

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill: Approval for Introduction

Proposal

1. This paper seeks Cabinet approval to introduce the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill to parliament. This Bill introduces amendments to the following legislation:
 - 1.1. KiwiSaver Act 2006
 - 1.2. Student Loan Scheme Act 2011
 - 1.3. Income Tax Act 2007
 - 1.4. Income Tax Act 2004
 - 1.5. Income Tax Act 1994
 - 1.6. Income Tax Act 1976
 - 1.7. Tax Administration Act 1994
 - 1.8. Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019
 - 1.9. Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018
 - 1.10. Taxation (Research and Development Tax Credits) Act 2019
 - 1.11. Accident Compensation Act 2001
 - 1.12. Income Tax (Adverse Event Income Equalisation Scheme Rate of Interest) Regulations 1995

Policy

2. The Bill contains a number of legislative changes to the KiwiSaver Act and Student Loan Scheme Act, to give effect to policy changes previously agreed by Cabinet. The Bill also contains a number of remedial changes that do not require Cabinet approval and have been approved in my capacity as the Minister of Revenue.
3. The KiwiSaver and Student Loan policy changes lay the foundations for Release 4 of Inland Revenue's Business Transformation programme, scheduled for 1 April 2020,

and enhance the administration of these schemes. The changes would ensure that New Zealanders receive the correct entitlements and find it easier to meet their obligations, in a timelier manner.

Policy items requiring Cabinet approval

4. Cabinet previously agreed to reduce the period within which a KiwiSaver scheme provider must provide member information and transfer funds to a new provider upon a member changing schemes from 35 days to 10 days [DEV-19-MIN-0038.01 and CAB-19-MIN-0109 refer]. Approval is now sought to specify that the reduced 10-day period would only apply to working days rather than calendar days.
5. The existing 35-day transfer period relates to calendar not working days and in practice only applies to non-default KiwiSaver scheme providers, as the transfer period that applies to default scheme providers is regulated. Default scheme providers' Instruments of Appointment specify that they must fulfil transfer requirements within a period of 10 working days. The rationale for reducing the legislatively mandated transfer period for non-default scheme providers was to align transfer timeframes across all KiwiSaver scheme providers. Therefore, to ensure that the timeframe for default and non-default scheme providers is consistent, it is proposed that the legislatively mandated transfer time should be "10 working days" as opposed to the "10 days" that was previously agreed to by Cabinet.

Policy items with prior Cabinet approval

6. The Bill contains legislative changes to give effect to a number of policy changes that have prior cabinet approval.
7. There are eight KiwiSaver changes with prior Cabinet approval [DEV-19-MIN-0038.01 and CAB-19-MIN-0109]. These changes require amending the KiwiSaver Act 2006, to apply from 1 April 2020, to take effect at the same time as Business Transformation Release 4. These changes are as follows:
 - 7.1. Allowing Inland Revenue to use Crown funds to pass employer contribution amounts to KiwiSaver scheme providers, before the contribution amount is received by Inland Revenue.
 - 7.2. Calculating interest on employer and employee contributions held by Inland Revenue from a member's pay day as reported by their employer.
 - 7.3. Reducing the KiwiSaver provisional period from three months to two months.
 - 7.4. Reducing the period that Inland Revenue must hold initial KiwiSaver employee and employer contributions from three months to two months.
 - 7.5. Allowing KiwiSaver members to change contribution rates through their scheme provider or Inland Revenue (rather than only through their employer).
 - 7.6. Removing the three-month grace period, for people who were invalidly enrolled in KiwiSaver, to gain New Zealand residence.
 - 7.7. Requiring employers to provide information to Inland Revenue on the:

7.7.1. income on which contributions are calculated; and

7.7.2. the employees employer superannuation contribution tax (ESCT) rate.

8. The Bill also contains five student loan policy changes with prior approval [SWC-19-MIN-0014 and CAB-19-MIN-0085 refers]. These changes require amendments to the Student Loan Scheme Act 2011, to apply from 1 April 2020 to take effect at the same time as Business Transformation Release 4. These changes will:
 - 8.1. limit the changes in a borrower's repayment obligations prior to 1 April 2013 to changes in residency status, where fraud is involved, or where a tax return has not been filed and it is cost effective to make changes. The Bill also proposes an exception to allow the Commissioner to correct the position of any borrower made worse off as a result of this change;
 - 8.2. rename the student loan repayment holiday to student loan temporary repayment suspension;
 - 8.3. give Inland Revenue the ability to write-off student loans taken out before 2000, in cases where borrowers have been able to prove that they did not take out the loan;
 - 8.4. allow Inland Revenue to notify a borrower's employer when the borrower's loan is close to being fully repaid; and
 - 8.5. treat overseas-based borrowers with serious illnesses or disabilities as New Zealand-based.
9. The Bill also contains legislative changes to extend the refundability of Research and Development tax credits, as previously agreed by Cabinet [DEV-19-MIN-0119 and CAB-19-MIN-0240 refer]. These changes will make tax credits more broadly refundable from the 2020/21 income year.
10. The Bill grants overseas donee status to four charities as previously agreed by Cabinet [DEV-19-MIN-0055 and CAB-19-MIN-0142 refer]. The charities are:
 - 10.1. Little Brother and Sisters International.
 - 10.2. Partners Relief and Development – New Zealand.
 - 10.3. Project Moroto.
 - 10.4. UN Women National Committee Aotearoa New Zealand Incorporated.

Items not requiring Cabinet approval (approved by the Minister of Revenue)

11. The Bill includes a range of remedial amendments. The changes described cover a range of issues and typically ensure the relevant tax laws are consistent with their policy intent. The changes are not significant in nature, and do not have any revenue or other fiscal effect. Because of the nature of the changes, Cabinet does not need to confirm these changes – they are approved in my capacity as Minister of Revenue.

Main home exclusion for bright-line test

12. 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 term “own” is defined in the Act. However, the period that a person owns land under this general definition can differ from the period that the bright-line test applies to. This means that 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 bright-line period, they have not used it as their main home for most of the time they owned the land. The opposite could also occur. The Bill proposes an amendment to align the period of ownership for the main home exclusion for the bright-line test with the bright-line period, to apply from the date of royal assent.

Allowing the Commissioner to withdraw short-process rulings

13. Inland Revenue will be able to issue short-process rulings for small-to-medium sized taxpayers from 1 October 2019. An oversight in the drafting of the legislation means that the Commissioner is unable to withdraw short-process rulings. The Bill proposes an amendment to the Tax Administration Act to enable the Commissioner to withdraw short-process rulings, which would mirror the existing rule that allows her to withdraw private binding rulings. The Commissioner relies on this ability in circumstances where there is a change in the interpretation of the law. The proposal would mean that taxpayers cannot rely on binding rulings for arrangements entered into from the date of notification of the withdrawal. The Bill proposes that this applies from 1 October 2019, being the date short process rulings can apply from. The Commissioner will not need to apply this provision before this bill passes into law.

Allowing taxpayers to rely on withdrawn binding rulings on matters not involving an arrangement for the duration of the ruling

14. Recent changes to binding rulings allow the Commissioner to issue binding rulings on matters, without the need for an arrangement (eg, on whether a person meets New Zealand tax residence requirements). The Bill proposes an amendment to ensure that where a binding ruling is withdrawn, taxpayers can continue to rely on the ruling for the duration specified in the ruling where there is no arrangement. The application date of this would be 18 March 2019, which is the date from which the Commissioner can issue binding rulings without the need for an arrangement.

Research and Development tax credits (approved by the Minister of Research, Science and Innovation and the Minister of Revenue)

15. There are a small number of cases where the legislation supporting the new R&D tax credit does not align with the policy intent. Issues relate to allocating tax credits to members of joint ventures, the timeframe for businesses to complete the disputes process and the certifier regime, clarifying the definition of internal software development, and removing the ability to challenge decisions of the Commissioner in certain circumstances so as to align with the rest of the scheme. The Bill proposes remedial changes for these issues, to apply from the beginning of the regime in the 2019/20 income year. The Bill also makes a remedial change to the refundability policy recently agreed by Cabinet to clarify that where a firm is part of a group, the payroll tax cap would be assessed at the group level rather than the individual firm.

Allowing IR to correct the PIR rate of PIE investors on the default rate

16. Currently, investors in PIE funds are expected to elect a tax rate, called a Prescribed Investor Rate (PIR). If they do not notify the PIE fund of a PIR, the top rate will apply by default. Unless the investor has nominated a lower PIR than they should have the tax is final, and the investor will not be able to get a refund for any overpayment. Inland Revenue can correct the rate for an investor who has provided an incorrect PIR but cannot use this power where an investor has been defaulted onto the top rate. The bill proposes an amendment to allow Inland Revenue to correct an investor's PIR if they have been defaulted onto the top rate. This would apply from 1 April 2020.

Income attribution rules

17. Income attribution rules apply when an individual earns income from providing their own services through an entity that has one main source of such income. The rules disregard the entity and tax the income directly to the person performing the services to prevent lower tax being paid. The Bill addresses two issues relating to these rules:
 - 17.1. If the entity provides services to a foreign party and pays tax overseas, a foreign tax credit may not be available to the working person, contrary to policy intent. The Bill includes an amendment to the Income Tax Act 2007 to clarify that a foreign tax credit is available to the individual, to prevent double taxation. This amendment would have retrospective application from 1 April 2008 to ensure that the law reflects current practice.
 - 17.2. When the income attribution rules are applied, dividends paid to the working person by the entity are exempt from tax, to prevent double taxation of income that has already been taxed to the working person. However, these dividends are exempt even if paid out of income that has not been attributed under these rules, which could result in some income never being taxed. The Bill contains an amendment so that the dividends are only exempt from tax if they have been taxed under the income attribution rules. This would also apply retrospectively to 1 April 2008, this being the original application date of these rules.

Trusts

18. Following an administrative review of the income tax treatment of trusts, a number of technical matters for remedial amendment have been identified. These changes will improve the clarity of the law and better reflect the policy intent. These amendments:
 - 18.1. ensure there is consistency within the trust rules on the treatment of distributions when a trustee elects to pay New Zealand tax on world-wide trustee income;
 - 18.2. clarify the relationship of the residence rules to trustees and their obligations under the Income Tax Act 2007;
 - 18.3. clarify rules relating to the value of a settlement;
 - 18.4. ensure there is internal consistency between the treatment of distributions, beneficiary income, taxable distributions and the ordering rules; and

18.5. address housekeeping matters such as terminology and notice requirements.

Disclosure of information about the misconduct of bookkeepers

19. An existing permitted disclosure allows Inland Revenue to disclose information about the misconduct of tax agents to their industry bodies. The Bill contains a change to the Tax Administration Act which introduces an additional permitted disclosure to allow Inland Revenue to disclose information about the misconduct of bookkeepers with their industry bodies. The Bill proposes an amendment to allow Inland Revenue to make these disclosures and requires that the same test must be met for both bookkeepers and tax agents before Inland Revenue can disclose information. This would apply from the date of enactment.

Tax treatment of non-resident international aircraft operators

20. The Income Tax Act allows New Zealand to grant a reciprocal income tax exemption to non-resident international aircraft operators, but the wording of the legislation limits the exemption to outbound aircraft. In practice, the exemption has been granted for both outbound and inbound transport. The Bill proposes an amendment to the Income Tax Act to align the legislation with the policy intent and current operational practice, with retrospective application from 1 April 1984, this being the date that the provisions allowing exemption applied from.

Māori authority tax credits

21. Under the current legislation, Māori authority tax credits are able to be attached retrospectively to any distribution from a Māori authority. The intention and current practice is that they can only be retrospectively attached to non-cash distributions under the transfer pricing rules. The Bill proposes an amendment to the Income Tax Act to align the law with policy intent and departmental practice, with retrospective application from 1 April 2008 as this will validate Inland Revenue's operational practice.

Consideration for grant of an easement

22. Under the current law, there are some cases where consideration for the grant of a permanent easement could be considered income. The policy intent is that consideration for the grant of a non-permanent easement is income and consideration for the grant of a permanent easement is capital. The Bill contains an amendment to ensure that the law fulfils this intent. This will apply retrospectively from 1 April 2015, this being the application date of the original provision.

Availability of GST tax credits

23. Under the current legislation, a GST tax credit becomes available to a taxpayer the day after the GST tax credit arises. This timing is problematic for Inland Revenue's systems. The Bill proposes amendments to allow GST tax credits to be available on the date that the credit arises. This will align the legislation with current practice and will be slightly favourable to the taxpayer. The application date proposed for this change is 1 April 2018 to align the legislation with the date the system changes applied from.

Inbound Thin Capitalisation de minimis

24. Under the current law a New Zealand taxpayer does not have to make adjustments for being over the thin capitalisation threshold provided they have less than \$1 million of group finance costs (and have a reduced adjustment if their group finance cost is less than \$2 million). This de minimis was not intended to be available if the New Zealand taxpayer borrowed from a non-resident related party; however, the legislation currently only removes access to the de minimis if the taxpayer has borrowed from an owner who is not a member of the same group. The Bill proposes to align the legislation with the intent for income years starting on or after 1 July 2018, to align with the introduction of the de minimis.

Employee Share Schemes

25. The Bill contains three changes to the Employee Share Schemes (ESS) rules. The application date of these changes is 29 March 2018, the original application date of the ESS reforms.

Definition of market value

26. Under the current legislation, the 'market value' of listed shares is defined as being the 'middle market quotation'. Obtaining this 'middle market quotation' is difficult in practice. From a policy perspective, there are a range of methods that are sensible approximations of market value. The Bill proposes an amendment to allow companies to use a wider range of methods to value shares for the purposes of the ESS rules.

Takeovers and similar reorganisations under employee share schemes

27. Currently, the exempt ESS rules require shares to be held by a trustee for a 'restricted period' (generally three years) before they can be released to employees. This is to prevent the rules being used to confer a tax-exempt cash benefit to employees. Exempt ESS trust deeds often provide for takeovers and other corporate re-organisations. If a takeover occurs, 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, making the shares taxable.
28. Providing an exemption to the restricted period in the case of takeovers or other re-organisations that are outside the control of the employee would not significantly undermine the policy intent behind the restricted period. The Bill proposes that takeovers and similar re-organisations and acquisitions do not disturb the exempt status of benefits provided under ESS even if this occurs within the restricted period, provided it is outside the control of the employee.

Flexibility to allow employees to retain their shares if they leave employment

29. Currently, employees who leave employment within the restricted period in the exempt ESS rules must have their shares bought back for the lesser of cost or market value, except in limited cases. These limited cases include employees retiring, being made redundant or if the employee dies. These employees are able to keep their shares or have them bought back for the lesser of cost or market value.

30. The ESS rules were amended in 2018 to allow trans-Tasman companies to offer Australian exempt schemes to their New Zealand employees. Australian ESS rules requires that all employees leaving employment must be able to keep their shares. Since this conflicts with New Zealand's rules, it is difficult for trans-Tasman companies to offer the same scheme in both countries.
31. The Bill proposes that companies have the option to choose whether their trust deed allows either:
 - 31.1. That all employees can keep their shares or have them bought back for the lesser of cost or market value; or
 - 31.2. That the trustee must buy the shares back for the lesser of cost or market value.

Provisional tax

32. The Bill includes a number of remedial amendments to align tax legislation with Inland Revenue's systems. This has arisen following the development and design of release 3 of Inland Revenue's business transformation programme. The changes either have no or a positive impact on taxpayers or are necessary to maintain the integrity of the tax system.

Removing the ability of taxpayers to make an estimate on their final instalment and receive the interest concessions for the standard uplift method.

33. This is an integrity measure to ensure that taxpayers cannot take advantage of the design of the system to both reduce their obligations under the provisional tax rules and obtain an interest concession. The Bill proposes that this amendment apply from the 2019-20 income year.

Clarify the calculation of interest for standard uplift method taxpayers

34. This amendment aligns the legislation with the policy intent and system design. This change will apply retrospectively from 1 April 2017 to align with the treatment in the system and provide certainty to taxpayers. The amendment is beneficial to taxpayers.

Clarify the application of late payment penalties applicable from the final instalment date for standard method taxpayers

35. This corrects an error in the legislation as originally enacted. Inland Revenue's systems have been applying the rule as it was intended to apply, which is beneficial to taxpayers. The Bill recommends this amendment apply from 1 April 2017 to provide certainty to taxpayers.

Remove the ability for taxpayers to choose the provisional tax instalment to which a payment is applied

36. This change will remove the ability for taxpayers to direct a payment to a particular instalment of provisional tax. It will prevent non-compliant taxpayers from reducing their exposure to late payment penalties and gaining an advantage compared to compliant taxpayers. In addition, Inland Revenue's systems have not been configured to allow for such payment directions. The proposed amendment will apply from 1 April

2017 to stop taxpayers revisiting prior periods to gain a retrospective advantage. A savings provision will cover the unlikely position where a taxpayer has requested the allocation of a payment.

Clarify the way in which provisional tax is truncated to whole dollars

37. The Bill proposes an amendment to confirm the current system approach of truncating cents. The application date proposed for this change is 1 April 2017 to provide certainty to taxpayers and ensure no taxpayer is disadvantaged by this technicality.

Clarify the wording in the interest concession rules to more clearly indicate how the interest rules apply to the final instalment of provisional tax

38. Some of the wording in the legislation for the current interest concession rules is unclear. This amendment will not have any practical impact on taxpayers. The proposed application date is 1 April 2017 to provide taxpayers with certainty.

Amend section 139B(6) of the Tax Administration Act 1994 to ensure it correctly covers taxpayers who have a non-standard number of instalments

39. The provisions that cover the interest concession rules do not allow for taxpayers with more or less than three instalments of provisional tax. The Bill proposes an amendment to ensure that these taxpayers are able to access the interest concession rules. This amendment should apply from the 2019-20 income year, to ensure that no taxpayers are disadvantaged.

Impact analysis

40. Regulatory Impact Assessments were prepared for the policy items in the Bill that required impact assessment. These were submitted at the time that the Cabinet Committee approval for the relevant policy items in the Bill was sought.
41. The regulatory impact assessments prepared cover:
- 41.1. Business Transformation related KiwiSaver refinements.
 - 41.2. Student Loans: Back-year reassessments prior to 2013.
 - 41.3. Extending the refundability of research and development tax credits.
42. The regulatory impact requirements do not apply to the remaining items in the Bill. A number of items involve technical “revisions” or consolidations that substantially re-enact the current law to improve legislative clarity and understanding (including the fixing of errors, the clarification of the existing legislative intent and the reconciliation of inconsistencies). Other items have no or only minor impacts on businesses, individuals or not-for-profit entities.

Compliance

43. The Bill complies with:
- 43.1. the principles of the Treaty of Waitangi;

- 43.2. the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
- 43.3. the disclosure statement requirements (a disclosure statement has been prepared and is attached to this paper);
- 43.4. the principles and guidelines set out in the Privacy Act 1993;
- 43.5. relevant international standards and obligations;
- 43.6. the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

44. The substantive policy initiatives to which this Bill is intended to give effect were subject to public and other consultation in accordance with the Generic Tax Policy Process.

Relevant government departments or other public bodies

45. The Treasury was consulted in the development of many of the proposals in the Bill. Other government departments and public bodies consulted on relevant aspects of the proposals include the Ministry of Education, the Ministry of Social Development, the Office for Disability Issues, the Ministry of Business, Innovation and Employment. The Financial Markets Authority and Office of the Privacy Commissioner have also been consulted on relevant proposals.

Relevant private sector organisations and public consultation processes

46. KiwiSaver scheme providers have been consulted on the KiwiSaver proposals and are supportive.
47. A wide range of organisations have been consulted on the development of the research and development tax credits policy. Officials have discussed the proposals with the Corporate Taxpayers' Group; Chartered Accountants Australia and New Zealand; representatives from PwC, KPMG, Deloitte and EY; approximately 25 representatives from R&D performing businesses in tax loss or with insufficient taxable income to fully utilise non-refundable R&D tax credits; some large established R&D performers; levy bodies; charities; cooperatives; Federation of Maori Authorities; and Māori business representatives. The refundability proposals have been shaped through these discussions.

The government caucus and other parties represented in Parliament

48. Both Government caucus and coalition and support parties will be consulted on this Bill prior to its proposed introduction.

Binding on the Crown

49. A number of the Acts being amended by this Bill currently bind the Crown. This Bill does not change this.

Allocation of decision making powers

50. The Bill does not involve the allocation of decision-making powers between the executive, the courts, and tribunals.

Associated regulations

51. No regulations are required to bring the proposed Bill into operation.

Other instruments

52. The Bill does not include any provision empowering the making of other instruments that are deemed to be legislative instruments or disallowable instruments (or both).

Definition of Minister/department

53. The Bill does not contain a definition of Minister, department, or chief executive.

Commencement of legislation

54. As an omnibus taxation Bill, each provision of the Bill comes into force on the date specified in the Bill for that particular provision.

Parliamentary stages

55. The Bill should be introduced on or after 26 June 2019, referred to the Finance and Expenditure Select Committee, and ideally reported back to the house by the end of 2019. Because the Bill contains changes necessary for Inland Revenue's Business Transformation release 4, the Bill should be passed no later than February 2020.

Proactive Release

56. I propose that this paper, alongside associated policy and Cabinet papers, be proactively released when the Bill is introduced, subject to redactions considered under the provisions of the Official Information Act 1982.

Recommendations

The Minister of Revenue recommends the Committee:

1. **note** that on 20 March 2019, the Cabinet Economic Development Committee agreed that the period a scheme provider has to share information and transfer funds to a new provider when a member transfers schemes be reduced from 35 days to 10 days [DEV-19-MIN-0038.1];
2. **agree** to recommend that Cabinet rescind the decision referred to in recommendation 1; and instead replace it with agreement that the period a scheme provider has to share member information and transfer funds to a new provider when a member transfers schemes be reduced from 35 days to 10 working days;

3. **note** that the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill holds a category 3 priority on the 2019 Legislation Programme (to be passed if possible in the year);
4. **note** that the Bill contains legislative changes that give effect to KiwiSaver and Student loan policy changes agreed by Cabinet to enable Inland Revenue's Business Transformation Release 4, changes that extend the refundability of Research and Development tax credits and grant overseas donee status to four charities and a number of remedial amendments;
5. **approve** the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives;
6. **agree** that the Bill be introduced on or after 26 June 2019;
7. **agree** that the government propose that the Bill be:
 - 7.1. referred to the Finance and Expenditure Committee for consideration;
 - 7.2. passed no later than February 2020.

Authorised for lodgement

Hon Stuart Nash
Minister of Revenue