would the exchange of such information by Inland Revenue to meet a treaty obligation. Comments further below, under "Privacy", that confirm that human rights and other legal safeguards will continue to apply, are also relevant to this issue.

However, as a matter of course Inland Revenue will monitor changes, with a view to notifying financial institutions and other taxpayers of any such changes. If inconsistencies or other issues are identified, the Order in Council mechanism recommended above could be used to defer implementation until the issues are addressed. It will also be open to financial institutions and taxpayers to challenge any changes, for example by seeking judicial review, if they consider their legal rights are infringed.

Recommendation

That the submissions be accepted in part, and that a regulation-making power be introduced to enable the Government, if it considers it necessary or otherwise appropriate, to act to require certain changes to commence from a particular date, or not to apply at all.

Issue: Ambulatory approach – timing concerns

Submissions

(Chapman Tripp, KPMG, Chartered Accountants Australia and New Zealand)

Changes to the CRS should not apply retrospectively. *(Chapman Tripp, KPMG)*

Inland Revenue should provide taxpayers with a sufficient transitional period to understand and make the systems/process changes that may be necessary as a result of any change to the CRS. Particular issues arise because New Zealand's reporting period is different from the 31 December reporting year adopted by most other countries. There is no evidence that the OECD would promote reasonable timelines. *(Chapman Tripp, Chartered Accountants Australia and New Zealand, KPMG)*

Comment

Changes to the CRS and OECD Commentary will normally be announced by the OECD at its annual Ministerial Council Meeting, which is typically held in June. In the normal course of events, any changes would be expected to apply from the beginning of the next reporting period (in the case of New Zealand, 1 April). That means New Zealand financial institutions can expect to have around nine months' lead time for changes.

However, it is difficult to envisage all circumstances that could arise, and it is not inconceivable that particular implementation timeframes could be mandated by the OECD in respect of some changes, for valid reasons. New Zealand officials would attempt to influence such decisions as they are developed and approved at the OECD to prevent unreasonable timeframes from occurring. But, again, it is not inconceivable that such decisions could be approved.

If that were the case, and if it were to give rise to difficulties for financial institutions, these matters would be relevant to considerations of whether penalties should be imposed in the circumstances. If the Government considered it to be necessary, the Order in Council mechanism recommended above could also be used to block or change implementation dates.

Recommendation

That the submissions be declined.

Issue: Ambulatory approach – advance notice

Submission

(KPMG)

New Zealand is involved in OECD working parties, and therefore should be in a position to publish proposals for change as they are proposed by the OECD.

Comment

The OECD itself generally submits proposals of this nature for public consideration, and calls for submissions. Otherwise, OECD confidentiality rules would normally apply, meaning that officials would be constrained from providing advance notice of specific proposals under consideration by the OECD.

Recommendation

That the submission be declined.

Issue: Ambulatory approach – notification by Inland Revenue

Submission

(Chapman Tripp)

Inland Revenue should notify taxpayers of any changes to the CRS (for example, in a *Tax Information Bulletin* or on the Inland Revenue website).

Comment

Officials agree and note that Inland Revenue would do this as a matter of course.

Recommendation

That the submission be noted.

Issue: Ambulatory approach – accessibility

Submissions

(Chartered Accountants Australia and New Zealand, Chapman Tripp, Corporate Taxpayers Group, KPMG, Westpac)

Inland Revenue should provide taxpayers with ready access to current and all historic versions of the CRS, OECD Commentary, and other relevant instruments, so that they can easily ascertain the version that applied at any particular time. *(Chartered Accountants Australia and New Zealand, Chapman Tripp, Corporate Taxpayers Group, KPMG, Westpac)*

The bill should be amended to require Inland Revenue to do this. (*Corporate Taxpayers Group*)

Inland Revenue should maintain and publish an up-to-date New Zealand version of the CRS and OECD Commentary. (*Chartered Accountants Australia and New Zealand, KPMG*)

Comment

This is similar to the issue raised above in relation to “Lack of accessibility”. As noted in relation to that submission, Officials intend publishing a New Zealand version of the CRS that will include all New Zealand-specific modifications and dates. Approval is currently being sought from the OECD for this approach, given that the CRS and OECD Commentary are subject to copyright.

Under this approach, updated and historic versions would all be publicly available.

It would be unusual to include this in the bill as a requirement. In any case, formal OECD approval has not yet been obtained for this approach. (No difficulties are anticipated, as there is a degree of implied consent for implementing jurisdictions to replicate the CRS, but the legal niceties must be observed.)

Recommendation

That the submissions to publish current and historic New Zealand versions be accepted (subject to the receipt of OECD approval).

That the submission to require this in the bill be declined.

PRIVACY

Issue: Privacy impact assessment

Submission

(Office of the Privacy Commissioner)

Inland Revenue has kept my office updated regularly as this initiative has progressed.

Implementation of the CRS as provided for in the bill does not seem unduly privacy-invasive.

I understand that Inland Revenue is currently assessing the potential privacy impacts of adopting the wider approach and my staff will continue to work with them as they finalise this.

Comment

The reference to assessing the potential privacy impacts alludes to a draft Privacy Impact Assessment that Inland Revenue has prepared, in consultation with the Office of the Privacy Commissioner. Finalising that Assessment report was deferred pending the Select Committee consideration of the bill, to ensure that any privacy concerns identified during consideration could be addressed in the report. In finalising the document, officials will continue to liaise with the Privacy Commissioner's office.

For clarification in relation to this submission and other submissions below, the reference in the submission to the "wider approach" refers to the compliance cost reduction options offered in the CRS that implementing jurisdictions can adopt, to:

- allow their financial institutions to identify account holders or (where relevant) controlling persons that are non-resident, as opposed to resident in particular ("reportable") jurisdictions; and
- allow their financial institutions the option of reporting all of the identified non-resident account holders and controlling persons, as opposed to only reporting on those that are only resident in reportable jurisdictions.

Recommendation

That the submission be noted.

Issue: Privacy Commissioner's endorsement required

Submissions

(AMP, BNZ, New Zealand Bankers' Association, Chapman Tripp)

Some industry participants have concerns that the wider approach has not been endorsed by the Privacy Commissioner. Inland Revenue should confirm with the Privacy Commissioner that financial institutions will not be in breach of the Privacy Act 1993 if they elect to adopt the

wider approach. This is urgent, as financial institutions need certainty before they build systems. (*AMP, BNZ, New Zealand Bankers' Association*)

The outcome of Inland Revenue's discussions with the Office of the Privacy Commissioner should be clearly communicated to all affected parties. (*Chapman Tripp*)

Comment

This issue is addressed in the Privacy Commissioner's submission on the bill. That submission is a public document.

The Privacy Commissioner does not view the proposals in the bill as unduly privacy invasive. However, the Privacy Commissioner has requested that Inland Revenue be transparent on the purposes for which it will use information, conduct a public education campaign, and have robust procedures in place.

As noted above, Inland Revenue will engage with the Office of the Privacy Commissioner as it finalises the Privacy Impact Assessment. Inland Revenue will disseminate information arising from that engagement in its proposed public education campaign, and on its website.

Recommendation

That the submissions be noted.

Issue: Legal safeguards

Submission

(*Cone Marshall Ltd*)

It is important that there is assurance that the data protection rules which are built into the Privacy Act 1993, the New Zealand Bill of Rights Act 1990 and the Tax Administration Act 1994 will extend to all data gathered under the CRS rules.

Comment

Inland Revenue will only exchange information required to be exchanged, and will do so in accordance with its legal obligations.

The Tax Administration Act rules will extend to data gathered under the CRS rules as a matter of course.

There are inherent conflicts between any cross-border information exchange involving tax-related personal information, and the Privacy Act. However, such conflicts are recognised and resolved in the various legislative and treaty mechanisms. In this regard, the submission referred to above from the Privacy Commissioner that the proposals in the bill do not seem unduly privacy-invasive, is relevant.

With regard to the New Zealand Bill of Rights Act (and other applicable legal safeguards), it is important to note that all of New Zealand's tax treaties under which information exchanges can be made expressly require such legal safeguards to continue to apply.

Recommendation

That the submission be noted.

Issue: Public education campaign

Submission

(Office of the Privacy Commissioner)

The Government should launch a public education/communication campaign to enhance awareness of AEOI.

The campaign should clearly explain the roles and responsibilities of taxpayers and financial institutions under the CRS requirements.

The bill proposes a new section 185P(4) which will place the onus on account holders to inform their financial institutions in a timely manner about any material changes of circumstance that will affect the information previously provided to the financial institution. The Government should put in place a public education programme to inform the public of their CRS obligations.

The campaign should also clearly explain the concept of "tax residence".

Comment

Officials agree. In addition to Inland Revenue's planned on-going engagement with financial institutions and stakeholders (which will include the provision of guidance material), a wider public education campaign will be undertaken. The campaign will address the specific points raised by the Privacy Commissioner.

Recommendation

That the submission be noted.

Issue: Potential use of data for purposes other than that for which it has been collected

Submission

(Office of the Privacy Commissioner)

Inland Revenue will need to develop robust procedures for managing any "residual information" it collects under the AEOI framework.

Both Inland Revenue and financial institutions will need to clearly communicate their chosen implementation processes to their customers to ensure they are fully informed of the impacts of the changes.

For consistency with New Zealand’s privacy laws, it is proposed that the potential use of residual information by Inland Revenue be subject to full transparency.

Comment

The reference to “residual information” in the submission relates to information that might be reported under the wider approach to reporting but which does not need to be exchanged with other countries for AEOI purposes.

Officials agree that Inland Revenue must have robust procedures for managing residual information.

Officials also agree that transparency is important in this regard. Officials intend ensuring transparency in different ways, including in its public information campaign and other messaging about how reported information can be used.

As noted above, officials will continue to engage with the Office of the Privacy Commissioner, in particular with regard to finalising the Privacy Impact Assessment.

Recommendation

That the submission be noted.

Clause 24(1)

Issue: “Permitted choice rule”

Submission

(Chapman Tripp, KPMG)

Financial institutions that choose to adopt the wider approach to reporting are likely to come under significant pressure and potential challenge from customers. A “permitted choice” rule similar to that applying for FATCA would protect financial institutions against such challenges.

Comment

In broad terms, the Privacy Act 1993 has a rule that provides that it will be overridden by express legislation. Accordingly, a financial institution providing information to Inland Revenue under an express legal requirement in tax legislation will not violate the Privacy Act. However, the situation is not as clear if a financial institution provides information on the basis of having elected to do so under an option allowed in the tax legislation, rather than being required to do so.

Financial institutions are concerned that they could be vulnerable to challenge that the Privacy Act is not overridden because there was no compulsion to make the election.

This issue was addressed in the FATCA legislation by means of a “permitted choice” rule⁴ that essentially provides that, if a financial institution makes an allowable election, it must then report to Inland Revenue on that basis. This creates the necessary legislative override.

The bill includes a similar rule in section 185N(8). However, the submission highlights the concern that this may not be sufficiently clear. Officials recommend that the rule be clarified, and relocated to follow the general provision on options in section 185O(5), to address the submitter’s concern.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Sections 185N(7) and 185O(5) – conflicting drafting

Submission

(KPMG)

Section 185N(7) allows a financial institution a choice to apply the wider reporting approach or not. Section 185O(5) suggests that this choice is subject to Privacy Act compliance. We understand that it is intended that the choice is freely available. That intention should be clearly expressed.

Comment

Officials agree that the current wording could lead to a lack of clarity, and that the drafting should be amended.

Recommendation

That the submission be accepted.

⁴ Section 185F of the Tax Administration Act 1994.

SUBORDINATE LEGISLATION

Clauses 12 and 25

Issue: Determinations

Submissions

(Corporate Taxpayers Group, David McLay)

The submitter supports the Commissioner having power to issue such determinations.
(Corporate Taxpayers Group)

Under proposed section 226D, the Governor General, in Council, can promulgate any territory outside New Zealand to be a reportable jurisdiction. Under proposed section 91AAU, the Commissioner can determine any jurisdiction to be a “participating jurisdiction”. It seems that the latter is the more important decision, as it applies for the purposes of Part 11B of the Tax Administration Act 1994 (information sharing agreements).

No grounds for inclusion are specified, and there are no procedural steps. As at 26 July 2016, there were 101 jurisdictions that had committed to the OECD’s Automatic Exchange of Information (AEOI). As New Zealand has a Double Taxation Agreement (DTA) with 40 jurisdictions and Tax Information Exchange Agreements (TIEA) with another 11 jurisdictions (and another 9 jurisdictions), it is clear that there are many potential recipients of information under the AEOI where there are no bilateral treaty obligations. (These numbers are based on the Inland Revenue Policy website – the reference to “90 jurisdictions” at page 8 of the Explanatory Note to the Bill is difficult to understand.)

It is submitted that each of proposed section 226D and proposed section 91AAU should be amended to permit jurisdictions with DTAs or TIEAs with New Zealand to be included as reportable jurisdictions or participating jurisdictions (respectively) by way of Order in Council, and that other jurisdictions can be added after the Commissioner is satisfied that there are appropriate protections for the secrecy of the tax information to be disclosed under the AEOI. It is respectfully submitted that anything less than this would be treating private tax information as being “owned” by Government rather than held by Government as a custodian.

This provision ought not to be enacted in its current form as it will be a serious erosion in the principle of taxpayer secrecy. *(David McLay)*

Comment

Officials acknowledge the submission that supports the proposal.

Officials note that the submitter raising privacy concerns may not have correctly understood the difference between the concepts of “reportable jurisdiction” and “participating jurisdiction”. New Zealand’s reportable jurisdictions are those that it will provide information to. New Zealand’s participating jurisdictions are those that will provide information to New Zealand. In the context of concerns over countries maintaining confidentiality in respect of information provided by New Zealand, the only relevant list is therefore the reportable jurisdiction list. This is why only that list is subject to the Order in Council mechanism, to ensure Government oversight. The mechanism proposed in the bill is therefore consistent with the submitter’s expressed aim.

The submission also signals potential confusion as to the exchange mechanism. The submitter appears to be concerned that exchanges might be made on the basis of the list of reportable jurisdictions rather than under tax treaties. Officials can confirm that all AEOI exchanges will be made under an authorising tax treaty. Officials also confirm that the existence of appropriate protections for the secrecy of exchanged information will be a key consideration in the selection of countries for addition to the list of reportable jurisdictions. Such considerations will be informed by the outcomes of comprehensive reviews currently being undertaken internationally by the OECD's monitoring agency (the Global Forum on Transparency and Exchange of Information for Tax Purposes). Submissions will also be called for domestically, to provide stakeholders with an opportunity to provide input into those considerations.

The tax treaty that will apply for all (or almost all) exchanges is the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which New Zealand signed in 2012. DTAs and TIEAs will only be relevant for AEOI exchanges if, for any reason, an exchange partner needs or has a strong preference to make the exchanges under a DTA or TIEA rather than the Multilateral Convention. No jurisdiction has yet announced that intention, but it cannot be ruled out as a possibility.

The reference to "90 jurisdictions" refers to the current number of parties to the Multilateral Convention that have also committed to implement AEOI. The remaining number of committed jurisdictions have either signed the Multilateral Convention and are awaiting entry into force, or are expected to do so shortly.

Recommendation

That the submissions be noted.

Clauses 12 and 25

Issue: Lack of objectives and criteria

Submission

(KPMG)

The proposals do not clearly state the objective of determination and regulation powers so it is difficult to test their validity. Explicit criteria should be provided. For example, the legislation should specify how the Commissioner should determine whether a country is a reportable jurisdiction.

Comment

The CRS requires implementing jurisdictions to publish lists of excluded entities and accounts, participating jurisdictions and reportable jurisdictions.

The bill proposes that the first three categories of list be made by "determination" by the Commissioner of Inland Revenue. The provisions in question authorise the Commissioner to "determine" which entities, accounts or jurisdictions are to appear on the lists. The criteria which the Commissioner must apply are set out in the CRS and do not need to be included in the legislation.

The reportable jurisdictions list is also required by the CRS, but the bill proposes an Order in Council process to ensure Government oversight, given that privacy and other important issues will need to be taken into account (as discussed earlier in this report).

Inland Revenue intends providing guidance in respect of the lists.

Recommendation

That the submission be declined.

Clause 12

Issue: “Determination” as a defined term

Submissions

(New Zealand Law Society)

The word “determination” is used in sections 91AAU, 91AAV and 91AAW as if it were a defined term. The bill *Commentary* also capitalises the word, suggesting it is a defined term. This may cause confusion.

Section 91AAU(3) also appears to read as a continuation to subsection (1) where the phrase “the determination” first appears. However subsections (1) and (3) refer to two different forms of determination.

Comment

The term “determination” is used in many places in the Inland Revenue Acts, and is not defined. Officials do not consider there to be any unique consideration applicable to AEOI that would require the term to be defined in this case.

However, officials concur there is merit in improving the drafting to improve clarity. In particular, in the issue with section 91AAU(3) the reference to “The determination” should be resolved.

Recommendation

That the submission be in accepted in part, subject to officials’ comments that the term “determination” should not be defined, but changes made to the drafting to improve clarity should be made.

Clauses 12 and 25

Issue: Timing

Submissions

(New Zealand Law Society, KPMG, AMP, New Zealand Bankers' Association)

Sections 91AAU, 91AAV, 91AAW and 226D are inconsistent. Sections 91AAU(2), 91AAW(2) and 226D(2) provide that a determination or regulation made under those provisions may set out the period for which it is to apply. However, section 91AAV(2) provides that the Commissioner must set out the period. *(New Zealand Law Society)*

Transitional rules which govern their effective date and period should also be included in the legislation. This should refer to a reporting period, and the legislation should provide that changes must not occur part-way through a reporting period. *(KPMG)*

Financial institutions require significant lead time for changes to the list of participating jurisdictions. Ideally any change to the list would take effect in the following reporting period in respect of obligations on financial institutions.

An exception to this could apply when general practice is at odds with tax administration and back-dating would merely align the two.

Inland Revenue should engage with the banking industry on transition periods when making changes. *(AMP, New Zealand Bankers' Association)*

Comment

The different approach highlighted in clauses 12 and 25 was intentional.

The determination and regulation-making powers proposed in those clauses relate to the CRS requirement for an implementing jurisdiction to publish lists of its non-reporting financial institutions, excluded accounts, participating jurisdictions and reportable jurisdictions.

Additions to these lists will generally be favourable for financial institutions and officials expect that financial institutions may not want to be precluded from such changes applying mid-reporting period. For example, a financial institution that is added to the list of non-reporting financial institutions would have a strong preference for that change to have immediate effect, to remove any obligation to report in relation to the current reporting period.

However, officials' acknowledge that concerns may arise in the reverse situation, when an entity, account or jurisdiction is removed from a list. Any removal would result in CRS obligations being "switched on". Officials agree in principle that such changes generally should not apply mid-reporting period.

However, there would be a risk in preventing the immediate application of changes. New Zealand needs the ability to swiftly respond to directives from the OECD/Global Forum directives. If, for example, a Global Forum peer review were to criticise New Zealand's list of participating jurisdictions, and require removal of a country from that list with immediate effect, a legislative prohibition against making an immediate change would be problematic.

Accordingly, the drafting proposed in the bill permits, but does not require, Inland Revenue to specify a reporting period.

Inland Revenue intends to clarify the processes around additions to, and removals from, lists in guidance material.

Recommendation

That the submissions be declined.

Clause 12

Issue: Three-month limitation in section 91AAV

Submission

(KPMG)

It is not clear why determinations that suspend reportable jurisdictions should be limited to three months. Either remove the three-month limitation or clarify in the legislation what the objective of the determination is (which would include an explanation of why a three-month period is imposed).

Comment

A treaty obligation to exchange information with a country by a particular deadline may need to be suspended as a matter of urgency, for example, in the case of a serious breach of privacy by that country.

Normally, such a suspension would be made by the Order in Council mechanism proposed in section 226D.⁵ However, if the exchange deadline is imminent, there may be insufficient time to promulgate an Order in Council. Section 91AAV is therefore a safety mechanism that authorises the Commissioner to suspend the exchange in these circumstances, pending confirmation by Order in Council.

The three-month limitation reflects the fact that the Commissioner's action must be confirmed by the Government (by Order in Council).

Officials do not consider that this needs to be explained in the legislation. Inland Revenue intends clarifying the matter in guidance.

Recommendation

That the submission be declined.

⁵ To clarify, the interaction of New Zealand's list of reportable jurisdictions with the treaty obligations effectively mean that removing a country from a list effectively "switches off" the applicable treaty obligation.

Clauses 12 and 25

Issue: Location of published lists

Submission

(AMP)

The bill provides that the lists of participating jurisdictions, non-reporting financial institutions and excluded accounts will be published “in a publication chosen by the Commissioner”.

Access to these lists impacts a financial institution’s ability to comply with its CRS obligations. The legislation or regulations should specify where, or how, a financial institution will be able to easily ascertain where the lists have been published. Ideally, this would be the Inland Revenue website.

Comment

Officials agree that it is important for the lists to be published in a way that is widely available and accessible. Inland Revenue will ensure that this is the case. At a minimum, Officials would expect the lists to be available on Inland Revenue’s website. However, the drafting proposed in the bill will ensure Inland Revenue has the flexibility to supplement this by other means.

Recommendation

That the submission be declined.

Clauses 12 and 25

Issue: Urgency

Submission

(AMP, Corporate Taxpayers Group, New Zealand Bankers’ Association, Russell McVeagh)

The lists of non-reporting financial institutions and excluded accounts should be published as soon as possible.

Inland Revenue’s intended date of early-to-mid 2017 may be too late and lead to unnecessary compliance costs, and adversely impact customer service. Preferably, the lists should be published at least six months before 1 July 2017.

Inland Revenue should issue a draft determination or other guidance describing the categories of entities and accounts that may be excluded as soon as possible. If it is not possible to issue a draft determination, officials should provide an indication as to the accounts that will be excluded.

There is a risk that financial institutions could also unnecessarily report excluded customers.

Comment

Officials agree it is important to disseminate this information as soon as possible. Given that determinations will only be authorised when the bill has been enacted, if possible, Inland Revenue will issue indicative lists as soon as decisions have been made.

Recommendation

That the submission be noted.

NEW ZEALAND TIMELINES

Clause 24(1)

Issue: Deadlines for reviewing and reporting pre-existing accounts

Submission

(New Zealand Bankers' Association)

From FATCA experience, involving smaller numbers and less complexity, CRS due diligence and reporting compliance will be extremely challenging. Compliance costs and efforts will be significantly higher in the first reporting period under CRS. This should be taken into consideration when setting the first reporting period.

In light of these challenges, there are workability issues with the three-month grace period set out in the bill for carrying out due diligence and “immediate” reporting (as opposed to reporting in the period following on from when an account is identified as reportable as per general FATCA and CRS obligations) on pre-existing accounts.

There is a risk that if the proposals remain unchanged, customer experience will suffer due to the pressure to complete due diligence. More customers will likely be reported simply because financial institutions will be unable to completely assess customers within the required period.

Comment

Officials acknowledge these difficulties. The bill proposes a three-month grace period for pre-existing account due diligence and a transitional approach to penalties to try to minimise compliance costs. Inland Revenue will also be producing guidance on CRS due diligence and reporting obligations with a view to clarifying these obligations and minimising compliance costs.

The grace period attempts to allow extra time for carrying out due diligence, while still ensuring that New Zealand complies with its AEOI exchange obligations. The grace period is broadly in line with that adopted by Australia.

It is also important to note that financial institutions that consider that utilising the grace period will be operationally difficult are not required to do so. They merely have the option to do so. That is, a financial institution could decide to take nine months to review and, if reportable, report pre-existing high value individual accounts and 21 months for other pre-existing accounts, as opposed to utilising the grace period and taking 12 months and 24 months respectively to review and, if reportable, report these accounts.

Recommendation

That the submission be noted.

Clause 25 and schedule 2

Issue: References to facilitate a non-calendar year reporting period

Submissions

(Chapman Tripp, New Zealand Law Society)

We support the adoption of a reporting period that aligns with the tax year. Proposed schedule 2, item 1, is intended to achieve that. However, there are many references to “31 December” throughout the CRS (for example, in sections V.D.2, VIIIA.6(b), VIII.C.15, VIII.C.17) and “calendar year” (for example, in sections III.C.6, I.C, V.B) that should also be changed so all date references are aligned to the concept of the period ended 31 March. *(Chapman Tripp)*

For item 10 of new schedule 2, the reference to “31 December” on line 4 of section V, subparagraph D(2) should be replaced with “31 March”. This is consistent with the approach taken in relation to the review of pre-existing entity accounts under FATCA (as stated at paragraph 94 of Inland Revenue’s FATCA due diligence guidance notes). *(New Zealand Law Society)*

For item 20 of new schedule 2 the second reference to “31 December” on line 3 of section VIII, subparagraph C(15) should be replaced with “31 March”. This is consistent with the approach taken in relation to the review of high-value accounts under FATCA (as stated at paragraph 67 of Inland Revenue’s FATCA due diligence guidance notes).

Comment

The bill intends to provide that references in the CRS are read as aligning with the tax year. However, the submitters have correctly identified some additional modifications that need to be made to facilitate this.

Recommendation

That the submissions be accepted.

COMPLIANCE COSTS

Clause 24(1)

Issue: Deadlines

Submission

(TGT Legal, New Zealand Bankers' Association)

Reporting deadlines should be reasonable having regard to the purpose for which the data is collected. They should be consistent with those applicable to, for example, the filing of returns by the trustees of other trusts. *(TGT Legal)*

From FATCA experience, which involved smaller numbers and less complexity, CRS due diligence and reporting compliance will be extremely challenging. Compliance costs and efforts will be significantly higher in the first reporting period under CRS. This should be taken into consideration when setting the first reporting period. *(New Zealand Bankers' Association)*

In light of these challenges, there are workability issues with the three-month grace period set out in the bill for carrying out due diligence and “immediate” reporting (as opposed to reporting in the period following on from when an account is identified as reportable as per general FATCA and CRS obligations) on pre-existing accounts. *(TGT Legal)*

There is a risk that if the provisions remain unchanged customer experience will suffer due to the pressure to complete due diligence. More customers will likely be reported simply because financial institutions will be unable to completely assess customers within the required period. *(New Zealand Bankers' Association)*

Comment

The bill proposes that the annual CRS reporting period will be for the period ending 31 March and that reporting will be by 30 June. The 31 March period approach was endorsed by a number of submitters in the initial round of consultation and is in line with New Zealand’s tax year and reporting date for FATCA. Submitters consider that this alignment should assist in minimising compliance costs for financial institutions.

The 30 June deadline for reporting is also in line with FATCA timeframes, and was broadly supported by submissions in initial consultation. This date will also provide Inland Revenue with sufficient time to process the information reported and exchange it with the relevant jurisdictions, in accordance with its international commitments.

Officials acknowledge that financial institutions will face difficult timelines. The bill proposes a three-month grace period for pre-existing account due diligence and a transitional approach to penalties to minimise compliance costs in this regard.

The grace period is broadly in line with that adopted by Australia. The grace period attempts to allow extra time for carrying out due diligence while still ensuring that New Zealand complies with its international commitments to complete first exchanges by 30 September 2018.

However, financial institutions that consider that utilising the grace period will be operationally difficult are not required to utilise this period; they merely have the option to do so.

Officials also note that New Zealand is allowing a longer period of time for the completion of reviews of pre-existing entity accounts (effectively 24 months) than Australia (effectively 13 months).

Officials also note that Inland Revenue intends producing guidance on CRS due diligence and reporting obligations with a view to clarifying such obligations and further minimising compliance costs.

Recommendation

That the submission be noted.

Clause 24(1)

Issue: Confirming reasonableness of self-certifications

Submission

(Chartered Accountants Australia and New Zealand, BNZ)

A financial institution must confirm the reasonableness of a self-certification based on the information they have obtained. It is not clear what this requires. For example, an account holder is required to specify their tax residence. However, determining tax residence is not always straightforward and can be difficult for an individual let alone a financial institution. Expecting a financial institution to confirm the reasonableness of a self-certification places an undue burden on them. *(Chartered Accountants Australia and New Zealand)*

Financial institutions should be able to rely on the self-certification provided by customers and additionally rely on the obligation placed on customers to provide information about a material change in circumstances relating to a self-certification. *(BNZ)*

Comment

Self-certifications (and checking the reasonableness of such certifications) are a critical element in the CRS, and New Zealand does not have the ability to unilaterally relax the requirements.

The CRS and OECD Commentary set out the circumstances in which a financial institution can reasonably rely on a self-certification. Generally, self-certifications can be relied upon unless a financial institution knows, or has reason to know, that the certification may not be correct. This means that, for example, a financial institution should cross-check the certification against any other information they have, for anything that might put them on notice that there is an inconsistency. Given that self-certifications will generally be obtained on account opening, this will typically mean cross-checking the self-certification against information received from the customer at the same time as the self-certification.

Inland Revenue intends to provide additional guidance on the circumstances when a financial institution can rely on self-certifications that they have received when classifying a customer for CRS purposes, and how the rules regarding changes in circumstances apply in this context.

Recommendation

That the submission be noted.

Clause 24(1)

Issue: Reliance on anti-money laundering (AML) processes

Submissions

(AMP, KPMG)

For CRS purposes, a financial institution should be able to use the information it collects under AML about controlling persons, particularly until the next raft of AML legislative changes are implemented and CRS and AML are fully aligned. *(AMP)*

The ability of financial institutions to rely on their AML processes for CRS purposes, to the extent they support CRS compliance, should be explicitly provided. *(KPMG)*

Comment

The CRS and OECD Commentary stipulate the specific circumstances in which a financial institution is able to rely on AML procedures to help carry out CRS obligations. There is no scope in the CRS for relying on AML procedures beyond those specified circumstances.

To the extent there is any non-alignment between AML and CRS, the CRS procedures must drive the CRS obligations. This is consistent with the fact that CRS is a global initiative and will need to be implemented consistently world-wide. The OECD and Global Forum will rigorously monitor New Zealand's compliance with the CRS obligations.

The circumstances in which a financial institution is able to rely on AML procedures to help it carry out CRS obligations are incorporated in the bill, through the importing of the CRS and the Commentary. Further explicit clarification is not required in the legislation. However, officials note this is a matter that Inland Revenue intends to provide guidance on.

Recommendation

That the submission be declined.

Clause 24(1)

Issue: Reliance on information provided by other means

Submission

(KPMG)

Efficient implementation of the CRS will require the use of existing information and processes. As drafted, it is not clear that information, directly or indirectly, already available to a financial institution can be used to satisfy CRS requirements.

Comment

The CRS sets out several instances when a financial institution can rely on information it already has (including information that may be held by, for example, an agent working on their behalf) in carrying out due diligence. There is also some scope for institutions within a group to rely on such information.

However, these instances are prescribed by the CRS itself. Financial institutions will (especially for new accounts) often need to obtain a self-certification with respect to the account.

These points are addressed in the CRS, which is already incorporated by reference in the bill. Inland Revenue will also provide guidance.

Recommendation

That the submission be declined.

Clause 12

Issue: Non-reporting financial institutions and excluded accounts

Submissions

(AMP, Corporate Taxpayers Group, New Zealand Bankers' Association, Russell McVeagh)

The list of CRS exempt entities and accounts should include those entities and accounts that are exempted for FATCA purposes. *(AMP, Corporate Taxpayers Group, New Zealand Bankers' Association)*

Any inconsistency between obligations imposed under FATCA and obligations imposed under the CRS applied standard should (to the greatest extent possible) be avoided. *(Russell McVeagh)*

Comment

For FATCA, it was agreed with the United States that certain types of entities and accounts would be exempt from FATCA obligations, on the basis that they were considered to pose a low risk of tax evasion. The submissions propose that these same exemptions should also apply for CRS.

The CRS also provides for exemptions for entities (non-reporting financial institutions) and accounts (excluded accounts). The CRS and OECD Commentary set out specific criteria that must be satisfied before these exemptions can apply. Importantly, these criteria do not focus solely on whether entities or accounts pose a low risk of tax evasion.

Although a number of the FATCA exemptions are likely to also apply for CRS purposes, any FATCA exemption will need to be tested against the CRS criteria before confirming that they will also apply for CRS purposes.

The OECD has been clear that an exemption for FATCA will not automatically apply for CRS purposes.

Recommendation

That the submissions be accepted in part. That is, that they are accepted to the extent that the entities and accounts that are exempt for FATCA purposes also comply with the defined criteria that must be satisfied before an exemption can apply for CRS purposes.

Clause 24(1)

Issue: Undocumented account reporting

Submission

(New Zealand Bankers' Association, BNZ)

The definition of undocumented accounts in the bill should be extended to include new as well as pre-existing accounts.

Comment

The OECD has a base expectation that self-certifications will always be obtained for new accounts. As a general rule, an account should not be opened unless and until the requisite self-certification is obtained.

Consistent with this, the CRS and OECD Commentary only contemplate the reporting of undocumented accounts in relation to certain types of pre-existing account. That is, the OECD seems to have taken the position that extending undocumented account reporting to new accounts is not applicable because either the requisite self-certifications will be obtained or the account will not be opened.

The framework that New Zealand has in requiring that financial institutions obtain self-certifications will be a key area of Global Forum peer review, particularly in the context of new accounts. There is a risk that if New Zealand has an explicit provision that allows the reporting of undocumented accounts for new accounts, New Zealand will be criticised as not having a sufficiently robust legislative framework to ensure that self-certifications are always obtained for new accounts. This is because undocumented new accounts will only arise if self-certifications have not been obtained in the first place.

One submission notes that the Cayman Islands and the United Kingdom both allow undocumented account reporting for new accounts. However, other countries have not adopted this approach. In particular, Australia's CRS legislation does not explicitly provide for undocumented account reporting for new accounts.

Officials consider that any decision to extend the key building blocks of CRS (of which this is one) should be done on a multilateral basis, rather than adopting a unilateral domestic amendment that could result in a failed peer review.

Recommendation

That the submission be declined.

Clause 24(1)

Issue: Timing for obtaining self-certifications

Submissions

(KPMG, TGT Legal, AMP)

Clear rules on when self-certification is required should be legislated. To be consistent with the CRS associated guidance, this should be within 90 days. *(KPMG)*

We understand from Inland Revenue that, if a financial institution is unable to obtain a self-certification at the time of opening a new financial account (under proposed section 142H(3)), a further period of 90 days would be given to the institution to obtain such certification. The provision of this grace period for self-certification reflects the approach expressly supported by the OECD, and is endorsed by Inland Revenue. However, there is no mention of a grace period in the bill.

The bill should be amended to include specific reference to the "90-day grace period" being available to financial institutions in relation to obtaining self-certification when opening new financial accounts. *(TGT Legal)*

AMP supports the stated Inland Revenue approach of permitting a financial institution up to 90 days to obtain a self-certification when it is not possible to obtain it on day one. *(AMP)*

Comment

The CRS generally provides that a self-certification is to be obtained "upon account opening". OECD "Questions and Answers" on its website clarify how this "upon account opening" requirement should apply in practice.

The general rule as set out in that clarification is that this should occur as part of a "day one" process. However, the clarification provides that there is scope for a 90-day period to be used, as an exception to this general rule, in certain circumstances.

These circumstances are highly nuanced, and do not amount to a blanket 90-day period always applying. The reference in the CRS to "upon account opening" should be read in accordance with this background context.

The bill provides, in this regard, that a financial institution is able to choose to avail itself of options consistent with the CRS. This would include the ability to apply the 90-day approach in the circumstances set out in the OECD clarification. Inland Revenue also intends to provide guidance on how this 90-day approach would apply in practice, given that the application of such a 90-day period will be highly fact-specific.

Recommendation

That the submissions be declined.

Clause 24(1)

Issue: Filing nil returns

Submission

(New Zealand Bankers' Association)

Financial institutions should not have to file nil returns as this adds to compliance costs. Instead, we recommend that financial institutions must evidence "nil returns" if required by Inland Revenue.

Comment

The CRS provides that jurisdictions may allow financial institutions to file nil reports. This ability is incorporated through the general option provision in proposed section 185O(5). There will be no compulsion for financial institutions to file nil reports. This is merely an option that is available to a financial institution if it has a preference to file nil returns.

Recommendation

That the submission be accepted.

OPTIONALITY

Clause 24(1) and schedule 2

Issue: Adoption of “optionality”

Submission

(BNZ)

We support the inclusion of “optionality” in the bill. Where there is optionality, requirements and definitions should be made clear to ensure consistency across financial institutions.

Comment

The bill sets out a general rule that financial institutions are able to take advantage of optionality consistent with the CRS. This is subject to some limited exclusions set out in proposed section 185N(11) and the exclusions set out in schedule 2, items 1 and 4.

Inland Revenue intends to provide guidance on the circumstances when optionality is permitted and what the requirements are in this regard. This should help to ensure consistency across financial institutions.

Elsewhere in this report, where potential areas of ambiguity are highlighted, recommendations for removing the ambiguity or otherwise clarifying the legislation are proposed.

Recommendation

That the submission be noted.

Clause 24(1) and schedule 2

Issue: The wider approach to due diligence

Submissions

(AMP, BNZ, New Zealand Bankers’ Association, Chapman Tripp)

The submitters broadly support the inclusion of the wider approach to due diligence in the bill. *(AMP, BNZ, New Zealand Bankers’ Association)*

The OECD’s suggested CRS replacement sections for facilitating the wider approach should be further modified to clarify that financial institutions are required to undertake due diligence to identify account holders (and controlling persons) that are resident in any foreign jurisdiction and to collect the requisite information that relates to them and to those foreign jurisdictions. *(Chapman Tripp)*

Comment

This issue is already addressed in proposed section 185N(3)(c) and the importing of the wider approach to due diligence under proposed schedule 2, item 2 (as modified by items 3 to 12).

However, officials consider it may be useful to seek additional clarity by including an express override of the CRS in relation to section 185N(3)(c). This matter could be referred to the drafter for consideration.

Recommendation

That the submissions supporting the wider approach to due diligence be noted.

That the submission recommending modifications be declined, but that the matter of including an express override of the CRS in relation to section 185N(3)(c) to be referred to the drafter for consideration.

Clause 24(1) and schedule 2

Issue: Wider approach to reporting

Submission

(AMP, BNZ, New Zealand Bankers' Association)

The submitters broadly support the inclusion of the wider approach to reporting in the bill.
(AMP, BNZ, New Zealand Bankers' Association)

The wider approach to reporting should be mandatory rather than optional. This is the approach taken in most other countries to reduce compliance costs and inconsistencies.

The optional approach will be confusing to customers if some financial institutions elect to report all of their CRS information to Inland Revenue and other institutions elect to report only on residents of reportable jurisdictions. This will add an unnecessary level of complexity for customers with foreign tax residencies.

Financial institutions that opt for the wider approach are likely to receive customer complaints if a customer is reported to Inland Revenue by one financial institution but not by another. Dealing with such complaints, notwithstanding the absence of any grounds for such a complaint, would unnecessarily and significantly increase compliance costs for institutions that are fully complying. Account holders may also choose to move their accounts to institutions that only report accounts on the reportable jurisdiction list, creating an unfair competitive advantage for some financial institutions.

Allowing financial institutions the choice to limit reporting will not reduce compliance costs as intended, but will simply spread them over a much longer period. The reportable jurisdiction lists will change over time and financial institutions will need to constantly update processes and reporting requirements to meet those changes. *(AMP, New Zealand Bankers' Association)*

Some industry participants have concerns that the wider approach has not been endorsed by the Privacy Commissioner. Inland Revenue should confirm with the Privacy Commissioner that

financial institutions will not be in breach of the Privacy Act 1993 if they elect to adopt the wider approach. (*AMP, BNZ, New Zealand Bankers' Association*)

Comment

The approach proposed in the bill is to allow financial institutions the option to decide whether to adopt the wider approach to reporting.

Officials consider that the “optional” nature of the wider approach to reporting is important for the following reasons:

- An overarching objective has been to have an implementing framework for CRS that aims to minimise compliance costs where possible and to allow financial institutions to make choices, where permissible, to allow them to achieve that end. This will generally involve the institution undertaking a cost/benefit analysis of the merits of adopting a particular option.
- It will allow a financial institution to choose to report all information about all non-residents that they have identified (choose to adopt the wider approach to reporting) if they consider that such an approach would be preferable from a business/compliance cost perspective. This is conceptually similar to the general “optionality” permitted in the bill (set out in proposed section 185O(5)), which has been broadly endorsed by the industry. All of these options have the ability to impact on what information will be reported to Inland Revenue.
- It will allow a financial institution to choose only to report information about non-residents from reportable jurisdictions (that is, choose not to adopt the wider approach to reporting) if it considers that such an approach would be preferable from a business/compliance cost perspective.
- The “optional” nature of the wider approach to reporting is particularly important for smaller financial institutions that may not otherwise be required to report to Inland Revenue for CRS purposes. A mandatory wider approach to reporting would require these institutions to file a CRS report to Inland Revenue on an annual basis (and potentially be subject to penalties for failing to do so) if they have any non-resident accounts, even if all of the information was information that Inland Revenue would not be exchanging for AEOI purposes (that is, even if the only non-resident accounts were not held or controlled by residents from reportable jurisdictions). This would add compliance costs for these institutions for those periods where they would be required to report. A number of submissions were made in the earlier consultation with industry on the compliance cost concerns associated with requiring such institutions to report under the wider approach in these circumstances.

Officials also note that there is not a consistent approach world-wide with regards to the wider approach to reporting. Some jurisdictions have not permitted it, whereas others have. Ultimately, a decision whether to adopt the wider approach to reporting and, if so, whether that approach should be optional or mandatory is a matter for implementing jurisdictions to consider. This is why the OECD has allowed each implementing jurisdiction the choice of what approach to adopt, after weighing up the relevant considerations. On balance, officials consider that the optional wider approach to reporting is preferable as it allows institutions to make a choice (as per other options available to them) that they consider will best suit them from a compliance cost perspective.

Submissions on endorsement by the Privacy Commissioner have been addressed above as a separate issue.

Recommendation

That the submissions be noted, but that the submissions for the wider approach to reporting to be mandatory be declined.

DEFINITIONS

Clause 8(2)

Issue: “CRS standard”

Submission

(New Zealand Law Society)

As currently drafted, the definition of “CRS standard” refers to “financial accounts as defined”. It is assumed that the phrase “as defined” is included as a reference back to the relevant definition of “financial accounts” in the CRS standard.

However, this reference may be confusing to a reader as it suggests there is a definition of “financial accounts” in the Tax Administration Act 1994. This is exacerbated by the absence of a similar reference back in relation to other terms used in the Act that are defined in the CRS applied standard.

The words “as defined” should therefore be removed.

Comment

Officials agree.

Recommendation

That the submission be accepted.

Clause 8(3)

Issue: “FATCA agreement”

Submission

(New Zealand Law Society)

The definition of “FATCA agreement” correctly refers to the full title of the agreement. However, it is more commonly known as the “intergovernmental agreement”, and the link to it on Inland Revenue’s website also uses that title.

It would assist a reader’s understanding if the definition were to include the words “commonly known as the intergovernmental agreement with the United States in relation to FATCA”.

Comment

Officials agree.

Recommendation

That the submission be accepted.

Clause 8

Issue: “Financial institution”

Submissions

(KPMG, New Zealand Bankers’ Association)

A definition of “financial institution” which applies for the CRS and FATCA rules should be included in the legislation. A standalone New Zealand definition of “financial institution” is not strictly required. However, including a definition that references the CRS and FATCA definitions would assist a reader’s understanding of the legislation.

Defining “financial institution” would mean that the term could then be used in the legislation in preference to “person” (FATCA) or “entity other than a person” (CRS).

The definition would need to be ring-fenced to the CRS and FATCA rules. *(KPMG, New Zealand Bankers’ Association)*

Due to differences in the definition of “financial institution” under the FATCA and CRS regimes, we recommend alignment of the FATCA financial institution definition to that contained in the CRS. *(New Zealand Bankers’ Association)*

Comment

Officials consider that any advantages of defining “financial institution” in the legislation would be outweighed by the disadvantages. Inserting a definition into the legislation would then require that term to be maintained to ensure that it remained consistent with the CRS. To avoid this, the legislation is been drafted in a way that facilitates changes by the OECD automatically applying.

The submitters acknowledge that including a definition is not strictly needed, but generally argue for its inclusion on the basis that it would make the legislation more readable. The same argument would apply for any other term defined in the CRS. Officials do not consider there is an advantage in referring to “financial institution” rather than “person” or that “entity other than a person” would materially change the position.

Under FATCA, the term “financial institution” is defined in the treaty (“the FATCA intergovernmental agreement”) that New Zealand has entered into with the United States, and cannot be unilaterally amended in New Zealand legislation. That said, the FATCA intergovernmental agreement allows entities to substitute the definition of “financial institution” in the United States’ Treasury Regulations, which is very similar to the CRS definition.

Therefore, an entity that wants broadly the same definition of financial institution applying for CRS and FATCA purposes can simply choose to use the United States’ Treasury Regulations definition of “financial institution” for FATCA purposes. This would result in broadly the same test applying for both CRS and FATCA purposes.

This is a matter that Inland Revenue intends to address in guidance following enactment of the bill.

Recommendation

That the submissions be declined.

Clause 6

Issue: “Foreign account information sharing agreement”

Submission

(EY)

The bill proposes amending the definition of “foreign account information-sharing agreement” in section YA 1 of the Income Tax Act 2007 to extend its application beyond FATCA and facilitate its application to AEOI.

The proposed new definition refers to agreements that facilitate “the automatic exchange by the parties of information relating to financial accounts”. The present definition, which is limited to New Zealand’s FATCA agreement with the United States, does not include the word “automatic”.

While the exchange of information between New Zealand and other jurisdictions is likely to become much more extensive and frequent, it will still be occurring under and in terms of New Zealand’s tax treaties. On that basis we suggest the word “automatic” may be misleading and could, preferably, be excluded from the statutory definition.

Comment

Officials do not agree. “Automatic” exchange has specific meaning under tax treaties. It refers to a programme of automatic exchanges of specific categories of information agreed between treaty partners. AEOI and FATCA are both programmes of automatic exchanges of financial account information. The reference to “automatic” in the definition is therefore appropriate.

Recommendation

That the submission be declined.

Clause 8(4)

Issue: “Maintain”

Submission

(AMP)

Is sub-paragraph (a) intended to make a broker a financial institution?

Subparagraph (c) should be made subject to the CRS, particularly the exclusions from “financial account” as there is a risk that this subparagraph could inadvertently negate the CRS exclusions.

Comment

In relation to sub-paragraph (a), the provision sets out the circumstances in which a financial institution, as defined, would be considered to maintain a custodial account. It does not determine the circumstances when an entity will be a financial institution.

In relation to sub-paragraph (c), officials consider that the submitted amendment is not needed as there is no conflict under the scheme of the CRS. By definition, a financial account can never include an excluded account.

Recommendation

That the submission on sub-paragraph (a) be noted, and the submission on sub-paragraph (c) be declined.

Clause 8(7)

Issue: “Passive income”

Submission

(New Zealand Law Society, Chartered Accountants Australia and New Zealand, KPMG, Westpac)

The submitter welcomes the inclusion of a definition of “passive income” in the Tax Administration Act 1994. This will facilitate consistent interpretation and application of the CRS applied standard in New Zealand.

However the definition has been drawn from the OECD Commentary and reworded, rather than replicating the Commentary. Replicating the Commentary would remove any risk of inadvertent gaps and ensure that any subsequent guidance issued by the OECD (in relation to “passive income”) will apply in New Zealand. *(New Zealand Law Society)*

The proposed definition of “passive income” should not apply for FATCA purposes. Most financial institutions that have implemented FATCA were not planning on revisiting decisions on their FATCA systems and processes unless changes had been initiated by the United States.

There is no specific definition of “passive income” for FATCA purposes. The definition that has been applied is “income from financial assets”. Importantly, this means that income from real property is excluded. A new and different definition would require reconsideration of the characterisation of entities for FATCA purposes.

There does not appear to be any requirement from the United States that a definition be introduced for FATCA to align with CRS. No such change should be made without the United States’ confirmation of the need for change and then only with a suitable lead time. *(Chartered Accountants Australia and New Zealand, KPMG, Westpac)*

Comment

With respect to restating the definition, officials disagree. Whereas other aspects of the CRS and OECD Commentary are incorporated into New Zealand law by reference, the OECD's Commentary on the meaning of "passive income" is worded in such a way that it cannot be directly imported. It therefore needs to be defined in the legislation. That definition has been drafted using the applicable New Zealand legislative drafting style. Officials cannot detect any difference in meaning.

The proposal that the definition of "passive income" would apply for FATCA as well as for CRS purposes was made with the intention of minimising compliance costs for financial institutions. However, a number of submitters have noted that such a change could actually increase compliance costs.

Recommendation

That the submission on restating the definition of "passive income" be declined.

That the submission on limiting the application of the definition to the CRS be accepted.

Clause 8

Issue: "Tax return"

Submission

(New Zealand Law Society)

The definition of "tax return" in section 3 of the Tax Administration Act 1994 should be amended to omit a return required under the CRS applied standard, in the same way that FATCA returns are carved out. This will ensure that late filing penalties do not apply (it is not necessary to impose late filing penalties, given that a general sanction applies).

Comment

Officials agree that the same approach should apply for both FATCA and CRS.

Recommendation

That the submission be accepted.

Clause 8(9)

Issue: “Taxpayer identification number (TIN)”

Submission

(AMP)

Why is any application of a double tax treaty disregarded?

Comment

The submitter’s reference to a double tax treaty refers to the fact that such treaties usually include “tie-breaker” rules to resolve dual-residence issues. The definition in question does not refer to such tie-breaker rules, because the reference is not needed.

For example, it is clear from the OECD Commentary that a customer that is dual-resident in New Zealand and Australia would apply the tax treaty tie-breaker rules, and self-certify on the basis of the outcome. This does not need to be built into the definition.

Recommendation

That the submission be declined.

Clause 8

Issue: “Undocumented account”

Submissions

(AMP, New Zealand Bankers’ Association)

The bill’s Summary of Proposed Amendments (*Commentary*) refers to “undocumented account”. Under the CRS, an undocumented account arises in extremely restricted circumstances, namely where an account has a *hold mail* instruction or *in care of* address, and no other address, and the financial institution has taken prescribed steps to try to document the account but has been unable to do so. The comparable FATCA term is “recalcitrant account”, but the reporting requirements for recalcitrant accounts and undocumented accounts are very different.

The above factors may give rise to confusion. The legislation should therefore be amended to clarify the limited circumstances in which “undocumented account” reporting can arise. *(AMP)*

If a financial institution is unable to determine the status of a pre-existing account it generally must report it as an “undocumented account”. However, the CRS provides that “undocumented account” only relates to particular situations and there is a conflict between the CRS and the OECD Commentary. Accordingly this requires clarification. *(New Zealand Bankers’ Association)*

Comment

Officials agree that, to avoid confusion, the limited circumstances in which “undocumented account” reporting can arise should be clarified in the legislation.

Inland Revenue also intends to provide guidance in respect of undocumented account reporting.

Recommendation

That the submissions be accepted.

ENFORCEMENT

Clause 9(3)

Issue: Record-keeping requirements – self-certifications (1)

Submissions

(AMP, BNZ, New Zealand Bankers' Association)

The bill takes a more comprehensive enforcement approach to record-keeping than the international AEOI obligations require, specifically around the requirement in proposed section 22(2)(1d) of the Tax Administration Act 1994 to keep records about any failure to collect a self-certification.

This requirement should be removed as existing section 22(2)(1c) imposes a general obligation on financial institutions to maintain records, and this is adequate to ensure compliance and accountability. Section 22(2)(1d) is superfluous given the obligation that already exists under section 22(2)(1c).

This legislative detail will add onerous and costly obligations, may result in unintended consequences, and is not necessary. For example, it would be costly, onerous, and unnecessary for a financial institution to extract into a dedicated database the failures of customers to respond to self-certification requests.

The appropriate mechanism in respect of failures to obtain self-certifications is through reporting of undocumented accounts, both new and pre-existing.

CRS record-keeping requirements should align with those currently imposed under FATCA. *(BNZ, New Zealand Bankers' Association)*

Comment

The CRS contains a number of due diligence procedures that require financial institutions to obtain self-certifications. The OECD Commentary highlights that obtaining the requisite self-certifications (particularly for new accounts) is a critical aspect of ensuring that the CRS is effective. The OECD's expectation is that implementing jurisdictions will have robust procedures in place to ensure that self-certifications are obtained for new accounts.⁶

There is also a broader expectation that implementing jurisdictions will have robust procedures in place to ensure that they are able to monitor and verify compliance with the CRS. Being able to monitor and verify when the requisite self-certifications have not been obtained will be a key element of this. This will, in turn, be a key part of the OECD's review of New Zealand's compliance with the CRS.

Proposed section 142H(3) imposes a penalty for a failure to obtain a self-certification for a new account. There is also a penalty in proposed section 142I(2)(f) and (h) that can apply to an account holder or other person that does not provide a required self-certification. A key aspect of monitoring and verifying compliance with these obligations will be being able to determine whether such self-certifications have been obtained or provided.

⁶ Paragraph 18, page 211 of the OECD Commentary.

For this reason, it is important that an obligation for a financial institution to keep a record of any failure to obtain a self-certification for a new account is imposed, so that compliance can be effectively verified in the context of review or audit activity.

It is arguable that the requirement to keep records of failures to obtain self-certifications is subsumed within section 22(2)(lc). However, officials consider that expressly stating the obligation in section 22(2)(ld) is an important clarification in light of the conflicting submission about whether such a requirement adds to or is subsumed by the general keeping obligation.

Officials disagree with the comment that compliance with section 22(2)(ld) would require a dedicated database of failures of customers to respond to self-certification requests. Workflow-type records and business processes should satisfy the proposed requirement.

The reference to an undocumented account reporting mechanism, for both new and pre-existing accounts was addressed above as a separate issue in the section on compliance costs.

With respect to the comment that CRS record-keeping requirements should align with those currently imposed under FATCA, officials note that this is effectively the same issue as that just addressed. The CRS record-keeping requirements are broadly in line with the FATCA requirements. The key difference is that for the CRS, the bill proposes an express record-keeping obligation for failures to obtain self-certifications.

Recommendation

That the submissions be declined.

Clause 9(3)

Issue: Record-keeping requirements – self-certifications (2)

Submission

(AMP)

The references in proposed section 22(2)(ld) to “failure by the person to obtain a self-certification” should refer to “the customer’s failure to provide information”.

Comment

The submitter suggests changing the emphasis from failure of a person to “obtain” a self-certification to failure of a customer to “provide” it. However, failure to obtain a self-certification could potentially arise in other circumstances. For example, the failure might arise from a failure of a controlling person to provide a self-certification.

The submitter also seems to be suggesting broadening the provision to refer to “information” rather than “self-certifications”. The objective of the provision is to buttress the rules around obtaining self-certifications.

Officials therefore do not support the suggested changes.

Recommendation

That the submission be declined.

Clause 9(3)

Issue: Record-keeping requirements – additional requirements

Submission

(New Zealand Law Society, Matter raised by officials)

The requirement, under proposed section 22(2)(1d), for a person to keep records of any failure to obtain a self-certification should be amended to read “a failure by a person to obtain information, or a self-certification as required by the CRS applied standard”. *(New Zealand Law Society)*

The CRS record-keeping obligations ought to cover all documents that are material to a financial institution’s CRS compliance. This may include documents other than self-certifications (for example, documentary evidence establishing an account holder’s tax residence).

An additional record-keeping requirement for financial institutions should be inserted into clause 9 of the bill, requiring financial institutions to keep records of the steps undertaken and any evidence relied upon for the performance of their CRS obligations. *(Matter raised by officials)*

Comment

The AEOI standard explicitly requires implementing jurisdictions to have rules in place that require financial institutions to keep records of (i) the steps undertaken and (ii) any evidence relied upon for the performance of their CRS obligations.

Officials had taken the view that these specific obligations would be subsumed within the general record-keeping obligation at section 22(2)(1c) into the Tax Administration Act 1994.

However, given the comments received in submissions (and cited above in respect of the previous issue) on proposed section 22(2)(1d), officials are concerned that some financial institutions might not interpret section 22(2)(1c) on this matter in the same way as officials.

To ensure that New Zealand does not fail peer review on this point, officials consider that the specific OECD requirements for financial institutions to keep records of (i) the steps undertaken and (ii) any evidence relied upon for the performance of their CRS obligations should also be inserted into the bill as express obligations.

This proposal will also address the issue raised by the New Zealand Law Society.

Recommendation

That the submissions be accepted, and addressed by means of inserting into the bill an express record-keeping obligation in respect of (i) the steps undertaken and (ii) any evidence relied upon for the performance of CRS obligations.

Clause 13

Issue: Penalties

Submission

(AMP)

The submitter agrees that penalties should be civil rather than criminal.

Given that a financial institution is dependent on account holders providing information (particularly pre-existing customers), the submitter supports the extension of penalties beyond financial institutions.

Comment

Officials welcome the submission that supports the approach proposed in the bill.

Recommendation

That the submission be noted.

Clause 13

Issue: Interaction of penalties

Submission

(Corporate Taxpayers Group, KPMG, New Zealand Bankers' Association, Russell McVeagh)

It is unclear how the penalties interact. Several penalties can be applied for the same offence. Clarification is required that a financial institution will not be subject to penalties under proposed new section 142H(1) or (3) as well as a penalty under proposed new section 142H(5).

Comment

Officials agree that the provisions should be amended to clarify that these penalties do not overlap.

Recommendation

That the submission be accepted.

Clause 13

Issue: Maximum limit on penalties

Submissions

(Corporate Taxpayers Group, New Zealand Bankers' Association, Russell McVeagh)

There is no cap or limitation on the penalties that can be applied. There should be a cap on the strict liability penalties (that is, the “absolute liability” penalty provisions at sections 142H(1) and (3)) that can be imposed in a given reporting period. *(Corporate Taxpayers Group, New Zealand Bankers' Association, Russell McVeagh)*

The potential liability should not exceed the potential liability under the penalty for lack of reasonable care (that is, the penalty provision at section 142H(5)). *(Russell McVeagh)*

The penalties imposed under section 142H(1) or (3) should be capped at \$10,000 per reporting period (half the amount applicable for a first offence under the penalty for lack of reasonable care (that is, the penalty provision at section 142H(5))). *(Corporate Taxpayers Group)*

In the case of a systemic failure, Inland Revenue should consider if the financial institution failed to take reasonable care.

Comment

Officials agree that the penalties that could be imposed under the absolute liability penalties (sections 142(H)(1) and (3)) should be capped in the manner proposed by submitters.

Although the submitters disagree on the actual amount of the cap, Officials consider that it should be set at \$10,000 per reporting period. That amount represents half the amount applicable for a first offence under the penalty for lack of reasonable care (section 142H(5)).

Officials also consider that there should also be a cap for the penalties that could be imposed under the penalty for lack of reasonable care (section 142H(5)). In that case the limit should be set at \$100,000 per reporting period.

Recommendation

That the submissions be accepted, and the penalty provisions amended as set out above.

Clause 13

Issue: Section 142H penalty defences – “reasonable efforts”

Submissions

(AMP, BNZ, KPMG, New Zealand Bankers' Association, TGT Legal, Westpac)

The 1 April 2019 limitation for the “reasonable efforts” defence for financial institutions should be removed, or extended.

With the volumes of data each year, the process will not be error free. Penalties also need to reflect the reality that customers will provide incorrect data or fail to provide data notwithstanding their awareness of the legal requirements. *(AMP, BNZ, KPMG, New Zealand Bankers' Association, TGT Legal, Westpac)*

The “reasonable efforts” defence is only available until 31 March 2019. It therefore does not apply to pre-existing entity accounts and lower value pre-existing individual accounts (for which the reporting deadline is 30 June 2019). *(AMP)*

There should be a single transitional period applying until 31 March 2020. Failing that, the transitional period for pre-existing entity accounts and lower value pre-existing individual accounts should be extended to 31 March 2020.

There is a no fault defence for a customer. A financial institution should also have a defence to the penalties in proposed section 142H if their inability to comply with an obligation is outside their control. *(AMP, TGT Legal)*

The “reasonable efforts” transitional relief should be provided for the penalty for lack of reasonable care in proposed section 142H(5). *(BNZ, New Zealand Bankers' Association)*

Comment

The CRS and OECD Commentary are clear that implementing jurisdictions must have effective penalties for deterring non-compliance and errors. The bill proposes a suite of measures for ensuring compliance, including strong sanctions.

However, the drafting of the bill reflects acknowledgment by officials that there are strong arguments for relaxing those sanctions for a transitional “introductory” period. The CRS is a complex regime and financial institutions face short implementation timelines. In addition, financial institutions face a challenging requirement to complete due diligence reviews of their pre-existing accounts within the first two-year period. Despite best efforts, there are likely to be errors over this period.

Officials also note that during the initial period Inland Revenue will endeavour to ensure that financial institutions receive adequate guidance to help them to comply with their CRS obligations.

In acknowledging these challenges, the bill proposes (in section 142H(1) and (3)), that financial institutions will be permitted to mount a “reasonable efforts” defence against the imposition of penalties. The ability to mount this defence will only apply until 31 March 2019.

This appears to go further than other countries. For example, Australia’s CRS legislation does not explicitly contemplate such a defence.

Officials consider that removing the 31 March 2019 limitation would pose a risk that the OECD, on reviewing New Zealand’s legislative framework, may consider that New Zealand does not have an adequate penalties regime to address non-compliance.

Similarly, officials do not support the proposed extension of the expiry date to 31 March 2020.

However officials agree that the transitional period could be extended by three months to 30 June 2019. Such an extension would then continue to apply during the three-month grace period

from 1 April 2019 until 30 June 2019, during which some financial institutions may wish to continue their due diligence of pre-existing entity accounts and lower value pre-existing individual accounts.

Officials also broadly agree that a financial institution should not be penalised under section 142H(1) for matters that are outside its control. An additional provision should therefore be included in the bill, to apply on a permanent basis, permitting a financial institution to mount such a defence to the application of that provision in such circumstances.

This defence would not apply to section 142H(3). This is because New Zealand’s framework for ensuring that the requisite self-certifications are always obtained for new accounts will be a key area that the OECD will review. Such a defence could be criticised by the OECD as unduly weakening the requirement to always obtain self-certifications for new accounts. A financial institution will also always have at least a degree of control when opening an account (that is, they could have systems in place such that the account will not be opened until after the requisite self-certifications have been obtained). Therefore, having a defence applying to the failure to obtain a self-certification for circumstances outside their control would not be appropriate.

Regarding the proposal to extend the reasonable efforts defence to the penalty for lack of reasonable care, Officials note that a financial institution that has failed to take reasonable care to meet their CRS obligations would, by definition, not be able to avail themselves of a “reasonable efforts” defence. Therefore, a “reasonable efforts” defence to this penalty would be redundant.

Recommendation

That the submissions be accepted in part, and that the bill be amended to extend the transitional period from 31 March 2019 to 30 June 2019, and to provide financial institutions with the permanent ability to mount a defence to the imposition of a penalty under section 142H(1) that failure to comply with a CRS obligation was due to circumstances outside their control.

Clause 13

Issue: Section 142H penalty defences – “reasonable time”

Submission

(Chartered Accountants Australia and New Zealand)

The provisions in section 142H(2) and (4) that permit a financial institution to mount a “reasonable efforts” defence against the imposition of absolute liability penalties only apply if the financial institution rectifies the error within a reasonable time of it being detected.

The use of the words “reasonable time” is unclear and does not provide institutions and account holders with certainty. The phrase “reasonable time” should be replaced with a specific time period, for example “x days” to provide greater certainty.

Comment

A set time-period would not be appropriate because the issue of what constitutes a “reasonable time” will be highly fact-specific. Some failures may require more time than others to rectify, depending on the facts. Inland Revenue intends to provide guidance about how this requirement is to apply in practice, which will help provide greater certainty.

Recommendation

That the submission be declined.

Clause 13

Issue: Section 142H penalty defences – AML processes

Submission

(KPMG)

A financial institution that follows its tested anti-money laundering (AML) processes should be able to claim a “reasonable efforts” defence set out in proposed section 142H.

For any financial institution that is not subject to AML, implementing AML-aligned processes should be an acceptable defence.

Comment

The CRS and OECD Commentary set out a number of circumstances when financial institutions will be able to rely on AML processes and information to help carry out CRS due diligence. However, it is clear under the standard that in other instances, further due diligence work will be required.

Therefore, carrying out AML processes will not necessarily be sufficient. Instead, it will sometimes be necessary for a financial institution to carry out further due diligence for CRS purposes. Therefore, it is not appropriate to have a provision that would in effect create a CRS safe-harbour for a financial institution that simply follows AML processes (or procedures in line with AML processes). There is a material risk that such a provision would be criticised by the OECD on review.

Officials note that the circumstances when a financial institution will be able to rely on AML processes for CRS purposes will be addressed by Inland Revenue in future guidance.

Recommendation

That the submission be declined.

Clause 13

Issue: Section 142I penalty defences – “no fault”

Submission

(KPMG)

If a failure to provide information is within the control of the person, the person needs to show that the failure is not due to their fault. It is difficult to see in what circumstances this could apply.

Comment

A person may fail to provide information for a number of reasons. For example, a person could simply be away on holiday when a financial institution requests the information and not be contactable. In these circumstances, any failure to provide information may potentially be subject to the no-fault defence even though the information is within the control of the person. This will be a question of fact.

Officials consider that the application of the penalties provisions (and the relevant defences) can be best clarified by Inland Revenue in guidance.

Recommendation

That the submission be noted.

Clause 13

Issue: Section 143A(1(a) and 143A(2) – information

Submission

(New Zealand Law Society)

The proposed revision to section 143A(2) and new section 143A(1)(ac) applies only in respect of a failure to provide a self-certification. Elsewhere in the bill, a person’s obligations are in respect of “information or a self-certification”. It is not clear whether this narrower liability in respect of knowledge offences is intended.

Comment

The narrower liability was not intended. The provision should be amended to refer to “information” and to a “self-certification”.

Recommendation

That the submission be accepted, and sections 143A(2) and 143A(1)(ac) be amended to refer to “information” as well as to a “self-certification”.

Clause 24(1)

Issue: Section 185P – persons other than financial institutions

Submissions

(KPMG, New Zealand Law Society, AMP)

Proposed section 185P imposes obligations on the account holder and other information providers to provide information.

Achieving clear obligations and clear consequences is better achieved by separating account holders from others. This would require redrafting section 185P. *(KPMG)*

Proposed section 185P applies to:

- persons or entities that are requested by a financial institution to provide information (“institution contacts”); and
- persons or entities that are requested by an institution contact or other person or entity to provide information (“secondary contacts”).

The reference to “or other person or entity” unnecessarily widens a secondary contact’s obligation to provide information. It introduces the possibility of a person being compelled to provide information other than at the request of an institution contact or at the request of a financial institution. *(New Zealand Law Society)*

Under proposed section 185P(4), potentially if person A who is associated with an entity account holder is provided with information from person B, who is also associated with the same entity, person A appears to have an on-going obligation under this provision to be advised by person B of any of B’s change in circumstances, even when A is no longer associated with the entity account holder. *(AMP)*

Comment

Officials consider that the current draft wording correctly reflects and addresses the complexity involved in the different ways that an information provider may be contacted, and the different capacities in which they may be required to obtain and provide information.

An account holder will generally be the institution contact and will provide information about themselves. However, the account holder will also, in certain circumstances, be required to obtain information from a person that is a secondary contact (such as a controlling person). Secondary contacts will, in turn, then have their own obligations to obtain and provide information.

With reference to the “or other person or contact” issue, officials consider that the reference is needed because there may be chains of persons or entities in an account holding structure. For example, a secondary contact may itself be a controlling person that is an entity. In these circumstances, CRS requires that the secondary contact is “looked through”.⁷ Natural persons at the end of the chain (that are also secondary contacts) may receive a request from a secondary

⁷ For example, refer to the comments at page 199 of the OECD Commentary.

contact, rather than from an institution contact. The reference to “or other person or entity” is therefore important.

Officials disagree with the submission on section 185P(4). Proposed section 185P is clear that the provision only applies to a person or entity associated with an account (as stipulated in section 185P(1)). Therefore, any obligations under the section would cease to apply when the person or entity no longer had that association. Officials note that Inland Revenue intends to elaborate on this point in guidance.

However, the submission does highlight a potential problem in that it would not then be clear under the legislation who a person (person B, in the case of the submitter’s example cited above) should then advise changes to.

Recommendation

That the submissions be declined, but that it be clarified who a person should advise changes to.

Clause 13

Issue: Monitoring compliance

Submission

(PwC)

The CRS requires implementing jurisdictions to have rules and procedures in place to ensure compliance and to address non-compliance. While the bill proposes a comprehensive suite of enforcement rules and penalties, it does not address how New Zealand intends to implement its programmes for reviewing a financial institution’s CRS compliance.

We recommend that New Zealand’s AEOI/CRS compliance review framework reflects a risk-based approach that is proportionate to the size and complexity of the financial institution concerned and focuses primarily on the financial institution’s processes and controls. Under this approach, the expectation is that only a representative sample of the financial institution’s customer and transaction records would require testing – this should cut down on the length of the review and any disruption to the financial institution’s business.

We consider that an appropriately qualified independent firm is best placed to review an institution’s CRS processes and controls. The findings from the firm’s independent review would then be provided to Inland Revenue who could make an assessment about whether any further investigations are required. This should result in significant costs savings for the Government/Inland Revenue given that part of AEOI compliance review is effectively outsourced to the private sector at no cost. This could also achieve efficiencies in leveraging off other review procedures such as those that apply for AML procedures.

Comment

Officials agree that the CRS requires that New Zealand has procedures in place to monitor compliance and to address non-compliance. This will be considered as part of the implementation of CRS.

Recommendation

That the submission be noted.

Clause 24(1)**Issue: Anti-avoidance rule****Submission**

(BNZ)

The submitter agrees that anti-avoidance rules should be in place and agrees that the anti-avoidance rules should be consistent across the CRS and FATCA.

Comment

No additional comment.

Recommendation

That the submission be noted.

TRUSTS

Clause 24(1)

Issue: Difficulties in applying CRS to trusts

Submissions

(Chartered Accountants Australia and New Zealand, New Zealand Bankers' Association)

Determining the controlling persons of a trust will place an unreasonable compliance burden on financial institutions, given that annually a financial institution will have to obtain from every trust information on discretionary beneficiaries who received distributions during that year.

A discretionary beneficiary who moves overseas (temporarily or permanently) and becomes a tax resident of another jurisdiction could result in a change of status for the foreign trust under AEOI. *(Chartered Accountants Australia and New Zealand)*

The CRS due diligence work effort for trusts is significant. One member bank has indicated that it has over 84,000 account holders with the word “trust” in their title. This will pose issues in terms of workability of the due diligence and reporting process and timelines. *(New Zealand Bankers' Association)*

Comment

Officials acknowledge that the CRS due diligence procedures are complex, particularly in so far as they apply to trusts. This includes procedures dealing with changes in circumstances. Those complexities are inherent in the CRS itself.

The bill contains a number of proposals (ability to use options, transitional period for enforcement, and the ability to adopt the wider approach), which are intended to address some of these challenges.

In addition, the bill proposes (in section 185P(4)) imposing an obligation on account holders and other persons to notify their financial institution of a material change of circumstance that will affect their status for CRS purposes.

Beyond that, however, there is no further scope for New Zealand to reduce the complexity without risking failure in peer review. Issues with the CRS must be addressed globally, and global solutions adopted.

In this regard, officials note that the OECD has recently released a number of “Questions and Answers” on its website, which provide some useful guidance on how trust due diligence can be carried out more efficiently. Officials also note that Inland Revenue intends to provide detailed guidance on the application of CRS to trusts. Raising awareness of the importance of complying with the obligation on persons or entities under section 185P will be addressed as part of Inland Revenue’s planned public education campaign.

Recommendation

That the submissions be noted.

Clause 24(1)

Issue: Treating all trusts as financial institutions

Submissions

(Chartered Accountants Australia and New Zealand, *KPMG*, *New Zealand Bankers' Association*)

The Government could consider finding an alternative solution for obtaining AEOI information from trusts. For example, Inland Revenue could explore the option of building on the information it already receives and collecting any additional information required as part of the trust's annual tax return. (*Chartered Accountants Australia and New Zealand*)

Trusts should be treated as financial institutions and the information required by CRS reported with the trust's income tax return. This is because the persons with the knowledge about the trusts are the trustees. Practically, financial institutions that maintain trust accounts will have difficulties with complying with their obligations to conduct due diligence on such accounts. Therefore, the CRS reporting obligations should sit with the trustees. (*KPMG*)

The Government (and indeed on a global basis, all CRS participating governments) must consider finding an alternative solution for obtaining AEOI information from trusts. Inland Revenue must explore the option of building on the information it receives and collecting any additional information required as part of the trust's annual tax return process. (*New Zealand Bankers' Association*)

Comment

The obligations to be imposed on trusts are an inherent part of the CRS. New Zealand has also already signed legal instruments that set out specific obligations to collect and exchange information as per the CRS. Officials consider that it is therefore not appropriate for New Zealand to unilaterally transfer to trusts any CRS due diligence and reporting requirements that are not subject to CRS obligations under the standard.

As noted above, any solution to the issue of trusts needs to be made on a multilateral basis. The OECD has also started to release "Questions and Answers" on its website on how trust due diligence can be carried out more efficiently.

Also as noted above, the bill addresses some of the concerns through the use of options, a transitional period for enforcement, wider approach and imposing an obligation on account holders and other persons to notify their financial institution of a material change of circumstance that will affect their residence status. Inland Revenue guidance and raising awareness through a public education campaign will also help.

Recommendation

That the submissions be declined.

Clause 24(1)

Issue: Discretionary beneficiaries

Submissions

(Chartered Accountants Australia and New Zealand, New Zealand Bankers' Association, AMP)

Proposed section 185N(10) should be amended to provide that a discretionary beneficiary of a trust is not treated as a controlling person. It would be unfair to require reporting financial institutions to have reasonable safeguards and procedures for identifying when a distribution is made to a beneficiary. *(Chartered Accountants Australia and New Zealand, New Zealand Bankers' Association)*

Distributions are often only determined after the end of a reporting period. This makes the application of a test based on when distributions are made problematic. *(New Zealand Bankers' Association)*

An additional provision should be inserted that explicitly states that where a financial institution has reasonable safeguards and procedures in place in compliance with section 185N(10), the institution has no liability in relation to any failure of the institution to identify when a beneficiary has received a distribution. *(AMP)*

Comment

It is neither appropriate nor permissible under the CRS to provide that a discretionary beneficiary is not a controlling person.

The need for a financial institution to identify distributions to discretionary beneficiaries of certain passive entity account holders will only arise if the institution elects to take advantage of the option offered in the CRS to treat only discretionary beneficiaries as controlling persons of such an account when a distribution has been made. Otherwise, discretionary beneficiaries are prima facie required to be treated as controlling persons.⁸

The CRS offers this option on the basis that it may help to reduce compliance costs for some financial institutions. Financial institutions are not compelled to take the option. Moreover, a decision to take advantage of the option should only be made if the financial institution is confident it has sufficient safeguards and procedures to identify when a distribution has been made (as stipulated in proposed section 185N(10)).

Officials do not think it would be appropriate to include a provision clarifying that a financial institution that has reasonable safeguards and procedures in place for identifying distributions can never be subject to penalty for failing to identify a distribution.

Whether a financial institution will be subject to a penalty for failing to comply with CRS due diligence will be highly fact-specific. For example, a financial institution may have procedures in place to try to identify whether and when a distribution is made to a discretionary beneficiary. However, the institution may become aware that the account holder is not complying with these procedures and may choose to proceed without addressing the issue. This could lead to the potential application of penalties even though safeguards and procedures are in place.

⁸ Page 199 of the OECD Commentary.

Inland Revenue intends to provide guidance on what would constitute reasonable safeguards and procedures.

With regard to the point that distributions may be determined after the end of a reporting period, officials note that for CRS purposes these distributions would not be relevant to that reporting period. The relevant distributions for a reporting period are those that are actually received (paid or payable) in that period, not in subsequent periods. This is set out in the CRS and OECD Commentary.

Recommendation

That the submissions be declined.

GUIDANCE ON CRS REQUIREMENTS

Clauses 3 to 26

Submissions

(AMP, BNZ, Chartered Accountants Australia and New Zealand, Chapman Tripp, Cone Marshall, Corporate Taxpayers Group, EY, KPMG, New Zealand Bankers' Association, New Zealand Law Society, Russell McVeagh, Westpac.)

In addition to a public messaging campaign, Inland Revenue should (with urgency) provide CRS guidance in respect of matters such as:

- the roles and responsibilities of taxpayers and financial institutions under CRS
- the concept of “tax residence”
- record-keeping obligations
- non-reporting financial entities and excluded accounts
- the application of the penalties provisions and defences
- undocumented account reporting
- reasonable safeguards and procedures for identifying when a distribution is made to “the beneficiary” of a trust
- the intended meaning of “distribution” in the AEOI context
- published lists, and determinations/regulations
- the ability to exercise choices.

Comment

Officials note that, in addition to a public messaging campaign to promote awareness of obligations, Inland Revenue intends to prepare detailed CRS guidance notes to help with compliance. This will include the matters identified by submitters, other points noted by officials in this report, and any other relevant matter that is subsequently identified.

Recommendation

That the submissions be noted.

MISCELLANEOUS MATTERS

Clause 24(1)

Issue: Section ordering

Submission

(KPMG, New Zealand Law Society)

The ordering of sections in the bill sets out the requirements for financial institutions (in proposed section 185N) before provisions relating to the application of the CRS (proposed section 185O). The order of these sections should be reversed, for a more logical order.

Comment

The ordering in the bill was intentional, and follows New Zealand's current legislative drafting style. That style involves first setting out the obligations (in this case, section 185N) and then following with provisions dealing with interpretation (in this case, section 185O).

Officials do not consider that reversing the order would be advantageous, and would conflict with New Zealand's legislative drafting style.

Recommendation

That the submission be declined.

Clauses 8(2) and 24(1)

Issue: References to legal instruments

Submission

(Matter raised by officials)

The references to "MCMAA convention" and "MCA agreement" in clause 8(2) and to "Multilateral convention" in clause 24(1) (in the heading "Multilateral convention and CRS standard" that appears immediately before section 185) could be misleading and give rise to confusion.

Comment

The references to "Multilateral Convention", "MCMAA convention" and "MCA agreement" refer to the principal legal instruments under which it is intended that exchanges of information for AEOI purposes will be made. However, the AEOI standard does not prevent jurisdictions agreeing to make AEOI exchanges under other forms of legal instrument.

Although New Zealand has not entered into any such agreement, officials cannot rule out the possibility that this will never be agreed to. Accordingly, the references to the above specific legal instruments could be misleading and create confusion.

As a minor drafting matter, officials therefore submit that the potentially misleading references be redrafted in more general terms.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185N – wider than intended

Submissions

(New Zealand Law Society, AMP)

The current drafting of section 185N goes further than is strictly necessary to incorporate the CRS standard into domestic law by reference (as was the policy intent). This creates an opportunity for inadvertent gaps and interpretative errors.

It is recommended that section 185N be pared back and refer more heavily to the CRS applied standard (similar to the approach taken to FATCA).

Alternatively, a number of specific drafting suggestions are made. *(New Zealand Law Society)*

Proposed section 185N(3)(c) is arguably a broader obligation than the corresponding obligation in the CRS. *(AMP)*

Comment

Section 185N is intended to incorporate the CRS requirements for financial institutions.

The submitters' primary concern is that section 185N(3)(c) could be read as requiring financial institutions to carry out due diligence and collect information in respect of all account holders and controlling persons, and not solely to non-resident account holders and relevant controlling persons (as required under the CRS wider approach to due diligence).

However, the reference in section 185N(3)(c) to “perform the due diligence procedures required by the CRS applied standard” limits the application of the provision. Therefore, in context, section 185N(3)(c) is not broader than the CRS.

The focus in section 185N(3)(c) on collecting information on account openings from all **foreign tax residents** that have been identified in accordance with the due diligence procedures is also based on an approach that the OECD has suggested⁹ in order to ensure that the wider approach to due diligence is implemented efficiently by financial institutions. Section 185(N)(3)(c) allows financial institutions to carry out the wider approach to due diligence in an efficient way,

⁹ Refer to paragraph 4, on page 285, of Annex 5 of the CRS publication.

as suggested by the OECD, by collecting information about relevant non-residents “up front” when an account is opened. This will help to minimise compliance costs.

However, in reviewing the drafting of section 185N(3)(c), officials consider that the following changes should be referred to the drafter for consideration:

- In section 185(3)(c), changing the reference to “due diligence procedures for each new financial account” to “due diligence procedures applicable to new financial accounts”.
- In section 185N(3)(b), adding the words “self-certification”, in the place suggested by the submitter.
- In section 185N(8), adding the words “to the Commissioner”, “financial institution’s” and “application of the” in the places suggested by the submitter.
- In section 185N(11), adding the words “under subsection (3)(d)” and replacing the words “with a” with “at” in the place suggested by the submitter.
- In section 185N(12), adding the words “by a financial institution under subsection (3)(d)” and “provided to the Commissioner”, in the places suggested by the submitter.

However, officials do not consider that the other specific drafting amendments suggested in the submission are necessary.

Recommendation

That the submissions be declined in part, and that the matters noted above be referred to the drafter for consideration.

Clause 24(1)

Issue: Section 185N(3)(c)(ii) – “reportable period”

Submission

(Matter raised by officials)

The reference in proposed new section 185N(3)(c)(ii) to “has domestic law requiring that the TIN be collected” is intended to reflect the exception at CRS Section I.D for a country that does not require the collection of TINs. (Currently, the OECD has only identified Australia as having this rule.)

As drafted, the legislation is ambiguous. That is, it could be argued that a TIN should only be collected if the country of residence has an express legislative requirement for the collection of TINs.

Comment

Officials consider that section 185N(3)(c)(ii) should be redrafted to remove the ambiguity and better reflect the intention of CRS Section I.D.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185N(5) – “reportable period”

Submission

(AMP)

The reference in proposed new section 185N(5) to “reportable period” should read “reporting period”.

Comment

Officials agree that section 185N(5) should refer to “reporting period”.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185N(5) – ambiguity regarding reporting dates

Submission

(AMP)

The bill’s Summary of Proposed Amendments *Commentary* has the following ambiguous statement:

“Importantly, any high value accounts identified as reportable during the grace period must be reported with respect to the reporting period of 1 July 2017 to 31 March 2018.”

Should this read:

“Importantly, any high value accounts identified during the grace period as reportable for the first reporting period must be reported with respect to the reporting period of 1 July 2017 to 31 March 2018.”

If not, it suggests that an account that becomes reportable on 31 May 2018 and is identified as reportable on 31 May 2018 must be reported for the reporting period ending on 31 March 2018. Clarification is needed. There is another corresponding paragraph for other accounts that requires similar clarification.

Comment

Officials agree that the wording in the bill's Summary of Proposed Amendments *Commentary* may be ambiguous. The wording of section 185N(5) in the bill appears to reflect similar ambiguity. Officials will explore alternative legislative wording to resolve the ambiguity.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185N(7) – ambiguity

Submission

(Matter raised by officials)

The definition of “Reportable Person” at CRS Section VIII.D(2), excludes certain entities (such as a corporation, the stock of which is regularly traded on one or more established securities markets).

Officials note that, as drafted, the option provided to financial institutions at proposed new section 185N(7) to adopt the wider approach to reporting, could be read as overriding the definition. That is, the legislation is ambiguous as to whether a financial institution that elects to adopt the wider approach can still take advantage of the above exclusions.

Comment

Officials consider that section 185N(7) should be redrafted to remove the ambiguity and clarify that the exclusions continue to apply.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185N(12) – reporting template

Submission

(Chapman Tripp)

Proposed new section 185N(12) requires financial institutions to provide their annual report to Inland Revenue in the prescribed electronic format. It would be helpful if Inland Revenue could provide a template for financial institutions to complete, which can be easily converted to the prescribed electronic format.

This is a particular issue for smaller financial institutions that do not have the resources or systems in place to generate electronic files in the prescribed format.

Comment

To meet the requirements of the broad range of financial institutions, Inland Revenue’s project team is exploring a number of reporting format; including an online form, a template and an XML file.

Recommendation

That the submission be noted.

Clause 24(1)

Issue: Section 185O(4) – reference to “used in the Inland Revenue Acts”

Submission

(KPMG)

Under proposed section 185O(4), a term defined in the CRS or relevant tax treaty, and used in the Inland Revenue Acts, has the meaning under the CRS and Multilateral Convention.

This broad importation of CRS and treaty definitions has the potential to override existing rules and tax concepts in unintended and unexpected ways, and should be restricted to provisions of the Inland Revenue Acts which apply the CRS.

For example, the Income Tax Act 2007 already has a definition of “financial institution” which applies for specific purposes. The drafting in section 185O(4) would appear to override that definition.

Comment

Officials do not agree with the analysis. The application of section 185O(4) is limited by its opening words “In the application of the CRS standard ...”. That means that it cannot override any provisions of the Inland Revenue Acts that do not relate to the CRS.

Recommendation

That the submission be declined.

Clause 24(1)

Issue: Section 185O(5)

Submission

(KPMG, New Zealand Law Society)

The requirement in proposed new section 185O(5) that the election is not contrary to the Tax Administration Act 1994 is unnecessary and complicating. Section 185O itself imports the election into the Tax Administration Act. By definition, the election should therefore not be contrary to the Tax Administration Act. *(KPMG)*

A minor amendment to section 185O(5) is recommended, to insert the words “under the CRS applied standard”, as follows:

“A person or entity may make an election that is expressed as being available to a person or entity under the CRS applied standard, if the election is not contrary to this Act and not otherwise contrary to the law of New Zealand.” *(New Zealand Law Society)*

Comment

In relation to the first point, the reference to “not contrary to this Act” is necessary because there are certain options contemplated in the CRS that are explicitly excluded in the Tax Administration Act 1994. For example, this includes the exclusions set out in proposed section 185N(11) and the exclusions set out in schedule 2, items 1 and 4.

On the second point, officials agree that greater clarity should be provided with respect to the reference to an election that is “expressed”. The additional words suggested by the submitter (“under the CRS applied standard”) are potentially limiting. For example, they could prevent financial institutions from taking advantage of guidance or clarifications that become available on the OECD website. Alternative wording such as “consistent with the CRS applied standard” would be more appropriate.

Recommendation

That the submission to delete the reference to “not contrary to the Act” be declined.

That the submission to provide clarity in respect of the reference to “expressed” be accepted, with officials to explore appropriate wording.

Clause 24(1)

Issue: Section 185P(1) – reference to “associated with”

Submission

(KPMG)

Proposed section 185P(1) requires a person associated with a financial account to provide information when requested by a financial institution.

However, “associated with” is a broad term, and in the income tax and GST contexts it has a defined meaning (through the “associated person” definition). This could result in a lack of clarity in the proposed legislation.

Comment

Officials agree that the current wording could lead to a lack of clarity, and that the drafting should be amended.

Recommendation

That the submission be accepted.

Clause 24(1)

Issue: Section 185Q

Submission

(KPMG)

Proposed section 185Q is a rule for those entities that are not “persons”. However, the rule may not be required or, if required, may not be effective.

The CRS includes as “entities” partnerships and trusts which are not legally persons. Generally these are not taxpayers (it is the partners or trustees and beneficiaries who pay the tax).

However, “person” is defined by the Acts Interpretation Act 1999 as including an unincorporated body of persons. This would normally include partnerships and trustees of trusts. For example, the Goods and Services Tax Act 1985 does not separately define a partnership as a person. It is assumed that the partnership is a person because it is an unincorporated body of persons.

This may mean that section 185Q would not apply as the entities would appear to be persons.

Comment

The proposed section 185Q contains express references to trusts, partnerships, joint ventures and legal arrangements. Therefore, it is clear on the face of the provision that these arrangements would come within the ambit of the section.

Recommendation

That the submission be noted.

Clause 24(1) and schedule 2

Issue: Schedule 2

Submission

(New Zealand Law Society)

The submitter broadly supports the inclusion of a new schedule 2 to modify the CRS standard for New Zealand. However, the following minor improvements are suggested.

- With respect to item 10 of the schedule, the reference to “31 December” on line 4 of Section V, subparagraph D(2) should be replaced with “31 March”, to align with the intended policy.
- With respect to items 13 and 22 of the schedule, a cross-reference to the relevant sections that provide for the Commissioner’s power to make the determinations referred to should be included.
- With respect to item 20 of the schedule, the second reference to “31 December” on line 3 of Section VIII, subparagraph C(15), should be replaced with “31 March”, to align with the intended policy.

Comment

Officials agree. The submission correctly identifies deficiencies between the proposals in the bill and the intended policy.

Recommendation

That the submission be accepted.

Clause 24(1) and Schedule 2

Issue: Contradictory exclusions

Submission

(Chartered Accountants Australia and New Zealand)

Section I paragraphs C, D and E of the CRS should be modified. All three paragraphs include exclusions that are contradictory.

Section 1 paragraph A imposes an obligation on a financial institution to collect certain information. The exclusions in paragraphs C, D and E apply only where the information is not required to be collected under domestic law. The CRS is incorporated into domestic law. This seems to imply the exclusions in paragraphs C, D and E can never apply. This needs to be clarified.

Comment

Officials disagree with the analysis. The wording in paragraphs C, D, and E ensures that the exclusions will continue to apply.

Recommendation

That the submission be declined.

Clause 24(1)

Issue: Default TINs

Submission

(AMP)

A default tax identification number (TIN) should be made available for financial institutions to use when they need to file a report and have been unable to obtain the account holder's TIN, particularly pre-existing account holders.

Financial institutions need to be able to successfully report accounts where they have been unable to obtain a TIN for the account holders. Financial institutions do not want reports to fail because not all files contain a TIN and we understand that some institutions have experienced this problem during FATCA reporting.

Comment

The CRS does not require a TIN to be reported in all circumstances. For example, it is not required when a TIN is not issued by the jurisdiction in which a reportable person is resident, or if the domestic law of that jurisdiction does not require the collection of the TIN. Therefore, as the reporting of a TIN element is not mandatory, Inland Revenue will ensure that system validations do not reject a report for failure to include a TIN.

A default TIN is not necessary.

Recommendation

That the submission be declined.

Foreign trusts

SUPPORT FOR PROPOSED RULES

Clause 10

Submissions

(Chartered Accountants Australia and New Zealand, New Zealand Bankers' Association, PwC, Russell McVeagh, Office of the Privacy Commissioner)

The proposed changes, which strengthen the disclosure rules, should discourage offshore parties from using New Zealand foreign trusts for inappropriate purposes. We are pleased that the Government is not generally changing the underlying trust rules, which are principled. *(Chartered Accountants Australia and New Zealand)*

We fully support the amendments to section 59B of the Tax Administration Act 1994 related to foreign trust registration and disclosure as outlined in clause 10 of the bill, and as recommended by the recent *Government Inquiry into Foreign Trust Disclosure Rules*. The proposed changes promote increased transparency, which will discourage the use of New Zealand trusts for illicit purposes by offshore parties. *(New Zealand Bankers' Association)*

We support enhancements to the disclosure rules for foreign trusts with a New Zealand-resident trustee. The proposals should, alongside other initiatives (such as FATCA, AEOI and other measures to increase transparency in the tax context as well as anti-money laundering regulations more generally) further prevent the foreign trusts regime from being used for illegitimate purposes. *(Russell McVeagh)*

We support the proposed introduction of additional disclosure requirements for foreign trusts. We strongly support the policy rationale behind these changes and commend the Government on taking steps to address the public concern about the New Zealand foreign trust regime. *(PwC)*

I was consulted during the *Inquiry* and I am comfortable that these proposals are appropriately designed to meet the policy objectives while not unduly impacting on the privacy of the individuals concerned. The personal information implicated by the amendments is relatively restricted and non-intrusive, but is sufficient to enable regulators to make further enquiries if required. The changes proposed are also equitable in that they more closely align the rules for foreign trusts with the existing rules for domestic trusts. *(Office of the Privacy Commissioner)*

Recommendation

That the submissions be noted.

RULES ARE UNNECESSARY

Submission

(Kensington Swan)

Section 17 of the Tax Administration Act 1994 allows for the Commissioner to request information. This allows the Commissioner access to a broader range of information relating to foreign trusts than will be disclosed under the proposed amendments. Therefore, rather than requiring information to be provided as part of increased disclosure, the Commissioner may just utilise section 17 of the Tax Administration Act 1994. *(Oral submission)*

Comment

This submission is suggesting there should be no change to the existing law. Officials disagree with this submission.

The *Inquiry* concluded that changes that require the New Zealand trustees to provide information to Inland Revenue upon the establishment of the trust and also to provide annual returns (which Inland Revenue can pass on to the relevant authorities, including overseas authorities, the Police, and the Department of Internal Affairs), are necessary.

Officials agree with the *Inquiry's* conclusion that requiring foreign trusts to disclose more information upon registration will ensure that Inland Revenue can proactively share information and therefore that the relevant tax authorities in other jurisdictions are aware of the existence of the trust. This is difficult to achieve, and administratively costly, under the existing legislation.

Recommendation

That the submission be declined.

Issue: The “qualifying resident foreign trustee” concept should be retained

Submission

(David McLay)

The “qualifying resident foreign trustee” approach provided greater tax integrity in many respects than the current proposals.

In the context of international trusts, it is not uncommon for the trust to “move jurisdiction” by the appointment of a new trustee in another jurisdiction.

The essence of the qualifying resident trustee rule is that a New Zealand-resident individual has a personal responsibility to retain trust records within New Zealand. Under the Tax Administration Act 1994 that obligation exists for seven years.

Retention of information within New Zealand will necessarily be limited to the prescribed information, but overseas jurisdictions may expect New Zealand to have an ability to obtain other information. It is highly probable that New Zealand authorities will not be able to obtain information requested by overseas tax authorities.

The proposed repeal of this concept (and associated rules) would detract rather than enhance New Zealand's reputation as a leading tax jurisdiction.

Comment

The submission appears to have conflated the definitions of “resident foreign trustees” and “qualifying resident foreign trustees” in the Tax Administration Act.

There is no existing “requirement” to have a qualifying resident foreign trustee. A foreign trust must have a resident foreign trustee. The existing disclosure and record-keeping requirements are imposed on the resident foreign trustee who may or may not also meet the definition of a “qualifying resident foreign trustee”.

A “resident foreign trustee” is defined as the New Zealand-resident trustee of a foreign trust. All resident foreign trustees are required to meet disclosure and record-keeping requirements. The bill retains this concept.

A “qualifying resident foreign trustee” is defined as a resident foreign trustee who is the member of a professional body. The sole effect under tax legislation for a foreign trust with a qualifying resident foreign trustee is that the foreign trust is subject to lesser sanctions in the case of non-compliance with the disclosure rules (the “safe harbour”).

The *Inquiry* recommended that this safe harbour be reviewed. After considering advice from officials, the Government decided to repeal this exemption (and as a result, the concept of a qualifying resident foreign trustee), and this is reflected in the bill.

Officials understand that in 2006 it was considered that this safe harbour would encourage foreign trusts to use a professional New Zealand accountant or lawyer as a trustee, and that having a trustee who is a professional New Zealand accountant or lawyer would be an appropriate check to prevent non-compliance. This bill proposes removing the safe harbour (and therefore the associated concept of a qualifying resident foreign trustee) because the Government considers it does not provide a clear and appropriate signal about the importance of complying with the disclosure rules.

In addition, concerns about the consequences on retaining trust records in New Zealand (and in relation to the point about trusts relocating) are mitigated by the proposed wider initial and regular disclosures that are required to be made to Inland Revenue. For example, requiring the trust deed would automatically mean that Inland Revenue will have this information on file in case the overseas jurisdiction requests it.

Recommendation

That the submission be declined.

INTERACTION WITH AEOI AND AML PROPOSALS

Issue: Foreign trusts will generally be subject to AEOI

Submission

(New Zealand Trustee Companies Association Limited)

The conclusion reached by the *Government Inquiry* that New Zealand needed specific trust disclosure seems to have been on the basis that a significant number of foreign trusts might fall outside AEOI/CRS disclosure requirements. This seems at best an exaggeration.

Comment

This issue relates to conclusions of the *Inquiry* about whether AEOI is likely to alleviate disclosure concerns in respect of New Zealand foreign trusts. The conclusions and recommendations of the *Inquiry* have informed the foreign trust disclosure proposals in this bill.

The *Inquiry* considered whether AEOI is likely to alleviate any disclosure concerns in respect of New Zealand foreign trusts. The *Inquiry* concluded that for a significant number of foreign trusts the proposed AEOI rules will not result in any material increase in the amount of information required to be disclosed to Inland Revenue.

AEOI is designed to counter tax evasion through requiring –

- financial institutions, in participating jurisdictions, to carry out due diligence on their account holders and (in certain circumstances) “controlling persons”¹⁰ to identify any non-residents;
- financial institutions to report information on financial activity, such as gross amounts paid or credited and account balances (including distributions to beneficiaries in the case of trusts) as well as identification information about each reportable person, annually, to the local tax authority (for New Zealand, Inland Revenue);
- the local tax authority to provide that information automatically to offshore tax authorities in participating countries throughout the world. The information will be provided to the countries in which persons identified by the “reporting financial institution” are tax resident.

There are two main ways in which AEOI may apply to a foreign trust –

- through the foreign trust itself constituting a “reporting financial institution” for AEOI purposes; and
- through the foreign trust holding an account with a New Zealand bank or other “financial institution”.

The *Inquiry* concluded that the activities of foreign trusts in New Zealand and the way they are operated means that in a significant number of cases they are unlikely to constitute financial institutions under the guidance set out in the CRS and therefore that they will not be reporting financial institutions.

¹⁰ For trusts this will generally include settlors, trustees, beneficiaries and other controlling persons.

Foreign trusts that maintain accounts with a bank or other financial institution in New Zealand are likely to be classified under the CRS as “passive non-financial entities” for AEOI purposes. Where this is the case, the financial institution (for example, the bank) will be required to carry out due diligence and to report to Inland Revenue information on the trust, and on its controlling persons. Importantly, however, financial information such as income and account balances will be limited to the account held with the financial institution.¹¹ It will not extend to the foreign trust’s overall financial position or to distributions to beneficiaries.

In summary, based on the information presently available, the *Inquiry* concluded that for a significant number of foreign trusts, AEOI will not result in any material increase in the amount of information required to be disclosed to Inland Revenue, and the *Inquiry* therefore did not regard AEOI as a solution to the tax disclosure issues identified with foreign trusts.

Officials agree with the *Inquiry’s* assessment of the applicability of AEOI to foreign trusts.

Recommendation

That the submission be declined.

Issue: Trusts should be subject to the AEOI rules rather than a separate regime

Submission

(KPMG, New Zealand Trustee Companies Association Limited)

A separate regime is not required for foreign trusts. Trusts will be reportable investors, under CRS, if the trust is controlled by a non-resident. A controlling person includes a beneficiary. For discretionary beneficiaries, they become controlling persons at the choice of the New Zealand financial institution when a distribution is received. Trusts should be treated as financial institutions and the information required by CRS should be reported with the trust’s income tax return. This means the CRS reporting obligations should sit with the trustees. The information can be reported as part of the tax return process. This solution could equally apply to trustees of New Zealand foreign trusts. *(KPMG)*

Trusts that are subject to AEOI/CRS under this bill should be considered to meet foreign trust information disclosure requirements unless additional information is justified, in which case that information should be specifically required as an addition to AEOI/CRS rules. When a trust is not subject to AEOI/CRS rules, disclosure requirements should be as consistent as possible with AEOI/CRS rules. This principle is not, it seems, reflected in the bill. *(New Zealand Trustee Companies Association Limited)*

If a different standard for trusts was adopted than for AEOI, this could cause unnecessary administrative and compliance costs and risks confusing overseas agencies by providing them with information in an unfamiliar form. There even seems to be a risk that by not adopting the internationally agreed standard of key information New Zealand might create international suspicion that we are deliberately not following international best practice, undermining our international reputation.

¹¹ Due diligence will not be required on accounts already in existence at 30 June 2017 if they are below, and at all times remain below, a threshold of US\$250,000.

Comment

Officials disagree that the AEOI rules should be extended to apply to foreign trusts. There are several reasons why a disclosure regime specific to foreign trusts is more appropriate than extending the AEOI rules to foreign trusts. Officials note that the *Inquiry* explicitly considered and rejected extending the AEOI rules to foreign trusts. This was on the basis that it would be inconsistent with the underlying design of the AEOI regime (which is that this is a global set of rules that should follow the common standard prescribed under the CRS).

AEOI is an automated programme reflecting a prescribed standard

AEOI refers to an exchange of information on an automated basis agreed upon in advance by the participating countries. AEOI will apply to information that is collected under the OECD's global AEOI/CRS rules. Under the AEOI programme, information will be collected by reporting financial entities, reported to the tax authority, and exchanged by automated means with other countries. The rules on which entities must report, and what information must be reported and exchanged, follow an internationally agreed-upon set of rules.

If New Zealand were to try to provide information regarding foreign trusts that are not subject to AEOI (and therefore modify the information it exchanges under the AEOI programme), this could cause confusion, given the highly prescribed and automated nature of the AEOI programme.

A separate set of disclosure rules for foreign trusts will maintain New Zealand's reputation as a leader in best practice of international exchange of information

Information held by Inland Revenue that is not collected under the OECD's AEOI/CRS rules (such as the proposed foreign trust disclosure rules) is generally exchanged either upon request by a treaty partner or under the spontaneous exchange of information mechanism. Most of New Zealand's treaties allow for spontaneous exchange.

For information collected in relation to foreign trusts, officials anticipate that Inland Revenue will provide certain information about the trust under the spontaneous exchange mechanism to the settlor's country of residence as a matter of course. The information that will be provided to the overseas tax authority as a matter of course will be information about any settlor resident in that jurisdiction (name, taxpayer identification number, contact details) and the New Zealand trustee's contact details. This will alert the overseas tax authority to the fact that their resident has a New Zealand trust, and give them the opportunity to seek further information about the trust from Inland Revenue (which, under the proposed changes in the bill, would generally hold).

It should be noted that more disclosure would be required under the proposed foreign trust disclosure rules than under the AEOI/CRS rules. For example, the foreign trust disclosure rules as introduced would require the New Zealand-resident trustee to provide the trust deed. This was a deliberate policy decision. Officials consider that requiring more disclosure than under the AEOI/CRS rules will help to ensure that New Zealand's reputation as a leader in best practice of international exchange of information is maintained. Accordingly, officials disagree that having a separate regime for foreign trusts that requires additional reporting would create international suspicion that New Zealand is deliberately not following international best practice.

It should be noted that New Zealand is already proactive in spontaneously exchanging information to other tax authorities. Accordingly, we see no risk of confusion for overseas tax authorities by separately collecting information that will be spontaneously exchanged.

Timing of introduction of AEOI and foreign trust rules differ

Apart from deliberate policy decisions to require certain additional information officials generally agree with the idea that the foreign trust disclosure rules should align with the AEOI where possible.

However, there is a timing difference between the implementation of AEOI and the new foreign trust disclosure rules. It is important that the new foreign trust disclosure change comes in as soon as possible in order to maintain New Zealand's reputation. The *Inquiry* recommended that the changes be implemented to require all existing trusts to register (and accordingly provide the initial registration disclosure) by 30 June 2017. In contrast, AEOI has a later timeline, with 30 June 2018 being the first reporting deadline.

Accordingly, full alignment will not be possible at this point in time.

Officials have discussed this with the New Zealand Trustee Companies Association Limited, but did not agree on this point.

Recommendation

That the submission be declined.

Issue: Duplication of information with Anti-Money Laundering and AEOI

Submission

(Kensington Swan, Cone Marshall, Chartered Accountants Australia and New Zealand, KPMG, New Zealand Trustee Companies Association Limited)

The foreign trust disclosure requirements effectively create a situation where trustees of foreign trusts are required to make disclosure of similar or overlapping data under three separate reporting regimes, namely, FATCA, CRS and the proposed enhanced foreign trust disclosure. *(Cone Marshall, Kensington Swan)*

Some of this information will be also be provided under the AML rules. Hence, it is submitted that much of the information requested under the foreign trust disclosure rules would be identical to that collected under the existing AML legislation, FATCA and CRS, and would not necessarily enhance New Zealand's fight against tax evasion. It is therefore submitted that instead of using section 10 of the bill for such purposes, the Anti-money Laundering and Countering the Financing of Terrorism Act could be amended to ensure that all trustees of foreign trusts are "reporting entities" and be required to conduct customer due diligence. *(Cone Marshall)*

We are concerned that the speed with which the reforms are being implemented risks creating duplicate information reporting requirements and processes that will impose high compliance costs. *(Chartered Accountants Australia and New Zealand)*

Comment

There is potential for some duplication under the requirements of the AEOI rules, the AML rules and the foreign trust disclosure rules.

However, where an entity is subject to more than one regime, officials expect that in the vast majority of cases, entities would be able to use the same information collected for foreign trusts. Accordingly, while duplication in those cases might potentially increase compliance costs, those compliance costs seem likely to be relatively minimal.

If there are significant compliance issues arising from the differences between AEOI and the foreign trust rules, officials recommend that these issues be considered after the AEOI rules have bedded in.

The Government noted the *Inquiry's* recommendation that – while the registration process should be the responsibility of Inland Revenue initially – there should be a review of the government agency responsible for administering the foreign trust regime in the future. The *Inquiry* also noted that there is potential for duplication, and that consideration might be given to having a single government agency assigned an overall coordination role to ensure these initiatives, and the resulting disclosure requirements, are implemented as efficiently as possible.

Recommendation

That the submission be declined.

Issue: A central portal should be established to collect the information

Submission

(Kensington Swan, Cone Marshall, TGT Legal)

Inland Revenue should provide a single portal for trustees to provide information for all relevant reporting regimes (FATCA, AEOI/CRS and foreign trust disclosure rules). *(Kensington Swan, Cone Marshall, TGT Legal)*

The Commissioner of Inland Revenue could then develop a second web form on the same platform for the purposes of the annual filing that is required under the relevant reporting regimes.

Alternatively, we suggest that a central regulatory agency could be established to receive and process CRS, AML, foreign trust and other regulatory data. *(Cone Marshall)*

Comment

In order to implement the new foreign trust rules in an expedient manner, and in light of Inland Revenue's significant Business transformation programme that is currently underway, a separate reporting process for foreign trusts is being developed.

However, the provision of a single portal or joined-up reporting mechanism could be considered in the future.

Recommendation

That the submission be declined.

RULES SHOULD BE LIMITED TO CERTAIN TRUSTS

Issue: The proposal should be limited to trusts established or administered in New Zealand

Submission

(KPMG)

All foreign trusts with New Zealand trustees will be subject to the rules. A failure to comply will mean that world-wide income is taxable in New Zealand. The proposal should be limited to trusts established or administered in New Zealand.

Comment

Officials disagree that any foreign trusts should be exempt from these disclosure rules. In order to increase transparency of the use of foreign trusts, all New Zealand-resident trustees of foreign trusts should be required to disclose the prescribed information under these proposed rules.

If the rules were limited to those trusts that are administered within New Zealand, this would add enable the disclosure rules to be circumvented and undermine the purpose of the reform. It would also add complexity to the rules.

The extension of the grace period and reduced requirements on non-professional trustees (as discussed below in “Issue: Disclosure regarding settlements should exclude historical settlements” and “Issue: No tax exemption if trustee is non-compliant”) would reduce the compliance costs faced by trustees who are not professionals, in addition to giving them a longer period to comply with the rules.

Recommendation

That the submission be declined.

Issue: Exception for a pre-existing trust which subsequently has a New Zealand-resident trustee

Submission

(KPMG, Russell McVeagh)

If Inland Revenue can be satisfied that despite one or more trustees being tax-resident in New Zealand, the trust remains subject to tax in the other relevant jurisdiction, the full disclosure rules are unnecessary and should not apply. One mechanism for achieving this outcome could be to provide an alternative form of disclosure in such cases.

We expect there will be trusts settled by non-residents which have New Zealand-resident trustees (family or friends of the settlor). We consider these are not trusts which are of concern. If a comprehensive regime is required, such trusts could be excluded on filing of a copy of a tax return for the settlor or other trustee’s tax jurisdiction. *(KPMG)*

Comment

The suggestion that Inland Revenue should assess whether the trust is subject to tax in another jurisdiction is not appropriate. Such a rule would be difficult to implement and administer. Among other things, Inland Revenue would not be able to determine whether the trust has complied with its tax obligations in the other jurisdiction. This is why it is proposed that information about the settlor would be disclosed to the other tax authority, as that other tax authority would be in a better position to assess whether they have any concerns about the trust's compliance with its tax obligations.

In addition, we agree with the *Inquiry's* conclusion that it is important to obtain information on foreign trusts for the purpose of Anti-Money Laundering and Countering Financing of Terrorism. The collection of information for these purposes is also an important feature of the rules.

Officials note that (as discussed below in "Issue: Disclosure regarding settlements should exclude historical settlements" and "Issue: No tax exemption if trustee is non-compliant"), concessions are recommended for non-professional trustees to reduce compliance costs and increase the length of time they have to comply with the rules.

Recommendation

That the submission be declined.

GENERIC TAX POLICY PROCESS

Submission

(David McLay, New Zealand Trustee Companies Association Limited)

We note that whereas AEOI/CRS has been subject to consultation between officials and the private sector, by its nature the proposed foreign trust disclosure rules have been subject to a different process that has in effect meant no consultation on the technical aspects of the proposals. In other words, there has been no Generic Tax Policy Process on the foreign trust disclosure rules.

There has been no opportunity in this process for detailed technical consultation so that workable law results.

Officials should be directed to consult with those with a detailed technical knowledge of how foreign trusts work to amend the bill to make it more workable in practice while meeting the stated objective of ensuring that our foreign trust disclosure rules meet the highest international standards for transparency. *(New Zealand Trustee Companies Association Limited)*

The generic tax policy process has not been followed in the development of these requirements, and there has been excessive rhetoric in the public media so that a full examination of tax issues and principles has not been possible. The use of the Commission of Inquiry process, and its haste, has impeded the more usual (and correct) manner in which new tax requirements are developed. *(David McLay)*

Comment

While the proposed foreign trust amendments have not been through the normal Generic Tax Policy Process, the Government considered the recommendations that arose from the *Inquiry* along with official's advice on these recommendations. The proposed amendments in this bill follow the Government's decisions based on the *Inquiry's* recommendations.

The *Inquiry* undertook an extensive independent review of the policy and operation of the foreign trust rules. As part of its review, the *Inquiry* invited submissions from the public. It received and considered 23 submissions.

Officials note that this officials' report to the Finance and Expenditure Committee recommends several changes to make it easier to comply and clarify technical issues in response to submissions received as part of the select committee process.

Officials will monitor the implementation of the proposals and report to the Ministers of Finance and Revenue if concerns with the effectiveness of the rules are identified. In addition to the usual monitoring, the *Inquiry* recommended that the registration process should be the responsibility of Inland Revenue initially, but that this should be reviewed in the future.

Recommendation

That the submission be declined.

INFORMATION SHARING AND DATA PROTECTION

Issue: Data protection

Submissions

(David McLay, Cone Marshall, Kensington Swan, TGT Legal)

Given the extent and type of information that needs to be reported under the foreign trust disclosure rules, it is important there is assurance that the data protection rules which are built into the Privacy Act 1993, the New Zealand Bill of Rights Act 1990 and the Tax Administration Act 1994, will extend to all data gathered under the disclosure rules, which are similar in scope to that required of New Zealand domestic trusts, and under the CRS rules. *(Cone Marshall)*

We also consider it important that there is assurance that the data protection rules which are currently provided for in the Privacy Act 1993, the New Zealand Bill of Rights Act 1990 and the Tax Administration Act 1994 will extend to the data gathered under the new foreign trust disclosure regime. *(Kensington Swan)*

It is critical that any data collection system established by Inland Revenue (whether for CRS, the new disclosure rules or FATCA) is secure and has mechanisms that ensure that the integrity and accuracy of the data is maintained. *(TGT Legal)*

There has been no analysis of how taxpayer information that is secret under New Zealand law is to be provided to overseas jurisdictions. The focus of the rhetoric has been on allegedly bad behaviours by settlors of trusts, and there has been none on the possibility of corrupt behaviours of government officials in overseas jurisdictions, where tax information may be misused. *(David McLay)*

Comment

Officials note that the register of foreign trusts will not be accessible by the public. This is in line with the *Inquiry's* recommendation that the register be shared with the Department of Internal Affairs and the New Zealand Police, but should not be available publicly.

The information will be held by Inland Revenue, the Department of Internal Affairs and the New Zealand Police.

Inland Revenue and the Police are able to share certain information with other parties (including other governments) in accordance with New Zealand law.

Strict secrecy provisions apply to information held by Inland Revenue, which prevents Inland Revenue from sharing information unless it is for tax administration purposes or purposes specified in the Tax Administration Act. A well-established principle, however, is that Inland Revenue is able to share information with other tax authorities under an international treaty, in accordance with that treaty. This information is only to be used by the tax authority for ensuring compliance with tax obligations.

The New Zealand Police would use and disclose information obtained from the foreign trust register to fulfil any of its functions and the information would have the same statutory protections as with any other information held by the New Zealand Police.

The New Zealand Police can share information domestically and internationally in accordance with New Zealand law (for example, the Privacy Act 1993, Policing Act 2008, Anti-Money Laundering and Countering Financing of Terrorism Act 2009, and the Mutual Assistance in Criminal Matters Act 1992).

Information can be shared through:

- international treaties and arrangements (such as memoranda of understanding);
- participation in multi-agency groups (for example, the Organised and Financial Crime Agency of New Zealand);
- through the Police Liaison Officer Network; and
- through international bodies established to enhance international cooperation in crime prevention and law enforcement such as INTERPOL, the Egmont Group of Financial Intelligence Units and, once operational, the International Anti-Corruption Coordination Centre.

The types of information shared must be relevant to the purpose for which the information is being used. The New Zealand Police can share information for purposes including crime prevention and law enforcement. The sharing of information is subject to the requirements of New Zealand laws and the conditions specified under each mechanism.

Sharing with international counterparts would occur where this was warranted either for the New Zealand Police's own law enforcement purposes or those of another police jurisdiction. Provisions in the Policing Act 2008 enable the New Zealand Police to share personal information held by the New Zealand Police with a corresponding overseas agency where disclosure is reasonably necessary to enable the corresponding overseas agency to perform a function in its jurisdiction that the New Zealand Police perform in New Zealand. Under the Policing Act provisions, the New Zealand Police is required to consult with the Privacy Commissioner before any agency-to-agency agreement is entered into or varied. Police is also required to report annually to the Privacy Commissioner on the operation of Police audit and assurance processes to show that the New Zealand Police is meeting our international sharing limits or obligations with regard to personal information.

In addition to the sharing of information described above, information held by the Police can be disclosed under the Criminal Disclosure Act 2008 provisions for disclosure of information in criminal proceedings. The Official Information Act 1982 also applies.

The Department of Internal Affairs will use the foreign trust disclosure register for the purposes of AML/CFT supervision to aid in the identification of risk within the sector it regulates. In particular, the information will be used to ensure that trust and company service providers are complying with the rules they operate under. The Department of Internal Affairs is experienced in handling information of a sensitive nature and has appropriate protocols in place.

Currently, the Department of Internal Affairs is not permitted to share any information relating to specific trust and company service providers (although it is possible that in future changes to domestic legislation or international treaties could allow for information sharing between certain overseas counterparts of the Department of Internal Affairs, or other domestic agencies).

Interdepartmental memoranda of understanding between Inland Revenue, the Department of Internal Affairs and the New Zealand Police on the handling of the information will be agreed.

It should be noted that there are existing data protection mechanisms contained in all New Zealand's tax treaties. Information exchanged under New Zealand's tax treaties will not be provided to another jurisdiction if it is contrary to public policy.

Recommendation

That the submissions be noted.

Issue: There should be a prohibition on automatic exchange of information for information disclosed under proposed rules

Submission

(TGT Legal)

Due to the sensitivity of the additional data collected under the new disclosure rules that is not available under CRS or FATCA, we are of the view that additional safeguards should be put in place to ensure that data provided under the new disclosure rules is not provided automatically to a foreign jurisdiction. We believe this is of such significance that the prohibition against such (automatic) disclosure should be enshrined in the legislation and underpinned by appropriate sanctions for breaches that occur. This would not, however, prevent exchanges to occur in the normal course under double tax agreements and other information exchange agreements.

We submit that the bill should be amended to prohibit the automatic exchange of information provided under the new disclosure rules together with appropriate sanctions for breaches of the prohibition.

Comment

Officials do not agree that there needs to be a legislative prohibition on the automatic exchange of information.

Officials note, however, that there will not be “automatic exchange of information” of foreign trust information under New Zealand's tax treaties.

Most of our international tax treaties provide for information exchanges under the following exchanges:

- exchange of information at the request of the other jurisdiction;
- spontaneously by New Zealand to the other jurisdiction; and
- automatically between the two jurisdictions.

Information exchange in relation to foreign trusts will occur under the spontaneous or “on request” exchange of information mechanisms and not the automatic exchange of information mechanism (which relates to an automated bilateral programme set up by both countries).

As noted above in “Issue: Trusts should be subject to the AEOI rules rather than a separate regime”, it is expected that, where a settlor is a resident in a jurisdiction which has an exchange of information agreement providing for spontaneous exchange, Inland Revenue will provide certain information to the tax authority of that jurisdiction as a matter of course. The

information that will be provided to the overseas tax authority as a matter of course will be information about the settlor (name, taxpayer identification number, contact details) and the trustee's contact details.

Officials consider that it is necessary to provide this information to overseas jurisdictions as a matter of course in order for the receiving jurisdiction to establish whether or not they need further information about the trust from Inland Revenue (which the jurisdiction can then request further information under the exchange of information on request mechanism).

This approach follows the approach taken under the current rules in relation to Australian settlors.

As noted above in the response to "Issue: Data protection", there are existing data protection mechanisms contained in all New Zealand's tax treaties. Information will not be provided to another jurisdiction if it is contrary to public policy.

Recommendation

That the submission be declined.

Issue: Purposes of collection is unclear

Submission

(Cone Marshall)

It is presently unclear about the purposes for which the Commissioner will be collecting information under the foreign trust disclosure rules.

Comment

As noted above, Inland Revenue will be collecting information to be held in a register that will be searchable by Inland Revenue, the Department of Internal Affairs, and the New Zealand Police. The information will be used for the purposes of preventing tax evasion and avoidance (both New Zealand and overseas tax), crime prevention and law enforcement, and regulation of trust and company service providers. Inland Revenue will also share information with overseas treaty partners so they can ensure compliance with tax obligations.

All information will be collected and used in accordance with the laws applying to the relevant agencies.

Recommendation

That the submission be declined.

Issue: Information sharing with other agencies should be limited to law enforcement purposes

Submission

(Russell McVeagh)

Disclosure of information to members, officers, employees or agents of other government agencies under proposed section 81(4)(y) should be limited to disclosure for law enforcement purposes. Proposed section 81(4)(y) should be amended such that it only applies to communications to a person for the purposes of criminal law enforcement and enforcement of the Anti-money Laundering and Countering the Financing of Terrorism Act.

Comment

The information is to be used by all three agencies in accordance with the laws under which they operate. The information will be used by the New Zealand Police for crime prevention and law enforcement, and by the Department of Internal Affairs for the regulation of trust and company service providers.

Under the submitter's proposal, before providing information to the New Zealand Police and the Department of Internal Affairs, Inland Revenue would be required to assess the intended use of the data by the New Zealand Police and the Department of Internal Affairs on a case-by-case basis. This is contrary to the policy intent of the bill as the New Zealand Police and the Department of Internal Affairs would be unable to search the database.

The policy intention is that the information is proposed to be contained on a shared register, which will be searchable by the Department of Internal Affairs and the New Zealand Police as well as Inland Revenue.

Recommendation

That the submission be declined.

Issue: Administrative process in cases where a person believed information has been used or disclosed outside of the scope or objective it was collected for

Submission

(Cone Marshall)

We submit that the Commissioner provides an administrative process for an aggrieved party to present their case to an impartial body if the person reasonably believes the information provided under the FTD/CRS rules has been used or disclosed outside of the scope or objective it was collected for, or where such information has already been reported by a Reporting Financial Institution or another body (in New Zealand or overseas), or where the information reported by different reporting entities are inconsistent /contradictory even though they relate to the same account.

Comment

Officials disagree with the submission that there should be a new administrative process for an aggrieved party to present their case to an impartial body. There are existing administrative

remedies available if persons are concerned about the Commissioner's use of powers. For example, they are able to seek a judicial review. These remedies are available to New Zealand-resident trustees of foreign trusts.

Recommendation

That the submission be declined.

Issue: Mechanism to ensure internal consistency of data held

Submission

(TGT Legal)

There should be mechanisms to ensure that the data held is accurate, and that there is internal consistency in terms of the data held by Inland Revenue about a trust.

The absence of a mechanism to correct errors may create issues in a settlor or beneficiary's home country, particularly if, for example, the settlor or beneficiary makes a tax disclosure to their home tax authority that does not match with data exchanged under CRS or FATCA.

Comment

Officials consider there are general points that are relevant to this submission.

- If Inland Revenue holds incorrect data because trustees have provided incorrect data, then this is an issue for the trustee to correct. Trustees are required to provide accurate data. The consequences of providing inaccurate information are losing eligibility for the tax exemption on foreign-sourced income in addition to potential penalties in the Tax Administration Act 1994 for providing incorrect information. If trustees discover they have provided incorrect information, they must correct it.
- If there is internal inconsistency between two sets of information held by Inland Revenue because of, for example, transposition errors, trustees are able to simply request that inconsistencies are corrected. There is no need for a special "mechanism" to correct errors.
- If there is a mismatch between data held by Inland Revenue and that held by another jurisdiction, this can be resolved through consultation between competent authorities as provided for in New Zealand's international treaties.

In all three scenarios above, accuracy of data is not an issue specific to this reform, and there are existing ways incorrect data can be corrected.

Recommendation

That the submission be declined.

REGISTRATION AND FILING FEE

Clause 10

Submission

(Chartered Accountants Australia and New Zealand)

The proposal to introduce a registration fee of \$270 and an annual filing fee of \$50 should not proceed. This proposal fails to recognise Inland Revenue's obligation to administer New Zealand's tax laws fairly and impartially.

Although the annual fee is not directly linked to the filing of the annual income tax return, the perception may be that the fee is payable to file a tax return. Other taxpayers do not pay fees to Inland Revenue when they file a tax return.

Comment

It is important to note that foreign trusts do not pay tax in New Zealand, so the fee is not a charge for paying tax.

Charging fees recognises that foreign trusts benefit from New Zealand's regulatory environment and that there are costs involved to the Crown, both in processing registrations and returns, exchanging information with other jurisdictions and also in enforcing the rules relating to foreign trusts. Charging fees would recompense the Crown for those costs.

The registration and annual filing fees are in line with those charged by the Companies Office for the registration of entities.

Further, the register of foreign trusts could, in future, be administered and maintained by a different government agency, where it may be more common to charge fees for registration services.

Accordingly, officials disagree with the submission that fees should not be charged.

However, as recommended by the Specialist Tax Adviser to the Committee, officials agree that it is appropriate for non-professional trustees to apply to the Commissioner for an exemption from the registration and filing fees. This should help to address situations where resident trustees have become trustees of a foreign trustee due to changes in circumstances (such as a trustee migrating to New Zealand or acting as an executor of a trust), rather than choosing to establish a foreign trust, and then having to register in order to fulfil their tax obligations.

Recommendation

That the submission be declined, subject to officials' comments.

IMPACTS ON NON-PROFESSIONAL TRUSTEES – GRACE PERIODS FOR NEW MIGRANTS

Submission

(Chartered Accountants Australia and New Zealand, EY)

The proposed grace period of two years should be extended to mirror the four-year transitional resident exemption. The grace period should begin on the first day of residence in New Zealand and end on the earlier of:

- the day before the person ceases to be a New Zealand resident; or
- the last day of the 48th month after the month in which the person satisfies the requirements of the permanent place of abode and the 183-day personal presence tests in section YD 1(2) – (4). *(Chartered Accountants Australia and New Zealand)*

Clarification is required on when individuals' New Zealand residence will be treated as commencing for section 59C purposes and the general back-dating of residence under section YD 1(4) should be excluded for these purposes. That rule is excluded from applying, however, when determining the application of the transitional resident rules under section HR 8 of the Income Tax Act 2007, and we suggest it would also be appropriate to exclude it in this context. *(EY)*

Comment

Officials note that the current disclosure rules provide a two-year grace period for natural persons who migrate to New Zealand and are not in the business of providing trustee services. The bill as introduced retains this grace period, with minor amendments.

Officials agree with the submission that the grace period in the foreign trust disclosure rules should be extended to four years to align with the principle of the four-year exemption in the transitional residence rules. This would simplify requirements for trustees migrating to New Zealand who are not in the business of providing trustee services, allowing them four years to understand and meet these obligations.

This also recognises that migrants may not have knowingly opted into being a New Zealand-resident trustee of a foreign trust when they became a trustee, and therefore are less likely to be using foreign trusts for illicit purposes.

The Specialist Tax Adviser to the Finance and Expenditure Committee further recommends in her report that eligibility for the grace period be extended to resident trustees who are not in the business of providing trustee services more generally, regardless of whether or not they are new migrants to New Zealand. This is discussed in further detail in “Issue: No tax exemption if trustee is non-compliant”, which relates to the impact of the foreign trust rules on so-called “accidental trustees”.

Recommendation

That the submission be accepted, subject to officials' comments.

INFORMATION TO BE PROVIDED UPON REGISTRATION

Clause 10

Issue: Trust deeds should not be required upon registration

Submission

(Kensington Swan, New Zealand Trustee Companies Association Limited)

Providing the trust deed and financial statements for a foreign trust places in a public register fundamentally private information.

It is also common for trust deeds to be amended and beneficiaries under trusts to be changed from time to time by supplemental deeds. The terms of a trust deed filed may not actually reflect the terms of the trust at the time the register is searched and so may be of limited utility. Furthermore, it is common for companies to be interposed between trusts and the assets held and so in these cases the financial statements of the trusts concerned may not provide any meaningful information. *(Kensington Swan)*

The same requirement that applies to domestic trusts should apply as it seems the *Inquiry* intended. That is, on registration, the trustee should provide excerpts from the trust documentation to identify the trust. *(New Zealand Trustee Companies Association Limited)*

The trust deed should be available for IRD inspection should that be required. In that case section 22 (7)(d)(i) of the Tax Administration Act – which requires trustees to retain documents that evidence the creation and constitution of trusts should not be repealed as proposed by clause 9(4) of the bill. *(New Zealand Trustee Companies Association Limited)*

Comment

Under current law, the trust deed of a foreign trust must be available and provided to Inland Revenue if requested. The bill proposes that the trust deed should be provided to Inland Revenue at the time the trust is registered in New Zealand.

A key conclusion of the *Inquiry* was that the trust deed should be provided to Inland Revenue at the time the foreign trust is registered.

The trust deed documents the creation and terms of the trust and is essentially the foundation document. Having the trust deed for a foreign trust provides Inland Revenue with the ability to verify the information provided by the trust.

It is possible that a foreign trust in New Zealand could wind up in order to avoid its trust deed being provided to an overseas tax authority. If Inland Revenue holds the trust deed, it can still be provided if requested by an overseas tax authority.

Moreover, requiring the trust deed upon registration sends an important signal and should provide a deterrent to foreign trusts being used for illicit purposes.

Officials note that, in the absence of a specific legislative requirement to disclose the trust deed, the Commissioner could use her powers under section 17 to request the deed. Having a legislative requirement to provide the trust deed upon registration avoids the administrative costs of Inland Revenue having to issue requests under section 17.

It should also be noted that Inland Revenue's forms currently require trust deeds to be provided for any trust applying for an IRD number (not just excerpts of the trust deed). Accordingly, requiring trust deeds for foreign trusts wishing to register in New Zealand is consistent with requirements for New Zealand trusts that are required to apply for IRD numbers.

Officials understand that submitters have expressed two concerns with providing the trust deed.

The first concern is that trust deeds contain sensitive information that mean trust deeds should only be available to Inland Revenue on request.

It should be emphasised that the information disclosed to Inland Revenue would not be made public. It is anticipated that the trust deed would be provided to overseas authorities only when it is requested. In addition, the trust deed would not be automatically provided to Department of Internal Affairs and the Police as part of the register. The trust deed would be provided only when requested by Department of Internal Affairs or the Police. More information on data protection in each agency is provided as part of the response to "Issue: Data protection".

The second concern relates to compliance costs. Officials do not consider that the costs of complying with this requirement would be significant. As previously noted, the trust deed is required to be kept and if requested, sent to Inland Revenue. Accordingly, the costs for providing the trust deed to Inland Revenue on registration are likely to be relatively minimal, and as noted above, are consistent with the current requirements for other trusts that apply for IRD numbers.

Officials have discussed the requirement to provide trust deeds with New Zealand Trustee Companies Association Limited, but did not reach agreement on this point.

Recommendation

That the submission be declined.

Issue: Reference to trust deed in registration requirement

Submission

(EY)

It appears not every foreign trust with a resident trustee would be required to register under the proposed section 59B and 59C requirements, as those requirements include having a trust deed. No specific definition of "trust deed" is already included in the Tax Administration Act 1994 or Income Tax Act 2007 or proposed to be included for these purposes.

Comment

Under the proposals, all foreign trusts with a New Zealand-resident trustee would be required to register under the proposed amended rules in order to be eligible for the tax exemption.

If a foreign trust does not have a trust deed (that is, if the foreign trust is based on an oral agreement), they will be unable to register and fulfil the associated disclosure requirements. Accordingly they will not be eligible for the exemption.

Officials note that Inland Revenue currently requires trusts to provide a trust deed in order for domestic trusts to get an IRD number.

Officials note that if there is an exception to the proposed rule that in order to get an exemption the foreign trust must effectively have a trust deed, this exception could be open to abuse.

Recommendation

That the submission be noted.

Issue: Any documents amending or to be read together with the trust deed should also be provided

Submission

(New Zealand Law Society)

Proposed section 59B(3)(e) requires that the trust deed be provided. This section should expressly provide that both a copy of the trust deed and any document that amends or that must be read together with the trust deed (such as, for instance, any document by which a person is appointed as protector), must be provided.

Comment

Officials agree and recommend that the bill should be amended to ensure that any documents that either amend or are to be read together with the trust deed should also be provided.

Recommendation

That the submission be accepted.

Issue: Agreement to provide information should be limited to information relevant to the trust

Submission

(Russell McVeagh)

The agreement of settlors, trustees and other persons who control a trust to provide information for compliance with the Tax Administration Act 1994, Anti-Money Laundering and Countering Financing of Terrorism Act and regulations under the latter Act should be limited to information necessary for the relevant trust's compliance with those laws. We assume that this is the intention but the requirement as drafted could on the face of it extend to information that has nothing to do with the trust.

Proposed section 59B(4) should be amended to require that each relevant person agree "to provide to the applicant trustee information necessary for the applicant trustee's compliance with the Tax Administration Act 1994, the Anti-Money Laundering and Countering Financing

of Terrorism Act 2009 and the regulations made under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 as those laws apply to the relevant trust”.

Comment

The requirement is that a trustee must provide a signed declaration that the trustees, settlors and persons able to control the trust (if any) have been informed of, and have agreed to provide the information necessary to comply with the Tax Administration Act 1994, the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 and the regulations made under the later Act.

Officials consider that the trustee’s obligations in relation to informing the settlors, trustees, and other persons able to control the trust could be clarified.

Recommendation

That the submission be accepted and referred to drafters.

Issue: Signed declaration is ineffective and should be deleted

Submission

(David McLay)

There is a proposed section 59B(4)) for a signed declaration by settlors and trustees and others having powers to control the trust. The declaration may be helpful, but it appears to be only required at the time of initial registration. Proposed section 59C does not require any new declaration upon changes affecting the trust. The declaration is a “makeweight” that is unlikely to enhance the proposals. It is otiose and should be deleted.

Comment

The submitter notes that the signed declaration is only required to be made at the time the trust is first registered with Inland Revenue. This means that if there are any subsequent changes to trustees or additional settlors or other relevant persons subsequent to the registration of the trust, the resident trustee is not required to obtain their signature.

The requirement to provide a signed declaration as part of the registration process was recommended by the *Inquiry*. Officials disagree that it is ineffective as it requires all persons to have turned their minds to the relevant laws and regulations that they will need to comply with.

In light of the submission, officials consider that it would be appropriate to require the resident trustee of a foreign trust to obtain a signature from any person who becomes one of the following subsequent to the registration of the trust:

- settlor;
- person with a power under the trust deed to control the dismissal or appointment of a trustee, to amend the trust deed, or to add or remove a beneficiary;
- person with a power under the trust deed to control a trustee in the administration of the trust; and
- trustee.

This will ensure the declaration is obtained regardless of the time that the person becomes involved with the trust.

Recommendation

That the submission be declined, subject to officials' comments.

Issue: Signed declaration – relevant persons may be deceased

Submission

(Cone Marshall, New Zealand Trustees Companies Association Limited)

Proposed section 59B (4) would require a trustee to provide on registration a signed declaration that the settlors, controllers and trustees have been informed of and agree to provide information necessary to comply with foreign trust disclosure and anti-money laundering rules. This raises some very practical problems when the settlor, for example, has died, is mentally incapacitated or cannot be traced. *(New Zealand Trustees Companies Association Limited)*

It is unclear what options are available to the resident trustee if any of the persons described above cannot be contacted because they are deceased, cannot be located or are incapacitated. To address such scenarios, we submit that the declaration from the resident trustee include words to the effect "to the best of my knowledge and belief" so as not to unreasonably prevent the registration of a foreign trust.

The resident trustee should be provided with the option, within the declaration, to advise the Commissioner that one or more of the above mentioned persons is deceased, cannot be located or is incapacitated so as to enable the resident trustee to comply with the remaining requirements of the trustee's declaration. *(Cone Marshall)*

Comment

Officials acknowledge that when a person is incapacitated, their legal guardian, personal representative, or power of attorney should sign on their behalf.

If the person cannot be located, the trustee should complete a statutory declaration outlining their attempts to find the person.

Officials considered requiring a copy of the death certificate when a settlor may be deceased, but this is likely to be impractical, particularly if the settlor is not recently deceased. It would be sufficient for the resident trustee to declare that a signature cannot be obtained as the settlor is deceased.

If incorrect information is provided, knowledge offence penalties under the Tax Administration Act 1994 could apply.

Recommendation

That the submission be accepted in part.

Issue: Email address

Submission

(Chartered Accountants Australia and New Zealand)

The requirement to provide the email addresses of specified persons under proposed sections 59C and 59D of the Tax Administration Act 1994 should not proceed. The requirement for the resident trustee to provide an email address for specified persons fails to recognise that not everyone has an email address.

Comment

Officials agree that the resident trustee should only be required to provide an email address when an email address is known by the resident trustee. This recognises that not all individuals have an email address.

When the email address is not known by the resident trustee, officials consider that the other address details required should provide sufficient information.

Recommendation

That the submission be accepted.

Issue: Applicable definition of “settlor”

Submission

(Russell McVeagh, New Zealand Trustee Companies Association Limited)

Given the broad definition of “settlor” in section HC 27 of the Income Tax Act 2007, the obligation to disclose information in respect of settlors may apply more broadly than intended.

The definition of “settlor” in section HC 27 of the Income Tax Act 2007 includes a person who transfers value to the trust, for the benefit of the trust or on terms of the trust. Consequently, a person may be a settlor of a trust when they have provided services to the trust for less than market value (for example, family members or friends who are lawyers or accountants providing services to a trust for less than market value). *(Russell McVeagh)*

Under the Income Tax Act 2007 the term “settlor” is specifically defined (sections HC 27(2) and HC 27(4)). This is a very wide definition (for example, it includes the provision of subsidised services) because it is designed to bring into the New Zealand tax base any trust that could be used to avoid New Zealand tax. It would seem inappropriate for these purposes. This definition applies only for the purposes of the “trust rules” that is defined by section YA 1 as including sections 59 and 93D of the Tax Administration Act 1994 but not proposed sections 59B or 59D. It is unclear what is intended by the term “settlor” in these sections. *(New Zealand Trustee Companies Association Limited)*

Comment

The definition of “settlor” in the Income Tax Act 2007 is not restricted to the trust rules. It is a general definition which also applies in the Tax Administration Act 1994 as provided for by

section 3(2) of the Tax Administration Act 1994. The definition of “settlor” is used extensively in the Income Tax Act and its wide meaning is consistent with the settlor-based focus of the trust taxation rules in the Income Tax Act 2007.

After discussing this issue with the Specialist Tax Adviser to the Committee, officials consider that there should be some restriction to the definition of settlor for the purpose of the foreign trust disclosure rules. This would allow an exception to making a person a settlor solely because they provide services at below market value, but only in restricted cases. Officials consider that it is important that there are appropriate restrictions on a narrower definition for the purpose of the disclosure rules in order to mitigate any potential abuse of the rules.

Officials consider that it is appropriate to exclude a person who would be settlor only because they provide services to the trust below market value and the services provided to the trust below market value are minor, and incidental to the activities of the trust.

The requirement for the services to be incidental to the activities of the trust would be relative to the trust in question. It would ensure that certain types of services are excluded depending on the activities of the trust.

For example, a service that would be both minor and incidental to the activities to the trust could include, for example, a friend carrying out an inspection of a rental property held in the trust for free.

However, the service would not be considered incidental if a person provides services similar to those provided by the trust. For example, where a friend carries out an inspection of a rental property, this would not be incidental if the trust were in the business of property management.

The requirement for the services to be minor introduces a standard that applies equally to all trusts. This will ensure that the incidental services would only be carved out where the value of the services is low. Officials considered stipulating an explicit threshold for what constitutes a “minor” service. However, this would introduce additional complexities and compliance costs.

Officials also considered using a test relevant to the trust, for example, allowing an exclusion for below market services where the asset base of the trust was less than NZ\$1 million. Officials considered that it would be possible to circumvent such a test by setting up multiple trusts to split the assets, and that there was a possibility for a large number of business activities to be run with a low asset base. In other cases, this could impose compliance costs on those well below the asset threshold as they would be required to obtain valuations to provide that they are in fact below the threshold. In addition, given that the number is a nominal value, it is also likely the threshold would need to be updated to take account of changes in asset prices to ensure that the threshold is appropriately targeted.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Provision of TIN and contact details of guardian when a beneficiary is a minor

Submission

(New Zealand Law Society)

In some cases there are very likely to be beneficiaries (such as, children) that do not have email addresses and/or tax numbers. A provision should be included allowing the contact details of a guardian or parent to be provided when the beneficiary is a minor.

Comment

Officials agree that it would be appropriate for the TIN and contact details of a guardian or parent be provided if the minor beneficiary does not have a contact number or TIN. However, the resident trustees should note on the registration form when a beneficiary is a minor, and update the details when the minor is no longer a minor (reaches age 16, consistent with the trust tax rules).

Recommendation

That the submission be accepted.

Issue: Estates of deceased individuals

Submission

(EY)

Although personal representatives of a deceased person are included in the Income Tax Act 2007 definition of “trustee”, we assume a will or other testamentary instrument would not be regarded as a “trust deed” for these purposes. On that basis, New Zealand residents who are or become trustees of a foreign trust by virtue of being or becoming personal representatives of a deceased person's estate would not be required to register, pay fees and report all required details to the CIR.

The proposed section 59C(3) grace period for registration would not necessarily be appropriate or adequate for estate situations as a New Zealand-resident personal representative may never have been non-resident or may not fall within the specific residence/non-residence criteria proposed.

Deceased individuals' estates should be excluded from being required to register, pay fees and meet the detailed information requirements and to limit application of the new rules to inter vivos trusts.¹²

¹² A trust created by a declaration of trust which commences at that time while the settlor is still living.

Comment

Officials agree that a will is not a trust deed in itself for the purposes of the foreign trust disclosure rules. However, a trust established under a will (a testamentary trust) will be a trust for these purposes.

As noted above, non-professional trustees will have a longer period to comply with the rules under the extended grace period. These trustees will also be eligible to apply for an exemption from the registration and annual filing fees and provide more limited disclosure on historical settlements.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Disclosure regarding settlements should exclude historical settlements

Submission

(Russell McVeagh)

The requirement to disclose details regarding settlements and settlors should be adapted so that it is workable for pre-existing trusts, in respect of which settlements may have been made years in the past, and the settlors may be deceased.

In the case of trusts established before becoming subject to the disclosure rules, proposed section 59B should require disclosure of settlements and settlors only for a certain period of time prior to applying to become registered. This period of time would need to be sufficient to ensure that the disclosure requirements could not be circumvented, but not so lengthy as to be impossible to comply with in practice. A period of three to four years would seem appropriate.

Comment

After discussion with the Specialist Tax Adviser to the Committee, officials agree that there should be a limit to the historical settlements for non-professional resident trustees. However, it is expected that professional trustees provide the details of all historical settlements for the trust.

To address compliance costs for non-professional trustees, officials consider that they should only be required to provide details of historical settlements for the previous four years. The beginning of this four-year period should be from the earlier of:

- the point that the trustee first becomes liable to register the foreign trust; and
- the application date of the legislation (30 June 2017).

Note that the four-year time limit for providing historical settlements can be different from the way the four-year grace period for registration is calculated.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Meaning of “each person with a power under the trust deed to control the dismissal or appointment of a trustee, to amend the trust deed, or to add or remove a beneficiary”

Submission

(New Zealand Law Society)

Proposed section 59B(3)(c)(ii) requires disclosure of “each person with a power under the trust deed to control the dismissal or appointment of a trustee, to amend the trust deed, or to add or remove a beneficiary”. This drafting does not appear to encompass a person with a power to control the amendment of the trust deed or control the appointment or removal of a beneficiary, nor is it clear that a person with the power to control the dismissal or appointment of a trustee encompasses a person with the power to appoint and remove a trustee. The drafting is also problematic as it requires the requisite power to stem from the trust deed. This should be redrafted as:

each person with a power (whether under the trust deed or otherwise) to dismiss or appoint a trustee, to amend the trust deed, or to add or remove a beneficiary and each person with a power (whether under the trust deed or otherwise) to consent, veto or otherwise control the exercise of a power to dismiss or appoint a trustee, to amend the trust deed, or to add or remove a beneficiary.

Comment

Officials agree that the details should be provided under proposed section 59B(3)(c) for any person who has a power to dismiss and/or appoint a trustee or appoint and/or remove a beneficiary, whether or not this power stems from the trust deed.

Recommendation

That the submission be accepted and referred to drafters for their consideration.

Issue: Bare trustee

Submission

(Russell McVeagh, New Zealand Trustee Companies Association Limited)

Section YB 21 of the Income Tax Act 2007 should be amended to clarify that it also applies for the purposes of the foreign trust disclosure rules. This would also clarify that the rules do not apply to trustees when the trustee is merely a bare trustee and that details of beneficiaries whose rights are held via a nominee must also be disclosed under proposed section 59B(3)(c)(v).
(Russell McVeagh)

It seems to be the policy objective that bare trusts (outside those covered by AEOI/CRS) should still be subject to disclosure. This needs to be provided for. *(New Zealand Trustee Companies Association Limited)*

Comment

Officials have discussed this with submitters.

We note that section YB 21 provides that a trustee is a nominee only if a trustee is a bare trustee (that is, a trust that has no discretion to administer the trust's assets). When a trustee is considered to be a nominee, they are effectively ignored and the tax rules "look through" to the person they are acting for.

We agree that it should be clarified that section YB 21 of the Income Tax Act should apply to the requirements, so that when a trustee is considered to be a nominee, they would not be subject to the foreign trust disclosure rules.

At this time, officials consider that this is the appropriate policy outcome, but officials note that this raises a concern in relation to potential abuse of the disclosure rules. Officials will monitor this issue.

Recommendation

That the submission be noted.

Issue: Clarification of "date and detail of each settlement"

Submission

(New Zealand Law Society)

Proposed section 59B(3)(b) requires the "date and detail of each settlement" to be disclosed. It is not clear what details are required, for example, the value of the settlement, the nature of the property settled, the location (if any) of the property settled, and/or the identity of the settlor of each settlement.

Comment

Disclosure on the detail of each settlement made on the trust should include the date of settlement, the name of the settlor and the nature (such as, land or shares) and value of the settlement. Specific details about the settlor are also required as part of the disclosure under proposed section 59B(3)(c)(i); name, email address (if known), residential address, country of tax residence, and taxpayer identification number.

Recommendation

That the submission be accepted.

Issue: Disclosure in relation to residence

Submission

(New Zealand Law Society)

Proposed section 59B(3)(c) requires the “residential address” of each person listed in (c) to be disclosed. Since, for instance, a trustee or settlor may not be an individual, clarification is needed as to what address, if any, is required for non-individuals, (such as, a registered office).

Comment

Officials will clarify in further guidance that for an individual, resident trustees will have to provide their physical or residential address. For non-individuals the registered office or servicing address should be provided.

Recommendation

That the submission be accepted.

Issue: Other identifying particulars

Submission

(New Zealand Law Society)

The words “other identifying particulars” in proposed section 59B(3)(a) are vague and, given the liability for inadequate disclosure, unhelpful. Proposed section 59B(3) requires the name of the trust and a copy of the trust deed to be provided, so it is not clear what other particulars are required to identify the trust. If it is desirable for the date of establishment of the trust to be expressly disclosed, for example, that should be specified.

Comment

This wording reflects the existing disclosure requirement in section 59B.

Under the existing rules, it was intended that other identifying particulars (for example, the date of initial settlement on the trust) are only to be provided when the foreign trust does not have a name.

Officials agree that this information is no longer necessary as a result of the other information that is proposed to be required upon disclosure.

Officials therefore recommend that the reference to “other identifying particulars” should be removed.

Recommendation

That the submission be accepted.

INFORMATION REQUIRED IN ANNUAL RETURNS

Clause 10

Issue: Requirement to provide any changes to details provided at registration within 30 days of alteration

Submission

(KPMG, TGT Legal, Russell McVeagh, Cone Marshall, Chapman Tripp, New Zealand Trustee Companies Association Limited, New Zealand Law Society)

A trustee is required to notify changes and also provide an annual return which contains the same information. The duplication of notification should be eliminated. *(KPMG)*

Given the additional work this would require throughout the year, it is appropriate that any changes made to the settlement dates or details only be disclosed to the Commissioner in the annual return. *(Chapman Tripp)*

Requiring changes about the trust to be reported under two separate provisions in the Tax Administration Act 1994 is unnecessary and simply imposes additional compliance costs, which we believe far exceed any benefits of doing so.

We submit that changes to trust data should only be reported either once in each year in the annual return or once within a reasonable timeframe after the change. Assuming the latter option is preferred, a reasonable timeframe for reporting changes is three months, which is consistent with the timeframe within which changes are required to be reported under the Charities Act. *(TGT Legal)*

The requirement to provide updates in 30 days seems to impose compliance costs for no obvious benefit. *(New Zealand Trustee Companies Association Limited)*

The requirement to file an annual return under proposed section 59D is sufficient to adequately inform the Commissioner of changes to the particulars of a foreign trust and that ad hoc disclosure during the year is not necessary. *(Russell McVeagh)*

The resident trustee advises of any changes to the registered information when the annual return of a foreign trust is filed, as is the case with New Zealand companies (that is, information is updated when the annual return is filed). *(Cone Marshall)*

Comment

In order to have current information on a foreign trust it is necessary that the details provided as part of a foreign trust's initial disclosure on registration are kept up to date. For example, holding up-to-date details of any settlors and their current tax residence impacts on information-sharing with relevant overseas jurisdictions. Accordingly, officials do not believe that the 30-day requirement is excessive. The current disclosure rules for foreign trusts require updates to any information provided as part of the initial disclosure to be updated within 30 days. Officials consider that this requirement should be kept for the purposes of the enhanced disclosure rules.

However, officials agree that requiring any changes to the registration document to be reported both within 30 days of alteration and as part of the annual return results is an unnecessary duplication.

Officials recommend that the annual return requirement be amended to remove the requirement to provide any changes to the information provided at registration. The requirement to provide any updates within 30 days of alteration would be sufficient.

Recommendation

That the submission be accepted in part.

Issue: Financial statements

Submission

(Chartered Accountants Australia and New Zealand)

The term “financial statements” in proposed section 59D should be defined to mean the minimum requirements as prescribed in clause 8 and the Schedule of the Tax Administration (Financial Statements) Order 2014. “Company” should be read as “trust”.

Comment

As noted by the submitter, the Tax Administration Act 1994 includes a provision for minimum standards for financial statements to be set by Order in Council.

Officials consider that rather than referring to the Order in Council setting out the requirements for companies, an Order in Council should be made under this provision to specify the minimum standards for financial statements for foreign trusts. This should provide certainty to resident trustees as to what is required as a financial statement.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Clarification regarding financial statement requirements

Submission

(New Zealand Law Society)

Proposed section 59D(1)(b)(ii) acknowledges the possibility of a foreign trust not preparing financial statements. If a foreign trust has not done so, it is not clear whether it is intended under proposed section 59D(2)(b) that financial statements are to be provided only if they are prepared, or whether the intention is for every registered foreign trust to prepare financial statements, even if they would not otherwise be prepared.

Comment

If a trust does not prepare financial statements for other purposes, they would have to prepare financial statements in order to meet their requirements under the enhanced disclosure rules.

As noted above, officials consider that an Order in Council should be made under section 21C of the Tax Administration Act 1994 to specify the minimum standards for financial statements for a foreign trust. This will make it clear for foreign trusts, including those who do not ordinarily prepare financial statements, what information must be provided.

Recommendation

That the submission be noted.

Issue: Annual return deadlines

Submission

(TGT Legal, New Zealand Law Society)

We believe that the three-month reporting deadline is too short, and is arbitrary.

By their nature, foreign trusts will invariably have all or substantially all of their assets, outside of New Zealand. Responsibility for administration, including the preparation of financial statements, is usually undertaken by administrators, accountants and advisers outside of New Zealand. In some cases timeframes are driven by foreign jurisdictional requirements. Because of this, we believe there will be logistical difficulties in filing financial statements of a foreign trust within the proposed three-month period.

In addition, we do not believe it is either appropriate or reasonable to impose a timeframe for the reporting of financial statements (and annual returns) by foreign trusts that are substantively shorter than those applicable to New Zealand-based trusts and entities.

To address these concerns, we submit that the timeframe within which:

- foreign trust annual returns (other than financial statements of the trust) are required to be filed should be extended to at least six months from the end of the trust's balance date; and
- foreign trust financial statements that are required to be reported be extended to the same time period that applies when the taxpayer is on the agency list of a registered tax agent (generally 12 months from balance date).

Three months is a very short timeframe. By contrast, the annual return for a charitable trust must be filed within six months of balance date. Moreover, if the majority of income is derived in other jurisdictions which have different balance dates, there may not be complete information available within three months of the end of the New Zealand tax year. Six months after balance date or six months after the end of the tax year (as applicable) would be a more reasonable timeframe. *(New Zealand Law Society)*

Comment

Given that any updates to the information provided as part of initial disclosure will be updated throughout the year, officials agree that six months following a trust's balance date is a more appropriate timeframe for the annual return. This would give resident foreign trustees more time to gather any required documentation and meet their obligations. Officials acknowledge that this is likely to be particularly important given that much of the documentation may be held overseas.

For foreign trusts that do not have a balance date, officials agree that they should be required to file six months after the end of the tax year (31 March).

Recommendation

That the submission be accepted.

Issue: Clarifications required in relation to distributions

Submission

(New Zealand Law Society)

Proposed section 59D(2)(e) requires the date and amount of each distribution to be provided in the annual return. It is not clear whether the required amount is the total of distributions made on a particular date or the amount of a distribution on a particular date to a particular beneficiary. If the latter is intended, that should be clarified. If so, it is also unclear whether the identity of the particular beneficiary is also required to be provided under (e), which would seem useful, in which case the requirements in proposed (f) could be transferred to (e) instead.

In addition, it should be noted that distributions can include items that are otherwise of money or assets (for example, the use of a property by a beneficiary for no consideration). It is not clear whether it is intended that these types of distributions be identified and valued.

Comment

Information on the amount of distributions required in the annual return of a foreign trust should specify the amount of a distribution made on a particular date to a particular beneficiary. The identity and contact information for each beneficiary should also be provided in accordance with section 59D(2)(f).

When a distribution takes the form of an item which is not money or an asset, the market value for the distribution should be provided. The form will prescribe what information is required.

Recommendation

That the submission be noted and referred to the drafter.

TAX EXEMPTION FOR FOREIGN TRUSTS

Clause 5

Issue: No tax exemption if trustee is non-compliant

Submission

(Chartered Accountants Australia and New Zealand, KPMG,)

Proposed section HC 26 (1)(c) of the Income Tax Act 2007, that treats foreign-sourced income as exempt income only if the resident trustee has complied with the registration disclosure requirements and fulfilled their annual filing obligation, should not be enacted.

Imposing New Zealand tax on the worldwide income of a foreign trust is inconsistent with the scheme and purpose of New Zealand's tax legislation. Non-compliance with the new requirements should be dealt with by the application of penalties to the New Zealand-resident trustee, as provided for by the Tax Administration Act 1994 currently.

We are particularly concerned in this context about “accidental” foreign trusts.

If proposed section HC 26(1)(c) is not removed, the “foreign trust” definition should be limited to trusts established under New Zealand law.

Comment

Officials consider that removing the exemption for foreign-sourced income is an appropriate sanction for lack of compliance with the new requirements, and therefore disagree with the submission.

However officials acknowledge submitters’ concerns about the impact of the proposed new disclosure rules on so-called “accidental trustees” and the significance of the sanction for resident trustees who are not in the business of providing trustee services.

To address these concerns, officials agree with the recommendations of the Specialist Tax Adviser to the Committee that there should be additional concessions to ensure that the rules are easier to comply with for non-professional trustees.

First, the Specialist Tax Adviser recommends in her report that eligibility for the grace period should also be extended more widely to natural persons who are not in the business of providing trustee services, regardless of whether they are migrants or existing New Zealand residents. Officials agree with the recommendation. Officials also note that in “Issue: Grace period for new migrants – consistency with transitional residence rules”, it is also recommended that the grace period be extended from two years to four years to give these resident trustees more time to comply with the increased obligations.

For migrants, the grace period is calculated from the day they first become New Zealand-resident. For non-migrants, the start of the four-year grace period should be when the person first becomes a resident trustee of a foreign trust.

This extended grace period for non-migrants should be available regardless of whether the start date is before or after the enactment of the proposed legislation.

This would mean that for natural person resident trustees who are not in the business of providing trustee services and who would become liable to register their foreign trust *upon* enactment of the legislation, these trustees may have up to an additional four years to register. This means that natural persons, who are not in the business of providing trustee services and who have only become resident trustees of foreign trusts in the past few years, would have some additional time beyond 30 June 2017 to meet the proposed new disclosure requirements.

It was not considered appropriate to extend the grace period to existing resident trustees of foreign trusts more generally beyond 30 June 2017, as they already have an obligation to disclose information under the existing foreign trust disclosure rules. For example, if someone has been a resident trustee of a foreign trust for eight years, it would not be appropriate to give them beyond 30 June 2017 to register.

For resident trustees who would become liable to register a trust *after* enactment of the legislation, they will have four years from the date that they would have otherwise become liable to register that trust if they were in the business of providing trustee services.

In addition to the grace period, officials agree with the Specialist Tax Adviser's recommendation that there should be some additional concessions for natural person resident trustees who are not in the business of providing trustee services. In particular, to ensure that existing trusts are able to transition into the rules without significant compliance costs, the requirement to provide historical settlements for the trust on initial disclosure should be limited to the earlier of four years prior to either:

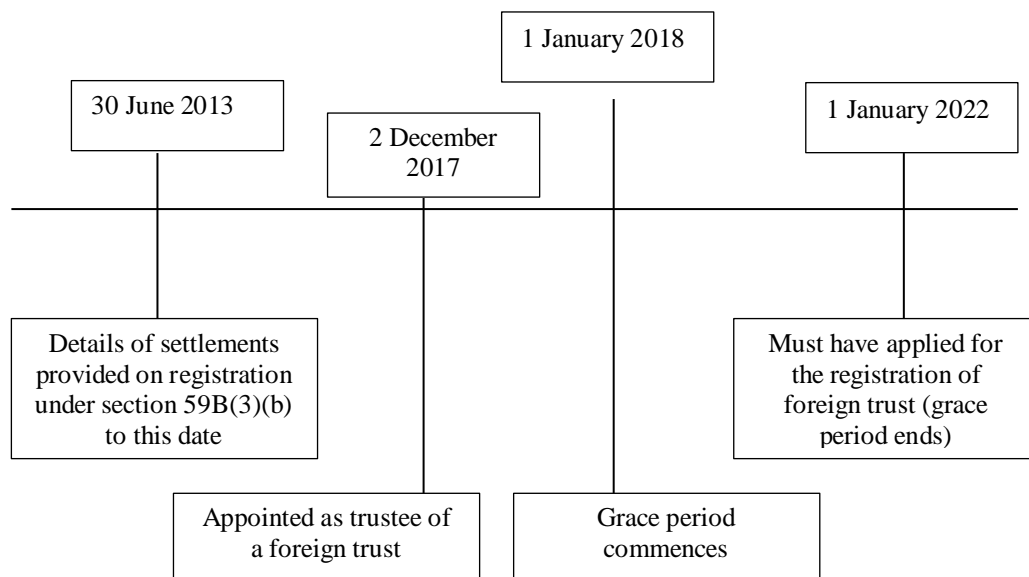
- the trustee's obligation to register commencing; or
- the application date of the legislation (30 June 2017).

As noted in "Issue: Registration and annual filing fee", officials agree with the Specialist Tax Adviser's recommendation that resident trustees who are not in the business of providing trustee services should be eligible to apply to the Commissioner for an exemption from registration and filing fees in relation to that trust.

Example 1: Four-year grace period

Ellie, a New Zealand-resident, was appointed a trustee of a foreign trust on 1 July 2013. She is not in the business of providing trustee services and is eligible for the four-year grace period. She will be required to apply for the registration of the foreign trust by 31 July 2017.

Example 2: Timeline of grace period



Recommendation

That the submission be declined but that officials' recommendations be accepted.

Issue: Trust must be registered before income derived to qualify for tax exemption

Submission

(Chapman Tripp, EY, New Zealand Trustee Companies Association Limited)

There is no policy justification to remove the current section HC 26 exemption from income tax for foreign-sourced income of foreign trusts with resident trustees who may not be required to register with the Commissioner under the registration provisions.

The new provisions are currently proposed to apply from enactment. This might happen at any point during a tax year or a trust's income year (if the trust does not have a 31 March balance date). Trustees will not have been able to register before enactment. It seems contrary to New Zealand's underlying policy of not taxing foreign-sourced income derived through foreign trusts to remove that exemption, effectively with retrospective impact, for the whole of an income year in which they may have already derived such income.

The proposed amendment to section HC 26 should be revised to ensure it applies only to subsequent income and to ensure trustees have a reasonable period to seek registration and provide all information required before the exemption ceases to apply. *(EY)*

Proposed section HC 26(1)(b) requires a trust to be registered before it derives any income. This seems excessive and unnecessary. A trust cannot register until it receives a settlement. From the point it receives a settlement it is likely to derive income making it necessary, it seems, to settle and register simultaneously. That is not likely to be practical. The requirement for

registration should be within a reasonable time. The current requirement under IR607 is 30 days. (*New Zealand Trustee Companies Association Limited*)

The current drafting does not achieve the policy objective of allowing an appropriate transitional period for existing foreign trusts to register. Accordingly, new section HC 26(1)(c) should be amended to avoid the loss of the foreign source tax exemption. (*Chapman Tripp*)

Comment

Officials agree that foreign trusts who meet the registration requirement before 30 June 2017 should be entitled to the tax exemption for income earned prior to their registration. Officials will revisit the drafting of this section to ensure the transitional outcome is achieved.

Recommendation

That the submission be accepted.

Issue: Strict liability for failure to comply

Submission

(*New Zealand Trustee Companies Association Limited*)

The main sanction for failure to comply with disclosure requirements seems to be loss of the tax exemption on offshore income (sections HC 26 and CW 54). That could be a very significant penalty.

There is no provision for trustees that do not meet even the most immaterial details of the information requirements set out in the proposed sections 59B and 59D.

It is submitted that exemptions along the lines of those in proposed section 142I (with respect to AEOI/CRS) should be included.

Comment

Officials agree that the exemption should still be available if a trustee makes a mistake in relation to registration or disclosure that is unintentional and remedied immediately. There should be a legislative provision that gives the Commissioner discretion to reinstate the exemption if she considers the mistake was unintentional and was remedied immediately.

Recommendation

That the submission be noted.

Issue: Clarification on whether tax exemption criteria to be applied on a year-by-year basis

Submission

(New Zealand Law Society)

Presumably the intention to treat foreign-sourced income as being liable to tax in New Zealand for failure to register relates only to income derived for that income year and not, if a trust is belatedly registered, for every year thereafter. In other words, the intention is that the criteria under section HC 26 are to be applied on a year by year basis, so that for:

- a new trust that fails to register within 30 days, or
- an existing trust that fails to register before 30 June 2017

foreign-sourced income could still be eligible for a tax exemption under section HC 26.

Presumably a failure to register within the required timeframe does not mean that the failure cannot be rectified for a later period, to bring the trust within the rules, however this ought to be made clear.

Comment

The eligibility for an exemption on foreign-sourced income of the trust will be assessed on a year by year basis. Accordingly, a foreign trust that fails to register on time will lose its exemption for that year. However, if it later registers and fulfils its annual reporting obligations it will be able to get to the exemption for those relevant years. Officials will consider whether the drafting could be made clearer.

Recommendation

That the submission be accepted.

OTHER ISSUES

Issue: Definition of a “foreign trust”

Submission

(KPMG, New Zealand Trustees Companies Association Limited, EY, Chartered Accountants Australia and New Zealand)

The term “foreign trust” is not defined for Tax Administration Act 1994 purposes. A definition of “foreign trust” for the proposed disclosure requirements is required.

Currently on establishment and until a distribution is made, a trust will not be a foreign trust. The proposed sections would not appear to apply in the interim. *(KPMG)*

For New Zealand income tax purposes, a foreign trust is defined merely for the purposes of determining the New Zealand tax status of distributions. The issues are complex but in short it would seem unlikely that any of the foreign trusts referred to in the media over the past few months would be “foreign trusts” with the result that none of the information disclosure rules in the bill would apply to them. This is obviously not intended. It is not obvious how the rules can be redrafted in a more satisfactory way. For example, information disclosure rules could apply to any trust the foreign income of which is tax exempt under sections HC 26 and CW 54, but that would apply on a year basis and it would only be apparent if a trust fell within the ambit of the rules at the end of the income year. *(New Zealand Trustees Companies Association Limited)*

The Income Tax Act 2007 definition of “foreign trust” may need amending to ensure the effectiveness of the bill's proposals, by replacing the words “in relation to a distribution” with wording along the lines “at any particular time” or “at any relevant time”. *(EY)*

Comment

The definition of a “foreign trust” is defined in the Income Tax Act 2007 for the existing disclosure requirements.

While the existing drafting does not appear to have caused significant uncertainty in practice, officials agree it would be useful to clarify in legislation that the definition of a “foreign trust” for the purposes of the disclosure rules in the Tax Administration Act 1994 applies to all trusts with a foreign settlor and a New Zealand-resident trustee, regardless of whether a distribution has been made.

Because this is a clarification of the existing law, officials recommend that this apply from the date of enactment of the legislation.

Recommendation

That the submission be accepted.

Issue: No resident trustee remaining in New Zealand

Submission

(Chartered Accountants Australia and New Zealand)

The amendments should clarify what, if any, obligations the trustees have in respect of a foreign trust registered under section 59B of the Tax Administration Act 1994 when the New Zealand-resident trustee leaves New Zealand and no New Zealand-resident trustees remain.

Proposed section 59D of the Tax Administration Act 1994 (annual return for foreign trust) and proposed section HC 25(1)(1)(c) of the Income Tax Act 2007 (exemption for foreign-sourced amounts) only apply to resident trustees of a foreign trust. In other words, if a foreign trust has no New Zealand-resident trustees, it appears the trustees have no New Zealand tax obligations. In our view, the new rules should set out the consequences of a foreign trust ceasing to have a New Zealand-resident trustee. Inclusion of specific rules will create certainty for the trustees of a foreign trust.

Comment

Officials note that if a trust with a foreign settlor has no New Zealand-resident trustees and no New Zealand income, there are no New Zealand tax obligations.

Accordingly, the trust will have no reporting obligation in New Zealand.

However, officials agree an amendment should be made to ensure the New Zealand-resident trustee is required to notify Inland Revenue if they cease to be New Zealand-resident.

Recommendation

That the submission be accepted.

MINOR DRAFTING ISSUES

Issue: Drafting issues raised by submitters

Clause 10

Submissions

(EY, Chartered Accountants Australia and New Zealand, Russell McVeagh, New Zealand Law Society)

The submitters raise a number of drafting issues:

- The reference to current section 59B(3) in section 22(7)(d) will be incorrect, the bill should amend section 22(7)(d) to impose the record-keeping obligation “other than during a grace period referred to in section 59C(3)”.
- Proposed section 59D(3)(b) should be clarified so that it is clear that it applies when section 59D(1)(b)(ii) applies. That is, a resident trustee must provide a return for the foreign trust by 30 June following 31 March if the foreign trust does not prepare financial statements.
- The official *Commentary* on the bill indicates that “year” in proposed section 59D(3) is to be construed as “tax year”, but this is not made clear in the bill. Proposed section 59D(2) should be amended to clarify that “year” means “tax year”.
- The words “all that is relevant to the trust of” in the opening line of proposed section 59B(3) are redundant, given the detailed list of items that must be disclosed which follow those words.
- It is not clear what is added by the words “when a distribution is made under the trust or when rights apparently vested under the trust are exercised” in proposed section 59B(3)(d). The Law Society recognises that such phrasing was suggested in the *Government Inquiry* report but the provision would appear to be effective if it simply read:
“for a discretionary trust, details of each class of beneficiary sufficient for the Commissioner to determine whether a person is a member of the class”.
- This provision also refers to the “country of tax residence”. This would be better expressed as “country, territory or jurisdiction of tax residence”.
- The reference in section 59C(3) to section 59C(2) appears redundant. The reference should be to section 59C(1) only.
- Proposed section 59C(2) includes the words “*except if subsection (3) applies*”.
“If a change to particulars provided on registration must be supplied within 30 days of the trustee becoming aware of the change, it is not clear why that 30-day requirement does not apply to an individual trustee who meets the requirements of subsection (3).”
- On applying to register, the date and detail of each settlement of the trust must be provided. Read literally, no trust will be able to comply as settlements can and do occur over time. A trustee will not have any details of future settlements.
- The reference in proposed section 59C(3)(b) to the trustee becoming New Zealand resident “on or after 1 October 2006” appears redundant, given that the grace period runs

from the time that residence is acquired and ends two years and 30 days after that date if the grace period ends after the date otherwise provided for in subsection (1) or (2).

Comment

Officials acknowledge these minor drafting points raised by submitters.

Recommendation

That the submissions be noted.

Issue: Clarifications regarding beneficiaries

Submission

(New Zealand Law Society)

The following clarifications are required regarding beneficiaries:

- Proposed section 59B(3)(d) requires, for a discretionary trust, “details of each class of beneficiary”. It is common for a discretionary trust to name specific individuals as beneficiaries. Proposed section 59B(3)(d) should be amended to refer to “each class of beneficiary (including a class consisting of one person)...”
- Proposed section 59B(3)(c)(v) requires details for “each beneficiary and nominee for an underlying beneficiary” to be provided to the Commissioner. The term “underlying beneficiary” is not defined and is not a concept recognised under the general law of trusts. Proposed section 59B(3)(c)(v) should be amended to require a trustee to provide details of each beneficiary and any nominee for a beneficiary.
- Proposed section 59B(3)(d) requires that a trustee of a discretionary trust provide sufficient information in respect of a class of beneficiaries “for the Commissioner to determine, when a distribution is made under the trust or when rights apparently vested under the trust are exercised, whether a person is a member of the class”. The reference to “rights apparently vested” is unnecessary. The term “distribution” is defined in section HC 14(1) of the Income Tax Act 2007 such that a trustee makes a distribution “when the trustee transfers value to a person because the person is a beneficiary of the trust”. The reference to “a distribution” in proposed section 59B(3)(d) is therefore sufficient to encompass all circumstances when a beneficiary benefits from a trust.

Recommendation

That the submission be noted.

Issue: Use of term “resident trustee”

Submission

(New Zealand Law Society, Russell McVeagh)

The bill uses the term “resident trustees” of a foreign trust. The Tax Administration Act 1994 and current section 59B uses the term “resident foreign trustee” which is defined in section 3 of the Tax Administration Act 1994. For clarity and to ensure that there is no difference in the application of the recordkeeping obligations under section 22 and the obligation to register and disclose information under proposed sections 59B to 59D, clause 10 should be amended to use the existing defined term “resident foreign trustee”. *(Russell McVeagh)*

Clause 10 contains a number of references to “resident trustee” (as does the heading to clause 5). This term is not defined. However, the term “resident foreign trustee” is already defined by section 3(1) of the Tax Administration Act 1994. This defined term should replace references in clause 10 to “resident trustee”, and the reference to “trustee” in proposed section 59B(3). *(New Zealand Law Society)*

Comment

Officials consider that this should be referred to drafters for consideration.

Recommendation

That the submission be noted.

MATTERS RAISED BY OFFICIALS

Issue: Registration and filing fees inclusive of GST

Submission

Currently the legislation is silent on whether the registration and annual filing fees are inclusive or exclusive of GST. Officials consider that the proposed registration fee of \$270 and the annual filing fee of \$50 will be inclusive of GST and that this should be made explicit in legislation.

Recommendation

That the submission be accepted.

Issue: Information sharing with the Overseas Investment Office

Submission

It is possible that for some trusts that meet the foreign trust definition (that is, they have a New Zealand trustee and a foreign settlor) may intend to invest in New Zealand assets.

Officials consider that Inland Revenue should be able to disclose information about a foreign trust where requested by the Overseas Investment Office (OIO), for the purposes of approving investment in sensitive New Zealand assets by overseas investors. This will allow the OIO to utilise relevant information when considering applications from overseas people who intend to invest in New Zealand.

Recommendation

That the submission be accepted.

Business transformation-related matters

ADMINISTRATION OF LATE PAYMENT PENALTY RULES – SUPPORT FOR THE AMENDMENT

Clauses 112 and 113

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The submitters support the amendment, and consider it to be a reasonable and pragmatic approach to take while Inland Revenue is operating tax types out of two software platforms.

Comment

Officials note the submitters' support for the proposed amendment.

Recommendation

That the submission be noted.

AMENDING THE RULES FOR NEW AND INCREASED ASSESSMENTS BY THE COMMISSIONER

Clauses 113(1) and (5), 115, 117 and 118

Submissions

(Chartered Accountants Australia and New Zealand, KPMG)

The proposal should not proceed:

- There is concern that it removes the long established grace period for taxpayers to pay tax which allows time for taxpayers to organise payment once the amount of tax was assessed. *(Chartered Accountants Australia New Zealand)*
- The amendments are unlikely to achieve the objectives of reducing taxpayers' interactions with the tax system and their risk of exposure to penalties and UOMI. *(Chartered Accountants Australia New Zealand, KPMG)*
- The only reason for the proposal seems to be cost savings for Inland Revenue. *(Chartered Accountants Australia New Zealand)*

Comment

The changes are designed to preserve the general principle to allow taxpayers time to organise payment in case of a new or increased assessment by the Commissioner. Taxpayers will have at least 30 days from date of the notice to organise payment without incurring late payment penalties or being subject to any collection actions. The proposed amendments will allow the earlier application of any credits or refunds that arise in the timeframe between notice of assessment and the date by which payment of the resulting tax is required. At present a taxpayer has to request any credit or refund to be applied to the tax due. Use-of-money interest on the new or increased assessment applies from the original due date for payment of the tax.

A wider review of the application of penalties including late payment penalties and interest in the future START system is currently being undertaken. This review will cover the setting of a new due date when a new or an increased assessment is issued. Officials see the proposed changes as an interim measure until we have reported to the Government on the outcome of this review.

In addition officials believe, contrary to the submitters' views, that taxpayers affected by the change will benefit from the proposal. This is because taxpayers affected by the relevant provisions are incurring UOMI from the date after the original due date and an early resolution or reduction of the assessed tax will reduce the exposure to UOMI.

Officials therefore consider the proposal should proceed.

Recommendation

That the submission be declined.

USE-OF-MONEY INTEREST AND TRANSFERS OF TAX

Clauses 106, 119 and 120

Issue: Support for the proposals

Submission

(KPMG, Chartered Accountants Australia and New Zealand)

The submitters support the proposal to limit transfers of tax to earlier periods for transfers within a taxpayer's accounts or to another taxpayer to the amount in debt and/or in dispute in that period. Submitters are also supportive of the proposal to clarify when a transfer takes effect for GST refunds and GST overpayments.

Comment

Officials welcome the support.

Recommendation

That the submissions be noted.

Issue: Limiting other transfers

Submission

(Matter raised by officials)

An amendment should be made to section 173S of the Tax Administration Act 1994 to ensure that transfers to earlier periods are limited to the amount in debt and/or in dispute in the requested transfer period for transfers of interest on overpaid tax.

Comment

The amendments to the transfer rules in the bill did not go far enough as they did not limit transfers of interest on overpaid tax to the amount in debt and/or dispute in the requested transfer period.

Recommendation

That the submission be accepted.

Issue: Definition of “deferrable tax”

Submission

(EY)

Clauses 119 and 120 of the bill propose amending sections 173L and 173M of the Tax Administration Act 1994 to limit the amount that can be transferred to an earlier period to the total of any debt and the taxpayer’s deferrable tax (tax in dispute) in that period at the requested date of the transfer.

The definition of “deferrable tax” should be amended to cover tax in dispute more comprehensively, by including tax subject to the Part 4A disputes process and tax for which a potential liability has been identified during an audit or investigation, even though no agreement or assessment has yet arisen and the formal Part 4A disputes process may not yet have started. The definition is currently limited to amounts in relation to which the person makes a competent objection under Part 8 or that the person challenges under Part 8A.

The definition of “deferrable tax” in section 138I of the Tax Administration Act 1994 should also be reviewed to accommodate potential liabilities identified in IRD audits or investigations and disputes under the Part 4A process.

Comment

The intention behind allowing a taxpayer to transfer an amount into an earlier period that has tax in dispute is to enable the taxpayer to reduce their liability to penalties and use-of-money interest should the dispute not be resolved in the taxpayer’s favour. Officials agree that using “deferrable tax” to refer to tax in dispute is too narrow. However, officials consider that the definition proposed by the submitter is too broad as it would allow the taxpayer to transfer tax to a prior period that was under audit or investigation, before the amount of the additional tax payable had been identified. As the additional tax payable would not have been identified, there would be no limit on the amount the taxpayer could transfer. This could give rise to taxpayers receiving more UOMI than otherwise entitled – the issue that this amendment was intended to prevent. In order to ensure the original intention is upheld, officials propose that the taxpayer’s tax in dispute for the purposes of the transfer rules should be limited to:

- the taxpayer’s deferrable tax for the period;
- an amount referenced in a notice of proposed adjustment issued by the taxpayer or the Commissioner for the period;
- an amount otherwise agreed with the Commissioner.

In relation to amending the definition of “deferrable tax” in section 138I, officials note that the submission would require further analysis and therefore officials will consider the issue’s priority for inclusion on a future tax policy work programme.

Recommendation

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

MATTERS RAISED BY OFFICIALS

Multiple statements and co-existence within START

Submission

There are current rules within the Tax Administration Act around the issue of statements of account and the cancellation of UOMI when a taxpayer pays the entire amount of tax, penalties and UOMI within 30 days of the issue of the statement.

The current configuration of Inland Revenue's FIRST system has an extremely complex process for tracking the issue of statements and the calculation of UOMI to be cancelled.

The current rules often result in a taxpayer paying more interest than is eventually charged to the taxpayer, leaving them with a small over-payment, which must be transferred or refunded. This is due to the statements indicating the UOMI charge to the date of the statement rather than the ultimate charge to the taxpayer.

Once all the main tax types are migrated to the new START environment the long-term solution is to move to a monthly billing cycle where UOMI will only be charged to an account at the same date every month. This will eliminate the need for the current 30-day rule.

To replicate the process for tracking statements to determine how much UOMI should be cancelled within START would be complex and involve considerable resources for what would be a limited 18-month life cycle until all taxes are migrated to the START environment, and the monthly billing cycle is introduced, which removes this issue.

A transitional solution is proposed to deal with the issue of multiple statements. This proposal will only affect goods and services tax within the START environment. The solution involves an amendment to section 183C of the Tax Administration Act, which practically, will mean no change for most taxpayers. This amendment will state that when a taxpayer receives a statement, no UOMI will be charged between the date of the statement and the date of payment of all the tax, penalties and UOMI charged on that statement if that date is within 30 days of the issue of the statement.

The only time this rule will not apply is when the liability to tax (being underlying tax only excluding penalties) is increased – in which case the 30-day period will reset.

Comment

We recommend that a clause be inserted in the bill to modify the current rule in section 183C of the Tax Administration Act 1994. This rule would provide that when a taxpayer receives a statement, no UOMI will be charged between the date of the statement and the date of payment of the total of that statement, as long as the period between the issue of the statement and payment is 30 days or less or the core tax liability excluding penalties is increased in which case the 30-day period will reset.

Recommendation

That the submission be accepted.

Prescribed forms

No clause

Submission

Currently the Commissioner of Inland Revenue can prescribe forms under section 35 of the Tax Administration Act 1994. There is, however, some concern that this section could be interpreted as requiring that information required under a prescribed form may have to be provided electronically or in writing. This would mean that declarations made under an Inland Revenue Act in a form prescribed by the Commissioner could not be made verbally (either by telephone or in person).

With some prescribed forms it is easier for taxpayers and more efficient for Inland Revenue if the information in the form and the declaration made in completing the form is able to be provided or made verbally.

There are also situations when Inland Revenue may wish to undertake an outbound calling programme to encourage taxpayers to register for different products or services. Again it would be more efficient if the registration could be completed based on the information provided verbally and would make outbound calling operations a more effective means of helping people to get their tax obligations right from the start.

Not all information will be permitted to be provided verbally. The proposed amendments will allow the Commissioner to dictate which “forms” can be provided verbally or in writing. A similar issue arises with “approved forms” in the Child Support Act 1991. Officials recommend this also be amended in the same manner.

Comment

We recommend that a clause be inserted into the bill to modify section 35 of the Tax Administration Act 1994 to clarify that information prescribed in a form can be provided to the Commissioner, in a manner permitted by the Commissioner.

We also recommend that a modification be made to the Child Support Act 1991 as this Act uses the term “approved form”. It is also proposed that this Act would be amended to clarify that information required in an “approved form” is allowed to be provided to the Commissioner in a manner permitted by the Commissioner.

Recommendation

That the submission be accepted.

Transitional regulations

OVERVIEW

As part of Inland Revenue’s business transformation, changes to legislation and administrative processes will be required in a range of areas, including supporting the upgrade to new technology. Some of these issues will require a prompt regulatory response to avoid the potential for delays to the transformation process. The proposed amendment would enact a regulation-making power to resolve any such transitional issues arising during the period of co-existence of two Inland Revenue Department software platforms.

Eight submissions were made on the proposed amendment. The submitters were divided over the need for the empowering provision. However, all the submitters raised concerns about the breadth of the scope of the proposed empowering provision. There were six main areas of concern raised by submitters. These were:

- whether the proposed regulation-making empowering provision is objectionable under rule of law grounds;
- whether the regulation-making power is justified in the circumstances;
- whether the general scope of the power is too broad;
- whether the empowering provision should be prevented from diminishing a taxpayer’s rights;
- whether the empowering provision should be prevented from increasing a liability; and
- whether certain parts of the Act should be excluded from the power.

All of the submissions are explained in more detail in the report.

Issue: Whether the proposed regulation-making empowering provision is objectionable under rule of law grounds

Submission

(New Zealand Law Society, Corporate Taxpayers Group)

The transitional override power is a “Henry VIII” clause and is objectionable on rule of law grounds. As a fundamental point, laws including tax laws should not be able to be changed by regulation, even if temporarily. The rule of law is a fundamental plank of New Zealand’s constitutional system, the suggestion in the Regulatory Impact Statement that it is of equal importance to cost efficiencies is of serious concern. This adds to the concern that Inland Revenue has failed to properly weigh the consequences of the transitional override powers. *(New Zealand Law Society)*.

Many commentators in New Zealand and in other countries have, over the years, criticised the use of such provisions. *(Corporate Taxpayers Group)*

Comment

Officials note that rule of law issues can be anticipated to arise if an urgent issue comes up during the transformation process. The question is whether transitional regulations are suitable for addressing the issue or not.

Professor John Burrows (QC) described transitional regulation-making powers as a “necessary evil in this modern complex legislative world”, in testimony to the Committee¹³ as part of its review of transitional regulation-making powers in November 2012. Professor Burrows also noted that:

It is not within the realms of human capability to foresee and provide for every eventuality in advance. There has to be a device for resolving this problem. An amending Act is not usually the answer because it is too slow and cumbersome, and would in any event weigh Parliament down with technical detail – if indeed it ever reached the top of the order paper. So the device most commonly used is to provide in the Act for the making of regulations to solve transitional problems which are not covered by the express transitional provisions in the Act itself.

There has to be a device to ensure that unforeseen happenings do not unduly impede an orderly transition from the old to the new. As already stated, regulation empowering provisions are often the most sensible solution. Principle at time has to give way to pragmatism, provided that it is properly controlled pragmatism.

Bill Moore (at the time, the Acting Chief Parliamentary Counsel, Parliamentary Counsel Office) in testimony to the Regulations Review Committee noted:

I think there has been an increase in the use of powers, ...— I really attribute this to three things. A lot of projects are dependent on successful implementation of new computer projects, and they almost never go to plan. You actually have an enormous rule of law dilemma here, because you can say, well, if something emerges late in the day, sorry the law says this, the computer system says that. And we can't change the computer system, because it's easier to change the law than the computer system.

So the dilemma is, and this is really from a rule of law perspective: do you say let us use these transitional regulation-making powers, arguably in a questionable way to at least say this is authorised by law until struck down or disallowed, or do you say we do nothing, in reality, and you can say well the rule of law means that we shall follow the law, but because the law is really in practice dictated by the computer it actually means that you're acting in breach of the law. So there's an interesting dilemma there about whether in fact, if you don't deal with these things that arise, whether that is in fact showing less respect for the principle of rule of law, because officials—or whoever Minister—say: “Well, we can't do anything about this. It's sort of administrative. We'll fix it up with some amendment having retrospective effect later.”

These observations, therefore, suggest that a rule of law dilemma arises if an urgent issue comes up during the transformation process whether transitional regulations are used to deal with the issue or not. For example, if retrospective legislation is used it will mean taxpayers have to apply the current law and run the risk the approach will be retrospectively undermined, or they have to ignore the current law and hope that the amendment is enacted as proposed.

¹³ *Regulation-making powers that authorise transitional regulations to override primary legislation* (Report of the Regulations Review Committee, I.16J, July 2014).

Officials have concluded, taking submissions into account that, appropriately drafted, a regulation-making power for the business transformation period can ensure that rule of law concerns are limited.

Recommendation

That the submission be noted.

Issue: Whether the regulation-making power is justified in the circumstances

Submission

(New Zealand Law Society, Chartered Accountants Australia and New Zealand, Deloitte, KPMG, Russell McVeagh, PwC)

Submitters had varying views on whether the regulation-making power is justified in the circumstances.

It is questionable whether the circumstances are sufficiently exceptional to justify the use of transitional override provisions in the present case. The use of such clauses is constitutionally unobjectionable when used to deal with unforeseen contingencies arising from the introduction of new legislation, although this is intended more for situations where there was an amalgamation of a large number of statutes rather than rewrites of an existing Act. The use of such clauses cannot be an acceptable substitute for a thorough and proper consideration of potential consequences from an IT upgrade and the use of tailored and appropriate regulations to address those particular potential consequences. The analysis does not appear sufficiently complete or convincing. The power should be removed from the bill, on the basis that the purported rationale for its inclusion did not meet the threshold requirements for creating such powers. Proposing such a provision without providing sufficient justification reflects a lack of appreciation of the seriousness and import of using transitional override powers. *(New Zealand Law Society)*

Although the proposal was well intentioned, it remained to be convinced that the case for its introduction is compelling. *(Chartered Accountants Australia and New Zealand)*

The motives behind the proposal are sound and that, on some occasions, it will be desirable to amend legislation without the need for the normal legislative process. However, there are insufficient taxpayer protections. *(Deloitte)*

It is accepted that in a project the size and scale of Inland Revenue's business transformation it is difficult to "know what you don't know". Although there is significant policy (and private sector) resource devoted to the project, perfect foresight is difficult to achieve. A regulation-making power to allow time for appropriate legislative amendments is necessary. *(KPMG)*

New Zealanders should be able to expect that Inland Revenue's new business systems would have been extensively tested prior to implementation (and appropriate contingencies built into the system to allow for any necessary changes after implementation). That said, the transition from the existing system may give rise to issues that require rapid technical amendments to the law. *(Russell McVeagh)*

Permitting primary legislation to be amended by way of regulation risks undermining the rule of law. It would also deviate from the Generic Tax Policy Process. Nevertheless, there is support in principle for conferring these regulation making-powers for the limited purpose of facilitating the business transformation process, where these powers are subject to sufficient safeguards. (PwC)

Comment

A general principle is that the use of transitional regulations is justified if there are exceptional circumstances and the regulations are demonstrably essential.¹⁴ Officials consider there is adequate justification for the proposed power while appreciating the seriousness and import of using transitional override powers. Specifically, officials consider the current circumstances satisfy the requirement to be exceptional and are demonstrably essential given the nature and scope of Inland Revenue's transformation process.

Officials note that Inland Revenue's business transformation process is the largest public sector transformation process ever undertaken and is exceptionally complex. As noted above, Professor Burrows and Bill Moore both noted that transitional regulations are useful in situations involving computer systems changes, given the difficulties with changing computer systems.

Given the size of the transformation process it needs to be undertaken in four stages. During each of these stages the rules and processes of a different part of the tax system will be transferred from the old system to the new system. This means that during the entire period of the transformation, there will be different parts of the tax system in different systems. This will significantly increase the likelihood of transitory issues arising (similar to the grace periods issue that is being remedied in the current bill). Coupled with this is the detailed nature of the Tax Administration Act 1994, which increases the likelihood of legislative issues arising.

Recommendation

That the submissions be noted.

Issue: Whether the nature of the transition supports the introduction of the power

Submission

(New Zealand Law Society)

Professor Burrows' comments (suggesting that transitional regulations were often used during information system transformations) related to an existing system that needs to be upgraded to meet the requirements of the new law. The present case is somewhat different. Inland Revenue put forward two situations where the transitional override powers may need to be used:

- The first situation – providing a bridge between the current process in the old computer system and the correct process in the new computer system – seems to fit within the scope of Professor Burrows' comments.
- The second situation – “when the new computer system offers a more efficient or different process to that currently legislated” – does not. This seems to be a situation where

¹⁴ Report of the Committee on Ministers' Powers 1932, Cmnd 4060 (The Donoughmore Report).

potential technological advantage is driving legislative change through delegated legislation. While that may be administratively convenient, it is not an exceptional circumstance nor demonstrably essential.

Comment

Officials understand the submitter's concern about technological advantages driving legislative change. Whether this gives rise to an exceptional circumstance will depend on the issue but officials consider the power should only be used in exceptional cases of this nature. Officials also note that Professor Burrows specifically referred to the child support and student loan transformation projects as examples of situations when the computer system affected the need for transitional regulations. Officials consider that the same two situations (noted by Professor Burrows) arose during the implementation of those reforms, and will also arise during the current Inland Revenue transformation.

Officials note it will not be appropriate to use transitional regulations to remedy an on-going issue with the new information system, given the regulations temporary nature. Instead, any on-going issues with the new system will need to be remedied by legislative amendment. However, there may be situations when it is appropriate to provide a temporary transitional provision to bridge to the new provision.

Recommendation

That the submission be noted.

Issue: Consideration of the specifics of the transition

Submission

(New Zealand Law Society)

Insufficient thought has been given to the specifics of the transition and the types of transitional override powers that are likely to be needed. Stating that it is impossible to anticipate where issues may arise in a transition is not an acceptable substitute for a thorough consideration of what may occur.

Comment

Inland Revenue is thoroughly considering whether the legislation fully supports the transition and as a result has already identified legislative issues that need to be addressed. These have been identified early enough to be remedied through the normal legislative process. Officials note that three such issues are being remedied in the current bill. We are concerned, however, that despite our best efforts not all issues will be identified sufficiently early. In those limited number of circumstances, an urgent remedy will be needed to provide certainty for taxpayers and to prevent delays to the transformation process (and increased costs).

Recommendation

That the submission be declined.

Issue: Whether the general scope of the power is too broad

Submission

(New Zealand Law Society, Chartered Accountants New Zealand and Australia, Chapman Tripp, Corporate Taxpayers Group, Russell McVeagh, KPMG)

Regulations to override primary legislation should be drafted in the most specific and limited terms possible. The proposed provision does not meet that principle. The expressed reasons for the provision are in relation to resolving issues between two software platforms. However, the provision does not make any reference to resolving such issues, or even to the software platforms. If the provision is needed, it should be expressly limited to resolving issues arising from the transition between software platforms. *(New Zealand Law Society)*

As currently drafted the empowering provision effectively provides the Minister of Revenue (on the advice of officials) with an almost unfettered regulation-making power to amend the Tax Administration Act 1994 where he considers it “necessary or desirable” to do so “for the orderly implementation of the business transformation process”. Overriding the normal legislative process in relation to an Act with such broad application and extensive powers raises serious questions of principle. Should a transitional empowering provision be enacted, its scope needs to be much narrower than currently drafted. The scope should be limited to regulations that are necessary (or critical) to enable compliance with, or the administration of, the substantive legislation that Inland Revenue administers (the Inland Revenue Acts). *(Chartered Accountants Australia and New Zealand)*

The proposal is too broad, allowing substantive changes to be made to the law without the checks and balances of the standard legislative process. *(Chapman Tripp)*

New Zealanders should be able to expect that the relevant systems deployed in the course of Inland Revenue’s business transformation will have been thoroughly tested prior to implementation (and appropriate contingencies built into the system to allow for any necessary changes after implementation). The proposal should be more targeted, and should contain safeguards to protect against taxpayers’ substantive rights under the Tax Administration Act 1994 being adversely affected by regulation. *(Corporate Taxpayers Group)*

A clearer articulation of the rationale for the regulation-making is required. The touchstone should be that the power may be exercised only where, as a result of business transformation, it is necessary to amend the Tax Administration Act to administer one or more of the Inland Revenue Acts and where the amendment is not inconsistent with the purposes of the primary legislation. *(Russell McVeagh)*

The regulation-making power is unfettered, and so taxpayers’ rights might be abrogated. This is compounded by the fact that the object is indirectly described, as there is no definition of “business transformation process”. The submitter accepted that the power was not intended to affect substantive rules in the Income Tax Act 2007 and the Goods and Services Tax Act 1985, but the border between administrative and core provisions is not clear. Focusing on what the regulations are intended to cover and on what the business transformation process is should assist in a better description of the key issue. *(KPMG)*

Comment

Officials agree that the regulation-making power was intended to be limited to resolving issues arising from the transition between FIRST and START. Officials agree that the purpose could be clarified in the provision to better describe this transitional process and thus to limit its scope.

Officials note that submitters also raised some specific proposals to limit the scope of the empowering provision. The specific proposals are discussed in the issues below.

Recommendation

That the submission be accepted, and recommend that the provision be specifically limited to resolving issues arising from the transition between FIRST and START.

Issue: Whether the empowering provision should be prevented from diminishing taxpayers' rights

Submission

(New Zealand Law Society, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, KPMG, Deloitte, Chapman Tripp)

The empowering provision should not allow a regulation that alters a right of a taxpayer to dispute or to challenge a tax liability or decision of the Commissioner, or the application of the statutory time bar. *(New Zealand Law Society)*

The empowering provision should not be able to remove or diminish the rights of any taxpayer under Part 4A (Disputes Procedures), Part 5 (Determinations), Part 5A (Binding Rulings), Part 8 (Objections), Part 8A (Challenges), Part 11 (Remission, Relief and Refunds). *(Corporate Taxpayers Group, Deloitte)*

Regulations made under the regulation-making power should only be made if the effect is taxpayer favourable. *(Chartered Accountants Australia and New Zealand)*

Parts 4A, 8 and 8A provide taxpayers with rights of challenge to the Commissioner's decision. It imposes time obligations on taxpayers and the Commissioner. It would be inappropriate for the regulations to waive requirements on the Commissioner to do certain things within a certain time to the detriment of taxpayers. This limitation is not obvious on the face of the proposed section. This may be achieved by a wide limitation which prevents a regulation from increasing taxpayer liabilities or abrogating taxpayer rights. *(KPMG)*

There should be a safeguard in the rules preventing the Governor-General from making regulations that detrimentally affect taxpayers. This safeguard would reflect Parliament's intention to make the business transformation programme work, without penalising taxpayers. *(Chapman Tripp)*

Comment

Officials agree that the proposed regulation-making power should not be able to remove or diminish the rights of any taxpayer under Part 4A (Disputes Procedures), Part 5 (Determinations), Part 5A (Binding Rulings), Part 8 (Objections), Part 8A (Challenges), or Part

11 (Remission, Relief and Refunds). The requirement that any proposed regulations would have to be consistent with the current policy was intended to prevent any amendments that would diminish taxpayers' rights. However, given the apparent lack of clarity as to whether this was achieved, officials recommend that the drafting be amended to expressly provide this.

Recommendation

That the submission be accepted and recommend that the empowering provision should specifically provide that it is not able to remove or diminish the rights of any taxpayer under the relevant parts.

Issue: Whether the empowering provision should be prevented from increasing a liability

Submission

(New Zealand Law Society, Chapman Tripp, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand)

The empowering provision should not allow a regulation that has the effect of imposing or increasing a liability for tax, use-of-money interest or penalties not already imposed under the primary legislation. *(New Zealand Law Society)*

There should be a safeguard in the rules preventing the Governor-General from making regulations that detrimentally affect taxpayers. This safeguard would reflect Parliament's intention to make the business transformation programme work, without penalising taxpayers. *(Chapman Tripp)*

No transitional regulations should result in a taxpayer being subject to any liability exceeding the taxpayer's liability under this Act if no regulation were made under the proposed provision. *(Corporate Taxpayers Group)*

Regulations made under the regulation-making power should only be made if the effect is taxpayer favourable. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials agree that that the empowering provision should not result in a taxpayer being subject to any liability exceeding the taxpayer's liability under this Act if no regulation had been made under the proposed provision. Officials recommend amendments to ensure this is the case.

Officials note this would significantly reduce the ability of the power to remedy transitional issues and would increase the likelihood that urgent taxpayer-unfriendly issues would need to be remedied by legislation passed under urgency or with retrospective effect. Using retrospective amendments to remedy such issues may arguably be less consistent with the rule of law, as noted by Bill Moore (at the time, the Acting Chief Parliamentary Counsel, Parliamentary Counsel Office) in testimony to the Regulations Review Committee.

Officials note, however, that ensuring that the regulations could not increase a taxpayer's liability will balance taxpayers' concerns with the need to deal with any urgent issues that may arise.

Recommendation

That the submission be accepted and recommend the empowering provision be amended so that it cannot result in a taxpayer being subject to any liability exceeding the taxpayer's liability under this Act if no regulation had been made under the proposed provision.

Issue: Whether certain parts of the Act should be excluded from the power

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, KPMG, Russell McVeagh)

If the regulation-making power is to be enacted its application should be limited to certain Parts of the Tax Administration Act 1994. A number of Parts / Subparts of the Act should be excluded from the scope of the regulation-making power either because they provide critical protections for taxpayers and / or should not create the IT system transitional issues that the regulation-making power is intended to address. The regulations made under the power should only affect the provisions in the Tax Administration Act 1994 that relate to the reporting, payment and collection of tax. By way of example, Part 3 of the Act includes sections which prescribe and restrict the Commissioner's rights to access premises, remove and copy documents and require the provision of information from a taxpayer. These rules are long-established and fundamental to the integrity of the tax administration system. Amending them in any way by a regulation would compromise the integrity of New Zealand's tax system. *(Chartered Accountants Australia and New Zealand)*

Various provisions of the Act should be protected from amendment by regulation. *(Corporate Taxpayers Group, Deloitte)*

The provision should exclude from its scope various provisions of the Act, being provisions that set out the fundamental rights of a taxpayer and obligations of the Commissioner. Given the significance of these provisions, any amendment should be a matter for Parliament, and not for the Executive by Order in Council. Further, it is difficult to imagine issues arising from the business transformation process ever requiring rapid amendment provisions. *(Russell McVeagh)*

The power should not allow a regulation that alters Part 2 of the Act (which contains the care and management provisions in sections 6 and 6A), or any of the provisions relating to the Commissioner's information gathering rights, privilege and non-disclosure in sections 16 – 21 (inclusive), or Parts 4 (Secrecy), 5 (Determinations) and 5A (Binding Rulings). *(New Zealand Law Society)*

Comment

Officials agree that certain parts of the Act will not be affected by the IT system changes. Additionally, given that the relevant administrative rules and processes are not dependent on automation it is very unlikely that there will be an urgent need to fix any issues in respect of the provisions. As a result, officials agree that the following provisions can be excluded from the scope of the provision:

- the care and management provisions in sections 6 and 6A;
- the information provisions in sections 16 to 21;
- the secrecy provisions in Part 4;
- a shortfall penalty under sections 141 to 141K;
- a criminal penalty under sections 143 to 148.

Officials think that it would be appropriate to include within the scope of the empowering some provisions within Part 9. The relevant provisions relate to the penalties that are imposed automatically, and exclude those relating to shortfall penalties and criminal penalties. The use of the regulation-making power for penalties that are imposed automatically would, however, only be appropriate in conjunction with the recommended requirement that there can be no increased liability for taxpayers under the empowering provision. In other words, the empowering provision should only be able to amend the application of the relevant penalties when it would maintain or decrease the amount of the penalty.

Officials consider it might be appropriate to have the ability to deal with any issues that may arise with the transition of the penalties that are automatically imposed (that do not result in an increase in liability for a taxpayer).

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Whether the “necessary or desirable” standard is appropriate

Submission

(New Zealand Law Society, Chartered Accountants Australia and New Zealand)

The empowering provision should require any regulations to be “necessary” for the implementation of business transformation, rather than “necessary or desirable”. *(New Zealand Law Society)*

The phrase “or desirable” should be removed. The phrase “or desirable” suggests changes that are not necessary but might be “nice to have”. The sole determining factor for application of the regulation-making power should be what is necessary for the orderly implementation of the business transformation process. *(Chartered Accountants Australia and New Zealand)*

Comment

The use of the phrase “necessary or desirable” is consistent with numerous previous transitional regulation-making provisions. Examples of when the phrase has been used in previous transitional provisions include the Child Support Amendment Act 2013, Financial Markets Conduct Act 2013, Local Government (Auckland Transitional Provisions) Act 2010, Student Loan Scheme Act 2011, and the Financial Advisers Act 2008. There are advantages in having a consistent form of words, as differences in words can lead to arguments that the words have differences in substance. However, officials also accept that the use of boilerplate provisions is not always appropriate.

Officials note that submitters have concerns with the use of the phrase in the current context. Officials accept that the phrase could be misinterpreted, so agree that it is more appropriate to require any regulations to be “necessary” for the business transformation.

Recommendation

That the submission be accepted and recommend removing the reference to “desirable”.

Issue: Consultation for empowering provision

Submission

(New Zealand Law Society, Chartered Accountants Australia and New Zealand, KPMG, Russell McVeagh, Corporate Taxpayers Group)

The consultation relating to the introduction of the regulation-making power has been inadequate. A transitional override power is a matter of great concern, and should be given full consideration, including proper public consultation. It should not be introduced through supplementary order paper. *(New Zealand Law Society)*

The regulation-making power should have been subject to the normal public consultation process under the first stage of the Generic Tax Policy Process (GTPP) with a proposal based on the outcome of that consultation then included in the bill. Including a proposal of such importance in a Supplementary Order Paper is inappropriate. The submitters believe that the lack of consultation on the proposal and the inclusion of it in the bill by Supplementary Order Paper mean that there has been limited opportunity for it to be properly thought through and that it is being implemented in haste. The opportunity should have been taken to consult on the issue and the options to address it prior to the bill’s introduction. *(Chartered Accountants Australia and New Zealand)*

Any amendments to the Supplementary Order Paper should be further publicly consulted. Consultation was undertaken within government but no public or private consultation was undertaken. Any amendments to the Supplementary Order Paper would normally only be apparent when the bill is reported back by the Select Committee. Given the potentially wide application of this provision, the Select Committee should invite further submissions on any proposed amendments to the Supplementary Order Paper. *(KPMG)*

A more meaningful opportunity should have been allowed for consultation on this proposal. It was submitted that officials should consult further with interested parties on the drafting. *(Corporate Taxpayers Group)*

Comment

Officials accept that the usual Generic Tax Policy Process (GTPP) was not followed in developing this policy.

Consultation was undertaken with the Legislation Design and Advisory Committee (LDAC), Crown Law, the Ministry of Justice and the Treasury. This consultation resulted in the clarification in the scope of the empowering provision. No wider consultation was undertaken on the proposal because of time constraints. The time constraints resulted from the need to have the proposal enacted as soon as possible given the benefits of the transitional regulation-making

provision and the timing of the transformation process. Officials acknowledge that the lack of wider consultation raised the risk that potential problems with the proposals had not been fully identified.

Officials agree that the proposal could benefit from further consultation with interested parties on the drafting.

Recommendation

That the submission be accepted and recommend that submitters be consulted on the drafting of the proposed empowering provision.

Issue: Consultation on the regulations

Submission

(New Zealand Law Society, PwC, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)

The consultative process for making the regulations should be a meaningful one, as it is a procedural check to ensure that the power is used appropriately. *(Corporate Taxpayers Group)*

The level of consultation for any exemptions or regulations made under the provision should be more clearly defined and meaningful, given the potential impact of exemptions and regulations. *(New Zealand Law Society)*

The bill should prescribe the following minimum standards for the consultative process in relation to a proposed regulation, before a Minister may recommend that regulation to the Governor General:

- consultation with the New Zealand Law Society and Chartered Accountants of Australia and New Zealand (or successor bodies);
- a minimum four-week period of public consultation; and
- a report from officials as to the outcome of consultations including:
 - a summary of submissions received;
 - indications as to the extent to which submissions are adopted; and
 - reasons for declining submissions not adopted. *(PwC)*

The consultation process for the introduction of regulations should state with whom the Minister is required to consult before making a regulation, as is required under section 21C(2) of the Tax Administration Act 1994. Specifically, it was submitted that the Minister of Revenue should have to consult with professional accounting and legal bodies that the Minister decides it is reasonable to consult with. This amendment to the section will make the decision-making process more robust and alleviate some of the perceived risks associated with legislative change by regulation. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials agree that the consultation process for the regulations will be important because it is a procedural check to ensure that the power is used appropriately. Officials also agree that the consultation process should be defined in the provision to give affected parties reassurance that their interests will be properly considered.

Officials consider given the remedial nature of the proposed power, and the fact that it is recommended to amend the power so it could not increase a liability or diminish taxpayer rights, there should not be a minimum period of consultation. Instead, officials recommend the period of consultation should be considered on a case-by-case basis.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Whether regulations should be subject to Parliamentary confirmation

Submission

(New Zealand Law Society)

The empowering provision has a sunset clause with a life of more than three years. The Regulations Review Committee has expressed a number of principles that ought to be followed concerning time limits on transitional override provisions including that regulations made pursuant to such a provision should be subject to parliamentary confirmation.

Comment

Officials note that no previous transitional regulation-making provisions have been subject to parliamentary confirmation despite having sunset periods longer than three years or no expiry dates. We note that Professor Burrows in testimony to the Regulations Review Committee described the confirmation process as cumbersome and as probably going beyond what is necessary.

Recommendation

That the submission be declined.

Issue: Whether the time limit on the empowering provision is appropriate

Submission

(New Zealand Law Society)

The empowering provision expires on 31 December 2021, which is over the three-year lifespan suggested under the Regulations Review Committee guidelines. The presumed reason is that this is when the entire transition process should be completed. However, it is not clear why it is

expected that there would still be issues between the two pieces of software (FIRST and START) right up until the last day of the proposed transition.

Comment

Officials consider there may be transitional issues until the last processes and rules are transferred over to the new system. There may be administrative processes that need to be carried on in both IT systems until then. As a result, officials consider that 31 December 2021 is the most appropriate sunset date.

Recommendation

That the submission be declined.

Issue: Whether the time limit for the transitional regulations is appropriate

Submission

(New Zealand Law Society, Chartered Accountants Australia and New Zealand)

While regulations made under the provision would have a sunset period of three years, the principle is that the three-year timeframe is an upper limit, not an aim. It is not clear that consideration has been given to whether the three-year period is necessary or appropriate in this case. *(New Zealand Law Society)*

The timeframe for repealing regulations made under the empowering provision should be reduced from three years to two years. A two-year deadline for repealing any regulations should give sufficient time for any underlying substantive IT system transitional issues to “self-resolve” or be addressed through the normal legislative process, should that be required. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials agree that the three-year period should be the maximum recommended timeframe for transitional regulations, rather than the default period. Officials consider this is consistent with the current drafting of the provision which allows regulations to have a sunset period of up to three years. Consideration was given to whether a shorter sunset period would be workable. However, the three-year period was considered appropriate given the complex nature of the transformation and the fact that the different parts of the tax functions will be in different systems for some time. This supports having a three-year sunset period for transitional regulations. Officials will need to consider the appropriate sunset period for any specific regulations keeping in mind that the three-year period is the maximum and not the default period.

Recommendation

That the submission be declined.

Issue: Whether substantive issues should be dealt with by legislative amendment

Submission

(Chapman Tripp)

If there are substantive issues arising from the business transformation programme, these should be dealt with under the standard legislative process.

Comment

Officials note that the empowering provision is limited to amendments that are consistent with the existing policy and contains other limitations both currently in the bill and from the recommendations in this report. This means substantive issues, that involve a change in policy, would have to be dealt with under the standard legislative process. As a result, officials consider no amendments to the empowering provision are needed in respect of the submission.

Recommendation

That the submission be noted.

Issue: Whether the empowering provision suggests that the IT system will dictate policy changes

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Russell McVeagh)

The regulation-making power should not be used as a means of avoiding costs that would otherwise need to be incurred to customise Inland Revenue's new software. The regulation-making power should not be used as a cost-saving measure to avoid customising of the START system. If the current law is not able to be translated into the new system without customisation the full Parliamentary process should be followed. *(Chartered Accountants Australia and New Zealand)*

A major aspect of the problem definition underlying the proposal is a concern that the complexities associated with the business transformation process may give rise to situations in which the relevant IT system has not resulted, or will not result in, the tax system being administered according to law. This in itself is cause for concern, as it suggests that regulations may be used to validate a systems-driven outcome that is otherwise inconsistent with the legislation as set down by Parliament. That is, the IT system would dictate what the law should be, not the other way around. *(Corporate Taxpayers Group)*

The proposal may promote a "systems-driven" approach to the administration of the tax system. That is, if regulations can be used to validate a "systems-driven" outcome that is otherwise inconsistent with the legislation as set down by Parliament, the regulation-making power could be used to amend the law to validate what the systems says. The system should reflect what the law says. *(Russell McVeagh)*

Comment

Determining what the best policy approach is to any issue includes determining the administrative costs for Inland Revenue as well as the range of other standard policy considerations. As a result, officials consider that one of the factors that will continue to be relevant in determining the best approach to a tax issue will be the IT costs of setting up the solution, and the on-going IT administrative costs.

If the issue is merely transitory then the temporary IT costs may be a significant element in determining the best approach to take to the issue. For on-going issues in the new system, the initial IT costs will be less significant in relative terms.

Recommendation

That the submission be noted.

Issue: Whether the changes to the care and management provision should be given priority

Submission

(Chartered Accountants Australia and New Zealand)

Inland Revenue's review of the care and management provisions in the Tax Administration Act 1994 and the role of subordinate legislation in the tax system should be given priority.

The Commissioner's care and management provisions are being reviewed as part of a broader project on the Tax Administration Act 1994. That review is likely to consider the merits of increased use of administrative solutions to resolve smaller and narrower tax administration issues.

The review should address the balance required between the need for pragmatic and quick solutions on the one hand and the need for ministerial and parliamentary oversight of any substantive changes on the other.

A wider conversation about the role of subordinate legislation in a tax context needs to be part of this workstream. The bill already includes a number of regulation and determination powers (in Part 1). It also proposes changes which could be usefully used as test cases for determining the boundary between legislation and subordinate legislation.

Comment

Inland Revenue has published an interpretation statement concerning the Commissioner's care and management responsibilities taking into account the New Zealand legislative provisions and the approach of the New Zealand courts.¹⁵ The statement views the "care and management" responsibility as two interrelated responsibilities. First, the Commissioner is charged with the "care of the taxes". Secondly, the Commissioner is charged with the "management of the taxes". This means that she is responsible for making managerial decisions in the interests of bringing about the efficient and effective administration of the tax system. This involves the

¹⁵ Interpretation statement "Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994", *Tax Information Bulletin* Vol 22, No 10 (November 2010).

Commissioner exercising judgement in how she carries out her duties and the relative resource she allocates to Inland Revenue's functions.

Importantly, the Commissioner's view is that she can manage and allocate resources but cannot deliberately act contrary to her view of the correct interpretation of the law. Some important implications of this are that the Commissioner cannot:

- disregard the requirements for the lawful exercise of powers and discretions conferred by other provisions;
- alter taxpayers' obligations and entitlements;
- issue extra-statutory concessions;
- administratively remedy legislative errors and other deficiencies;
- interpret provisions other than in accordance with statutory interpretation principles contained in the Interpretation Act 1999 and court decisions; or
- act inconsistently with the obligation to use her best endeavours to protect the integrity of the tax system.

Inland Revenue is currently reviewing the care and management provision as part of the policy stream of work related to its business transformation process. The review is considering whether to provide the Commissioner with a power to remedy minor or transitory legislative anomalies in limited situations. The proposed extension would not be limited to tax administration issues and is not limited to transitory issues during the business transformation process but would apply generally on an on-going basis. Given the broader nature of the proposed extension to the care and management provision, it is considered appropriate to consult widely on that proposal. This issue is expected to be included in a discussion document on the Tax Administration Act which will be released in the near future.

The role of subordinate legislation in the tax administration system is also being reviewed in the same discussion document.

As a result, officials consider neither option is an appropriate substitute for the transitional regulations in the current proposal.

Recommendation

That the submission be declined.

Issue: Whether there should be a searchable database of any transitional regulations

Submission *(Deloitte)*

It is inevitable that some provisions will be suspended or amended under the proposed power. This is likely to result in increased compliance costs faced by taxpayers and their advisors because they may be unable to look up the Act to determine the current law. To minimise these

compliance costs, there will need to be a searchable database of regulations created by Inland Revenue under this proposed power.

Comment

Officials consider if the proposed empowering provision is enacted it is likely to be used sparingly. From 2001–2014, only 14 regulations were made under six of 25 Acts containing transitional provisions. This suggests that the powers are not used very often. Officials consider it is likely that the current power (if enacted) would similarly be used sparingly (especially if the recommended changes in this report are adopted).

Any regulations made under the power will be Orders in Council and so will be published on the New Zealand Legislation website. They would also be published on Inland Revenue’s policy website.

Recommendation

That the submission be declined.

Issue: Whether any regulations made should be referred to the Regulations Review Committee

Submission

(KPMG)

The regulations are subject to Parliamentary scrutiny and revocation if found to be invalid. This is important protection for taxpayers. However, the regulations made are likely to be time critical. They will likely apply within a short time of being issued as well as lasting only for a short time.

Judicial review and other protections for taxpayers are unlikely to be of practical use to aggrieved taxpayers. The section should therefore require immediate reference to the Regulations Review Committee for early review.

Comment

Following discussions with staff from the Regulations Review Committee, officials think it would be contrary to commonly established practice to legislate for a Parliamentary process, such as legislating that all regulations would need to be referred to the Regulations Review Committee for early review. Officials note that the Legislation Advisory Committee Guidelines do not suggest such an approach.

Recommendation

That the submission be declined.

Issue: Whether a case study should be published to illustrate the intended effect

Submission

(KPMG)

The Regulatory Impact Statement (RIS) and other documents proceed on the basis that the potential regulations are unknown. However, in the “grace period” rules, the bill already contains an example of a business transformation issue against which the regulation-making power can be tested.

If the regulation-making power was already in place, potentially, this issue could have been dealt with by regulation.

A published case study on this (whether a regulation would have been made, why or why not, its detail) would provide comfort on the intended effect and application of the power.

Comment

Officials agree that under the proposal the grace periods issue could have been dealt with by a transitional regulation if there had not been sufficient time to remedy it by legislative amendment. The details of the issue are set out in the *Commentary* to this bill.

In short, the current tax rules impose a late payment penalty if a taxpayer does not pay on time. If, however, the taxpayer has punctually paid all relevant taxes due in the two years before the default in question, the Commissioner must first issue a notice to the taxpayer specifying a further date for payment of the unpaid tax, before a late payment penalty can be imposed. This gives the taxpayer a grace period in which to pay the amount owing before late payment penalties are imposed. Application of the late payment penalty grace period is determined on the basis of the taxpayer’s previous compliance in terms of the payment of tax across all relevant tax types (such as GST, income tax and PAYE deductions).

The transition from Inland Revenue’s FIRST to START system will be done on a tax-type basis, in four stages, with GST being transferred in early 2017 and income tax, FBT and PAYE scheduled to be transferred in 2018. This raises an issue in relation to the late payment penalty grace period, as the current legislative framework for the application of the penalty requires the Commissioner to consider the taxpayer’s compliance history across all applicable tax types. As information relating to the taxpayer’s tax compliance history and payment activity will reside in two software systems, it will be difficult for the Commissioner to look across all applicable tax types to determine whether the taxpayer is entitled to a grace period without significant manual intervention.

A proposed amendment in the current bill will enable the Commissioner to look only at tax information about a taxpayer’s compliance history held in the system from which the tax type in payment default is being administered.

Inland Revenue identified the issue in time to remedy it by legislative amendment, so there was no need to remedy it by regulation. If hypothetically there had been insufficient time to remedy the issue by legislative amendment then there could have been a regulation to provide a similar remedy (but one that would be limited to up to three years). The details of the regulation are likely to have been similar to the proposed amendment in the current bill. Under the recommended proposal, before any regulation could be made to remedy the hypothetical issue, consultation would need to have been undertaken with appropriate accounting and legal bodies

including providing a copy of the proposed regulations. Any regulations made under the proposal would be subject to disallowance.

Officials will consider a suitable example to include in the *Tax Information Bulletin* on the bill.

Recommendation

That the submission be accepted.

RETROSPECTIVE APPLICATION OF EMPOWERING PROVISION

Clause 120B

Submission

(Matter raised by officials)

Following their formal submission to the Committee, the New Zealand Law Society raised concerns with officials about whether the empowering provision should be prevented from having retrospective application.

The Society noted that if the power could not increase a liability under the Act or remove or diminish a right under the relevant parts, then any issues that had a retrospective aspect to them could be remedied by the Commissioner's care and management powers. Specifically, the Society believed that the Commissioner could acknowledge that the system had operated in a more favourable way but, in order to maintain the integrity of the tax system, and taxpayers' perceptions of that integrity, in circumstances where (but for the transition) she was satisfied with the operation of the system, she would not collect the additional amounts, and would move to introduce correcting legislation at the earliest opportunity. The Society's concerns were that allowing the power to apply retrospectively would undermine the rule of law.

Comment

Officials agree that the empowering provision should be prevented from having retrospective application. However, officials accept that a possible implication of preventing the empowering provision from applying retrospectively, would be that it would not provide certainty to taxpayers in some situations.

Officials agree that in a situation when the system had operated in a more favourable way than legislated for, the Commissioner could decide not to allocate resources to determining which specific taxpayers had benefited from the favourable treatment in past periods. Officials consider deciding not to allocate resources would be within the scope of the care and management power.¹⁶

However, Inland Revenue's view is that the care and management power does not allow the Commissioner to administratively remedy legislative errors and other deficiencies, or issue extra statutory concessions. This means the Commissioner would have to apply the law correctly going forward. This would mean that either resources would have to be committed to altering FIRST or the law would have to be changed to deal with the transitional issue (that is, until the concessional treatment could be remedied under START).

If the transitional regulation could not apply retrospectively, there would be situations when it would not provide certainty for taxpayers. In other words, without a regulation, taxpayers would not be sure the favourable treatment would not be reversed. For example, as the Commissioner cannot administratively remedy legislative errors, if a taxpayer was under audit and its assessment was subsequently amended, the Commissioner would have to apply the law correctly (which would result in the favourable treatment being reversed).

¹⁶ Interpretation Statement IS 10/07: Care and management of the taxes covered by the Inland Revenue Acts – section 6A(2) and (3) of the Tax Administration Act 1994.

Taxpayers could see this as unfair as they would be disadvantaged compared with other taxpayers with similar discrepancies that were discovered earlier (that is, before the favourable treatment was discovered).

However, officials agree that on balance the risk to the rule of law outweighs the possible disadvantages to taxpayers.

Recommendation

That the submission be accepted, and the empowering provision be prevented from applying retrospectively.

Student loan interest exemption

SUPPLEMENTARY ORDER PAPER NO. 229 TO EXTEND THE STUDENT LOAN INTEREST EXEMPTION FOR STUDY OVERSEAS TO RECIPIENTS OF NEW ZEALAND GOVERNMENT-FUNDED SCHOLARSHIPS

Clauses 121AA and 122

Submission

(Matter raised by officials)

As part of the International Connections for New Zealanders Budget 2016 package, Government proposed a number of policy changes which, together, would encourage more New Zealand citizens and New Zealand permanent residents to study outside New Zealand as part of their New Zealand qualification. The package included increased funding for the Prime Minister's Scholarships for Asia and the establishment of the Prime Minister's Scholarships for Latin America. However, it is inconsistent for the Government to provide funding for overseas study while requiring the recipients of that funding to pay interest on their student loans and make repayments based on their loan balance rather than their ability to pay.

Comment

Student loans are interest-free for New Zealand-based borrowers. In addition, student loans remain interest-free for borrowers who go overseas for 183 consecutive days or less and who have lived in New Zealand for at least 183 days before leaving. Further, the exemption from interest is extended to borrowers who go overseas principally to study full-time for longer than six months provided they meet specific criteria. However, those criteria limit the interest exemptions to full-time study at Level 7 or above on the New Zealand Qualifications Framework, whereas the purpose of the Prime Minister's Scholarships and other government-funded scholarships is broader than academic scholarship (e.g. they aim to identify the scholar's potential to build connections that can be later used in the person's career, not just academic scholarship). Furthermore, Government scholarships may be targeted to students studying or undertaking internships at lower levels of study. Excluding the scholarship recipients from the interest exemption is inconsistent with the policy objectives of providing consistency and clarity across funding policy settings and developing new international connections and capabilities for New Zealanders.

The proposed amendments to the Student Loan Scheme Act 2011 (the Act) in the Supplementary Order Paper would extend interest-free student loans to recipients of New Zealand Government-funded scholarships, including the Prime Minister's Scholarships to Asia and Latin America. The scholarship recipients may be studying full-time or undertaking an internship that is full-time or part-time with study.

The proposed amendment to section 25 of the Act adds two new situations in which the Commissioner may treat borrowers as being physically in New Zealand (and eligible for interest-free student loans).

The proposed amendments to Schedule 1 of the Act set out the conditions that must be satisfied by borrowers who apply under the new provisions in section 25:

- The conditions for overseas study are that the borrower must receive a qualifying government-funded scholarship for the study and undertake the study overseas on a full-time basis.

- The conditions for overseas internships are that the borrower must receive a qualifying government-funded scholarship for the internship and undertake the internship overseas on a full-time basis, or a part-time basis if combined with study.

Recommendation

That the submission be accepted.

Miscellaneous matters

TIMEFRAME FOR SUBMISSIONS

No clause

Submission

(Corporate Taxpayers Group)

It would be preferable if more time was provided for submitters to consider the amendments to this bill, particularly given the bill has fundamental changes to the way taxes are paid that impact many taxpayers. A shorter consultation runs the risk that issues with this legislation may not be picked up or not be given sufficient attention given the limitations on submitters' resources to achieve this within the imposed timeframe.

Comment

The bill contains amendments to business tax that apply from 1 April 2017 as well as amendments to implement the G20/OECD standard for *Automatic Exchange of Financial Account Information in Tax Matters* that applies from 1 July 2017. It is important that the bill is enacted in time for taxpayers to implement these changes.

Recommendation

That the submission be declined.

LAND REMEDIALS – RLWT AND BRIGHT-LINE

Clause 92

Issue: Amending the definition of “offshore RLWT person” for limited partnerships and look-through companies

Submission

(Matter raised by officials)

The recently introduced residential land withholding tax regime is intended to apply to certain disposals of residential land when the land is disposed of by an “offshore RLWT person”. The definition of “offshore RLWT person” is critical to the operation of the regime. The definition refers to limited partnerships and look-through companies.

For limited partnerships, the RLWT rules are intended to apply at the partnership level for limited partnerships given their separate legal status, despite their look-through status for tax purposes. This separate legal status results in the residential land being registered in the name of the limited partnership. Consequently it is the limited partnership that disposes of the residential land which means the limited partnership will be liable for any RLWT.

The same issue arises for look-through companies; the RLWT rules are intended to apply at the company level given a look-through company’s separate legal status, despite their look-through status for tax purposes.

The current definition of “offshore RLWT person” requires clarification to ensure that the definition applies at the limited partnership level (rather than the partner level which is the case for ordinary partnerships) and at the company level for look-through companies.

Recommendation

That the submission be accepted.

Clause 102B

Issue: Certificate of exemption requirements

Submission

(Matter raised by officials)

RLWT does not apply when the vendor who is disposing of the residential land holds a certificate of exemption for RLWT that relates to the land that is being disposed. A certificate of exemption may be issued to a vendor who is in the business of developing land, dividing land into lots or erecting buildings, if the vendor meets certain criteria. One of these requirements is that the vendor needs to have complied with their tax obligations in the two years before they apply for the certificate of exemption. Meeting this requirement is difficult for entities that have been specifically set up for a particular development. These special purpose entities are often

limited partnerships or companies and are often associated with other taxpayers who would be able to meet this requirement.

To help newly formed entities meet this requirement, it is recommended that the certificate of exemption requirement in section 54E(3) be amended to allow another taxpayer closely associated with the newly formed entity to meet the two-year good compliance history requirement on behalf of the newly formed entity. This amendment would only apply to partners in a limited partnership and members of a wholly owned group of companies because of their close connection with the newly formed entity.

This matter was also raised by submitters during submissions on the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill.

Comment

The certificate of exemption for RLWT rules is an important part of the RLWT regime for property developers, sub-dividers of land and builders who would otherwise be liable for RLWT on residential land disposals. The recommended remedial will assist with the issuing of these certificates to newly formed entities.

Recommendation

That the submission be accepted.

Clause 91B

Issue: Relationship property – RLWT

Submission

(Matter raised by officials)

Relationship property may be transferred from one partner in a relationship to another following the breakdown of a relationship. Relationship property will often include residential property. It was not intended that these residential property transfers would be subject to any RLWT liability because the transfer results from a relationship property agreement rather than a disposal of residential property to another party. An amendment is required to ensure that these types of transfers are not caught under the RLWT rules. It is noted though that any subsequent disposal of the relationship property may be subject to RLWT under the ordinary rules.

Recommendation

That the submission be accepted.

Clause 91D

Issue: RLWT calculation – GST

Submission

(Matter raised by officials)

Section RL 4 sets out how to calculate RLWT but does not state whether or not RLWT calculations are done net of GST. The policy intent is that RLWT is calculated net of GST on the basis that income and deductions are net of GST for income tax purposes. Therefore it is recommended that this point be clarified in section RL 4.

Recommendation

That the submission be accepted.

Clause 91C

Issue: Technical amendment to RLWT rules

Submission

(Matter raised by officials)

Section RL 2 sets out when vendors must pay RLWT and how that payment is made. The section includes references to the defined term “residential land purchase amount” which is the amount that triggers a RLWT liability. A remedial amendment is required to fix a drafting oversight in section RL 2(6) and (8) where the word “amount” was omitted from the term “residential land purchase amount”.

Further, the heading to section 54C of the Tax Administration Act 1994 requires a remedial amendment to ensure the section heading accurately describes the purpose of the section. It is recommended that the title of the section is changed to “Information in relation to RLWT” to reflect that the section sets out the information requirements for determining whether RLWT applies.

Recommendation

That the submission be accepted.

Issue: Change of trustees – bright-line test

Submission

(Matter raised by officials)

The bright-line test in section CB 6A is intended to apply to disposals of residential land where the land was owned for less than two years. The bright-line test was intended to supplement the existing land rules by targeting short-term speculation in the residential housing market. The bright-line test applied to disposals of interests in land when the interest was acquired on or after 1 October 2015.

For the purposes of the bright-line test, section CB 6A(1) sets out what date the two-year bright-line period begins from. Generally this period will start from when the instrument to transfer the residential land is registered. When a trust owns land and there is a change to the trustees, a new instrument is registered to reflect the change of trustee event. This change of trustee affects the timing of the bright-line period because it is linked to the date of transfer and the registration of the new instrument reflecting the change of trustees. It was not intended that these types of transfers would trigger the application of the bright-line test because the trust property has not been disposed of to another party.

An amendment is proposed to ensure that a change of trustee does not trigger the application of the bright-line test in section CB 6A.

Recommendation

That the submission be accepted.

Clause 55B and 55C

Issue: Technical amendment – application for date for section CB 15B(3)

Submission

(Matter raised by officials)

A remedial amendment is required to fix a drafting oversight in relation to the application date of the recently enacted amendments to section CB 15B(3). The amendment relates to determining the date land is acquired when it is acquired through the exercise of an option. It is intended that the amendment apply from the date of enactment of the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016.

Recommendation

That the submission be accepted.

AGENCY PROVISIONS – UNINTENDED LEGISLATIVE CHANGE

Submission

(Matter raised by officials)

Section HD 3 contains an unintended legislative change arising from the rewrite of Income Tax legislation. This should be corrected.

Comment

The agency rules in subpart HD apply to a person declared to be an agent for income tax purposes on behalf of a principal who is not present in, or who is a non-resident of, New Zealand. Some of the agency rules relate solely to business activity and some relate to non-business activity, such as income earned from passive investment by absentee non-resident insurers.

The rewrite of the agency rules into the Income Tax Act 2007 inadvertently restricted all of the agency rules to business situations. This has resulted in an inability to collect income tax from agents when a business activity does not exist.

Some taxpayers have relied on the existing law in taking tax positions prior to this proposed amendment. Therefore, officials recommend the unintended legislative change be corrected on a prospective basis, from date of enactment of the bill. This would protect tax positions already taken.

Recommendation

That the submission be accepted.