Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill

*Commentary on the Bill*

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Minister of Revenue

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KiwiSaver

# On-payment of KiwiSaver employer contributions

***(Clauses 4(1), 16, 17, 18, 20, 21, 26 to 32, and 36)***

## Summary of proposed amendment

The proposed amendments would allow Inland Revenue to pay employer contributions to a member’s KiwiSaver scheme provider based on employment income information, in advance of the employer paying the contribution to Inland Revenue.

## Application date

The proposed amendments would apply from 1 April 2020.

## Key features

The proposed amendments would allow Inland Revenue to pay KiwiSaver employer contributions (both compulsory and voluntary) to scheme providers, before the contribution amount has been received by Inland Revenue. Employer contributions would be paid to providers as soon as practicable after employment income information was filed with Inland Revenue indicating that an employer contribution had been made for a pay period.

Along with the other KiwiSaver amendments in this Bill, this change would improve the administrative efficiency of KiwiSaver as it would facilitate the earlier transfer of employer contributions to KiwiSaver scheme providers. This would result in a member’s employer contributions being invested by their scheme providers sooner.

The proposal would also align with the existing treatment of KiwiSaver employee contributions.

## Background

Under current KiwiSaver settings, Inland Revenue on-pays employee contributions to a member’s scheme provider as soon as practicable after receiving payday employment income information that an employee contribution amount has been deducted from the member’s salary and wages. As employment income information is due with Inland Revenue prior to the due date for payment of these deductions, this means that employee contributions can be on-paid to scheme providers sooner than they otherwise would be.[[1]](#footnote-1)

The law currently provides no comparable arrangement for employer contributions. Instead, when Inland Revenue receives employment income information relating to an employer contribution, the employer contribution is not on-paid to the KiwiSaver scheme provider until the contribution amount has been paid to Inland Revenue by the employer. This makes it difficult for members to reconcile the amounts in their KiwiSaver account with the contribution amounts listed on their payslips. It also means that employer contributions are not invested by scheme providers as soon as employee contributions.

## Detailed analysis

All section references are to the KiwiSaver Act 2006.

### Amendments to Inland Revenue KiwiSaver Holding Account rules (Part 3, subpart 2)

Under existing section 72 Inland Revenue is required to establish a memorandum account – called the “Inland Revenue KiwiSaver Holding Account” – which all contributions made under the Act must be paid into in the first instance.

The existing Act contains a provision which allows Inland Revenue to pay employee contributions to a KiwiSaver scheme provider based on employment income information, before the contribution is paid to Inland Revenue by the employer. Section 73(3) provides that after being paid into the Inland Revenue KiwiSaver Holding Account, these contributions must be paid out of the Holding Account to a KiwiSaver scheme provider as soon as practicable. The proposed amendments to subsections 73(1) and (2) would allow Inland Revenue to on-pay employer contributions to a KiwiSaver scheme provider under section 73(3), in addition to employee contributions.

Under amended section 73(1), before on-paying the contribution amount to the scheme provider Inland Revenue should be satisfied that the contribution has actually been deducted from salary and wage or for employer contributions that the employer is able to make the contribution at the time it was reported in the employment income information. However, in the absence of evidence to the contrary, Inland Revenue can assume that if an amount has been reported on employment income information this is the case. Under the existing Act the entitlement for Inland Revenue to make this assumption about employee contributions is included in section 73(6), but it is proposed this entitlement be moved to new section 221B and extended to employer contributions.

Proposed new section 73(1) would also clarify that section 73 only applies to employee and employer contributions that are on-paid to a KiwiSaver scheme provider by Inland Revenue before the contribution is paid to Inland Revenue by the employer. Employee and employer contributions that are not on-paid to a scheme provider before the contribution is paid to Inland Revenue, would be captured by existing section 74 and treated as being held on trust under this section. Contributions received by Inland Revenue that are neither employee or employer contributions would also continue to be subject to section 74 (section 95 allows for a person who is not an employer to make contributions to a KiwiSaver account by paying them to Inland Revenue).

The Act contains a provision to prevent the employee being disadvantaged by their employer failing to pay deductions to Inland Revenue. Existing section 78(a) provides that Inland Revenue must pay an amount of the unpaid employee contribution from a Crown Bank Account into the Inland Revenue KiwiSaver Holding Account if the employer has not paid the contribution amount by its due date. Proposed new section 78 would extend this to allow Inland Revenue to also pay the amount of unpaid employer contributions.

It is also proposed to repeal section 76 which allows Inland Revenue to wait to on-pay an employer contribution until a member’s employee contribution is next on-paid to a KiwiSaver scheme provider. As the proposed amendments would allow employee and employer contributions to be on-paid to a KiwiSaver scheme provider at the same time, this provision is no longer necessary.

Cross-referencing and nomenclature amendments are also proposed to sections 71 and 74(3).

### Amendments to employer contribution rules (Part 3, subpart 3)

It is proposed to repeal sections 98 and 99 which set out rules for how part payments of employer contributions to Inland Revenue are treated. Part payment rules are no longer required as the proposed amendments above would allow employer contributions to always be on-paid in full to a scheme provider. In their place new section 95B is proposed. Proposed section 95B would specify when an employer contribution shown on employment income information would be treated as received by Inland Revenue for the purpose of the KiwiSaver Act 2006, where the contribution was not paid to Inland Revenue by or before its payment due date. This provision would be consistent with the existing rule for employee contributions in section 69.

The amendments to section 73 requiring the on-payment of employer contributions to a KiwiSaver scheme provider as soon as practicable after they are paid into the Inland Revenue Holding Account would be subject to proposed new sections 95C and 95D. Where an employer has failed to provide particulars required by Inland Revenue about an employer contribution reported in employment income information, proposed new section 95C would allow Inland Revenue to wait to on-pay the contribution until it can be established which member it should be attributed to. Proposed new section 95D would provide that such a contribution would not be treated as being received by Inland Revenue until the date it was established who it was attributable to. These provisions would be consistent with the existing rules for employee contributions in sections 70 and 71.

Proposed new section 101(1B) would provide that where an employee opts-out after an employer contribution has already been on-paid to their scheme provider the amount must be refunded to Inland Revenue. Proposed new section 101AA would provide that where this amount has been paid out of a Crown Bank Account and the amount has not subsequently been received from the employer, the employer contribution amount must be refunded to a Crown Bank Account. This would ensure that an employer was not refunded an amount they had not paid.

Employee and employer contributions are required to be held by Inland Revenue for the duration of the standard opt-out period (an amendment also proposed in this Bill would reduce this holding period for initial contributions from 92 days to 62 days, while the opt-out period ends 55 days after a person has been automatically enrolled in KiwiSaver). Therefore, the proposed amendments to the opt-out refund rules would only have limited application in circumstances when the late opt-out rules have been applied.

A similar amendment to the one proposed to the opt-out refund rules is not proposed for refunds resulting from a person being invalidly enrolled in KiwiSaver, as existing section 59D(4) already allows refunds of contribution amounts (without reference to the specific contribution type) to the Crown where appropriate, in invalid enrolment situations.

Cross-referencing and nomenclature amendments are also proposed to sections 93(5), 96 and 98A.

# Other KiwiSaver administrative refinements

***(Clauses 4(2) and (4), 5, 6, 7(2) and (3), 8 to 15, 19, 22 to 25, 33 to 38, and 132)***

## Summary of proposed amendment

A number of additional technical amendments are proposed to the KiwiSaver Act 2006 aimed at enhancing Inland Revenue’s administration of KiwiSaver. In particular, the amendments aim to ensure that KiwiSaver members receive the correct contribution amounts and to facilitate the faster transfer of contributions to KiwiSaver scheme providers.

## Application date

The proposed amendments would apply from 1 April 2020.

## Key features

* Reducing the KiwiSaver provisional period (during which individuals who are automatically enrolled in KiwiSaver are provisionally allocated to a default KiwiSaver scheme) and initial holding period from three months to two months.
* Aligning the date KiwiSaver contributions are treated as received by Inland Revenue with a member’s payday.
* Reducing the maximum period within which a scheme provider has to send information and funds to a new scheme provider when a member transfers schemes, from 35 days to 10 working days.
* Allowing members to change their contribution rate through their scheme provider or Inland Revenue, in addition to their employer.
* Requiring employers to provide Inland Revenue with information about an employee’s KiwiSaver income and ESCT rate.
* Removing the three-month grace period for members who have been incorrectly enrolled in KiwiSaver, to gain New Zealand residence.

## Detailed analysis

All section references are to the KiwiSaver Act 2006 unless otherwise stated.

### Reducing the KiwiSaver provisional period and initial holding period (sections 4, 18, 48, 51, 57, 59B, 64, 75, 81, 88, 104, 108, 112B and 226 amended)

Where an individual has been automatically enrolled, opted-in via their employer or is no longer eligible to be a member of their existing KiwiSaver scheme, under section 50 the individual will be provisionally allocated to a default KiwiSaver scheme. Section 51(4) provides that this provisional allocation will be made final three months after being allocated to the scheme. The effect of this is that if the individual does not make an active choice to join another KiwiSaver scheme before the end of the three-month period, they will be treated as having accepted the offer of membership to the scheme they were provisionally allocated to. The provisional period is distinct from the KiwiSaver opt-out period (which applies from day 13 until the end of day 55 after a person has been automatically enrolled in KiwiSaver).

As a consequence of the provisional period being set at three months section 75 requires that a member’s initial contributions are also held by Inland Revenue for three months before being on-paid to the member’s KiwiSaver scheme provider.

It is proposed that section 51(4)(a) and (b) be amended so that the provisional period be reduced from three months to two months. Section 75 would also be amended so that the initial holding period was also reduced from three months to two months. As they would be receiving a member’s initial contributions earlier, scheme providers would become aware they had been allocated a default member sooner and would be able to engage with the member about their investment options earlier. It would also mean a member’s initial contributions were invested by scheme providers sooner. Moreover, members would still have the opportunity to transfer between schemes after the provisional period ended if they wished to.

As a result of reducing the initial holding period it is proposed that an amendment be made to section 81(1) so that in addition to being required to refund contributions to Inland Revenue that were more than was required to be paid under the Act, a scheme provider would also be required to refund contributions to Inland Revenue when a member opts out. This provision would apply where the KiwiSaver late opt out rules have been used, which can be up to three months after a person has been automatically enrolled in KiwiSaver (previously such a rule was not necessary as the late opt-out period ended at the same time as the initial holding period). A similar amendment has been made to the employer contribution specific refund rules and is discussed in the section about on-payment of KiwiSaver employer contributions.

Currently, section 4(3) of the Act defines “3 months” to mean 92 days. It is proposed that section 4(3) be repealed and where appropriate references in the Act to “3 months” are replaced with “92 days”. Instead of being expressed as “2 months”, section 51(4) would also refer to “62 days”.

Consequential amendments to sections 48(1)(d), 56(4) and 226(1B) and (1C) are also proposed to align with the reduced provisional and holding periods.

### Aligning the date KiwiSaver contributions are received with member’s payday (proposed sections 95B and 221B and sections 4, 69, 78, 85 and schedule 1, clause 8 amended)

Under existing section 85(1), employee contributions are treated as received by Inland Revenue on the 15th of the month they were deducted from the member’s salary or wages, for the purpose of determining when interest calculations commence on employee contributions while they are held by Inland Revenue. Sections 69(2), 78(b) and schedule 1, clause 8 also contain a 15th of the month timing rule for employee contributions – these provisions relate to when unpaid employee contributions are treated as received and when employee contributions are treated as received for the purpose of the KiwiSaver first home withdrawal rules.

Section 85(3) provides that employer contributions are treated as received on the first of the month that Inland Revenue received payment for the contribution. The reason employer contributions are treated as received on a different date from employee contributions, was a result of the fact employer contributions could not be on-paid to a scheme provider until the contribution amount had been paid to Inland Revenue. If interest was calculated from the 15th of the month and there was a delay in the employer contribution amount being paid to Inland Revenue, this would create a risk that Inland Revenue would be required to pay interest on these contributions for an extended period of time. The proposed on-payment of employer contributions amendment outlined above means it would no longer be necessary to treat employee and employer contributions differently for timing purposes.

The current timing rules reflect the fact that previously Inland Revenue did not have sufficient information to determine the date of an employee’s payday. This timing approach is unsatisfactory as it results in the under and over payment of interest on employee contributions and underpayment of interest on employer contributions.

New employment income information requirements came into effect from 1 April 2019. Employers are now required to report the date of their employee’s payday to Inland Revenue. Therefore, it is proposed that sections 69, 78 and 85 are amended so that employee contributions would be treated as received by Inland Revenue on the date of the member’s payday as reported by the employer. Similarly, amended section 85 and new section 95B(2) (which relates to the date employer contributions are treated as received for the on-payment of employer contributions amendments above) would specify that employer contributions were also treated as received on the date of the member’s payday.

All of the proposed amendments would include a carve out stating that where an employer has not provided information to Inland Revenue about an employee’s payday, both employee and employer contributions would be treated as received on the 15th of the month that the employee contribution was deducted/employer contribution was made for. This would cover situations where Inland Revenue has granted an employer a variation for employment income information requirements, which results in them not being required to report the date of their employee’s payday.

Under existing sections 69 and 85 Inland Revenue should be satisfied that an employee contribution has actually been deducted from salary and wages for these sections to apply. Similarly, it is proposed that for employer contributions proposed section 85 and new section 95B would require Inland Revenue to be satisfied the employer is able to make the contribution at the time it was reported in the employment income information for these sections to apply. Proposed new section 221B would entitle Inland Revenue to assume that if an amount was included on employment income information these requirements were met for employee and employer contributions unless there was evidence to the contrary.

An amendment is also proposed to section 4 to clarify that “payday” would have the same meaning as it does in the Tax Administration Act 1994.

### Transfer of member’s information and funds to a new scheme provider (sections 56 and 57 amended)

Section 56(4) specifies that where an existing KiwiSaver member decides to transfer schemes, the old scheme provider must send the member’s funds and relevant information to the new scheme, within 35 days of receiving notice that the member has opted to transfer schemes. However, KiwiSaver default provider Instruments of Appointment require them to complete these transfer requirements within 10 working days of receiving notice that the member has transferred schemes.

It is proposed the above section be amended so that the legislatively mandated transfer time is reduced from 35 days to 10 working days. This would result in the transfer time being aligned across all KiwiSaver scheme providers. A consequential amendment is also proposed to section 57(5).

### Changing employee contribution rates (section 64 amended)

Under section 64(2) an employee can choose what KiwiSaver contribution rate they wish to have contributions deducted from their salary or wages at by giving notice to their employer. It is proposed that this section be amended so that a member would be able to change their contribution rate by contacting Inland Revenue or their KiwiSaver scheme provider, in addition to their employer. This would reduce compliance costs for members who may be more likely to engage with Inland Revenue or their scheme provider in the first instance about contribution rate changes.

Proposed new section 64(2B) to (2D) outline information that would need to be provided by a member or a scheme provider to Inland Revenue where a contribution rate change is made, and what information Inland Revenue would be required to subsequently provide a member’s employer to ensure the contribution rate change is given effect to.

### KiwiSaver income and ESCT rate information (proposed section 63B of the KiwiSaver Act 2006, and 93 amended of the KiwiSaver Act 2006 and schedule 4 of the Tax Administration Act 1994)

As part of the KiwiSaver on-boarding process, employers are required to provide Inland Revenue with certain information about new enrolments to the scheme.

To improve Inland Revenue’s ability to ensure that KiwiSaver members are receiving the correct KiwiSaver contribution amounts and that these amounts are taxed at the correct rate, it is proposed that employers should provide the following KiwiSaver information to Inland Revenue:

* *Proposed new section 63B*: The amount of salary and wages a KiwiSaver deduction is made from for an employee, if there is a difference between amounts that an employer must treat as gross earnings for the purpose of calculating PAYE tax obligations and amounts they must treat as salary and wages for the purpose of calculating KiwiSaver employee and employer contribution amounts. If there is a difference between amounts that an employer must treat as gross earnings (for calculating PAYE deductions) and amounts they must treat as salary and wages (for calculating KiwiSaver employer and employee contributions), then the employer must report the latter. There are some amounts that are treated as income for PAYE that are exempt for KiwiSaver purposes. (Some examples of amounts included in gross income for PAYE that are not included within the definition of salary and wages for KiwiSaver are the value of accommodation, a benefit from an employee share scheme or a redundancy payment).
* *Proposed new section 93(7)*: Where the employer is reporting information to Inland Revenue on employer KiwiSaver contributions (that is all employers making KiwiSaver employer contributions) the employee’s employer superannuation contribution tax (ESCT) rate.

It is not proposed that employers would provide this information every payday. Instead, the employer would report to Inland Revenue about new employees or existing employees where the information has changed since the last KiwiSaver employee contribution was deducted or employer contribution was paid for that member. This would mean employers would not have to provide this information about existing employees who are KiwiSaver members when the proposals came into effect.

Consequential amendments are also proposed to schedule 4 of the Tax Administration Act 1994, to clarify that the proposed new reporting requirements fall within the ambit of what is considered employment income information under that Act.

### KiwiSaver invalid enrolment residence grace period (sections 59B, 59C and 59D amended)

Section 59A provides that when an individual does not meet the KiwiSaver residency requirement, the invalid enrolment rules will apply. However, under section 59B the member will be treated as meeting the KiwiSaver residence requirement for the first three months after the invalid enrolment is discovered. Section 59C then provides if the person becomes someone who meets the residence requirement within this three-month period, the enrolment will be retrospectively validated and their KiwiSaver account would remain open.

In practice, the three-month residence grace period has not operated as intended, as non-residents who have been enrolled in KiwiSaver typically do not intend to become a resident in the short-term (for example, individuals on temporary work visas). Therefore, it is proposed that new section 59B(2)(ab) be inserted. Where an individual has been invalidly enrolled on the basis of not meeting the residence requirement, this provision would result in their membership ending as soon as their scheme provider discovers, or is notified about, the invalid enrolment.

Proposed amendments to section 59C(1) would clarify that where a person who did not meet the residence requirement was invalidly enrolled this enrolment could not be retrospectively validated. While amendments to section 59D(1) would confirm that the refund process set out under this section, for contributions that a person had made while invalidly enrolled, would apply if an individual’s account had been closed on the basis of them not meeting the residence criteria when enrolled.

The effect of these amendments would be to remove the three-month residence grace period and mean the member’s account would be closed immediately. The individual would then be able to open a new KiwiSaver account if they later became a resident.

Student loans

# Limiting ability to reopen repayment obligations prior to 1 April 2013

***(Clause 57 and Schedule)***

## Summary of proposed amendments

Several proposals are made to limit the situations where either the Commissioner or the borrower can reopen a borrower’s repayment obligation for tax years prior to 1 April 2013.

## Application date

The proposed amendments would apply from 1 April 2020.

## Key features

The proposed amendments to the Student Loan Scheme Act 1992 and the Student Loan Scheme Act 2011 limit the situations where a borrower’s repayment obligations for tax years prior to 1 April 2013 can be amended. For these tax years a borrower’s repayment obligation would only be reopened where a borrower:

* becomes overseas or New Zealand based;
* has committed fraud;
* has not filed information to the Commissioner when required to do so under the Act and it is cost effective for the Commissioner to reopen the repayment obligation.

A savings provision is proposed to allow the Commissioner to correct the position of any borrower who might be unduly disadvantaged by these proposals.

## Background

Inland Revenue is currently required to maintain the student loan scheme rules back to 1992 when the scheme was introduced in case either the Commissioner or the borrower seeks to review a borrower’s repayment obligation. Retaining rules back to 1992 has increased the complexity of the scheme over time as changes have been made to the scheme in 21 of the last 26 years. Compliance costs for borrowers are high, as understanding changes to their loan balance is difficult due to historical rules applying for prior years. Administration costs for Inland Revenue are also high, as are the costs of building the rules back to 1992 into new systems and processes, with little benefit.

As part of Inland Revenue’s Business Transformation programme, it is proposed that a simplified set of rules will apply for the period from 1992 to 1 April 2013. This will reduce compliance costs for borrowers, the administration costs for Inland Revenue, and the time and cost of implementing changes to the student loan scheme.

The 1 April 2013 date was chosen as nearly all adjustments to borrowers’ repayment obligations have occurred within this timeframe and the rules applying from that date onwards are largely the same as applies today.

## Detailed analysis

Schedule 6 of the Act is amended by introducing a new part, Part 5. This part sets out the proposed new rules for tax years prior to 1 April 2013.

A new definition of closed-off tax years is proposed relating to tax years from 1992 up to 1 April 2013. During this period both the Commissioner and the borrower are precluded from reopening any repayment obligation except where the borrower: has a change in residency status; has committed fraud; has not provided information (for example. an unfiled return) and it is cost effective for the Commissioner to reopen the obligation; or has been disadvantaged because of this proposal.

If one of these exceptions apply, the borrower’s repayment obligation can be reopened.

### Residency changes

If a change in a borrower’s residence status is identified after 1 April 2020 and the change relates to a closed-off tax year, a simplified set of rules will apply. Loan interest would be calculated on the borrower’s loan balance from the date the borrower went overseas, or loan interest would cease to apply from date they returned to New Zealand.

Where a borrower goes from New Zealand-based to overseas-based during the closed-off period, no overseas-based borrower repayment obligation for the period will be imposed.

Where a borrower goes from overseas-based to New Zealand-based during the period, overseas-based repayments would not be collected. Any payments already collected would go against the loan balance.

However, changes to a borrower’s repayment obligations due to residency changes will apply from 1 April 2013 onwards.

Example 1

Bob went overseas in April 2008 but did not advise Inland Revenue. Since 2008, Bob has been treated as a New Zealand-based borrower (so was not charged loan interest). Bob has not met his repayment obligations since 2008. In April 2021, Bob returns to New Zealand and Inland Revenue identifies that Bob has been overseas since April 2008. Bob’s obligations for the 2008–2013 tax years can be reopened only to the extent that Bob must pay loan interest from April 2008. His repayment obligations for the 2008–2013 tax years cannot otherwise be assessed or reassessed. Bob’s obligations for the 2014–2021 tax years can be reopened in full (because those tax years are not closed off). For the period from 1  April 2013 until he returned to New Zealand, Bob may be liable to an overseas-based borrowers’ repayment obligation and loan interest. From 1 April 2013 onwards, associated late payment interest charges can apply.

Example 2

Ngaire went overseas in April 2000 and advised Inland Revenue of her departure. Ngaire returned to New Zealand in July 2008 but did not advise Inland Revenue. Since April 2000, Ngaire has been treated as an overseas-based borrower (so was charged loan interest and assessed with an overseas-based repayment obligation). Ngaire has not met her repayment obligations since March 2000. In April 2021, Inland Revenue identifies that Ngaire returned to New Zealand in July 2008. Ngaire’s obligations for the 2008–2021 tax years can be reopened. For the period from July 2008 to 31 March 2013, the loan interest charge, and any overseas-based borrower repayment obligations, can be reversed but no New Zealand-based repayment obligation can be assessed in its place. For the 2013–2014 tax year and later tax years, Ngaire can be assessed with a New Zealand-based borrowers’ repayment obligation (because those tax years are not closed off). From 1 April 2013 onwards, associated late payment interest charges can apply.

Example 3

Pip went overseas to work as a volunteer for a recognised charity in April 2008 and returned in April 2010. Pip could have applied under section 25 of the Student Loan Scheme Act 2011 to be treated as if still physically in New Zealand during the period of absence but did not. Pip’s obligations for the 2008–2009 to 2009–2010 tax years can be reopened if she makes an application under section 25 of the Student Loan Scheme Act 2011. For the period of absence, the loan interest charge, and any overseas-based borrower repayment obligations, can be reversed but no New Zealand-based repayment obligation can be assessed in its place.

### Fraud or unfiled returns or information

Where fraud is involved, or the borrower has failed to provide a return or information to the Commissioner, the borrower’s repayment obligation may be reopened during the closed-off period. In these situations, a simplified calculation would be used to calculate the borrower’s repayment obligation, namely, 10 percent of the difference between the income of the borrower that should have been used to calculate the repayment obligation and the income that was used less any unused repayment threshold. Other rules that applied in that year would be disregarded.

A one-off penalty may also apply to penalise the non-compliant action. Late payment interest will not be imposed for the closed-off period. However, late payment interest may apply from 1 April 2013 onwards. Imposing late payment interest on repayment obligations for the period 1992 to 2013 can disproportionately increase the debt owed to Inland Revenue to the point where the borrower cannot repay the debt and disengages with the Student Loan Scheme.

Example 4

Chris fraudulently failed to declare a large source of income for the 2008–09 tax year. This has implications for both income tax and student loan obligations. The four-year (statute bar) period for making changes to an income tax obligation after a return is filed does not apply where fraud is involved. Therefore, the Commissioner of Inland Revenue amends Chris’s income tax liability for the 2008–2009 year and the student loan repayment obligation for that year is also amended. The reopened student loan repayment obligation is the difference between the previous income amount and the new income amount, less any unused repayment threshold, multiplied by the repayment percentage (which was 10% up to 1 April 2013). Chris could be considered for a shortfall or criminal penalty for not filing or for the fraudulent activity.

### Borrowers adversely affected

Where a borrower considers that they are worse off because of these changes, they can apply to the Commissioner and if the Commissioner agrees then their repayment obligation will be corrected.

# Overseas-based borrowers with serious illness or disabilities

***(Clauses 40 to 44, 53, and 56)***

## Summary of proposed amendment

The proposed amendment to the Student Loan Scheme Act 2011 will allow the Commissioner of Inland Revenue to treat borrowers who are unable to meet their overseas-based repayment obligation as a result of a serious illness or disability as being physically in New Zealand. This means they could be eligible for an interest-free loan and have repayment obligations based on their income.

## Application date

The proposed amendment would apply from 1 April 2020.

## Key features

The Bill provides a new circumstance for when a borrower can be treated as being physically in New Zealand.

Borrowers with a serious illness who are unable to meet their overseas-based repayment obligations will be able to be treated as physically in New Zealand for the purposes of determining whether they are New Zealand-based or overseas-based.

The amendment will require the borrower to provide evidence of their medical and financial position as the Commissioner of Inland Revenue requires. Unlike for hardship relief, the borrower would not necessarily need to supply evidence annually. Instead they would need to do so as the Commissioner of Inland Revenue reasonably requires. This helps to recognise that some borrowers have long term medical conditions.

The borrower will be required to notify the Commissioner of Inland Revenue of their adjusted net income. This is required of all borrowers who have repayment obligations based on their income.

## Background

Many borrowers with serious illnesses can work and can meet their repayment obligations. However, some overseas-based borrowers with serious illnesses can struggle to meet their overseas-based repayment obligation and over time their loan can increase in size because of loan interest being charged.

New Zealand-based borrowers, as defined in section 22, do not pay loan interest and their repayment obligations are based on their income. Whereas overseas-based borrowers incur loan interest and their repayment obligations are based on their loan size.

The treatment will be available to borrowers who have an injury, illness, or disability that results in them being unable to engage in paid work, other than work for which the person is paid a token payment or a very low wage, or where that injury, illness or disability poses a serios and imminent risk of death.

Example 5

Ben lives overseas and was seriously injured in a car accident. Ben after the accident had to quit his job and he is now financially unable to meet his overseas-based repayment obligation. Ben is now working at his local community gardens, as part of the country’s welfare programme. Ben, as part of this welfare programme, receives a payment for his work that is below the country’s minimum wage. Ben is eligible to apply to be treated as a New Zealand-based borrower, meaning he would have an interest free loan and repayment obligations based on his income.

The proposed amendment will assist in aligning the repayment obligation of overseas-based borrowers in serious illness with their ability to make repayments. It also ensures the size of the borrower’s loan does not increase as a result of loan interest charges.

The proposed amendment will not change borrowers’ abilities to receive hardship relief.

# Notifying employers when student loans are close to being repaid

***(Clause 45)***

## Summary of proposed amendment

This proposed amendment will allow Inland Revenue to notify employers of a borrower’s remaining loan balance when the borrower’s loan is close to being fully repaid. Employers will be instructed to reduce the amount of the final deduction to an amount equal to the remaining loan balance. This will reduce the likelihood of overpayments being made.

## Application date

The proposed amendment would apply from 1 April 2020.

## Key features

Employers will be notified of a borrower’s loan balance when Inland Revenue becomes aware that the borrower’s loan is close to being fully repaid. Where possible, borrowers will also be notified that their loan is close to being repaid. Employers will need to reduce the amount of the final deduction.

## Background

Currently, employers make salary and wage deductions from their employee’s wages at the rate of 12 cents in the dollar for every dollar over the repayment threshold. This flat rate generally leads to employers deducting more than the remaining loan balance. These overpayments often require contact between Inland Revenue and the borrower to resolve.

Inland Revenue currently contacts employers after loans are fully repaid to instruct them to cease making student loan deductions.

This proposal is possible now because since 1 April 2019, employers have been required to provide information on employees’ income and deductions each payday giving Inland Revenue more timely and accurate information regarding an employee’s earnings.

# Renaming the student loan repayment holiday

***(Clauses 46 to 52, and 54)***

## Summary of proposed amendment

The proposed amendment changes the name of the Student Loan Repayment Holiday to Student Loan Temporary Repayment Suspension.

## Application date

The proposed amendment would will apply from 1 April 2020.

## Background

The repayment holiday reduces a borrower’s overseas-based repayment obligation to zero. Renaming the repayment holiday will send a better signal to borrowers that their repayment obligations are only on hold. In practice, there will be no change to the effect of the policy on borrowers.

# Writing off historic fraudulent loans

***(Clause 57(4) and Schedule)***

## Summary of proposed amendment

The proposed amendment allows Inland Revenue to write off loans taken out before 2000, where the Commissioner is satisfied that the borrower did not take out the loan, and the correct borrower cannot be identified.

## Application date

The proposed amendment would apply from 1 April 2020.

## Key features

The proposed change will allow Inland Revenue to write off loans that were transferred before 1 April 2000 where the Commissioner is satisfied that the person who has been allocated the loan did not take it out, and the correct borrower cannot be identified.[[2]](#footnote-2)

This is intended to be used in a small number of cases that officials are aware of and suspect identity theft has occurred. If the correct borrower could be identified the loan would be transferred to them.

Research and development

# Refundability and new tax exempt entity exclusion

***(Clauses 101, 106, 107 and 113(6), (9), (10) and (13))***

## Summary of proposed amendment

The Bill proposes an amendment to make refundable R&D tax credits available to more firms. It is proposed that the existing corporate eligibility criteria, wage intensity test, and $255,000 cap be removed and replaced with a payroll-tax based cap. It is also proposed that entities that derive tax exempt income (other than levy bodies, and claimants that only receive exempt income from certain intercompany and foreign dividends) be ineligible for the R&D tax credit.

## Application date

The proposed amendment would apply from a business’s 2020–21 income year. The proposed amendment in clause 107 would apply from the 2019–20 income year.

## Key features

### Proposed new refundability rules

It is proposed that the existing limited refundability rules be replaced with new rules that make refundable R&D tax credits available to more firms from the 2020–21 income year (year two of the R&D tax credit regime). This means the new rules would apply from the start of each business’s 2020–21 income year, so would apply from 1 April 2020 for standard balance date taxpayers. These credits would be available for claimants in a tax loss position, or with insufficient income tax liability to utilise all of their R&D tax credits in the relevant income year.

Table 1 compares the current limited refundability rules with the proposed new refundability rules.

Table 1: Current and proposed refundability rules

| **Area** | **Existing rules2019–20 income year** | **Proposed new rules2020–21 income year** |
| --- | --- | --- |
| Eligibility criteria | Must satisfy the corporate eligibility criteria (section MX 2) – this includes a requirement that claimants must be companies, cannot be listed, and cannot be considered a tax resident of another jurisdiction under a double tax agreement | No corporate eligibility criteria. |
| Must satisfy the wage intensity criteria (section MX 3) – this requires twenty percent of a firm’s labour costs to be on R&D labour | No wage intensity criteria. |
| Exempt income exclusion | Must not derive exempt income or be associated with a person who derives exempt income (unless the exempt income is from intercompany or foreign dividends under section CW 9 or 10). | Must not derive exempt income (unless the exempt income is from intercompany or foreign dividends under section CW 9 or 10, or the claimant is a levy body researcher) – note that this is an exclusion from the R&D tax credit regime, not just from refundability. |
| Cap | $255,000. | The total payroll taxes (PAYE, FBT, and ESCT) paid by the claimant (exceptions and grouping rules apply). |
| Outstanding tax | Must not have an outstanding tax liability. | Must not have an outstanding tax liability. |

There would be two exceptions to the payroll tax-based cap. The cap would not apply to R&D tax credits:

* derived from eligible R&D expenditure on approved research providers; or
* claimed by levy body researchers (a levy body researcher is an industry organisation to which a levy is payable under New Zealand statute, such as the Commodity Levies Act 1990).

Grouping rules would apply to allow certain companies to allocate their payroll taxes to other companies they control or that sit within the same wholly-owned group.

Similar to the existing refundability rules, any non-refundable R&D tax credits may be carried forward to the next income year provided the shareholder continuity requirements in section LY 8 are met.

### Proposed new exclusion for tax exempt entities

Tax exempt entities, other than firms that receive exempt income from dividends under section CW 9 or 10, (“excluded tax exempt entities”) are ineligible for year one refundability. Given that, the Government has decided these organisations should not be eligible for refunds of their tax credits in year two.

It is proposed that these excluded tax-exempt entities will also be completely ineligible for the R&D tax credit regime from the 2020–21 income year (year two of the R&D tax credit regime), except where the claimant is a levy body researcher.

Any R&D tax credits received by tax exempt entities in year one cannot be carried forward to year two. These credits will be extinguished from the beginning of year two.

## Background

The Taxation (Research and Development Tax Credits) Act 2019 introduced an R&D tax incentive regime from the 2019–20 income year. The R&D tax incentive was developed under tight timeframes, so there was insufficient time to resolve some associated issues before the legislation was enacted. These included the eligibility of tax-exempt entities, and refundability for firms in loss or with insufficient income tax liability to use all of their R&D tax credits in the relevant income year.

### Eligibility for the credit

A firm must first be eligible for the R&D tax credit more generally before it can be eligible for refundable R&D tax credits. Claimants have to satisfy a number of criteria to be eligible for the credit, which include having a core activity in New Zealand and carrying on business through a fixed establishment in New Zealand.

### Excluding tax exempt entities from the R&D tax credit regime

Tax exempt entities are currently eligible for non-refundable R&D tax credits in year one of the R&D tax credit regime. Since these entities do not pay any income tax and do not qualify for year one refundability, they are unable to benefit from any R&D tax credits they receive in year one.

### Broader refundability rules

In year one of the incentive (that is, the 2019–20 income year), limited refundability rules applied to provide refundable credits for a small portion of eligible R&D tax credit claimants. The limited refundability rules built on the existing R&D tax loss cash-out regime. The Government committed to reviewing the refundability rules, so that broader, more accessible refundability would be available from year two of the incentive (the 2020–21 income year).

Refundability is important, because it ensures all claimants doing R&D are able to immediately benefit from the tax credits they are eligible for under the incentive. Without refundability, some claimants may not be able to benefit from the incentive until a much later date (if at all, depending on the circumstances of each claimant). Removing the corporate eligibility and wage intensity criteria (section LA 5(4B(a)(i) and (ii)) should make refundable tax credits available to more claimants.

It is proposed that the existing $255,000 cap be replaced with a payroll tax-based cap. The payroll tax-based cap would be based on the total PAYE (which includes withholding taxes paid on behalf of contractors), FBT, and ESCT paid by a claimant. This is in line with approaches taken in other jurisdictions and is intended to prevent refundable tax credits being paid out for fraudulent claims.

Some exceptions are proposed to the payroll tax-based cap, so that the cap would not apply to credits resulting from eligible approved research provider expenditure and credits claimed by levy body researchers. There is a lower fraud risk associated with approved research provider expenditure and claims by levy bodies. This is because approved research providers have to be registered with Inland Revenue and have record-keeping obligations, and levy bodies are industry organisations empowered to collect levies under legislation (such as the Commodity Levies Act 1990).

## Detailed analysis

### Tax exempt entity exclusion (sections LA 5(4B), LY 3(2)(f), LY 8(2B), CW 9, CW 10 and YA 1)

It is proposed that from year two of the R&D tax credit regime, most tax-exempt entities will be ineligible for the R&D tax credit (so they will be unable to receive any R&D tax credits from year two). It is also proposed that any credits received by these entities in year one cannot be carried forward to year two but instead will be extinguished from the beginning of year two.

The rationale behind this exclusion is that tax exempt entities sit outside the tax system, so should not benefit from incentives provided from within the tax system. Charities, which come within the tax-exempt entity exclusion, do not pay income tax, and receive additional Government support in the form of GST concessions, an exemption from FBT, and the donor tax credit regime.

A carve-in is proposed for levy bodies and claimants whose only exempt income is from foreign or intercompany dividends under section CW 9 or 10. Claimants who receive exempt dividend income will typically be businesses who also derive assessable income and otherwise sit within the tax system. Levy bodies’ members are normally businesses, and these businesses fund R&D performed by the levy bodies for their benefit, so levy body R&D is fundamentally business R&D.

**Example 6: Charity’s year one credits extinguished**

In the year ended 31 March 2020, Charity X claims $100,000 of R&D tax credits. Charity X does not pay income tax, so it has no income tax liability to offset its R&D tax credits against. It is not eligible for refundability, because Charity X receives exempt income.

Charity X’s $100,000 of R&D tax credits are extinguished from 1 April 2020. Charity X ceases to be eligible for the R&D tax credit from this date.

### New payroll tax-based cap for refundability (sections LA 5(4B), LA 5(5B), LA 5(5C), YA 1)

The proposed amendment to LA 5(4B) would replace the existing $255,000 cap with a payroll tax-based cap.

Under the payroll tax-based cap, a claimant that is unable to offset all of their R&D tax credits against their income tax liability would receive refundable R&D tax credits equal to or less than the amount of payroll taxes (PAYE, FBT, and ESCT) they have paid for the relevant income year. That is, the maximum amount of refundable R&D tax credits a person may claim in an income year is the lesser of:

* The amount of payroll taxes paid by the person for the relevant income year; or
* The amount of R&D tax credits claimed by the person.

The proposed payroll tax-based cap would not apply to refundable R&D tax credits paid to levy body researchers or derived from eligible expenditure on approved research providers.

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| **Example 7: Fully refundable credits (because payroll taxes paid exceed refundable credits claimed)**In the year ended 31 March 2021, Edmonds Bros Ltd (EBL) has eligible R&D expenditure of $1,000,000, so is eligible for $150,000 of R&D tax credits. EBL has no income tax liability to offset its R&D tax credits against.EBL has 10 full time employees and has paid payroll taxes of $200,000 for these employees. EBL is able to receive an R&D tax credit refund of $150,000, because its R&D tax credits are less than its total payroll taxes paid for the year.

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| **Edmonds Bros Ltd – 31 March 2021** |
| Eligible R&D expenditure | $1,000,000 |
|  | x 15% |
| **R&D tax credits claimed** | **$150,000** |
|  |  |
| Income tax liability | $0 |
| **Remaining R&D tax credits\***  | **$150,000** |
|  |  |
| Total payroll taxes paid | $200,000 |
| Remaining R&D tax credits\* | $150,000 |
| **R&D tax credits refunded** | **$150,000** |

*\* after offsetting against income tax payable* |

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| **Example 8: Insufficient payroll taxes paid to refund all credits**In the year ended 31 March 2021, Bags & Archie Ltd (BAL) has eligible R&D expenditure of $1,000,000, so is eligible for $150,000 of R&D tax credits. BAL has no income tax liability to offset its R&D tax credits against.BAL has 5 full time employees and has paid payroll taxes of $100,000 for these employees. BAL is only able to receive an R&D tax credit refund of $100,000, because its R&D tax credits are more than its total payroll taxes paid for the year. Its remaining $50,000 of R&D tax credits must be carried forward to the 2021–22 income year.

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| **Bags & Archie Ltd – 31 March 2021** |
| Eligible R&D expenditure | $1,000,000 |
|  | × 15% |
| **R&D tax credits claimed** | **$150,000** |
|  |  |
| Income tax liability | $0 |
| **Remaining R&D tax credits\***  | **$150,000** |
|  |  |
| Total payroll taxes paid | $100,000 |
| Remaining R&D tax credits\* | $150,000 |
| **R&D tax credits refunded** | **$100,000** |
| **R&D tax credits carried forward to 2021–22** | **$50,000** |

*\* after offsetting against income tax payable* |

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| **Example 9: Credits paid to levy bodies are fully refundable**Levy Body A (LBA) is an industry organisation to which levies are payable under the Commodity Levies Act 1990. LBA incurred $1,000,000 of eligible R&D expenditure in the year ended 31 March 2021. It has no income tax liability and pays $50,000 of payroll taxes for the year. LBA receives a full refund of its $150,000 R&D tax credits, because the payroll cap does not apply to levy body researchers.

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| **Levy Body A – 31 March 2021** |
| Eligible R&D expenditure | $1,000,000 |
|  | × 15% |
| **R&D tax credits claimed** | **$150,000** |
|  |  |
| Income tax liability | $0 |
| **R&D tax credits refunded**  | **$150,000** |

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### Allocating payroll taxes paid by other companies

The proposed payroll tax-based cap would include payroll taxes allocated to the claimant that have been paid by other companies. This is through proposed new sections LA 5(5B) and (5C), which provide the formula for calculating the payroll tax-based cap:

*own payroll + other wholly-owned payroll + other controller payroll – double dip allocation*

**Table 2: Definitions for the proposed formula**

| **Term** | **Definition** |
| --- | --- |
| Own payroll | The total payroll taxes paid by a claimant for the relevant tax year. |
| Other wholly-owned payroll | The amount of payroll taxes allocated to the claimant that have been paid by a member of the claimant’s wholly-owned group for the relevant tax year. |
| Other controller payroll | The amount of payroll taxes allocated to the claimant that have been paid by a company that controls the claimant for the relevant tax year. |

The “double-dip allocation” part of the formula strips out any amounts allocated to a claimant that have already been allocated to another person. This prevents the same payroll taxes going towards more than one claimant’s payroll tax-based cap.

It is important that any given amount of payroll taxes is only allocated to one claimant.

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| **Example 10: R&D company controlled by another company**R&D Co is an R&D-intensive firm that is eligible for $300,000 of R&D tax credits in the 2020–21 income year. R&D Co is in a tax loss position, so does not have any income tax liability to offset its R&D tax credits against.R&D Co pays $50,000 of payroll taxes for the 2020–21 income year. The $50,000 is considered “own payroll” for the purposes of the formula.R&D Co is in the same wholly-owned group as B Co. B Co pays payroll taxes of $200,000 in the 2020–21 income year. B Co allocates $100,000 of its payroll taxes to R&D Co for the purposes of calculating R&D Co’s payroll tax-based cap. B Co does not allocate these payroll taxes to any other companies, and does not use the $100,000 for the purposes of calculating its own payroll tax-based cap. The $100,000 is considered “other wholly-owned payroll” for the purposes of the formula.R&D Co is controlled by A Co, which owns sixty five percent of the shares in R&D Co. A Co pays payroll taxes of $100,000 for the 2020–21 income year. A Co does not claim any R&D tax credits in the 2020–21 income year, so it decides to allocate all of its payroll taxes ($100,000) to R&D Co for the purposes of calculating R&D Co’s payroll tax-based cap. A Co does not allocate its payroll taxes to any other companies. The $100,000 is considered “other controller payroll” for the purposes of the formula.In summary, R&D Co’s payroll tax-based cap is made up of these amounts:* Own payroll: $50,000.
* Other wholly-owned payroll: $100,000.
* Other controller payroll: $100,000.
* Double dip allocation: $0.

Applying the formula:$50,000 + $100,000 + $100,000 − $0 = $250,000Since R&D Co has a payroll-tax based cap of $250,000, it can obtain an R&D tax credit refund for $250,000 of its credits. Its remaining $50,000 of R&D tax credits are non-refundable in the 2020–21 income year. R&D Co can carry its non-refundable credits forward to the 2021–22 income year provided it satisfies the R&D tax credit shareholder continuity requirements. |

### Ordering rules for R&D tax credits (section LA 5(4B))

The proposed amendment to section LA 5(4B) retains a reference to section LA 6(2), which relates to the treatment of refundable tax credits. It is proposed that any R&D tax credits claimed by a person must first be used to satisfy their income tax liability, if any, for the income year to which the credits relate (note that non-refundable R&D tax credits are applied to satisfy income tax liability before refundable R&D tax credits).

Once a person has used their credits to satisfy their income tax liability for that year, different rules apply depending on whether any remaining R&D tax credits are refundable or non-refundable.

Table 3: Rules for treatment of remaining R&D tax credits

| **Non-refundable credits** | **Refundable tax credits** |
| --- | --- |
| Any remaining non-refundable tax credits can only be offset against income tax liabilities in the current year and must then be carried forward. | Before any remaining refundable R&D tax credits can be refunded, the credits must first be applied to any other liabilities in this order:1. An income tax liability for the current year;
2. An income tax liability for a previous year;
3. An income tax liability for a future tax year;
4. A current provisional tax liability for a future tax year; and
5. A different tax period or type (as requested by the claimant, or as applied by Inland Revenue if the claimant has any other tax outstanding).
 |

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| **Example 11: Refundable credits from approved research provider expenditure and application of ordering rules**In the year ended 31 March 2021, Kimmie’s Lab Ltd (KLL) incurred $50,000 of eligible R&D expenditure. Of the $50,000 of eligible R&D expenditure, $30,000 was incurred on eligible R&D activities performed by an approved research provider. KLL had $2,000 of income tax payable for the year and did not pay any payroll taxes.KLL is eligible for $7,500 of R&D tax credits:* $4,500 of refundable R&D tax credits ($30,000 of approved research provider expenditure × 15%); and
* $3,000 of non-refundable R&D tax credits ($20,000 of other eligible R&D expenditure).

Before receiving an R&D tax credit refund, KLL’s R&D tax credits must first be offset against its income tax liability for the year. KLL offsets $2,000 of its non-refundable R&D credits against its income tax liability of $2,000. KLL receives an R&D tax credit refund of $4,500 for the income year. Its $1,000 of surplus non-refundable R&D tax credits can be carried forward to the 2021–22 income year provided KLL satisfies the R&D tax credit shareholder continuity requirements.

|  |
| --- |
| **Kimmie’s Lab Ltd – 31 March 2021** |
| Eligible R&D expenditure on ARP | $30,000 |
| Other eligible R&D expenditure | $20,000 |
| **Total eligible R&D expenditure** | **$50,000** |
|  |  |
| Eligible R&D expenditure not on ARP | $20,000 |
|  | × 15% |
| **Non-refundable R&D tax credits** | **$3,000** |
|  |  |
| Income tax liability  | $2,000 |
| Less non-refundable R&D tax credits | ($3,000) |
| **Non-refundable R&D tax credits carried forward to 2021–22** | **($1,000)** |
|  |  |
| Eligible R&D expenditure on ARP | $30,000 |
|  | × 15% |
| **Refundable R&D tax credits**  | **$4,500** |

 |

### No corporate eligibility criteria for refundability (section LA 5(4B))

The proposed amendment to section LA 5(4B) would remove the corporate eligibility criteria (LA 5(4B)(a)(i)). The criteria currently restrict refundable tax credits to firms that:

* are companies;
* are New Zealand tax resident (both under domestic law and any applicable double tax agreements);
* don’t have fifty percent or more of their shares held by a public or local authority, crown research institute, or state enterprise;
* are not established by, or subject to, the Education Act 1989, the New Zealand Public Health and Disability Act 2000, or the Crown Entities Act 2004; and
* are not a listed company or otherwise listed on a recognised exchange.

Removing the corporate eligibility criteria may bring the following claimants within the scope of refundability from year two:

* all businesses regardless of their legal structure – including companies, partnerships, and trusts – provided they carry on business through a fixed establishment in New Zealand;
* levy body researchers;
* council controlled organisations and state enterprises; and
* listed companies.

### No wage intensity criteria for refundability (section LA 5(4B))

The proposed amendment to section LA 5(4B) would also remove the wage intensity test (section LA 5(4B)(a)(ii)). Currently, the wage intensity test requires at least twenty percent of a firm’s labour costs to be R&D related.

# Timeframe for completing disputes process

***(Clauses 122 and 123)***

## Summary of proposed amendment

The Bill proposes an amendment to allow the Commissioner to adjust a person’s R&D tax credit claim upwards if the person has initiated the disputes process through issuing a notice of proposed adjustment (NOPA) within four months of filing their income tax return or a year after their income tax return due date.

## Application date

The proposed amendment would apply from a business’s 2019–20 income year.

## Key features

It is proposed that sections 108(1E) and 113E of the Tax Administration Act 1994 be amended to allow the Commissioner to adjust a person’s R&D tax credit claim upwards if the person has initiated the disputes process through issuing a NOPA before the earlier of:

* four months of filing their income tax return; or
* a year after their income tax return due date.

## Background

A person can only file a NOPA to increase their R&D tax credit claim once for each R&D tax credit claim they make (section 113E).

The legislation currently requires the disputes process to be completed within a year of a person’s income tax return due date if the person seeks to increase their R&D tax credit claim. This is contrary to the policy intent, which is that a person must **initiate** the disputes process within a year of their income tax return date. The policy rationale for this rule is to prevent the retrospective reclassification of expenditure.

The retrospective reclassification of expenditure includes where R&D activities or expenditure are identified after the end of an income year. If a person receives R&D tax credits for R&D they were unaware of at the time the R&D activities took place, the R&D tax credit regime has not provided any incentive to the person to undertake additional R&D. The retrospective reclassification of expenditure has been problematic in other jurisdictions.

The proposed amendment will require a person to initiate the disputes process by filing a NOPA within a year of their income tax return due date but does not require the disputes process to be completed within this time frame. This time limit is intended to provide a person with enough time to prepare the required information to file a NOPA while nevertheless discouraging the retrospective reclassification of expenditure.

# Declining R&D certifier applications

***(Clause 127(1) and (3))***

## Summary of proposed amendment

The Bill proposes an amendment to clarify the circumstances in which a person’s R&D certifier status will be declined. The amendment allows the Commissioner to decline a person’s application where approving the person as an accepted R&D certifier would adversely affect the integrity of the tax system.

## Application date

The proposed amendment would apply from a business’s 2020–21 income year.

## Key features

It is proposed that section 124ZI of the Tax Administration Act 1994 be amended so that the Commissioner can decline a person’s application to be an accepted R&D certifier, where approving the person’s application would adversely affect the integrity of the tax system.

## Background

Accepted R&D certifiers are able to provide R&D certificates to claimants in the significant performer regime. From the 2020–21 income year, all claimants will be required to either obtain activity approval under the general approval regime or opt into the significant performer regime. Significant performers must provide R&D certificates to the Commissioner with their R&D supplementary returns (which are due within 30 days of a claimant’s income tax return due date).

The proposed amendment provides the Commissioner with another ground for declining a person’s application to be an accepted R&D certifier. The amendment is consistent with the policy intent, which is that the Commissioner should be able to decline a person’s application where their status as an accepted R&D certifier would adversely affect the integrity of the tax system.

It is arguable that the Commissioner already has this ability because of section 6 of the Tax Administration Act 1994. For the avoidance of doubt, however, this amendment clarifies that the Commissioner can decline a person’s application in these circumstances.

# Revoking R&D certifier approvals

***(Clause 127(2) and (3))***

## Summary of proposed amendment

The Bill proposes an amendment to extend the circumstances in which the Commissioner can revoke a person’s accepted R&D certifier status. The amendment requires the Commissioner to revoke a person’s approval as an accepted R&D certifier where the accepted R&D certifier has provided an R&D certificate to another person in the last two years who has entered into a tax avoidance arrangement for R&D tax credits, or where allowing the accepted R&D certifier to retain their R&D certifier status would adversely affect the integrity of the tax system.

## Application date

The proposed amendment would apply from a business’s 2020–21 income year.

## Key features

It is proposed that section 124ZI of the Tax Administration Act 1994 be amended so that in addition to the grounds under which the Commissioner can currently revoke a person’s approval, the Commissioner can also revoke a person’s approval as an accepted R&D certifier where:

* allowing the person to retain their approval would adversely affect the integrity of the tax system; or
* the person has provided an R&D certificate to another person, and that other person has entered into a tax avoidance arrangement for R&D tax credits.

## Background

Claimants in the significant performer regime must obtain an R&D certificate from an accepted R&D certifier.

The proposed amendment to section 124ZI is consistent with the policy intent, which is not reflected in full by this provision as currently enacted. It provides the Commissioner with additional grounds to revoke a person’s approval as an accepted R&D certifier.

### Revoking approvals with adverse effect on tax system integrity

As with the other remedial amendment to section 124ZI regarding declining a person’s application to be an accepted R&D certifier, the policy intent is that a person would have their approval revoked if their retaining it would adversely affect the integrity of the tax system. It is arguable that the Commissioner already has this ability because of section 6 of the Tax Administration Act 1994. For the avoidance of doubt, however, this amendment clarifies that the Commissioner can revoke a person’s accepted R&D certifier status in these circumstances.

### Providing certificates to participants of tax avoidance arrangements

The legislation currently allows the Commissioner to revoke a person’s approval as an accepted R&D certifier if they have provided an R&D certificate in the last two years to a person who received shortfall penalties arising from tax evasion and taking an abusive tax position (this is through the references in section 124ZI(7)(b) to sections 141D and 141E). Tax avoidance may not always involve taking an abusive tax position, however, so this amendment is proposed so that providing an R&D certificate to a person who enters into a tax avoidance arrangement is another ground on which the Commissioner must revoke a person’s approval.

# Challenging the Commissioner’s decisions

***(Clauses 128 and 145)***

## Summary of proposed amendment

The Bill proposes an amendment to prevent a person from challenging the Commissioner’s decisions made for the pilot approval scheme and exceeding the $120 million cap.

## Application date

The proposed amendment would apply from a business’s 2019–20 income year.

## Key features

It is proposed that section 138E of the Tax Administration Act 1994 be amended so that a person cannot challenge the Commissioner’s decisions made for the pilot approval scheme (see sections 68CB and 68CC) and exceeding the $120 million cap (section 68CD).

## Background

### Pilot approval scheme

In year one of the R&D tax credit regime (the 2019–20 income year), a pilot approval regime will be in place. The pilot is aimed at enabling the Commissioner to test and refine the in-year approval regimes before they are rolled out more broadly in year two (the 2020–21 income year).

To be a part of the pilot, both the Commissioner and a person must agree that the person will take part in the pilot. The person will be required to submit an approval application by a prescribed date, which the Commissioner will then approve or decline. There is a legislative requirement that the Commissioner notify the person of her intent to decline their application before declining it. This is to provide the person with an opportunity to provide additional information in support of their application where appropriate.

It is proposed that taxpayers will not be able to challenge the Commissioner’s decisions made for the pilot approval scheme, other than through judicial review.

### Exceeding the $120 million cap

There is a cap of $120 million on the amount of eligible R&D expenditure for which a person can claim R&D tax credits. This equates to a cap of $18 million R&D tax credits. A person can apply to exceed the $120 million cap by applying for an approved R&D cap. The Commissioner can approve an application for an approved R&D cap if she is:

* satisfied the relevant R&D activities give rise to substantial net benefit for New Zealand; and
* she has consulted with the chief executive of the Ministry of Business, Innovation and Employment.

It is proposed that taxpayers will not be able to challenge the Commissioner’s decisions made about approved R&D caps. This is through adding section 68CD to section 138E(1)(e)(iv) from year one of the R&D tax credit regime.

### No right to challenge in other parts of R&D tax credit regime

Section 138E currently prevents a person from challenging the Commissioner’s decisions made about:

* approved research providers (sections 124ZH and 138E(1)(e)(iv));
* R&D certificates and certifiers[[3]](#footnote-3) (sections 124ZI and 138E(1)(e)(iv));
* general approval[[4]](#footnote-4) (sections 68CB and 138(1)(e)(iv)); and
* the significant performer regime[[5]](#footnote-5) (sections 68CC and 138E(1)(e)(iv)).

Adding sections 68CB, 68CC and 68CD to section 138E(1)(e)(iv) from year one of the regime is consistent with the approach taken in the rest of the regime regarding decisions made by the Commissioner. It is also consistent with the policy intent, which is for decisions made by the Commissioner regarding the R&D tax credit to be final and not subject to challenge other than through judicial review.

# Allocating credits to joint venture members

***(Clause 105)***

## Summary of proposed amendment

The Bill proposes an amendment to correct the allocation of R&D tax credits claimed for R&D activities performed by joint ventures, so that these credits are allocated in accordance with members’ interests in the joint venture rather than the members’ interest in the income of the joint venture.

## Application date

The proposed amendment would apply from the 2019–20 income year.

## Key features

It is proposed that section LY 1(4) of the Income Tax Act 2007 be amended so that credits are allocated in accordance with each member’s interest in the joint venture. This is to ensure the provision operates as intended for joint ventures regardless of whether they derive income. The onus will be on joint venture members to use an appropriate methodology to determine their interests in the joint venture for the relevant income year.

Section LY 1(4) currently requires credits claimed for R&D activities performed by unincorporated joint ventures to be allocated in accordance with each member’s interest in the income of the joint venture.

# Internal software development expenditure

***(Clause 113(5))***

## Summary of proposed amendment

The Bill proposes an amendment to broaden the definition of internal software development expenditure subject to the $25 million cap, so that it includes all software development expenditure that isn’t external software development or software development undertaken for the purpose of internal administration.

## Application date

The proposed amendment would apply from the 2019–20 income year.

## Key features

It is proposed that the definition of “internal software development expenditure” in section YA 1 of the Income Tax Act 2007 be amended because the current definition may not cover expenditure on all activities that would be normally considered internal software development (such as operational internal software development). The expanded definition would cover any software development expenditure that isn’t:

* software development undertaken for the purpose of internal administration of a person’s business or their associate’s business (this comes within the existing definition of “ineligible internal software development” in YA 1); or
* external software development expenditure.

## Background

“Internal software development expenditure” is currently defined in section YA 1 to:

* include expenditure/loss incurred on developing software to provide services, if the main reason recipients of the software use the software is not to use the software or technology but rather the services themselves; and
* exclude external software development expenditure (which is expenditure/loss incurred on developing software if the software is developed mainly for the purpose of sale/disposal to third parties, either in its own right or as an integral part of goods disposed of in the ordinary course of business).

Without the proposed amendment, it is likely that contrary to the policy intent, some internal software development expenditure (such as operational internal software development expenditure) would either be completely excluded through the definition of ineligible internal software development or be completely uncapped.

Other policy and remedial changes

# Employee share schemes – definition of market value

***(Clauses 69 and 71)***

## Summary of proposed amendment

The proposed amendment expands the definition of “market value” in the Income Tax Act 2007 (ITA) for the purposes of the employee share scheme (ESS) rules to include a 5-day “volume weighted average price” or an equivalent, and other methods accepted by the Commissioner of Inland Revenue. This will make it easier for companies to value their shares, reducing compliance costs and improving accuracy of valuations.

## Application date

The proposed amendment would apply retrospectively from 29 September 2018 for the purposes of the general ESS rules, the date from which the reforms to the general ESS rules came into effect. For the purposes of the exempt ESS rules, the proposed amendment would apply from 29 March 2018, being the date the amendments to those rules came into effect.

## Key features

Currently, the definition of “market value” in the ITA is the “middle market quotation”. For the purposes of valuing a share benefit received by an employee under the ESS rules, the definition will be expanded to include:

* the 5-day volume weighted average price or a comparable measure; or
* any other measure accepted by the Commissioner of Inland Revenue (for example, one of the methods set out in the Commissioner’s statement *Valuation of employee share schemes* (CS 17/01)).

## Background

For the purposes of valuing listed shares, “market value” is currently defined in section YA 1 of the ITA as being the “middle market quotation”. This is the average of the best buying and selling prices quoted by market makers, taken at the close of the market each day. Obtaining this middle market quotation is reported to be difficult in practice, and a much more common and practical measure is a “volume weighted average price”. This is equal to the total value of the shares traded divided by the number of shares traded over a particular time period. In her operational statement CS 17/01, the Commissioner accepts a 5-day volume weighted average price (among other methods) for valuing shares obtained under an ESS.

Expanding the definition of “market value” for the purposes of the ESS rules to include these methods will make it easier for companies to value their shares and reduce compliance costs.

# Takeovers and similar reorganisations under exempt employee share schemes

***(Clause 70)***

## Summary of proposed amendment

The proposed amendment adds an exception to the “restricted period” in the exempt employee share scheme (ESS) rules in the Income Tax Act 2007 (ITA) for takeovers and similar reorganisations.

## Application date

The proposed amendment would apply retrospectively from 29 March 2018, being the date the exempt ESS rules came into effect.

## Key features

Section CW 26C(7) of the ITA is amended to add an exception to the restricted period for the case of takeovers or other similar share reorganisations that are outside the control of the employee and apply equally to all shares.

## Background

In order for an exempt ESS to qualify as such, the terms of the scheme must provide that shares are held by the employer (or a trustee) for a period of time – generally three years – before they can be released to employees.

Exempt ESS trust deeds and similar constituting documents often provide for takeovers and other corporate reorganisations. There is concern that if an exception to the restricted period for takeovers or similar share reorganisations is included in the constituting document, the scheme may fail to meet the exempt ESS criteria. There is also a concern that if a takeover does occur, which can include the shares of minority interests being compulsorily acquired, this could breach the restricted period and mean the scheme fails to meet the statutory criteria; the shares may then become taxable at that time. This is despite these events being outside the control of the employee.

Adding an exception for takeovers and similar reorganisations to section CW 26C(7) of the ITA will ensure that companies and participating employees are not penalised for such uncontrollable events.

# Employee share schemes – flexibility to allow employees to keep shares if they leave employment

***(Clause 70)***

## Summary of proposed amendment

The proposed amendment to the exempt employee share scheme (ESS) rules in the Income Tax Act 2007 (ITA) will allow companies to choose whether employees who leave the company voluntarily are permitted to keep their shares, or whether they must have their shares purchased back by the company for the lesser of cost or market value. This amendment broadly aligns the treatment of these so-called “bad leavers” under the New Zealand exempt scheme rules with Australian exempt scheme rules, which will make it easier for trans-Tasman companies to offer the same scheme in both countries.

## Application date

The proposed amendment would apply retrospectively from 29 March 2018, being the date the exempt ESS rules came into effect.

## Key features

It is proposed that section CW 26C(8) of the ITA be amended to allow companies to choose, in the case of bad leavers, whether their trust deed or similar constituting documentation provides that either:

* employees can choose whether to keep the shares or have them bought back for the lesser of cost or market value; or
* the trustee/company must buy the shares back for the lesser of cost or market value.

## Background

Currently, upon expiry of the “restricted period” in section CW 26C(7), “good leavers” – employees whose employment ends due to their death, accident, sickness, redundancy, or retirement at normal retiring age – or their estate, can choose whether to keep their shares in the company or have the trustee buy them back for the lesser of cost or market value. “Bad leavers” – employees who leave for other reasons (for example, going to work for a competitor) – must have their shares bought back for the lesser of cost or market value. There is no option for the company to allow bad leavers to keep their shares. Therefore, there is less flexibility in the case of bad leavers.

One objective of the 2018 amendments to the ESS rules was to allow trans-Tasman companies to offer Australian exempt schemes to their New Zealand employees. However, the Australian exempt scheme requires that bad leavers must be able to keep their shares. Since this conflicts with New Zealand’s rule for bad leavers, it is difficult for trans-Tasman companies to offer the same scheme in both countries.

While Australian schemes can be amended for New Zealand employees, so as to comply with the New Zealand rules, this carries compliance costs and means New Zealand employees have a commercially less favourable ESS than their Australian counterparts. Aligning New Zealand’s exempt scheme rules with Australia’s rules by allowing companies to choose whether bad leavers can keep their shares will make it significantly easier for trans-Tasman companies to offer their schemes in both countries.

# Schedule 32 overseas donee status

***(Clause 114)***

## Summary of proposed amendment

The Bill proposes to amend the Income Tax Act 2007 by adding four charities to the list of donee organisations in schedule 32 of the Income Tax Act 2007.

## Application date

The proposed amendments would apply from 1 April 2019.

## Key features

It is proposed to add four charitable organisations to schedule 32 of the Income Tax Act 2007. Donors to these charities will be eligible for tax benefits on their donations.

## Background

Donors to organisations listed in schedule 32 are entitled as individual taxpayers, to a tax credit of 33⅓% of the monetary amount donated, up to the amount of their taxable income. Companies and Māori authorities may claim a deduction for donations up to the level of their net income. Charities that apply funds towards purposes that are mostly outside New Zealand must be listed in schedule 32 of the Income Tax Act 2007 before donors become eligible for these tax benefits.

## Detailed analysis

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

### Little Brothers and Sisters International

Little Brothers and Sisters International has been set up to support and work in partnership with Alongsiders International, the latter has a mentorship programme in 15 Asian and African countries which is directed at keeping potentially at-risk children in established education programmes.

### Partners Relief and Development – New Zealand

Partners Relief and Development – New Zealand was established in 2017 and works in association with a wider Partners Relief and Development network carrying out emergency relief and community development work in the developing world. It is active in South East Asia (Myanmar and Thailand) and the Middle East (Yemen and Syria).

### Project Moroto

Project Moroto was established in 2011 with the purpose of providing safe housing, upbringing, education and advancement of life to vulnerable or orphaned children in Uganda or other impoverished regions of Africa.

### UN Women National Committee Aotearoa New Zealand Incorporated

The UN Women National Committee Aotearoa New Zealand supports the work of the United Nations Entity for Gender Equality and the Empowerment of Women through contributing funds raised in New Zealand for UN Women projects in developing countries worldwide, but particularly those in the Pacific region.

# Widening the Commissioner’s power to put investors on the correct prescribed investor rate

***(Clause 99)***

## Summary of proposed amendment

The proposed amendments would enable Inland Revenue to notify a multi-rate portfolio investment entity (PIE) of a tax rate to apply for an investor in that PIE, irrespective of whether the investor has advised the PIE of their notified investor rate or been defaulted on to the top 28% rate.

## Application date

The proposed amendment would apply from 1 April 2020.

## Key features

An amendment is proposed to the PIE rules in the Income Tax Act 2007 to allow Inland Revenue to notify a multi-rate PIE where it is using an incorrect prescribed investor rate (PIR) for an investor and provide an alternative rate that the PIE must then use.

Such an amendment would widen the existing power in section HM 60(5) of the Income Tax Act 2007 which allows Inland Revenue to advise a PIE of an alternative tax rate to apply where an investor’s notified investor rate is different from their PIR (this provision currently does not cover investors who have been defaulted onto the top 28% PIE tax rate).

## Background

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 enacted changes meaning Inland Revenue is starting to receive more frequent employment and investment income information. One of the benefits of the timelier collection of income information is that Inland Revenue is better able to identify where an individual appears to be using an incorrect tax rate. This would include identifying instances where an investor’s PIE income is being taxed at an incorrect rate.

Section HM 60(5) of the Income Tax Act 2007 allows Inland Revenue to use the improved income information to provide an alternative tax rate to a multi-rate PIE that it must apply for an investor, where an investor has provided the PIE with a notified investor rate that is different from the investor’s actual PIR. However, Inland Revenue is currently unable to put an investor on their correct PIR where the investor has not notified the PIE of a tax rate to use in the first place and has been defaulted onto the top 28% rate. This means in many instances Inland Revenue would not be able to notify a PIE where an investor is being over-taxed.

The PIE tax rules apply to collective investment vehicles, including KiwiSaver funds. Under the PIE rules an investor’s PIR is based on the lower amount of taxable income (plus PIE income) that they derived in either of the previous two tax years. Investors are able to elect a tax rate for a PIE to apply (referred to as a “notified investor rate”).

Where an investor has not notified the PIE of a tax rate, then the top 28% PIE tax rate will apply by default. Tax is paid by a multi-rate PIE based on the rates of its investors.

Unless the investor has nominated a lower PIE tax rate than they should have, PIE tax is a final tax. Therefore, an investor will not get a refund for any overpayments – this includes situations where the investor is defaulted onto the top 28% rate and that rate is too high.

## Detailed analysis

Proposed new section HM 60(6) of the Income Tax Act 2007 would allow Inland Revenue to notify a multi-rate PIE where it is using an incorrect PIR for an investor, either where the investor has provided a notified investor rate to the PIE or the investor has been defaulted onto the top 28% rate and that rate is too high. Where Inland Revenue had notified a PIE that an investor was on an incorrect PIR, Inland Revenue would advise the PIE of an alternative tax rate that the PIE must use for the investor. These amendments would ensure Inland Revenue had the power to correct an investor’s tax rate, in all situations where an investor was on a tax rate that was different from their actual PIR.

Proposed new section HM 60(7) clarifies that where subsequent to Inland Revenue advising the PIE of the tax rate, the investor advises the PIE that a different PIR should apply, the PIE should apply the rate subsequently advised by the investor.

As a consequence of the proposed amendments, existing section HM 60(6) – relating to when an investor is defaulted onto the 28% PIE rate – will be re-ordered to become section HM 60(5).

### When PIE income treated as excluded income

Under existing section CX 56 of the Income Tax Act 2007 PIE income derived by an individual investor in a multi-rate PIE will generally be treated as excluded income of the investor (as tax will have already been paid on this income at the investor’s tax rate by the PIE). An exception to this rule is where an investor has provided a notified investor rate to a PIE that is lower than the investor’s actual PIR. Section HM 60(4) of the Income Tax Act 2007 provides that in this situation the PIE income will not be treated as excluded income to the investor under section CX 56 and the investor will be required to include it in their individual income tax return. They would then be required to pay tax on the PIE income at their marginal tax rate (although they would receive a credit for tax on this income that had already been paid by the PIE).

If Inland Revenue were to notify a PIE to apply a tax rate to an investor that was lower than their actual PIR the rule in section HM 60(4) would not apply, meaning that the PIE income would remain excluded income to the investor.

Clarifications and remedials

# Eliminating the requirement to estimate at the final instalment date for provisional tax

***(Clauses 110 and 125(4))***

## Summary of proposed amendment

This proposed amendment removes the requirement for taxpayers to switch to the estimate method at the final instalment of provisional tax when they believe their residual income tax for the year will be less than the standard instalments and retain the interest concession contained in section 120KBB of the Tax Administration Act 1994.

Taxpayers will continue to be able to pay what they consider is the amount remaining at the final instalment date without changing from the standard “uplift” method. This will reduce compliance costs to the taxpayer.

Taxpayers who do estimate at any time during the income year will be subject to the standard use of money interest (UOMI) rules in section 120KB of the Tax Administration Act 1994 and will potentially be subject to UOMI from the date of their first provisional tax instalment.

In practical terms, this will not affect any taxpayers as they will continue to do what they always have, however, the method in which they do that will alter. Furthermore, the compliance costs of having to make an estimate will be removed.

## Application date

The proposed amendment would apply from the 2019–20 income year.

## Key features

These changes will allow provisional taxpayers who use the standard method to pay provisional tax to pay an amount lower than the standard method obligation on the final instalment date without having to switch to the estimation method.

## Background

The interest concession rules are contained in section 120KBB of the Tax Administration Act 1994, these rules essentially allow those taxpayers who use the standard method and make the required payments to have no exposure to UOMI until the day after the final provisional tax instalment is due for the year.

This rule also applies to taxpayers who make the first two instalments using the standard method and make their final instalment under the estimation method. This rule was included in the final amending act due to a number of submissions made at the finance and expenditure committee which stated that if a person anticipated that their residual income tax (RIT) for the year in question was less than their uplifted provisional tax amount there was no legal ability for them to make a payment less than the standard instalment amount. This was notwithstanding the UOMI calculation would have calculated UOMI correctly and no late payment penalty would have been charged.

Example 12

Cookie Monsters Limited (Cookie) is a provisional taxpayer on a 31 March balance date who uses the standard uplift method. For the 2020–21 income year their standard instalments are based on 105% of their CY[[6]](#footnote-6)-1 RIT which was $200,000. This gives them 3 instalments of $70,000. They pay both the first and second instalments on time on that basis but by the time the third instalment is due Cookie has calculated that due to the ongoing pressure from anti-obesity campaigns the market for their high sugar and fat content signature biscuit, “The Clogger”, has dramatically reduced. Cookie’s estimate of their 2020–21 RIT is $23,000 for the year.

Cookie decides to estimate their final instalment of provisional tax and make no payment. Cookie will still be able to use the interest concession rules even though they estimated at their final instalment date. UOMI will apply from the date of the final instalment where its tax liability is more than payments made.

This creates a compliance cost on taxpayers who then must switch provisional tax methods at their final instalment date and file an estimate. It also potentially exposes them to penalties for lack of reasonable care in making a reasonable estimate.

## Detailed analysis

The proposed changes will allow taxpayers who make provisional tax payments under the standard method to vary their final instalment payment from the standard instalment to whatever they consider is owing at that date without having to switch provisional tax methods.

As UOMI will apply to any shortfall from the final instalment date taxpayers are always incentivised to pay their “actual” liability at that date and given the final instalment is some time after their balance date taxpayers should be able to reasonably accurately approximate the final amount payable.

The ability to use the estimation method will be removed from the interest concession rules in section 120KBB and therefore if a taxpayer estimates at any point during the year they will be under the estimation method for the entire year and potentially subject to UOMI from the date of the first instalment.

Practically, this will make no difference to taxpayers as they will continue to do the same as they always have but the compliance cost of switching provisional tax methods will be removed.

# Clarifying the “lesser of” calculation of interest for standard “uplift” taxpayers

***(Clause 109(2) and (3))***

## Summary of proposed amendment

The proposed amendment clarifies the legislation to reflect the application of the “lesser of” calculation for standard “uplift” taxpayers to ensure this aligns with the way in which UOMI is calculated in Inland Revenue’s technology platforms.[[7]](#footnote-7)

## Application date

The proposed amendment would apply from the 2018–19 income year as the amendment aligns the legislation with the treatment within Inland Revenue’s systems. The proposed amendment is concessionary compared to the current legislation.

## Key features

The proposed amendment aligns the application of the “lesser of” calculation of UOMI for standard “uplift” taxpayers with the way that Inland Revenue’s technology platforms have been calculating UOMI for those taxpayers. The proposed amendment provides that less UOMI is calculated than under the current legislation.

## Background

For taxpayers who qualify to be able to use the interest concession rules contained in section 120KBB of the Tax Administration Act 1994*,* UOMI is calculated on a different basis than for other taxpayers. Generally, a taxpayer will be exposed to UOMI on the difference between their actual liability for the year divided by the number of instalments and what they paid. For example, a taxpayer who has residual income tax[[8]](#footnote-8) (RIT) of $90,000 and has paid nothing will be charged interest on $30,000 at each instalment date (that is, $90,000 ÷ 3).

The interest concession rules operate differently and calculate UOMI (and late payment penalties) based on a “lesser of” rule contained in section 120KBB(3) of the Tax Administration Act 1994. This calculates UOMI on the difference between the lesser of the amount of the standard method instalment and the actual liability divided by the number of instalments. For example, if a taxpayer has an actual RIT of $40,000 at each instalment and their standard uplift instalments were $30,000 at each instalment date. UOMI for interest concession taxpayers will be charged on the $30,000 amounts less the amount paid at each instalment date (except for the final instalment which will have UOMI charged on the outstanding balance of RIT less payments made to date).

## Detailed analysis

The standard “uplift” provisional tax method allows taxpayers to base their provisional tax instalments for the year on 105% of the prior year’s (CY[[9]](#footnote-9)-1) RIT or 110% of the year previous to the prior year (CY-2) dependent on when they have filed their CY-1 tax return.

Up until the taxpayer files their CY-1 return a taxpayer will use 110% of the CY-2 RIT (initial uplift). When they file their CY-1 return and 105% of that RIT (the final uplift) is more than the initial uplift the system leaves the previous instalments at the initial uplift. The reason for this is that at that time the taxpayer made that payment, the only information they had to base the payment on was the initial uplift.

However, if the taxpayer files their CY-1 return and the final uplift is less than the initial uplift the system overwrites the initial uplift amount and replaces it with the lower final uplift amount. This is on the basis that once the taxpayer has filed their CY-1 return there is no ability to use the initial uplift and the final uplift effectively replaces that.

Logically these two rules make sense. If the initial uplift is lower than the final uplift, it should be used as it would be unfair to require a taxpayer to make a payment based on figures they had not yet calculated. Alternatively, if the final uplift is lower than the initial uplift that should replace the initial uplift as, firstly the taxpayer would have used that amount if they had known it at the time and, secondly, once that final uplift is known the initial uplift technically is no longer available. This rule will apply to instalments prior to the date the taxpayer files their CY-1 return (that is, the return with the final uplift).

Prior to the introduction of the interest concession rules this rule generally only mattered for the calculation of late payment penalties. Since the interest concession rule was introduced this distinction is more important as it affects the calculation of UOMI. As the lower of the two amounts is taken into account this treatment is taxpayer friendly, however, the distinction does matter when taxpayers transfer funds from a tax pool as they want to ensure they are making the correct transfer to avoid the payment of UOMI.

Inland Revenue’s legal team has determined that the legislation is not clear on this rule. The proposed amendment will clarify the legislation to ensure that the lowest amount of the initial or final uplift is used for the purposes of calculating UOMI and late payment penalties for instalments made prior to the date the taxpayer files the CY-1 tax return.

This rule does not change the obligation to pay either the initial or final uplift amounts in that if the taxpayers final uplift is less than their initial uplift they were still required to pay the initial uplift amount notwithstanding UOMI may not be charged on that basis. This will be important in determining if a taxpayer is an interest concession taxpayer if they are subsequently subject to a reassessment.

Both the FIRST and START systems apply this rule and thus the amendment will not affect taxpayers, but it will align the legislation with the system and policy intent.

# Clarifying the application of late payment penalties applicable from the final provisional tax instalment date

***(Clauses 124 and 130)***

## Summary of proposed amendment

An inadvertent legislative change meant that late payment penalties are applied to a taxpayer’s total provisional tax liability for the year rather than an instalment amount on the final instalment date. This proposed amendment aligns the legislation with administrative practice and with policy intention. As such, it will have no effect on taxpayers.

## Application date

The proposed amendment would apply from the 2017–18 income year to provide certainty to taxpayers.

## Key features

This change will align the legislation with Inland Revenue’s systems to ensure that late payment penalties are only calculated on an instalment amount at the date of the final instalment of provisional tax for the year rather than on the total outstanding tax liability at that date. UOMI will continue to accrue on the total tax liability outstanding. This change will align the legislation with the policy intent and the system configuration of Inland Revenue’s technology platforms.

## Detailed analysis

The interest concession rules are contained in section 120KBB of the Tax Administration Act 1994, these rules essentially allow those taxpayers who use the standard method and make the required payments to have no exposure to UOMI until the day after the final provisional tax instalment is due for the year.

When the interest concession rules were introduced it was seen as desirable to align the basis for the calculation of UOMI and late payment penalties. This was done in the legislation and for the instalments other than the final one this is working as intended as both UOMI and late payment penalties are calculated using the lower of the standard instalment (105% of CY-1 or 110% of CY-2) or one third of their current year RIT.

However, on the final instalment the legislation currently requires the same formula to be used to calculate UOMI and the late payment penalty amount.[[10]](#footnote-10) For the calculation of UOMI all of the taxpayer’s remaining tax liability is deemed to be due at the date of the third instalment as UOMI applies to that amount from the day after that date.

However, for late payment penalties this basis is inappropriate as charging a taxpayer for their entire RIT at that final instalment date is particularly unfair where they do not necessarily know the exact amount due. The basis for the penalty should be the lower of the instalment amount or one third of the taxpayer’s RIT. The legislation currently does not support this. Late payment penalties should only apply to an instalment amount rather than the total tax liability at that point although UOMI should apply on the full shortfall.

Inland Revenue’s systems have not been configured to reflect the legislation but have been configured to reflect the policy intent to charge a penalty based on the lower of the instalment amount or one third of the taxpayers RIT – the same basis as the other instalments.

It is desirable to align the legislation with the system in this case and change the legal basis for the calculation of the penalty on the final instalment to be the lower of the standard instalment due or one third of the taxpayer’s RIT.

In addition, the definition of RIT for the purposes of calculating UOMI will be clarified to ensure it more clearly refers to the taxpayer’s current year RIT.

# Removing the ability for taxpayers to choose the provisional tax instalment to which a particular payment is applied

***(Clause 126)***

## Summary of proposed amendment

The Tax Administration Act1994 contains a provision that permits a taxpayer to direct the application of a provisional tax payment made to a particular instalment. Inland Revenue’s legal team has recently reviewed the application of this provision. Prior to the introduction of the interest concession rules in section 120KBB of the Tax Administration Act 1994 and the removal of incremental penalties from income tax it was always beneficial for taxpayers to apply payments to the oldest debt first.

Since the introduction of the interest concession rules and removal of incremental penalties this is no longer true. A taxpayer might now inappropriately apply the payment to more recent debt in order to avoid late payment penalties.

Removing the ability of taxpayers to choose the particular instalment to allocate a provisional tax payment will eliminate this issue. It is also proposed that the section be clarified to specifically require the Commissioner to allocate the particular payment to the oldest debt first.

Inland Revenue’s systems do not allow the allocation of a payment to particular payment dates when there is debt on a prior provisional tax date.

This proposed amendment will have no impact on most taxpayers but will prohibit non-compliant taxpayers from reducing their exposure to late payment penalties.

## Application date

The proposed amendment would apply from the 2018–19 income year for integrity reasons. In the unlikely event of a taxpayer having previously requested and obtained a payment direction a savings provision will preserve this treatment.[[11]](#footnote-11)

## Key features

The ability for taxpayers to allocate their provisional tax payment to particular instalments will be removed and the Commissioner will be required to allocate payments to the oldest outstanding provisional tax instalment.

## Detailed analysis

The payment allocation rules for provisional tax payments are contained in section 120L of the Tax Administration Act 1994. These provide that if a taxpayer makes a provisional tax payment and does not specify which instalment it should be directed to, the Commissioner must apply the payment where she thinks the taxpayer would have applied it.[[12]](#footnote-12) Or if the taxpayer does specify which instalment, the Commissioner must apply the payment to that particular instalment.[[13]](#footnote-13)

Prior to the inclusion of the interest concession rules and removal of incremental late payment penalties[[14]](#footnote-14) from income tax it was always beneficial to apply payments to the oldest debt first as this would reduce the taxpayer’s liability to both incremental penalties and UOMI.

Since the interest concession rules were introduced it can be more advantageous for taxpayers to allocate their payments to specific provisional tax instalments to reduce their liability to late payment penalties on later instalments.

Example 13

Grouchy Limited is owned by Oscar and is a provisional taxpayer for the 2020–21 year. Its instalments are $25,000 at each provisional tax instalment. Oscar is a bit cash strapped and fails to pay the first instalment of provisional tax for Grouchy. Grouchy is charged a late payment penalty on the $25,000 debt of $1,250 as well as UOMI for that debt. At the second instalment date Grouchy has a spare $25,000 and decides to make a payment as provisional tax.

Prior to the removal of incremental penalties and the interest concession rules it would be more beneficial for Oscar to allocate that payment of $25,000 to the first instalment of provisional tax to reduce both incremental penalties and UOMI on that outstanding debt.

Subsequent to the changes Oscar now considers it more advantageous to allocate that payment to the second instalment. This will avoid any late payment penalties or UOMI arising on that payment. Given that there are no further late payment penalties on the debt from the first instalment and only UOMI is accruing on that, he will be $1,250 better off by allocating the payment to the second instalment.

This example is not appropriate. It gives a benefit to taxpayers who have outstanding debt. In addition, both the FIRST system and the configuration of the START system cannot allocate payments in this manner.

The proposed amendments remove the ability for taxpayers to request which provisional instalment their payment is allocated to. This will remove the ability for non-compliant taxpayers to reduce their exposure to late payment penalties and UOMI. In addition, it is recommended that a provision be added to the legislation to require the Commissioner to apply payments to the oldest unpaid instalment first.

# Clarifying the way in which provisional tax is truncated to whole dollars

***(Clause 110)***

## Summary of proposed amendment

It is Inland Revenue’s operational practice to truncate provisional tax amounts to whole numbers and its technology platforms have been designed in keeping with that practice.

However, Inland Revenue’s legal team has concluded that the way in which its technology platforms truncates instalments to whole numbers is not consistent with the legislation.

Inland Revenue’s systems have been configured to apply these rules on truncated whole dollars and will not prevent taxpayers receiving a concession when partial dollars are truncated. The proposed amendment confirms that configuration. In practical terms, this amendment will not affect any taxpayers.

## Application date

The proposed amendment would apply from the 2019–20 income year.

## Key features

The proposed amendment would confirm that where Inland Revenue systems truncate provisional tax amounts to whole numbers, payment of those whole dollar amounts rather than the amount including cents will be considered to meet the requirements to take advantage of concessionary regimes such as the safe harbour.

## Detailed analysis

Truncating to whole dollars for any instalment is beneficial to taxpayers both through simplicity and marginally financially. However, it can have negative consequences when assessing whether taxpayers meet certain requirements, such as the safe harbour[[15]](#footnote-15) from UOMI. If cents are included and taxpayers pay the truncated whole dollar amount which the system has told them to pay, technically, they do not meet the requirements of the safe harbour.

Inland Revenues legal team has recently reviewed the legislation that deals with the calculation of provisional tax instalments and the application of UOMI to any shortfalls.

One of their conclusions is that the legislation and the system do not align for the way in which amounts are truncated. When provisional tax instalments are calculated under the standard method the legislation requires the uplifted amount to be divided into three equal instalments. For simplicity to taxpayers the system ignores, or truncates, any cents in that calculation.

For example, assume that Grover Limited is a provisional taxpayer who uses the standard uplift method. Their RIT for the 2020–21 income year was $124,567. This will make their standard method uplift amount for the following year $130,795.35. Grover’s three instalments will be calculated as follows:

Table 4: Truncation calculation example

|  |  |  |  |
| --- | --- | --- | --- |
| **Instalment** | **Calculation** | **Amount of instalment** | **Truncated amount** |
| 1 | $130,795.35 ÷ 3 | $43,598.45 | $43,598 |
| 2 | ($130,795.35 × (2 ÷ 3)) − $43,598.45 | $43,598.45 | $43,598 |
| 3 | ($130,795.35 − $43,598.45 - $43,598.45) | $43,598.45 | $43,599 |
| Total |  | $130,795.35 | $130,795 |

However, to determine whether a taxpayer has met the criteria for the interest concession rules, for example, technically the taxpayer should have paid the instalment outlined in the amount of instalment column in table 4, which is $43,598.45. The system does not use this amount and assesses the ability to use concessions based on the truncated whole number.

This is a taxpayer friendly treatment and is much simpler. This proposed amendment would align the legislation with the system to ensure that taxpayers are not prohibited from using a concession because they have not paid the cents for an instalment.

# Non-standard provisional tax instalments

***(Clause 129)***

## Summary of proposed amendment

An amendment was made to section 139B(6)(bb) of the Tax Administration Act 1994 when the interest concession rules in section 120KBB were inserted into the Tax Administration Act 1994 to ensure the definitions worked with the new rules. A taxpayer that has more or less than three instalments of provisional tax, were not correctly dealt with and this should be corrected for clarity.

## Application date

The proposed amendment would apply from the 2019–20 income year.

## Key features

This proposed amendment alters section 139B(6)(bb) of the Tax Administration Act1994 to account for taxpayers who have a non-standard number of instalments of provisional tax.

## Detailed analysis

When the interest concession rules were introduced in the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 a late change was made to the legislation to deal with taxpayers who had more or less than three instalments of provisional tax.

A number of references were correctly altered in the final Act to account for this change, however, one appears to have been missed. A definition in section 139B(6) of the Tax Administration Act 1994 was not updated for the inclusion of these taxpayers and still refers to three instalments of provisional tax.

While this has not adversely affected any taxpayers as Inland Revenue has applied that section as it was intended officials suggest this now be corrected to account for taxpayers who have more or less than three provisional tax instalments from the 2019–20 income year.

# Taxation of trusts

***(Clauses 59, 87 to 97, and 113(16) to (20))***

## Summary of proposed amendments

The proposed amendments arise from an administrative review of the taxation of trusts which identified several areas in the current law that are unclear or do not appropriately reflect the policy intent.

The proposed amendments are:

* remedial in nature; and
* clarify the trust rules so that they work as intended, as described in IS 18/01.

## Application date

The proposed amendments would apply from the date of enactment unless otherwise stated in this commentary item.

## Detailed analysis

The Commissioner’s application of the Income Tax Act 2007 (ITA) relating to the taxation of trustees and beneficiaries (the trust rules) is set out in *Interpretation statement IS 18/01 Taxation of trusts – income tax*[[16]](#footnote-16) (IS 18/01).

### Clause 59: Clarifying the relationship between section BB 2 and BF 1

The core provisions of the ITA (the core provisions) impose:

* income tax on taxable income, withholding taxes on some classes of income and other forms of tax (termed ancillary tax); and
* provide the method for calculating a person’s income tax liability links to parts of the Act that set out detailed mechanisms for calculating withholding tax and ancillary taxes.

The proposed amendment ensures that the wording in section BB 2(5) refers to both income tax and ancillary tax, to provide consistency in terminology between sections BB 2(5) and BF 1 (ITA 2007).

### Clause 87: Residence of a trustee treated as a notional single person

In the ITA 2007, the term trustee is defined to include all co-trustees for the time being. Under section HC 2 of the ITA, co-trustees are treated as a notional single person for satisfying the income tax obligations for trustee income of that trust.

Under the core provisions, the source of the income and the residence of the trustee are important for determining the income tax obligations for trustee income. These obligations are determined by either:

* the residence of the trustee (a New Zealand resident trustee is taxable on world-wide trustee income);
* the source of the income (New Zealand taxes income sourced in New Zealand);
* the residence of the settlor, if the trust derives foreign sourced income (New Zealand taxes foreign sourced income only if the settlor of the trust is a New Zealand resident).

Under IS 18/01 and *Interpretation statement 16/03: Tax residence*[[17]](#footnote-17) (IS 16/03), the Commissioner considers that the current law treats co-trustees as resident in New Zealand as follows:

* at any point in time, or for a period, the trustee (as a notional single person) is a New Zealand resident if at least one of the co-trustees is resident in New Zealand at that time or for that period; and
* correspondingly, the trustee (as a notional single person) is a non-resident only if all the co-trustees are non-resident at that time or for that period.

The proposed amendments to section HC 2 align the law with how the Commissioner applies the law. As a result, the residence of co-trustees is determined (as described above) for:

* calculating the trust’s taxable income for an income year;
* providing a joint return of income for the trust for each income year;
* assessing the trust’s taxable income and income tax liability for each income year;
* satisfying the income tax liability on trustee income of the trust for each income year; and
* satisfying the trustee’s obligations as an agent under section HC 32 for a distribution of beneficiary income and a taxable distribution.

#### Application date

The proposed amendment would apply for income years beginning after enactment date.

### Clause 88: Corpus of a trust

#### What is not included in corpus

The proposed amendment to section HC 4(1) clarifies that if a settlement is not capable of being distributed as income to beneficiaries, it cannot be included in the corpus of the trust, that is, the assets such as property, bank accounts, stocks, etc.

For example, the value of free legal services provided to a trustee for the benefit of the trust is a transfer of value (unless those services are incidental to the operation of the trust). Under current law, the value of those free services:

* the person providing the legal services is a settlor of the trust (the residence of the settlor is important for determining whether a trust is a foreign trust);
* constitute a settlement; and
* is not capable of being distributed.

#### Consistency with section HC 3 (ITA)

Under trust law, each settlement creates a separate trust. For income tax purposes, this is modified to permit trustees to elect to treat multiple property settlements on the terms of a trust deed as being additions to corpus of the same trust (section HC 3 of the ITA). The value of each settlement is equal to the market value at settlement.

The proposed amendment (new section HC 4(1B)) clarifies that, when a trustee treats multiple property settlements as being on one trust, the total value of corpus is the market value of all those property settlements. This clarification:

* is consistent with practice; and
* ensures that the ordering rules for distributions (section HC 16 of the ITA) can be applied in a manner consistent with the ability of trustees to elect for multiple settlements to be treated as being on one trust for income tax purposes.

### Clause 89: Exclusions from corpus that are treated as trustee income

The policy purpose for excluding property settlements from corpus under section HC 7(3) is to mitigate against a deferral of tax.

The proposed amendment clarifies that when a settlement excluded from corpus it is included in trustee income for the income year in which the settlement occurred unless the income is distributed in the same income year to a beneficiary. The amendment is proposed to apply from 1 April 2008 to validate tax parties taken on this basis.

If the trustee distributes this income as beneficiary income or a taxable distribution in the same income year (which is taxed to the beneficiary), the amount of trustee income for a settlement excluded from corpus is reduced by the amount of that distribution.

The proposed amendment applies to the following types of resettlements so that the beneficiary and not the trustee is taxed if that re-settlement is distributed to a beneficiary in the same year:

* A re-settlement by a trustee on a sub-trust that could otherwise have been distributed as income that would be taxable to a New Zealand resident beneficiary.
* A settlement that is an allowable deduction for the settlor (for example, an employer’s contribution to a trust that provides non-retirement benefits for employees).
* A settlement that would otherwise be income of the settlor and assessable for income tax in New Zealand.

### Clause 90: Election to be a complying trust

The proposed amendment to section HC 10(1)(ab) clarifies the point in time from when a trust may be treated as a complying trust if an election has been made to pay New Zealand tax on worldwide trustee income.

The main clarification is that a trust will be a complying trust for a distribution of trustee income earned after the application date of election.

Under the proposed amendments to section HC 33 in clause 97, a trust may elect to alter its status from a foreign trust or a non-complying trust to become a complying trust, but only from the date from which the election applies.

The proposed amendment confirms that a complying trust is either:

* a trust that has always had a New Zealand resident settlor and has always satisfied its New Zealand tax obligations on its taxable income; or
* a trust that has elected (or is deemed to have elected) to pay New Zealand tax at the trustee rate on world-wide trustee income and from the date the election applies, the trust has always satisfied its New Zealand tax obligations for its taxable income.

This proposed clarification, together with the proposed amendments to section HC 33 (clause 97 refers), ensures that the taxation of distributions from a trust operates as intended for tax-paid trustee income and capital gains.

### Clause 91: Taxable distributions from foreign trusts and non-complying trusts

#### Clause 91(1): Source of a capital gain included in a taxable distribution

A distribution (other than beneficiary income) from a trust that is not a complying trust is subject to tax because it may consist of income and gains derived by the trustee that have never been subject to New Zealand tax.

This rule ensures that New Zealand tax cannot be avoided by sheltering income and capital gains in a foreign trust or in a trust that is non-compliant with New Zealand’s tax laws. Instead, when this sheltered income or gain is distributed to a beneficiary, the distribution is taxable to the beneficiary and the trustee is liable as agent to pay this tax. Such a distribution is termed a taxable distribution.

A taxable distribution may consist of tax-paid trustee income and certain capital gains arising in a year before the distribution is made. Ordering rules in section HC 16 determine the composition of a taxable distribution. Some clarifications for these ordering rules are discussed in the commentary item for clause 92.

A taxable distribution is treated as:

* income of the beneficiary, if it is distributed from a foreign trust and included in the calculation of the beneficiary’s assessable income and taxed at the beneficiary’s marginal rate of tax;
* excluded income of the beneficiary, if it is distributed from a non-complying trust. This amount is not included in the beneficiary’s assessable income but is instead subject to a special income tax at the rate of 45%; and
* for both cases, a non-resident beneficiary is not taxable on a foreign-sourced amount included in that taxable distribution.

Proposed new section HC 15(5C) of the ITA clarifies that the source of a capital gain included in a taxable distribution is determined by applying the source rules in section YD 4 of the ITA that apply to income. This clarifies that a non-resident beneficiary will not be taxed on a capital gain included in a taxable distribution if that capital gain is not sourced in New Zealand. This is because New Zealand taxes non-resident beneficiaries only on their income and gains sourced from New Zealand.

#### Clause 91(2): Taxable distribution not subject to the ordering rule

The proposed amendment to subsection HC 15(6) removes redundant wording relating to the tax consequences of distribution, transmission and gifts of property. These rules treat distributions of property from a trust as being made at market value and the omitted words are no longer necessary.

However, the provision of financial assistance or any services by the trust to beneficiaries at less than market value continues to be a taxable distribution in the year of the distribution (for example, rent-free house accommodation provided to a beneficiary of the trust). Such a distribution is not subject to the ordering rules in section HC 16.

### Clause 92: Ordering rules

*Clause 92(1) to (5): Order of distributions*

The current ordering rules in section HC 16 of the ITA determine the amounts of tax-paid trustee income, capital gains and corpus that are included in a distribution to a beneficiary from either a foreign trust or a non-complying trust. The ordering rules do not apply to a distribution from a complying trust.

The current ordering rule is unclear on how a distribution of beneficiary income from a prior year is to be treated. This is because the ITA gives a trustee a period after the end of the income year to determine the amount of beneficiary income and provide for the distribution of that income.

The proposed amendments to section HC 16(2) of the ITA ensure that distributions of beneficiary income in the preceding and current years are treated as intended.

#### Clause 92(6), (7): Manipulating the nature of a distribution

Section HC 16(5) of the ITA is intended to prevent trustees using the ordering rule to manipulate the nature of a distribution for New Zealand tax purposes to stream income and capital to different classes of beneficiary (for example, resident and non-resident beneficiaries). The rule ignores the tax effect of an earlier distribution in determining whether a subsequent distribution would not be treated as either beneficiary income or a taxable distribution.

The proposed amendments address a question raised about whether the rule should apply to genuine transactions that result in a distribution of beneficiary income that is not placed beyond the control of the trustee. A normal practice for trustees is to credit a beneficiary’s current account for an amount of beneficiary income. However, this practice does not necessarily result in that amount of beneficiary income being placed beyond the control of the trustee, even though the amount of income that has been vested in the beneficiary.

The proposed amendments to section HC 16(5) clarify that the provision:

* applies to a second distribution that is not treated as either beneficiary income or a taxable distribution; and
* removes the requirement that the distribution be placed beyond the control of the trustee to ensure that commercial practices for vested distributions are not disturbed.

### Clause 93: Foreign sourced income, resident trustees

The proposed amendment to section HC 26 of the ITA addresses a question raised about the scope of the exemption for foreign sourced income derived by a resident trustee during an income year for a trust that does not have a New Zealand resident settlor at any time during that year.

The proposed amendment clarifies that foreign sourced income derived by such a trustee will be exempt income only if it is retained as trustee income. Therefore, the exemption will not extend to either:

* foreign sourced income that is distributed as beneficiary income; or
* minor beneficiary income that is attributed back to the trustee and taxed as if it were trustee income (33% tax rate applies).

### Clause 94: Who is a settlor – direct or indirect settlements

The administrative review of the taxation of trusts identified uncertainty about the scope of section HC 27 that deems a person to be a settlor of a trust for a series of transactions that result in a transfer of value to a trust.

The proposed amendment clarifies that for a person to be a settlor for an indirect transfer of value to a trust, that person must have some influence or control over the transactions involved so that it can be said that the person causes the transfer or provision to occur. IS 18/01 indicates at paragraph 2.62 a causative factor is more likely to occur where associated parties are involved.

### Clause 95: Activities treated as those of a settlor

The proposed amendments to section HC 28 clarify when a shareholder of a controlled foreign company (CFC) is treated as a settlor. If a CFC has settled a trust, it is intended that a shareholder in the CFC is also treated as a settlor of that trust if the shareholder has a control interest of at least ten percent in the CFC either:

* at the time of the settlement; or
* for the accounting period of the CFC in which the settlement occurs.

The proposed amendment aligns the law with the policy intent and is consistent with the Commissioner’s practice set out in IS 18/01.

### Clause 96: Valuation for transfer of values by deferral or non-exercise of right to demand payment

The proposed amendment (which inserts a new section HC 31B) addresses a question raised during the administrative review of the taxation of trusts relating to the valuation of financial assistance provided if there is:

* an obligation to repay interest or principal on demand;
* and the right to demand repayment is not exercised or is deferred.

The proposed new section provides a formula for calculating the value of either a settlement under section HC 27(2)(b) or a distribution arising from a transfer of value, in either case arising from:

* the provision of financial assistance (including a guarantee) by one person (the creditor) for the benefit of another person; and
* the right of the creditor to demand the debt amount, or a guarantee, is not exercised or is deferred.

The proposed formula is like the calculation of the value of a fringe benefit for on-demand shareholder current accounts and is consistent with the recent law change proposed for section HC 27(5) (see clause 56 of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill.

The formula is based on the nominal value of the financial assistance given (the debt amount) and the prescribed interest rate. The value of the distribution or settlement for any period (for example, an income year) is the amount by which the prescribed rate of interest (currently 5.77%) exceeds the actual rate of interest payable for the financial assistance.

If a trustee owes an amount to a beneficiary of the trust, the beneficiary will not be a settlor of the trust if either of the following applies:

* the trustee pays interest at a rate equal to or greater than the prescribed rate of interest; or
* the amount owing at the end of the income year is not more than $25,000.

### Clause 97: Elections to pay New Zealand tax on worldwide trustee income

#### Redundant wording omitted

Clause 97(1) proposes the removal of redundant wording from section HC 33(1B), consequential to other proposed amendments in this clause.

#### Notification requirements

Clause 97(2) proposes a clarification to section HC 33(1B) that treats a notification of complying trust status in a return of income as an election to pay New Zealand tax on the trust’s worldwide trustee income.

This deemed election applies to a trust that derives income that would either not be taxed in New Zealand or not be taxed at the trustee rate (33%) on any of the following classes of income:

* non-resident passive income (for example, dividends and interest derived by a non-resident trustee from a New Zealand source);
* non-resident’s foreign sourced income (for example, rents derived by a non-resident trustee from a foreign source); or
* foreign sourced income that is exempt income of a resident trustee under section CW 54 (the exemption applies to trustee income if the trust does not have a settlor resident in New Zealand).

The deemed election applies in any year in which the classes of income described above are not fully taxed in New Zealand. An example of such a trust is one that does not have a resident settlor because the settlor has migrated from New Zealand and the trust was a complying trust up to the migration. Because this trust no longer has a New Zealand resident settlor, it might not satisfy the requirements of section HC 10(1)(a) to be a complying trust because for example:

* if the trust has a non-resident trustee, foreign sourced income would not automatically be taxable in New Zealand under the rule in section HC 25 (a trust with a resident settlor is taxable on its world-wide trustee income);
* if the trust has a resident trustee, foreign sourced income may become exempt under section CW 54 (a trust with a non-resident settlor is taxable only on income sourced from New Zealand).

Under current law, this deemed election ensures that when a New Zealand resident settlor of a complying trust migrates out of New Zealand, the trust’s complying trust status is not disturbed provided the return of income from the year of migration indicates the trust is a complying trust and the trustee continues to pay New Zealand tax on the worldwide trustee income.

The proposed amendment clarifies that the deemed election can also apply to a registered foreign charitable trust, as such a trust is required to file an annual return of income for periods ending after 1 April 2019.

A trust that has previously elected to pay New Zealand tax on its world-wide trustee income may become an inactive trust. An inactive trust is a trust that derives no income, has no deductions, and makes not distributions to beneficiaries that are income of the beneficiary. An inactive trust may wish to retain this complying trust status after the trust notifies the Commissioner it has non-active status.

The proposed amendment clarifies that such a trust must notify the Commissioner on an annual basis that the election to pay New Zealand tax on world-wide trustee income is to continue. This requirement is to draw the trustee’s attention to the requirements for being a non-active trust, and to assist the Commissioner in identifying whether any distribution from such a trust is from a complying trust. It is expected that this requirement will be satisfied by notifying the commissioner through the trustee’s MyIR account.

#### Election requires taxable income to be calculated on world-wide trustee income at the trustee rate

Clauses 97(3) and (4) propose a clarification in new section HC 33(1C) to ensure that if an election is made for a trust to pay tax on its world-wide trustee income, it must calculate its taxable income:

* as if it had both a New Zealand resident trustee and a New Zealand resident settlor; and
* the obligations for New Zealand income tax on world-wide trustee income must be satisfied on that basis.

The interaction between the proposed amendments in HC 10 (clause 90), HC 33(1C) and HC 33(2)(a) mean that a trust electing to pay tax on world-wide trustee income can only be a complying trust if:

* New Zealand has full taxing rights to that world-wide trustee income;
* the New Zealand tax obligations for that trustee income are satisfied for each income year from the application date of the election (N.B. this requirement considers that foreign tax credits may be allowed to the trustee for foreign tax paid on trustee income not sourced in New Zealand).

#### Application date of elections

Clause 97(5) proposes to clarify in section HC 33(3) the date from which an election to pay New Zealand tax at the trustee rate applies:

* From the date of the election for a settlor who has migrated to New Zealand and who makes the election within either one year of the migration or one year of transitional residence ceasing.
* From the date chosen by the person making the election in other cases (this is either the date of the election or the beginning of the income year in which the election is made).
* For a deemed election (for example, for a trustee company that wasn’t aware the settlor of their client trust had migrated out of New Zealand), from the beginning of the first income year the return of income indicates the trust is a complying trust.

In addition, the proposed amendment in section HC 33(3B) clarifies that if the trust’s New Zealand tax obligations are not satisfied, the complying trust status is lost from the beginning of the income year in which those obligations are not satisfied.

#### Taxation of distributions from a trust that has elected to become a complying trust

Clause 97(6) proposes an amendment to insert a new subsection HC 33(5). This would apply for all trusts that have elected (or deemed to have elected) to pay New Zealand tax at the trustee rate on world-wide trustee income.

The proposed amendment clarifies that the tax treatment of a distribution of tax-paid trustee income or a capital gain from a trust that has elected to become a complying trust is dependent on:

* the compliance status of the trust at the time when the trustee derives the income or capital gain being distributed;
* the ordering rules that apply to determine the composition of distributions from a foreign trust or non-complying trust.

The proposed amendment ensures that distributions from tax-paid trustee income are treated as being made from a complying trust only if the distribution is made from trustee income is derived after the date from which the election applies. The ordering rules in section HC 16 are applied to determine the composition of a distribution.

For example, a non-complying trust elects to be a complying trust in March 2021, for the year beginning 1 April 2020 and the tax obligations for that trustee income are fully complied with from 1 April 2020. However, all distributions from trustee income and capital gains earned before 1 April 2020 would continue being treated as a distribution from a non-complying trust and included in a taxable distribution.

The amendment also proposes that, when all income and capital gains from the trust during the period it was a non-complying trust have been fully distributed, only then would distributions be treated as being made from a complying trust.

### Clause 113(16) to (18): Definition of transfer of value

#### Clearer distinction in terminology

The amendment proposed in clause 113(16) and (17) provide a clearer distinction in the definition of “transfer of value” in section YA 1 of the ITA. A distinction is drawn between a transfer of value relating to dividends paid by a company and a transfer of value relating to the meaning of the definitions of settlor and distribution. Clauses 63 to 68, 76, 77, 79, 82 and 86 propose consequential effects for this clarification.

#### Unintended legislative change corrected

In clause 113(18), it is proposed to clarify the definition of “transfer of value” to correct an unintended legislative change in the rewrite relating to the scope of the meaning of settlor, settlement and distribution. This proposed amendment restores the law to its pre-rewrite effect to ensure that a transfer of value by providing money’s worth occurs whether or not that money’s worth is convertible into money.

### Clause 113(19) and (20): Definition of trust rules

The proposed amendments ensure that the defined term “trust rules” in section YA 1 of the ITA refers to provisions that were inadvertently omitted from this definition during the rewrite of the trust rules.

The proposed amendment would apply from the beginning of the 2008–09 income year. This reflects the Commissioner’s practice.

# Tax credits for beneficiaries of trusts

***(Clause 104)***

## Summary

The proposed amendment:

* corrects an unintended legislative change in the rewrite of the provision; and
* restores the law to its Income Tax Act 2007 pre-rewrite position to ensure that tax credits attached to distributions from trusts are pro-rated by reference to the amount of all distributions made to beneficiaries.

## Application date

The proposed amendment would apply from the beginning of the 2008–09 income year. A savings provision is proposed to protect taxpayers who have taken a tax position in a manner consistent with the pre-rewrite legislation.

## Key features

Māori authority tax credits attached to a distribution from a trust are intended to be apportioned by reference to all distributions and all tax credits distributed from that trust.

An unintended legislative change in the rewrite of this provision resulted in the formula working incorrectly. The proposed amendment restores this aspect of the law so that it works as intended.

# Income attribution rule and foreign tax credits

***(Clauses 84 and 103)***

## Summary of proposed amendment

The proposed amendment addresses two issues raised about the income attribution rules in the Income Tax Act 2007 (ITA). If an associated entity of a working person under the rules pays tax overseas, a foreign tax credit (FTC) does not appear to be available to either the entity or the person for the foreign tax paid. The term “net income” is clarified to reflect the policy intent and how the Commissioner is applying the law.

## Application date

The proposed amendments would apply retrospectively from 1 April 2008, being the date from which an FTC is intended to be allowed.

## Key features

* Section GB 29 is amended to clarify how the calculation of the associated entity’s “net income”, which is attributed to the working person, interacts with the definition of “net income” in the ITA.
* Section LJ 2 is amended to ensure the working person receives an FTC for foreign income tax paid by an associated entity on an amount attributed to the working person.

## Background

The income attribution rules apply when an individual (“the working person”) earns income from providing their own services to a buyer (“personal services income”) through an interposed entity (“the associated entity”)[[18]](#footnote-18) that has one main source of such income. The rules disregard the entity and seek to tax the working person directly to ensure that the personal services income is taxed at the working person’s marginal rate, rather than at the company tax rate. Under the attribution rule:

* an amount attributed from the associated entity to the working person is income of the working person; and
* the associated entity is allowed a deduction for the amount attributed to the working person so that the personal services income derived by the entity is not subject to double taxation.

The proposed amendments to sections GB 29 and LJ 2 ensure that if the associated entity pays foreign income tax on its personal services income, the working person can obtain an FTC for that foreign tax.

## Detailed analysis

The proposed amendments seek to address:

* the clarity of the calculation in the income attribution rule; and
* the inability of the working person (who is a New Zealand resident) to obtain a foreign tax credit for foreign income tax paid on personal services income attributed to them from the associated entity.

### Income attribution rule

An issue has been identified concerning the use of the term “net income” in section GB 29, which provides the calculation for the amount of income to be attributed from the associated entity to the working person. Officials consider that the use of “net income” in this calculation is confusing. The Commissioner interprets this “net income” amount as ignoring the deduction allowed to the associated entity for the attribution of the net income amount, otherwise the provision is circular and therefore unclear.

The proposed amendment aligns the law with both the policy intent and how the Commissioner applies the law.

### Foreign tax credit

A person resident in New Zealand is allowed an FTC for foreign tax paid on an amount of foreign sourced income. The amount allowed as an FTC is the lower of:

* the NZ tax payable on that foreign sourced income; and
* the foreign income tax paid on that foreign sourced income.

Under the current law, it is not possible to treat foreign sourced personal services income derived by the associated entity as also being foreign sourced income of the working person. This prevents the working person (being a New Zealand resident) from receiving an FTC for foreign tax paid by the associated entity on that attributed income.

The proposed amendments ensure that:

* the working person receives an FTC for foreign tax paid by the associated entity on income attributed to the working person, provided they are a resident of New Zealand when the income is derived; and
* the associated entity does not receive a FTC for the foreign income tax paid on income attributed to the working person.

# Income attribution rule and treatment of dividends

***(Clause 83)***

## Summary of proposed amendment

The proposed amendment resolves an issue regarding one of the income attribution provisions in the Income Tax Act 2007 (ITA). The amendment ensures that a dividend paid by a company (“associated entity”) that has previously attributed income to a shareholder (“working person”) will be exempt only if the company can show that the dividend has been paid out of income that has already been attributed to and taxed in the hands of the working person.

## Application date

The proposed amendment would apply retrospectively from 1 April 2008, when section GB 27(4) came into force, with a savings provision (to apply from 1 April 2008 until the date of introduction of the Bill) to protect tax positions taken based on the existing law.

## Key features

Subsection GB 27(4) is amended to ensure that a dividend is exempt only if it is paid:

* by the associated entity to the working person no earlier than the end of six months after the end of the income year; and
* it is paid from personal services income that has been previously attributed to the working person under the income attribution rules.

There is an additional criterion that the entity must keep sufficient records to enable the Commissioner to verify the source of the dividend.

## Background

The income attribution rules apply when an individual (“the working person”) earns income from providing their own services to a buyer (“personal services income”) through an interposed entity (“the associated entity”)[[19]](#footnote-19) that has one main source of such income. The rules disregard the entity and tax the working person directly to prevent tax on income from the individual’s personal services being paid at the company rate of 28%, instead of at the working person’s marginal rate of tax.

The income attribution rules effectively distinguish between two types of dividend paid by an associated entity to the working person:

* a dividend paid during the income year in which the income was derived and is to be attributed, or before the end of six months after the end of that income year (“in-year dividend”);
* a dividend paid later than six months from the end of the income year in which the income was derived and attributed (“post-year dividend”).

The distinction between the two types of dividend is intended to ensure that:

* when calculating the amount of income to attribute to the working person, the associated entity can recognise in that calculation the amount of an in-year dividend paid out of personal services income derived by the associated entity;
* a dividend sourced from personal services income derived by the associated entity, and which has already been taxed to the working person, is not taxed a second time when it is paid to the person (post-year). This is achieved by exempting the post-year dividend in the hands of the working person.

The current wording in subsection GB 27(4), which treats post-year dividends as exempt from tax, is not sufficiently clear that its application is limited to dividends paid out of income that has already been attributed. Therefore, the proposed amendment more clearly limits the exemption to post-year dividends.

# Date withdrawal takes effect for binding rulings on matters not involving arrangements

***(Clauses 119 to 121)***

## Summary of proposed amendment

The amendments clarify that where the Commissioner of Inland Revenue has issued a private, short-process, or product ruling for an issue that does not involve an arrangement, and the ruling is withdrawn, taxpayers can continue to apply the ruling for the period specified in the ruling.

## Application date

The proposed amendments would apply for:

* private and product rulings from 18 March 2019; and
* short-process rulings from 1 October 2019.

## Key features

The key feature of the proposal is to make it clear that taxpayers can continue to rely on a private, short-process, or product ruling for the period specified in the ruling, if the ruling is on a matter not involving an arrangement.

## Background

The binding rulings regime is contained in Part 5A of the Tax Administration Act 1994. The provisions within Part 5A enable the Commissioner to issue binding rulings, which provide certainty to taxpayers about how the Commissioner will apply tax laws in relation to a person’s circumstances.

Until recently, the Commissioner was only able to issue binding rulings for an arrangement. Amendments included in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 extended the scope of matters for which the Commissioner could issue binding rulings (without the need for an arrangement) to allow rulings on:

* a person’s status (for example, on their New Zealand tax residency);
* whether an item of property meets the definition of “trading stock” or “revenue account property” as defined in section YA 1 of the Income Tax Act 2007; and
* whether an amount derived by a person is income under certain provisions in subpart CB of the Income Tax Act 2007 relating to land transactions.

The Commissioner has an existing ability to withdraw binding rulings under various provisions in the Tax Administration Act 1994. Where a ruling is withdrawn, if it relates to an arrangement, taxpayers can continue to rely on the ruling for the period specified in the ruling if they have already entered into the arrangement prior to receiving notification that the ruling has been withdrawn.

The existing rules do not cater for circumstances where a binding ruling is issued for a matter that does not involve an arrangement. An amendment is therefore proposed to allow taxpayers to continue to rely on a ruling for the period specified in the ruling where the ruling is for a matter not involving an arrangement.

## Detailed analysis

The Bill proposes to amend existing sections 91EI and 91FJ of the Tax Administration Act 1994. These provisions contain the rules for withdrawing private and product rulings.

The amendments provide that where a private or product ruling is issued for an issue that does not involve an arrangement, if that ruling is subsequently withdrawn, taxpayers can continue to rely on the ruling for the remainder of the period or tax year specified in the ruling.

It is proposed that these amendments apply from 18 March 2019 as this is the date from which the Commissioner can issue binding rulings on a broader range of matters without the need for an arrangement.

A corresponding amendment is also proposed to be included in proposed section 91ESB of the Tax Administration Act 1994 which would provide the Commissioner with the ability to withdraw short-process rulings. This amendment would apply for short-process rulings issued on or after 1 October 2019, which is the date from which the Commissioner can issue short-process rulings.

# Ability to withdraw short-process rulings

***(Clause 120)***

## Summary of proposed amendment

The proposed amendment provides the Commissioner with the ability to withdraw short-process rulings.

## Application date

The proposed amendment would come into force from the date of enactment and includes an application provision to ensure that the Commissioner is not precluded from withdrawing short-process rulings that are issued before the passing of this Bill.

## Key features

The key feature of the proposal is to provide the Commissioner with the ability to withdraw short-process rulings. The proposed amendment mirrors the existing rule which allows the Commissioner to withdraw private rulings.

## Background

The short-process binding rulings regime was introduced as a cheaper, more straightforward binding rulings service targeted at small-to-medium sized taxpayers as part of changes made to modernise core components of the Tax Administration Act 1994 by the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019.

The provisions within the Tax Administration Act 1994 that provide the rules for short-process rulings are modelled on the existing rules for private rulings. Section 91EI of the Tax Administration Act 1994 provides the Commissioner with the ability to withdraw private rulings, which may occur where there is a change in the interpretation of the law, or where the ruling needs to be withdrawn and reissued with a variation. A similar provision was inadvertently omitted from the rules for short-process rulings.

## Detailed analysis

Proposed section 91ESB of the Tax Administration Act 1994 would provide the Commissioner of Inland Revenue with the ability to withdraw a short-process binding ruling. The new section is modelled on the provision that allows the Commissioner to withdraw private rulings (section 91EI of the Tax Administration Act 1994).

A short-process ruling may be withdrawn (as in the case of a private ruling) where there is a change in the interpretation of the law (either by the courts or by the Commissioner) or where the ruling needs to be replaced with a variation.

Proposed section 91ESB(2) provides that where the Commissioner withdraws a short-process ruling, the withdrawal takes effect from the date of withdrawal which is included in the notice of withdrawal. The date cannot be earlier than the date on which the person could reasonably be expected to receive the notice of withdrawal.

Proposed section 91ESB(3) replicates the rule that allows the Commissioner of Inland Revenue to withdraw private binding rulings and provides that where a short-process ruling is withdrawn for an arrangement, the ruling no longer applies if the arrangement had not been entered into after the date of withdrawal. However, the ruling continues to apply for the period specified in the ruling, if the arrangement was entered into before the date of withdrawal.

Proposed section 91ESB(4) is included to make it clear that where the Commissioner issues a short-process binding ruling on a matter that does not involve an arrangement (such as on a person’s New Zealand tax residence status) and that ruling is subsequently withdrawn, the person can continue to apply the ruling for the period specified in the ruling.

It is proposed that new section 91ESB of the Tax Administration Act 1994 comes into force on the date of enactment. An application provision has been included to make it clear that the Commissioner is not precluded from withdrawing short-process rulings that were issued on or after 1 October 2019 (which is when the short-process rulings regime comes into force) but before the passing of the Bill.

# Bright-line main home exclusion

***(Clause 60)***

## Summary of proposed amendment

The main home exclusion for the bright-line test requires that a person use the land as their main home for most of the time they own the land. The proposed amendment aligns the period of ownership for the main home exclusion for the bright-line test with the period in the bright-line test itself.

## Application date

The proposed amendment would apply from the date of enactment.

## Key features

The proposed amendment clarifies that, for the purpose of the main home exclusion for the bright-line test in section CB 16A, the period a person owns the land is the same as the period that the bright-line test applies for. It is consistent with the policy intent for the periods to be aligned.

## Background

The main home exclusion for the bright-line test in section CB 16A applies where land has been used predominantly, for most of the time the person owns the land, for a dwelling that was the main home for the person.

“Own” is defined in section YA 1 for land as having an estate or interest land. “Estate or interest” is defined as including all estates and interests in land whether legal or equitable. Under these definitions, a person will typically own land from the date a binding contract to purchase the land is formed until the date of registration of the transfer on sale.

However, this period can be different from the period that is counted for the purpose of the bright-line test. Under section CB 6A(1), a person generally acquires land for the purposes of the bright-line test on the date the instrument to transfer the land to the person was registered. The bright-line test period ends on the “bright-line date”, which is defined in section CB 6A (7) as the earliest of the date the person enters into an agreement for the disposal of the land, or the date on which the land is disposed of (including by way of gift, compulsory acquisition or mortgagee sale).

Because the period that a person “owns” land for the purposes of the main home exclusion can be different from the period that the bright-line test applies for, it is possible that taxpayers may not be eligible for the main home exclusion because, although they have used land as their main home for most of the period the bright-line test applies to, they have not used it as their main home for most of the time they owned the land. The opposite could also occur.

# Consideration for grant of an easement

***(Clauses 61 and 62)***

## Summary of proposed amendment

The proposed amendments address the tax treatment of a one-off payment for the grant of a permanent easement. The proposals aim to ensure that *periodic* payments for a permanent easement and any payment for the grant of a *non-*permanent easement (whether one-off or periodic), should be taxable, but *one-off* payments for the grant of a *permanent* easement should not be taxable.

|  |  |  |
| --- | --- | --- |
| **Type of payment** | **Permanent easement** | **Non-permanent easement** |
| Periodic payment | Taxable | Taxable |
| One-off payment | Currently taxable, but should be non-taxable | Taxable |

## Application date

The proposed amendment would apply retrospectively from 1 April 2015, being the date from which the current provision that was intended to make one-off payments for a permanent easement non-taxable had effect.

## Key features

* Repealing section CC 1(2C).
* Introducing an exception for one-off payments for the grant of a permanent easement in section CC 1B.

## Background

There is currently an exclusion for one-off payments for the grant of a permanent easement in section CC 1(2C). However, in *Commissioner of Inland Revenue v Vector Limited* [2016] NZCA 396*,* the Court found, contrary to the policy intention, that a lump sum payment for the grant of an easement could not be taxable under section CC 1. This is because a one-off payment is a capital receipt and could not fall under “other revenues” in subsection CC 1(2)(g), and none of the other amounts listed in section CC 1(2) was applicable. Therefore, a one-off payment for the grant of a permanent easement is not captured by section CC 1, and consequently section CC 1(2C), the specific exception for that type of amount, is redundant and needs to be repealed.

One-off payments for the grant of an easement, permanent or non-permanent, are subject to tax under s CC 1B (this section was enacted after the years at issue in the *Vector* case). However, section CC 1B requires an amendment to ensure it does not tax one-off payments for the grant of a permanent easement, consistent with the policy intent.

# Māori authority tax credits attached to distributions

***(Clause 108)***

## Summary of proposed amendment

The proposed amendment corrects an unintended legislative change relating to the ability to retrospectively attach a Māori Authority Tax Credit (MATC) to a distribution from a Māori authority. The unintended change occurred during the rewrite of the Income Tax Act 2007.

## Application date

The proposed amendment would apply from the beginning of the 2008–09 income year. A savings provision is also proposed to protect a taxpayer who has taken a tax position based on the existing legislation.

## Key features

Imputation credits and MATCs may be attached retrospectively to a distribution only if the Commissioner has made an assessment under the transfer pricing rules to change the effect of a transaction.

The rewrite of this provision incorrectly resulted in Māori authorities being able to retrospectively attach a MATC to a distribution for any reason. The proposed amendment restores the law to its pre-rewrite position so that it works as intended.

# Reciprocal exemption for income from inbound international air transportation

***(Clauses 75, 113(2), 137, 139, 143, and 144)***

## Summary of proposed amendment

As a member of the International Civil Aviation Organisation (ICAO), New Zealand is obligated to reciprocally grant a full income tax exemption to non-resident aircraft operators. New Zealand gives effect to this obligation in section CW 56 of the Income Tax Act 2007, first introduced in 1985 as section 64A of the Income Tax Act 1976.

## Application date

The proposed amendment would apply retrospectively from 1 April 1984 for section 64A of the Income Tax Act 1976 (the application date of the original legislation). The application date of the proposed amendments to equivalent provisions in subsequent Acts (the Income Tax Act 1994, the Income Tax Act 2004 and the Income Tax Act 2007) would be the original date of enactment of each of those Acts. Retrospective application ensures that any full exemption previously granted by the Commissioner under any Act has been granted correctly.

## Key features

The proposed amendment corrects a deficiency in section CW 56. As currently worded, the provision only permits an exemption to be granted for income from outbound air transport when it should also apply to inbound air transport. Extending the scope of the provision to cover inbound transportation will ensure that New Zealand has given full effect to its international obligations.

To meet the ICAO obligation to grant an income tax exemption to the fullest possible extent, section CW 56 should also expressly apply to inbound air transportation. The proposed amendments achieve this by providing that, to the extent there is reciprocity, both air transport from New Zealand and air transport to New Zealand is exempt income.

## Background

ICAO member jurisdictions are obligated to reciprocally grant an exemption from income tax to international aircraft operators “to the fullest possible extent”. Members are primarily required to give effect to this obligation by including a reciprocal exemption mechanism in their double tax agreements (DTAs). As a backup, members are also required to include a domestic legislation provision that enables reciprocal exemptions to be granted in the absence of a DTA. As an ICAO member, New Zealand introduced a domestic legislative provision to give effect to the backup exemption mechanism in 1985. The provision is currently located at section CW 56 of the Income Tax Act 2007.

Section CW 56 is not an automatic exemption. Rather, to ensure reciprocity, the provision authorises the Commissioner of Inland Revenue to exempt income of a non-resident aircraft operator from New Zealand tax if the Commissioner is satisfied that in reciprocal circumstances the other jurisdiction will exempt the income of a New Zealand aircraft operator. The exemption is typically exercised by means of an exchange of letters, in which each side’s tax administration confirms that it will exempt the other side’s international airlines. The exemption mechanism only needs to be exercised on rare occasions, as most international air services to and from New Zealand are with jurisdictions with which New Zealand has a DTA. On the few occasions that it has been exercised, the Commissioner has granted full exemption (that is, for both inbound and outbound transportation).

However, section CW 56 only expressly refers to income that is attributable to “carriage outside New Zealand by an aircraft of cargo, mail or passengers emplaned or embarked on the aircraft at an airport in New Zealand” (outbound transportation). The provision is silent about income from the carriage of cargo, mail or passengers into New Zealand (inbound air transportation).

Income derived by an international airline from inbound transportation has a New Zealand source under section YD 4(2) or (3) of the Income Tax Act 2007 to the extent that it is attributable to business carried out in New Zealand or a contract made or performed in New Zealand. This means that at least some inbound air transportation is potentially taxable in New Zealand.

# Amend the date a goods and services tax credit becomes available for a taxpayer to use

***(Clause 131)***

## Summary of proposed amendment

This proposed amendment moves the day a GST credit is available from the day after the return was filed, to the day the credit arises. As this amendment is minor and is taxpayer favourable this change has already been operationalised within the system and thus will not practically affect any taxpayers.

## Application date

The proposed amendment would apply from the date the original change was made, for taxable periods on or after 1 April 2018, as practically this will have no impact on any taxpayer and it will protect those taxpayers who have already received credits at the earlier date.

## Key features

This amendment alters the date that a GST credit becomes available to a taxpayer when they file their GST return other than on the due date for the return. It moves the date the credit is available to be used from the day after the return is filed to the day the return is filed.

## Detailed analysis

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 made a change to the day on which a GST refund was available to a taxpayer. This more closely aligned the availability of a GST refund to when the taxpayer filed the return in which the credit arose.

Credits are currently available on:

* the earlier of either the day after the taxpayer filed their return or the day after the GST period which the credit relates to if the taxpayer filed early, or
* the day after the end of the GST period to which the refund relates if they filed on the due date, or
* the day after they filed their return if they filed their return late.

Having the credit available the day after it arises (that is, the day the return is processed, and the refund established) is problematic for administrative purposes. It is generally good practice to have the credit available on the same date that it arises within the system. As a consequence, it is prudent to change the date in the legislation to the date the GST refund arises.

As this change is taxpayer friendly and the issues that arose from treating the credit available the day after it was assessed were problematic this change has already been operationalised within the START environment and will have no practical effect on taxpayers.

It is proposed that this amendment would apply from the date the original change was made (taxable periods ending after 1 April 2018) to provide certainty to taxpayers who may have received credits earlier than specified in the legislation.

# Inbound thin capitalisation *de minimis*

***(Clause 81)***

## Summary of proposed amendment

The Bill proposes to restrict access to the *de minimis* in the inbound thin capitalisation rules (no adjustments when interest is up to $1 million and reduced adjustments up to $2 million), so it is not available when the borrower has related party debt from a non-resident. This is consistent with the original intent of the inbound thin capitalisation *de minimis*.

## Application date

The proposed amendment would apply to income years starting on or after 1 July 2018 to align with the original application of this *de minimis* to inbound thin capitalisation.

## Key features

The “adjust” term in the thin capitalisation formula to apportion interest by an excess debt entity, which is defined in section FE 6(3)(ac), is zero when the *de minimis* does not apply. Section FE 6(3)(ac)(i) is proposed to be extended so that “adjust” will be zero if a borrower subject to inbound thin capitalisation has related party debt from a non-resident.

## Background

There is a *de minimis* in the thin capitalisation rules in section FE 6(3)(ac) of the Income Tax Act 2007 so that certain excess debt entities do not need to make adjustments upon breaching the thin capitalisation threshold. This applies when these entities have a group finance cost of up to $1 million and abates up to a group finance cost of $2 million.

Changes in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 extended this *de minimis* from the outbound thin capitalisation rules to also apply to the inbound thin capitalisation rules provided the borrower does not have any owner-linked debt.

However, owner-linked debt, which is described in section FE 18(3B) of the Income Tax Act 2007, exists only where the borrowing is, directly or indirectly, from an owner who is not a member of the group. It was always intended that the *de minimis* should not be available where there was borrowing from a non-resident member of the same group. This is because a group with related party lending that does not have to apply thin capitalisation could have very high levels of debt in New Zealand and derive a return on their total investment without making any taxable profits due to high interest deductions. This is not appropriate, even where the interest expense is less than $1 million or $2 million.

# Disclosure of information about representatives

***(Clause 134)***

## Summary of proposed amendment

The proposed amendment extends the coverage of an existing rule which permits the Commissioner to disclose information about tax agents to associations or groups that represent them to also permit the Commissioner to disclose information about representatives (including bookkeepers) to associations or groups that represent them.

## Application date

The proposed amendment would apply from the date of enactment.

## Key features

The key feature of the proposal would allow Inland Revenue to provide information about representatives (as defined in the Tax Administration Act 1994) to associations or groups that represent them. The proposal mirrors an existing rule that allows Inland Revenue to disclose such information about tax agents to associations and groups that represent them in certain circumstances.

## Background

As part of Inland Revenue’s Business Transformation programme it has extended its online service offerings to a broader range of intermediaries. This was facilitated, in part, by changes made to the Tax Administration Act 1994 in the recent Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 which introduced a new category of intermediary referred to as “representatives”. This includes intermediaries such as bookkeepers, who typically represent their clients for GST and PAYE (but not income tax).

Inland Revenue has an existing ability to, in defined circumstances, disclose information about tax agents to associations and groups that represent them. This applies where:

* the person is, or purports to be, a member of the association or group as a person who is in the business of preparing tax returns for other people; and
* the members of the association or group are subject to a professional code of conduct and a disciplinary process that enforces compliance with the code of conduct; and
* the information being disclosed is relevant to a decision of the Commissioner to remove the person from the list of tax agents, refuse to list the person as a tax agent, or in the Commissioner’s opinion, would be relevant to such a decision.

This exception to the general rule of confidentiality contained in section 18 of the Tax Administration Act 1994 is confined to tax agents and consequently does not permit Inland Revenue to disclose information in the same circumstances about representatives. From a policy perspective, there is no reason why representatives should be treated differently from tax agents in these circumstances.

## Detailed analysis

Section 18D of the Tax Administration Act 1994 allows Inland Revenue to, despite the confidentiality rules in section 18 of the Tax Administration Act 1994, make disclosures for the purposes of carrying into effect revenue laws as set out in schedule 7, part A.

Schedule 7, Part A, clause 3 is the provision under which Inland Revenue can disclose information about tax advisors or persons acting as tax agents. Proposed subclause (3) would permit Inland Revenue to disclose information about a person to an association or group if:

* the person is, or purports to be, a member of the association or group as a person who is in the business of preparing tax returns for other people as a representative meeting the criteria of section 124D(2) of the Tax Administration Act 1994; and
* the members of the association or group are subject to a professional code of conduct and a disciplinary process that enforces compliance with that code of conduct; and
* the information being disclosed is relevant to a decision of the Commissioner disallowing the person’s approval as a representative, or refusing to approve the person as a representative, or would, in the Commissioner’s opinion, be relevant to such a decision.

Without the amendment Inland Revenue may not be able to disclose such information to associations or groups that represent representatives (such as the Institute of Certified New Zealand Bookkeepers). This could inhibit the representative from being subjected to the association or group’s disciplinary processes.

Maintenance items

# Maintenance amendments

## Summary of proposed amendments

The proposed amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

## Application dates

Commencement dates for each proposed amendment are stated in table 5.

## Minor maintenance items

The amendments relate to minor maintenance items to correct any of the following:

* ambiguities;
* compilation issues;
* cross-references;
* drafting consistency, including readers’ aids – for example, the defined terms lists;
* grammar;
* consequential amendments arising from substantive rewrite amendments; or
* the consistent use of terminology and definitions.

**Table 5: Maintenance amendments – schedule of clause numbers and changes to text**

| **Enactment** | **Clause** | **Section** | **Amendment** | **Commencement date** |
| --- | --- | --- | --- | --- |
| KiwiSaver Act 2006 | 7(1) | 51(1B) | Correction of cross-reference | 1 December 2014 |
| Income Tax Act 2007 | 72 | CW 38 | Correction to subsection headings  | 1 April 2008 |
| 73 | CW 38B | Correction to subsection headings  | 18 March 2019 |
| 74 | CW 39 | Correction to subsection headings | 1 April 2008 |
| 78 | EE 47 | Correction to subsection heading | 28 June 2018 |
| 80 | FE 5 | Improving drafting consistency | 1 July 2011 |
| 85 | GC 10 | Improving drafting consistency | 1 April 2008 |
| 98 | HM 3 | Improving drafting consistency | 29 March 2018 |
| 100 | IQ 4 | Improving drafting consistency | 1 April 2008 |
| 102 | LD 6 | Correction to defined terms list | 6 January 2010 |
| 111 | RD 5 | Improving drafting consistency | 1 April 2019 |
| 112 | RZ 16 | Correction of cross-reference | 1 April 2008 |
| 113(3) | YA 1 “deductible output tax” | Correcting grammar | 1 April 2011 |
| 113(4) | YA 1 “employee” | Correcting grammar | 29 March 2018 |
| 113(11) | YA 1 “premium” | Correcting grammar | 1 July 2010 |
| 113(12) | YA 1 “RWT proxy” | Correction of cross-reference | 18 March 2019 |
| 113(15)  | YA 1 “services” | Correction of cross-reference | 1 April 2019 |
| Tax Administration Act 1994 | 116 | 22(2)(ke) | Correction of cross-reference | 1 April 2019 |
| 117 | 36BB | Correction of cross-reference | 1 April 2020 |
| 118 | 78D | Improving drafting consistency | 1 April 2020 |
| 133 | Schedule 5 | Correcting grammar | 1 April 2019 |
| 135 | Schedule 8 | Correcting grammar | 1 April 2019 |
| Income Tax Act 2004 | 138 | MD 1C | Correcting cross-reference | 1 April 2005 |
| Taxation (Annual Rates for 2018–19, Modernising Tax Administration and Remedial Matters) Act 2019 | 141 | 34 | Repeal redundant provision | Date of enactment |
| 142 | 375 | Omit redundant cross-reference | 1 October 2019 |
| Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 | 146 | 332 | Repeal redundant provision | Date of enactment |
| Income Tax (Adverse Event Income Equalisation Scheme Rate of Interest) Regulations 1995 | 148 | Revocation | Revoke redundant regulation | 18 March 2019, applies from beginning of income years after 18 March 2019 |

1. Under the payday filing requirements, employment income information is due within 2 days or 10 days of a payday depending on the size of the employer. Payment is not due until the 20th of the month and the 5th of the following month for large employers. For other employers, payment is not due until the 20th of the following month. [↑](#footnote-ref-1)
2. If Inland Revenue discovers a similar case for a loan taken out after 2000, the loan can be sent to Studylink, who are able to write off the loan. Loans taken out before 2000 were not issued by Studylink so cannot be sent back to them. [↑](#footnote-ref-2)
3. These sections come into force in year two. [↑](#footnote-ref-3)
4. These sections come into force in year two. [↑](#footnote-ref-4)
5. These sections come into force in year two. [↑](#footnote-ref-5)
6. CY = Current year. [↑](#footnote-ref-6)
7. Inland Revenue’s technology platforms are FIRST (Future Inland Revenue Systems and Technology), the heritage platform, and START (Simplified Tax and Revenue Technology), the new platform. [↑](#footnote-ref-7)
8. Residual Income Tax is the amount of tax liability after tax credits such as PAYE and RWT have been deducted. [↑](#footnote-ref-8)
9. CY= Current year. [↑](#footnote-ref-9)
10. Note that for the final instalment taxpayers cannot use 110% of the year previous to the prior year as they must have filed their prior year return before the date of this payment. [↑](#footnote-ref-10)
11. This is an unlikely event as the FIRST system does not support this type of payment allocation. [↑](#footnote-ref-11)
12. Section 120L(2)(b). [↑](#footnote-ref-12)
13. Section 120L(2)(a). [↑](#footnote-ref-13)
14. Incremental late payment penalties applied at 1% for each month the debt was outstanding. These were removed from income tax from 1 April 2018. Thus, the only late payment penalties that apply to income tax are the initial penalty of 1% the day after the due date and 4% seven days after the due date. [↑](#footnote-ref-14)
15. The safe harbour includes taxpayers with RIT of less than $60,000 who have made the required standard instalments. In this case UOMI will not start until the terminal tax date (usually 7 February the following year). [↑](#footnote-ref-15)
16. <https://www.classic.ird.govt.nz/resources/2/9/2999de34-26c3-4ac3-bdb3-cad3e97c3cd6/is18-01.pdf> [↑](#footnote-ref-16)
17. [https://www.classic.ird.govt.nz/resources/9/2/9227e1f5-aaac-4bab-8bf1-5ef527fd4441/IS+1603.pdf](https://www.classic.ird.govt.nz/resources/9/2/9227e1f5-aaac-4bab-8bf1-5ef527fd4441/IS%2B1603.pdf) [↑](#footnote-ref-17)
18. “Working person”, “associated entity” and “personal services” income are technical terms used in the legislative provisions for the income attribution rules. They are replicated in this commentary for precision. [↑](#footnote-ref-18)
19. “Working person”, “associated entity” and “personal services” income are technical terms used in the legislative provisions for the income attribution rules. They are replicated in this commentary for precision. [↑](#footnote-ref-19)