Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Bill

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

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Making Tax Simpler – employment income information

OVERVIEW

A good tax system means having both good tax policy settings and good administration systems. These elements need to go hand in hand. The tax system includes social policies administered by Inland Revenue: Working for Families tax credits, child support, student loan repayments, KiwiSaver and paid parental leave.

Inland Revenue is modernising New Zealand's tax administration through business process and technology change to make it simpler and more certain for New Zealanders, and to reduce the compliance and administration costs of the system as a whole (known as Inland Revenue's Business Transformation (BT) programme).

A key design feature of the BT programme is to integrate tax obligations and reporting requirements into normal business processes to reduce compliance costs for businesses. In doing so, the tax obligation then becomes part of a wider process rather than an additional step required by the tax system. As part of the BT programme, progressive changes to support and frame the modernisation of tax and social policy administration are being made.

A major part of the business transformation changes involve more efficient and timely provision of information to Inland Revenue. The Bill contains two sets of proposals relating to the provision of:

- employment income information and related deductions from that income; and
- investment income information and the tax withheld.

This section of the report deals with employment income information.

Employment income information

Improving the administration of the pay as you earn (PAYE) system is an integral part of the BT programme. The decision to employ staff exposes an organisation to a range of regulatory requirements including PAYE obligations which can add significant compliance costs.

Increasingly employers are using software to help them run their organisations. This Bill therefore proposes changes to take advantage of modern digital systems to reduce compliance and administrative costs associated with the PAYE process by making meeting tax obligations, such as the provision of information, part of their process of paying employees rather than a separate and additional activity.

A key design principle in the proposed PAYE reforms is for Inland Revenue to receive employment income information on a "payday" rather than the current aggregated (monthly) basis. Payday information would detail the PAYE income and deductions made from employees each payday and would be due with Inland Revenue within a number of working days after payday determined by employer size and the payroll systems they use.

Eliminating the current requirement for employers (or their systems) to aggregate this information over a month before sending it eliminates a step and should enable some errors to be identified and rectified more quickly. This should improve the accuracy of PAYE. For example, it will be more readily apparent where an incorrect tax code is being used or where an individual could benefit from using a special tax code.

In addition payday information will enable Inland Revenue to improve the administration of social policy by providing a sound basis to ensure that employees transitioning off benefits receive their proper entitlements. Payday reporting will also create a foundation for a reduced assessment period for Working for Families tax credits and child support. A reduced assessment period would help ensure that periods of assistance better match periods of need.

There was general support for the payday return of employment income information. However, a number of submitters proposed that seven working days was insufficient time for small employers who choose to continue to file a paper-based return. In addition, several submitters proposed that the time allowed to file "non-standard" information, such as that relating to out-of-cycle pays, schedular payments or shadow payrolls, should be longer than two (or seven) working days.

All those who submitted on the subject of the proposed repeal of the payroll subsidy opposed its repeal on 1 April 2018, some suggesting that it should be better targeted and others proposing that the question of repeal should be revisited when the changes recommended in the Bill had had a chance to "bed in".

REPEAL OF THE PAYROLL SUBSIDY AND THE LISTED PAYE INTERMEDIARY STATUS

Clauses 129(1), 151(1), 167, 168, 171, 172(32), (42) & (64), 187(22) & (25), 188, 190, 191, 193, 280, 281, 317 and 318

Issue: Retention of payroll subsidy

Submission

(KPMG, BusinessNZ, Datacom Employer Services, Chartered Accountants Australia and New Zealand, ANZ, MYOB, Payroll Intermediary Industry (on behalf of MYOB, Datacom, Flexitime, iPayroll, Simply Payroll, Crystal Payroll and Thankyou Payroll))

Submitters universally recommended that the subsidy not be repealed from 1 April 2018.

The subsidy plays an important role in assisting micro employers, in particular, in meeting their PAYE compliance obligations. *(KPMG)*

The possible removal of the subsidy would be better examined once all significant tax compliance changes have been passed and the business community has had some time to understand and comply with the new settings. Any steps toward the removal of the subsidy should not be taken until 1 April 2019 at the earliest. *(BusinessNZ)*

Instead of repealing it, consideration should be given to amending the subsidy threshold so that it targets very small employers. *(Chartered Accountants Australia and New Zealand)*

The proposal should be removed in favour of reducing the threshold of application for the subsidy. Any decision to remove the subsidy should be delayed at least until 2020 when an assessment of the effectiveness of the new reporting arrangements can be made. *(Datacom Employer Services)*

The subsidy should be maintained but it should better target eligibility by lowering the threshold to $100,000 of PAYE and ESCT per annum (*MYOB*) or to small businesses. (*Payroll Intermediary Industry (MYOB, Datacom, Flexitime, iPayroll, Simply Payroll, Crystal Payroll and Thankyou Payroll))*

The removal of the subsidy should be paused and the question of repeal reviewed after the implementation of the Business Transformation programme. (*MYOB, Payroll Intermediary Industry (MYOB, Datacom, Flexitime, iPayroll, Simply Payroll, Crystal Payroll and Thankyou Payroll))*

Comment

The payroll subsidy subsidises only one model of payroll service and potentially distorts the payroll service and product market. The proposed repeal is part of a set of proposals that overall are intended to improve the administration of PAYE by taking advantage of modern digital systems to reduce compliance and administrative costs. Because the subsidy only subsidises payroll services provided by listed PAYE intermediaries it is not well designed to support the broader objective of encouraging the use of digital systems and software.

Officials consider that there is some merit in the recommendation to retain the subsidy but target it better at small employers in the short term then revisit the question of its repeal once the payday reporting of PAYE information has bedded in. Officials have begun discussions with Ministers on whether they wish to revisit the repeal of the subsidy from 1 April 2018.

Recommendation

That the submissions, and officials' comment, be noted.

Issue: Retention of listed PAYE intermediary status

Submission
(MYOB, Payroll Intermediary Industry (on behalf of MYOB, Datacom, Flexitime, iPayroll, Simply Payroll, Crystal Payroll and Thankyou Payroll))

The submitters recommend the retention of the listed PAYE intermediary status as they have played an important part of the payroll landscape for the last 10 years in providing a service layer between Inland Revenue and small employers by being responsible for the PAYE obligations of those employers.

Comment

Both PAYE intermediaries and listed PAYE intermediaries take on the PAYE obligations of the employer although only listed PAYE intermediaries are able to claim the payroll subsidy.

There is no legal requirement for the Commissioner to publicly identify those who can provide tax services to the public, and whether she continues to publish a list is a matter for the Commissioner to determine in the context of care and management of the tax system.

Recommendation

That the submission be declined.

Issue: Redesign of the subsidy to be a service payment

Submission
(MYOB (on behalf of MYOB, Datacom, Flexitime, iPayroll, Simply Payroll, Crystal Payroll and Thankyou Payroll), Chartered Accountants Australia and New Zealand)

MYOB considers that if the payroll subsidy is retained, it should be redesigned as a service level payment. The submission reflects the view that if a payroll subsidy was not paid some currently subsidised employers would do their own payroll and, because of their relative lack of payroll knowledge, more assistance would be required from Inland Revenue. Instead of viewing the payment as a "subsidy" which encourages employers to outsource their legal obligations around PAYE, this submission suggests the subsidy becomes a "payment" recognising that Inland Revenue has outsourced the provision of advice to this segment of the market.

Comment

Currently, all rules in relation to listed PAYE intermediaries and the payroll subsidy are contained in the legislation, which is a consistent way of regulating PAYE intermediaries. Legislation is more transparent than a contractual arrangement and any PAYE intermediary who is considering becoming a listed PAYE intermediary can give a clear understanding of all requirements, rights and obligations by simply checking the publicly available legislation. In addition, it could be claimed that by entering into a contractual arrangement, Inland Revenue has "appointed" a payroll intermediary as its agent. This puts Inland Revenue at risk that the actions of the payroll intermediary are seen as the actions of Inland Revenue.

Officials therefore do not consider that the payroll subsidy should be redesigned as a service level payment.

Further, PAYE intermediaries are not the only service providers who manage the payroll including completing PAYE returns for employers. Payroll bureaus, book keepers and some tax agents also perform this function and, if the subsidy was reframed in the manner recommended by the submitters, it would be difficult to exclude these other third party providers.

The service that PAYE intermediaries provide which other third parties do not is to take over the legal responsibility for discharging employers' PAYE obligation. In officials' view, this can only ever be a service provided to employers and not to Inland Revenue.

Recommendation

That the submission be declined.

Issue: Subsidy should be paid direct to employers

Submission
(Chartered Accountants Australia and New Zealand)

The payroll subsidy should be paid to the employer, not to the PAYE intermediary.

Comment

While paying the subsidy to the employer might encourage competition between listed PAYE intermediaries, the current design is intended to minimise compliance costs for employers and administrative costs for Inland Revenue. Under the current legislation, the subsidy is paid directly to listed PAYE intermediaries when they submit a subsidy claim form identifying the employers for whom they have "run payrolls" during the month.

Officials believe this submitter's proposal would result in greater compliance costs for 30,000 employers compared with the current 20 listed PAYE intermediaries. Employers on whose behalf the subsidy is paid would need to keep records of how often their payroll had run and for how many employees, and they would have to file claims with Inland Revenue in order to claim a subsidy designed to relieve them of record keeping and filing obligations. The current design also reduces administrative costs for Inland Revenue as the subsidy is only paid to the approximately 20 listed PAYE intermediaries, not approximately 30,000 employers.

Recommendation

That the submission be declined.

PAYDAY PROVISION OF EMPLOYMENT INCOME INFORMATION

Clause 200

Issue: Support for moving to payday provision

Submission
(PwC)

The submitter supports the proposal to move to payday filing of employment income information. Moving employment tax information reporting requirements into an employer's existing pay cycle is simpler than the current process of filing Employer Monthly Schedules and Employer Deduction Forms separately and once implemented should reduce compliance costs.

Recommendation

That the submitter's support be noted.

Issue: Inland Revenue should provide a free basic software package

Submission
(Chartered Accountants Australia and New Zealand)

The submitter suggests that the Government should reconsider the option of Inland Revenue developing its own basic payroll software suitable for small employers and making it freely available. A basic payroll system does not need to include all the features usually associated with a computerised payroll system, such as holiday pay entitlement calculation. This would facilitate the provision of employment income information digitally by small employers, minimising their compliance costs.

Comment

Designing and maintaining payroll systems is not Inland Revenue's core business. PAYE and related deductions are only a small part of what a payroll system must do to meet employers' needs, including meeting other regulatory obligations such as those imposed by the Holidays Act 2003. A simple system which excluded features like holiday pay, such as suggested by the submitter, could mislead employers into believing they had met their payroll obligations when they had not. In addition, providing an entry level payroll system could put Inland Revenue in competition with providers of payroll software whose active participation Inland Revenue requires to transform the PAYE system.

Inland Revenue will continue to provide an online calculator that employers will be able to use to calculate the amount of PAYE and related deductions to be withheld from a payment of salary or wages.

It is intended that, as part of business transformation changes, employers who have used the calculator will be able to save the calculations directly to an "on-screen" employment income form, accessed through myIR, which will include pre-populated information such as employee details. The ability to export information from the calculator to the "on-screen" form will eliminate the need to manually enter the information which should eliminate a source of error as well as reduce compliance costs.

Recommendation

That the submission be declined.

Issue: Setting electronic and non-electronic filing requirements

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to require the Commissioner to prescribe both electronic and non-electronic forms and means of delivery for employment income information.

Recommendation

That the submitter's support be noted.

IMPLEMENTATION DATES

Clause 2(28)

Issue: Support for application dates

Submissions
(KPMG, Chartered Accountants Australia and New Zealand)

Submitters support a 1 April 2019 mandatory application date. It provides employers with sufficient time to transition to the new employee income reporting requirements. *(KPMG)*

Another supports the proposal to allow employers to adopt payday filing from 1 April 2018. *(Chartered Accountants Australia and New Zealand)*

Recommendation

That the submitters' support be noted.

Issue: Longer implementation timeline

Submission
(MYOB)

For a successful implementation of the payday reporting proposals there needs to be further engagement on the design of the scheme and longer implementation timeframes. Based on similar experience in other jurisdictions, there should be at least two years for implementation and transition to the new rules.

Comment

Officials consider that the current implementation timelines are adequate. Employers, payroll intermediaries and payroll software developers should have about a 12 month lead-time before it will be mandatory to provide employment information on a payday basis. Inland Revenue is working with payroll software developers and employers who wish to be early adopters of payday reporting from 1 April 2018.

Recommendation

That the submission be declined.

EMPLOYERS (AND PAYE INTERMEDIARIES) TO FILE DIGITALLY WITHIN TWO WORKING DAYS OF PAYDAY (ONLINE GROUP)

Clause 200

Submission
(KPMG, Chartered Accountants Australia and New Zealand)

One submitter expressed support for the proposal to classify employers over the electronic filing threshold as part of the "online group". Members of this group are required to provide employment income information in electronic form within two working days after payday. Also, they support the classification of employers who are below the electronic filing threshold as part of the online group if they use payroll software. *(Chartered Accountants Australia and New Zealand)*

In contrast, another submitter stated that requiring such employers and payroll intermediaries to provide PAYE information within two working days may put undue pressure on employers. The impetus for a two working day reporting rule is unclear. The provision should occur within seven working days of the payday to allow employers to better manage their compliance costs. *(KPMG)*

Comment

The underlying premise for moving to payday reporting is to better integrate PAYE obligations into normal business processes. The information to be provided to Inland Revenue will be available as a result of the payment of salary or wages to employees. The proposal removes the need for this information to be stored and retrieved to complete the employer monthly schedule. Allowing up to seven working days to file the information reduces the incentive to file the information as part of finalising the payroll process, which undermines the potential for savings.

Recommendation

That support for the proposal be noted, and that the submission suggesting that two working days be extended to seven working days be declined.

REPORTING AD HOC IRREGULAR AND OTHER UNUSUAL PAYMENTS

Clause 200

Issue: Out-of-cycle (ad hoc) payments of salary or wages

Submission

(Corporate Taxpayers Group, Deloitte, ANZ,)

The submitters note that many large employers make several pay runs a week in addition to their regular payday(s), once various extra pays and out-of-cycle pays are taken into account. The requirement to report out-of-cycle pays on a payday basis could significantly increase compliance costs.

One submitter proposed that such out-of-cycle payments could be better managed by having a minimum period such as a week for reporting on such payments or they could be included in the regular salary or wages pay run. *(ANZ)*

Comment

Employees must be paid wages "when they fall due". The employer may set a pay period frequency and payday when what is due for that period is paid. This is referred to in what follows as the "regular payday". Some employers have different pay periods and different regular paydays for different classes of employee. Out-of-cycle pays are not an employment law requirement but are made by employers as part of their good employer obligations.

Officials acknowledge the concerns that submitters have raised in relation to out-of-cycle payments of salary or wages. Officials note however that some providers of payroll software responded negatively to the prospect that employers could hold the reporting of such payments over until the next regular pay. Payroll providers were concerned that this would encourage employers to process out-of-cycle pays outside the core payroll system and subsequently add the information back in, a practice which risks errors and omissions.

Officials therefore recommend that employers should have the ability to report out-of-cycle pays on a payday basis or to report the out-of-cycle payments with the next regular payment of salary or wages.

The ability to include out-of-cycle pays with the next regular pay run would however be subject to an exception which would prevent the out-of-cycle pay being reported with the next regular pay run where the delay would carry the reporting over the end of a PAYE "payment period".[1] This exception would require the employer to report such out-of-cycle pays in an ad hoc report, treating the payments as if they were made on any date up to the end of the employer's payment period.[2] This exception is necessary to enable the amount paid and the amount reported to be reconciled.

[1] The largest employers have two payment periods in a month, amounts withheld from payment made between the 1st and the 15th of the month must be paid by the 20th and amounts withheld from payments made between the 16th and end of the month must be paid by the 5th of the following month. All other employers must pay amounts withheld during the calendar month by the 20th of the following month.

[2] The flexibility to choose a date up to the end of the payment period would allow an employer who had made several out-of-cycle pays on different days to aggregate them and report them in one additional report.

If, for example, an employer with a monthly payment period makes an out-of-cycle payment to an employee after the last regular payday in the month, but before month end, the Income Tax Act 2007 requires them to pay the PAYE on that amount by the 20th of the following month. If the employer held reporting over into the next regular payday, it would be reported as if the payment to the employee had been made on that subsequent regular payday. In this event the amount paid to Inland Revenue would not match the information provided by the employer. To prevent this, such payments would need to be reported out-of-cycle so that they relate to the correct payment period.

Mon	Tue	Wed	Thurs	Fri	Sat	Sun
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30	31	

(shaded)	Regular paydays.
(bold lines)	Out of cycle pays which if reported with the next regular pay would be included with reports for the month.
(hatched)	Out-of-cycle pay which, if the information is held over to the next regular payday (in the next month), would be reported as if it had been paid in the subsequent month. This would give rise to a "mismatch" with the amount of PAYE paid for the earlier month which would include deductions made on the 29th.

Officials are investigating whether this exception will be required once PAYE is fully processed within Inland Revenue's new computer system, which will not be before 2020. It is likely that any solution would require changes to payroll software, as well as to Inland Revenue's systems, and so would need to be fully assessed and consulted on before it could be introduced.

Recommendation

That the submission be accepted so that employers are allowed to include reporting on out-of-cycle payments of wages and salary with the next regular payday report, except where this would carry information over beyond the end of a PAYE payment period.

Issue: Reporting of schedular payments

Submission

(ANZ, EY, Deloitte (oral))

Proposed section 23D(1) of the Tax Administration Act 1994 should include a separate group for employment income information in relation to schedular payments, with monthly reporting similar to the current EMS process retained for schedular payments. Many schedular payments are administered outside of payroll. Requiring payday reporting of such payments will create additional compliance costs. *(EY)*

Regular reporting of schedular payments should be on a fortnightly basis. *(ANZ)*

In their oral submission, Deloitte outlined concern about how schedular payments would be managed on a payday basis.

Comment

Officials understand that many employers pay schedular payments via their accounts payable system which may not be capable of directly reporting to Inland Revenue. In this situation the information would need to be sent to payroll before being filed with Inland Revenue. In addition, schedular payments, like out-of-cycle payments, may be made on a frequent basis. Unlike out-of-cycle payments to wage and salary earners considered above, there is however no "regular payroll" to which schedular payments naturally belong.

More frequent reporting of PAYE income is a core objective of the proposed PAYE reforms and a response to this issue requires an appropriate trade-off between the competing objectives of more frequent reporting and reduced compliance costs. In addition, the rules should be as simple as possible while catering for employers in different circumstances.

Officials consider that employers should have the option of payday reporting schedular payments, but if they choose not to, any schedular payments made between the 1st and the 15th of the month should be reported at a time convenient to the employer but, at the latest, as if the payment(s) had been made on the 15th. Payments made between the 16th and month end should be reported, at the latest, as if they were made at month end.

This formulation would allow an employer with only occasional schedular payments to include them with a regular payday report for salaried employees, except where the schedular payment was made after the last regular pay in each half-monthly period. In those cases the employers would need to file a one-off return. Employers with large numbers of schedular payments could however aggregate them and report all such pays made between the 1st and the 15th as if they were paid on the 15th and all schedular payments made in the second half of the month as if they were paid on the last day of the month.

Recommendation

That the submissions be accepted, and the option of twice monthly reporting be added for schedular payments.

Issue: Shadow payrolls for internationally mobile employees

Submission

(ANZ, Corporate Taxpayers Group, Deloitte (oral), EY)

Submitters explained that employers of internationally mobile employees working in New Zealand may have PAYE reporting and payment obligations in New Zealand even though the employees have been paid in a foreign jurisdiction.

The process of determining the New Zealand taxable income includes not only obtaining employee payment information from offshore payroll providers but also engaging tax agents to confirm the calculation of New Zealand taxable income of that employee. This can be time consuming and complex. *(ANZ)*

There should be an exemption from the proposed payday reporting for employment income information relating to internationally mobile employees. Applying the proposed payday reporting to this type of employment income information would not only increase compliance costs significantly for employers, but would be impossible to comply with given the proposed timeframes. The current reporting basis should be retained for the purposes of filing employment income information for internationally mobile employees. *(ANZ)*

There will need to be an exception for employers who operate payroll functions outside their ordinary New Zealand payroll processes. A significant compliance cost will arise for employers who have these arrangements, and in most cases complying with the proposed timeframes will simply not be able to be achieved. This issue could be resolved by either widening the scope of the exemption under proposed new section 23G of the Tax Administration Act 1994 to allow employers with employees on foreign payrolls to be exempt from the payday reporting rules, or by the Commissioner of Inland Revenue exercising her discretion to vary employment income information reporting requirements. *(Corporate Taxpayers Group)*

Non-resident employers who operate shadow payrolls and make tax equalisation payments to their non-resident employees working in New Zealand will need more time – 20 to 25 days from payday – to provide employment income information to Inland Revenue. Such employees are unlikely to receive social policy entitlements, or have social policy obligations, in New Zealand, so there is not the same rationale for requiring the information to be provided so soon after payday. *(Deloitte)*

Proposed section 23D(1) of the Tax Administration Act 1994 should include a separate group for employers filing employment income information for employees by way of shadow payroll. The provision covering this group should make it clear that an employer's PAYE reporting obligations can be satisfied by another entity reporting shadow payroll information to Inland Revenue, provided that the employer has approved the shadow payroll information. Those who fall within this group should have the option of filing either in a prescribed paper form or electronically through Inland Revenue's website, in both cases with the information due within 30 working days of the date of the payment. *(EY)*

Comment

Officials acknowledge the difficulties that would be faced by non-resident employers who operate a shadow payroll if they were required to report information about their employees working in New Zealand to Inland Revenue on a payday basis. In addition to the issues that arise for schedular payments,[3] additional time is required to calculate the value of shadow payroll for offshore-based employees before the information can be reported to Inland Revenue.

In order to minimise the number and complexity of the rules relating to special groups, officials recommend that the requirement for reporting shadow payrolls should build on those proposed for schedular payments.

It is recommended that employers should have 20 days to calculate the value of the shadow payroll. The 20th day would be deemed to be the date on which the employee is treated as deriving the income and would be the payday for the purpose of establishing when payment of tax withheld, is due to the Commissioner. Reporting obligations would be as follows:

[3] The information is not calculated in the payroll so time is required to get it into a format that can be reported and, secondly, there may be multiple payments on different paydays.

- For any payment valued through a shadow payroll where the 20th day after payment falls between the 1st and 15th of the month the information must be reported to Inland Revenue at the latest as if the "payday" was on the 15th.
- For any payment valued through a shadow payroll where the 20th day after payment falls between the 16th and month end the information must be reported to Inland Revenue at the latest as if the "payday" was the last day of the month.

The regime proposed above would allow a minimum of 22 days[4] following payment for the information on shadow payrolls to be reported, and a maximum of 44 days. If an employer considers that this is insufficient because of their circumstances they can apply to the Commissioner for a variation under proposed section 23P.

Similarly there is no obvious reason why an employer above the electronic filing threshold should have the option proposed by EY, of reporting such information on paper. However, if there is a good reason why digital reporting is not reasonable, the employer could apply either under proposed section 23P or for an exemption under proposed section 23G(3).

Lastly, in response to the concern that it should be clear that an employer's PAYE reporting obligations can be satisfied by another entity, officials note that, under current law, the Commissioner may receive information relating to a taxpayer from a person who is authorised to act on behalf of the taxpayer. Therefore, officials consider that a legislative amendment to provide that an employer's PAYE reporting obligations can be satisfied by another entity reporting shadow payroll information to Inland Revenue is unnecessary.

Recommendation

That the submissions to allow extra time for the reporting of shadow payrolls be accepted, subject to officials' comments.

[4] For example, if the 20th day after payment fell on the 15th of the month or on the last day.

CONSEQUENTIAL CHANGES TO EMPLOYER REPORTING OF EMPLOYEE SHARE SCHEME BENEFIT INFORMATION

Clauses 13, 132, 136, 148, 172(19) & (41), 187(5), 200, 284(1)(b) and schedule 2

Issue: Support for the proposals

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

Chartered Accountants Australia and New Zealand supports the proposal to defer recognition of benefits derived by an employee under an employee share scheme. *(Chartered Accountants Australia and New Zealand)*

KPMG supports the proposed 20 day time frame for reporting employee share benefits. *(KPMG)*

PwC is supportive of the proposal to extend the concession to defer the recognition of benefits derived by an employee under an employee share scheme by 20 days from when the employee receives the benefit, which was previously only provided to large employers, to all employers. PwC agrees with the rationale that all employers, regardless of size, will require additional time to compile information to support the required disclosures and, if applicable, deduction of tax. *(PwC)*

Recommendation

That the submitters' support be noted.

Issue: Frequency of employee share scheme benefit information reporting

Submission
(ANZ, Corporate Taxpayers Group)

The proposed payday reporting would result in a material increase in compliance costs for employers who offer employee share schemes, particularly where the date of exercise of those share options is at the employee's discretion. Employment income information relating to employee share schemes should be reported to Inland Revenue on a fortnightly basis, rather than on a payday basis. *(ANZ)*

Corporate Taxpayers Group is supportive of a deferral mechanism because employee share scheme arrangements are often administered outside of ordinary payroll processes and it would not be possible to provide the information within two working days. However, instead of recognition being deferred by 20 days, the employer should instead be required to report the information by a fixed date in the following month. This would significantly reduce compliance costs by allowing employers to combine information relating to multiple employees who received employee share scheme benefits on different days during a month. *(Corporate Taxpayers Group)*

Comment

More frequent reporting of PAYE income is a core objective of the proposed PAYE reforms and, as with schedular payments, a response to this issue requires a trade-off between the competing objectives of more frequent reporting and reduced compliance costs.

It is recommended that the proposal that employers should have 20 days to calculate the value of the employee share scheme benefit should be retained and then an approach to reporting, similar to that proposed for schedular payments and shadow payrolls, should be adopted:

- For any benefit received from an employee share scheme where the 20th day after receipt falls between the 1st and 15th of the month the information must be reported to Inland Revenue at the latest as if the "payday" was the 15th.
- For any benefit received from an employee share scheme where the 20th day after receipt falls between the 16th and month end the information must be reported to Inland Revenue at the latest as if the "payday" was at month end.

The regime proposed above would allow a minimum of 22 days[5] following receipt of the employee share scheme benefit for the information on employee share schemes to be reported and a maximum of 44 days. By having fixed dates of the 15th and end of the month, the proposal allows for the combination of numerous payments into one report.

If an employer considers that this is insufficient because of their circumstances they can apply to the Commissioner for a variation under proposed section 23P.

Recommendation

That the submission to limit the frequency of employee share scheme benefit information reporting be accepted, subject to officials' comments.

Issue: Length of deferral of the recognition of ESS benefits

Submission
(EY)

The deferral in the recognition of employee share scheme benefits should be 30 days from when the employee receives the benefit, with backdated effect from 1 April 2017. A deferral of 20 days is unlikely to provide employers with enough time to satisfy their reporting and withholding (if any) requirements in relation to the employee share scheme benefit, particularly in relation to payrolls that are run offshore. An extension to the deferral should be backdated to 1 April 2017 to cover any employers who have been unable to comply with the current timeframe for reporting and withholding (if any) requirements.

[5] For example, if the 20th day after payment fell on the 15th of the month or on the last day of the month.

Comment

The Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016 brought in new rules for the collection of tax on employee share schemes and the reporting of employee share scheme benefit information. Officials note that the Finance and Expenditure Committee considered a number of submissions on the length of time needed by employers to make the required disclosures of employee share scheme benefit information and PAYE withheld (if any) when it considered the Taxation (Transformation: First Phase Simplification and Other Measures) Bill. The conclusion reached by the Committee, which is now reflected in the law, provides employers with a minimum period of 20 days between the date on which an employee receives an employee share scheme benefit and when the employer is required to report information about it to Inland Revenue.

Officials note that, if the proposed responses to other submissions (relating to frequency of reporting and time for those not required to report digitally) are accepted, while employers will still have 20 days to value the benefits they will then have between 2 and 24 days after valuation to report them.

Officials do not support extending the timeframe for recognition of an employee share scheme benefit retrospectively, particularly in the absence of any evidence that this minimum period of 20 days, which received extensive consideration, has proved in practice to be insufficient for employers.

In addition, if an employer considers that because of their circumstances the time allowed for reporting is insufficient they can apply to the Commissioner for a variation under proposed section 23P.

Recommendation

That the submission be declined.

Issue: Clarification as to how the deferral of the recognition of benefits will be treated if the deferral bridges the end of the tax year

Submission

(PwC)

Further clarification is required on how the proposed deferral of the recognition of benefits will be treated if the deferral bridges the end of a tax year.

Comment

Under the proposals in the Bill, an employee share scheme benefit received by an employee between 12 and 31 March will be treated as employment income of the employee in the following tax year (commencing 1 April). This is an intended outcome, and one that can arise under the existing rules for employee share scheme benefits received between 16 and 31 March.

Officials note that a *Special Report* published by Inland Revenue upon the enactment of the Taxation (Transformation: First Phase Simplification and Other Measures) Act 2016 stated that:

> Inland Revenue may investigate instances where employees seek to exploit for personal advantage the deferred recognition of income for share benefits provided between 16 and 31 March if those share benefits are provided out of pattern with previous years or the decision to acquire shares is out of step with market conditions.

Recommendation

That the submission be declined.

EMPLOYERS ABLE TO FILE NON-DIGITALLY

Clause 200

Issue: Requirement to provide information within seven working days of payday

Submission

(BusinessNZ, KPMG, Chartered Accountants Australia and New Zealand, MYOB, EY)

The seven working day period allowed for filing employment income information by those exempt from digital filing should be extended. *(BusinessNZ, KPMG, Chartered Accountants Australia and New Zealand, MYOB, EY)*

There is potential for increased compliance costs for "paper-based businesses". Filing obligations for those below the mandatory electronic filing threshold should not change until the business community "is aware of the overall net benefits and/or costs of the total Business Transformation programme". *(BusinessNZ)*

The manual filing option available for small employers, including those without electronic payroll systems, is supported. However, the timeframe for providing employment income information should be aligned to such employers' due dates for the remittance of PAYE and ESCT, namely, the 20th of the month following payment of the employment income. *(KPMG)*

The due date for the provision of information by employers who are not required to provide information digitally should be increased from seven working days to 14 days to allow sufficient time for posting a return. Alternatively, consideration should be given to changing the requirement from "must deliver" to "must post" the information within seven working days. *(Chartered Accountants Australia and New Zealand)*

Employers who are required to file employment income information within seven working days should be required to file employment income information within 14 working days after payday. Seven working days after payday is not enough time for employers in these groups, who are permitted to provide employment income information in a prescribed paper format, to provide accurate information to Inland Revenue. *(EY)*

The move to seven working days after payday will significantly increase the burden on small employers and could even put them off transitioning to technology solutions. *(MYOB)*

Comment

One of the underlying policy outcomes being sought with these changes is the provision of payday information rather than a monthly aggregate. Payday reporting will mean that information is more usable – for example, in determining whether an employee is on the right tax code – and will improve the delivery of social assistance and the provision of cross-agency information.

While Inland Revenue will provide online services to allow small employers to file their employment income information digitally through myIR services, there will be employers who cannot access appropriate digital services and others who will still choose to provide paper returns and use mail services to file their returns. Officials note that NZ Post has indicated that it proposes to cease its FastPost mail service from 1 January 2018.

The information to be provided in payday reporting will be readily available to the employer as part of paying their employees. Payday reporting requires them to enter it into the relevant return format and send it to Inland Revenue each payday rather than to put it aside, return to it at month end, aggregate it and then send it to Inland Revenue.

More timely receipt of the information is important to enable problems to be identified and rectified more quickly and to support future changes to social policy. The key question in determining an appropriate number of days is what period would enable a compliant taxpayer to be confident that they will not be exposed to a penalty for reasons outside their control.

Officials consider that the time allowed for filing returns by taxpayers able to file using paper should be ten working days. This roughly equates to 14 days.

Recommendation

That the submission be accepted.

Issue: Definition of payroll software

Submission
(Chartered Accountants Australia and New Zealand)

The definition of payroll software should be reconsidered to exclude applications such as spread sheets and PAYE calculators. Such applications do not have the ability to provide the information directly into Inland Revenue’s system.

Comment

The definition of payroll software is significant because if you are a small employer but use payroll software you are in the “online group”.

Recommendation

That the submission be accepted.

Issue: Support for electronic filing threshold

Submission
(Chartered Accountants Australia and New Zealand)

The submitter expressed support for the proposal that an employer is in the threshold group (who do not have to file electronically) of employers if the PAYE and ESCT payable for the preceding tax year is less than $50,000 and the employer does not use payroll software.

Recommendation

That the submitter's support be noted.

Issue: Electronic filing threshold should remain at $100,000 of PAYE and ESCT

Submission
(BusinessNZ)

The submitter recommends that the threshold for mandatory electronic filing should remain at $100,000 a year of PAYE and ESCT. In the regulatory impact statement officials recommended a threshold of $100,000 a year because a lower threshold would have one-off and cash flow impacts and may adversely impact small employers.

Comment

The regulatory impact statement comments were made in the context of a recommended threshold which would also impose an obligation to remit (pay) PAYE on payday. The recommendation that employers be required to remit PAYE to Inland Revenue on payday was not accepted and so is not included in the Bill. In the absence of this obligation, officials do not consider that a lower threshold will have cash flow implications. While a decision to adopt payroll software would have costs, it is generally regarded as bringing wider benefits relating to payroll accuracy and reduced administration costs. Further, given the option of filing employment income information through Inland Revenue's website, an employer could meet the requirement to file electronically without incurring additional expenditure by adopting payroll software.

Recommendation

That the submission be declined.

Issue: Electronic exempt group and new employers group

Submissions
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal that an employer is in the electronic-exempt group if they are unable to access digital services.

The submitter supports the proposal that an employer is included in the new group[6] if the employer starts employing in a tax year and in the absence of this rule would be in the online group. The proposal to classify new employers who use payroll software as part of the online group is also supported.

Recommendation

That the submitter's support be noted.

Issue: Extending the six month period to file paper returns

Submission
(KPMG)

The six month grace period for a new employer should be able to be extended by application to the Commissioner.

Comment

Officials acknowledge that there may be reasons for the Commissioner to extend the six month grace period but consider that proposed new section 23P, which allows the Commissioner to vary the requirements set out in subpart 3C for an employer or class of employers, would meet the need outlined by the submitter.

Recommendation

That the officials' comment be noted.

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[6] The "new group of employers" allows a new employer who would otherwise be included in the "online group" and required to file digitally a period of six months before they are required to do so.

Issue: Timeframe for employment income information reporting by employees

Submission

(KPMG)

Under the proposals in the Bill, current IR56 taxpayers will need to provide their employment income information monthly, within seven working days of month-end. A longer time frame for the provision of the employment income information by this group should be allowed. This should be similar to the time allowed for employers who file manually, which KPMG recommends is aligned with those employers' due dates for payment of PAYE and ESCT.

Comment

The time frame of seven working days from month-end is aligned with the time frame for those able to file non-digitally. If the recommendation to extend that deadline is accepted it would provide ten working days for an employer to file employment income information.

Officials recommend that employees required to file employment income information should have ten working days following the end of the month to file their information.

Recommendation

That the submission to provide more time for an employee to file employment income information be accepted, subject to officials' comments.

NEW AND DEPARTING EMPLOYEE INFORMATION

Clause 200

Issue: Support for proposal

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal for the delivery of employment income information for new and departing employees.

Recommendation

That the submitter's support be noted.

Issue: New and departing employees – contact details

Submission
(EY)

The term "contact details" used in proposed schedule 4, tables 2 and 3 of the Tax Administration Act 1994 should be defined in legislation.

Comment

It is important that the term "contact details" is defined given employers will be required to provide this information to Inland Revenue. Contact details are relevant for new schedules 3, 4 and 6 (investment income).

Recommendation

That the submission be accepted.

Issue: Departing employee information

Submission
(PwC)

Some clarity is required as to when an employee has departed to ensure this does not result in operational difficulties, such as an employee ceasing employment with their employer but still being entitled to receive a subsequent PAYE income payment from that employer (such as a bonus or paid out annual leave).

Comment

Officials agree that clarifying when an employee has stopped being an employee of the employer is desirable. The Bill provides that the information that an employee is departing must be provided on the payday on which the employee is last paid or earlier if the employer chooses. If however there is an on-going obligation to make PAYE income payments, the person to whom the payments are made remains an "employee" for tax purposes until that obligation ceases. Following enactment, guidance will be included in an Inland Revenue *Tax Information Bulletin* and other guidance provided to employers on payday reporting.

Recommendation

That the officials' comments be noted.

Issue: Date of birth and contact information

Submission
(Chartered Accountants Australia and New Zealand, BusinessNZ)

The submitters expressed support for not making the new requirement to supply date of birth information mandatory.

Recommendation

That the submitters' support be noted.

Issue: Consolidation and simplification of new employee information

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to consolidate and simplify information requirements for new employees (including KiwiSaver requirements).

Recommendation

That the submitter's support be noted.

Issue: Providing a timely response on new employees

Submission
(KPMG, Corporate Taxpayers Group)

The submitters support the proposal to allow new employee information to be provided to Inland Revenue before the first payday to ensure tax codes and the like are validated. However, the real benefits from this proposal will only be realised if any validation information is received before the first payday. KPMG is concerned that such information may just go into a "black hole".

Comment

The ability and decision to provide new employee information prior to the first payday is in the employer's hands.

Once PAYE is fully processed within Inland Revenue's new computer system, START, if new employer information is provided before the first payday, it is Inland Revenue's objective to notify the employer almost instantaneously of any required changes to the tax codes or similar – for example, a requirement to deduct child support payments. This is not expected to be before early 2020.

Recommendation

That the officials' comments be noted.

Issue: Using employee-provided information to make deductions if validation has not occurred before the first payday

Submission
(KPMG)

The submitter notes that the lack of any validation prior to the first pay should not prevent the employer from paying employees. This could mean that a grace period should be allowed for deducting PAYE at the declared rate, rather than at the non-declaration rate, provided that the IRD number is associated with any amounts paid during this grace period.

Comment

The Bill provides that new employee information must be provided with the employment information for the employee's first payday, unless it is provided earlier. The information provided by the employee will be used to calculate the PAYE and related deductions until Inland Revenue informs the employer (and the employee) that a different code should be used; pre-payment validation by Inland Revenue will not be required. The non-declaration rate should only apply if the employee has not provided their name, their tax file number, and their tax code.

Recommendation

That the officials' comments be noted.

Issue: Employer must have access to the same information that Inland Revenue holds

Submission
(Corporate Taxpayers Group)

To ensure that the maximum benefit is obtained from the interactions between the employer's payroll software packages and Inland Revenue's systems, there should be significant improvements in the information that employers can access.

Comment

Inland Revenue intends that through its new computer system, START, employers should be able to access their filed submissions and should be able to update employee details online. This is not possible at present. This will represent a significant advance on the current state.

Recommendation

That the officials' comments be noted.

Issue: Notification when employer ceases to employ

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal that an employer notify Inland Revenue within 30 days of the date on which the employer permanently ceases to employ any staff.

Recommendation

That the submitter's support be noted.

EMPLOYMENT INCOME INFORMATION – ERROR CORRECTION AND ADJUSTMENT MECHANISMS

Clause 200

Issue: Regulation making power for matters relating to the correction of errors

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

Submitters support the use of a regulation making power for matters relating to the correction of PAYE errors and adjustments. Corporate Taxpayers Group notes the importance of pragmatic error correction mechanisms that are efficient for both employers and Inland Revenue.

Comment

Officials welcome the support for use of regulation making powers for the matters relating to correction of PAYE errors and adjustments.

Recommendation

That the submitters' support be noted.

Issue: Public consultation on regulations

Submission
(EY)

The submitter considers that the error correction mechanisms should be determined before any of the proposed employment changes are enacted. If they are to be contained in regulation, proposed new section 23M(3) of the Tax Administration Act 1994 should require mandatory public consultation on the regulations.

Comment

Officials note that amendments to primary legislation can take time and some issues, where appropriate, may require a more timely response than is possible with primary legislation.

The regulation making power proposed in the Bill requires mandatory public consultation to be undertaken before such regulations can be made. An officials' issue paper entitled *PAYE error correction and adjustment* was released on 9 August 2017 seeking feedback on options on how PAYE errors may be corrected and adjustments made. This consultation will be used to inform any regulations that will be made and EY's submission in response to the Select Committee will be considered in this context.

Recommendation

That the officials' comments be noted.

Issue: Application date of regulation making power

Submission
(Matter raised by officials)

The regulation making power for error correction in employment income information in proposed section 23M has an application date of 1 April 2019. To enable regulations to be in place by 1 April 2019 it is necessary that the power has an earlier application date.

To achieve this, a transitional regulation making power is proposed. The new section would apply from the date of Royal assent until the new section 23M comes into force.

Recommendation

That the submission be accepted.

TAX CODES AND PAYE RECORD KEEPING

Clause 204

Issue: Requirement to provide a name to the employer

Submission
(KPMG, Chartered Accountants Australia and New Zealand)

The proposal for a legislative requirement for an employee to notify their employer of their name, tax file number and tax code is supported. If this information is not provided, the non-notified deduction rate of 45 cents applies. There is some uncertainty as to what "name" means if a person does not generally use their legal name recorded on the birth certificate or passport but uses an alias or different spelling. *(Chartered Accountants Australia and New Zealand)*

The requirement to obtain the name of the employee appears to be a potentially absurd requirement and appears to be unnecessary. "It is expected that the employer will know who they are employing". *(KPMG)*

Comment

Officials accept that more clarity should be provided and that the employee's full name should be provided rather than just their name which could be an alias or a nick-name.

While the employer will know the name the employee has provided, certainty of tax affairs requires matching the name with the person and their IRD number. The rule requires that all three pieces of information be provided to prevent the non-notified tax code (non-declaration tax code) applying. The prescribed form IR330 currently requires these three points but without explicit legislative backing. The non-notified tax code is intended to incentivise the employee to provide this information to the employer. This information is critical so that the income information and the PAYE and related deductions can be allocated to the right person.

Recommendation

That the submission be accepted.

Issue: Grace period to provide tax file number for new employees

Submission
(Chartered Accountants Australia and New Zealand)

The submitter proposes that there be a grace period of one month for a first time employee who does not have a tax file number before the non-notified deduction rate applies.

Comment

Officials understand the submitter's proposal to provide a grace period for a first time employee who does not have a tax file number before the non-notified deduction rate applies. Such an exemption already exists for non-resident seasonal workers.

Managing such a grace period would however impose additional costs on employers who would have to determine if the employee is "a first-time employee" and then monitor the grace period. Inland Revenue would also incur additional costs because of the need to establish and manage exemptions to the normal process for an employee who is reported as not having a tax file number but who is not on the non-notified rate (non-resident seasonal workers have a different tax code). This process could require Inland Revenue to make contact with the employer, further increasing compliance costs.

While new employees do require proof of identity to obtain a tax file number, immigrants with New Zealand residency can now obtain a tax file number online as part of the immigration process. Increasingly, New Zealand born new employees already have a tax file number as a consequence of belonging to KiwiSaver or having had child support payments made on their behalf. In addition, as those whose parents have obtained a tax file number for them at birth begin to join the labour market, issues around obtaining a tax file number will be further reduced.

Recommendation

That the submission be declined.

Issue: Restructuring of existing provisions

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

Submitters generally support the restructuring of the existing provisions dealing with core requirements such as tax codes and PAYE recording keeping. The Corporate Taxpayers Group notes that moves to consolidate sections that are directly relevant to each other are welcomed, as long as they do not mistakenly give rise to unintended policy outcomes.

Recommendation

That the submitters' support be noted.

Issue: Process for changing tax codes

Submission

(Corporate Taxpayers Group)

As part of Inland Revenue's business transformation programme the opportunity should be taken for the process for changing tax codes to be electronic.

Comment

Where employers are using payroll software that allows for providing information between systems, the process for notifying changes in tax codes will be electronic. Also, any notification from Inland Revenue to an employee will be through an electronic notification if the employee uses Inland Revenue's online tax transactions system, myIR.

Recommendation

That the officials' comment be noted.

Issue: Retention of current remittance rules

Submission
(Corporate Taxpayers Group, PwC)

The submitters support the retention of the current remittance rules for PAYE and related deductions.

The period in which PAYE and related deductions is held by the employer is in effect compensation for the employer having to bear the costs of being a tax collector. *(Corporate Taxpayers Group)*

Another submitter seeks confirmation that this is not a transitional measure and that there is no future intention to align the payment obligations with payday filing. *(PwC)*

Comment

Officials note the support for the retention of the current remittance rules for PAYE and related deductions. Officials note that there is nothing on the current tax policy work programme to align payment obligations with payday filing. The Government may wish to add it to its work programme at a later date.

Inland Revenue will accept payments of PAYE and related deductions with the provision of payday information.

Recommendation

That the officials' comments be noted.

Issue: Remittance threshold changes by Order in Council

Clause 130

Submission
(EY, KPMG, Chartered Accountants Australia and New Zealand)

The threshold above which employers are required to pay PAYE and other deductions twice monthly should not be able to be amended by Order in Council. *(EY, KPMG)*

If this proceeds, section RD 4(7) should require mandatory public consultation prior to any Order in Council being made. Changing this threshold by Order in Council is an overreach. Any decision to change this threshold should be a matter for Parliament, given the potential for a change in the threshold to have a material impact on the business of many taxpayers. *(EY)*

The submitter supports the proposal to allow the threshold to be changed by Order in Council following appropriate consultation. It, however, notes that any regulation should allow sufficient time for affected employers to be able to comply. *(Chartered Accountants Australia and New Zealand)*

Comment

The Regulations Review Committee in its letter of the 1 June 2017 to the Committee on the delegated legislative powers in the Bill did not raise any concerns with the proposed regulation making power to change the remittance threshold for PAYE and related deductions.

Officials agree with the point that Chartered Accountants Australia and New Zealand makes that any regulation should allow sufficient time for affected employers to be able to comply. Officials consider that the requirement, in proposed new section RD 4(7) of the Income Tax Act 2007, to undertake consultation that is appropriate and reasonable for the purposes of the section, would require consultation on the application date of any such regulation.

Recommendation

That the submission that the threshold should not be able to be amended by Order in Council be declined.

That the submission supporting the proposal to allow the threshold to be changed by Order in Council following appropriate consultation be noted.

PENALTIES

Clauses 268, 269, 270, 271, 272 and 275(2)

Issue: Late filing and non-electronic filing penalties to remain monthly

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

The submitters support the proposal to leave late filing and non-electronic filing penalties monthly despite the move to payday reporting.

Recommendation

That the submitters' support be noted.

Issue: Maximum penalty for non-electronic filing

Submission
(EY)

Section 139AA(4) of the Tax Administration Act 1994 should be amended such that the maximum monthly non-electronic filing penalty is the lesser of a flat $250 or $1 per employee. The purpose of the penalty should be to encourage employers to comply. A penalty of the greater of $250 or $1 per employee would unduly punish large employers.

Comment

As noted in the submission, the Bill does not increase the current maximum monthly penalty for non-electronic filing. However, because payday filing will generally increase the number of returns required, the risk of incurring the penalty will increase. The electronic filing threshold is proposed at a level that equates to 10 full-time employees on the minimum wage or four full-time employees at the average wage. Employers with more than 250 employees should already be filing digitally and the current penalty incentivises that.

Recommendation

That the submission be declined.

Issue: Shorten the period for resetting the good behaviour penalty reduction in section 141FB of the Tax Administration Act 1994

Submission
(Corporate Taxpayers Group)

The Corporate Taxpayers Group submits that consideration be given to shortening the period for "resetting" the good behaviour penalty reduction in section 141FB of the Tax Administration Act 1994 from two years to one year for PAYE, given the increased filing frequency.

Comment

The use of "resetting periods" is broader than PAYE. Subject to Government priorities, a review of the shortfall penalties system may be undertaken and consideration of the relevant "resetting" period could be considered in this review.

Recommendation

That the submission be declined, but the officials' comment be noted.

Issue: Focus during the period of transition to the new rules should be on education

Submission
(Corporate Taxpayers Group)

As employers transition to new ways of doing business as a result of these proposals, there should be leniency shown towards businesses who inadvertently do not comply with the tax rules. The focus should be on educating rather than punishing businesses who make mistakes.

Comment

In the early stages of payday filing, it is intended that the Commissioner will adopt a compliance improvement focus and be in touch with taxpayers to raise awareness and assist compliance. Officials recommend that the Bill should provide the Commissioner with flexibility around whether to impose late filing and non-electronic filing penalties during the early stages of the new employment income information regime.

Recommendation

That the submission be accepted.

EMPLOYEE SHARE SCHEME TRANSITIONAL PROVISIONS

Clause 282

Issue: Support for the proposals

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to require early adopters of payday filing to apply the proposed modifications to the employee share scheme rules early as well.

Recommendation

That the submitter's support be noted.

Issue: Meaning of "ESS deferral date" during the transitional period

Submission
(Matter raised by officials)

The transitional provision (proposed new section 227C) should be amended to clarify the meaning of the term "ESS deferral date" when an employer has chosen to adopt payday filing of employment income information prior to clause 14 of the Bill coming into force.

Comment

Subsections (3) and (4) of the proposed transitional provision (new section 227C of the Tax Administration Act 1994) in clause 282 of the Bill provide that an employer who chooses to adopt payday filing of employment income information during the transitional period must apply the proposed modifications to the rules for reporting employee share scheme benefit information early as well. Proposed new section 227C will allow an employer to choose to adopt payday filing of employment income information from 1 April 2018.

Subsection (6) of the proposed transitional provision specifies which clauses of the Bill are treated as coming into force early when an employer chooses to adopt payday filing of employment income information during the transitional period. One of these is clause 13, which inserts a new section CE 2(9) into the Income Tax Act 2007. This new subsection, which defines the term "ESS deferral date", refers to the terms "share scheme taxing date" and "employee share scheme beneficiary". These two terms are defined in sections (included in clause 14) that are not intended to come into force until six months after the Bill receives Royal assent, which could be up to six months into the transitional period.

Officials recommend that the transitional provision is amended to clarify the meaning of "ESS deferral date" when an employer has chosen to adopt payday filing of employment income information prior to clause 14 coming into force.

Recommendation

That the submission be accepted.

OTHER MATTERS RAISED

Issue: Accelerating the transfer of KiwiSaver contributions

Submission
(Financial Services Council)

The Bill should make provision to accelerate KiwiSaver contributions being passed on to KiwiSaver providers by providing that they are paid directly by employers to KiwiSaver providers, with reporting to Inland Revenue.

KiwiSaver contributions are currently subject to a 12 week delay in passing through Inland Revenue to KiwiSaver providers.

Comment

Officials recognise that it can take up to 12 weeks from when an employee's contribution is deducted from their salary or wages, until it is received by the KiwiSaver provider. This delay is due to the deadlines for employment income information reporting. Currently, KiwiSaver deductions are paid to Inland Revenue by the 20th of the month and the 5th of the following month for the largest employers, and by the 20th of the following month for all other employers. Information on these deductions is provided to Inland Revenue by the 5th and 20th of the following month respectively. It is then checked and, if needs be, corrected. Once these checks are complete, KiwiSaver contributions are passed on to scheme providers.

When Inland Revenue receives employment information on a payday basis and KiwiSaver processing is completed within Inland Revenue's new computer system (estimated to be in 2020), KiwiSaver employee contributions will be able to be passed on to providers earlier.

Officials disagree with the submitter's suggestion that employers pass on KiwiSaver deductions directly to scheme providers. This would increase compliance costs for employers, given they would likely need to make payments to a wide range of KiwiSaver scheme providers. Further, compliance costs for providers would increase as providers would need to police whether the payments were being made.

Recommendation

That the submission be declined.

Issue: Information sharing with other Government agencies

Submission
(Corporate Taxpayers Group)

The submitter notes the need for improvement in the relationships between Inland Revenue and other government departments, such as ACC. They cite the example of when ACC invoices are received from ACC, the invoice can often be wrong as a result of the data that has been transferred from Inland Revenue being incorrect. It is the submitter's expectation

that, as Inland Revenue's computer system is upgraded, the interface between Inland Revenue and ACC's systems can be improved.

Comment

One of the outcomes from the implementation of the BT programme and the timelier provision of income information will be improved information sharing with other government agencies, such as ACC. This will enable ACC to deliver better services to their clients, thereby reducing the need for employers to provide the same information twice to the government. Inland Revenue is working with ACC and other agencies to improve the provision of information.

Recommendation

That the officials' comments be noted.

Issue: Employer should not become an intermediary/messenger between Inland Revenue and the employee

Submission
(Corporate Taxpayers Group)

The Corporate Taxpayers Group supports the proposal that employees should continue to be directly notified of their obligations and that the employer should not be "an intermediary/messenger between Inland Revenue and the employee".

Recommendation

That the submitter's support be noted.

Issue: Implementation of proposed rules

Submission
(Corporate Taxpayers Group, PwC, ANZ, MYOB)

Submitters emphasised the need for Inland Revenue to work closely with payroll software developers and employers to produce specifications which employers will need to implement changes to payroll systems.

Comment

Inland Revenue acknowledges the need to engage with employers, PAYE intermediaries, and payroll software developers in the development of payroll specifications and guidance. Inland Revenue has set up a team responsible for working with the payroll sector and with employers and is in the process of establishing a working group to co-ordinate the technical aspects of the transition. A draft payroll specification has been published for comment.

Recommendation

That the officials' comments be noted.

Issue: Voluntary payday reporting from 1 April 2018 limited to payday reporting via digital systems

Clause 200

Submission
(Matter raised by officials)

Employers who do not use a digital system to file employment income information should be excluded from being able to provide PAYE employment information on a payday basis during the voluntary period – between 1 April 2018 and 31 March 2019.

Comment

Officials consider that the early transition to payday reporting should be limited to employers (including PAYE intermediaries) who use payroll software systems or who file digitally through myIR. The voluntary period is intended to allow Inland Revenue, employers and payroll providers to transition to payday filing using the new digital systems. During this time, the primary focus for paper filers should be on encouraging them to consider adopting digital services. If paper filers can adopt payday filing during the voluntary phase, Inland Revenue will have to bring forward its investment in amending forms and developing new materials and systems. Officials consider that this would be a disproportionate investment for what is likely to be low take-up of payday filing by paper filers during the voluntary phase.

Recommendation

That the submission be accepted.

Issue: Declaration of entitlement to work in New Zealand

Clause 204

Submission
(Matter raised by officials)

That the requirement for an employee when advising of their tax code, to also declare their entitlement to work in New Zealand, be repealed.

Comment

Proposed new section 24C(2) continues the existing requirement that whenever employees notify their employer of their tax code they must complete a declaration of their entitlement to work in New Zealand. This section precedes the Immigration Act 2009 which imposes a positive obligation on employers to determine that workers are legally able to work for them. Completing the declaration required by proposed new section 24C(2) does not discharge the employer from independently ascertaining the right of the employee to work in New Zealand. The Ministry of Business, Innovation and Employment has indicated that the section is no longer required and that its removal "could remove some confusion as certain employers are still regarding holding a copy of the declaration as sufficient to fulfil their checking obligations".

Recommendation

That the submission be accepted.

Issue: Employers reporting information for special tax codes or special tax rates

Clause 148

Submission
(Matter raised by officials)

An employer who "withholds an amount of tax for a PAYE income payment" has a general obligation to provide employment income information. The provision should be clarified so that it is clear that where an employer makes a PAYE income payment but withholds no tax because the employee has a special tax rate of zero, or a special tax code that requires no amount of tax to be withheld, the employer nonetheless still has to report the relevant details. These will generally include the amounts of gross earnings and ACC earners' levy deductions, KiwiSaver contributions, student loan repayments, and child support deductions, as applicable.

Recommendation

That the submission be accepted.

Issue: Record keeping requirements for employment income information

Clause 197

Submission
(Matter raised by officials)

Proposed new section 22AA(3)(b) should be amended to state that records do not need to be kept where they have been delivered to the Commissioner as required by the Tax Administration Act 1994 or the Income Tax Act 2007.

Comment

As currently drafted, proposed new section 22AA(3)(b) provides that records do not need to be kept if the employer or PAYE intermediary is *required* by the Tax Administration Act 1994 or Income Tax Act 2007 to deliver the records to the Commissioner. However, it is not the requirement to send them that is important, but the fact that they have been sent. The suggested change to the provision in the Bill would prevent employers who are obligated to file the information with the Commissioner, but fail to do so, from being exempt from the obligation to keep a record of the information.

Recommendation

That the submission be accepted.

Issue: Schedular payment drafting

Submission
(Matter raised by officials)

The Bill contains a number of consequential amendments to the schedular payment rules as a result of the employment income information changes. Officials propose a number of drafting changes to these amendments to ensure they are clear and work as intended.

Recommendation

That the submission be accepted.

Issue: Employment income information – transitional provisions

Clause 282

Submission
(Matter raised by officials)

Proposed new section 227C(6) of the Tax Administration Act 1994 should be amended to include sections relating to definitions, record keeping, tax codes, KiwiSaver and child support obligations, and to correct previous mis-numbering.

In addition, the general obligation in section 227C(4) that the employer who voluntarily adopts payday reporting must apply other relevant provisions relating to the delivery of information, treatment of benefits or interpretation, should be expanded so that it applies whether or not the relevant provision is listed in section 227C(6).

Proposed new section 227C(6) should be amended to provide that the clauses listed in that section apply from the date the person voluntarily adopts the new provisions.

Comment

Proposed new section 227C allows employers and PAYE intermediaries to voluntarily provide employment information on a payday basis from 1 April 2018 until payday filing becomes compulsory from 1 April 2019. A number of sections need to be added to the transitional provisions in proposed new section 227C(6) to ensure the voluntary adoption works as intended. In addition, to protect against inadvertent omission, it is proposed to add a general provision that "relevant sections" apply to those who voluntarily adopt payday reporting, even if they are not listed in proposed section 227C(6).

The date from which the transitional provisions in proposed section 227C(6) apply should be from when the employer chooses to apply the new provisions, not from 1 April 2018. Otherwise, taxpayers who choose to adopt payday filing part way through the year would be contravening the law from 1 April 2018 until the point they started applying the new provisions.

Recommendation

That the submission be accepted.

Issue: Definition of KiwiSaver status

Clauses 288, 290, 291 and 292

Submission
(Matter raised by officials)

The phrase “KiwiSaver status” should be a defined term.

Comment

The current legislation requires employees changing jobs and employees who wish to opt in to KiwiSaver, or who wish to cease having contributions made on their behalf, to provide their employer with particular forms.

To enable digital exchanges of information, the requirement to provide specified forms has been replaced by a requirement for the employee to notify their employer of their “KiwiSaver status” or a desired change in KiwiSaver status. The clarity of the provisions could be improved if “KiwiSaver status” becomes a defined term which includes membership, deduction rate, and a request for the employer to cease making deductions under section 112B(1) of the KiwiSaver Act.

Recommendation

That the submission be accepted.

Issue: Reporting of employment income information: other particulars as required by the Commissioner

Clause 284

Submission
(Matter raised by officials)

That table 1 in schedule 4, *Employment income information for reporting on a payday basis,* should have an additional row added to require “other particulars as the Commissioner requires”.

Comment

The existing definition of the employer monthly schedule in section YA 1 of the Income Tax Act 2007 includes other particulars required by the Commissioner for a class of employer.

While proposed section 23P already confers a power to vary the requirements in schedule 4 for an employer or class of employers, it is recommended that for clarity the ability for the Commissioner to require other particulars should be included in the schedule itself.

While “other particulars” will often be specific to a “class of employers”, such as those who use software or those who offer payroll giving, it is recommended that the ability to require other particulars should not be limited to “an employer” or “class of employers”.

Recommendation

That the submission be accepted.

Making Tax Simpler – investment income information

OVERVIEW

Clauses 2, 81, 85, 122, 123, 124, 163, 180(2), 210, 211, 212, 215, 218, 219, 220, 224, 239, 241, 246, 269, 284 and schedule 2

A central component of the Government's objective of modernising tax administration in New Zealand is to improve information flows to Inland Revenue. This will allow Inland Revenue to provide smoother service to customers, including pre-populating individuals' tax returns.

This Bill contains proposals to improve the administration of investment income information. Investment income refers to interest, dividends, portfolio investment entity (PIE) income, taxable Māori authority distributions and royalties.

The proposed amendments aim to reduce compliance costs for recipients of investment income and administrative costs for Government, by improving the administration of investment income to enable the pre-population of tax returns and to ensure that taxpayers' tax obligations and social policy entitlements and obligations are calculated more accurately during the year.

Inland Revenue currently receives limited and infrequent information about the investment income that taxpayers earn and the tax withheld or paid on that income. For interest subject to resident withholding tax (RWT) or non-resident withholding tax (NRWT) and PIE income, Inland Revenue only receives information about the income taxpayers earned and the tax deducted from that income after the end of the tax year. For dividends, Māori authority distributions and interest income that is exempt from RWT or subject to the approved issuer levy (AIL), Inland Revenue only receives information about the amounts received by recipients when it is specifically requested, or is included by the recipient in their tax return.

The key changes relate to the following:

- obtaining more frequent and detailed information for interest, dividends and Māori authority distributions;
- bringing forward the due date when PIEs are required to provide information to Inland Revenue;
- encouraging the provision of IRD numbers;
- increasing electronic filing;
- improving the administration of RWT exempt-status (certificates of exemption);
- removing some requirements to provide end-of-year withholding tax certificates; and
- improving error correction.

Twelve submissions were received on the amendments. While there was general support for the rationale behind the changes, the main concern was that the proposals overreach and are not justified as the costs imposed on payers of investment income exceed the benefits to the tax system as a whole. The majority of the submissions focussed on ways to reduce these compliance costs.

Officials consider that changes to the administration of investment income are necessary to improve services to taxpayers, however recommend the following changes to address submitters' concerns of overreach:

- removing the requirement that payers report detailed information on payments made to payees with RWT-exempt status;
- removing the requirement for taxpayers with RWT-exempt status to provide detailed information in relation to the acquisition or disposal of financial arrangements;
- removing the requirement for PIEs to report investor's prescribed investor rates (PIRs) six-monthly;
- allowing public unit trusts to report dividend information annually;
- reducing information reporting requirements for information that has not been digitised;
- extending the error correction provisions to PIEs and non-cash dividends;
- clarifying the scope of reporting requirements in relation to joint accounts held by companies and trusts; and
- incorporating the information required by the company dividend statement into monthly reporting.

INVESTMENT INCOME INFORMATION GENERALLY

Issue: General support for amendments to investment income information

Submission
(Belmont Partners, BusinessNZ, EY, New Zealand Bankers Association, Chartered Accountants Australia and New Zealand, ANZ, KPMG)

The submitters agree in principle with the rationale behind the changes to investment income information.

Recommendation

That the submitters' support be noted.

Issue: The costs and benefits of monthly reporting

Submission
(BusinessNZ, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Financial Services Council, KPMG, Olivershaw)

Submitters consider that the cost of monthly reporting outweighs the benefits. Investment income can be received at year-end to pre-populate tax returns. The only remaining justifications to get the information monthly are to proactively correct tax rates and adjust social policy payments. These benefits are overstated and do not justify the cost of monthly reporting as:

- High income taxpayers, who pay the bulk of the taxes, have more complex tax affairs and will not benefit from the savings unless the accruals basis of individuals' taxation is changed.
- Many lower income taxpayers, representing the majority of taxpayers and of social policy payment recipients, will have little or no investment income.
- For the small remaining group of taxpayers with investment income subject to withholding who do not need to make accrual adjustments to that income, income is likely to be realised in an uneven and unpredictable pattern during the income year, making within-year adjustments to social policy payments difficult.

Investment income information should be provided quarterly or annually, not monthly.

The proposals inappropriately shift costs from government to the private sector.

The proposals are not robust enough to be enacted in their current form – further work and a full cost-benefit analysis should first be undertaken.

To reduce compliance costs, the proposals should be better targeted toward those paying an amount of investment income above a minimum threshold.

Comment

Payers of investment income will already have the information that is required to be provided to Inland Revenue at the point they pay the income to the taxpayer. Inland Revenue is therefore simply asking for information that payers already hold. While providing this information monthly may involve some upfront system configuration costs, the compliance costs are not expected to be significant going forward.

Receiving this information on a monthly basis will enable Inland Revenue to proactively adjust taxpayers' social policy payments and tax rates. This will reduce the number and quantum of end-of-year square ups, improving taxpayer compliance and reducing compliance costs, thereby improving the overall efficiency of the tax system.

Officials disagree with the submitters' suggestions that payers of investment income report less frequently than monthly, or that the proposals are targeted at those paying an amount of investment income above a minimum threshold. The RWT rules are currently targeted at payers paying interest above $5,000 per year. Information reporting on interest paid that is below this threshold is only required in limited circumstances.

Recommendation

That the submission be declined.

Issue: Support for application date of investment income provisions

Clause 2

Submission
(KPMG)

KPMG supports a 1 April 2020 mandatory application date as this provides investment income providers with sufficient time to transition to the new requirements.

Recommendation

That the submitter's support be noted.

Issue: Application date for provision of investment income information should be deferred

Clause 2

Submission
(EY)

The proposed amendments should come into force on 1 April 2021, with the rules able to be applied voluntarily from 1 April 2020.

An extra year to make systems changes would be helpful for organisations that operate numerous systems that deal with many different tax types.

Comment

Officials consider that (an estimated) 24 months from the date of enactment of the legislation is a sufficient amount of time for systems development and have discussed this timeframe with a number of investment income payers. Those payers have generally accepted the timeframes as being manageable.

Recommendation

That the submission be declined.

Issue: Engagement and partnership between Inland Revenue and investment providers

Submission
(AMP, ANZ, New Zealand Bankers Association)

Inland Revenue should engage with AMP and the PIE industry regarding the nature and form of the electronic reporting in proposed new sections 25J and 25K. (*AMP*)

Significant and ongoing partnership between impacted taxpayers and Inland Revenue is required:

- to obtain clarity and certainty of detail on the proposed changes in order to embark on systems development;
- to ensure unified communication occurs to as many New Zealanders as possible regarding the upcoming changes, particularly in regard to the increase of the non-declaration rate on interest income to 45%; and
- in relation to the proposed gateway for electronic filing.
(*ANZ, New Zealand Bankers Association*)

Comment

Inland Revenue is committed to working with investment income payers to ensure a seamless transition to the new requirements. Inland Revenue has appointed a number of account managers to engage with the private sector on various aspects of Inland Revenue's Business Transformation programme, including the proposed changes to investment income information.

Recommendation

That the officials' comments be noted.

Issue: Provision of information that is not easily accessible

Clauses 212 and 284

Submission
(AMP, ANZ, Corporate Taxpayers Group, New Zealand Bankers Association)

Submitters were of the view that the following information should only have to be provided if it is held and reasonably accessible (that is, it has been digitised):

- joint investor information; (*AMP*)
- joint investor information and date of birth; (*ANZ, New Zealand Bankers Association*) and
- joint investor information, date of birth and IRD number. (*ANZ*, *New Zealand Bankers Association, Corporate Taxpayers Group*)

Comment

In order to reduce compliance costs for payers, officials agree with the submitters that information on joint owners and date of birth information that has not been digitised should not have to be provided to Inland Revenue. However, officials recommend that this only applies to any records received by the payer prior to 1 April 2018. Records received after 1 April 2018 should be provided to Inland Revenue, even if received or held in paper format.

Officials disagree with the submission that IRD numbers should only need to be provided where held in a digital format. An IRD number is a unique identifier and as such is a critical piece of information for Inland Revenue to receive as it enables income to be attributed to the correct investor.

Recommendation

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

Issue: Optionality for provision of combined or separate information

Submission
(ANZ, New Zealand Bankers Association)

The Bill is silent on how investment income information should be provided to Inland Revenue. Flexibility should exist for investment income information to be provided in either combined or separate formats. This will reduce compliance costs of payers by aligning with how information is stored across multiple systems, for example, it would be preferable to provide dividend information separately as such information is obtained from manual processes or from third parties.

Clarification on this topic should be provided through the Bill or through subsequent guidance from the Commissioner to ensure systems can be developed.

Comment

Officials agree with the submitters and guidance will be issued by the Commissioner.

Recommendation

That the submission be accepted.

Issue: Flexibility to provide cumulative or month by month information

Submission
(ANZ, New Zealand Bankers Association)

The Bill is silent on whether investment income information should be provided in cumulative format (that is, year to date) or non-cumulative format (that is, month by month). ANZ recommends that the Bill (or subsequent guidance) clarify that the information can be provided in either format. This will minimise compliance costs by aligning with how information is produced by payers' systems. For example, it is easier to provide cumulative information about interest income as this aligns with ANZ's systems, but this is not the case for certain dividend income.

Comment

Officials agree that clarity is needed on whether reporting will be month by month or cumulative. Using one method will reduce the risk of error. Officials therefore recommend that the Bill is amended to require investment income information in a month by month format.

Recommendation

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

Issue: End-of-year withholding tax certificates

Clause 211

Submission
(ANZ, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, New Zealand Bankers Association, KPMG)

Submitters support the removal of the requirement to provide annual withholding tax certificates where the taxpayer has provided their IRD number, but consider a significant benefit will not result from this as financial institutions already have the systems in place to provide these certificates and are likely to continue to do so. (*ANZ, Corporate Taxpayers Group, New Zealand Bankers Association, KPMG*).

Submitters have concerns with the removal of this requirement as it does not address the implications of taxpayers having to verify their year-end tax position. For example, verification of the allocation of income from jointly held investments may be problematic without a year-end certificate. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)*

Comment

While the requirement to provide annual withholding tax certificates will be removed, this does not prevent payers of investment income continuing to provide these certificates to their customers if they are concerned about their customers being unable to verify their year-end tax position.

Recommendation

That the officials' comments be noted.

Issue: Streamlining information reporting

Submission
(KPMG)

Consideration should be given to how provision of investors' identity information to Inland Revenue could be streamlined, such that only information that is "variable" in nature – for example, tax rate, the amount of investment income and tax deducted – is required to be transmitted periodically.

Comment

Large payers of investment income will be required to provide all the required information with each report as they will be providing this information in specialised files. For smaller payers of investment income, Inland Revenue will pre-populate online forms with non-variable information such as the name, date of birth and IRD number of the taxpayer that has been provided by the payer in previous returns.

Recommendation

That the officials' comments be noted.

Issue: Overlap with other investor information collection regimes

Submission
(KPMG)

Officials should consider how the various investor information collection regimes (that is, US FATCA, the new Common Reporting Standard, and non-tax "Know Your Client" information requirements such as anti-money laundering/countering the financing of terrorism laws) can be rationalised to reduce costs on affected entities. There is significant overlap in information collected under these different regimes. This consideration should be undertaken in consultation with affected financial institutions and investment providers to ensure a practical solution.

Comment

Officials met with a number of registered banks as the proposals for inclusion in the discussion document were being developed. They were all of the view that it would be easier to provide the information separately, rather than to determine what information had already been provided under other reporting regimes.

Recommendation

That the submission be declined.

Issue: Six monthly reporting of Prescribed Investor Rates (PIRs) by multi-rate Portfolio Investment Entities (PIEs)

Clause 212

Submission
(AMP, Corporate Taxpayers Group, KPMG)

The submitter supports the provision of PIRs six monthly (*AMP*).

An investor's PIR is set with reference to their prior years' income, therefore reporting PIRs annually would be sufficient. If Inland Revenue has concerns and wants to investigate the PIR of investors, they could request this from the particular PIE fund manager. (*Corporate Taxpayers Group*)

PIR reporting should only be required where there has been a change since the last reporting (*KPMG*).

Comment

Proposed new sections 25J and 25K in clause 212 of the bill currently require multi-rate PIEs to provide PIR information 6-monthly. Officials agree with the submitters that annual PIR reporting will be sufficient in most cases and consider that the status quo should be retained. Where Inland Revenue wishes to investigate the PIR of a particular investor, they will request this information from the PIE fund manager.

Recommendation

That the submission is accepted in part, subject to officials' comments.

Issue: Advancing the filing deadline from 31 May to 15 May for non-locked in PIEs

Clauses 212 and 246

Submission
(Chartered Accountants Australia and New Zealand, KPMG)

Chartered Accountants Australia and New Zealand supports the proposal to bring forward the reporting date for multi-rate PIEs that are not superannuation funds or retirement schemes from 31 May to 15 May following the end of the income year. *(Chartered Accountants Australia and New Zealand)*

KPMG cannot see how bringing forward the reporting date by two weeks will materially improve the calculation of social policy obligations/entitlements. (*KPMG*)

Comment

Bringing forward the reporting date from 31 May to 15 May for non-locked in PIEs (proposed new section 25J in clause 212) will allow the PIE information to be pre-populated in taxpayers' tax records sooner. This will enable the information to be automatically included in social policy income declaration forms (for Working for Families, child support and student loans) as well as enabling the income and tax credits to be pre-populated into income tax calculations where the taxpayer has selected a PIR that is too low. In addition, the information will be available to calculate the taxpayer's PIR for the following year at the time they would potentially look at their tax information. Each of these benefits is dependent on the PIE income information being pre-populated as soon as possible after the end of the tax year as the tax return and social policy processes need to be completed within a fixed time from the tax year end.

Recommendation

That the officials' comments be noted.

Issue: Further information as required by the Commissioner – PIEs

Schedule 2

Submission
(Financial Services Council)

The ambit of the provision to require further information as required by the Commissioner should be clarified in relation to PIEs.

Comment

This provision, in proposed new schedule 6 (schedule 2 of the bill), is intended to allow the Commissioner of Inland Revenue some degree of flexibility in setting the reporting that is required and is reproducing what is already required by section 57B of the Tax Administration Act 1994. Section 57B has been used to date by the Commissioner to specify the filing requirement for PIEs in the guide Inland Revenue produces (IR860).

Recommendation

That the submission be declined.

Issue: PIE filing due date – incorrect application date

Clauses 2 and 246

Submission
(Matter raised by officials)

Clause 246(4), which changes the PIE filing due date from 31 May to 15 May, should be amended to apply from the 2018–2019 income year (that is, year ending 31 March 2019).

Comment

The PIE filing due date change currently applies from 1 April 2018. This would have the effect of requiring the 2018 return to be filed by 15 May. It was intended that the earlier date apply to the 2019 and later returns, not the 2018 return.

Recommendation

That the submission be accepted.

Issue: Support for error correction proposals and extending them to PIEs

Clause 122

Submission
(AMP, ANZ, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, EY, Financial Services Council, New Zealand Bankers Association, KPMG)

The submitters support the proposed amendments relating to correcting errors in the following year without the imposition of penalties or interest *(AMP, ANZ, Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, New Zealand Bankers Association, KPMG).*

There is no need to defer the application of the error correction provisions until the new investment income reporting requirements take effect (*KPMG*).

The error correction provisions should be extended to include multi-rate PIEs *(AMP, ANZ, EY, Financial Services Council, New Zealand Bankers Association, KPMG).*

Comment

Officials agree with the submitters and recommend that PIEs are able to correct errors within one month of their discovery, by adjusting the investor's accruing tax liability in the fund, without the imposition of penalties or interest:

- during the year (no limit on the total amount of adjustments); or
- in the following tax year, provided the total adjustments for that year, relating to the previous year, do not exceed the greater of $2,000 or 5 percent of the PIE's tax liability for that previous year (that is, the year in which the error occurred).

The error correction provisions are intended to apply from when the new investment income reporting requirements take effect to reduce the burden of more frequent reporting.

Recommendation

That the submission is accepted in part, subject to officials' comments.

Issue: Error correction notification

Submission
(ANZ, New Zealand Bankers Association)

Notification to Inland Revenue of errors should occur separately from monthly electronic filings.

The Bill is silent as to how the IRD will seek correction of information if it becomes aware of errors. This could arise, for example, if the IRD identifies that a taxpayer is using an incorrect withholding rate. ANZ recommends that any communication to change the rate should come from Inland Revenue, as Inland Revenue holds the information on the taxpayer's total income, and therefore can best determine the appropriate rate.

Comment

Corrections made in the same tax year do not require reporting to Inland Revenue. As corrections made in the following tax year can be made by adjusting a subsequent payment to the payee, it is important that information on this correction is provided at the same time as the information on that subsequent payment is provided to Inland Revenue, so that income is allocated to the correct tax year.

Officials agree with the submitter that Inland Revenue will be better placed to advise of corrections to withholding tax rates. It is recommended that section 25A(2) of the Tax Administration Act 1944 is amended to provide that if the Commissioner notifies the payer that the payee is on an incorrect marginal rate, the Commissioner must also notify the payee.

Recommendation

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

Issue: Error correction mechanisms

Clause 122

Submission
(Chartered Accountants Australia and New Zealand, EY)

While the proposed de minimis rule allows withholding tax to be corrected in a subsequent period, it does not assist when amounts are above the threshold or the under-deduction is discovered after the payee has been assessed. *(Chartered Accountants Australia and New Zealand)*

No limit should be put upon the level of self-correction of errors given no tax is at stake, with any differences being of timing only. Inland Revenue would retain protection from any financial institutions deliberately under-reporting withholding taxes, as full disclosure is required and all other record keeping requirements and anti-avoidance laws within the tax acts would continue to apply. (*EY*)

Comment

A limit on the amount that could be corrected in the next tax year without the imposition of penalties or interest is necessary to prevent the deferral of tax. The timing difference may result in a significant revenue cost if a large error was not corrected until several years later.

Recommendation

That the submission be declined.

Issue: Error correction threshold

Clause 122

Submission
(Matter raised by officials)

The error correction threshold for corrections between tax years in clause 122(3) (proposed section RA 11(3)(b)) should be amended to provide that all adjustments made by the payer cannot exceed 5 percent of the payer's withholding liability for the year, rather than just the adjustment in question.

Comment

The error correction mechanism in section RA 11 provides that where a payer does not withhold enough tax from a payment of income to the payee, the payer may correct the error by subtracting from a later payment to the payee an amount to correct the deficiency. Clause 122 amends this provision to allow for the adjustment to be made in the next tax year, provided it is no more than the greater of $2,000 or 5 percent of the payer's withholding liability. As the threshold is based on the adjustment in question, rather than all adjustments made by the payer in the tax year, there is effectively no error correction threshold. No single payee adjustment is likely to equate to 5 percent of the payer's total RWT/NRWT liability. The threshold should state that total corrections made in the following year cannot exceed 5 percent of the payer's liability for the year that the correction relates to, not just the particular correction in question.

Recommendation

That the submission be accepted.

Issue: Correction of errors in the following year

Clause 122

Submission
(Matter raised by officials)

Section RA 11(3) should be amended to provide that the error must be corrected in the next reporting period following its discovery provided it is reasonably practical to do so.

Section RA 11(6) should be amended to require the payer to notify the Commissioner of an adjustment made under RA 11(3)(b) at the time the adjustment is made.

Comment

Section RA 11 provides that an underpayment error (where not enough tax has been withheld) may be corrected by withholding an amount from a later payment to the payee. It provides that the later payment must be made in the same tax year, or in the next tax year provided the adjustment is within a threshold. The result of this is that a taxpayer could discover an error at the beginning of a tax year, and not correct it until the end of the following year. This was not intended. It was intended that following discovery of the error, it should be corrected in the next available reporting period, with some allowance made for where it would not be reasonably practical to do so (for example, if an error was discovered immediately prior to a payment being due to the investor, it would be acceptable to wait and correct it in the next payment so as to avoid any delays in processing the payment).

Section RA 11(6) provides that a payer must notify the Commissioner, at the earliest possible opportunity, of an adjustment made in the following tax year, or by the next reporting date for the investment income type in question. It is important that Inland Revenue receives information on the correction at the time it is made so that Inland Revenue knows which income year it relates to.

Recommendation

That the submission be accepted.

Issue: Error correction mechanism for excess amounts

Clause 123

Submission
(Matter raised by officials)

Section RA 12(2) and RA 12(3) should be amended to provide an error correction mechanism for when a payer withholds an excess amount of NRWT.

Section RA 12(5) and RA 12(6) should be amended to ensure excess tax paid is not refunded twice.

Comment

Section RA 12(1) states that the section applies to RWT and NRWT, but the error correction mechanism in RA 12(2), which allows the payer to repay the excess amount to the payee, is currently limited to resident passive income. Section RA 12(2) and RA 12(3) should be amended to apply to NRWT.

Section RA 12(5) provides that if the tax has already been paid to the Commissioner, the Commissioner must refund the excess amount to the payee. If the Commissioner has refunded the excess amount to the payee, RA 12(6) provides that the payer may subtract the amount from a later payment to the Commissioner, or apply for a refund. The result of this would be to effectively refund the excess twice.

Example

Suppose a payer pays the payee $77 ($100 gross income, $33 tax deducted, instead of $10.50, that is, tax is over-withheld by $22.50). The Commissioner then refunds $22.50 to the payee, resulting in Inland Revenue collecting $10.50 of tax. If the Commissioner was to allow the payer to get a refund of the amount over-withheld, or allow it to be deducted from a subsequent payment, the net effect would be: $89.50 to the payee, $22.50 to the payer, and negative $12 to Inland Revenue.

It appears to be an inconsistency in the Income Tax Act. The equivalent to section RA 12 in the 2004 Act was sections NF 6, NF 7, NG 16 and NG 16A. These sections provided that where an excess deduction of RWT or NRWT was made:

- The Commissioner must refund the excess deduction to the payee, or to the payer where the payer has already paid the amount of the excess to the payee.
- Where the payer has refunded the amount to the payee and has not received a refund from the Commissioner, the payer may offset the amount from subsequent tax payable to the Commissioner.

Sections RA 12(5) and (6) should be amended to reflect this.

Recommendation

That the submission be accepted.

Issue: Tax payments arising from an error

Clause 124

Submission
(Matter raised by officials)

Sections RA 15(5) and RA 15(6) should be repealed.

Comment

Sections RA 15(5) and RA 15(6) provide that where there is an error and an amount remains unpaid, the person must pay it to the Commissioner no later than 20 April after the end of the tax year. The proposed amendments to section RA 11 in clause 122 provide that an underpayment error can be corrected by subtracting an amount from a subsequent payment to the payee. This amount is then paid to the Commissioner at the relevant reporting date for the subsequent payment, which is the 20th of the following month per section RA 15(2), not after the end of the year as suggested by section RA 15(6). Sections RA 15(5) and RA 15(6) should be repealed.

Recommendation

That the submission be accepted.

DIVIDENDS

Clause 212

Issue: Application to deemed and non-cash dividends

Submission
(Belmont Partners, AMP, Corporate Taxpayers Group)

The legislation should specifically clarify whether the proposals apply to deemed dividends and non-cash dividends. *(Belmont Partners)*

The dividend reporting requirements should only apply to taxable cash dividends provided to shareholders. (*AMP*)

In many instances companies may not be aware that the manner in which they have transacted with a shareholder could constitute a dividend for tax purposes until after the fact when tax advice is sought when preparing tax returns. The investment income reporting rules should only apply to cash dividends. (*Corporate Taxpayers Group*)

Comment

Officials disagree with the submission. Deemed and non-cash dividends are still part of a taxpayer's income. Information on this income, as required by proposed new section 25G in clause 212, will be necessary for pre-population and to proactively adjust tax rates and social policy payments.

However, officials sympathise with Corporate Taxpayer Group's submission and recommend that the error correction provisions in clause 122 are extended to cover this situation. Clause 122 provides that an underpayment error (that is, where not enough tax has been withheld) may be corrected by withholding an amount from a later payment to the payee or by recovering the amount from the payee. This would not work for non-cash dividends as the tax is calculated by grossing-up the payment. Extending the error correction provisions allow a company that has genuinely misunderstood the tax consequences of their transaction to return the tax and associated information the following year without the imposition of penalties or interest. Payers would make a correction by grossing-up the payment for the tax (provided this adjustment meets the thresholds for corrections made in the following tax year).

Recommendation

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

Issue: Company dividend statement

Submission
(Belmont Partners)

The requirement to provide company dividend statements to Inland Revenue should be repealed as Inland Revenue will already be obtaining the information under the proposed changes.

Comment

Officials agree with the submitter. Instead of having a separate company dividend statement, officials recommend that the additional information required by the company dividend statement that is not covered by monthly reporting be added to the monthly reporting requirements, and the company dividend statement requirement removed.

Recommendation

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

Issue: Deemed dividends and public unit trusts

Submission
(AMP)

Taxable deemed dividends on withdrawals from a public unit trust can accrue to either the fund manager or withdrawing investor (depending on the withdrawal method), where the unit trust has not elected into the PIE rules. Most commonly this is seen in legacy public unit trusts where system constraints have prevented PIE election. Deemed dividends are subject to imputation and RWT. Given the legacy nature of these products, with many in run-off across the industry, AMP submits that taxpayer level information is most efficiently reported on an annual basis.

Comment

Officials agree with the submitter and recommend that dividend reporting for public unit trusts is due annually by 15 May after the end of the tax year.

Recommendation

That the submission be accepted.

Issue: Dividend information and foreign companies

Submission
(ANZ)

The Bill should clarify that foreign companies are not required to provide detailed investor information.

Comment

To provide certainty, officials recommend that proposed new section 25C (in clause 212) is amended to refer to resident passive income subject to a withholding obligation under sections RE 3 and RE 4 of the Income Tax Act 2007.

Recommendation

That the submission be accepted.

Issue: Reporting requirements for dividends between wholly-owned companies

Submission
(AMP, ANZ, Corporate Taxpayers Group)

Dividends paid between wholly-owned companies should be exempt from the reporting requirements, as this information is more efficiently reported through disclosures in annual income tax returns. *(AMP, ANZ)*

There should be no need to provide more frequent reporting on exempt dividends paid between companies than is currently the case. (*Corporate Taxpayers Group*)

Comment

Dividends paid between wholly-owned companies are currently exempt from the reporting requirements in the Bill. These dividends are excluded from the definition of resident passive income per section RE 2(5)(a). Proposed new section 25C of the Bill provides that the reporting obligations in proposed new subpart 3E only apply to resident passive income. To provide certainty, officials recommend that proposed section 25E(1)(c) is amended to refer to a “taxable dividend”.

Recommendation

That the officials’ comments be noted.

RWT FILING DEADLINE (TRANSITIONAL PROVISION)

Clauses 239 and 241

Issue: Advancing the filing deadline from 31 May to 15 May for RWT and NRWT

Submission
(ANZ, New Zealand Bankers Association)

The submitters do not support bringing forward the deadline for filing annual reconciliations for RWT and NRWT from 31 May to 15 May in May 2019 and May 2020 (from 1 April 2020, the information will be provided monthly). The provision of this information is currently a manual process, and will be occurring at the same time as significant systems changes are made to meet the new monthly information reporting requirements. Advancing the filing deadlines creates a risk of errors arising in the annual filings as the same resource involved in completing the annual reconciliation within a compressed timeframe will also be involved in the systems and process development.

Comment

While officials understand the submitters' concerns, bringing forward the due date will enable Inland Revenue to pre-populate interest and therefore to issue PTSs and refunds to taxpayers sooner.

Pre-population is also considered important for the years ended 31 March 2019 and 2020 as it will allow the recipients of interest to confirm that the interest income being pre-populated is the same as the interest income being shown on their end of year tax certificates. This will allow recipients the opportunity to gain confidence in the pre-population process or raise any concerns before the removal of the requirement for interest payers to provide end of year tax certificates takes effect.

Recommendation

That the submission be declined.

Issue: Transitional provision

Submission
(Matter raised by officials)

Clause 239 should be amended to ensure that the 15 May reporting date does not apply to payers of royalties.

Comment

Clause 239 provides that NRWT withholding certificates and annual reconciliations must be provided to the Commissioner by 15 May instead of 31 May for the 2019 and 2020 tax years (the "transitional provision"). The rationale behind this is to ensure that payers of investment income do not have two reporting dates as the RWT due date is being moved forward to 15 May to facilitate pre-population tax returns prior to monthly reporting applying. The RWT and NRWT information comes from the same system so it is easier to report it at the same time. The transitional provision currently applies to royalties, however payers of royalties will not need to provide information monthly from 1 April 2020, the current requirement of yearly reporting on 31 May will remain. The effect of this transitional provision on royalties is to therefore change the reporting date for the 2019 and 2020 tax years to 15 May, which will then revert back to 31 May from 1 April 2020. This was not intended.

Recommendation

That the submission be accepted.

Issue: Application date of transitional provisions

Submission
(Matter raised by officials)

Clauses 239 and 241 should apply for the 2018–19 and 2019–20 tax years, as opposed to income years.

Comment

Clauses 239 and 241 require payers of investment income to provide year-end information relating to NRWT and RWT by 15 May instead of 31 May. It would be inappropriate for this to apply from an income year, given the reporting of RWT/NRWT does not operate on an income year basis. It should instead apply for the 2018–19 and 2019–20 tax years.

Recommendation

That the submission be accepted.

Issue: Provision of information relating to RWT exempt payers

Clause 212

Submission

(Corporate Taxpayers Group, New Zealand Bankers Association, Olivershaw)

The group does not support the proposal to require payers to provide taxpayer specific information to Inland Revenue in relation to payments made to persons with RWT-exempt status by 20 April following the end of the tax year.

As currently drafted, this will require reporting on investment income unless the payment was not in furtherance of a taxable activity. At its most extreme, it would require any individual with a rental property who is paying interest to a bank to report that interest to Inland Revenue.

In order to keep within the purpose of the investment income proposals – namely to pre-populate individuals' tax returns and ensure more accurate social policy calculations, this reporting should be limited to investment income payments made to RWT exempt individuals.

There are a number of instances where the group believes reporting is unwarranted or would create undue compliance costs. New Zealand Bankers Association encourages officials to consider these scenarios:

- interest paid to financial institutions;
- interest paid between related companies that are not wholly-owned;
- hire purchase and finance leases;
- interest on SME overdrawn current accounts;
- overdue trade credit accounts; and
- dividends exempt from tax (between wholly-owned companies).

New Zealand Bankers Association queries the need to report detailed investment income information regarding interest paid to holders of certificates of exemption. By creating an electronic database of taxpayers with RWT-exempt status, Inland Revenue should have increased certainty of accuracy of tax positions without the need to impose additional compliance burdens on banks to report detailed information which is unlikely to provide any benefit to Inland Revenue. (*New Zealand Bankers Association*)

This proposal should be removed from the Bill or a number of exemptions made to it. Holders of certificates of exemption from withholding tax are generally banks, large corporates and high net wealth individuals who do not have 31 March balance dates, and therefore the reporting of this information is of no relevance. (*Olivershaw*)

Comment

Officials agree with the submitters that the proposal to require payers to provide taxpayer-specific information to Inland Revenue in relation to payments made to persons with RWT-exempt status (proposed new section 25M), should be removed from the Bill. This proposal would require a significant number of exemptions in order to be workable, and even then, the value of this information is likely to be limited given that Inland Revenue will be establishing an electronic database of taxpayers with RWT-exempt status. There are some people with RWT exempt status that it would be useful for Inland Revenue to receive information about, however, it would be difficult for payers to single out these people. Officials therefore recommend that the Commissioner obtain this information as needed by requesting it from the payer.

Recommendation

That the submission be accepted.

Issue: RWT-exempt status

Clauses 163, 220 and 224

Submission
(ANZ, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, New Zealand Bankers Association, KPMG)

The submitters are supportive of the proposal to create an electronic database of current certificates of exemption. *(ANZ, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, New Zealand Bankers Association, KPMG)*

KPMG also supports the proposed requirement for investors who have ceased to be RWT-exempt to inform their investment provider. (*KPMG*)

Recipients of investment income exempt from tax under another Act should be granted an exemption automatically as Inland Revenue should already have sufficient details available – for example, through the Charities Register. (*EY*)

Comment

Officials welcome the support.

Officials disagree with EY's suggestion that exemptions should be automatically granted to recipients of investment income exempt from tax under another Act. It will not be possible to confer exemptions automatically on entities exempt under other Acts, as many of these are not subject to a regulatory body, such as the Charities Services – Department of Internal Affairs, from which information on those entitled to an exemption can be obtained.

Officials note that charities are exempt from tax under the Income Tax Act 2007, not another Act. Officials will consider granting charities RWT-exempt status as a matter of course, and will proactively contact persons exempt under other Acts where possible.

Recommendation

That the submissions be noted, and one declined.

Issue: The information published on the electronic register of RWT-exempt status should be limited

Clause 220

Submission
(Russell McVeagh)

The information that the Commissioner must publish on the electronic register of persons with RWT-exempt status should be limited to the person's IRD number and the start date and end date of their RWT exempt-status. It would be inappropriate for the Commissioner to publish the name of a person alongside their IRD number on a publicly searchable register as this would allow anybody to search the register and access the tax file number of a person.

Comment

Officials agree with the submitter. The publication of the person's IRD number and start and end date of their RWT exempt-status will be sufficient to allow payers to verify whether a person has RWT-exempt status whilst also adequately protecting their privacy. This is also consistent with what is currently published in the New Zealand *Gazette*.

Recommendation

That the submission be accepted.

Issue: The methods for determining RWT-exempt status

Clause 163

Submission
(Russell McVeagh)

In addition to the proposed new method – searching the electronic register – the two existing methods for allowing "Person A" to determine whether "Person B" has RWT exempt status should remain, namely that:

- person A has taken reasonable steps to confirm that person B is a person listed in section 32E(2)(a) to (h) of the Tax Administration Act 1994;
- except in relation to a person listed in section 32E(2)(k) or (l) or to whom a certificate has been provided under section 32I, person A has been given person B's tax file number and has been notified that person B has RWT-exempt status.

Removing these methods does not simplify the process in all situations and will increase compliance costs in some situations.

Comment

Officials agree with the submitter that the two existing methods should remain. This would reduce compliance costs in some instances – for example, a person paying interest on their mortgage would not need to check the register to determine that their bank was exempt from RWT. The fact that the person knew they were paying to a bank would be sufficient to constitute "reasonable steps" to determine that the bank was a person listed in section 32E(2)(a) to (h).

Recommendation

That the submission be accepted.

Issue: Tertiary education subsidiaries and RWT-exempt status

Clause 218

Submission
(Matter raised by officials)

Clause 218 of the Bill should further amend section 32E of the Tax Administration Act 1994 to enable tertiary education subsidiaries to qualify for RWT-exempt status. The amendment should apply from 1 July 2008.

Comment

Tertiary education institutions (TEI) and subsidiaries that applied their income for the purposes of the TEI were generally income tax exempt as charities until 1 July 2008, when a requirement was introduced for charities to be registered with the Charities Commission[7] in order to be tax exempt. Because the TEIs would have been subject to multiple reporting and monitoring requirements, a specific exemption was enacted for them in section CW 55BA, but this did not cover their subsidiaries.

To restore the position that existed for tertiary education subsidiaries (TES) before the original enactment of section CW 55BA, the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act widened the exemption to include TESs.

There appears to be an unintended gap in the legislation as there is currently a specific provision (section 32E(2)(kc) of the Tax Administration Act 1994) that allows a TEI to apply for RWT-exempt status, but no provision for TESs. This means that unless a TES is able to qualify on other grounds (such as turnover exceeding $2 million), they will be unable to qualify for RWT-exempt status. It was not intended that an entity exempt from tax would be unable to apply for an exemption from withholding tax.

[7] Now Charities Services – Department of Internal Affairs.

The fiscal impact of this is in timing only as currently TESs are subject to withholding tax but exempt from tax generally.

Recommendation

That the submission be accepted.

Issue: RWT-exempt status – electronic register

Clause 220

Submission
(Matter raised by officials)

Clause 220 should be amended to require the Commissioner to publish the IRD numbers of persons granted RWT-exempt status on an electronic register.

Comment

Clause 220 currently only requires the Commissioner to add the details of persons granted RWT-exempt status to the electronic register. The intention was that this information would be published. This is consistent with clause 224 which requires the Commissioner to publish on an electronic register a list of all persons whose RWT-exempt status has been revoked.

Recommendation

That the submission be accepted.

Issue: Interaction of financial arrangement rules

Submission
(Chartered Accountants Australia and New Zealand)

Non-cash basis persons return financial arrangement income on an accruals basis, whereas in the future, tax records will be pre-populated on a cash basis. There needs to be some mechanism to alert taxpayers that the financial arrangement rules may apply so that taxpayers can calculate and return investment income on an accruals basis when that applies.

Comment

Officials agree with the submitter's comment and will consider including an alert mechanism on myIR as part of the online form design, as well as guidance on the Inland Revenue website.

Recommendation

That the officials' comments be noted.

Issue: Accruals-based tax system and cash-based reporting

Submission
(EY)

An accruals-based tax system does not sit well with cash-based reporting. Reporting income on a cash basis will lead to inaccuracies. For example, dividends are not always received in cash. Also the financial arrangement rules will be particularly problematic as cash basis persons will be required to complete a base price adjustment on the disposal or maturity of investments. Many individuals are required to return financial arrangement income on an accruals basis, in which case the information provided to Inland Revenue by their financial institution may bear almost no relationship with their actual taxable income. Unless the Government plans to significantly amend the tax treatment of investment income, these proposals will not work for many taxpayers.

Comment

The rules have been designed to work for the majority of taxpayers. There will always be taxpayers for whom the rules do not provide the final taxable income position – for example, taxpayers required to return income on an accruals basis under the financial arrangement rules. Work is currently under way to reduce the number of taxpayers that have to return interest under the financial arrangement rules. This will generally leave a minority of potentially more sophisticated taxpayers subject to the accrual method of returning interest income. Officials also note that accruals basis taxpayers already receive end of year tax certificates from banks on a cash basis and are required to calculate their tax position on an

accruals basis under current law and do not consider that the changes make a significant difference to this position.

Cash basis taxpayers will only be required to complete a base price adjustment on a few specific types of investments. Pre-populating income for these taxpayers will be accurate for all years except for the year of maturity or disposal where a base price adjustment may be required.

Officials note that non-cash dividends will have to be reported and will be pre-populated. While reporting for non-cash dividends is more likely to be done manually rather than via computer systems, it will only lead to inaccuracies where an error is made.

Recommendation

That the submission be declined.

Issue: Information on financial arrangements

Clause 212

Submission
(Corporate Taxpayers Group)

The group does not support requiring a person with RWT-exempt status to provide detailed information in relation to the acquisition or disposal of financial arrangements with their return of income for the year.

The group understands that this is currently required under the Tax Administration Act 1994 and the proposal simply moves this obligation to a new section, however, there is widespread non-compliance with this section and Corporate Taxpayers Group query the need for it. If this provision is required, Inland Revenue should demonstrate how it uses this information and what the benefit of this information is.

Comment

Officials agree with the submitter. This provision (section 53 of the Tax Administration Act 1994, moved to proposed new section 25O in clause 212 of the Bill), is not being used and therefore should be removed from the Bill.

Recommendation

That the submission be accepted.

ELECTRONIC FILING

Issue: Encouraging electronic filing

Clause 212

Submission
(Chartered Accountants Australia and New Zealand)

Chartered Accountants Australia and New Zealand supports the requirement to file investment income information electronically.

Recommendation

That the submitter's support be noted.

Issue: Non-electronic filing penalty

Clause 269

Submission
(KPMG)

The focus should be on helping taxpayers to comply with the new electronic filing requirements, rather than necessarily penalising them. It is critical for small payers that a simple electronic filing option is made available (such as a web-based portal).

Comment

Paper filing is slower, more expensive in terms of compliance costs for payers of investment income and administrative costs for Inland Revenue, and more prone to errors. Officials therefore recommend that the proposed non-electronic filing penalty is retained, and note that there is an exemption from electronic filing available for taxpayers unable to access digital services and that an online form will be available for filing which may be more suitable for small payers of investment income.

In the early stages of the new requirements, it is intended that the Commissioner will adopt a compliance improvement focus and be in touch with taxpayers to raise awareness and assist compliance. In addition, officials recommend that the Bill should provide the Commissioner with flexibility around whether to impose non-electronic filing penalties during the early stages of the new investment income information regime.

Recommendation

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

APPROVED ISSUER LEVY

Clause 212

Submission
(ANZ, New Zealand Bankers Association)

The Bill should clarify that the approved issuer levy (AIL) information requirements for investors does not extend beyond the initial investor (such as nominees).

While nominees inform ANZ of the amount of AIL to be paid in respect of the investors they hold on behalf of, ANZ may not have access to the detail required in the Bill of who they hold the debt on behalf of. As such, it would be prohibitive, and in some cases potentially impossible due to foreign privacy laws, to trace through nominees to obtain and provide details of ultimate investors to the Inland Revenue.

Comment

The requirements on payers of AIL are contained in proposed new sections 25E and 25F (clause 212 of the Bill). Officials agree with the submitter that it may not be possible to obtain information on investors who have invested via an agent or nominee. Officials recommend that the Bill be amended to provide that only information on the initial investor is required.

Recommendation

That the submission be accepted.

Issue: Information on joint account holders

Clause 212

Submission
(ANZ, New Zealand Bankers Association, Financial Services Council)

Further clarification is required on who is considered to be joint account holders, particularly in the case of partnerships, trusts and companies. For example, it is uncertain what will constitute a joint holder in the case of a partnership, a trust or a company having an account with a bank (that is, will it be necessary to identify all partners in the partnership, all trustees or beneficiaries in respect of a trust and all shareholders in respect of a company). Identifying the "controlling persons" of such entities for Automatic Exchange of Information purposes has caused (and continues to cause) significant issues for both financial institutions and customers. A light touch should be adopted for the purposes of the Bill. (*ANZ, New Zealand Bankers Association*)

The Financial Services Council is concerned about the number of records its members will need to capture and store on joint owners, for example, multiple trustees, and requests these data requirements be limited to the extent possible. (*Financial Services Council*)

Comment

Proposed new section 25D in clause 212 sets out the information that payers must provide in relation to joint accounts. Officials recommend that the Bill is amended to provide that information on the beneficiaries of a trust, shareholders of a company, and partners in a partnership that are required to file a joint return (a "formal partnership"), is not required. The rationale behind obtaining more frequent information is to enable pre-population of tax returns and to allow Inland Revenue to adjust tax and social policy payments. Income earned by a trust/company is generally not income to the beneficiaries/shareholders until distributed, which may not occur until sometime later. It would therefore be contrary to this rationale to obtain the information at the point where income was paid to the trust or company.

For look-through companies (LTCs), and partnerships that are required to file a partnership return, there is little benefit in receiving this information to enable pre-population into the LTC/partnership tax return, given the shareholders/partners will then need to file their own returns and include the income relative to their respective shares.

Information on the partners in a partnership will be required where it is held by the payer, however not for formal partnerships as mentioned above.

Recommendation

That the submission be accepted.

Issue: Joint investments – splitting investment income

Submission

(Chartered Accountants Australia and New Zealand, Financial Services Council)

Joint owner account information should not be automatically assessed on the assumption of an equal split as this will often be incorrect. Joint owners should have the option of determining how the income is apportioned, however if the proposal to pre-populate the income on an equal basis proceeds, the Commissioner should be required to alert the taxpayer that jointly owned investment income has been included in their tax record based on the assumption that it has been derived in equal shares. *(Chartered Accountants Australia and New Zealand)*

The Bill should be amended to provide clarity in relation to joint owners, including the basis of splitting by the Commissioner. (*Financial Services Council*)

Inland Revenue should publish guidance on how it will split investment income between joint account holders. (*Financial Services Council, AMP*)

Comment

Officials recognise that pre-populating income on the basis of equal shares may not be correct in all instances. However, by not pre-populating the information there is a risk that the income will not be returned. Whilst tax would have been withheld on that income, not including it on the taxpayers' tax information may affect the tax rate applicable to the taxpayers' other sources of income.

Officials recommend that this income is pre-populated on the assumption that the income was earned in equal shares, however agree with the submitters that taxpayers are notified of this and given the option of adjusting their income shares. This process can be dealt with administratively and does not require an amendment to the proposed provisions in the Bill – the *Tax Information Bulletin* can explain that Inland Revenue will allocate joint account income to the owners on a proportionate basis. Where that allocation is incorrect the owners will have the opportunity to adjust this to reflect their true income share. Inland Revenue will notify taxpayers of this through myIR.

Recommendation

That the submission be accepted in part.

PROVISION OF INVESTMENT INCOME INFORMATION BY MĀORI AUTHORITIES

Clause 212

Submission
(EY)

When providing investment income information, a Māori authority should:

- not be required to seek, obtain and check additional information from or relating to beneficiaries;
- be able to provide information in a format which can be extracted easily from existing systems; and
- be allowed to provide information regarding identity once only, with further returns required only when updated details are available.

In addition, the Commissioner of Inland Revenue should confirm that she will not seek to convict a Māori authority of any offence if it is unable to provide the required information.

Several larger Māori authorities have more than 10,000 beneficiaries generally in receipt of small amounts. Contact details are not always available for the beneficiaries. Some Māori authorities will withhold tax and make a payment to the latest bank account on record but find that money is returned because the account is closed and they are unable to contact the beneficiary. Unlike other investors, Māori authority beneficiaries do not choose to invest in a particular institution. Instead, fragmented ownership interests over the last century mean that many beneficiaries have died, with their personal representatives unaware of any Māori authority entitlements.

Comment

Officials largely agree with the submitter that the information requirements on Māori authorities in proposed new section 25I (clause 212) should be revised, and recommend that:

- In relation to information a Māori authority receives from its customers, for example, name, contact details, date of birth, IRD number and tax rate, they are only expected to pass on the information provided to them. Officials recommend that this is clarified in the *Tax Information Bulletin*.
- Date of birth information received by the Māori authority prior to 1 April 2018 that has not been digitised does not have to be provided to Inland Revenue.
- For smaller Māori authorities, Inland Revenue will look into pre-populating online forms with identity information. Large Māori authorities will be required to provide this information with each report as they will be providing this information in specialised files.

Recommendation

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

Issue: Measures to encourage the provision of IRD numbers

Clauses 81, 85, 180(2) and 215

Submission
(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Financial Services Council, KPMG)

The submitters support the increase of the non-declaration rate from 33% to 45% for interest income (*KPMG, Corporate Taxpayers Group*), and the requirement that investors opening new investments in PIEs provide their IRD numbers within 6 weeks in order to remain a member of the PIE. (*Corporate Taxpayers Group, EY, Financial Services Council*)

Chartered Accountants Australia and New Zealand also support both of the above measures, but not for existing account holders.

EY submits that the proposal to increase the non-declaration rate for interest income from 33% to 45% should not proceed. A 33% non-declaration rate will ensure that income tax is paid in full except in rare cases where individuals' social policy obligations leave them with a higher marginal tax rate. Forcing existing investment income account providers to add a further withholding rate is likely to add compliance costs with little impact on tax revenue. (*EY*)

Specific provision should be made in relation to the tax file number requirement for non-residents that subsequently become resident and the notification of such to the PIE. *(Financial Services Council)*

Comment

Officials welcome the support.

Officials disagree with submitters' suggestions that the increased non-declaration rate not apply to existing account holders or not apply at all. The increased non-declaration rate is intended to incentivise taxpayers to provide their IRD numbers to their investment income provider. Currently 20 per cent of interest certificates received by Inland Revenue do not contain the recipient's IRD number, if the increased non-declaration rate proposals only applied to new accounts, these taxpayers would have no incentive to provide their IRD number to their investment income payer.

The non-declaration rate needs to be higher than 33% in order to incentivise taxpayers on a 33% marginal rate, and those with social policy entitlements/obligations who may have a higher effective tax rate, to provide their IRD number to their investment provider. In 2015, the average annual household income of taxpayers receiving Working for Families was $90,948 and the median was $75,920. Taxpayers on the 17.5% marginal tax rate would have an effective tax rate above 33% once Working for Families abatement is considered.

A 45% non-declaration rate is consistent with the non-declaration rate applicable to salary and wage income.

Inland Revenue intends to work with the banks to reduce the number of taxpayers subject to the non-declaration rate prior to its increase to 45%.

Officials agree with Financial Services Council's suggestion that provision be made for non-resident PIE investors that subsequently become residents. Officials recommend that these taxpayers are given 6 weeks from notifying their PIE that they have become resident to obtain an IRD number in order to remain a member of the PIE.

Recommendation

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

Issue: Sharing IRD number data

Submission
(ANZ, New Zealand Bankers Association)

It would be useful to share IRD number information between IRD and payers of investment income. It is highly likely that the IRD will have IRD number data which banks do not have. Sharing such information in advance of 1 April 2020 will minimise the number of taxpayers impacted by the increase in the non-declaration rate.

Comment

Officials agree with the submitter and propose that the matter be subject to consultation. It could then be included in a future tax Bill. As an interim measure, Inland Revenue will consider ways to work with banks to share IRD numbers on an administrative basis.

Recommendation

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

Issue: Date of birth

Clauses 212, 284 and schedule 2

Submission
(EY)

Investment income information should exclude a customer's date of birth. The customer's IRD number is already a unique identifier; therefore date of birth information will only be useful to identify taxpayers who have not provided their IRD number. The marginal identification benefits of providing this is likely to be exceeded by the compliance costs.

Comment

In addition to taxpayers who have not provided their IRD number, date of birth information is useful in confirming a taxpayer's identity where two or more taxpayers have the same name or where an incorrect IRD number has been provided. Obtaining date of birth information would also enable Inland Revenue to associate information received from other government agencies with the correct taxpayer, and vice versa.

Recommendation

That the submission be declined

Issue: Interest and dividends between associated parties in the small and medium enterprise (SME) sector

Submission

(Olivershaw, Belmont Partners)

Interest and dividends paid between associated parties in the SME sector should be exempt from RWT and instead taxed under the provisional tax rules.

This treatment would be consistent with how shareholder salaries are taxed and recognises that interest and dividends paid by SMEs can be close substitutes for salaries. It would result in material compliance cost savings as the accountant could calculate the tax payable as part of completing the end of year tax return, rather than having to withhold RWT and report on it during the year. Further, the tax would be paid earlier under provisional tax than it currently is under the RWT rules as interest in a closely-held company is generally paid at the end of the year. (*Olivershaw*)

The Bill is silent on how year-end interest calculations are treated – for example, interest charged on overdrawn shareholders' current accounts, where the interest is calculated and paid when the tax return is filed, which is after the end of the tax year. This gives rise to the following issues:

- *In which year will the interest be taxable*: Under current law the interest is returned in the year it relates to, but RWT is not withheld until the following year when the interest is paid. Given Inland Revenue will be pre-populating tax returns, this may indicate that Inland Revenue is expecting the interest to be returned in the year it was paid.
- *RWT credits*: RWT credits can only be claimed once the interest has been paid, despite the interest relating to, and being returned in, the prior year.

Belmont Partners submits that year-end interest accruals should be exempt from RWT, or deemed to arise in the subsequent year, and that RWT credits should be able to be claimed in the year in which the interest income is returned.

Inland Revenue guidelines in regards to the appropriate method for calculating interest on overdrawn shareholders' current accounts and non-interest advances to associated persons would be welcomed as calculation practices currently differ. Further, when the current account becomes overdrawn part way through the year, it is unclear whether the gross interest or net interest income is to be used for RWT reporting purposes. (*Belmont Partners*)

Comment

Officials acknowledge the issues in this area; however, it is out of scope of the proposals in the Bill which focuses on the administration of investment income information, rather than what income is or is not subject to RWT. Further, a proposal of this magnitude would need to be consulted on before it was proceeded with. Officials will recommend that the Government considers this issue for inclusion in the next tax policy work programme.

Inland Revenue guidelines outlining the appropriate calculation methods for interest on shareholders' current accounts and non-interest advances to associated persons has not been published and is out of the scope of this Bill.

In relation to whether the net or gross interest amount should be used for reporting purposes, guidelines were published in March 1991, *Tax Information Bulletin*, Vol. 2 No. 7, page 8. This *Tax Information Bulletin* concluded that the RWT rules apply when interest is "paid" which requires the amount to be quantified and either paid, credited to, or otherwise dealt with in the interests of the shareholder – which generally occurs when the accounts are actually ratified. Therefore, in response to the submitter's question, the net amount should be used for RWT reporting purposes.

Recommendation

That the officials' comments be noted.

Issue: Responsibility for providing correct information

Submission
(Corporate Taxpayers Group, New Zealand Bankers Association, EY)

The Bill is silent as to who the onus of proof would be on to ensure the taxpayer specific information provided to Inland Revenue was correct, or whether any penalties would apply for failing to provide correct information. Financial institutions are reliant on their customers to provide accurate data (that is, their IRD number); therefore the onus should be on the customer. The financial institution should not be required to follow up with the customer if Inland Revenue's system identifies that incorrect information has been provided. The responsibility for following up any discrepancies should lie with Inland Revenue.

Comment

The responsibility for following up discrepancies in information provided will be Inland Revenue's.

The onus will be on customers to provide accurate identity information to their investment income payer – for example, name, contact details, date of birth, IRD number and tax rate. Payers of investment income are only expected to pass on to Inland Revenue the information their customers provide them. For information determined by the payer, for example income paid and tax withheld, the onus would be on the payer to get this right and the existing penalties provisions in the Tax Administration Act 1994 would apply.

Officials recommend that this is clarified in a *Tax Information Bulletin.*

Recommendation

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

Issue: Method of reporting information

Submission
(Corporate Taxpayers Group)

Inland Revenue should be flexible in regards to the methods allowed for reporting information. For example, smaller businesses may use spreadsheets to record information, whereas larger businesses use registry systems.

There should be an electronic gateway for businesses to provide information to Inland Revenue, with the additional option of an online form for payers who would not be suited to using the electronic gateway.

Comment

Officials agree with the submitter. The *Making Tax Simpler: Investment income information* discussion document released in July 2016 proposed both the electronic gateway and the online form as methods for providing information to Inland Revenue. Inland Revenue will be making these two options available. This can be dealt with administratively without the need for legislation.

Recommendation

That the officials' comments be noted.

Issue: Provision of investment income information by financial intermediaries

Clause 212

Submission
(EY, Financial Services Council, KPMG)

The Bill should be amended to clarify the requirements of the investment income information proposals for intermediaries such as custodians[8] and wrap account service[9] providers. (*EY, Financial Services Council, KPMG*)

Further consultation with financial intermediaries should occur before any recommendations on this are made. (*EY*)

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[8] A custodian holds assets on behalf of clients in the name of the custodian and will only act on proper instructions from their client (or a party authorised by their client). The use of a custodian achieves a segregation of duties between the role of the client's investment manager (and brokers and other market players) and the legal ownership of the client's assets. The custodian will also process transactions, provide settlement of trades, provide consolidated reporting of holdings and provide monitoring of payments services associated with the assets held.

[9] A wrap account allows investors wishing to simplify their investments and their administration to consolidate all of their investments in one place. Investors are able to access various investments through a single account. A single consolidated tax report is also received at the end of each year, providing potential savings on accounting fees.

Comment

Officials agree with the submitters. However, this matter will require public consultation so is therefore unable to be included in this Bill. Officials will recommend that the Government considers this issue for inclusion in the next tax policy work programme.

Recommendation

That the officials' comments be noted.

Issue: Notified investor rates

Schedule 2

Submission
(Russell McVeagh)

The reference to “prescribed investor rate” and “the tax rate of the investor” in proposed schedule 6, table 1 of the Tax Administration Act 1994 (schedule 2 of the Bill) rows 11 and 12, should be replaced with “notified investor rate” and “the tax rate of the investor for the period as notified to the payer”.

Comment

Officials agree with the submitter. Payers of investment income will only hold information on the tax rate or PIR that an investor has declared to them. While this may be the same as the investor’s tax rate or PIR most of the time, it may be different – for example, where the investor misunderstood the rules and gave the PIE an incorrect rate. Payers of investment income cannot be expected to determine the correct withholding rate or PIR for their investors, but rather to pass on to Inland Revenue the rate provided to them by the investor.

Recommendation

That the submission be accepted.

Issue: Evidential requirements for tax credits

Submission
(Matter raised by officials)

Section 78D of the Tax Administration Act 1994 should be amended to only require evidence of a tax credit from non-declared taxpayers.

Comment

Section 78D requires a taxpayer who has a tax credit to provide the Commissioner with a shareholder dividend statement, RWT withholding certificate, or Māori authority distribution statement, depending on the tax credit being claimed. This is no longer appropriate for declared taxpayers as Inland Revenue will be receiving information from payers of investment income on the amount of income a taxpayer has earned and the tax that has been withheld from that income, and will therefore know the amount of credit the taxpayer is entitled to.

Recommendation

That the submission be accepted.

Issue: Terms not defined

Clauses 161, 212 and schedule 2

Submission
(Russell McVeagh, EY)

The terms "investment provider" and "domestic debt" should be defined in legislation (*Russell McVeagh*).

The term "contact details" used in proposed schedule 6 should be defined (*EY*).

Comment

Proposed new section RE 27(4) of the Income Tax Act 2007 (clause 161(6)) requires a person who has RWT-exempt status to notify their "investment provider" of their status and a change in their status.

Proposed new section 25E(1)(b) of the Tax Administration Act 1994 refers to a person who chooses to pay approved issuer levy in relation to domestic debt.

Proposed new schedule 6 requires payers to provide Inland Revenue with their contact details, as well as the contact details of their investors.

These three terms should be defined in order to add clarity to the legislation.

Recommendation

That the submission be accepted.

Issue: Incorrect cross-reference

Clause 180

Submission
(Matter raised by officials)

Clause 180(2)(a) should be amended to refer to table 2 of schedule 1, part D, clause 3 of the Income Tax Act 2007, instead of table 1.

Recommendation

That the submission be accepted.

Issue: Information on dividends

Clause 212

Submission
(Matter raised by officials)

Proposed new section 25G in clause 212 should be amended so that information in rows 12 and 13 of schedule 6, table 1 is not required in relation to a dividend payment.

Comment

Rows 12 and 13 of schedule 6, table 1, refer to the notified investor rate of the investor and whether or not the PIE fund is a superannuation fund or a retirement savings scheme. This information relates to PIEs and therefore should not be required to be provided by companies paying dividends.

Recommendation

That the submission be accepted.

Making Tax Simpler – other items

EXEMPTIONS FROM ELECTRONIC FILING REQUIREMENTS

Clauses 200, 212 and 231

Issue: Clarifying the reasons for granting an exemption

Submission
(Matter raised by officials)

Concerns have been raised with officials that the wording in proposed sections 23G(3) and 36BD did not obviously include taxpayers for whom it would be unreasonable to expect electronic filing of returns, for example, because of the unreliability of their broadband access, their lack of digital skills or a handicap.

Comment

Officials agree that each of the above reasons could be grounds for an exemption under proposed sections 23G(3) and 36BD and note that it is intended that guidance will be included in the *Tax Information Bulletin* to assist taxpayers to understand how the exemption provisions would be applied.

Officials agree, however, that the current wording is unclear and could deter taxpayers from applying for an exemption and recommend that the provision is clarified. A reworded provision would require the Commissioner to have regard to the nature and availability of digital services, including the reliability of those services, the capability of the person relating to the use of computers and whether the costs the taxpayer would incur in complying with a requirement to file electronically would be unreasonable in the circumstances.

Recommendation

That the submission be accepted.

Issue: Specifying the status of the exemptions granted

Submission
(Regulations Review Committee)

The Bill should be amended to clarify whether exemptions from electronic filing granted by the Commissioner under the proposed new sections 23G and 36BD are disallowable instruments or not.

Comment

The Bill contains proposed requirements for taxpayers over a threshold to file tax information electronically. The threshold can be set or amended by Order in Council. The Commissioner may grant exemptions from the legislative requirement to file information electronically. Officials consider the relevant exemptions are administrative in character and do not extend or

vary the scope of the Tax Administration Act 1994. Officials recommend that the Bill be amended stating that these exemptions are not disallowable instruments.

Recommendation

That the submission be accepted.

Issue: Statement of reasons for exemptions granted

Submission
(Regulations Review Committee)

The Bill should be amended to require that any exemption granted under the proposed new sections 23G and 36BD include a statement of reason as a safeguard to the exercise of the power to make an exemption.

Comment

Both proposed sections 23G and 36BD set out criteria for the granting of exemptions and further guidance as to the factors the Commissioner has to have regard to in determining whether to exempt a person or class of persons from an electronic filing requirement. However, they do not currently require a statement of reason. Officials agree with the submission and recommend that the Bill be amended to require that any exemption granted under the relevant provisions give a reason as to why the exemption was granted.

Recommendation

That the submission be accepted.

Issue: Expiry of exemptions after a specific period of time

Submission
(Regulations Review Committee)

The Bill should be amended to provide that any exemption granted under the new sections 23G and 36BD expires after a specified period of time.

Comment

Officials partly agree that exemptions from an electronic filing requirement should have a specified time limit in some circumstances. However, requiring this of any exemption from electronic filing is not warranted and may impose undue administrative and compliance costs in situations where the exemption is granted because of circumstances that are not or are not likely to change over time – for example, religious or disability reasons.

Officials therefore recommend that the Bill be amended to give the Commissioner the discretion to limit exemptions to a specific period of time. It is also recommended that the Bill be amended to state that any exemption is valid until the Commissioner gives notice cancelling it, with a minimum of 6 month period from the notice until the cancellation takes effect. This is similar to the current provisions for removing the authorisation to file an employer monthly schedule by non-electronic means for employers who are currently required to file these electronically.

Recommendation

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

Issue: Aligning the non-electronic filing exemption for investment income information

Submission
(Matter raised by officials)

Proposed new section 25Q in clause 212 should be amended to ensure the language used is consistent with the electronic filing exemptions for employment income information and Goods and Services Tax information in clauses 200 (proposed new section 23G) and 231 (proposed new section 36BD).

Comment

Proposed new section 25Q provides that the Commissioner may discharge a payer from the requirement to deliver their investment income electronically, and sets out factors that the Commissioner must have regard to in determining whether or not to discharge the payer. Clauses 200 and 231 provide exemptions from electronic filing for employment income information and GST registered persons, but the wording and factors to be taken into account by the Commissioner are slightly different. All three exemptions are intended to be subject to the same standard; therefore it is proposed that the electronic filing exemption for investment income is amended so that it is consistent with the exemptions for employment income and GST purposes.

Recommendation

That the submission be accepted.

TAX TREATMENT OF ADVANCE PAYMENTS OF HOLIDAY PAY OR SALARY OR WAGES

Clauses 142, 294(1) and 306(1)

Issue: Support for the proposal

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

Three submitters expressed support for the proposal.

Chartered Accountants Australia and New Zealand support this proposal as a compliance saving measure. *(Chartered Accountants Australia and New Zealand)*

PwC support the proposal mainly for the reasons outlined in the *Commentary* on the Bill, particularly around the fact that the current treatment can cause financial hardship for certain groups of employees, and the fact that the new option can result in a more accurate amount of tax being withheld. *(PwC)*

Recommendation

That the submitters' support be noted.

Issue: Alternative proposal

Submission
(EY)

Advance payments of holiday pay (or salary or wages) should be taxed as if the payments were paid over the pay periods to which they relate, and not as an extra pay. EY believes the treatment proposed for future payments is overly complex and would likely give rise to unnecessary payroll system complications for employers. Any future payments made for the pay periods to which the leave relates should be treated in the same way as regular salary or wages. The exception to this treatment should be where the employee is receiving a payment in addition to holiday pay, in which case the payment should be treated as an extra pay.

Comment

It has been the Commissioner of Inland Revenue's published operational position since 17 November 2015 that holiday pay paid to an employee in a lump sum before their leave starts should have PAYE deducted using the deduction method for extra pay.

The proposed amendment follows current law and would allow employers to continue to treat advance payments of holiday pay as an extra pay. The proposed amendment, however, would allow employers the option of applying a more accurate withholding method, which is based on how some payroll software operated in practice, prior to the Commissioner publishing her operational position. The proposed amendment would allow payroll software developers to code their software to apply this more accurate withholding method once again.

The proposal does not require employers to apply this more accurate, but more complex, method. If their payroll system is not capable of applying it, they could choose to apply the method of treating advance payments of holiday pay as an extra pay. Officials consider that this is not an overly complex calculation and is required in relation to other types of extra pays such as a bonus.

EY's alternative proposal would often result in under-withholding of PAYE, because for pay periods that are not taken entirely on leave, but partially taken on leave and partially worked in, there will be two payments made to the employee. Each of these payments (which are each only part of the employee's salary or wages for the pay period) would be assumed for the purposes of calculating PAYE to be all of the employee's salary or wages for the pay period.

Recommendation

That the submission be declined.

Issue: Inland Revenue should provide examples for employers

Submission
(PwC)

PwC notes this proposal results in a complication to the current landscape, rather than a clarification or simplification. As such, it is paramount that Inland Revenue provides clear examples outlining the proposed options available to employers.

Comment

Guidance on the options available to employers will be provided in a *Tax Information Bulletin* item that will be published shortly after the Bill's enactment. The proposed amendment will allow employers (payroll software developers) to adopt a more accurate method which operated in practice, prior to the Commissioner publishing her operational position in November 2015.

Recommendation

That the officials' comments be noted.

Issue: Need for payroll systems to have the functionality to enable employers to easily switch between options

Submission
(PwC)

Payroll systems will need to have the functionality to enable employers to easily switch between the options for taxing advance payments.

Comment

Payroll software would not necessarily need to have the functionality to switch between the options for taxing advance payments; that would be a matter for payroll software developers to decide. Payroll software developers, who decide to code their software to apply the more accurate method, might quite reasonably decide it would not be beneficial to also provide employers with the option to apply a less accurate method of calculating PAYE that is more suited to employers without payroll software.

Recommendation

That the officials' comments be noted.

APPLICATION OF LEGISLATED RATE AND THRESHOLD CHANGES

Clauses 140, 144, 152, 293, 301 and 304

Issue: Support for the proposal

Submission
(Chartered Accountants Australia and New Zealand)

Chartered Accountants Australia and New Zealand agrees the appropriate PAYE deduction should be set by the rates and thresholds in force on the date the income payment is made.

Recommendation

That the submitter's support be noted.

Issue: ACC earners' levy alignment

Submission
(Matter raised by officials)

The Accident Compensation (Earners' Levy) Regulations 2017 should be amended, with effect from 1 April 2018, so that the rule for determining the amount of ACC earners' levy an employer must deduct from an employee's earnings is aligned with the rule for the income tax component of PAYE, following a change to rates or thresholds.

Comment

Proposed amendments to the Income Tax Act 2007, the KiwiSaver Act 2006 and the Student Loan Scheme Act 2011 included in the Bill align the rules about how legislated rate or threshold changes are applied across the different types of PAYE income payments and social policy initiatives administered through the PAYE system, such that the rates and thresholds to be applied are those in force on the date the payment is made.

The PAYE deductions employers are required to make from their employees' earnings comprise the ACC earners' levy and income tax. The ACC earners' levy rate and the maximum liable annual earnings threshold are prescribed by regulations made under the Accident Compensation Act 2001. Currently, the prescribed ACC earners' levy rate applies "for pay periods ending in the applicable tax year".

It is particularly important that the rule for determining the amount of ACC earners' levy an employer must deduct from an employee's earnings is aligned with the rule for the income tax component of PAYE, following a change to rates or thresholds. However, given the timing of the making of the Accident Compensation (Earners' Levy) Regulations 2017, it was not possible to include an amendment to these regulations to align the rule for the ACC earner's levy in the introduction version of the Bill. Therefore, to align with the proposed amendment

to the rule for calculating the income tax component of PAYE contained in clause 140 of the Bill, officials recommend that the Accident Compensation (Earners' Levy) Regulations 2017 be amended, such that the rule for the ACC earners' levy operates on a pay date (rather than a pay period end date) basis, with effect from 1 April 2018.

Recommendation

That the submission be accepted.

REMEDIAL HOLIDAY PAY PAYMENTS

Submission
(EY)

It would be helpful for the Government to provide legislative clarification around the tax treatment of holiday pay amounts paid in arrears, for example remedial remuneration due under the Holidays Act 2003. A number of employers are currently grappling with the application of the extra pay rules to holiday pay remedial payments, with issues arising in particular for former employees who would not otherwise be required to file income tax returns.

Comment

Officials note that legislative clarification as to the tax treatment of back-dated remedial payments of entitlements under the Holidays Act 2003 was recently provided, through the Income Tax (Employment-related Remedial Payments) Regulations 2017, which declare such a payment to be an "extra pay".

Officials acknowledge that it is likely that former employees will have tax under-withheld if the standard tax calculation for extra pays is used, which may lead to them being required to file an income tax return and pay any tax owed. However, officials note that there is an existing legislative mechanism by which a former employee could avoid this. Section RD 10(2) of the Income Tax Act 2007 enables an employee to notify their employer of their election to fix their rate of tax on extra pays at their expected marginal income tax rate.

When the legislation was recently clarified, Inland Revenue issued guidance for employers on how back-dated remedial payments of holiday pay should be treated for the purposes of PAYE and other deductions, such as student loan repayments and KiwiSaver contributions.[10]

Inland Revenue also recently updated its guidance for individuals to explain the implications for tax and for Inland Revenue-administered social assistance of receiving a lump sum payment (including of back-paid holiday pay).[11]

The guidance for both employers and individuals specifically refers to an individual's ability to request that their employer withhold tax from a lump sum payment at a higher rate, which they may wish to do to avoid a potential end of year tax debt.

Officials consider that providing guidance on the existing legislative mechanism is the best solution to the issue raised by the submitter. If a legislative amendment was made to require employers to withhold tax from payments made to former employees at a specific tax rate, that rate would inevitably be either too high, or too low, for many of the recipients.

Recommendation

That the submission be declined.

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[10] http://www.ird.govt.nz/resources/e/a/ea3bfec0-424f-43ba-ad3f-06af818dcf1c/CS+17-02+Tax+treatment+of+backdated+remedial+payment+of+holiday+pay.pdf
[11] http://www.ird.govt.nz/yoursituation-ind/taxing-lump-sum/

PENALTIES AND INTEREST AMENDMENTS

Clauses 263, 273, 274 and 276

Issue: Setting a new due date for default assessments, date interest starts and the date an excess credit arises

Submission
(KPMG, Chartered Accountants Australia and New Zealand)

Submitters expressed support for the following proposals:

- align the treatment for electronic default assessments and non-electronic default assessments so both types are due on the original due date for the payment of tax;
- reduce the number of working days referred to in the definition of "date interest starts" from 15 working days to 10 working days to reflect the reduced processing times for GST refunds; and
- alter the date a credit arises in respect of goods and services tax (GST) to reflect when a taxpayer files their return.

Recommendation

That the submitters' support be noted.

Issue: Aligning the due dates for default assessments – application date for clauses 273 and 274

Submission
(Regulations Review Committee)

Clauses 273 and 274 of the Bill align the due dates for paying tax on default assessments, whether those assessments are raised electronically or manually. This change can only be made once a tax type migrates to the new START system and where incremental penalties have been removed from the particular tax type.

The amendments in the Bill apply on a date appointed by the Governor-General by Order in Council once those two conditions have been met.

The Regulations Review Committee raised concerns with the application date.

The first concern was that the provision for the application should be moved from its current place within the Bill to clause 2 which deals with application dates generally.

Secondly the Regulations Review Committee recommended inserting a "fall back" date where the proposed section 142AB would commence.

Comment

Officials agree with the submission in that the two suggestions by the Regulations Review Committee will provide more certainty to taxpayers around the application date of the provisions.

Recommendation

That the submission be accepted.

Issue: Date interest starts and excess tax is available – application date for clauses 263 and 276

Submission
(Matters raised by officials)

Clause 263 of the Bill reduces the number of working days referred to in the definition of "date interest starts" from 15 working days to 10 working days because of the migration of GST to Inland Revenue's START system. This change reflects efficiencies in the processing time for GST returns in the new START system.

Clause 276 alters the time that excess tax is able to be transferred within a taxpayers accounts to more closely align the availability with the date a taxpayer files their tax return.

The amendments in the Bill apply from the date of Royal assent.

The current application date of the date of Royal assent is likely to cause issues and uncertainty around the application of the provisions. This will create issues for the application of the changes within the system environment as it may not give sufficient time for changes to be made to the system to adjust the application date. It would be preferable that the application date for this change have a certain date.

Officials recommend that the application dates are amended to GST periods ending after 1 April 2018.

Recommendation

That the submission be accepted.

ELECTRONIC FILING REQUIREMENTS FOR GST RETURNS

Clauses 187(18), 227, 231, 232, 269(3) and 275(1)

Issue: Support for the proposal

Submission
(Chartered Accountants Australia and New Zealand)

The submitter expressed support for the proposal to require electronic filing of GST returns above a certain threshold.

Recommendation

That the submitter's support be noted.

Issue: Imposition of non-electronic filing penalty

Submission
(Chartered Accountants Australia and New Zealand, KPMG)

The focus should be on educating about the advantages of electronic filing *(Chartered Accountants Australia and New Zealand)* and helping *(KPMG)* taxpayers to meet their new electronic filing obligations, rather than penalising them for not complying.

Comment

The threshold for electronic filing of GST information is to be set by Order in Council at a later point in time following appropriate and reasonable consultation. In support of the Order in Council, Inland Revenue will ensure that registered persons are made aware of the available exemptions from electronic filing, and that there is a sufficient amount of time for affected registered persons to implement electronic systems or obtain an exemption where appropriate.

Recommendation

That the officials' comments be noted.

Employee share schemes

OVERVIEW

Clauses 7, 10, 11, 12, 14, 23, 25, 28, 31, 41, 42, 60, 70, 74, 172(12), (13), (16), (19), (37), (43), (46), (50), (57), (58), (59), (60), (61), (67) and 248

Employee share schemes are arrangements for companies to provide shares and share options to their employees. They are increasingly an important form of employee remuneration in New Zealand and internationally. Although the design and the accounting treatment of these plans have evolved considerably over recent decades, the tax rules applying to them in New Zealand have not been comprehensively reviewed during that period and are now out of date.

Recently a number of problems with these rules have emerged, primarily in three areas:

- complex arrangements allow taxable labour income to be converted into tax-free capital gains;
- there is a lack of an employer deduction for the provision of employee share scheme benefits in some circumstances; and
- the rules and thresholds relating to tax-exempt widely-offered employee share schemes are out-dated and need review.

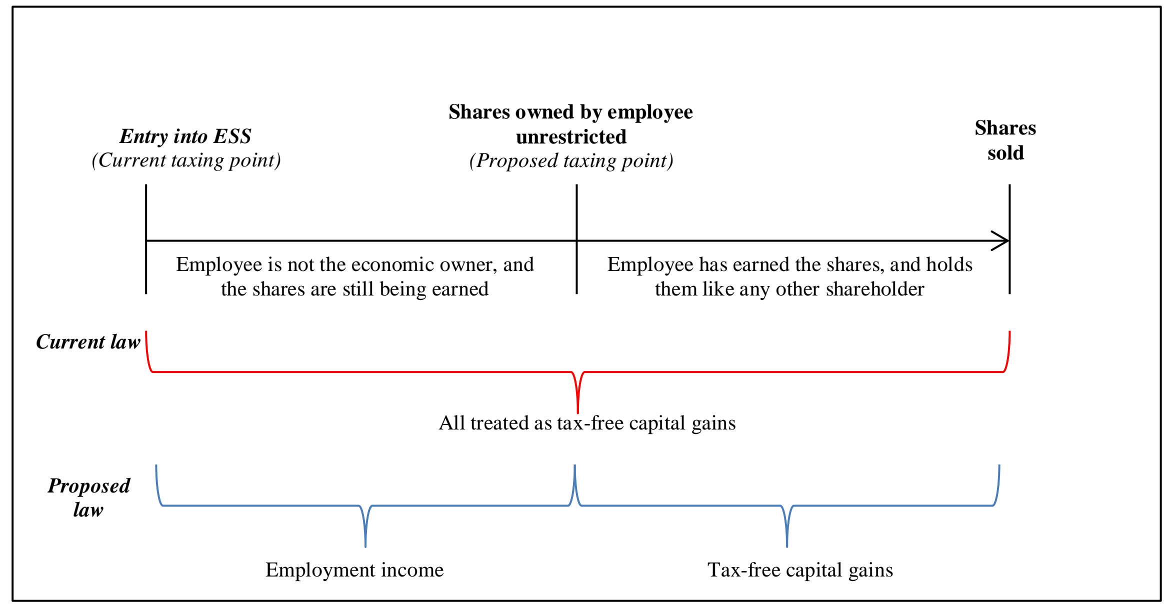
New core rules

The Bill proposes new core rules for determining the amount and time of derivation of income and incurring of expenditure under an employee share scheme. The objective of the proposals is neutral tax treatment of employee share scheme benefits. That is, to the extent possible, the tax position of both the employer and the employee should be the same whether remuneration for labour is paid in cash or shares. This will ensure that employee share schemes cannot be structured to reduce the tax payable in respect of these arrangements, as compared to an equivalent cash salary or other more straight-forward employee share schemes.

Generally these rules will apply to benefits where the taxing point under current law has not occurred before the day six months after the enactment of the Bill.

Income tax treatment of employees' employee share scheme benefits

In essence, the provisions in the Bill redraw the line – for certain arrangements – which determines when an employee is treated as having earned shares under an employee share scheme (at which point they are taxable on the shares' value), and after which they hold the shares like any other shareholder.



Like any other form of income, in straight-forward cases income received by an employee in the form of shares is not taxable until it is earned – that is, until the employee has performed all services and satisfied all conditions necessary for them to be fully entitled to the shares – at this point they have full ownership and control of the shares. The amount of income is the value of the shares at that time. So, changes in the value of the shares occurring before that time will affect the employee's income.

Once the employee has earned the shares and holds them like any other shareholder, increases in value will generally be tax-free capital gains.

This is the longstanding tax treatment of straight-forward share schemes (that do not use trusts) and options.

It is also the same as the tax treatment of any other non-cash payment for services. For example, an employee could be paid in gold bars or a boat. The market value of that non-cash asset is taxable as employment income when the employee earns it, thereafter, fluctuations in its value will generally be on capital account.

The Bill proposes changes to the way employees are taxed when shares are given to a trustee to hold for an employee until certain conditions are met.

In these arrangements, while the shares are held by the trustee, the employee is neither the legal owner, nor the full economic owner of the shares (even if they have certain rights, such as to receive dividends). Legal title, and the ability to trade in the shares, like any other shareholder, is not transferred to the employee until they meet employment conditions – that is, until they earn the shares. If the employee does not meet those conditions, the shares can be transferred back to the company by the trustee, or used to provide a benefit to another employee.

Under current law, the employee is nevertheless taxed when the shares are transferred to the trustee (albeit that many arrangements eliminate tax at this point by allowing the employee to pay full market value for the shares using a limited recourse loan, which is only repaid in certain circumstances). The Bill would change this, so that the employee is taxed when the shares are transferred by the trustee to the employee, and the employee is the economic owner. This is the appropriate taxing point. After that point, the employee is treated like any other shareholder, and can derive tax-free capital gains.

The Bill also proposes to change the law in cases beyond those involving a transfer of shares to a trustee. However, the proposals are carefully targeted – following consultation – to ensure they do not defer the taxing point past the time when the shareholder really is the economic owner. In particular, the provisions in the Bill will not apply where the employee has to sell the shares back to the company for market value[12] if they leave the company. The proposals would therefore not prevent any gain on a sale of the shares being treated as a capital gain in this case.

Employers' deductions

The Bill also proposes a new deduction rule for employers providing employee share scheme benefits to employees.

The Bill proposes allowing the employer a tax deduction for the amount of the employee's income, at the same time as the employee is taxable, in order to align the tax treatment of providing employee share scheme benefits with the tax treatment of paying other types of employment income.

When an employer pays for an employee's services – whether in shares or cash – there is a cost that should be reflected in the calculation of the company's income.

Until the mid-2000s, financial accounting standards did not require this cost to be recognised in the company's financial accounts and this enabled companies to artificially inflate their profits. The relevant accounting standards now recognise the economic cost of issuing shares for services and this amount is treated as an expense of the company in calculating its income.

The provisions in the Bill ensure that tax law also recognises this economic cost. At the time the company gives the employee a valuable asset (the shares) in exchange for their services, the employee is better off by an amount equal to the value of those shares, and the other owners of the company are correspondingly worse off.

The argument can be made that the provision of the shares leaves the company itself no worse off, since it has not had to part with any property. However, it is clear that there is an economic cost to the other shareholders, since their interest in the company has been diluted. Under our corporate tax system, this deduction cannot be claimed by the shareholders, but it is appropriate for it to be claimed by the company.

This is exactly the same tax treatment as for cash salary which the employee uses to subscribe for shares at market value.

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[12] This includes an amount intended to approximate market value.

Widely-offered exempt schemes

The Bill also proposes a simplified set of rules for certain widely-offered employee share schemes (commonly referred to as "exempt schemes"), with a greater level of exempt benefits able to be provided and more flexibility in the design of these schemes.

The Bill aims to clarify that employers offering exempt benefits will not be entitled to a deduction for the cost of providing those benefits.

The retention of the tax exemption for exempt schemes departs somewhat from the objective of neutral tax treatment for all remuneration, but is justified on compliance cost grounds.

Consequential and technical amendments

The Bill also proposes a number of consequential and miscellaneous changes to the employee share scheme rules and provides transitional arrangements for existing schemes.

Issue: Support for reforms

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

Chapman Tripp and Roger Wallis support the measures in the Bill on the basis they simplify and clarify the treatment of employee share schemes. Roger Wallis also supports the objective of aligning the tax treatment of share and option schemes with other forms of employment income.

KPMG welcomes the clarification of the law following the issue of a Revenue Alert regarding employee shares schemes.

Chartered Accountants Australia and New Zealand supports the objective of the proposals to modernise and rationalise the tax treatment of employee share schemes.

Recommendation

That the submitters' support be noted.

Issue: Proposals increase complexity and uncertainty

Submission
(Russell McVeagh, Spark, Olivershaw)

The proposals increase uncertainty and complexity, and should not proceed.

Russell McVeagh submitted that the proposed rules will impose higher compliance costs, which will disincentivise employee share schemes. They also submitted that the proposals appear broadly fiscally neutral, as the amount of the employer's deduction is equal to the employee's taxable income. A wholesale change to the tax rules for employee share schemes is therefore unnecessary.

Spark submitted that the increased complexity is not warranted for the sake of a five percent differential (between the company tax rate of 28% and the top marginal rate of 33%).

Comment

Like all significant tax policy proposals the proposals have been subject to full public consultation. Issues such as ambiguity, complexity and compliance costs were raised and dealt with to the extent possible as part of that process.

The proposed rules are simple for simple transactions. For complex arrangements that involve loans, bonuses, trusts or intercompany recharges, then the rules are necessarily more complex.

It is true that, for some arrangements, the current rules are more certain, because they apply a very legalistic rule to determine when employee share scheme benefits are taxable – the time that the employee (or a trustee on their behalf) acquires the shares.

However, experience has shown that this rule can be used to produce results which are not appropriate for the integrity of the tax system. In particular, it allows employers to provide employees with what are effectively employee share options and cash bonuses with no or minimal tax to pay. This has led to the general anti-avoidance provision being applied to some schemes. Applying the general anti-avoidance rule inevitably leads to uncertainty, and therefore to law which involves greater compliance and administrative costs because it requires careful analysis in every case and often resort to the courts.

The Bill contains a more substance-based test for determining when employee share scheme benefits are taxable. In the vast majority of cases, and given the usual level of Inland Revenue guidance, this test will be no more difficult to apply than the current test. Crucially, it will be more difficult for taxpayers to achieve unintended outcomes under the proposed test in the Bill, and therefore there will be much less need to rely on the general anti-avoidance rule.

Officials note that a number of submitters believe the changes will increase certainty.

Officials therefore do not agree that uncertainty would be increased to the point that the proposals should not proceed.

Officials do not agree that the proposals are revenue neutral (as submitted by Russell McVeagh). The package of measures is forecast to generate $30 million of revenue per annum once fully phased in.

Officials do not agree with the submission that the proposals should not proceed on the basis that there is at most only a five percent difference between the tax payable by an employee on an employee share benefit and the benefit of the tax deduction available to the employer for providing that benefit. By this rationale we would give up taxing employment income altogether, since the five percent differential is the case for cash salary and wages as well.

Taxing employee share schemes benefits, and employment income generally, ensures that:

- employees are taxed at the appropriate marginal rate; and
- income tax is paid when a company in tax loss or which is tax exempt makes a payment to an employee.

Including employee share schemes benefits is also relevant for measuring eligibility for income tested benefits and student loan repayments.

Officials note that tax rates do change from time to time, and the difference between the top marginal rate and the corporate rate may change in future.

Recommendation

That the submissions be declined.

Issue: The policy framework is fundamentally flawed

Submission
(Olivershaw, Corporate Taxpayers Group, Spark)

The assumption in the proposals is that cash and shares derived from employee share schemes are substantially the same and should be taxed in the same manner. However in reality, cash bonuses are not equivalent to share scheme awards.

Employees, when offered an amount of shares or an equivalent amount of cash, would almost always favour a cash award due to its greater liquidity. Cash bonuses are not directly comparable to a share award unless the bonus amount is linked to the share price (for example, a phantom share scheme).

Comment

Officials do not agree with the submission that the framework for the Bill is fundamentally flawed.

Essentially, the Bill proposal rests on three pillars:

- Taxing employee share scheme benefits only when they have been earned.
- Taxing employee share scheme benefits in the same ways as other forms of remuneration (such as cash bonuses).
- Taxing share options, and arrangements like share options, only when and if the option is exercised.

While cash remuneration is obviously different in some respects to remuneration paid in shares (or to other fringe benefits, for that matter), none of the differences are meaningful for the purposes of the tax treatment. In particular, one form of remuneration should not have a tax advantage over the other. Otherwise, there is a tax incentive to pay people using share schemes, when it may be more economically efficient to simply pay them cash salary.

Recommendation

That the submission be declined.

Issue: Employee share schemes are a valuable economic tool and the rules should not discourage their use

Submission
(Corporate Taxpayers Group)

Employee share schemes are a valuable economic tool. The rules should not discourage their use.

Employee share schemes are an important employee remuneration tool and provide significant economic benefits to New Zealand more generally. Specifically, employee share schemes:

- assist with aligning employee and business interests; and
- build employee loyalty and encourage staff retention.

They also provide wider economic benefits through increased participation in capital markets, boosting savings and developing a financially literate population.

Comment

Officials agree that employee share schemes can be a valuable remuneration tool and their use should not be discouraged. The Bill does not discourage their use. It removes an avenue by which they can be unfairly advantaged, and also for some schemes removes an existing disincentive to their use (that is, the inability of the employer to claim a deduction).

While well-designed employee share schemes can achieve the outcomes identified by submitters, these benefits are largely enjoyed by the parties to the arrangement (that is, the employer and employee). Accordingly, there is no reason that employee shares schemes should enjoy preferential tax treatment as compared to other forms of remuneration.

Recommendation

That the submission be declined.

Issue: Proposals result in double taxation

Submission
(Olivershaw)

The proposals seem to result in double taxation of the same income when the gain in share value merely reflects increased and already taxed income of the company as the employee is also taxed on this gain.

Comment

Officials do not agree that the proposal results in double taxation. The submission overlooks the fact that the company will be entitled to a deduction equal to the employee's income. There is no aggregate increase in income, simply a change in who is treated as earning it. A simple example illustrates this. Assume a company earns $100 (this is its only asset), and gives its employee 10 percent of the shares in the company. The employee will be taxable on $10 and the company will receive a $10 deduction. So the company will only be taxable on $90. Therefore there has been no double taxation with respect to the $10 of income received by the company.

Recommendation

That the submission be declined.

Issue: Issues with consultation process

Submission
(Corporate Taxpayers Group)

The process for consulting on this collection of policy changes has not been well coordinated, with additional proposals constantly being added outside of formal consultation processes. The Group strongly opposes the addition of any further "officials' changes" to these rules through the Select Committee process.

Comment

Officials do not agree that the process has not been well co-ordinated. A function of public consultation is that issues are flushed out. As issues have emerged during the consultation process, officials have gone back to the private sector to consult on them. This is a natural and efficient means for addressing issues rather than as subsequent legislative amendments.

There have been two rounds of public consultation, with numerous workshops with interested parties.

After discussions with submitters, officials have decided not to recommend one particular change (relating to subordinated ordinary shares) through the Select Committee process, but instead to progress this issue separately, for possible inclusion on the Government's tax policy work programme.

Recommendation

That officials' response to the submitter's comments be noted.

Issue: Additional guidance on share valuation

Submission
(EY)

EY would appreciate more guidance around how to value shares in an unlisted company at the share scheme taxing date.

Comment

Officials note that the Commissioner has recently released CS 17/01, providing guidance on the valuation of shares in both listed and unlisted companies. Taxpayers can seek amendments to this document if they are concerned about lack of guidance.

Recommendation

That officials' response to submitter's comments be noted.

Issue: Clarification of terms used in Bill

Clause 14

Submission
(Chapman Tripp, Olivershaw, KPMG, Russell McVeagh, Roger Wallis, EY)

More guidance is needed on the terms "no real risk" and "no commercial significance" (in proposed section CE 7B(1)(a) and 2(c)).

Proposed section CE 7B should contain examples clarifying the application of the "no real risk" test. *(Chapman Tripp, Roger Wallis)*

The term "no real risk" should be changed to "no significant risk" or "no material risk". The term "no real commercial significance" should be changed to "no commercial significance". *(EY)*

Comment

Officials agree that these terms should be further explained and examples should be provided in the legislation and following enactment, in a *Tax Information Bulletin* to illustrate their application.

Recommendation

That the submission be accepted.

Issue: The definition of employee share scheme is too wide

Clause 14

Submission
(Chapman Tripp, Olivershaw, KPMG, Russell McVeagh, Roger Wallis, EY)

Definition of "employee share scheme" is too wide and unintentionally capture share transfers that are gifts. For example, a mother gifts shares to daughter who is also an employee.

Arrangements referred to in proposed section CE 7(a)(i) and (ii) should be qualified with the statement "if the arrangement is connected to Person A's employment or service". Otherwise the definition could cover on-market transactions where someone buys shares in their (future/current/past) employer but it is entirely unrelated to their employment.

Comment

Officials agree with these submissions. In particular, the criterion in proposed section CE 7(a)(iii) of the employee share scheme definition – that the arrangement is connected to a person's employment or service – should apply to all three subparagraphs in proposed section CE 7(a).

Recommendation

That the submission be accepted.

Issue: The proposals result in tax on capital gains

Clauses 11, 12 and 14

Submission
(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Olivershaw, Spark, KPMG, Russell McVeagh)

The existing rules draw an appropriate distinction between the employment income component and the capital gain or loss component of an employee share scheme benefit. The proposed rules would tax capital gains as employment income.

Value fluctuations in shares held on trust for an employee as part of an employee share scheme are a function of capital markets, not of anything the employer or employee does. Because the price changes are outside the control of the employee, these should not be taxed as employment income.

Egregious arrangements could be struck down by applying the GAAR and enacting specific anti-avoidance rules.

Comment

Officials do not agree that the current rules draw an appropriate line between income from employment and income from capital gains. This can be explained with a simple example. Under the current rules, if A's employer promises to give her 100 shares in two years' time if she remains employed, A is taxed on the value of the shares in two years' time. If B is a beneficiary under an employee share scheme where the scheme trustee is given 100 shares now, on the basis that they will be transferred to B in two years' time if they remain employed, B is taxed on the value of the shares when they are given to the trustee. This difference in treatment is not sensible, since the two employees are effectively in the same position.

Officials do not agree with the submission that because changes in the value of shares are outside an employee's control, such changes should not be treated as employment income, but should instead be treated as capital gain or loss. Employment income is income given as a reward for services. The status of a payment as employment income has nothing to do with whether or not the amount of that payment can be controlled by the employee. For example, suppose an employee of a listed company is promised a cash bonus at the end of the year equal to the increase in the employer's share price. Whether or not a bonus eventuates, and

the amount if it does, may have little to do with the employee's individual efforts, and much more to do with the workings of the capital markets. Nevertheless, no one would suggest that the cash bonus should not be taxed as employment income. Similarly, an employee can be paid for their services in other assets (for example, a gold bar or a boat) whose value is not determined by the employee's individual efforts; nevertheless they are taxable on the value of the asset as it is labour income.

Recommendation

That the submission be declined.

Issue: Should impose fringe benefit tax on any downside risk protection

Clauses 11, 12 and 14

Submission
(Olivershaw)

If the problem is the tax-free benefit of downside risk protection to an employee under the current law, then the solution seems simple – to the extent the employer buys or arranges for the purchase of shares at more than their current market value, the difference should be taxed under the fringe benefit tax (FBT) rules.

Comment

The submitter suggests that the key tax policy problem is the current tax treatment where an employer provides protection from a fall in the shares' value. They say this protection is a valuable benefit that currently goes untaxed. They suggest that any issues that arise with the current tax law in relation to employee share schemes would be solved if this benefit was subject to FBT. Officials do not agree with this viewpoint. This suggestion was raised by the submitter and thoroughly canvassed during consultation.

The way employers typically provide "downside protection" for employees is by providing an employee with a limited-recourse loan to buy the shares or a put option that allows the employee to sell the shares back to their employer at the price they paid for the shares. If the shares go down in value, the employer has to accept the shares back from the employee in full satisfaction of the loan or the employer must buy the shares back from the employee for the price the employee paid for them. Alternatively, in cases where the employee can keep the shares, the loan is forgiven/repaid by the company to the extent the share value is less than the loan balance. If the shares go up in value, the employee can pay off any outstanding loan (often funded by a bonus from the employer), and keep the shares.

The submitter's suggestion is based on the proposition that the benefit being provided in this case by the employer is that when the shares are worth less than the loan (or the original purchase price, in the case of an employee who does not receive a loan to buy the shares), the employee is protected from that drop in value – either because, in the case of a loan to buy the shares, they can repay the loan by providing the shares to the employer or they are otherwise indemnified from the obligation to repay the loan to the extent the share value is less than the loan balance. Similarly, in a case where the employee does not have a loan to buy the shares, the employee is protected from the loss of their original investment as a result of the put

option. The submitter's suggestion would require FBT to be paid if the shares drop in value and the employee receives nothing from the arrangement – that is, the shares revert to the employer and the loan is unwound, or the employee keeps shares that are ultimately worth what they paid for them (there is no net benefit).

Conversely, if the shares go up in value and the employee gets to keep the shares which are worth more than they paid for them, then the submitter says they would not be taxable on this benefit. Therefore the submitter's suggestion would tax the employee if they received nothing from the share scheme on a net basis, but fail to tax them if they actually received a benefit.

As well as being conceptually incorrect, this proposal is counterintuitive and, in our view, would be completely unpalatable to the vast majority of share scheme participants. It taxes when an employee ends up with nothing, while imposing no tax where a person receives valuable share benefits for working for a company.

If people are taxed when no benefit has accrued, this suggestion would actually have the effect of discouraging the use of employee share schemes.

Additionally, as a matter of principle, if an employee holds both the shares and a put option that protects them from a fall in the value of the shares (and these two assets must always be held together as part of an employment arrangement), this is economically equivalent to holding a call option over the shares (plus holding a zero coupon bond equal to the purchase price of the shares).[13] This is because in both cases, the employee is entitled to the upside in the share price movement, without any exposure to the downside in the share price movement. The longstanding tax treatment of call options is to tax these on exercise – this is consistent with the proposals contained in the Bill in relation to downside protection arrangements such as put options and loan forgiveness. If the arrangements in questions were taxed in the way the submitter's suggests, then two economically equivalent transactions would be taxed quite differently. This outcome is inefficient and not consistent with good tax policy.

As a secondary comment, officials note that recent reforms allowing employees to pay PAYE on employee share scheme benefits looked at FBT as an alternative mechanism and submitters were overwhelmingly against this option (as was Inland Revenue). So the suggestions that FBT should be payable in the circumstances described above is unlikely to be favourably viewed by companies offering employee share schemes.

Recommendation

That the submission be declined.

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[13] Obviously, if the shares pay dividends, then an arrangement whereby the employee holds shares plus a put option is different to just holding a call option over the shares in future. However, for tax purposes, the dividends are taxable if and when they are received, and therefore are not relevant to assessing whether the two arrangements are equivalent for tax purposes.

Issue: The proposals are not a neutral framework for taxing income

Clauses 11, 12 and 14

Submission

(Chartered Accountants Australia and New Zealand)

The proposals are not a neutral framework for taxing income. Cash remuneration is taxed at the time of receipt rather than at the time the services are performed.

Consider an employee who is paid monthly and receives an annual salary of $120,000. Payment is made on the 15th of the month. Payment is for past services (1st – 15th) and for future services (16th to the end of the month).

The employee will be taxed on the total $10,000 when it is received each month, regardless of the fact that some of the services are not yet performed.

For consistency and fairness, the time the shares are received under an employee share scheme should be the taxing date.

Comment

Officials do not agree that the example of cash remuneration paid in the middle of the month is relevant to the proposals in the Bill. In this case, under the provisions in the Bill, the shares would be taxed at their value on the 15th of the month when the shares were received, so long as there was no requirement for their return if the employee did not remain employed for the next two weeks.

If the example is modified, so that the shares are not able to be sold by the employee until the end of the month, and must be returned if the employee does not remain employed until the end of the month, then the shares would be taxed at their value at the end of the month. Officials believe that is the correct outcome.

In the submitter's example, the employee has the cash at their disposal and may spend it as they wish – even before they have provided all the services required to earn it. Presumably, if they spend the money and then do not provide the services, the employer could require them to pay it back. Nevertheless, until this time the employee has had the cash at their complete disposal. This differs from employee share scheme arrangements where shares are transferred to a trustee for an employee subject to the satisfaction of certain conditions, as the shares are not fully at the disposal of the employees and in the majority of cases are not even received by them. The shares are held in trust.

A more accurate comparison in respect of the employee share scheme proposals, would be a situation where cash salary is put in a trust account for the employee and only released, and able to be spent, by the employee when they have provided the services to earn the cash. In this case, the cash would not be "received" or taxable until it has been released from the trust. In this comparable case, the taxing point is the same for both the cash and the shares under the employee share scheme proposals.

In an extreme (and commercially unusual case), if the shares were given to the employee at their complete and unrestricted disposal, but on the condition that if the employee did not perform services over a specified period of time they would have to deliver an equivalent parcel of shares back to the employer, then this would be a comparable scenario to the cash salary example the submitter sets out above. In this case, the employee could sell the shares and spend the proceeds before they have performed the services needed to earn the shares, but they take the risk that they may have to deliver those shares back to the employer and – if they have sold them in the interim – they would have to buy them back on market (if this is even possible). This is similar to short selling and would not make sense in an employee share scheme context, because employees would be better off if their employer's shares *drop* in value (rather than *increase* in value) as they can sell the shares at a high price, then buy them back at a low price and pocket the difference. Thus such an arrangement creates the opposite incentives that an employee share scheme seeks to create (that is, the incentive to increase the value of an employer's shares). Accordingly, officials do not believe this example would occur in practice.

In addition – in relation to the cash payment, it is immaterial whether the situation is analysed as giving rise to income of $10,000 on the 15th of the month, or $5,000 on the 15th and $5,000 on the 30th. The same amount is taxable, at almost exactly the same time. For convenience, and because most tax from employment income is collected by way of withholding, the law focuses on when cash is paid. However, in relation to employee share scheme benefits, where values can change and time frames are often much longer, more care needs to be taken to define the time of derivation.

In view of these various scenarios, officials believe that the proposals do provide a neutral framework for taxing employee share schemes compared to an equivalent cash transaction.

Recommendation

That the submission be declined.

Issue: Future employment conditions should not delay the taxing point

Clauses 11, 12 and 14

Submission
(Chartered Accountants Australia and New Zealand)

Future employment conditions should not delay the taxing point. They should be factored into valuation.

Comment

Officials do not agree with the submission that shares transferred to an employee (or trustee) subject to return if employment conditions are not met should be taxed when provided at a discounted value. For example, when an employee is offered a cash bonus payable in one year if the employee remains employed for that time, there is no suggestion that the cash bonus should be taxed at the time it is offered, with a discount for the risk that the employee will not be employed in one year. The bonus is taxed when it is paid, in one year's time. The

position should be the same with shares. Waiting to tax employment income until employment conditions are met is both orthodox and sensible.

It would also be practically very difficult for the parties to the employee share scheme to determine an appropriate valuation to take account of specific employment related condition, and consequently compliance cost intensive.

Recommendation

That the submission be declined.

Issue: Effect of proposals on small and medium enterprises

Clauses 11, 12 and 14

Submission
(Olivershaw)

The proposals have an unknown effect on small and medium enterprises (SMEs). If employees have to sell their shares back when they leave employment they will hold them on revenue account.

Comment

Through two rounds of public consultation, the effect of the proposals on SMEs has been explored. As a result, certain arrangements have been excluded from the ambit of the proposed rules. For example, officials note that shares will not be "held on revenue account" (that is, the taxing date will not be deferred) merely because there is an obligation on an employee to sell those shares to their employer for an amount intended to be the shares' market value when they leave employment (which officials understand is usual commercial practice in this case) (see proposed section CE 7B(2)(a) in clause 14).

Recommendation

That the submission be declined.

Issue: There is a lack of certainty under the proposals

Clauses 11, 12 and 14

Submission
(Spark)

When the participant enters into the share scheme, the employer and participant will not know what the ultimate income and/or deductions will be. A lack of certainty is a poor outcome for both the employer and share scheme participant.

This uncertainty is highly undesirable for any business because the employee's income is effectively uncapped based on factors outside the control of the employer and employee. If the employer has agreed to fund the tax liability, this exposes the employer to an uncertain tax Bill in addition to complex compliance. Commercially, it would be unusual for a business to enter into such an uncertain arrangement.

For the participant, while it may be possible to arrange the scheme in a way that they can sell some shares to meet the tax cost, it is possible that they are restricted from selling these shares due to blackout periods or insider trading restrictions. A scheme that requires participants to sell shares is less likely to be attractive to participants and shareholders who would prefer that employees retain shares in the company to have some "skin in the game".

Comment

Some submitters are concerned that the effect of the proposals is that the amount of taxable income from an employee share scheme is not known at the outset, that is, when the employee share scheme benefits are offered to the employee on some kind of conditional basis.

Officials observe that:

- this seems an inevitable result of the commercial transaction, where the benefit provided is unconditional ownership of shares at a future point in time. The value of the shares is not known when the benefit is offered or when the shares are transferred to the trust. If the taxable income were known at the outset, that would suggest that the tax treatment is not matching the economic reality;
- many companies and employees already cope with exactly this uncertainty, for example those offering or receiving benefits under share option schemes or simple conditional share schemes;
- employers, when designing their schemes, can ensure they have the ability to meet any tax liability by issuing shares (either new shares or treasury stock) to fund any tax liability;
- if employers do not want employees to sell their shares to pay tax on employee share scheme benefits, the employers can pay PAYE on the share benefits, or provide the employee with an additional cash bonus; and
- schemes can generally be designed so that vesting occurs outside no-trading periods.

With respect to the "skin in the game" submission, even if the employee sells all of the shares required to pay the tax, they will still be left with 67 percent of the shares, that is, they will still have considerable skin in the game. To ensure that any "skin in the game" requirement can easily be met, employers can require the employee to retain a certain number of the shares provided.

Recommendation

That the submission be declined.

Issue: There should be an allowance for black-out periods and other sale restrictions

Clauses 11, 12 and 14

Submission
(Spark, Russell McVeagh)

The rules should provide an allowance for “blackout periods” (that is, periods of time when employees are unable to trade their listed shares because of insider trading or other restrictions). That is, the taxing point for these shares should be deferred until the blackout period ends and employees can sell their shares.

Employees of unlisted companies may be prohibited from selling their shares by the company’s constitution or shareholder agreement.

Comment

Officials note the suggestion that the taxing point should be further deferred is contrary to other submissions by the same submitters that the taxing point should not be deferred. These submitters have also argued that shares should be taxed when provided to a trustee who holds them on behalf of an employee, even where the shares may not be able to be sold for some years.

Given that blackout periods are generally short, and that schemes can generally be designed so that shares vest outside that period, officials do not believe it is necessary for the rules to cater for blackout periods.

In terms of the observation that employees of unlisted companies may be prohibited from selling their shares by the company’s constitution or shareholder agreement, officials do not believe this is directly relevant to the proposals in the Bill. These restrictions exist as separate commercial arrangements, unconnected with the employee share scheme. To the extent this presents a cashflow (or other) issue, this issue exists under current law (and in relation to other non-cash income). Under existing law, an employee who is given shares in their employer which the person is unable to sell is taxable on those shares when they are acquired by the person or a trustee.

Under the proposal, the employee will be taxable once the shares vest in the person (broadly speaking). In either case, the employee has to pay tax on the value of shares which they are unable to sell. Under the Bill, the tax will be paid at a point which generally speaking is closer to when the shares are able to be sold.

Inability to sell shares does not mean that the employee has received no value or that they should not be taxed. The employee will be entitled to dividends and any increase in the shares’ value over time.

Recommendation

That the submission be declined.

Issue: Clarification of “bad leaver” exclusion

Clauses 11, 12 and 14

Submission
(EY)

If the desired policy outcome is that the risk of being a “bad leaver” should not affect the share scheme taxing date, the legislation should specifically say this.

Comment

Officials agree with this submission. An example will be provided in the legislation to clarify this.

Recommendation

That the submission be accepted.

Issue: Social policy and compliance cost implications

Clauses 11, 12 and 14

Submission
(Spark)

The proposals will complicate participants’ income tax compliance and may require them to interact with Inland Revenue to handle various social policy obligations. In addition, the uncertain final tax outcome may also drive the participant into the complexity of the provisional tax rules (which the submitter states should be viewed as being anathema for employment remuneration).

Trustees will be required to play a more active role in facilitating the sale of shares on behalf of participants in order to meet the participants’ tax and social policy obligations.

The business will be required to calculate the income/deduction and advise the employee of this.

Comment

The tax treatment proposed in the Bill aligns with the longstanding treatment of share options, which have been successfully used by a number of companies for many years. Offering employee share schemes (or any other form of non-cash remuneration) generally involves slightly higher compliance costs than simply paying an employee in cash. Notwithstanding this, it is important that employee share scheme benefits are taken into account in working out social policy entitlements, so that people receiving employee share schemes do not have any advantage compared to someone receiving cash salary.

Officials agree that under longstanding current law, employees who receive employee share scheme benefits of more than approximately $7,500 per annum will be subject to provisional tax, although they will not be subject to use-of-money interest unless they have benefits that exceed approximately $180,000 per annum.

While it would be possible to exclude employee share scheme benefits from the application of provisional tax, there is an equity issue with other types of one-off income which would continue to have provisional tax implications. It is more appropriate to consider this as part of the continuing business tax stream of Inland Revenue's business transformation.

In addition, employers have recently been given the option of paying PAYE which ensures that employees are not subject to the provisional tax regime and will reduce compliance costs for their employees more generally – particularly in respect of social policy entitlements.

Currently, employee share scheme benefits (whether subject to elective PAYE or not) are included as income for the purposes of Working for Families, student loan repayments and child support. They are excluded for KiwiSaver and ACC levies.

For Working for Families, an employee can call Inland Revenue to advise they have received the employee share scheme benefit and Working for Families will be adjusted accordingly.

Child support is calculated based on previous years' earnings. So if an employee receives an employee share scheme benefit, it will be taken into account for the employee's next years' obligations, but will not affect the current year obligations.

If PAYE is withheld from an employee share scheme benefit, then student loan repayments will be automatically withheld as well. If the employer has not elected to pay PAYE, then there may be an under-deduction and the recipient might have to make extra repayments at the end of the year.

In terms of the trustee's involvement in managing the tax obligations of an employee share scheme, there is no requirement that the trustee do this. Some employers choose to engage a trustee or registry service to assist participants to sell shares to meet tax obligations, but – again – this is something many trustees already do under current law.

With respect to the comment that employers will be required to calculate the income/deduction and advise the employee of this – employers already have to do this under existing law to comply with their PAYE and information disclosure requirements. The measures contained in the Bill do not impose any additional requirements in this respect. In particular, there is nothing in the proposed measures in the Bill that would require an employer to tell an employee what figures the employer has used in their employer monthly schedule (EMS) in respect of that employee's employee share scheme benefit. However, employers may choose to do this as a matter of good practice.

Recommendation

That the submission be declined.

Issue: Support for apportionment rule

Clause 12

Submission
(KPMG)

KPMG supports the apportionment rule in relation to employee share scheme income earned partly offshore and partly in New Zealand.

Recommendation

That the submitter's support be noted.

Issue: The apportionment rule should be extended to all remuneration

Clause 12

Submission
(PwC)

There is no equivalent rule in the Income Tax Act 2007 for cash settled remuneration which apportions income accrued while the employee was a non-resident, as the Bill proposes for employee share scheme income. An equivalent apportionment formula should be introduced for cash settled remuneration.

Comment

Employee share scheme benefits often relate to the provision of services over an extended period. This is not generally the case for cash remuneration. Accordingly, officials do not see any compelling reason for a similar apportionment formula for cash remuneration.

Recommendation

That the submission be declined.

Issue: Support for the proposal

Clauses 23 and 41

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

Corporate Taxpayers Group and Chartered Accountants Australia and New Zealand support the deduction proposal in principle, subject to specific submissions on the timing and amount of the deduction.

KPMG strongly supports the proposal to provide a deduction and to align it with income derived by an employee. This ensures consistency between treatment of employee share schemes and other remuneration.

Recommendation

That the submitters' support be noted.

Issue: Employer should be able to claim a deduction for actual costs

Clause 41

Submission
(ANZ, Corporate Taxpayers Group, Russell McVeagh, EY, Chartered Accountants Australia and New Zealand)

A deduction by reference to an employee's income ignores the cash cost to the employer of providing an employee share scheme benefit. The deduction should be for the cash cost in the case of a recharge or payment to a trust. The proposal may overtax.

For example, Parent Co issues 700 shares worth $3 each to an employee of Employer Co. Parent Co charges Employer Co $2,100 for the shares. The scheme's taxing date is at the end of Year 1, at which time the market value of the shares is $2 each. Based on the proposed rule, Employer Co has a deduction for $1,400 at the end of Year 1 although it actually paid $2,100 in Year 0.

Corporate Taxpayers Group and EY submit that the deduction available to the employer should be the greater of:

- the actual costs incurred by the employer to provide the shares to the employee. This would include the cost of acquiring the shares/reimbursing the parent company as well as associated transaction costs; and
- the amount of income arising to the employee plus associated transaction costs.

Actual cash costs should be immediately deductible. Any further cost (when the employee receives income) should be deductible at that point.

Comment

Contrary to views expressed in some submissions, under current law a company is not allowed a deduction for the cost of acquiring shares which are subsequently provided to employees. Certain arrangements have been developed to achieve a tax deduction – most commonly:

- settlement of funds on an interposed trust to enable the trust to buy the company's shares for the purpose of the employee share scheme; and
- payments to a parent company to procure the parent company to provide shares to the subsidiary's employees.

Officials would like to clarify the economic nature of share repurchases by trusts and parent reimbursements in the context of employee share schemes. Submitters see share repurchase and parent reimbursement payments as deductible costs of remuneration, whereas from an economic perspective they are payments in respect of the company's share capital – the company is dealing in its own shares. The remuneration expense does not arise until such time as the shares are actually provided to the employee.

Share repurchases

Money paid by a company to purchase its own shares is a return of funds to its shareholders. Generally it is treated by the company as either a return of paid up capital, or a distribution of retained earnings. If the shares are purchased as treasury stock and reissued within 12 months, then for tax purposes the transaction is disregarded altogether by the company. In either case the tax effect of the purchase of the shares is that they no longer exist. Under current law, there is no tax deduction in respect of this transaction. Companies have been achieving a deduction by interposing a trust that buys and holds the shares until they are allocated. The use of the trust (which is generally controlled by the company through its directions to the trustee) does not fundamentally change the nature of the transaction – it is a transaction involving the company purchasing its own shares to be held effectively as treasury stock until such time as they are allocated.

This tax treatment of a share purchase by the issuing company applies whether the shares are purchased in order to later provide them to an employee, or for some other reason. Accordingly, it is not appropriate from a policy perspective to treat the amount paid to repurchase the shares as a deductible expense, even if the shares are later issued to an employee. From a policy perspective, the shares purchased by the company are destroyed, and the shares issued are not the same shares as those acquired. This is also the effect of current law.

Under the Bill, the deductible expense arises when shares are issued to an employee in satisfaction of employee share scheme obligations. The expense is the dilution of the other shareholders' interests in the company. The amount of the expense is not affected by whether the shares issued are new shares, or existing shares acquired on market.

Accordingly, officials do not agree with the submission that the cost of acquiring shares from existing shareholders for the purpose of satisfying employee share scheme obligations is a deductible expense to the company. It is either a return of capital, a distribution of earnings, or disregarded altogether.

Reimbursement paid by employer to share issuer

Under current law an employer company is permitted a deduction for reimbursement paid to another group company for issuing shares. From a policy perspective, the amount of an employer's deduction for issuing shares under an employee share scheme should be equal to the employee's income. This is true whether the shares are in the employer or its parent. The value of what has been provided to the employee is the same, and the cost to the group as a whole is the same. If the employer is not required to make any payment to its parent in reimbursement, or is required to make a payment that is less than the value of the shares, that is equivalent to a contribution of capital by the parent to the employer. If the employer is required to make a greater payment, that is equivalent to a distribution by the employer. The potential tax consequences of a distribution can be avoided by the employer agreeing to pay no more than the value of the shares at the taxing point. If the reimbursement payment does exceed the share value, the Bill minimises the possibility of any immediate tax consequences by debiting the amount of the overpayment first to the employer's available subscribed capital (ASC) – the amount of a company's share capital which can be distributed tax free to shareholders.

In the example, there is no reason to give the employer a deduction for $2,100, when the shares provided are worth only $1,400. If the employer were providing the shares itself, it would have a deduction of $1,400. So, the employer claims a deduction for $1,400 regardless of the reimbursement arrangement. The additional $700 payment is treated as return of capital by the employer to the parent. There is no black hole expenditure. All payments by the employer are recognised by the tax system, either as expenditure or distributions to shareholders.

Recommendation

That the submission be declined.

Issue: Deduction proposal is practically unworkable

Clause 41

Submission
(ANZ)

The proposal providing a deduction for the cost of providing employee share schemes by reference to an employee's taxable income is practically unworkable. Employers will have difficulty determining an employee's residence (if they earn the employee share scheme benefit partly in New Zealand and partly overseas, and thus apportion their income) and obtaining information in relation to former employees. Employees are likely to be reluctant to share this personal information and the information in their tax return with employers.

Comment

In relation to existing employees, employers are required to include income information in relation to each employee in their employer monthly schedule (EMS). All that is required is for an employer to aggregate these figures for the purpose of calculating its deduction. The proposed rules do not require the employer to confirm the amount each employee includes in their individual tax return.

It is not necessary that the figure used by the employer perfectly matches the figure used by the employee provided that each party uses the same vesting date and a market value that is permitted under *CS 17/01 – valuation of employee share schemes*. In most cases the discrepancy between the figures (if any) would be negligible.

In relation to former employees, the employer is not required to include income information on their EMS. However, officials understand that in most cases the relevant information can be requested from the share registry when the shares are issued or transferred to the employee.

In relation to employees who use the apportionment formula in proposed sections CE 2(5) and (6), use of this formula is not relevant to employers. It is only relevant to the employee. The employer's expenditure in this case is calculated under proposed section DV 27(7) and (8). The calculation is not affected by proposed section CE 2(5) and (6). The apportionment that would be relevant to the employer is based on whether the expenditure has the necessary nexus with earning New Zealand taxable income (as is the standard test for any expenditure). If the nexus exists, it is irrelevant that the employee might not be New Zealand resident during part of the vesting period.

Officials have discussed the matter with the submitter, who has advised that they are able to deal with the issues raised in their submission within their current systems and no changes need to be made to the Bill to facilitate that.

Recommendation

That the submission be declined.

Issue: Clarification of deduction formula required

Clause 41

Submission
(ANZ)

The formula in proposed sections DV 27(7) and (8) – which calculates the employer's deduction – requires clarification and should only apply to new grants. Specifically:

- The words “the shares, related rights, or employee share scheme” in the definition of “previous deductions” in proposed section DV 27(8)(b) should be amended to clarify that it is only the amount of any deductions in respect of costs attributable to the particular share scheme benefits which have given rise to taxable income to the employee in question which are to be taken into account. Under the drafting in the Bill, any costs attributable to the share scheme including in respect of benefits provided to other employees would be taken into account. That would likely then lead to a significant income amount under proposed section DV 27(9).
- The application of this rule should be clarified to ensure that it does not have retrospective application to prior year deductions where the rules at the time were clear that employers were entitled to a deduction. Consequently, the new rules should only apply to share benefits granted after enactment.

Comment

Officials agree with the first submission point. It is only deductions attributable to the benefits provided to the particular employee that should be reversed under proposed subsection (7).

Regarding the second submission point, officials do not believe any clarification is required. The Bill provides that the deduction rule will only apply from six months after enactment – see clause 2(25).

Recommendation

That the first submission point be accepted. That the second submission pointed be declined.

Issue: Bill should confirm that costs of setting up an employee share scheme are deductible

Clause 41

Submission
(Chapman Tripp)

The rules should be amended to confirm that the cost of setting up a scheme and accounting and legal fees (for setting up the scheme and on an on-going basis) fall within the meaning of “administrative or management services”.

Comment

The Bill is intended to give employers a deduction for the amount of the employee share scheme benefit taxable to an employee. It is not intended to deal with the deductibility of other employee share scheme costs. Whether or not the costs of setting up a scheme (including accounting and legal fees) are deductible should be determined under the general tests for whether an item is deductible. Accordingly, the Bill should be amended to ensure that the rule in proposed section DV 27 does not apply to deny deductions for the costs of setting up a scheme, and that these costs are subject to the usual capital/revenue tests.

This may mean that the costs of setting up an employee share scheme are blackhole expenditure. There is on-going policy work on blackhole expenditure generally, and this issue could be considered for inclusion on the Government's tax policy work programme.

Recommendation

That the submission be declined and the Bill be amended to ensure that the rule in proposed section DV 27 does not apply to deny deductions for the costs of setting up a scheme.

Issue: Clarification as to timing of deduction

Clause 41

Submission
(Chapman Tripp)

The proposed rules should be amended to confirm that the timing of an employer's deduction is the same as the employee's share scheme taxing date.

This could be remedied by simply adding the following to section DV 27:

> *"Timing of employer's deduction*
> (10) The person is allowed a deduction for the period in which the employee amount (referred to in subsection (8)(a)) arises."

Comment

Officials believe proposed section DV 27(6) to (8) already establishes the time at which the employer is entitled to a deduction for providing an employee share scheme benefit. This is because, before the formula in proposed section DV 27(7) can apply, there must be an "employee amount" (that is, an amount of income the employee has derived from an employee share scheme under proposed section CE 2(1)). In the income year in which the employee has derived that amount, the employer is able to calculate – for that income year – its corresponding deduction. There is no need to state that the employer's deduction arises in the same year in which the employee's income arises, because this is the outcome already as a result of the mechanical operation of the proposed section.

Recommendation

That the submission be declined.

Issue: Deductions will be fiscally costly to the Government

Clause 41

Submission
(Olivershaw)

The proposals are likely to be fiscally costly to the Government since the Bill proposes allowing companies deductions for paper share option costs which currently are not tax deductible.

Comment

The cost of giving deductions to employers for employee share scheme benefits, including where those were not previously available, has been taken into account in forecasts for the entire package of measures that estimate an increase in revenue of $30 million per annum once fully phased in.

Officials note that since a deduction is now being allowed, and will undoubtedly be claimed, in situations where it previously was not, it will be important to ensure that income is also returned by employees.

Recommendation

That officials' comment on the submission be noted.

Issue: Financial reporting adjustments will be required

Clause 41

Submission
(Spark)

There will be additional adjustments to the company's tax return and associated financial reporting implications.

Comment

As is the case for many expenses, the deduction for employee share scheme benefits under tax law currently does not match the accounting expense figure, and this discrepancy has been manageable. It is likely that the proposals will create more consistency between financial reporting and tax rather than less. For example, officials are aware of many employee share schemes which currently give rise to an accounting expense under international financial reporting standards (IFRS) but no tax expense (for example, option schemes). Under the proposals in the Bill, there will now be a tax expense as well as an IFRS expense (albeit they are unlikely to match). Accordingly, officials do not believe this inconsistency should affect the proposals.

Recommendation

That officials' comment on the submission be noted.

Issue: Support retaining and modernising schemes

Clause 25

Submission
(BusinessNZ, Chapman Tripp, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Spark, KPMG, Roger Wallis, Russell McVeagh)

The submitters support retaining and modernising the widely-offered tax exempt schemes.

Recommendation

That the submitters' support be noted.

Issue: Support for repeal of the notional 10% interest deduction

Clause 25

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

Submitters support the repeal of the notional 10% interest deduction.

Recommendation

That the submitters' support be noted.

Issue: Support for the increased threshold for amount that can be spent purchasing shares

Clause 25

Submission
(Chartered Accountants Australia and New Zealand)

Support increasing the monetary threshold from $2,340 to $5,000.

Comment

Officials welcome this support. However, officials note that the current $2,340 threshold over three years is not being replaced by a $5,000 threshold, but rather a $3,000 per annum threshold. Under current law, the $2,340 monetary limit for an exempt scheme is not a limit on the amount of the benefit or the value of the shares. It is a limit on the amount that the employee pays for the shares, over a three year period. The limit is $2,340, or $780 per year.

Under the Bill, there are two limits, one for the total value of the shares ($5,000 per annum) and one for the maximum discount offered to employees ($2,000 per annum). This means the maximum amount an employee can pay for the shares is $3,000 per annum (or $9,000 over three years), which is an increase of 385 percent on the current amount. It is this amount that is replacing the current threshold of $780 per annum (or $2,340 over three years).

Recommendation

That the officials' comments be noted.

Issue: The threshold should be regularly reviewed in future

Clause 25

Submission
(Roger Wallis, Corporate Taxpayers Group)

The monetary thresholds that the Bill proposes to increase will need to be reviewed in future for inflation.

The legislation should provide for regular review *(Roger Wallis)*.

Comment

Officials note that monetary thresholds in tax legislation are not generally indexed, and that in a low inflation environment, the administrative complexity of indexation may outweigh the benefit.

Recommendation

That the submission be declined.

Issue: The threshold should be higher

Clause 25

Submission
(EY)

To provide a meaningful compliance saving, the monetary thresholds need to be high enough to justify the creation and running of the schemes. The maximum value of shares provided under an exempt scheme should be $10,000 per year. The maximum discount an employer can provide to an employee should be $4,000 per year.

Comment

The exempt schemes are intended as a de minimis, to eliminate tax compliance costs for schemes providing modest benefits to 90 percent or more of a company's employees. Given that the average wage in the March quarter of 2017 was approximately $62,000 per annum, a cap of $10,000 seems too high for a de minimis. Officials note that the 385 percent increase in the amount that can be spent by employees in an exempt scheme (to $3,000 per annum) is slightly below the level of wage inflation over the same period, which is 436 percent. A 436 percent increase would produce a figure of $3,400.

Recommendation

That the submission be declined.

Issue: There should be no limit on the minimum purchase price if an employee is required to buy shares

Clause 25

Submission
(Chartered Accountants Australia and New Zealand)

Some schemes do not require employees to pay anything for their shares. However, some schemes require employees to pay something for the shares, but they are generally given a discount to market value. If employees are required by the scheme to pay anything for the shares, the Bill currently requires that if there is a minimum amount employees are required to spend. This minimum should be no more than $1,000 per annum.

Chartered Accountants Australia and New Zealand submits that this $1,000 per annum limit is unnecessary. The monetary threshold is sufficient to ensure an exempt scheme is correctly targeted.

Comment

In cases where employers specify a minimum amount employees have to spend on shares to be eligible to participate in an exempt scheme, the purpose of capping that minimum amount is to make sure that employees on lower incomes are not effectively excluded from participation by the employers because the minimum amount they are required to spend is too high. So for example, if an employer required an employee to spend a minimum of $3,000 per annum buying shares, some employees would consider that too expensive (even with a loan from their employer) and the scheme would be targeted at higher earners by default.

Accordingly, officials disagree with the submission and consider that the $1,000 maximum is necessary.

Recommendation

That the submission be declined.

Issue: Share purchase schemes should be renamed "exempt schemes" in the legislation

Clause 25

Submission
(Roger Wallis)

The submitter proposes that the term "share purchase scheme" be instead replaced with the term "exempt employee scheme". This is because:

- "share purchase agreement" is currently used in existing sections CE 2 – CE 7 of the Income Tax Act 2007 (although that phrase will be replaced by the more user-friendly "employee share scheme" by clause 12 of the Bill);
- as noted in the *Commentary* on the Bill, the concessionary regime is more commonly known as an "exempt scheme";
- a concessionary scheme will not always involve a "purchase" element – under the Bill, employees can be conferred up to $2,000 of shares without having to make a purchase.

Comment

Officials agree that it would be helpful to rename the widely-offered share purchase shares "exempt employee share schemes".

Recommendation

That the submission be accepted.

Issue: Loans to employee should not have a minimum repayment schedule

Clause 25

Submission
(Corporate Taxpayers Group)

Corporate Taxpayers Group submits that there should be greater flexibility with the loan arrangements with employees. The requirement in proposed section CW 26C(4)(d) states that the arrangement must provide that any loan to an employee to buy shares is repayable by regular instalments of a month or less. As currently drafted, this suggests it is compulsory for employers to require repayments of loans provided to employees to acquire shares to be made on at least a monthly basis.

Corporate Taxpayers Group submits that this requirement is overly restrictive. Currently the wording in section DC 13(4) states that the scheme must provide for employees to be able to repay the loan by regular equal instalments, which is an optional requirement. The Group submits that the treatment should be the same in the new rules which would, for example, allow an employer to set annual repayments.

Comment

The policy intention of both the existing provision and the proposed new provision is that repayment instalments should be regular enough so as to keep the repayment amounts affordable for employees. If the equal instalments were able to be, say, annual then it would be possible for these repayments to be quite large. This could allow employers to target only high income earners who can afford a large one-off repayment. To ensure the schemes are genuinely available to be taken up by all eligible employees, officials recommend retaining this requirement.

Recommendation

That the submission be declined.

Issue: Can payment by "regular instalment" include regular purchase of parcels of shares?

Clause 25

Submission
(Russell McVeagh)

It not clear whether "regular instalment" arrangements include arrangements where shares are acquired regularly by the employee (for example, each payday) with the entire purchase price paid off each time, or if it only applies to arrangements where shares are acquired and the purchase price is paid off in instalments.

Comment

The policy intention of this repayment by regular instalment requirement is to ensure the scheme is kept affordable for all employees. It is consistent with this policy aim to allow employees to purchase a smaller parcel of shares each payday. Accordingly, officials agree that either paying for or acquiring shares in regular instalments should be within the provision.

Recommendation

That the submission be accepted.

Issue: Support the reduction of eligible employees participating from all to 90 percent

Clause 25

Submission
(Chartered Accountants Australia and New Zealand)

Currently all employees must be offered the opportunity to participate in a widely-offered scheme for it to qualify as an exempt scheme. The submitter supports the reduction of the percentage of eligible employees from all to 90 percent.

Recommendation

That the submitter's support be noted.

Issue: Support requirement to notify Commissioner of Inland Revenue (CIR) of scheme rather than request CIR approval

Clause 25

Submission
(Chartered Accountants Australia and New Zealand)

Currently the CIR must approve all widely-offered exempt schemes. The Bill proposes that employers self-assess their eligibility and simply notify the CIR that their scheme qualifies. The submitter supports the change from an approval, to a notification system.

Recommendation

That the submitter's support be noted.

Issue: Support the removal of the trustee requirement

Clause 25

Submission
(Chartered Accountants Australia and New Zealand)

Currently all widely-offered exempt schemes must have a trustee to administer the scheme. This requirement is unnecessary and is being removed. The submitter supports this simplification.

Recommendation

That the submitter's support be noted.

Issue: Support removing the deduction as the benefit is exempt

Clause 42

Submission
(KPMG)

KPMG supports removing the deduction as the benefit is exempt.

Recommendation

That the submitter's support be noted.

Issue: Do not support removing the deduction for providing exempt benefits

Clause 42

Submission

(ANZ, BusinessNZ, Corporate Taxpayers Group, Russell McVeagh, Chartered Accountants Australia and New Zealand)

The proposal to deny employers a deduction for any costs associated with exempt schemes, other than administrative and management fees, is understandable if Parliament wishes to achieve a symmetrical treatment for income and deductions. However, employers should be allowed a deduction for the cost of the shares. Denying employers a deduction ignores the underlying purpose of the concessionary regime, to encourage employers to offer shares to employees, and the fact that there is a cost to the employer notwithstanding the concessionary tax treatment for employees. *(Chartered Accountants Australia and New Zealand)*

Deductions should be allowed. They have been a longstanding feature of the existing schemes. If there is no deduction, the schemes should not be called "concessionary".

Comment

The exemption is not designed to be concessionary – that would be contrary to New Zealand's neutral broad-base, low-rate (BBLR) tax policy framework. The exemption is designed to minimise compliance costs so employers can provide relatively small parcels of shares to most of their employees without worrying about the costs of complying with tax obligations. The benefit for the employer is that it does not need to report the employee share scheme income through the PAYE system, and is able to assure its employees that they do not need to report the income either. For many of the employees, there will also be a significant compliance cost saving. Receipt of a taxable employee share scheme benefit which has not had PAYE withheld will oblige the employee to file an income tax return, and in many cases there will be compliance costs in ensuring that there are appropriate adjustments made to Working for Families tax credits, child support or student loan repayments. This will not be necessary if the benefit is exempt.

The trade-off for a tax exemption for the income is a denial of a deduction for the employer. When the rules were originally enacted (in the 1970s) it was not envisaged that employers would be eligible for a deduction (as there is no deduction for issuing shares).

It has subsequently become apparent that employers can adopt structures that allow them to claim deductions. These deductions are unintended and should never have been available.

Recommendation

That the submission be declined.

Issue: Deductions should not be denied from date of introduction of the Bill

Clauses 2(22) and 42

Submission
(ANZ, BusinessNZ, Corporate Taxpayers Group, New Zealand Law Society)

Deductions for exempt schemes should not be denied from date of introduction of the Bill. Some submitters suggested the new rules should apply from the date of enactment at the earliest. Others suggested they should have the same grandparenting as the core proposals. Corporate Taxpayers Group considers the proposed application date is unprincipled and there is no reason for exempt schemes to be treated any differently to non-exempt schemes.

Comment

When the rules were originally enacted (in the 1970s) it was not envisaged that employers would be eligible for a deduction (as there is no deduction for issuing shares). It has subsequently become apparent that employers can adopt structures that allow them to claim deductions. These deductions are unintended and should never have been available.

The application date (date of introduction of the Bill) was designed to ensure that employers cannot extend these unintended deductions by accelerating the purchase of a large parcel of shares through a trust, which are then allocated to employees over a number of years in the future.

However, officials agree with submitters that, provided the shares have been acquired in the ordinary course of the scheme, a later application date (date of enactment) is appropriate.

Recommendation

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

Issue: Period of restriction should be clarified

Clause 25

Submission
(Russell McVeagh)

Proposed section CW 26C(7)(a) refers to a period of restriction that is "no longer than the shorter of" two points in time, which seems inconsistent with the *Commentary* as this would seem to allow for a period of restriction of even one day.

Comment

Officials agree with this submission. The intention is that, if the shares have not been acquired for market value, they generally have to be held for three years (either by the employee or by a trustee of a trust on behalf of the employee) – this is to ensure that the scheme is really a share purchase scheme, and not a mechanism for providing cash

remuneration at a tax advantage. Accordingly, proposed section CW 26C(7)(a) should read "that period of restriction is the shorter of…".

Recommendation

That the submission be accepted.

Issue: Employers should report annually in respect of exempt schemes

Clauses 25 and 248

Submission
(EY)

The "form prescribed by the CIR" referred to in proposed section 63B of the Tax Administration Act 1994 should be an annual return, as opposed to a requirement to provide multiple notifications to the CIR throughout the tax year.

Comment

Officials agree with this submission.

Recommendation

That the submission be accepted.

Issue: Clarification that employees in existing schemes can benefit from increased limits under the new rules

Clause 25

Submission
(Spark)

It is unclear whether employees who wish to participate in future grants of shares under an exempt scheme are restricted by the requirements of the current rules. This should be clarified.

Comment

Officials understand that there is some concern that an employee who receives shares under an exempt scheme that are not taxed under current law might become taxable on those shares if the employer subsequently provides the employee, under the proposed law, with shares in excess of the current limits.

Officials understand this concern, but believe that the proposed provisions in the Bill ensure that there will be no such effect on non-taxable share grants made under existing law.

In order to be approved as an exempt scheme (technically a "share purchase scheme") under current law, a scheme must provide that the amount paid by the employee for shares under the scheme or any similar scheme is no more than $2,340 over a three year period. Once the Commissioner's approval has been obtained, under current law all benefits provided under the scheme are deemed to have zero value – that is, how the "exemption" is currently provided (section CE 2(7)). This provision applies up until the date of enactment of the Bill. After enactment, this treatment will cease to apply, but will be replaced by a new – more generous – provision.

If an employer with an existing approved scheme wishes to take advantage of the proposed increase in the cost of shares that can be offered under an exempt share scheme, the employer will have to amend the terms of the scheme and re-qualify it by notifying the Commissioner. Amendment, requalification and grant of shares with a cost in excess of the current limit will have no effect on the special valuation rule that applies to grants made before enactment of the Bill. Those actions do not affect the fact that the grant was made under an approved share purchase scheme which met the requirements of the law at that time.

If, after enactment, an employer does not wish to change their schemes to take advantage of the new thresholds, then a scheme that was previously approved by the Commissioner of Inland Revenue under the old law will continue to qualify for the exemption under the new law.

Recommendation

That the submission be declined.

Issue: Do existing exempt schemes have to notify CIR when grants are made?

Clauses 25 and 248

Submission
(Spark)

It is unclear whether grandfathered exempt schemes have to notify the Commissioner of Inland Revenue when grants are made in the same way as new exempt schemes.

Comment

Officials believe the current wording in the Bill clearly provides that grandfathered exempt schemes also have to notify the Commissioner of Inland Revenue when a grant is made.

Proposed section 63B of the Tax Administration Act 1994 (clause 248 of the Bill) requires a company that has a "share purchase scheme" to notify the Commissioner of Inland Revenue when a grant of shares is made to an employee. The definition of "share purchase scheme" is contained in proposed section CW 26C(1) and includes both a new exempt scheme notified under proposed section 63B of the Tax Administration Act 1994 and an existing scheme approved under section DC 12 of the Income Tax Act 2007. Accordingly, it seems clear that

both existing grandfathered schemes and new exempt schemes need to notify the Commissioner of share grants.

Recommendation

That the officials' comments be noted.

Issue: Deductibility of set-up costs

Clause 25

Submission
(Spark)

Under the proposed reforms, employers will be denied a deduction for any costs associated with an exempt share scheme, except to the extent to which the expenditure or loss is for administrative or management services. While it is noted in the *Commentary* to the Bill that this includes fees associated with setting up or running the scheme, this is not reflected in the wording of proposed section DV 28(2).

The wording of this section should be expanded to reference both set-up and on-going running of a share scheme, to clarify that employers can take a deduction for both types of costs (rather than being interpreted as only allowing a deduction for fees relating to on-going administration and management).

Comment

Section DV 28(2) was only intended to ensure that employers could not take a deduction for the amount of an employee share benefit which is exempt to an employee. Whether or not the costs of setting up a scheme (including accounting and legal fees) are deductible should be determined under the general tests for whether an item is deductible. Accordingly, the Bill should be amended to ensure that the rule in proposed section DV 28 does not apply to deny deductions for the costs of setting up a scheme, but that these costs are subject to the usual tests.

This may mean that the costs of setting up an employee share scheme are blackhole expenditure. There is on-going policy work on blackhole expenditure generally, and this issue could be considered for inclusion on the Government's tax policy work programme.

Recommendation

That the submission be declined and the Bill be amended to ensure that the rule in proposed section DV 28 does not deny deductions for the costs of setting up a scheme.

Issue: Do not support proposal

Clauses 7 and 10

Submission
(Corporate Taxpayers Group, PwC)

The submitters do not support the proposal as it is complex and will increase taxpayer compliance costs.

Officials should consider the increased administration costs of tracking available subscribed capital (ASC) increases and decreases on a notional basis.

The Corporate Taxpayers Group submits that there should be an alternative lower compliance cost option available to employers where the amount of ASC created is equal to the actual cash cost of acquiring the shares.

Officials should consider the potential misuse that could arise by allowing employers to bolster their ASC pool where the employer does not actually issue shares (rather its parent does) and the risks of allowing New Zealand subsidiaries of multinational parents to increase their ASC reserves on a notional basis.

Comment

ASC is a notional tax balance that represents amounts paid to a company for its shares, which can be returned to shareholders later tax-free as simply being a return of the shareholders' original capital investment in the company.

As is the case for any share subscription, the proposals provide for an increase in the employer's ASC by the amount deemed to be paid (plus actually paid) for the shares. The ASC proposals are taxpayer-friendly as ASC allows companies to return amounts to their shareholders tax-free.

The purpose of the ASC proposals is to ensure that employee share schemes are not disadvantaged as a form of remuneration compared with an equivalent cash transaction, which would generally give rise to either an ASC increase (if the cash is used to subscribe for shares) or a reduction in the value of the company (if it is not).

For example, if an employer paid an employee a $100 bonus to subscribe for shares for $100, the employee would be taxable on $100, and the employer would receive a $100 deduction and be entitled to $100 of ASC. There would be no reduction in the company's value. The increase in ASC means it can return $100 to the shareholder tax-free in future – ensuring that the employee is not subject to double tax on that same $100.

The proposals are based on this simple principle. However, because of the complex arrangements involved in some employee shares schemes (in particular recharges paid to a parent company who then issues shares to an employee) there are various adjustments needed to make sure the ASC is correct.

In most cases, under the provisions of the Bill as currently drafted, companies that acquire shares for provision to employees under an employee share scheme can do so in a way which has no ASC impact. So long as the shares are allocated to an employee (not necessarily vested) within 12 months of acquisition, their acquisition and reissue by the company can be treated in the same way as an acquisition and reissue of treasury stock, which is entirely disregarded for ASC purposes.

To further simplify the ASC rules, officials also recommend allowing a company which issues shares to an employee (or trustee on their behalf) for market value not to apply subsections (6E) to (6J).

This means the only time any ASC adjustment is required is when shares are not allocated to an employee within a year of acquisition or ceasing to be allocated to another employee, or when shares are issued for other than market value.

Officials do not support the suggestion that the amount of ASC created should be equal to the actual cash cost of acquiring the shares. This is because this amount does not reflect the value of what is provided to the employee – it reflects an antecedent capital treasury stock transaction between the company and another shareholder.

In terms of the tax base risks of allowing deemed ASC, officials consider the rules are robust and reflect the economic reality of the transactions occurring. They also match the employer and employee positions – which minimises the potentially for artificially inflating ASC, as this would also generally require increased income to employees. To the extent that companies enter into tax avoidance transactions, the general anti-avoidance rule would apply.

Recommendation

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

Issue: The ASC proposal should be simplified

Clauses 7 and 10

Submission
(Chartered Accountants Australia and New Zealand)

The submitter understands the rationale for the proposal however they consider the practical issues associated with the proposed ASC rule outweigh the benefits. To implement this rule, employers will need to track employee share scheme shares for actual and deemed ASC. The rule will override commercial and actual transactions that have occurred.

The proposed rule should be simplified.

It should not apply to situations where there is no cancellation or issue of shares.

Comment

The outcome sought by Chartered Accountants Australia and New Zealand can be achieved by using the treasury stock regime, provided shares are allocated within 12 months of acquisition – which officials understand would be common commercial practice.

Officials also recommend allowing a company which issues shares to an employee (or trustee on their behalf) for market value not to apply subsections (6E) to (6J).

This means the only time any ASC adjustment are required is when shares are not allocated to an employee within a year of acquisition or ceasing to be allocated to another employee, or when shares are issued for other than market value. This should be relatively rare.

Recommendation

That the submission be declined.

Issue: Support for the proposal

Clauses 7 and 10

Submission
(KPMG)

The submitter strongly supports the proposed deduction and the accompanying creation of ASC.

Recommendation

That the submitter's support be noted.

Issue: No dividend should arise if a reimbursement payment that is greater than ASC is made to parent company

Clauses 7 and 10

Submission
(Corporate Taxpayers Group)

In the scenario where the employing company is reimbursing the parent for shares provided, the Corporate Taxpayers Group also submits that a dividend should not arise to the extent that the ASC created under complex proposed formula is less than the amount the employer reimburses the parent.

Comment

A dividend will only arise if, in addition to the reimbursement being more than the deduction for the provision of the shares, the total existing ASC of the employer/reimbursement paying company is less than the shortfall. This is consistent with how any payment to a shareholder would be treated when the paying company has insufficient ASC.

If the ASC is more than the shortfall, there will simply be a reduction in the employer's ASC (see proposed sections CD 43(6H) and (6I)).

Recommendation

That the submission be declined.

Issue: Clarification of existing ASC rules needed

Clauses 7 and 10

Submission
(Chartered Accountants Australia and New Zealand)

The *Commentary* to the Bill states the ASC is increased by the amount received for the provision of the shares under existing section CD 43(2)(b). The legislation should be clarified that ASC is increased by the consideration paid for shares. Arguably, if a company has provided shares to an employee under an employee share scheme, proposed section CD 43(6E) is the appropriate subsection that determines the subscriptions amount.

Comment

Current section CD 43(2)(b) states that ASC is increased by "the total amount of consideration that the company received, after 30 June 1994 and before the calculation time, for the issue of shares of the same class (the class) as the share, ignoring section HB 1 (Look-through companies are transparent)".

Accordingly, if the employee pays the company anything for the shares (in addition to providing their services), then the cash amount paid will increase the company's ASC under existing rules. In this case "the issue of shares" will include allocation of existing shares that fall outside the proposed one year allocation rule for treasury stock.

However, submitters do not find the legislation clear on this point and, accordingly, officials recommend the drafting be amended to make this more explicit.

Recommendation

That the submission be accepted.

Issue: Support for proposal that employee share scheme trusts be ignored

Clause 14

Submission
(Chartered Accountants Australia and New Zealand)

Chartered Accountants Australia and New Zealand supports the proposal that an employee share scheme trust will be ignored for income tax purposes. In particular, the submitter supports the proposal as it will make it explicit that the treasury stock regime can apply to an acquisition by an employee share scheme trust, just as if the shares were acquired by the company and not cancelled.

Recommendation

That the submitter's support be noted.

Issue: Use "trustee of a trust", not "trust"

Clause 14

Submission
(Russell McVeagh)

Proposed section CE 6 says a trust is treated as a nominee. A trust cannot be a nominee but a trustee of a trust can.

Comment

Officials agree with the submission.

Recommendation

That the submission be accepted.

Issue: The effect of trustee nominee provision is unclear

Clause 14

Submission
(Russell McVeagh)

It is unclear what would happen if the trustee holds shares that have been issued or sold to employees given that nominees are ignored for the purposes of the Income Tax Act 2007 under section YB 21.

Treating a trust/trustee as nominee would override and reverse the terms of many employee share schemes which is that when shares are acquired by an employee they are held by a trustee on trust for the employee for a period of time.

Comment

Officials believe it is clear from proposed section CE 6 in clause 14 of the Bill as drafted that to the extent to which a trustee of a trust holds shares for a particular employee, the company is treated as holding the shares as trustee for the employee (because the trustee, as nominee, is ignored). To the extent to which the trustee is acting on behalf of the company itself in respect of the shares (for example, if the shares have not be allocated to a specific employee), the company will be deemed to be undertaking any activities of the trustee in its own personal capacity. This will also be explained in guidance. However, the changes in the Bill mean that the acquisition of shares by a trustee for an employee will generally not be significant for tax purposes.

In terms of the comment that treating a trustee as nominee would override and reverse the terms of many employee share schemes, officials note that the nominee provision in proposed section CE 6 does not change the legal arrangements between the parties, it simply prescribes a particular tax treatment. Accordingly, for general legal purposes, the terms of the employee share scheme will continue to have effect.

Recommendation

That officials' comments on the submission be noted.

Issue: Should deem income and expenditure of trustee to be that of the company

Clause 14

Submission
(Russell McVeagh)

If the policy intent is that any income/expenditure of trustees is to be treated for income tax purposes as the income/expenditure of the company, this should be done other than by treating the trust/trustees as a nominee of the company.

Comment

The purpose of treating the trustee as a nominee is wider than simply deeming any income/expenditure to be the income/expenditure of the company. Deeming the trustee to be a nominee of the company will, for example, mean that the acquisition of shares by the trustee (prior to the allocation of those shares to a particular employee) is taxed in the same way as an acquisition by the company.

This will generally eliminate the uncertainty that currently exists as to whether a trustee has a taxable gain when it acquires shares and then provides them to an employee when their value has increased.

It will also avoid the issue of whether contributions by a company to a trustee are on capital or revenue account – such contributions will generally have no impact for income tax purposes.

Recommendation

That the submission be declined.

Issue: Transitional period should be 12 months rather than six months

Clause 28

Submission
(Spark)

Six months is not long enough, especially for a large listed company, to change an employee share scheme, get the relevant board approvals, advise staff of changes and update payroll processes. The transitional period should be 12 months following enactment.

Comment

Officials do not agree with this submission. Officials note that even the proposed six month delay in implementing the rules is relatively unusual and, during public consultation, has generally been welcomed by submitters. In addition, the nature of the changes has been known for some time as there has been extensive public consultation on the proposals in the Bill. Officials do not believe that a longer lead-in period is justified.

Recommendation

That the submission be declined.

Issue: There should be a fixed application date for exempt scheme changes

Clause 28

Submission
(Spark)

The submitter suggests that there should be a fixed application date for the exempt scheme rules (not date of enactment) – for example, 1 April 2018. The current application date does not provide enough certainty for existing schemes.

Comment

Officials do not agree with this submission. It would not be appropriate to have an application date for the increased exemption which might pre-date enactment of the Bill.

The date of enactment of legislation is inevitably uncertain, and those affected by changes which take effect immediately will find ways to deal with this. Officials would also emphasise that in this respect, the changes proposed are beneficial to taxpayers, and therefore bringing them into effect as soon as possible after (but not before) enactment is beneficial for taxpayers.

Recommendation

That the submission be declined.

Issue: Support for cost base proposal

Clause 12

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports specifying a cost base for shares acquired under an employee share scheme.

Recommendation

That the submitter's support be noted.

Issue: Support for exclusion from foreign investment fund rules

Clause 60

Submission
(Chartered Accountants Australia and New Zealand)

Support the proposal to exclude employee share scheme shares from the foreign investment fund (FIF) rules until the share taxing date.

Recommendation

That the submitter's support be noted.

Issue: Do not support specific anti-avoidance rule

Clause 70

Submission
(Chartered Accountants Australia and New Zealand, KPMG, Russell McVeagh)

The submitters do not support the inclusion of a specific anti-avoidance provision. It is not required if the proposed legislation clearly reflects the policy intent of the rules. The Commissioner of Inland Revenue can also rely on the general anti-avoidance rule in section BG 1.

Comment

Officials do not agree that a specific anti-avoidance provision is not useful. Such provisions are not uncommon within the Act, and discourage businesses from entering into tax motivated transactions, not all of which can be predicted when drafting the specific provisions or covered by the general anti-avoidance rule.

Recommendation

That the submission be declined.

Issue: Support the amended definition of "tax shortfall"

Clause 70

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports amending the definition of "tax shortfall" so there is a penalty for not taking reasonable care in relation to EMS disclosure.

Recommendation

That the submitter's support be noted.

Issue: Trustee definition should allow for single or multiple trustees

Clause 70

Submission
(Russell McVeagh)

It is not clear why the definition of "trustee" in proposed section CW 26G refers only to groups of persons and not single persons (including corporate trustees). If it does include single persons then it is not clear why this definition is necessary and the existing section YA 1 definition would be unsuitable.

Comment

Officials do not agree with the submission. Section YA 1 states that a "group of persons" includes 1 person. Accordingly, the provision already includes a single trustee, as well as multiple trustees.

The definition in proposed section CW 26G is necessary because it is a more specific definition of "trustee" than that contained in section YA 1. In particular, the definition of "trustee" in proposed section CW 26G specifies that it applies only to "a group of persons appointed to administer a share purchase scheme of a company that employs an employee,

and to hold shares under that scheme on trust for the employee during any period of restriction described in section CW 26(7).”

Recommendation

That the submission be declined.

Other policy matters

ANNUAL SETTING OF INCOME TAX RATES

Clause 3

Submission
(Corporate Taxpayers Group)

The annual income tax rates should be set in advance of the tax year commencing and not in arrears, so that there is certainty about the rate(s) of income tax that will apply for a tax year, prior to its commencement. This Bill should also confirm the annual income tax rates for the 2018–19 tax year.

Comment

Section BB 1 of the Income Tax Act 2007 provides that the income tax rates must be fixed by an annual taxing Act. The section does not provide that they must be set in advance of the tax year's commencement. The practice has been for the annual income tax rates to be confirmed by legislation enacted during the tax year to which the rates relate. Setting the annual tax rates in advance of a tax year's commencement would not provide taxpayers with the certainty suggested by the submitter because, in accordance with the fundamental constitutional principle of Parliamentary sovereignty, a Parliament cannot bind its successors. Thus, if Parliament set the annual tax rates in advance of a tax year's commencement, they could still be altered by Parliament during that tax year, before income tax assessments for that year are made.

Recommendation

That the submission be declined.

DEMERGERS – COMPANY SPLITS BY LISTED AUSTRALIAN COMPANIES

Clauses 8, 45, 63, 172(3) and 182

Introduction

The Bill proposes that certain transfers of shares received by New Zealand shareholders as a result of a company split (demerger) by a listed Australian company are not treated as a dividend. Current law views the full value of the shares in the demerged company to be treated as a dividend. Demergers, which do not involve a distribution of income, should not, in principle, give rise to taxation consequences.

What is a "demerger"?

A "demerger", or company split, describes the situation when a company (or a group of companies) splits off part of itself and distributes that part to its shareholders. The effect of the demerger is that shareholders, instead of having one shareholding in the company, have two different shareholdings in separate companies and the shares can be traded separately. A demerger is generally undertaken by a company when its value is less than the sum of its constituent parts.

The current tax treatment

Under the Income Tax Act 2007, the full value of the shares in the demerged company is a dividend for the shareholder. This is because the Income Tax Act defines a dividend as generally any transfer of value from a company to a shareholder that is caused by the shareholding. A demerger involves the transfer of value from the company to its shareholders (being the distribution of the shares in the demerged company); as such, the shares that result from the demerger because of the shareholding are treated as a dividend for tax purposes.

Furthermore, the amount of the dividend is usually very large, as it will equal a significant percentage of the corporate group's total market value.

The problem with the current tax treatment

The current tax treatment is a problem if the demerger is, in substance, the division of a corporate group rather than a distribution of income. Following the demerger, the shareholders still have the same proportionate interests in the same underlying assets. Therefore a demerger can be thought of as akin to a share split, with the assets of the corporate group divided between the split shares.

This means, in substance, there is no distribution of income or underlying assets by the corporate group on a demerger that should be taxed as a dividend. A shareholder's economic ownership has not changed.

Scope of the problem

The current tax treatment raises potential issues for demergers of both New Zealand and foreign companies and is particularly acute for demergers by listed Australian resident companies. This is because:

- New Zealand companies can often structure their demergers so that no dividend arises; and
- shares in other foreign companies are more commonly subject to the foreign investment fund (FIF) rules (which ignore dividends).

Shareholders will generally not be subject to the FIF rules in respect of listed Australian shares or if they are natural persons whose total offshore shareholdings cost $50,000 or less.

Listed Australian companies, however, often have several thousand New Zealand shareholders that are taxable on any dividends received, but they do not structure their demergers to be efficient for New Zealand tax purposes. Furthermore, dividend taxation for Australian demergers can seem particularly unfair for New Zealand shareholders, as Australian shareholders are not usually taxable on a demerger.

The proposal in the Bill removes from the dividend rules in the Income Tax Act the receipt of shares by a New Zealand taxpayer when those shares are the result of a demerger by a listed Australian resident company, provided the shares received as a result of the demerger are not treated as a dividend under Australian tax law. The focus on Australian-listed companies is based on the need to develop a solution that addresses the greatest need, primarily "mum and dad" shareholdings in ASX-listed Australian companies.

Submitters have raised concerns that the proposals could have the effect of creating in investors' minds a preference for ASX-listed stocks over NZX-listed stocks. Officials note that the amendments in the Bill are intended to respond to situations where New Zealand shareholders incur taxation liabilities as a result of company governance decisions by Australian companies. In the cases that have been brought to officials' attention, the New Zealand shareholding base represents a minority and no steps have been taken by the Australian company to mitigate the New Zealand tax effect on New Zealand shareholders. To this end, the proposed amendments respond directly to this concern only and are not intended to create a preference.

Issue: Support for the proposal, with some reservations

Submission

(Chapman Tripp, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, FNZ, Glendinnings, KPMG, New Zealand Law Society, New Zealand Media and Entertainment, New Zealand Shareholders Association Inc, NZX Limited, PwC, Roger Wallis, Russell McVeagh)

Submitters support the proposed changes subject to issues discussed in this part.

Recommendation

That the submitters' support be noted.

Issue: Proposed demerger rules should also apply to New Zealand companies and other company demergers generally

Submissions

(Chapman Tripp, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, FNZ, New Zealand Law Society, New Zealand Shareholders Association Inc, NZX Limited, PwC, Roger Wallis, Russell McVeagh)

The proposed demerger rules should apply to New Zealand companies and company demergers generally.

The Government is encouraged to carry out further work on the tax treatment of company demergers generally as part of the tax policy work programme.

Comment

The proposed amendments are intended to be a targeted response to deal with the tax problems for those that are currently most affected, being New Zealand shareholders in ASX-listed companies. While there is an argument that the demerger rules should be extended to New Zealand companies, New Zealand companies have available to them a number of mechanisms in the Income Tax Act to prevent demergers giving rise to a taxable dividend for their shareholders. For example:

- Share repurchases: In this case an amount equal to a company's paid-up share capital (referred to as "available subscribed capital", or ASC, for tax purposes) is excluded from being a dividend.
- Liquidation: In this case an amount equal to any net capital gains (realised and unrealised) plus the ASC of the distributing company is excluded from being a dividend.

Further, a dividend arising from a demerger will only be taxable if the demerging company is a New Zealand resident, or if the demerging company is a non-resident and the shareholder is not subject to the FIF rules. In the latter situation, this is the case if:

- the shareholder is a natural person whose total offshore shareholdings cost $50,000 or less; or
- the shares are held in an Australian listed company (which is the focus of the proposed amendments in the Bill).

Officials note that Australian companies are less inclined to take into account the tax treatment of their minority New Zealand shareholders to prevent dividend treatment when carrying out a demerger. Australian shareholders are generally not taxed on these transactions under Australian tax law, subject to specific anti-avoidance rules not applying.

The Bill addresses, in a timely manner, the problem in practice.

A comprehensive and robust set of rules for company demergers, including demergers by New Zealand companies, could not be developed in time for inclusion in the Bill. In particular, there is a need to protect the integrity of the tax system to ensure that any exclusion from dividend taxation for demergers is not abused. In this regard, Australia, the United Kingdom, the United States and Canada all have rules which exempt qualifying demergers

from dividend taxation. These rules are generally subject to numerous restrictions to ensure that they apply to company demergers when there is no economic change in shareholder ownership (a genuine demerger). They do not apply if the demerger is used to effect a tax-free distribution of income to shareholders or a sale of the companies.

The private sector has focused on the tax treatment of Australian demergers as the main problem and requested an urgent solution. The proposed amendments in the Bill are the response to the problem. The amendments are limited to demergers by Australian-listed companies when Australian tax law does not treat the shares received as a result of the demerger as a dividend (thus incorporating the protective aspects of Australia's anti-avoidance measures).

Officials acknowledge the submissions requesting additional work be done to extend the scope of the demergers proposal in the Bill to New Zealand company demergers (and other demergers, generally). This issue can be considered when the Government's tax policy work programme is refreshed.

Recommendation

That the submissions be declined.

Issue: Application date

Submission
(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Glendinnings, New Zealand Media and Entertainment, New Zealand Shareholders Association Inc)

Submitters have suggested a number of dates from which the proposed amendments should apply, including the income years:

- 2013–14 *(Chartered Accountants Australia and New Zealand)*
- 2015–16 *(Corporate Taxpayers Group, Glendinnings)*
- 2016–17 (as proposed in the Bill) *(New Zealand Media and Entertainment, New Zealand Shareholders Association Inc)*

The New Zealand Shareholders Association Inc would prefer an earlier application date but appreciate it may not be administratively feasible.

Comment

The Bill provides that the amendments apply from the start of the 2016–17 and later income years. Shareholders will not have filed tax returns for this income year until sometime after May 2017.

Applying the change from 1 April 2016 allows for taxpayers to take advantage of the proposal for the current income year and does not disturb existing tax positions. This application date reduces compliance costs and the need for Inland Revenue to reconsider earlier taxpayer tax positions. The fiscal impact of applying the change from 1 April 2016 is not likely to be material.

Backdating the application of the proposed solution from an earlier date would have compliance implications (and administration impacts on Inland Revenue) if taxpayers were to reverse earlier tax positions. There would also be an associated (but unquantifiable) revenue cost.

Inland Revenue has insufficient information to assess taxpayer compliance on returning dividend income from demerger transactions. The exact revenue cost and number of taxpayers affected varies from year to year depending on the number of demerger transactions in the income year. Inland Revenue does not specifically record such income. Officials are aware from consultation in November 2016 that some custodial service providers have paid RWT (by redeeming units) on previous demergers to meet unitholder tax obligations. A retrospective application date would mean that these tax positions would need to be unwound, including the need for custodial providers to reverse earlier unitholder tax payments.

Recommendation

That the submissions be declined.

Issue: Treatment of ASC

Submission
(Bell Gully, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, New Zealand Media and Entertainment, PwC, Roger Wallis)

The proposed amendments should allow taxpayers to calculate the available subscribed capital (ASC) of the new company, if practical.

If it is not practical, the ASC of the demerged company should be zero as proposed by the Bill, provided that the original company's ASC remains unaffected.

Comment

The Bill proposes that the ASC of the demerged company has a nil balance. The ASC of the original company, if it exists, would remain unchanged following the demerger.

Australian-listed companies are generally not resident for New Zealand tax purposes and there is no requirement to keep records for ASC for New Zealand income tax purposes. Following consultation in November 2016 on the proposal in the Bill, officials considered that creating a requirement to ascribe an ASC amount to the demerged company would be impractical as the information to support such a value would not be readily available.

Submitters have argued that if taxpayers are able to calculate and attribute relevant ASC values to the original company and the demerged company, those values should be recognised for income tax purposes.

Provided that information is available, and it is practical for the splitting company and the subsidiary to allocate ASC between the companies immediately after the demerger, officials recommend that proposed section ED 2B should recognise the allocation of ASC to the demerged company and a corresponding reduction in the ASC balance of the splitting company. If calculating the ASC of the demerged company is not practical, taking into account the information available to the taxpayer, and the costs connected with collating and calculating the ASC value, the proposed amendments in the Bill should continue to apply.

Recommendation

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

Issue: Proportion of shareholding requirements

Submission

(Bell Gully, Chapman Tripp, Corporate Taxpayers Group, KPMG, New Zealand Media and Entertainment, New Zealand Shareholders Association Inc, PwC)

The Bill proposes that shareholders' interests in the demerged company must be exactly the same proportion as the shareholding immediately before the demerger. This requirement is not practical and does not recognise situations where a small number of shareholders are ineligible to participate in the demerger.

Comment

The Bill contemplates situations where shareholdings in the original and demerged companies would be commensurate. Officials agree that the proposed amendment imposes too strict a test and should provide a tolerance for rounding, and not count shareholdings that are ineligible to participate in the demerger.

Officials recommend that the scope of proposed section ED 2B ensure that non-participating, and immaterial deviations in participating shareholding proportions immediately before and immediately after the demerger arise, are ignored.

Recommendation

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

Issue: Scope of the proposed amendments

Submission

(Chapman Tripp, Corporate Taxpayers Group, Financial Services Council, FNZ, New Zealand Shareholders Association Inc, PwC)

A range of views have been expressed regarding the scope of the proposed amendment, including comments about the type of security involved in the demerger, and the manner in which the demerger is carried out.

- The amendments should apply to listed-stapled securities. *(New Zealand Shareholders Association Inc)*
- The amendments should apply to Australian unit trust redemptions. *(Financial Services Council, FNZ)*
- The amendments should apply to unit trusts listed on the ASX, when it is part of a stapled-security structure. *(Corporate Taxpayers Group)*
- The amendments in the Bill should also provide for other methods used by companies to demerge. *(Chapman Tripp)*
- In section ED 2B(7)(b), the phrase "or New Zealand" should be added. *(Chartered Accountants Australia and New Zealand)*
- Relief from dividend taxation should be available for redemptions of units in Australian unit trusts by de minimis investors (individuals and trusts holding foreign portfolio investments costing $50,000 or less and who choose not to apply the FIF rules). *(Financial Services Council, FNZ, PwC)*

Comment

Officials' comments are below:

- As noted earlier, the proposed amendments are intended to be narrow in focus to shareholding in listed Australian companies. New Zealand companies are not intended to be within scope for the reasons set out earlier.
- Given the narrow focus of the amendments, wider arrangements used by companies to demerge as submitted by Chapman Tripp, are not within scope. These matters could be considered as part of any future work into the tax consequences of demergers.
- Officials do not recommend extending the proposals to Australian unit trust redemptions. Unit trusts are treated differently in Australia and are taxed as trusts, rather than companies as is the case in New Zealand. This difference in tax treatment means it is possible – notwithstanding the comment from the Financial Services Council and FNZ – for distributions to be paid tax-free in Australia. In such cases, not taxing the distribution as a dividend in New Zealand could create a risk to the tax base. Further, officials consider a redemption of units in a unit trust involves the investor receiving cash from the unit trust, so there is a distribution that should be subject to New Zealand tax.
- Officials note that stapled securities are intended to be within scope if the debt instrument is "stapled" to a share in an Australian ASX-listed company.

- Officials consider that shareholdings other than in New Zealand companies or ASX-listed companies would, for the most part, be taxed under the foreign investment fund (FIF) rules. The FIF rules ignore dividends and, as a result, the problems with demergers do not arise. If, however, the cost of a natural person's total offshore shareholdings is less than $50,000 the FIF rules do not apply and the dividend rules would apply. As the proposal does not apply to unlisted Australian companies, New Zealand natural person shareholders in such companies under the $50,000 de minimis would, in principle, continue to be affected by a demerger (although such shareholders can choose to apply the FIF rules and therefore not be subject to dividend taxation on demergers). However, officials expect very few New Zealand natural person shareholders would invest in Australian companies that are outside the ASX.
- Officials accept submitters' concern that the scope of the proposal is narrow. Resolving these wider concerns about scope would require a more complex solution that balances issues of fairness against potential risks to the tax base and the need for appropriate anti-avoidance measures. For example, the proposal in the Bill relies on existing anti-avoidance measures in Australian tax law to prevent company splits by ASX-listed companies being used to distribute tax-free income to shareholders.

These wider matters would be more appropriately considered as part of any work directed at developing a comprehensive set of rules for demergers generally by New Zealand and non-resident companies. This further work would be subject to being prioritised under the Government's tax policy work programme.

Overall, officials consider the scope of the proposed change in the Bill deals with the main problem in practice with company demergers.

Recommendation

That the submissions be declined.

Issue: Technical matters

Submission
(Chapman Tripp, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, PwC, Roger Wallis)

Submissions have made a range of technical suggestions with the drafting of the proposal in the Bill:

- The proposed ASX definition is confusing for taxpayers. Reference should instead be made to a company that is listed on the ASX. *(Corporate Taxpayers Group)*
- Proposed section ED 2B does not consider the situation when part of the share transfer is not a dividend or a dividend that is not assessable under the Income Tax Assessment Act 1936. *(Chartered Accountants Australia and New Zealand, Chapman Tripp, KPMG)*
- In proposed section ED 2B(1)(c) – the word "immediately" should be inserted at the start of the section. *(Chartered Accountants Australia and New Zealand)*
- Proposed section ED 2B(1)(c) should align with the Australian demerger rules. *(KPMG)*

- In proposed section ED 2B(1)(d) – the reference to the Australian Income Tax Assessment Act 1936 should be future proofed. *(Chartered Accountants Australia and New Zealand)*
- Proposed section ED 2B(1)(d) should explicitly refer to the situations when a dividend would arise under the Income Tax Assessment Act 1936. *(Chapman Tripp, KPMG)*
- Proposed section ED 2B(1)(d) should explicitly refer to the situations when a dividend is not assessable income or exempt income under the Income Tax Assessment Act 1936. *(KPMG)*
- In proposed section EB 2B(5), confirm that if the ASC of the subsidiary company is zero, the ASC of the splitting company remains unaffected. *(Roger Wallis)*

Comment

Submitters' comments will be taken into account as part of any recommended revisions to the Bill to remove ambiguities and uncertainties with the proposed amendments, subject to the changes being consistent with our earlier comments. For example, the definition of ASX-listed Australian company confirms the narrow focus of the proposed amendment.

Recommendation

That the submissions be accepted in part, subject to officials' comments.

Issue: Inland Revenue to provide guidance to taxpayers

Submission
(Chapman Tripp, Corporate Taxpayers Group, FNZ)

It should be clarified that if an ASX exempt stock undertakes a demerger, if the new company is a FIF, there is a purchase in the calculation of the Comparative Value method of FIF income equal to the deemed cost base. *(FNZ)*

Inland Revenue should clarify if the shares in the demerged company are held on capital or revenue account. *(Corporate Taxpayers Group)*

If shareholders originally hold shares on revenue account, the shares in the demerged company should be held on a similar basis, with the proceeds taxed on sale. *(Chapman Tripp)*

Is it intended that section CQ 5 should be used by de minimis shareholders to use the FIF rules to remove the tax on dividends deemed to arise from a demerger? *(PwC)*

Comment

Officials will provide additional comments clarifying these points as part of the *Tax Information Bulletin* item on the Bill following its enactment.

Recommendation

That the submissions be noted.

BANK ACCOUNT REQUIREMENT FOR IRD NUMBERS

Clause 244

The proposed amendment will give the Commissioner of Inland Revenue a discretion to issue IRD numbers to offshore persons without a New Zealand bank account where the Commissioner is satisfied with their identity and background.

Issue: Support for the proposed amendment

Submission
(New Zealand Law Society, ANZ, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, New Zealand Law Society, New Zealand Bankers Association, Russell McVeagh, PwC, KPMG)

All submitters supported the proposed amendments. Some (Corporate Taxpayers Group, KPMG) strongly supported it, noting that the existing requirement has been a significant impediment to offshore businesses/persons trying to meet their New Zealand tax obligations. One submitter (ANZ) noted that "the administration required to open, maintain, monitor and close accounts for overseas persons is costly and resource intensive and creates operational, compliance and sanctions risks for banks". One submitter (Chartered Accountants Australia and New Zealand) noted "the practical problems currently faced by offshore persons who wish to comply with their New Zealand tax obligations", stating that "the discretion is therefore welcome".

Recommendation

That the submitters' support be noted.

Issue: Guidelines

Submission
(New Zealand Law Society, ANZ, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, New Zealand Law Society, New Zealand Bankers Association, Russell McVeagh, PwC, KPMG)

All submitters have asked for detailed guidance on how an offshore person could satisfy the Commissioner of Inland Revenue of their identity and background. One submitter (ANZ) asked for clarification on what types of identification documents and background information from different types of applicants will be needed. The same submitter also asked for guidance in a schedular format so that the Commissioner can add scenarios to it when discretion was used. One submitter (Corporate Taxpayers Group) remarked that a dedicated email address or online application form needs to be created as IRD numbers often need to be obtained at short notice.

Corporate Taxpayers Group also noted that it is "important that taxpayers do not need to first establish that they cannot open a bank account".

Two submitters (ANZ, New Zealand Bankers Association) requested that Inland Revenue work with the banking industry to develop guidance when the discretion will be applied, to ensure certainty of application.

Comment

Some examples of when the discretion may be exercised will be provided in Inland Revenue's *Tax Information Bulletin*, as well as the information on what documents may be sufficient. However, these guidelines cannot be exhaustive as circumstances in which the Commissioner's discretion may be exercised may vary significantly.

On enactment of the proposal an existing email address (offshore@ird.govt.nz) will be available for applications for IRD numbers by offshore persons without a New Zealand bank account. Additionally, all non-individual offshore persons, and individual offshore persons who are migrants,[14] will be able to send their IRD number applications through the current server https://myir.ird.govt.nz/eservices/home/_/ .

There are no plans to create a new online application form for offshore persons without a New Zealand bank account, but the existing IRD number application forms (IR742, *IRD number application form – non-resident/offshore individual*, and IR744, *IRD number application – non-resident/offshore non-individual*) will be amended to accommodate the Commissioner's discretion.

Officials confirm that offshore persons will not need to first establish that they cannot open a bank account, before the Commissioner will consider whether or not to exercise her discretion.

The nature and extent of consultation on any guidelines has yet to be decided.

Recommendation

That officials' comments on the submissions be noted.

Issue: Location of the amendment in legislation

Submission
(Corporate Taxpayers Group)

The amendment is currently proposed to be included as new section 55B of the Tax Administration Act 1994 (TAA). In the Group's view this is not the most logical place for this discretion amongst the Residential Land Withholding Tax rules and other rules relating to withholding taxes.

The Group submits the proposed rule should instead be included alongside the rule requiring a taxpayer to have a bank account prior to the Commissioner issuing an IRD number (contained in section 24BA of the TAA). It is more logical to include these two provisions together and makes the TAA easy to read for taxpayers trying to work out their obligations.

[14] "Migrants" are individuals entering New Zealand on a resident, work or student visa.

Comment

Proposed section 55B of the TAA replaces section 24BA of the TAA in its entirety. Section 55B is a more suitable location for the amendment as it follows sections relating to requirements for the provision of information. The current section 24BA follows provisions requiring taxpayers to keep records.

Recommendation

That the submission be declined.

Issue: Exclusion of PAYE amounts and schedular payments from penal non-declaration rates

Submission
(PwC)

PAYE income amounts and schedular payments should be excluded from penal non-declaration/without notification rates while the Commissioner considers the application for the IRD number under the proposed section 55B(1)(b) of the TAA. Employers may not be in the position to defer salary and wage payments as they are also subject to labour laws. The penalty will also cause additional administrative cost to Inland Revenue.

Comment

It is expected that in straightforward cases, the Commissioner will decide whether or not to exercise her discretion within the standard processing timeframe, which is currently 10 working days. In straightforward cases, IRD numbers can in some instances be issued urgently, in a shorter timeframe.

Current tax provisions are also sufficiently flexible to address the situation described by the submitter. For example, if tax was deducted at the no-notification tax rate (formerly "no declaration rate") before the employer has the employee's IRD number, the employee can claim back any overpayment by requesting a personal tax summary or filing an IR3 return – whichever applies. Therefore, officials do not consider this to be a significant issue that needs to be separately legislated for.

Recommendation

That the submission be declined.

PETROLEUM MINING DECOMMISSIONING

Clauses 17–21, 33–38, 48–52, 57, 95, 99, 100, 102–104, 113, 172(8), (44), (45), (47) & (49), 265 and 266

The tax rules for petroleum mining currently include a "spread-back" process which allows prior income tax periods to be reopened to include losses arising from decommissioning expenditure incurred in the current year. This method ensures that decommissioning expenditure, which is a large cost incurred near or at the end of production, does not result in a loss carried forward that would be of little or no value to the petroleum miner unless it had income from another source.

As the current spread-back requires Inland Revenue to amend assessments for previous periods it involves high compliance and administration costs and is considered an outdated process. A number of other issues have also been identified where the current petroleum mining decommissioning rules are not sufficiently detailed or arrive at an incorrect outcome.

As well as correcting the identified issues, the spread-back mechanism for deducting decommissioning costs is proposed to be replaced with a refundable credit similar to other refundable credits already included in the Income Tax Act 2007, most relevantly the refundable credit for mineral mining rehabilitation expenditure.

Submitters were generally in favour of the proposals and submissions largely focused on clarifying some technical details.

Issue: Replacing spread-back with a refundable credit

Submission

(Chapman Tripp, Corporate Taxpayers Group, Tamarind, Petroleum Exploration & Production Association of New Zealand)

Chapman Tripp supports the proposal to replace the current spread-back mechanism for decommissioning losses with a refundable credit mechanism, to the extent that the proposed changes are consistent with the original policy intent and do not result in more adverse consequences for petroleum miners than what their position would have been if the current spread-back mechanism is retained. *(Chapman Tripp)*

The Group supports the amendments to the petroleum decommissioning rules contained in the Bill. In particular, the Group supports the proposal to replace the spread-back mechanism with a refundable credit. *(Corporate Taxpayers Group)*

Tamarind agrees with the vast majority of the proposed decommissioning amendments. *(Tamarind)*

Petroleum Exploration & Production Association of New Zealand supports the replacement of the current spread-back mechanism for decommissioning losses with the proposed refundable credit mechanism, so long as specific elements of it remain consistent with the original policy intent. They also welcome the correction of unintended errors and clarification of identified issues in the current legislation. *(Petroleum Exploration & Production Association of New Zealand)*

Comment

Officials acknowledge the support for the proposed refundable credit regime. Officials note that due to other changes in the proposals, such as the removal of the link with relinquishing a permit, there will be specific circumstances where a petroleum miner may qualify for a refundable credit where they did not qualify for a spread-back, or vice-versa; however, the proposed rules are intended to be broadly consistent with the current rules.

Recommendation

That the submitters' support be noted.

Issue: Removal of link with relinquishing a permit

Submission
(Chapman Tripp, Petroleum Exploration & Production Association of New Zealand)

The submitters support the proposal to remove the requirement for decommissioning actions to be linked to the relinquishment of a permit.

Recommendation

That the submitters' support be noted.

Issue: Planning for decommissioning

Submission
(Chapman Tripp, Petroleum Exploration & Production Association of New Zealand)

The proposed "decommissioning" definition should be amended to clarify, for the avoidance of doubt, that "decommissioning", includes the planning, management and execution of the physical acts of decommissioning. *(Chapman Tripp)*

The decommissioning process requires extensive planning, technical and environmental assessments, stakeholder, community and regulatory engagement, regulatory approvals, as well as management support and ongoing monitoring. These activities are all a direct part of undertaking the decommissioning work, and the costs involved are significant and equally as unavoidable and necessary for the derivation of income as the costs of other more "physical" decommissioning activities. *(Petroleum Exploration & Production Association of New Zealand)*

Comment

Officials always intended for the definition of “decommissioning” to include necessary planning and management activities such as the examples provided by submitters. Officials agree that the definition should be clarified to ensure they are included.

Recommendation

That the submission be accepted.

Issue: Alignment with current “removal or restoration operations” definition

Submission
(Petroleum Exploration & Production Association of New Zealand)

The definition of “decommissioning” should, where possible, align with the current “removal or restoration operations” definition in order to eliminate the potential for any unintended change in meaning. For example, while the Petroleum Exploration & Production Association of New Zealand is not opposed to removing the reference to the defined term “petroleum mining asset” and replacing it with a description, that description should use the same terminology as used in the “petroleum mining asset” definition (such as “asset” rather than “equipment or structure”, and “acquired for the purpose of carrying on” rather than “used”).

Comment

Officials agree that the definition of “decommissioning” should align with “removal or restoration operations” where possible to reduce the potential for unintended changes. Officials consider that the definition of a “petroleum mining asset” could be reinserted into the proposed paragraph (a) of the “decommissioning” definition which should resolve the submitter’s concerns.

Recommendation

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

Issue: Definition of commercial wells

Submission
(Petroleum Exploration & Production Association of New Zealand)

The description of commercial wells in subparagraph (b)(i) of the definition of “decommissioning” requires minor revision to make clear that it covers all wells involved with the commercial production of petroleum, which includes producing wells as well as those that involved the injection of water and gas. For example, wells used for water injection, water disposal, gas reinjection and gas disposal can all be integral parts of a petroleum mining operation. The words “directly or indirectly” are proposed to make this clear.

Comment

Officials agree that wells used for water or gas, reinjection or disposal should be covered by the commercial wells part of the decommissioning definition as these wells can be an integral part of the production process. Expenditure on these wells would be petroleum development expenditure as the wells are a petroleum mining asset. The current wording in the decommissioning definition is “a well… used for the commercial production of petroleum” rather than an alternative such as a well that petroleum is extracted from. Officials consider the current wording is already sufficiently wide to include the types of wells referred to by the submitter. Including a “directly or indirectly” phrase would not increase certainty and would risk expanding the definition beyond that intended – for example, to an exploration well that discovered, or expanded knowledge of a reserve that was subsequently used for commercial production.

However, officials recommend that reinjection and disposal wells be specifically included within the commercial well paragraph to remove any uncertainty that these are intended to be included.

Recommendation

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

Issue: Exploration wells in a mining permit

Submission
(Tamarind)

The proposed definition of “decommissioning” should be amended so it is clear that all exploratory wells located in the relevant petroleum mining permit are eligible for the tax credit. Intentionally or unintentionally excluding any exploratory wells from the definition will encourage petroleum miners to incur the costs of plugging and abandoning those wells at the time they are drilled in order to ensure that tax relief can be obtained for the costs.

Comment

While officials acknowledge there could be timing and cashflow benefits to the petroleum miner from allowing exploration wells to access the refundable credit this would effectively allow a concession to petroleum miners that is not available to other industries.

Allowing a refundable credit for all exploration wells in a permit area would allow a tax credit for expenditure on plugging and abandoning an exploration well to be refunded against previous tax paid from a production well. This expenditure is analogous to expenditure in other industries incurred in a year where losses are incurred but tax has been paid in previous years – taxpayers in these industries cannot carry back losses to get a refund of income tax paid in previous years.

Recommendation

That the submission be declined.

Issue: Exploration wells used in the production process

Submission

(Tamarind, Petroleum Exploration & Production Association of New Zealand)

Exploratory wells that are, or could be, used in the petroleum production process in the mining permit should also qualify for the refundable credit. *(Tamarind)*

There is a drafting error with subparagraph (b)(ii) of the definition of "decommissioning" (that is, it is not possible for a well to be both within the permit area and in an area that is geologically contiguous to the permit area). The inclusion of certain exploration wells through this subparagraph is supported in principle as there are a range of logical reasons why it could be appropriate to plug and abandon such wells in conjunction with the decommissioning of petroleum mining activities. It is appropriate for this to be limited to wells in the same permit area. *(Petroleum Exploration & Production Association of New Zealand)*

Comment

The current legislation does not allow a spread-back for any exploration wells. The proposed legislation is intended to extend the refundable credit to cover certain exploration wells where there could be a commercial purpose for plugging and abandoning them as part of the same arrangement to decommission a development well. This is on the premise that these exploration wells may have been used, or suspended for potential future use, in the production process – for example as a water or gas injection well to increase production in a development well. It is not intended that the refundable credit be available to all exploration wells.

In order for an exploration well to be suitable for use for water or gas injection it needs to access the same oil reserve as a development well. It is for this reason the proposed legislation has two requirements for an exploration well to meet the definition of decommissioning. These are that:

- the exploration well is in the same permit area as the development well; and
- the exploration well is geologically contiguous to the development well.

Officials agree with the submitter that it would not be possible for an exploration well to be in both the same permit area and another permit area that was geologically contiguous to the permit area. Officials recommend drafting changes to clarify the scope of the decommissioning definition as it applies to exploration wells.

Recommendation

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

Issue: Part of an arrangement

Submission
(Petroleum Exploration & Production Association of New Zealand)

Petroleum Exploration & Production Association of New Zealand is comfortable with the use of "as part of an arrangement" in paragraph (b)(ii) of the definition of "decommissioning" based on the existing definition of "arrangement" provided elsewhere in the Act and recognising that decommissioning activities are commonly undertaken pursuant to decommissioning plans.

Comment

The submitter is suggesting that an exploration well (subject to the geologically contiguous issue referred to elsewhere in this officials' report) should be included in paragraph (b)(ii) of the decommissioning definition even where the only arrangement concerning the abandoning of an exploration well and the decommissioning of a commercial well is a decommissioning plan submitted to the Government.

"Arrangement" is an existing defined term in the Income Tax Act 2007. This definition is very wide and means "an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect". Officials consider that a decommissioning plan would meet the definition of an arrangement.

Officials did not intend the relevant paragraph to be sufficiently wide to include a decommissioning plan agreed between a petroleum miner and the Government. The purpose was to cover agreements between a petroleum miner and another party undertaking the decommissioning of both an exploration well and a development well in that there may be economies of scale to decommission both wells at a similar time. If the only link between decommissioning an exploration well and a development well is they are covered by the same decommissioning plan these synergies are much less likely to exist.

Officials suggest this provision should be clarified to apply only when an agreement exists between a petroleum miner and another party undertaking the decommissioning. Within this confine officials agree that the existing definition of "arrangement" should apply.

Recommendation

That the submission be noted, and the officials' suggested clarification be accepted.

Issue: Geologically contiguous

Submission
(Tamarind, Petroleum Exploration & Production Association of New Zealand)

The proposed definition of "geologically contiguous" in the definition of "decommissioning" lacks clarity and may prove to be ambiguous as it can be subject to different interpretations in a geological sense. *(Tamarind)*

The term "geologically contiguous" could be open to a degree of interpretation when used in this context and could overlook wells for which there are appropriate reasons to align plugging and abandoning with wider field decommissioning. *(Petroleum Exploration & Production Association of New Zealand)*

Comment

The term "geologically contiguous" has previously been used in a number of petroleum mining provisions in previous Income Tax Acts and is currently used in section IZ 3 which is proposed to be repealed by this Bill. While it has not previously been defined it was included in the Bill with the intention of covering a well within the same permit area and accessing the same reserves as a production well. The reasons for this are covered in more detail in the issue above.

Recommendation

That officials' comments on the submission be noted.

Issue: Plugged and abandoned terminology

Submission
(Petroleum Exploration & Production Association of New Zealand)

Consideration should be given to the varying use of "plugged and abandoned" and "abandoned" in the current drafting.

Comment

The proposed section YA 1 definition of "decommissioning" includes three references to "plugged and abandoned" and one to "abandoned" without "plugged". No distinction was intended to be made with this difference so officials agree that the additional words should be added.

Recommendation

That the submission be accepted.

Issue: Ongoing monitoring

Submission
(Petroleum Exploration & Production Association of New Zealand)

The definition of "decommissioning" clarifies that the ongoing monitoring of plugged and abandoned wells is included, but subclause (d) should equally cover the ongoing monitoring of restored sites of petroleum mining operations.

Comment

Officials agree that ongoing monitoring of a restored site of petroleum mining operations should be included within the definition of "decommissioning" provided the original restoration of that site also met that definition.

Recommendation

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

Issue: Alignment with royalty regime

Submission
(Tamarind)

Royalty relief is available for the decommissioning costs of all exploratory wells and Tamarind sees no reason why the tax rules should provide for a different outcome.

Comment

While there are many overlaps between the tax and royalty treatment of petroleum mining they do not achieve complete alignment.

The royalty regime allows a refund for the cost of decommissioning an exploration well as it reduces the total accounting profit of the petroleum miner over the entire life of the field. The tax regime also allows a deduction for the cost of decommissioning an exploration well as these costs reduce the tax profit of the petroleum miner.

The tax regime has never allowed a spread-back for the cost of decommissioning an exploration well as these costs are analogous with expenditure in other industries incurred in a year where losses are incurred but tax has been paid in previous years. The proposed refundable credit follows the same policy other than extending to include certain exploration wells where there is a commercial production reason to abandon at the same time. Allowing a spread-back/refundable credit for all exploration wells would provide a concession that is not available to other industries.

Recommendation

That the submission be declined.

Issue: Shareholder continuity

Submission
(Chapman Tripp, Petroleum Exploration & Production Association of New Zealand)

Section RM 15(2) should be amended to achieve the policy intent that the provision applies to refunds arising from the proposed refundable tax credit.

- Section RM 15(2) is drafted with the classic refund scenario in mind, where a taxpayer wishes to reopen an earlier return to claim a refund of tax that was overpaid in that year, but there has been a shareholder continuity breach in the intervening period between the overpayment and the claiming of the refund.
- For the purpose of the refund limitation in section RM 13, section RM 15(2) reinstates imputation credits that are lost on a shareholder continuity breach if the debit for loss of shareholder continuity arises "after a credit is made to the company's imputation credit account for an amount that has satisfied the company's income tax liability for the tax year". This means that the imputation credits for the overpaid tax that is to be refunded must have arisen before the debit for the loss of shareholder continuity.
- It is not clear whether the above timing requirement would be met where the refund in question arises from a refundable tax credit (that is, it is not clear which tax year is being referred to in the phrase "for the tax year" in section RM 15(2)). Although the decommissioning tax credit in proposed section LT 1 is calculated by reference to the amount of tax paid by the petroleum miner in previous years, the refundable tax credit itself arises in the year of decommissioning. Section RM 2(1B) deems the amount of refundable tax credit to be an amount of tax paid for the purpose of the operative refund provision in section RM 2, but it does not specify the year in which that deemed tax payment is made. Accordingly, it is not clear whether the relevant imputation credits could be said to have arisen before the debit for the loss of shareholder continuity as required by section RM 15(2).
- This is an issue that applies not only to the decommissioning refundable credit under proposed section LT 1, but potentially to all refundable tax credits.

Comment

The tax system allows companies to pass on to shareholders the benefit of any New Zealand tax paid as an imputation credit to ensure that company profits are only taxed once. Subject to certain exceptions, imputation credits are lost if the company's shareholders are not at least 66% the same as when the credit was generated. This is known as shareholder continuity and is intended to ensure the shareholders who bore the tax paid by the company get the benefit of it.

The objective of section RM 15(2) is that an imputation credit account (ICA) company is not prevented from receiving a refund of an overpayment of tax by a breach of shareholder continuity. This is what the submitter refers to as a "classic refund scenario".

This provision works correctly when applied to the current spread-back as the petroleum miner would be receiving a refund of the tax paid in the year that the loss is spread-back to. However, the reference to the "company's income tax liability for the tax year" does not make sense when applied to a refundable credit – as the company has paid tax in previous years but has no liability in the year the refundable credit arises.

There is no policy reason why a petroleum miner should not be eligible for a refundable credit if the only reason to not make that refund was a shortage of imputation credits caused by a breach of shareholder continuity.

The submitter states that this issue potentially applies to all refundable credits. The list of refundable credits is in section LA 6. This issue will not arise for most of these refundable credits as the credit arises due to tax paid during a tax year and/or does not apply to ICA companies. However, officials agree it could potentially also be an issue for a refundable credit of a mineral miner in section LU 1.

Officials recommend drafting changes to ensure that a petroleum miner or a mineral miner is not prevented from receiving a refundable credit solely due to a breach of shareholder continuity.

Recommendation

That the submission be accepted.

Issue: Imputation debits for refund

Submission
(Petroleum Exploration & Production Association of New Zealand)

The current legislation prevents a company from receiving a refund of a refundable tax credit where imputation credits have previously been lost by virtue of a shareholder continuity breach – the refund is available but creates a negative ICA balance that the company is required to restore. This effectively negates the refund. This issue applies to all refunds of refundable tax credits, not just petroleum mining tax credits under proposed section LT 1.

Section RM 15(2) merely “reinstates” imputation credits lost due to a shareholder continuity breach for the purpose of calculating the refund under section RM 13 but does not actually credit the company’s ICA. The refund of the refundable tax credit will create an ICA debit for the amount of a refund. The refund may therefore cause the company to go into an ICA debit balance.

In the context of a refund of overpaid income tax (as opposed to a refundable tax credit), the provisions work as intended. The reason is that, although an income tax refund normally also results in an ICA debit, specific carve-outs in sections OB 32(2)(b)/OP 30(2)(b) apply where income tax that was paid prior to the continuity breach is refunded. These carve-outs prevent a double debit arising for the same amount of tax (that is, where the tax has already been debited for the continuity breach, it should not also be debited for receipt of the refund).

Sections OB 37/OP 35 should contain similar carve-outs to the ones in section OB 32(2)(b)/OP 30(2)(b).

Comment

Officials agree that the current legislation could result in an imputation credit account debit balance where there has been a breach of shareholder continuity followed by a refund of a refundable credit. This is not intended and amendments should be made to ensure a refund is available in these circumstances.

The submitter considers this issue applies to all refundable credits, not just those relating to petroleum mining. This will only be the case to the extent the credit is available to an ICA company, which not all are.

Recommendation

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

Issue: Minor drafting issues

Submission

(Petroleum Exploration & Production Association of New Zealand)

There are a number of minor drafting issues and cross-referencing errors that should be corrected:

1. Proposed section EJ 13 should be linked back to section DT 5 which is the operative provision for the deduction of petroleum development expenditure.
2. Proposed section LT 1(10) should refer to subsection (8) rather than subsection (9).
3. The cross-referencing error in subsection IS 5(1)(a) has been corrected by replacing the incorrect reference to section DT 7 with section DT 5, but there is no express linkage between section DT 5 and the allocation provision in proposed section EJ 13.
4. Section IS 5 is being deleted, the cross references to section IS 5 in sections EJ 12B(9) and EX 21(14) should also be deleted.
5. As section EJ 14 is being repealed, sections DZ 5, EA 2, EA 3, EJ 17 and EJ 18(b) which currently refer to "sections EJ 12 to EJ [16, 17 or 20]" should also be amended.
6. As the definition of "petroleum mining operations" is being amended to exclude references to "removal or restoration operations" or "decommissioning", "or decommissioning" should be added back in after the phrase "petroleum mining operations" in section LT 2(1), LT 2(3) and the header to section DT 20.
7. As the definition of "petroleum mining company" is being deleted, the "controlled petroleum mining holding company" definition should be amended to refer to "petroleum miners" instead.

Comment

Officials comment on each item as follows:

1. Section EJ 13 accelerates deductions that would have been claimed in future periods if the petroleum miner had not permanently ceased operations. Officials agree that a cross-reference should be included within existing section DT 5(2), which provides for the timing of deductions.
2. Officials agree.
3. Equivalent linkages to section DT 5 are already included within existing sections EJ 12(2) and EJ 12B(3). A similar provision should be inserted in proposed section EJ 13.

4. Officials agree.

5. Each of these provisions cross-references to a range of provisions that includes section EJ 14 but does not explicitly refer to it. Therefore, if section EJ 14 is repealed the cross-references will continue to operate correctly to the remaining provisions within that range. No change is required.

   However, officials note that section EJ 18 includes two references to section EJ 19 which was repealed by the Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009. These references should be removed.

6. Officials agree that "or decommissioning" should be added to proposed section LT 2(1) and (3). Section DT 20 is already proposed to have "or decommissioning" added. While the heading may be considered in ascertaining the meaning of the provision, officials consider there is no ambiguity to be resolved in this provision and it would be simpler to retain the existing heading.

7. This issue was discussed on page 124 of the Bill *Commentary*. A "controlled petroleum mining holding company" is an existing defined term that refers to "shares in petroleum mining companies". The Bill proposes to repeal the definition of a "petroleum mining company" and the sections that use it except for the controlled petroleum mining holding company definition – where it was never intended to be used. "Petroleum miner" is an existing defined term that is consistent with the intended application of paragraph (b)(i) of the definition of "controlled petroleum mining holding company" and officials agree that it should be included instead.

Recommendation

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

Issue: Notification requirements

Submission
(Matter raised by officials)

The Commissioner should not have to prescribe the manner in which taxpayers notify the Commissioner about the refundable credit.

Comment

Proposed section LT 1(1)(b) requires the petroleum miner to notify the Commissioner before they file the return of income for the income year in a manner prescribed by the Commissioner. This notification is very important as it will allow Inland Revenue to forecast the impact on government revenue as well as manage the administration requirements to facilitate the refund.

There are only a small number of petroleum miners who may qualify for a refundable credit and Inland Revenue will continue to interact with these businesses. It is not necessary for Inland Revenue to prescribe the manner in which they notify the Commissioner about the refundable credit. Most important is that these petroleum miners can be identified in a timely manner so that discussions can be held with the relevant staff.

Furthermore, the *Commentary* to the Bill refers to a specific email address intended for this notification. Due to the very small number of notifications expected to be received this is not seen as necessary. Notification should be made through normal communication channels.

Recommendation

That the submission be accepted.

RECIPIENTS OF CHARITABLE OR OTHER PUBLIC BENEFIT GIFTS

Clause 183

Issue: Against Malaria Foundation (New Zealand)

Submission
(Against Malaria Foundation)

The submitter has requested the reference to The World Swim for Malaria Foundation (New Zealand) in schedule 32 of the Income Tax Act 2007 be updated to read Against Malaria Foundation (New Zealand). The charity has been listed on the schedule since 1 April 2008. The trustees have advised that the charity's name has been changed to Against Malaria Foundation (New Zealand) with effect from 3 July 2008.

Recommendation

That the submission be accepted.

Issue: Child Rescue Charitable Trust

Submission
(Matter raised by officials)

Destiny Rescue Charitable Aid Trust was added to the list of organisations on schedule 32 of the Income Tax Act 2007 with effect from 1 April 2016. The trustees have advised officials that the charity's name has been changed to Child Rescue Charitable Trust with effect from 11 August 2017.

Recommendation

That the submission be accepted.

TRUSTEE CAPACITY AMENDMENTS

Clauses 77(1), (2) & (4), 172(5) & (35), 173, 175, 176, 185, 187(10), 264(1), 309 and schedule 1

The trustee capacity amendments introduce a new rule into the Income Tax Act 2007 which distinguishes between a trustee's personal, body corporate, or other capacity, and their separate trustee capacity. The rule will clarify that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal, body corporate, or other capacities. A number of exceptions to this general rule are proposed where it would be contrary to the policy intent of the provisions to exclude a corporate or natural person trustee. There are also a number of proposed consequential amendments to the Income Tax Act 2007, the Tax Administration Act 1994, and the Goods and Services Tax Act 1985, resulting from the general trustee capacity amendment.

Issue: General support for the trustee capacity amendments

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, New Zealand Law Society, Russell McVeagh)

All submitters supported the trustee capacity amendments in the Bill in principle.

However, most of the submitters had some concerns about the specific features of the amendments. The specific concerns are addressed below.

Recommendation

That the submitters' support and comments be noted.

Issue: Application date should be retrospective

Submission

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

The application date for the amendments should be retrospective so that the proposals apply from 5 September 2014, the date of the High Court judgment of *Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140. This application date may need to preserve any reassessment that the Commissioner has made to date following the judgment.

Comment

The proposed trustee capacity amendments deal with trustee capacity in general. As the amendments are not intended to solely address the overreach resulting from the High Court cases (they should apply broadly), officials consider the date of enactment to be the appropriate application date for these proposals.

Recommendation

That the submission be declined.

Issue: The two High Court decisions would have been decided the same, even if the proposed amendments were in place

Submission
(New Zealand Law Society)

The New Zealand Law Society commented that the decisions in both High Court cases *Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140 and *Staithes Drive Development Ltd v Commissioner of Inland Revenue* [2015] NZHC 2593 would have been the same regardless of the proposed amendments.

Comment

Officials acknowledge that the decisions in the two High Court cases would have been the same even under the proposed amendments. However, the implications of the decisions would have resulted in overreach in other cases. The amendments are therefore necessary to prevent such overreach in future cases.

Recommendation

That the officials' comments be noted.

Issue: Inherent jurisdiction of the courts

Submission
(KPMG)

The High Court cases (*Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140 and *Staithes Drive Development Ltd v Commissioner of Inland Revenue* [2015] NZHC 2593) raise questions as to the inherent jurisdiction of the court, as well as the overlap of different statutes and rules. In the interests of justice, clarification that the Courts are limited to considering the arguments put before them is required.

Comment

The comment in the submission on the inherent jurisdiction of the courts is not relevant to the amendments.

Recommendation

That the submission be noted.

Issue: Location of section YA 5 in the Income Tax Act 2007

Submission
(New Zealand Law Society, Russell McVeagh)

Proposed section YA 5 (the general trustee capacity rule) should be inserted as section YB 22, and the heading of subpart YB should be changed to "Associated persons, nominees and trustees". This is because section YB 21 deals with bare trustees so the position of trustees should logically be dealt with immediately after section YB 21.

Comment

Proposed section YA 5 is broad in its application, dealing with trustee capacity in general. The proposed amendment, in conjunction with the amendments to the definitions of "company" and "natural person", clarify that (subject to any identified exceptions) any reference to:

- "company" in the Income Tax Act 2007 does not include a corporate trustee; and
- "natural person" in the Income Tax Act 2007 does not include a natural person trustee.

As it is not specifically focused on the associated persons rules, officials consider that proposed section YA 5 is better placed in subpart YA (General definitions).

Recommendation

That the submission be declined.

Issue: Drafting of section YA 5 may not achieve policy intent

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

As currently drafted, proposed section YA 5 (general trustee capacity rule) may not achieve the policy intent – the rule merely confirms that a person acting as a trustee of a specific trust is acting in a different capacity to any other capacity they may have.

Comment

The proposed rule is intended to address the potential overreach arising from the High Court decisions *Concepts 124 Ltd v Commissioner of Inland Revenue* [2014] NZHC 2140 and *Staithes Drive Development Ltd v Commissioner of Inland Revenue* [2015] NZHC 2593. The rule aligns the legislation with its original policy intent (that corporate shareholders should be treated as ultimate shareholders and not looked-through) by clarifying that when a person is acting in the capacity of trustee of a trust, they are treated, for income tax purposes, as acting in that capacity and not in their personal, body corporate, or other capacities.

Recommendation

That the officials' comments be noted.

Issue: Single notional person

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

Inland Revenue should consider adopting the concept of trustees being a "single notional person" either by amending section YC 9 of the Income Tax Act 2007 or by introducing a new provision that treats a trustee of a trust as a separate person, different from the trustee individually and the same person should the trustee change.

Comment

Officials consider that extending the single notional person concept to the trust rules would be an unnecessary complication and create potential confusion. For example, there are currently no residence rules in the Income Tax Act 2007 for single notional persons. Under this proposal, there would be no way of determining a trustee's (as a single notional person's) residence. While there are currently no residence rule for trustees in the Income Tax Act 2007, the proposal includes an exception to the company and natural person residence rules to ensure they apply to trustees.

Recommendation

That the submission be declined.

Issue: Clarify what will happen if there is a change in trustee

Submission
(Chartered Accountants Australia and New Zealand)

As currently drafted, it is uncertain whether a change in trustee would result in a different "person" for tax purposes.

Comment

It is unnecessary for the amendments to clarify the consequences of a change in trustee, as the Income Tax Act 2007 already deals with this. The current definition of "trustee" in section YA 1 of the Income Tax Act 2007 states that a trustee "includes all trustees, for the time being, of the trust". This means that a change in trustee does not result in a different "person" for tax purposes.

Recommendation

That the submission be noted.

Issue: Definition of “close company”

Submission
(Chartered Accountants Australia and New Zealand)

The proposed amended definition of “close company” should be clarified as the current drafting is not clear as to whether the reference to “trustees” refers to five individual trustees or five trusts.

Comment

The current definition of “trustee” in section YA 1 of the Income Tax Act 2007 makes it clear that a trustee “includes all trustees, for the time being, of the trust”. The reference to “trustees” in the proposed amended definition of “close company” therefore refers to the trustees of up to five different trusts (each made up of “all trustees, for the time being, of the trust”). However, the current drafting which treats all natural persons or trustees associated with each other as 1 person should be simplified to apply to natural persons only, which is consistent with the current provision.

Recommendation

That the submission be noted, and officials’ proposed simplification to the associated persons reference in the proposed close company definition be accepted.

Issue: The amendment to section HD 15 should not proceed

Submission
(New Zealand Law Society)

The amendment to section HD 15 in the Income Tax Act 2007 should not proceed as the provision does not apply to a company acting in the capacity of a trustee of a trust.

Comment

The proposed amendment to section HD 15 (asset stripping of companies) is intended to ensure the provision applies to a company acting in its capacity as trustee. This amendment is consistent with the Commissioner of Inland Revenue’s current interpretation that section HD 15 applies to corporate trustees.

Recommendation

That the submission be declined.

Issue: Clauses 172(5) and 172(35) should be amended

Submission
(New Zealand Law Society)

The proposed amendments to the definition of "company" and "natural person" in the Income Tax Act 2007 should not refer to the defined term.

The Bill drafting should be amended as follows:

- clause 172(5) should be worded: "(abc) does not include an entity that is acting in the capacity of trustee:", or "(abc) does not include a person that is acting in the capacity of trustee:"
- clause 172(35) should be worded: "(a) does not include an individual who is acting in the capacity of trustee:" or "(a) does not include a person who is acting in the capacity of trustee".

Comment

It is common drafting practice for a definition to refer to the defined term. An example of this can be found in the definition of "trustee" in section YA 1 of the Income Tax Act 2007.

Recommendation

That the submission be declined.

Issue: Section 2A of the Goods and Services Tax Act 1985 should be rewritten

Submission
(New Zealand Law Society)

Section 2A of the Goods and Services Tax Act 1985 should be entirely rewritten so that it is consistent with the non-land based test of association in subpart YB of the Income Tax Act 2007, as this would more appropriately deal with instances of underreach and overreach than the proposed piecemeal amendment.

Comment

Rewriting the entire associated persons definition in section 2A of the Goods and Services Tax Act 1985 does not fall within the scope of the proposals. Furthermore, such a rewrite would be a significant project in itself and require separate prioritisation and resourcing.

Recommendation

That the submission be declined.

Issue: Definitions of "market value interest" and "voting interest" in section 2A(3) of the Goods and Services Tax Act 1985

Submission
(New Zealand Law Society)

The definitions of "market value interest" and "voting interest" in section 2A(3) of the Goods and Services Tax Act 1985 should be amended to overcome the reasoning in the High Court cases. In particular, the cross-reference to the Income Tax Act 2007 definitions of "market value interest" and "voting interest" should specifically refer to and import the nominee provision in section YB 21 of the Income Tax Act 2007, along with the proposed general trustee capacity provision in proposed section YA 5 of the Income Tax Act 2007.

Comment

Section 2A(3) of the Goods and Services Tax Act 1985 is already interpreted as incorporating section YB 21 of the Income Tax Act 2007. As for proposed section YA 5 of the Income Tax Act 2007, officials consider that it is unnecessary to specifically refer to it in section 2A(3) – as trustees are already treated as having a separate capacity in the Goods and Services Tax Act 1985.

Recommendation

That the submission be declined.

Issue: Application to unit trusts

Submission
(Corporate Taxpayers Group)

Where shares are held by a unit trust, the look-through rules for corporate shareholders in section YC 4 of the Income Tax Act 2007 could potentially be read as looking through to the shareholders of the unit trust's corporate trustee, rather than to the unit holders of the unit trust.

Comment

A unit trust is a trust under general law. However, for tax purposes, a unit trust is treated as a company. The Income Tax Act 2007 definitions of "company", "share", and "shareholder" make it clear that for income tax purposes a unit trust is treated as a company, a "share" includes a unit in a unit trust, and "shareholder" includes a "holder of a share" – and therefore a holder of a unit in a unit trust.

This means that when determining association for unit trusts, it is the company associated persons tests that apply. The proposed trustee capacity amendments clarify that any reference to "company" does not include a company acting in its capacity as trustee (a corporate trustee). As such, the look-through rules for corporate shareholders in section YC 4 do not apply to corporate trustees. The provision can therefore not be read as looking through to the shareholders of a unit trust's corporate trustee.

Recommendation

That the officials' comments be noted.

Issue: Further clarifying amendments

Submission
(KPMG)

Clarifying amendments may be needed in the future as it is difficult to be certain that the proposed law changes properly deal with all scenarios and with all provisions of the Inland Revenue Acts.

Comment

Best efforts have been made to identify all areas where amendments may be needed and all the relevant provisions of the Inland Revenue Acts. It is always possible, however, for new and unanticipated scenarios to arise. Officials will deal with these if and when they arise.

Recommendation

That the submission be noted.

Issue: Further guidance

Submission
(Corporate Taxpayers Group)

Inland Revenue should publish guidance for the trustee capacity amendments. The guidance should be illustrated with examples to clearly demonstrate the intended application of the new rules.

Comment

Officials will be providing guidance on the trustee capacity amendments in a *Tax Information Bulletin* article following the Bill's enactment.

Recommendation

That the officials' comments be noted.

PHARMAC REBATES AND GST

Clauses 308 and 310

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal but notes that the proposal is inconsistent with a comprehensive GST regime which requires all supplies to be taxed and appropriate input tax credits to be accounted for in a GST return. However, they also noted the compliance benefits of a single treatment.

Recommendation

That the submitter's support and comment be noted.

LLOYD'S OF LONDON – TAX SIMPLIFICATION

Clauses 16, 43, 62, 76, 78, 91, 172(31), (33), (38), (55) & (69), 179 and 180(1)

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed changes.

Recommendation

That the submitter's support be noted.

EXTENDING THE FINANCIAL ARRANGEMENT REPORTING METHOD CONCESSIONS

Submission
(Belmont Partners)

The methods for spreading income under financial arrangements in sections EW 15D and EW 15G should be extended to all taxpayers (not just non-IFRS companies).

Comment

Officials have discussed this with the submitter who agrees that this issue can be dealt with administratively outside the context of this Bill.

Recommendation

That the officials' comments be noted.

TRANSFER OF OVERPAID TAX FROM AIM TAXPAYER TO SHAREHOLDERS – EXTENSION OF THE AGENCY MECHANISM

Submission
(Matter raised by officials)

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a new provisional tax method called the accounting income method (AIM) which allows certain taxpayers to pay tax as they earn their income using accounting software.

That Act contains a mechanism to allow an AIM entity to transfer to shareholder-employees overpaid provisional tax where shareholder-employee remuneration has not been permitted as a deduction to the company during the year.

This mechanism has the disadvantage of leaving the shareholders of an AIM entity in the provisional tax regime notwithstanding the tax owing on the income may have been fully paid by the entity as a result of the non-deductibility of the shareholder-employee provision.

Since the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 was enacted officials have continued to work on a better mechanism for achieving this transfer and removing taxpayers from the provisional tax regime by effectively having AIM entities act as agent for the shareholder-employee similar to the mechanism trustees have to pay tax on behalf of beneficiaries.

Officials recommend an amendment to allow an AIM company to act as agent for the shareholder-employees for the purpose of the definition of residual income tax only, rather than requiring a broad agency arrangement. This will enable a company using the AIM provisional tax method to make tax payments on behalf of shareholder-employees that will reduce their residual income tax for the year and as a consequence could remove them from provisional tax.

Officials recommend this amendment apply from the 2018–19 income year to align with the introduction of the AIM provisional tax method.

Recommendation

That the submission be accepted.

FBT DUE DATE UNDER CLOSE COMPANY OPTION DURING THE CO-EXISTENCE OF TWO INLAND REVENUE SOFTWARE PLATFORMS

Submission
(Matter raised by officials)

Under the close company option in section 46C(3) of the Tax Administration Act 1994, the due date for filing and paying fringe benefit tax is the employer's income tax terminal tax date.

The employer is automatically given a two month later terminal tax date if their income tax return is linked to a tax agent and the tax agent has an extension of time arrangement with Inland Revenue for filing their clients' income tax returns.

However, the Commissioner can refuse or cancel an extension of time arrangement for specific taxpayers and returns linked to the tax agent.

Some tax agents will have clients who have been refused an extension of time or had the extension of time cancelled. It is administratively complex to pinpoint those taxpayers amongst a tax agent's clients. During the transition to Inland Revenue's new software platform, fringe benefit tax and income tax will be administered through different platforms. The FBT administering platform will not be able to be informed that an employer has been refused or has had cancelled the benefit from their tax agent's extension of time arrangement for income tax purposes.

As a transitional solution, section 46C of the Tax Administration Act 1994 should be amended to allow for a later due date for filing and paying of fringe benefit tax under the close company option for this specific circumstance during co-existence of the two platforms. This later due date would be aligned with the two month later terminal tax date that is generally given to employers linked to a tax agent with an extension of time arrangement.

Comment

The current process in Inland Revenue's FIRST software platform of determining for fringe benefit tax purposes whether an employer has had their tax agent's extension of time arrangement refused or cancelled for their personal income tax return(s) is very complex and involves numerous separate steps. The new START platform will have a simplified process once it administers both fringe benefit tax and income tax.

However, the administration of fringe benefit tax will be migrated to the new START platform ahead of income tax which is planned to follow about a year later. During this time co-existence will not allow the relevant information to determine the filing date and due date for fringe benefit purposes in these specific circumstances to be extracted from one system and applied in the other.

Officials recommend that section 46C of the Tax Administration Act 1994 be amended to allow for a two month later due date for return filing and paying of fringe benefit tax under the close company option for these specific circumstances during the transitional period of co-existence.

The proposal is likely to affect only a small number of employers but is taxpayer friendly.

Recommendation

That the submission be accepted.

Remedial amendments

EMPLOYEE MEAL ALLOWANCES AND DEFINITION OF EMPLOYER’S WORK PLACE

Clause 24

Submission

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

Submitters support the proposed amendment that clarifies the meaning of “employer’s workplace”. The definition is used in the provision that exempts certain work-related meal payments provided to employees from income tax.

Recommendation

That the submitters’ support be noted.

PIE REMEDIALS

Clause 217

Issue: Online registration process

Submission
(Matter raised by officials)

Proposed section 31B(1B) of the Tax Administration Act 1994 should not require the notice to be in the prescribed electronic form.

Comment

Section 31B(1) prescribes the electronic format for entities electing to become a portfolio investment entity (PIE). This online registration process does not cater for PIEs electing to change their calculation method. It is not cost effective to expand this process for the small number of PIEs that change their calculation method. There should not be a prescribed electronic form – Inland Revenue will accept these elections through normal correspondence channels.

Recommendation

That the submission be accepted.

Issue: Notification requirement cross-reference

Submission
(Matter raised by officials)

Sections HM 42(1), HM 43(1) and HM 44(1) should refer to section 31B of the Tax Administration Act 1994 rather than section 31C.

Comment

Sections HM 42 to HM 44 were amended by the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 to refer to section 31C instead of 31B. Section 31B refers to notification requirements for one-off elections to become or cease being a PIE whereas section 31C refers to on-going notification requirements for a PIE to Inland Revenue or its investors. Neither section currently contains the notification requirements for a one-off calculation method election so the amendment in the Taxation (Annual Rates for 2015–16, Research and Development, and Remedial Matters) Act 2016 did not resolve the underlying issue. The calculation method election sits more appropriately in section 31B; this Bill proposes the introduction of section 31B(1B), and it is to this provision that sections HM 42(1), HM 43(1) and HM 44(1) should cross-refer.

Recommendation

That the submission be accepted.

Issue: Consistency of notification requirements

Submission

(Matter raised by officials)

The wording in sections HM 42(1), HM 43(1) and HM 44(1) should be consistent.

Comment

The final sentence of each of these provisions is intended to achieve the same purpose – to cross-reference to the notification requirements in the Tax Administration Act. However, each currently uses slightly different wording as follows (after the change to section 31B as discussed above):

- HM 42(1) – The PIE must notify the Commissioner under section 31B of the Tax Administration Act 1994 of this election.
- HM 43(1) – The notice requirements are set out in section 31B of the Tax Administration Act 1994.
- HM 44(1) – Notification regarding the type of PIE and attribution period is made under section 31B of the Tax Administration Act 1994.

The current wording of section HM 42(1) is the clearest. However, a multi-rate PIE must choose an attribution period in section HM 34 and a calculation option in section HM 41 and these should both be reflected in sections HM 42(1), HM 43(1) and HM 44(1). Officials recommend that these three sections be amended using similar wording to existing section HM 42(1) but also referring to an attribution period.

Recommendation

That the submission be accepted.

Issue: Insurance business CFC amendment – minor drafting issue

Clause 260

Submission
(KPMG)

The submitter suggests that drafting changes should also be made to section 91AAQ(2)(c) and section 91AAQ(3)(a) for readability.

Comment

Officials agree that minor changes should be made to sections 91AAQ(2) and (3), as these are currently drafted in the past tense due to the 30 June 2009 requirement. With the proposed removal of the 30 June 2009 ownership requirement, use of the past tense would no longer be necessary.

Recommendation

That the submission be accepted.

Issue: Insurance business CFC amendment – extension to New Zealand sourced premiums

Clause 260

Submission
(KPMG)

To qualify for an active income exemption determination under section 91AAQ of the Tax Administration Act 1994, section 91AAQ requires that all or nearly all of the income of the CFC (or group of CFCs) arises from insurance premiums covering risks in the same jurisdiction where the CFC or group is located. The submitter proposes that this requirement should be extended to premiums from insurance contracts offered or entered into in New Zealand.

The submitter considers that this extension would not circumvent the purpose of section 91AAQ or open the section to possible abuse as income derived from an insurance business carried on in New Zealand should already be subject to tax in New Zealand.

Comment

Insurance business CFCs that derive some income from New Zealand-sourced insurance premiums are not automatically precluded from meeting the requirements for a determination under section 91AAQ. This is because the current "all or nearly all" requirement is intended to approximate the active business test, which allows an active business to derive 5% of its income from passive sources before the active income exemption is denied. Therefore, an

insurance business CFC that derives a relatively small portion of its income from New Zealand insurance premiums would still be able to qualify for a section 91AAQ determination.

While it is possible that an insurance business CFC may derive income from premiums from insurance contracts offered or entered into in New Zealand by virtue of the fact that it is owned by a New Zealand resident, officials consider the provision to be adequate and that allowing a CFC to satisfy the "all or nearly all" requirement with New Zealand-sourced premiums could raise integrity concerns.

New Zealand has different rules for taxing income from insurance contracts sourced in New Zealand depending on whether the insurer is a resident or non-resident. General insurers are taxed according to general income tax rules if they are New Zealand tax residents, but in the case of non-resident general insurers 10% of the gross premiums are treated as having a New Zealand source and the corporate tax rate (28%) is applied to that figure, without any deductions. This difference in treatment is due to the difficulty met in apportioning between New Zealand and foreign sources for general insurance compared with other types of businesses.

If a CFC could satisfy the requirements for an active income exemption determination under section 91AAQ by solely deriving New Zealand insurance premiums, an insurer earning large profits could restructure the business to benefit from the 10% source-deeming rule and the active income exemption to reduce its New Zealand tax liabilities, even if the CFC is 100% owned by a New Zealand insurance business. This would have the potential to undermine New Zealand's tax rules.

Recommendation

That the submission be declined.

Issue: Insurance business CFC amendment – extension to fee income for administering and managing funds

Clause 260

Submission
(KPMG)

To qualify for an active income exemption determination under section 91AAQ of the Tax Administration Act 1994, section 91AAQ requires that all or nearly all of the income of the CFC (or group of CFCs) arises from insurance premiums covering risks in the same jurisdiction where the CFC or group is located. The submitter proposes that this requirement should be extended to include consideration for services provided to policyholders in administering and managing funds under the insurance contracts where the contracts would be saving product policies or not profit participation policies if they were subject to the life insurance rules.

Comment

As noted in the item above, *Issue: Insurance business CFC amendment – extension to New Zealand sourced premiums,* the "all or nearly all" requirement for the issuance of a determination under section 91AAQ is intended to approximate the active business test, which allows an active business to derive 5% of its income from passive sources before the active income exemption is denied. Therefore, an insurance business CFC that derives a relatively small portion of its income from these fees would still be able to qualify for a section 91AAQ determination.

Section 91AAQ was only intended and designed to operate in relation to insurance contracts/businesses, but not other types of financial institutions or finance activities. The determination facility was not made available for other types of financial institutions because the boundary between active and passive income is less apparent.

One concern is whether the submission could lead to financial institutions being able to access an active income exemption determination under section 91AAQ simply by pairing with an insurance business, which would not be the intended policy outcome, particularly where the income received in consideration for administering and managing funds represents a substantial part of the business. Part of the difficulty in relation to life insurance businesses in particular stems from the fact that life insurance can be used as a form of savings, so it would be difficult to establish a clear boundary between life insurance businesses and other investment providers.

While it is not certain when the work on extending the active income exemption in the CFC rules to financial institutions will be progressed, extending the determination facility to other types of income or financial institutions would be more than remedial in nature and would require substantial analysis to ensure the facility operates as intended.

Recommendation

That the submission be declined.

Issue: Non-attributing Australian CFCs – Australian unit trusts

Submission

(Corporate Taxpayers Group, PwC)

Australian unit trusts that are owned by Australian companies should qualify as non-attributing Australian CFCs. The legislation was recently amended to exclude unit trusts on the basis that Australian unit trusts are generally flow through in nature. However, Australian income tax is paid where an Australian resident company is interposed between the unit trust and the New Zealand investor, either because the unit trust forms part of an income tax consolidated group or the head company is subject to tax on the income it is presently entitled to as the unit holder. If the head company is not presently entitled to the income, the penal tax rate of 45% applies.

Comment

The rationale behind the exemption for Australian CFCs through the concept of the non-attributing Australian CFC is that any income derived in Australia would have been subject to tax in a similar manner as it would have been if that income were derived in New Zealand.

An amendment in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 excluded Australian unit trusts from this exemption on the basis that unit trusts are generally flow through in nature so where the unit holder is not resident in Australia, not all of the unit trust's income would therefore be subject to tax in Australia. Under the Australian trust regime only a low rate of tax is withheld from passive income; under the New Zealand CFC or non-portfolio FIF regime that income is exempt. In addition, no Australian tax is paid on non-Australian sourced income to which a New Zealand-resident beneficiary is presently entitled.

That amendment did recognise that a unit trust itself can be subject to income tax under Australian law on its income in the same way as a company, but did not contemplate the situations outlined by the submitters.

Officials recognise that where units in a unit trust are owned by an Australian resident company, the unit trust's income in relation to those units is subject to comprehensive taxation either at the corporate rate (if the unit trust is part of the company's income tax consolidated group or if the company is presently entitled to the income) or at the penal rate of 45%. This is also the case where the unit trust is held by other types of Australian resident entities that are taxed as companies.

In this situation, officials consider that the unit trust should be able to qualify as a non-attributing Australian CFC in respect of the units in the unit trust held indirectly by the New Zealand resident investor through the Australian resident entity that is comprehensively taxed as a company, as the unit trust's income is subject to comprehensive income tax in Australia which is in line with the policy intent of the exemption for certain Australian CFCs (as would be the case in the examples provided by submitters).

Recommendation

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

Issue: Foreign tax credits – support for proposal

Clause 112

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

The Group supports the policy intent behind the proposed amendment. That is, a tax credit should be available where foreign income tax is paid by the interest holder or a member of the interest holder's group (that is, anyone who is "economically part of the same unit as the person who has the income interest in the CFC") in relation to a CFC from which attributable income is derived. *(Corporate Taxpayers Group)*

PwC supports the proposals in the Bill to allow a foreign tax credit to be claimed for tax paid in relation to a CFC by members who are part of the same functional economic unit. *(PwC)*

Chartered Accountants Australia and New Zealand support the proposal to allow a foreign tax credit for foreign income tax paid in relation to a CFC from which attributable income is derived, when the foreign income tax has been paid by the taxpayer's parent or a member of the taxpayer's group. *(Chartered Accountants Australia and New Zealand)*

Recommendation

That the submitters' support be noted.

Issue: Foreign tax credits – drafting

Clause 112

Submission
(Corporate Taxpayers Group, PwC)

PwC considers that there may be a drafting issue in terms of how proposed section LK 1(1B) will interact with the rest of the section. Associated sections such as section LK 2 will also be required to be amended to ensure that the foreign tax credit provided can be included in the calculation of the amount of the credit. *(PwC)*

Corporate Taxpayers Group considers that the preferred (and in our view much simpler) approach to be to allow the tax credit to the New Zealand interest holder with the attributable CFC income in the first place. *(Corporate Taxpayers Group)*

Comment

Officials agree with submitters that the drafting of proposed section LK 1(1B) should be modified to ensure it interacts correctly with the rest of the section.

In relation to PwC's comment regarding section LK 2, officials agree with the submission and note that further changes to section LK 2 also need to be made to take account of the insertion of section LK 1(1)(d) as a rewrite issue in the Taxation (Livestock Valuation, Assets Expenditure, and Remedial Matters) Act 2013, because a corresponding amendment to section LK 2 was not made at the time. Officials also note that a similar adjustment may need to be made to section LK 1(4).

Recommendation

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

Issue: Foreign tax credits – tax paid by other CFCs

Clause 112

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

The proposed mechanism will not apply in a number of common scenarios and further amendments are required to the proposed legislation to ensure it addressed common commercial transactions. For example, in the case of a New Zealand interest holder who owns a US corporation which owns a US limited liability company (LLC), the proposed amendment would not allow the US corporation to offset the credit to the New Zealand interest holder because the US corporation does not meet the requirement in section IC 7 regarding tax residence. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)*

While it may be possible to relax the residence requirements in section IC 7 to allow the rule to work properly in this situation, this does not address the issues arising in relation to section LK 1(1)(d) in a two tier transparent CFC situation. Corporate Taxpayers Group considers the preferred (and in our view much simpler) approach to be to allow the tax credit to the New Zealand interest holder with the attributable CFC income in the first place when tax is paid by another group company in relation to the attributable foreign income. This would only require amendments to section LK 1 as previously discussed with officials. *(Corporate Taxpayers Group)*

Comment

Officials agree with submitters' concerns and in particular that the tax credit should be transferrable to the New Zealand investor with the attributable CFC income in the example with the US corporation and the US LLC, even though the US corporation does not meet the residence requirements in section IC 7.

Recommendation

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

Issue: Foreign tax credits –Australian unit trust CFCs and FIFs

Clause 112

Submission
(Corporate Taxpayers Group, PwC)

The scope of the amendment should be extended to include the scenario where a CFC is interposed between the New Zealand investor and the underlying FIF interest where the chain of entities are Australian unit trusts. There is an inability to claim foreign tax credits where a CFC is interposed between the New Zealand investor and the underlying FIF interest. This is because the New Zealand investor is deemed to hold the FIF interest directly.

Comment

Issues have previously been raised in relation to indirectly-held foreign investment fund (FIF) interests – that is, where an interest in a FIF is held through a CFC.

From a policy perspective, it is generally preferable to align the treatment of indirectly-held FIFs with directly-held FIFs to ensure that tax is not a strong motivator behind the decision to hold a FIF interest indirectly. In other situations, it may also be preferable to align the treatment of FIF interests and CFC interests.

However, officials note that by their very nature, the CFC rules are more complex and detailed than the FIF rules, and this characteristic extends to the availability of foreign tax credits and how they are calculated.

In addition, for income interests in FIFs of greater than 10%, taxpayers are permitted to use the attributable FIF income method if desired. The attributable FIF income method follows the CFC rules, including the rules that relate to the availability of foreign tax credits. This means that the proposed amendment would be available for both directly and indirectly-held FIF interests where the attributable FIF income method is used, therefore alleviating the submitters' concerns in many situations.

Recommendation

That the submissions be declined.

Issue: Use of part-year accounts for accounting standards method – support for proposal

Clauses 58(2) & (3) and 59

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

The submitters support the proposal to allow a person who holds an income interest in a CFC for part of an accounting period to use accounts that cover that part-period to determine whether or not the CFC passes the active business test under the accounting standards method.

Recommendation

That the submitters' support be noted.

Issue: Use of part-year accounts for accounting standards method – extension to the default test and attribution calculations

Clauses 58(2) & (3) and 59

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

The proposal should be extended to allow the default test and attribution calculations to be performed based on the period of ownership where CFCs are held for part of the year.

Comment

The accounting standards test is intended to be a concessionary approach available when audited and consolidated financial statements that meet an applicable accounting standard are prepared. It allows taxpayers to utilise the financial statements that have already been prepared. The proposal in the Bill allows the interest holder to use such accounts that are only prepared for a part-period due to the fact that the CFC was only acquired part-way through the accounting period or was disposed of before the end of the accounting period. It is intended to be an extension of the concessionary approach, so from a policy perspective it is not problematic if the accounting standards test does not fully align with the default test and attribution calculation.

Changing the CFC attribution calculation as submitted would be a fundamental change to the CFC rules and should be carefully considered. It would not be a remedial change and there are many complexities that would need to be considered and such a proposal should go through the full policy process.

It would not be appropriate to change the nature of the default test without also changing the nature of the attribution calculation, as this could create integrity concerns. Note that the default test is based on the attribution calculations, but with some modifications. Using a part-period for one and not the other may give substantially different results for certain calculations (for example, foreign exchange calculations for financial arrangements).

Regarding the lack of information available to the interest holders for the part of the accounting period either before they acquire their interest or after they dispose of their interest, officials expect that the interest holder would have the necessary information for the part-period prior to their acquisition of the interest in the CFC to undertake the calculation for the default test and attribution calculations. It is possible that there may sometimes be difficulty in obtaining the required information following the disposal of an interest in a CFC, but officials consider that it would not be appropriate to create a mismatch in the default test/attribution calculation between disposal and acquisition.

Recommendation

That the submissions be declined.

Issue: Deductible foreign equity distributions and apportioned funding calculations

Submission

(Corporate Taxpayers Group, PwC)

The amount of deductible foreign equity distributions (DFED) received by a New Zealand resident investor should be fully deductible in calculating the CFC's net attributable CFC income (or loss) to ensure there is no double taxation to the New Zealand resident investor.

Comment

The CFC rules generally treat dividends from certain types of shares (DFEDs in this case) in the same way as interest on debt. This is because these shares have debt-like characteristics and are highly substitutable for debt.

Officials acknowledge that in the example given by submitters, double taxation may arise, but consider that the issue is complicated and requires further analysis, particularly as it is not related to a proposal in the Bill. Officials need to determine whether the same problem would occur with other fact patterns and structures and if so, what the optimal solution would be.

Officials do not consider that allowing a full deduction for the DFED would be an appropriate solution, as allowing the full deduction could make deductible foreign equity more attractive than debt in cases where there is no on-lending. A more appropriate solution may be to extend the on-lending concession instead. Note that the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 amended the on-lending concession to align the treatment of DFEDs with that of interest.

Part of submitters' concern may also stem from the broad definition of deductible foreign equity, which looks at whether there was a deduction further up in the chain of payments, not just at the level of the distribution. However, narrowing the definition would raise integrity concerns, as a taxpayer could insert a holding company to circumvent the rule.

Officials will recommend that the Government considers the priority of this issue for inclusion in the next tax policy work programme.

Recommendation

That the submissions be declined.

Submission
(Matter raised by officials)

Some remedial issues with recent amendments to the GST legislation have been identified as follows:

- The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 has resulted in some amendments to sections 10(13) and 54B of the Goods and Services Tax Act 1985 that have two different potential application dates.
- A recent change ensures that the rules dealing with changes in consideration for a supply apply correctly to deductions claimed by GST-registered purchasers of secondhand goods; however, the drafting of the provision is wider than what was intended. Further, the provision incorrectly refers to a "debit note" instead of a "credit note".
- Section 20H(1) of the Goods and Services Tax Act 1985 contains an incorrect cross-reference to section 20(3)(hc) of the same Act.

Comment

Section 2(5) of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 incorrectly provides that the application date for an amendment to section 10(14)(b) of the Goods and Services Tax Act 1985 is 1 August 2003, while section 2(18) of the same Act provides for a 1 April 2012 application date for the amendment, which is the intended application date. Officials therefore propose an amendment to repeal the unintended application date of 1 August 2003 to provide certainty for taxpayers, and replace it with a 1 April 2012 application date.

Similarly, an amendment to section 54B(1)(d) and new subsections (4), (5) and (6) potentially come into force on either 1 April 2014 or 1 October 2016. The intended application date for both amendments is 1 April 2014.

Under the GST rules for secondhand goods, GST-registered persons can claim a GST deduction for goods that were not supplied as a taxable supply. This is typically the case when the vendor is not a registered person or when the supply is exempt. Recent changes to the GST Act ensure that the rules dealing with changes in consideration for a supply apply correctly to deductions claimed in respect of secondhand goods that were not supplied as a taxable supply; however, the drafting of the provision applies to all secondhand goods (including those that were supplied as a taxable supply). New section 25AB should be amended so that it only applies to secondhand goods when a deduction was claimed by the purchaser in line with the GST rules for secondhand goods, and so that subsection (1)(d) refers to "credit note" instead of "debit note".

Section 20H(1), which allows GST-registered businesses that principally make taxable supplies to deduct the GST on their capital raising costs, should refer to new section 20(3)(hd) instead of (hc).

Recommendation

That the submission be accepted.

TRADING GAINS OF NON-RESIDENT INVESTMENT FUNDS

Clauses 26 and 30

Issue: Support for trading gains of non-resident investment funds proposal

Submission
(Russell McVeagh)

Comment

The submitter supports the proposal to exempt from tax the trading gains of foreign PIE equivalents. In particular, the retrospectivity of the proposal is appropriate given that it corrects an inconsistency in the law.

Recommendation

That the submitter's support be noted.

Issue: Cross-referencing amendments in relation to trading gains of non-resident investment funds proposal

Submission
(Russell McVeagh, Matter raised by officials)

Comment

The submitter is of the view that there is an incorrect cross-reference in the relevant table for this proposal. The submitter proposes that the table be corrected with application from the 2013–14 and later income years. *(Russell McVeagh)*

Officials have noticed that, in relation to this proposal, the Bill incorrectly refers to the table for PIE investments rather than the table for foreign investment variable-rate PIEs and notified foreign investors. Officials propose that this be corrected. *(Matter raised by officials)*

Recommendation

That the submissions be accepted.

NON-EXEMPT CHARITIES: TAXATION OF TAX EXEMPT ACCUMULATIONS

Clause 90

Issue: Clarify the definition of "assets"

Submission
(Deloitte)

The Bill defines "assets" as "all assets of any kind, whether in the form of real or personal property, money, shares, securities, rights, or interests". Listing specific assets after such a broad definition might be interpreted as narrowing the scope of what is meant by "all assets of any kind".

Comment

Officials agree with this submission. The definition is not intended to narrow the scope of what is meant by "all assets of any kind" and should be amended.

Recommendation

That the submission be accepted.

Issue: Application of section HR 12 to deregistered entities that are still exempt under section CW 42

Submission
(New Zealand Law Society, Simpson Grierson)

Under current law, an entity may be deregistered as a charity by the Department of Internal Affairs – Charities Services, but still remain exempt from income tax under section CW 42, which exempts charities' business income and does not require registration.

The deregistration tax should not apply in this situation if the entity remains eligible for the charitable business income exemption.

Comment

Officials have concerns about the scope of the exemption for business income under section CW 42. In particular, there are potentially wider implications for the transparency of the charitable sector if this submission is accepted, as entities may choose to deregister with Department of Internal Affairs – Charities Services but continue to be exempt from income tax.

The stated policy intent of the deregistration tax is to protect the integrity of the revenue base by ensuring the tax concessions that apply to charities are well-targeted. This includes ensuring that if an entity has claimed tax exemption as a charity and has accumulated assets, these assets should always be destined for a charitable purpose. This supports the broader policy objective of maintaining trust and confidence in the charitable sector through the regulation and transparency requirements of the Charities Act.

Recommendation

That the submission be declined.

Issue: Application of new section HR 12 to entities wholly or partly tax-exempt under section CW 42

Submission
(New Zealand Law Society)

If section HR 12 were amended as proposed, this would create a disincentive for taxpaying entities to "tithe" a percentage of their profits for charitable purposes, as the value of the taxpaying entity's net assets would be treated as income if the charity ceased to be registered.

Comment

Officials do not consider that the proposed amendment would create a disincentive for taxpayers to "tithe" a percentage of their profits for charitable purposes. Taxpayers are at liberty to tithe any percentage of their income. In order to be exempt from income tax however, the requirement under existing law is that the entity must derive business income wholly for the benefit of a tax charity – which would require all of their income to be derived for the benefit of the charity.

Officials note that tax benefits are available to taxpayers that wish to make charitable donations. Donation tax credits are provided to individuals who make charitable gifts, and companies and Māori authorities are entitled to a deduction. The proposed amendments do not disturb taxpayer entitlements.

Recommendation

That the submission be declined.

Issue: Application date of the proposed amendments – savings provision

Submission
(New Zealand Law Society, Simpson Grierson)

The new section applies retrospectively but with a savings provision which allows entities that have already filed a tax return to be able to rely on the position they have taken in that return.

Submitters are concerned with the retrospective nature of the amendment, and that the current drafting of the grandfathering provision is too narrow.

Entities that have relied on the old section HR 12 will be charities that are exempt from income tax and most likely will not have taken a tax position in a return of income.

The new section should either not apply retrospectively at all, or at least delete the requirement that an entity must have taken a tax position in a return of income that the entity has filed.

Comment

The purpose of including the savings provision was to ensure that those entities which had relied on the previous law could continue to rely on the position they had taken.

However, officials agree that deregistered charities may not be able to evidence a tax position through a return of income relying on the current law, if they have remained exempt from income tax through another provision of the Income Tax Act.

The amendments should instead apply to charities deregistered on or after 6 April 2016, being one year prior to the introduction of this Bill. This is because sections HR 12 and CV 17 include as income the net assets of a deregistered charity one year following deregistration (or after all appeals and Court proceedings have been finalised – whichever is the later date).

Deregistered charities would therefore be subject to the current law if their net assets were included as income of that entity before the introduction of this Bill. However, other charities that were deregistered on or after 6 April 2016 would have had sufficient notice of the proposed new law and should be subject to it.

Recommendation

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

Issue: Potential over-taxation of charitable assets where members of a charitable group deregister

Submission
(Deloitte)

As currently drafted, if the parent entity in a charitable group ceases registration with Charities Services then an amount of income arises in each entity that ceases being a registered charity or that is no longer entitled to claim a charitable tax exemption. This would apply to the parent entity and any entity owned by the parent (as they would each lose their charitable tax exemption).

The shares that a parent charity holds in a subsidiary will form part of the assets of the parent, while the assets of the subsidiary are also income of the subsidiary. Therefore if the deregistration tax is applied to both the parent and the subsidiaries, the value of the underlying assets could effectively be taxed more than once.

Comment

Officials agree in principle that there could be an overreach of the rules in circumstances where a parent entity is deregistered and it, as well as its subsidiaries, are subject to the deregistration tax.

Officials propose to consider the extent to which the net asset calculation should exclude the value of an investment in a subsidiary company exempt under section CW 42 if that subsidiary is deregistered (or otherwise no longer meets the requirements for exemption under section CW 42) at the same time as its parent.

However, changing the net asset calculation to exclude the value of an investment in a subsidiary company would be a significant change to the deregistration tax rules and would benefit from being subject to wider consultation in order to consider its implications. For that reason officials do not recommend the changes to be made in this Bill but agree that this issue should be considered for inclusion in the tax policy work programme.

Recommendation

That the submission be declined.

Issue: Disposal of assets by a charitable group for market value

Submission
(Deloitte, PwC)

If a parent charity acquires shares in a subsidiary, holds those shares, and subsequently sells its shares, then that subsidiary will be taxed on the value of its net assets because it has exited the charitable group, and no longer meets the requirement of section CW 42.

However, if the subsidiary is sold at arm's length for market value, no value has left the charitable group and it is an overreach to impose the deregistration tax on the subsidiary.

Comment

Officials agree in principle that it may not be appropriate to apply the deregistration tax in the circumstances outlined by submitters. The charitable group in that situation has simply replaced a certain amount of value in shares with the same amount in cash (in the form of the proceeds of the sale of those shares).

However, an amendment to exclude investments in wholly owned subsidiaries from the scope of the deregistration tax rules would represent a significant change to the deregistration tax rules and would arguably be outside the scope of the proposals contained in this Bill.

Therefore while officials agree in principle with the broad thrust of this submission, any proposed amendments should be subject to wider consultation. Officials do not recommend that the changes be made in this current Bill but agree that this issue should be considered for inclusion in the tax policy work programme.

Recommendation

That the submission be declined.

Issue: Tax on assets held before an entity had tax exempt status

Submission
(Deloitte, PwC, New Zealand Law Society)

Where an existing non-charitable entity acquires tax exempt status and later loses that tax exemption (whether due to the sale of that entity to a third party, or otherwise), then the provision, as drafted, will include as income the value of the net assets at the date of deregistration.

Where an entity becomes a charity exempt from income tax, but had existing assets that it had acquired prior to becoming a registered charity, then section HR 12 should only seek to tax the gains made on those assets or any other income accumulated, while the entity had tax exempt status.

These assets were not funded by tax-exempt income, and including them in the "net assets" which are subject to tax would effectively tax those assets twice. Section HR 12 carves out certain assets like non-monetary gifts and assets received from a Treaty of Waitangi settlement claim, and the same treatment should be extended to "day-one capital".

The Law Society suggests that the amount of income of "Person B" should be the lesser of: the value of the net assets at the date when it ceases to be exempt (less assets transferred within 12 months for charitable purposes), or the amount of exempt income derived by Person B under section CW 42 that has not been applied to charitable purposes within 12 months of ceasing to meet the requirements of section CW 42.

Comment

In the officials' report to the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill in 2014 which first introduced the deregistration tax rules, officials addressed this issue. The deregistration tax has two purposes. Firstly, it is intended to ensure that charitable assets are ultimately used for charitable purposes and secondly, if charitable assets are transferred out of the charitable base, to claw-back an approximate value of the tax benefit that has been accrued on those assets and not used for charitable purposes. The latter claw-back is not intended to be a precise calculation because in most cases a precise calculation would be very difficult to calculate and verify. Rather, it is an approximation of a tax benefit claw-back and a disincentive to transfer assets out of the charitable base.

The current calculation of net assets is therefore consistent with the policy intent.

Recommendation

That the submission be declined.

CONSOLIDATED GROUPS AND LOCAL AUTHORITIES

Clauses 64 and 68(6), (7)

Submissions
(Greater Wellington Regional Council, KPMG on behalf of Christchurch City Council, PwC, PwC on behalf of the Auckland Council, Simpson Grierson on behalf of the Auckland Council)

- The current exemption for local authorities that derive dividends from another member of the consolidated group should not only be preserved, but, in fact, be extended to all local authorities that derive dividend income from a Council Controlled Organisation (CCO). *(Greater Wellington Regional Council)*
- Section CW 10(3)(a) of the Income Tax Act 2007 should be repealed. Instead dividends derived by local authorities from CCOs should be specifically exempt from tax. *(Greater Wellington Regional Council)*
- The proposal to amend section FM 31 of the Income Tax Act 2007 should not proceed as the ability for a local authority to consolidate with CCOs does not in any way impact competitive neutrality – the policy rationale for taxing CCOs in the first place. *(KPMG on behalf of Christchurch City Council)*
- State owned enterprises are subject to income tax for the same competitive neutrality reasons for taxing CCOs, yet dividends paid to their tax exempt shareholder are not considered to compromise neutrality. *(KPMG on behalf of Christchurch City Council)*
- If the amendment proceeds, a transitional provision should be provided which grandfathers consolidations that are the subject of an existing binding ruling until at least the end of the income year in which the binding ruling ceases to apply. *(KPMG on behalf of Christchurch City Council)*
- Any dividends paid to a local authority by a CCO should not be taxable and an amendment to sections CW 10 and CW 39 of the Income Tax Act 2007 should be made to ensure this is the case. *(KPMG on behalf of Christchurch City Council)*
- The consolidation regime should remain an option for local authorities so that they can avail themselves of its benefits such as deferral of income tax consequences of intra-group asset transfers and simplified compliance (for example, lodgement of a single income tax return). (*PwC)*
- The proposed amendment is an impediment to Auckland Council's objective of building a better Auckland. *(PwC on behalf of Auckland Council)*
- The amendment is at odds with Inland Revenue's simplification focus. *(PwC on behalf of Auckland Council)*
- The amendment represents a policy shift rather than a remedial change. *(PwC on behalf of Auckland Council)*
- The proposal to exclude local authorities from the consolidated group rules should not proceed. *(Simpson Grierson on behalf of the Auckland Council)*
- The proposed amendment is not remedial in nature. *(Simpson Grierson on behalf of the Auckland Council)*

Comment

Officials have analysed these submissions and consider that many of them comprise two consistent themes.

- the payment of dividends by a CCO to a local authority does not impact on the competitive neutrality basis for taxing CCOs and the exemption for inter-corporate dividends paid within a wholly-owned group should be available for dividends paid by CCOs to their local authority; and
- local authorities should continue to be eligible to be a member of a consolidated group because intra-group transactions are ignored in calculating taxable income for the group. This means that the policy objective of taxing the income of a CCO continues to be achieved under consolidation.

Other submissions focus on different points, as follows:

- that the proposed amendment is non-remedial in nature;
- that the exclusion for non-rates income under section CW 39(4) of the Income Tax Act 2007 should be subject to public consultation;
- that if the amendment proceeds, a savings provision should be introduced to protect existing binding rulings relating to a consolidated group.

Officials comment on these submissions as follows.

Taxation of dividends

The current policy is that dividends derived by a local authority from a CCO are taxable and do not qualify for the wholly-owned group dividend exemption. This is consistent with the long-standing policy that all non-rates income derived by a local authority from a CCO is taxable.

As the consolidated group rules disregard intra-group dividends, allowing a local authority to be eligible to be a member of a consolidated group provides a permanent exemption from income tax for dividends derived by a local authority from a CCO.

However, officials consider the submissions raise a valid policy question about the policy for taxing dividends derived by a local authority from a CCO. This question is a substantive policy matter that should be considered for inclusion in the tax policy work programme.

Consolidated group rules and benefits for local authorities

A consistent view amongst submitters was that local authorities that have elected to join consolidated groups have benefited from reduced compliance costs and the deferral of tax on intra-group asset transfers (for example, depreciation recovery income).

The reduction in compliance costs is the key policy objective underpinning the consolidated group rules. The deferral of tax on intra-group asset transfers are intended outcomes of the consolidated group rules. The deferral crystallises when the asset is disposed of to a third party. Officials consider this is an appropriate outcome for local authorities.

Some of the submissions indicate that local authorities have made commercial decisions based on their membership of a consolidated group and have received binding rulings relating to tax positions taken or to be adopted.

Officials agree with PwC's submission that preventing a local authority from being a member of a consolidated group could affect outcomes of past decisions and transactions, and have taken this into account in formulating the recommendations summarised below.

Consolidated group rules and non-rates income

The key policy objective for excluding local authorities from the consolidated group rules was to ensure that CCOs cannot benefit from the tax-exempt status of the local authority through intra-group deductible transactions.

With the exception of the taxation of dividends paid by CCOs to a local authority, officials agree with the submissions that the consolidated group rules do not change the next tax result of intra-group, non-rates transactions (for example, management fees paid to a local authority for management services provided to a CCO). This is because the consolidated group rules treat these non-rates transactions as non-deductible and non-assessable which results in the appropriate amount of tax being payable on such transactions.

The consolidated group rules result in dividends paid by a CCO to a local authority not being taxed. In particular, officials note that non-rates income derived from a CCO can include an untaxed capital gain included in a dividend paid to a local authority.

Not a remedial amendment

In support of this submission, both Simpson Grierson and PwC point to a submission on the Income Tax Bill that resulted in the Income Tax Act 2007 (a Bill relating to the project to rewrite income tax legislation using plain language techniques) relating to the definition of "eligible company".

Those submissions misunderstand the mandate and policy objectives for the rewrite project. Those objectives were to reduce compliance costs by rewriting the law using plain language techniques. In this process, approved policy or remedial changes could only be made if it was necessary to clarify ambiguity or address irresolvable conflicts between rules.

None of these criteria existed in relation to the definition of "eligible company", as it applied to local authorities. The rewrite project correctly re-enacted the law as it stood prior to the Income Tax Act 2007. Remedial amendments such as correcting the definition of "eligible company" was not a function of the rewrite project because it was never intended to be a forum for resolving policy or remedial matters.

Local authorities were originally excluded from the consolidation rules as being ineligible to be a member of a consolidated group. This was to ensure that all dividends passing from a CCO to a local authority are taxable. However, an amendment to the definition of "eligible company" in the Taxation (Savings Investment and Miscellaneous Provisions) Act 2006 inadvertently resulted in local authorities not being excluded from the consolidation rules.

The purpose of that 2006 amendment to the definition of eligible company was to permit a dual-resident company to use the consolidated group rules only if the company was able to use the general loss grouping rules. This amendment was never intended to allow local authorities to access the consolidated group rules. As set out in the *Commentary* on the 2006 Bill introducing this amendment):

> *Certain dual-resident companies will be prevented from grouping foreign losses under the rules for consolidated groups if they cannot do so under loss rules applying to non-consolidated groups.*
>
> *The amendment will make the rules for consolidated groups consistent with loss rules for non-consolidated groups by preventing losses from being used in two different jurisdictions.*

Exclusion from the local authority exemption for non-rates income

Officials consider this submission raises a substantive policy matter about the scope of the local authority exemption. This issue should be considered for inclusion in the tax policy work programme.

Imputation

Officials agree with submissions that identify:

- the ability to maintain a single imputation credit account for the consolidated group reduces compliance costs; and
- imputation credits attached to a dividend may be credited against the income tax payable on dividends derived by a local authority.

A local authority is not able to maintain an imputation credit account in its own right because of the local authority exemption from income tax. Officials have analysed the effect on total tax borne if a local authority is a member of a consolidated group. Officials conclude that inclusion of a local authority in a consolidated group will not affect the total tax borne on non-rates income derived by a local authority, provided that local authorities continue to be taxed on dividends derived from a CCO.

Savings provision

Officials agree that, if the amendment proceeds as proposed:

- Any existing binding rulings should be protected by a savings provision, as a local authority will have made commercial decisions based on the Commissioner’s ruling. As a change in law would cause such a ruling to expire, officials consider it is important that existing binding rulings should be saved for their term.
- Past transactions that were previously disregarded in calculating taxable income for a consolidated group (such as intra-group asset transfers) should not give rise to taxable income. This is because the consolidated group rules permit deferrals of tax consequences on certain intra-group transfers of assets until either the company owning the asset exits the group or the asset is sold to a third party. Officials consider an appropriate savings provision would address this issue if local authorities are not able to be included in a consolidated group.

Summary

In considering the submissions officials are of the view that:

- the proposed amendment should not proceed as currently set out in the Bill; and
- local authorities should be eligible to be a member of a consolidated group; but
- an amendment should be made to the consolidated group rules that ensures dividends derived by a local authority from a CCO that is a member of the consolidated group must be included in the calculation of taxable income of the consolidated group, consistent with the treatment for non-consolidated groups.

Officials recommend the amendment to the consolidated group rules should apply from the beginning of the 2019–20 income year, to give local authorities sufficient time to prepare for the proposed amendments.

This approach ensures that:

- the law works as intended, in that all income derived by a local authority from a CCO is taxable;
- local authorities can continue to benefit from reduced compliance costs and deferral of tax (for example, depreciation recovery) on intra-group transfers of assets without impinging on the above policy objective;
- the policy matter raised relating to the scope of the local authority tax exemption could be referred for consideration as an item to include in the tax policy work programme;
- grouping of tax losses is not affected; and
- current binding rulings will be protected by a savings provision until the end of the year in which the binding ruling expires (this is likely to be the 2019–20 income year).

Officials have discussed the proposed approach with local authorities that have submitted on the Bill, including permitting local authorities to continue to use the consolidated group rules subject to dividends derived by local authorities from their subsidiaries being taxed. Officials consider that the main purpose of the original exclusion from the consolidated group rules was to ensure that dividends derived by a local authority from a CCO would be taxed. Officials also consider that the recommended amendments should reflect this current policy setting.

Recommendation

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

RESIDENTIAL LAND WITHHOLDING TAX (RLWT) RULES – REMEDIAL AMENDMENT

Submission
(Chapman Tripp)

The submitter contends that the definition of "offshore RLWT (residential land withholding tax) person" in section YA 1 is unintentionally broad in relation to trusts that have a statutory trustee company as one of the trustees.

Because of the definition of "offshore RLWT person", the RLWT rules will apply to a trust where (among other things) 25% or more of the trustees are offshore RLWT persons. If a trustee is a company, it will be an "offshore RLWT person" if more than 25% of its directors or ultimate shareholders are offshore RLWT persons (among other tests).

As a consequence, if a statutory trustee company is an "offshore RLWT person", any trust with three or fewer trustees for which it acts will be an "offshore RLWT person" and the RLWT rules will apply to that trust. This is the case even where the settlors, beneficiaries, and other trustees are all New Zealand residents. This would affect all professional trustee companies, including those registered under the Trustee Companies Act 1967. This outcome does not align with the policy objectives underlying the RLWT regime, and unduly prejudices affected trustee companies compared to their competitors who are not offshore RLWT persons.

The submission proposes the definition of "offshore RLWT person" be amended so that the status of a statutory trustee company (as defined in section YA 1) will not cause a trust for which it acts as trustee to be an "offshore RLWT person" if it would not otherwise be one.

A related remedial amendment is required to the definition of "statutory trustee company" in section YA 1. That definition says that "statutory trustee company" is defined in section 2 of the Trustee Companies Act 1967. However, section 2 of the Trustee Companies Act 1967 does not define "statutory trustee company" but rather "trustee company". It is submitted that an amendment to the definition of "statutory trustee company" in section YA 1 be made, so that it refers to the definition of "trustee company" in the Trustee Companies Act 1967. It is submitted that this amendment have retrospective application to ensure that this drafting error does not affect historical positions taken by statutory trustee companies (for example by calling into question their entitlement to RWT exemption certificates).

Comment

Officials agree that it is not consistent with the policy objectives underlying the RLWT regime for the offshore status of a statutory trustee company (which must be one of a defined list of companies in the Trustee Companies Act 1967) to make any trust with three or fewer trustees for which the trustee company acts an "offshore RLWT person" if it would not otherwise be so.

Officials also agree that the reference in the definition of “statutory trustee company” in section YA 1 to the definition of “statutory trustee company” in the Trustee Companies Act 1967 is an error and should instead be a reference to the definition of “trustee company” in that Act.

Recommendation

That the submission be accepted.

TAX RATE FOR EXTRA PAYS PAID TO NON-RESIDENT SEASONAL WORKERS AND EMPLOYEES ON NON-NOTIFIED TAX CODES

Clauses 138(1), (2) & (4), 145(1) & (4) and 181(8)

Issue: Support for the proposal

Submission
(PwC)

The submitter supports the proposal to clarify that the general rule for calculating an amount of tax to withhold from an extra pay does not apply to extra pays paid to non-resident seasonal workers or employees who have not notified their employer of their tax code. This is the treatment that many taxpayers have already been applying, and how payroll systems are set up to function. However, a reading of the current legislation leads to a different outcome.

Recommendation

That the submitter's support be noted.

Issue: Tax rate for extra pays made to employees who have not received any PAYE income payments in the previous four weeks

Submission
(PwC)

It is noted that issues arise for many taxpayers where extra pays are made to employees on primary employment tax codes who have not received any PAYE income payments in the four weeks prior to the date of the payment of the extra pay. This can occur in respect of payments made to former employees, or employees on parental or unpaid leave, and has become apparent in respect of holiday pay remediation payments. The submitter urges consideration of a legislative change to address this issue. It can create undue employment relations issues because tax is withheld from employees at a rate much lower than their marginal or average tax rate.

Comment

Officials acknowledge that employees on primary employment tax codes who have not received any PAYE income payments in the four weeks prior to the date of the payment of an extra pay will likely have tax under-withheld if the standard tax calculation for extra pays is used. This may lead to the employee being required to file an income tax return and pay any tax owed, which could conceivably create employment relations difficulties. However, officials note that there is an existing legislative mechanism by which this outcome could be avoided. Section RD 10(2) of the Income Tax Act 2007 enables an employee to notify their employer of their election to fix their rate of tax on extra pays at their expected marginal income tax rate.

Inland Revenue recently updated its guidance for individuals, to explain the implications for tax and for Inland Revenue-administered social assistance of receiving a lump sum payment (including of back-paid holiday pay).[15]

Inland Revenue also recently issued guidance for employers on how back-dated remedial payments of holiday pay should be treated for the purposes of PAYE and other deductions, such as student loan repayments and KiwiSaver contributions.[16]

The guidance for both individuals and employers specifically refers to an individual's ability to request that their employer withhold tax from a lump sum payment at a higher rate, which they may wish to do to avoid a potential end of year tax debt.

Officials consider that providing guidance on the existing legislative mechanism is the best solution to the issue raised by the submitter. If a legislative amendment was made to require employers to withhold tax from extra pays made to employees on primary employment tax codes who have not received any PAYE income payments in the four weeks prior to the date of the payment at a specific tax rate, that rate would inevitably be either too high, or too low, for many of the recipients.

Recommendation

That the submission be declined.

[15] http://www.ird.govt.nz/yoursituation-ind/taxing-lump-sum/

[16] http://www.ird.govt.nz/resources/e/a/ea3bfec0-424f-43ba-ad3f-06af818dcf1c/CS+17-02+Tax+treatment+of+backdated+remedial+payment+of+holiday+pay.pdf

RESIDENT WITHHOLDING TAX AND NON-CASH DIVIDENDS

Clauses 6, 106, 159 and 160

Submission

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

Chartered Accountants Australia and New Zealand support the proposed amendment to clarify that a dividend includes any tax paid or withheld. *(Chartered Accountants Australia and New Zealand)*

The Group is supportive of the clarifications to the rules regarding RWT on non-cash dividends. The Group considers these amendments are uncontroversial and do not require further comment. *(Corporate Taxpayers Group)*

The clarifications are not fully effective:

(i) The proposed change to section CD 15 should be clarified to ensure the increase in dividends for RWT and NRWT is not a double-up.

(ii) Proposed section RE 14B should also apply to non-cash dividends derived by trusts as trustee income.

(iii) The term "intermediary" in proposed section RE 14B(a)(iii) should be defined.

(EY)

It should be clarified whether dividends arising under a dividend reinvestment plan come within the scope of the proposed amendment.

Consideration should be given to clarifying the new definition of "dividend" in section CD 15 to ensure that for both cash and non-cash dividends, there is no double counting between the ordinary meaning of dividend and RWT/NRWT deducted from dividends. *(FNZ)*

Comment

The proposed amendment to section CD 15 is to clarify that the assessable dividend is the gross amount of a dividend, including taxes withheld from or paid in relation to the dividend.

Officials agree that if a dividend of $100 is paid and has $33 withheld from the cash dividend (net cash of $67 to the investor), the assessable dividend will be $100. However, if a non-cash dividend of $100 is derived, $49 of RWT must be paid in relation to that non-cash dividend. The assessable dividend will be $149 (the sum of the non-cash dividend amount and the RWT paid). The proposed amendment confirms the long-standing application of the law.

Officials agree that it would be useful to revise the drafting to ensure that the gross amount of the dividend is correctly determined.

Officials consider that the amendments in section RE 14B should not apply to dividends derived by a trustee that are retained as trustee income. The policy intent is to ensure that a company or trustee acting as an intermediary is not required to pay RWT on a non-cash dividend derived from a foreign company provided that the dividend passes through to the investor in the same income year. In the absence of this amendment, the company or trustee would be required to pay RWT on the non-cash dividend derived from a foreign company.

The measure is a simplification that ensures a natural person investor is appropriately taxed on non-cash dividends derived from a foreign company, whether the dividend is derived directly or indirectly through a trust or a company. It is not consistent with the policy intent if a trustee retains the non-cash dividend as trustee income instead of passing the dividend through to the beneficiary.

Officials believe the meaning of intermediary in context is clear and do not consider it is necessary to define the term.

Officials consider the proposed amendments do not apply to dividends that arise from dividend reinvestment plans, which are taxed as bonus issues in lieu.

Recommendation

That the officials' comments be noted. That submission (i) from EY and the submission from FNZ relating to clarifying the gross amount of the dividend be accepted.

CONSOLIDATED GROUP'S IMPUTATION CREDIT ACCOUNTS AND USE OF PRE-CONSOLIDATION IMPUTATION CREDITS

Clause 120

Submission

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

The submitters supported the proposal.

One stated that the *Commentary* does not appear to correctly reflect the position under the Income Tax Act 2004 or the proposed legislative amendment. *(Chartered Accountants Australia and New Zealand)*

Another stated that the *Commentary* to the Bill misstates the operation of the rule and may cause confusion and this should be clarified in a *Tax Information Bulletin* following enactment of the Bill. The submitter also notes that the proposed legislation does not appear to limit the rules to the group debit balance. *(Corporate Taxpayers Group)*

One stated that the *Commentary* is incorrect as the transfer of imputation credits from a group company to the group imputation credit account (ICA) is intended to be allowed when a debit entry arises in the group ICA and there are credits older than the debit in a group company ICA. *(PwC)*

Comment

The proposed remedial amendment is technical in nature. It is intended to ensure the law works as intended, and correctly reflects the policy intent, which has remained unchanged since the enactment of the consolidated group rules. The proposed amendments also reflect the Commissioner's application of the law.

The problem being addressed by the proposed amendments can be illustrated by the following example.

> Company A in a consolidated group pays a dividend on 30 September 2016 with $50,000 imputation credits attached. Prior to paying the dividend, the consolidated group's ICA credit balance was $10,000. Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance of $70,000. No other transactions occur in the group ICA during the year to 31 March 2017.

Correct policy outcome

The transfer of pre-consolidation credits is limited to the amount by which the group ICA would go into debit as a result of the imputation credits being attached to the dividend on 30 September 2016.

Date	Group ICA	Company B ICA
1 April 2016	10,000	70,000
30 September 2016 (dividend paid by Coy A)	(50,000)	
30 September 2016 (transfer from Coy B)	40,000	(40,000)
31 March 2017 (balance)	0	30,000

Submitters' arguments

The submissions suggest that the legislation permitted the full amount of the debit entry to be matched by a transfer from the pre-consolidation credit balance of a group company. This outcome is inconsistent with the policy intention (as set out above) and with the Commissioner's view of the law.

Date	Group ICA	Company B ICA
1 April 2016	10,000	70,000
30 September 2016 (dividend paid by Coy A)	(50,000)	
30 September 2016 (transfer from Coy B)	50,000	(50,000)
31 March 2017 (balance)	10,000	20,000

Original policy explanation

An explanation of the policy was given in example 20 of the *Tax Information Bulletin* item in December 1992 (Vol. 4, No.5).

> **Example 20**
> ACo and BCo are members of ABC Group. Both companies have pre-consolidation credit balances and, in particular, credits of $100 and $200 which arose at the same time (5/7/92). On 10/10/95 a debit of $100 arises to the group ICA which is not offset by any group credit. Assume no election is made. The credits from ACo and BCo are offset proportionately, that is, one-third from ACo and two-thirds from BCo.

This example from the 1992 *Tax Information Bulletin* item illustrates that the transfer from an individual company's pre-consolidation ICA balance is not determined by whether available pre-consolidation credits are older than the group credits, but solely by whether a debit arises to the group ICA to the extent that debit is not offset by a group credit. This example shows that only $100 of pre-consolidation credits may be transferred to the group ICA (that is, the debit entry that is not offset by a group credit). The example illustrates that the transfer may be made if:

- a debit entry arises to the group ICA that is not offset by any group credit (that is, in practical terms, this means that the debit entry would result in the group ICA going into debit); and
- a group company has a pre-consolidation credit balance.

Officials consider it is appropriate to further clarify the proposed amendment to ensure the correct policy outcome is achieved.

Recommendation

That officials' comment on the submissions be noted.

TRUSTEE’S REQUIREMENT TO FILE INCOME TAX RETURNS

Clauses 73 and 225

Submission
(New Zealand Law Society)

The New Zealand Law Society is concerned that Inland Revenue may interpret proposed section 33(1D) of the Tax Administration Act 1994 (TAA) more widely than section 42(1)(a) of the TAA to require all trusts to file income tax returns, whether or not those trusts have derived any income or incurred any expenditure.

Further, the New Zealand Law Society is concerned that Inland Revenue may apply this interpretation with retrospective effect, to require all trusts (including those without IRD numbers) to file income tax returns from the 2008–09 income year. Such trustees could not rely on section 43B to excuse the trust from filing income tax returns as section 43B was only enacted on 16 November 2015 and does not apply retrospectively.

Comment

The purpose of the proposed amendment is to ensure that the trust rules correctly refer to a provision in the TAA that requires a trustee to file a return of income. The obligation to file a trust return can come within the general return filing requirements of section 33(1) of the TAA and a separate return filing requirement, such as proposed section 33(1D) is not necessary.

Therefore, officials consider the proposed amendment should be simplified to be a cross-reference from the trust rules to section 33(1). Officials agree with the submitter that there is no need for retrospectivity for this proposed provision.

On the second point raised, it should be noted that while non-active trusts will continue to be excused from filing returns under section 43B of the TAA, the declaration of non-active status requires the trust to have a tax file number.

It is important for wider tax and social policy purposes that all trusts have an Inland Revenue number.

Recommendation

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

SMALL AMOUNTS OF PENALTIES AND INTEREST NOT CHARGED

Submission
(Matter raised by officials)

In general, penalties and interest are not charged on small balances of $100 or less of tax. In 2009, an unintended legislative change in section 183F of the Tax Administration Act 1994 has meant that some tax types were inadvertently removed from this concessionary rule.

Comment

Because this change was inadvertent, Inland Revenue has continued to apply the historical position notwithstanding this change. Officials submit that the tax types that were inadvertently removed from this concessionary rule should be reinstated so that small amounts of penalties and interest are not charged to taxpayers consistently across tax types.

Officials propose this change apply retrospectively back to the date that the inadvertent change was made.

Recommendation

That the submission be accepted.

CLARIFY THE DEFINITION OF "PROVISIONAL TAX ASSOCIATE"

Submission
(Matter raised by officials)

A number of external parties have raised some uncertainty with respect to the definition of "provisional tax associate" that was inserted into the Tax Administration Act 1994 in section 120KBB by the Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017.

The uncertainty relates to para (c)(iii) of section 120KBB, which can be read as requiring two natural persons to use the same provisional tax method, which was not intended. It was only intended this test consider association between a person and a company.

Comment

Officials recommend the wording be clarified to ensure that the association test does not include two natural persons. The test is only in respect of the association of a person and a company.

Officials propose this change apply retrospectively back to the application date of the original change to section 120KBB.

Recommendation

That the submission be accepted.

CLARIFY THAT TAXPAYERS WHO HAVE A TRANSITIONAL YEAR CAN USE THE CONCESSIONARY PROVISIONS OF SECTION 120KBB OF THE TAX ADMINISTRATION ACT 1994

Submission

(Matter raised by officials)

Officials have received feedback that it is not clear that a provisional taxpayer who has a transitional year but otherwise meets the requirements of section 120KBB of the Tax Administration Act 1994 can use section 120KBB.

It was agreed during the select committee process for the Taxation (Business Tax, Exchange of Information, and other Remedial Matters) Act 2017 that section 120KBB should apply to those taxpayers in a transitional year. It was thought at the time that a wording change made to the Bill was sufficient to permit this. This does not appear to have been the case.

Comment

Officials recommend clarification be made to the legislation to make it clear that those taxpayers who have a transitional year but otherwise meet the requirements of section 120KBB can use those provisions.

Officials propose this change apply retrospectively back to the application date of the original change to section 120KBB.

Recommendation

That the submission be accepted.

REMOVE NEW PROVISIONAL TAXPAYERS WHO HAVE A TRANSITIONAL YEAR FROM THE ABILITY TO USE THE CONCESSIONARY PROVISIONS OF SECTION 120KBB OF THE TAX ADMINISTRATION ACT 1994

Submission
(Matter raised by officials)

New provisional taxpayers cannot use the concessionary rules in section 120KBB of the Tax Administration Act 1994.

However, for those taxpayers who have an initial provisional tax liability and also have a transitional year they are dealt with under section 120KD as that section includes those taxpayers who have an initial provisional tax liability and a transitional year.

This means that for a new provisional taxpayer who also has a transitional tax year they will be permitted to use the concessionary rules in section 120KBB although those new provisional taxpayers who do not have a transitional year cannot use those rules.

Comment

This was not intended and those new provisional taxpayers who have a transitional year should have use of money interest calculated under the current rules in section 120KD.

Officials recommend that the provisions be amended to ensure that all new provisional taxpayers are treated on the same basis whether they have a transitional year or not.

For some taxpayers in this situation the date for the first instalment of provisional tax has passed it would be unfair to now expose them to use of money interest where the taxpayer has applied the rules under section 120KBB in calculating their instalment for the current year.

Officials therefore recommend the application date for this change should be the 2018–19 and later income years.

Recommendation

That the submission be accepted.

ACCOUNTING INCOME METHOD AND STUDENT LOANS

Submission
(Matter raised by officials)

The legislation enacted in February 2017 to provide for the accounting income method ("AIM") did not correctly provide for those taxpayers who use AIM but also make student loan payments with their provisional tax payments. Currently the legislation provides for student loan repayments to be made along with AIM payments which could be from 6 to 12 payments per year. However, these repayments are only able to be accepted by Inland Revenue systems from provisional taxpayers three times a year.

Comment

Officials recommend that the Student Loan Scheme Act 2011 be amended to provide that those taxpayers paying provisional tax using AIM make student loan repayments only three times a year rather than with each AIM payment.

Officials recommend this change apply from the 2018–19 income year. This is the same application date as the AIM provisions.

Recommendation

That the submission be accepted.

EMPLOYEE TAX CODES

Submission
(Matter raised by officials)

Due to an oversight the lower bound on the "S" tax codes has been omitted. The "S" code is described in section 24B(3)(c) as applying for secondary employment earnings for an employee whose annual income is not more than $48,000. The range should read as "is more than $14,000 but not more than $48,000".

Recommendation

That the submission be accepted.

WITHHOLDING TAX TREATMENT OF BACK-DATED REMEDIAL PAYMENTS OF EMPLOYMENT-RELATED ENTITLEMENTS

Submission
(Matter raised by officials)

Retrospective amendments should be made to the Income Tax Act 2007 to clarify the withholding tax treatment of back-dated remedial payments of entitlements under the Holidays Act 2003 and/or an employment agreement.

Comment

As a result of apparently widespread miscalculation of entitlements under the Holidays Act 2003, numerous employers across the public and private sectors have made, or will soon be making, remedial lump sum payments to affected employees and former employees.

Inland Revenue recently considered how the law applies to such payments and concluded that the character of a back-dated payment (that is, whether it is "salary or wages" or an "extra pay" for the purposes of the PAYE rules) should follow that of the original incorrectly calculated payment. This view was inconsistent with common employer practice and the existing policy intent, and would have given rise to a number of undesirable implications, including that:

- it would have been difficult for employers to implement;
- it would be more likely to result in employees having tax over-withheld than if all back-dated remedial payments were treated as extra pays; and
- it would have meant more individuals would have needed to contact Inland Revenue to obtain tax refunds.

To respond to this issue on a timely basis, the Income Tax (Employment-related Remedial Payments) Regulations 2017 were made to declare such payments to be an "extra pay" for the purposes of the PAYE rules on a prospective basis.

To address the issue with the past treatment by employers, officials recommend that retrospective amendments to the Income Tax Act 2007 are added to the Bill. Officials recommend an amendment to categorise past remedial payments made to a person in respect of their entitlements under the Holidays Act 2003 and/or an employment agreement as an "extra pay" (consistent with how employers likely treated them).

Officials also recommend an amendment to protect the position of employers who may have applied the withholding tax treatment that was correct according to Inland Revenue's legal view prior to the Income Tax (Employment-related Remedial Payments) Regulations 2017 coming into force. Officials recommend that these amendments apply from 1 April 2008, the date the Income Tax Act 2007 came into force.

As the proposed retrospective amendments to the Income Tax Act 2007 will also apply prospectively, there will no longer be a need for the regulations. Accordingly, officials also recommend that the Bill revoke the Income Tax (Employment-related Remedial Payments) Regulations 2017 on the date the Bill receives Royal assent.

Recommendation

That the submission be accepted.

TRANSFERRING PAYE CREDITS TO SHAREHOLDER-EMPLOYEES

Submission
(Matter raised by officials)

As part of the recently enacted labour hire rules, labour hire firms are required to withhold tax from payments that are made to a company established by the contractor (the shareholder-employee) performing the relevant services. In this situation, it is common for the company to pay out all of its income to the shareholder-employee through shareholder salaries or attribute the income through the personal services attribution rule.

The issue is that there is currently no mechanism to transfer the PAYE credits arising from withholding tax withheld from the company to the shareholder-employee in the correct income year.

Comment

From a policy perspective, tax credits should be able to be transferred from the company to the shareholder-employee, since the tax credits arise from withholding tax deducted on income earned through labour services provided by the shareholder-employee of the company. If the tax credits cannot be transferred, there is a risk of the shareholder-employee being subject to use-of-money-interest ("UOMI") on income that has actually been taxed.

Accordingly, a rule should be introduced to allow taxpayers to elect to transfer the PAYE credits from the company to the shareholder-employee for the income year in which the income is derived.

The issue is not confined to labour-hire contractors. Officials therefore consider the rule should apply broadly where withholding tax is deducted from schedular payments made to a company, rather than being limited to withholding tax deducted by labour-hire firms.

The application date should be 1 April 2017, to align with the application date for the labour hire rules.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

Officials recommend remedial amendments to correct provisions in the recent Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 to:

- ensure that the qualifying company continuity provisions are included in the list of continuity provisions (treating all trustees as a single notional person and to maintain continuity in the event of death);
- correct an error in the "entry tax" formula for look-through companies (LTCs). This error results in a company effectively not getting the benefit of an imputation credit for income tax payable for an earlier income year, but not due to be paid after the date of entry into the LTC regime;
- ensure the self-remission provisions work as intended when a LTC converts to an ordinary company by ensuring there is an effective base price adjustment at the time of conversion for the owner in their various capacities;
- simplify the rules that enable variable employment income to be subject to PAYE, provisional tax, or a combination of both by removing the shareholder-salary "anti flip-flop" rule. The rule is considered unnecessary as the recently enacted provisional tax interest avoidance arrangement rule can be relied on instead;
- ensure the transitional rule for companies affected by the changes to the LTC eligibility criteria only applies to LTCs that lose their LTC status in the income year the new eligibility rules commenced;
- clarify the drafting of section RD 36, which currently provides the option for a company to not withhold RWT on fully imputed dividends; and
- minor drafting clarifications in relation to the definitions of "grandparented charity" and "look-through company".

An amendment is also proposed to correct an unintentional narrowing of the provisions for PAYE and shareholder salaries that arose out of the rewrite of the Income Tax Act.

Recommendation

That the submission be accepted.

AIRCRAFT OVERHAUL EXPENSES

Submission
(Matter raised by officials)

A cross-reference error in new sections EZ 23BA(4) and EE 60(2)(e) results in aircraft having an incorrect opening tax value of zero tax at the start of the 2017–18 income year.

Comment

The Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 contained amendments to the timing of tax deductions for aircraft overhaul expenses.

One of the amendments related to a transitional deduction which allowed a faster deduction for an aircraft engine overhaul component. As a result of the transitional deduction, the historic cost and accumulated depreciation of the aircraft needed to be adjusted.

Officials recommend that the following cross-references giving effect to these adjustments be corrected to ensure that the legislation cannot be interpreted to mean that an aircraft would have a zero tax depreciated value at the start of the 2017–18 income year:

- Section EZ 23BA(4) should apply for the purpose of section EE 60, not section EE 56 as currently stated.
- Within section EZ 23BA(4), the adjustment should be clarified to equal the difference between the two amounts referred to in section EZ 23BA(2) and (3).
- Section EE 60(2)(e) should refer to section EZ 23BA(4) and not section EZ 23BA(3).

Recommendation

That the submission be accepted.

ALLOCATION OF RESIDENT WITHHOLDING TAX CREDITS BY A TRUSTEE

Submission

(Matter raised by officials)

That the RWT substitution payment rules be clarified to ensure that they achieve their intended outcome.

That the proposed amendments:

- are retrospective to the beginning of the 2008–09 income year, consistent with the commencement of the RWT substitution payment rules; and
- include a savings provision applying to tax positions taken on the basis of the current law as it was prior to enactment of the Bill.

Comment

A recent review of an Inland Revenue publication relating to trusts revealed that the RWT substitution rules enacted in 2011 (but applying from the beginning of the 2008–09 income year) do not achieve their policy intent.

The RWT substitution payment rules are intended to allow the trustee to more efficiently manage the trustee's obligation to pay income tax on beneficiary income, so that the total tax paid by the trustee takes into account each beneficiary's marginal rate of tax.

The rules were intended to permit a trustee to either:

- retain the benefit of refundable RWT credits for use in satisfying the trustee's income tax obligation on trustee income; or
- re-allocate refundable RWT credits attached to resident passive income (interest and dividends) between beneficiaries, for use by the trustee in satisfying the trustee's obligation to pay income tax on beneficiary income; or
- a combination (at the discretion of the trustee) of both of the options set out in the two bullet points above.

This was expected to have the same effect as the trustee requesting the Commissioner to transfer a refund of RWT to another beneficiary or to the trustee, and so would result in a compliance saving for a trustee. However, the current law does not allow the trustee to re-allocate that credit as intended.

The proposed amendments to the RWT rules are to ensure that a trustee may retain the benefit of or re-allocate RWT credits between beneficiaries, as was originally intended. The retrospective application is intended to ensure that past tax positions taken on the basis of policy intent are validated, and also to ensure that a trustee cannot seek an amended assessment to re-allocate RWT credits retrospectively.

Under the RWT substitution payment rules, a trustee may detach a RWT credit from resident passive income paid to one beneficiary and obtain the benefit of that credit in calculating the trustee's income tax liability on trustee income. No change is proposed to the law in this respect.

Chartered Accountants Australia and New Zealand, the New Zealand Law Society, the Trustees Association of New Zealand and other stakeholders have been consulted on the framework for these remedial amendments. Two responses were received which supported the framework for the proposed amendments.

Recommendation

That the submissions be accepted.

AVAILABLE CAPITAL DISTRIBUTION AMOUNT AND DEPRECIABLE ASSETS

Submission
(Matter raised by officials)

That an error in section 23(2) of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 be corrected.

Comment

Section 23 of the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017 amended the calculation of the available capital distribution amount that is not taxed on distribution from a company. The available capital distribution amount is the net difference between total capital gains and total capital losses of a company over its life.

That amendment works correctly for depreciable assets that do not give rise to a depreciation loss on disposal (for example, a building) but does not work correctly for other depreciable assets.

This error could result in the available capital distribution amount taking into account depreciation losses arising on disposal of a depreciable asset, and would result in unintended double taxation.

Officials recommend this issue be corrected to ensure the legislation works as intended.

Recommendation

That the submission be accepted.

AVAILABLE CAPITAL DISTRIBUTION AMOUNT AND DISREGARDED FIF INCOME

Clauses 27 and 61

Submission
(Matter raised by officials)

That section CD 44 of the Income Tax Act 2007 (ITA 2007) should be amended to clarify how it applies to amounts that are disregarded in calculating a New Zealand resident's income from an interest in a foreign investment fund (for example, shareholdings in non-resident companies).

That the proposed amendments to sections CX 57B and EX 59 section be clarified.

Comment

Section CD 44 of the ITA 2007 sets out how much of a distribution from a company is treated as a capital gain amount and not taxed on distribution. Under this rule, a gain on disposal of an asset can only be distributed tax free if the asset is capital property.

Proposed amendments in clauses 27 and 61 clarify that disregarded FIF income amounts are excluded income and so not counted in determining taxable income for a tax year. These disregarded amounts comprise dividends and gains on disposal derived by a New Zealand investor that are not separately taxed on derivation, if the investor calculates their FIF income (which is taxed) using either:

- the fair dividend rate method (FDR);
- the comparative value method (CV method);
- the deemed rate of return method (DRR method); or
- the cost method.

An intended effect of the proposed amendments is to also clarify that, if the FIF investment is held through a New Zealand company, distribution of the disregarded amounts will not be a capital gain (and tax free on distribution) if the FIF interest is revenue account property.

The ability to distribute such disregarded amounts tax-free from a company is intended to be restricted to FIF interests for which income is calculated using either the CV or DRR methods. However, technical arguments have been raised that all such FIF interests are revenue account property and therefore all distributions of disregarded amounts are taxable. This is not the intended outcome if a company calculates FIF income using either the FDR or cost methods.

At present, the rule in section CD 44 is unclear how it applies to FIF interests for which the FIF income is calculated using the FDR or cost methods. Officials recommend that this provision be amended to clarify how it applies to distributions of disregarded amounts from FIF interests held by a company.

In addition, officials consider the drafting in clauses 27 and 61 should be improved to address an ambiguity.

Recommendation

That the submissions be accepted.

DONATION TAX CREDITS FOR DONATIONS TO COMMUNITY HOUSING ENTITIES

Clause 109

Submission
(Matter raised by officials)

The proposed amendment to section LD 3(2)(ac) should be refined by substituting the current drafting with the words "entity, if the gift is made at a time the entity is eligible to derive exempt income".

Comment

The amendment to section LD 3(2)(ac) is intended to ensure that donation tax credits for donations made to community housing entities can be claimed only for the period the entity qualifies for the income tax exemption in section CW 42B of the Income Tax Act 2007. The proposed refined drafting better achieves this intent.

Recommendation

That the submission be accepted.

MULTIPLE STATEMENTS AND CO-EXISTENCE WITHIN START

Submission
(Matter raised by officials)

There are current rules within the Tax Administration Act around issuing multiple statements of account and cancellation of use of money interest (UOMI) when a taxpayer pays the entire amount of tax, penalties and UOMI within 30 days of the issue of the statement.

A rule was added to the provision by the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 which introduced a transitional solution for goods and services tax (GST) statements when GST was migrated to the new START computer platform.

The amended rules were designed specifically for GST when it migrated to the new START system, now with the continuation of the business transformation programme, it is necessary to modify the cancellation of interest rules for those taxes which will be migrating to START from April 2018.

A clarification is also required to the rules to reflect a modification made to the system which reduces the negative application of the previous amendment. The amendment will also extend to multiple notices of assessment as well as statements of account.

The rule defines the period in which interest cancellation will run where multiple statements of account or notices of assessment are issued. The rules only apply where two statements or two notices are issued. The current rules will continue to apply where a notice and a statement are issued in respect of the same liability.

Where a statement of account has been issued (the first statement) and a second statement is issued, interest will be cancelled from the date of the first statement and ending on the date payment is received as long as that is within 30 days of the first statement being issued.

Where a notice of assessment has been issued (the first assessment) and a second assessment is issued, interest will be cancelled from the date of the second assessment and ending on the date payment is received as long as that is within 30 days of the second assessment.

This new cancellation of interest provisions will apply for notices and statements issued after 1 April 2018 for the following taxes:

- goods and services tax;
- approved issuer levy;
- resident withholding tax on dividends;
- resident withholding tax on interest;
- non-resident withholding tax;
- residential land withholding tax;
- fringe benefit tax;
- gaming machine duty; and
- portfolio investment entities that pay tax on an exit or quarterly basis.

Recommendation

That the submission be accepted.