Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill

Commentary on the Bill

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Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill – Commentary on the Bill.

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Annual rates for 2020–21

ANNUAL SETTING OF INCOME TAX RATES

(Clause 3)

Summary of proposed amendment

The Bill sets the annual income tax rates that would apply for the 2020–21 tax year. The annual rates to be confirmed are the same as for the 2019–20 tax year.

Application date

The proposed amendment would apply for the 2020–21 tax year.

Key features

The proposed annual income tax rates for the 2020–21 tax year would be set at the rates specified in schedule 1 of the Income Tax Act 2007.

Feasibility expenditure

FEASIBILITY EXPENDITURE

(Clauses 11 and 16)

Summary of proposed amendment

Changes are proposed to codify when businesses can deduct expenditure related to completing, creating or acquiring unsuccessful and abandoned assets or business models. The proposed rules also introduce a new immediate deduction for expenditure that in total is $10,000 or less in an income year that is incurred in developing assets in a business context. Together, the changes are intended to set out the circumstances when expenditure related to business innovation and asset development can be deducted for property that, if completed, created or acquired, would be depreciable property or revenue account property.

The rules complement the current tax depreciation rules in situations when property is not completed and abandoned.

Application date

The proposed amendment would apply to qualifying expenditure incurred in the 2020–21 and later income years.

Key features

Changes are proposed that affect the operation of the general deduction rules in sections DA 1 and DA 2 of the Income Tax Act 2007.

Specifically, for certain items of expenditure proposed, new sections DB 66 and DB 67 override the limitation for expenditure of a capital nature.

Proposed section DB 66 allows taxpayers to deduct expenditure incurred in completing, creating or acquiring property if:

- that property:
  - would be depreciable property, including depreciable intangible property;
  - would be revenue account property; and
- progress on the asset is abandoned with the outcome that the property is not completed, created or acquired; and
- no other deduction for the expenditure is allowed under any other provision in the Act.

The deduction does not apply to property that is depreciable at the rate of zero percent.

Deductions meeting the conditions above can be spread in equal proportions over a five-year period from the income year in which progress on the property is abandoned (section DB 66(2)).

Proposed section DB 67 allows an immediate deduction in the income year for expenditure incurred in completing, creating or acquiring property if the total expenditure is $10,000 or less and:

- the expenditure is related to depreciable property or revenue account property; and
- no deduction for the expenditure is allowed under any other provision in the Act.

The expenditure under both sections must be incurred in making progress towards completing, creating or acquiring the property.

The amount of the available deduction is equal to the expenditure the taxpayer incurs related to making progress towards completing, creating, or acquiring property.

For abandoned property that is later completed, new section CH 13 claws back the deductions allowed under section DB 66 by treating the amount deducted as income in the income year the property is completed, created, or acquired. The completed property is then subject to the tax depreciation rules in subpart EE, or deductible under section DB 23 of the Act.

Background

The proposed changes to the tax treatment of feasibility expenditure are part of tax measures the Government is implementing to support its economic strategy.

The changes in the Bill:

- respond to private sector concerns following the 2016 decision by the Supreme Court in *Trustpower Limited v Commissioner of Inland Revenue*,[1] which limited taxpayer expectations relating to deductibility of expenditure incurred on assets that are subsequently abandoned; and
- ensure tax is not a barrier for businesses seeking to invest in new projects or assets, except when there is an explicit denial of deductions (for example, expenditure related to assets when the taxpayer is not expected to incur an economic loss, such as land and shares).

As a general principle, the economic value of business expenditure that is expected to decline in value should be either immediately deductible or, when it provides an enduring benefit, deductible over time if that benefit declines over time. When the tax system does not provide for that treatment, an economic distortion is created.

An example of this distortion arises with expenditure by taxpayers to determine the practicality of an investment or new proposal: "feasibility expenditure". In some cases, the Act will deny taxpayers an immediate deduction for such expenditure when it has a connection with an asset that has the potential to yield future economic benefits beyond the current income year. If the asset is not completed, it is not recognised for tax depreciation purposes and is unable to be deducted for tax purposes, resulting in what is referred to as "black hole" expenditure. This creates an incentive for businesses to complete projects that, but for the tax effect, would otherwise be abandoned.

[1] SC 74/2015 [2016] NZSC 91.

The non-deductibility of this expenditure effectively raises the cost of risky investments in new assets (where the chance of a viable outcome is uncertain) and therefore can act as a barrier to businesses committing resources to developing new assets, business models or processes – which are important to innovation and driving productivity improvements.

The proposed amendments are intended to sit alongside the Act's rules for tax depreciation and Inland Revenue's interpretation statement IS 17/01[2] for businesses that regularly incur feasibility expenditure.

The proposed amendments do not give tax deductions for expenditure related to assets that are not expected to decline in value. While assets that are not expected to decline in value sometimes do, it would only be appropriate to provide deductions for this expenditure if the tax system taxed gains in assets that appreciated. Under current policy settings it would not be correct to allow deductions for expenditure related to property that is not depreciable (or that result in expenditure that would not otherwise be deductible if the property is completed).

The proposed amendments are not designed to alter the rules that exist for:

- tax depreciation;
- company administration costs;
- research and development;
- resource consents;
- unsuccessful software projects;
- patents; and
- plant variety rights.

The amendments also do not affect the application and effect on the general permission test relating to deductions.

The proposed amendments in this Bill are the product of discussions with stakeholders following the release of the Government discussion document *Black hole and feasibility expenditure*, released May 2017, and further rounds of targeted consultation in October 2017 and November 2019. The Tax Working Group also made recommendations regarding reform to the tax treatment of feasibility expenditure and other non-deductible expenditure. The Bill seeks to implement those recommendations.[3]

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[2] Interpretation statement IS17/01: Deductibility of feasibility expenditure. Tax Information Bulletin Vol 29, No 3 (April 2017) available at https://www.taxtechnical.ird.govt.nz/tib/volume-29---2017/download-tib-vol29-no3

[3] Future of Tax: Final Report Volume I – Recommendations, Thursday, 21 February 2019 https://taxworkinggroup.govt.nz/resources/future-tax-final-report-vol-i-html#section-3, recommendation 33 refers.

Detailed analysis

Spread deduction rule for feasibility expenditure

Proposed section DB 66 is directed at expenditure incurred by taxpayers in making progress towards completing, creating or acquiring property that is subsequently abandoned. The term property is defined by reference to property that if completed would be depreciable property, including certain types of intangible property, and/or revenue account property.

A deduction is allowed for expenditure related to completing, creating or acquiring the abandoned property. Abandonment is when no further money is applied, or the taxpayer documents a decision to not proceed with the property, whichever happens first.

The expenditure must satisfy the general permission requirements, in that the taxpayer must have an existing income-earning process and to which the expenditure must have sufficient nexus. The capital limitation, however, is overridden.

The amount of the available deduction is equal to the expenditure the taxpayer has incurred in relation to the abandoned property, and is not otherwise deductible under any other provisions of the Act. The proposed amendment is designed to allow a broad concept of what expenditure can be deducted, including direct and indirect expenses. General overhead expenses that have an indirect relationship, or expenses that are later determined to have been connected with the abandoned property are expected to be within scope.

The deduction for the expenditure is spread in equal proportions (one-fifth) over a five-year period, starting from the year of abandonment.

Example 1: When the new sections apply – wind studies

Company A, an electricity generator, is exploring the practicality of establishing a new wind farm. It incurs expenditure over a five-year period associated with measuring wind frequency and speeds (anemology) relevant to the local geography. Anemology expenditure connected with the project is booked against a work in progress account (an asset on Company A's balance sheet for financial accounting purposes). At the end of year two, the studies regarding the site are inconclusive as to reliability of wind supply and the project is mothballed.

Tax impact

Under current law, the anemology expenditure incurred in developing an asset does not give rise to an immediate deduction under the Act. As the asset is not completed, there is no tax asset to depreciate.

Under new section DB 66, the collective anemology expenditure would, had the project gone ahead, have formed part of a depreciable asset (wind turbine generators). The expenditure will be deductible in equal parts over five years.

Example 2: When the new sections apply – nanotechnology study

Company B, a water management company, is working on ways to meet demand in times of low-aquifer inflows and drought, to prevent water restrictions. It is exploring the viability of desalination. The company carries out a number of studies on the practicality of building and operating a desalination plant, and researches how water from the plant could be connected to the wider network. Work on the project is abandoned after an assessment determines it is uneconomic, in terms of energy needs and water output, for the plant to meet forecast demand. The project is shelved pending future advances in desalination nanotechnology.

Tax impact

Under current law, the expenditure incurred in studying the practicality of desalination would be included as part of an asset and does not give rise to an immediate deduction under the Act. As the asset is not completed, there is no tax asset to depreciate.

Under new section DB 66, the collective desalination study expenditure would, had the project gone ahead, have formed part of a depreciable asset (water treatment plant and reservoir). The expenditure will be deductible in equal parts over five years.

Example 3: When the new rules will not apply – design property rights

Company C, an aeronautics company, has plans to redesign the cockpit and airframe canopy for a model of small single propeller aircraft. The redesign is intended to improve flight performance and pilot visibility for such purposes as aerial crop dusting.

The company incurs expenditure in costing the project and scoping initial airframe designs. The multi-year project is shelved in year two when a competing overseas company brings a comparable (and cheaper) improved aircraft to the market.

Tax impact

Under current law, the design expenditure is incurred in developing depreciable intangible property. The designs are subject to tax depreciation and therefore cannot be deducted under new section DB 66.

Example 4: When the new rules will not apply – acquisition of shares

Company D is seeking to diversify the range of products it provides to commercial clients. It is considering options to either directly acquire the products or acquire the shares in another firm that is offering comparable products. Company D decides to acquire the shares in the firm as it is keen to retain the firm's existing staff, management and the client list the firm has built up.

Tax impact

Expenditure connected with Company D acquiring the firm are not deductible under new section DB 66 as they relate to the acquisition of shares (which are not depreciable property). If Company D had decided to acquire the products directly but abandoned the idea after working though the implications of distribution and product support, the expenditure attributable to that work would be deductible under DB 66 as the expenditure has a relationship with the acquisition of revenue account property.

Example 5: When the deduction starts

The finance team at Company E is considering the expenditure debited in its work in progress account after balance date for the year 20X1. They decide that a study directed at improving the energy efficiency of the company's plant won't proceed due to cash flow constraints. The abandoned work related to a potential refit of the company's premises for lighting and heating. No further amounts had been spent on the project after balance date and the decision is made in 20X2 that the project has been abandoned for financial reporting purposes.

Tax impact

The expenditure would be deductible under new section DB 66 given its relationship with depreciable property. A deduction of one-fifth of the expenditure can be made in the 20X1 tax return.

Immediate deduction for feasibility expenditure

Proposed section DB 67 works in a similar way to DB 66, with modifications to reflect that DB 67 is a compliance cost saving measure. That is, feasibility expenditure can be immediately deducted by the taxpayer if the total expenditure incurred is $10,000 or less in an income year. There is no requirement that the property be abandoned.

However, like the requirements of section DB 66, the expenditure must satisfy the general permission provisions and not be deductible elsewhere under the Act. Section DB 67 is not a replacement for tax depreciation for low-value assets.

Example 6: When the deduction can be claimed immediately – revenue account property

Retailer F specialises in selling cake decoration supplies, cupcakes and other baked goods, and is considering adding takeaway coffee and other hot drinks. It incurs expenditure in doing a cost-benefit analysis and a survey of foot traffic and customer opinion. During the study a coffee shop opens two doors down and the project finishes. About $1,700 was committed to the analysis.

Tax impact

Under Inland Revenue's Interpretation statement 17/01, the retailer would not be able to deduct the expenditure as it is not recurrent. Under new section DB 67, as the expenditure is connected with selling revenue account property (trading stock) and a coffee machine (depreciable) and other consumables, it would be deductible. As the expenditure is under $10,000 it would be immediately deductible.

Example 7: When the deduction cannot be immediately claimed – depreciable property

Retailer G incurs expenditure in acquiring a secondhand vehicle to assist with deliveries. The vehicle and associated expenditure totals $8,000.

Tax impact

The cost of the vehicle is not immediately deductible under section DB 67 as the cost of the vehicle is subject to the tax depreciation rules.

Clawback of abandoned expenditure deductions

As an integrity measure, amounts deducted for abandoned property that is later completed, created or acquired are treated as income in the year in which that happens. Under proposed section CH 13, the income equals the direct costs for that property. The requirement to return as income amounts previously deducted does not apply to expenditure that has been immediately deducted under the $10,000 de minimis rule.

This deduction clawback rule is directed at situations where taxpayers may be incentivised to prematurely abandon work on property. For example, property may be partially abandoned to take advantage of the five-year deduction if this would accelerate the deductions that would have been allowed had the property been completed and depreciated.

Example 8: Previous deduction clawed back – example 2 continued

A decade after Company B's decision not to proceed with a desalination plant, population growth in the region and the need for greater water infrastructure has led Company B to restart its earlier work on nanotechnology. Development of the plant and reservoir begins and seven years later it is operational and connected to the wider water supply network. In the year in which the depreciable property is operational, the deduction claimed 17 years earlier is returned as income, with the expenditure included in the cost of the depreciable property.

Example 9: Previous deduction not clawed back – example 5 continued

Company E's financial situation improves, and it refits the lighting and heating in its premises three years after the initial study using an alternative model. The earlier deduction taken for the previous study is not clawed back as those expenses do not have a direct connection with the final fitout as it did not use any of the earlier work to complete the fitout.

Land

HABITUAL BUYING AND SELLING OF LAND

(Clauses 5, 6 and 7)

Summary of proposed amendment

The proposed amendments expand the regular pattern restrictions in the main home exclusion, the residential exclusion and the business premises exclusion to apply to regular patterns of buying and selling land by a group of persons acting together. The amendments will ensure that taxpayers cannot structure around the regular pattern restrictions by using different people or entities to carry out separate transactions, or by varying what is done to the land in each transaction so that there is no "pattern".

The proposed amendments also clarify that the regular pattern restrictions in the residential and business premises exclusions will only apply when the land was acquired with a purpose or intention of disposal.

Application date

The proposed amendments would apply to land acquired after the date of enactment. However, land acquired before the application date would be able to be considered for the purposes of determining whether a group of persons have a regular pattern.

Key features

The proposed amendments will:

- expand the regular pattern restrictions in the main home, residential and business premises exclusion so they apply to a group of persons undertaking buying and selling activities together, rather than the activities of a single person;
- expand the regular pattern restrictions in the residential and business premises exclusions so they apply to a regular of pattern of buying and selling land, focusing on the regularity of the transactions rather than what is done on the land while it is held; and
- clarify that the regular pattern restrictions in the residential and business premises exclusions apply only when the land was acquired with a purpose or intention of disposal.

Background

The land sales rules in subpart CB of the Income Tax Act 2007 contain various exclusions for land used as a main home, residence or business premises. If one of these exclusions applies, an amount that would otherwise be subject to tax under one of the land sales rules, will not be taxable. For example, an amount derived by a land dealer from selling land is usually subject to tax, but will not be taxable if the land dealer used the land as their residence while they owned it.

However, the following exclusions do not apply when there has been a regular pattern of buying and selling land used for such purposes:

- main home exclusion in section CB 16A (which applies for the bright-line test in section CB 6A);
- residential exclusion in section CB 16 (which applies for some of the other land sales provisions); and
- business premises exclusion in section CB 19.

The restrictions assume that a person who has a regular pattern of buying and selling land primarily acquires that land for sale and should be taxed on any gain, whether or not they used the land as their residence or business premises while they owned it.

There are concerns that the current regular pattern restrictions allow taxpayers who habitually buy and sell land to structure around the rules. This can be done by using different people or entities to carry out separate transactions, or by varying each transaction so that there is no “pattern”. This undermines the integrity of the tax system by allowing people to take advantage of the exclusions in circumstances when this was not intended.

Detailed analysis

Group of people acting together

All of the current regular pattern restrictions apply quite narrowly to the activities of a single person. This allows taxpayers to circumvent the application of the regular pattern restrictions by buying and selling land using different people and entities each time (for example, the first property is purchased by the person, the second is purchased by their partner, the third by their family trust, and so on).

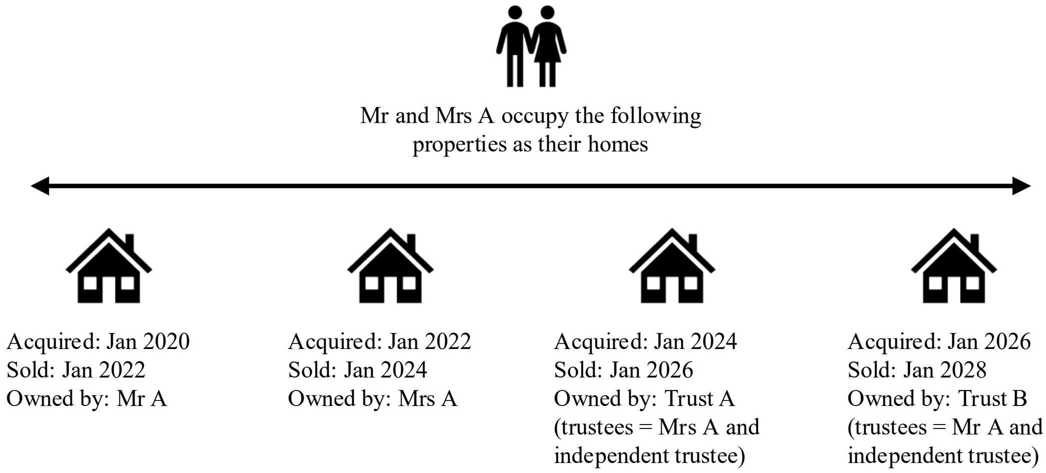
The proposed amendments will expand all of the regular pattern restrictions so they apply to a group of persons undertaking buying and selling activities together.

For the main home and residential exclusions, a group of persons will be treated as undertaking buying and selling activities together when:

- all the people occupy all of the properties together as their residence; and
- where a property is owned by a trustee or other entity, at least one of the people who occupy all the properties has significant involvement in, or control of, the trust or other entity.

Example 10 illustrates a regular pattern involving a group of persons for the main home or residential exclusions.

Example 10: Residential and main home exclusions



Mr and Mrs A occupy all of the properties together as their residence. As a trustee of Trust A, Mrs A has significant involvement in, or control of, Trust A. As a trustee of Trust B, Mr A has significant involvement in, or control of, Trust B. Because Mr and Mrs A occupy all of the properties and have significant involvement in, or control of, the trusts that own two of the properties, Mr and Mrs A, Trust A and Trust B will be treated as a group of persons who undertake buying and selling activities together. Because those buying and selling activities form a regular pattern (as the properties are bought and sold at regular intervals), they will be subject to the regular pattern restriction (assuming all the properties were acquired with an intention of resale (see below)).

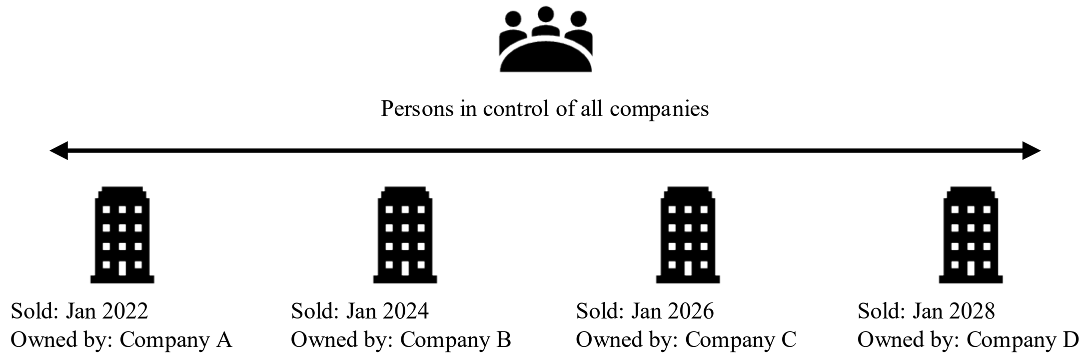
For the residential and main home exclusions the most important factor is that all the people in the group occupy all the properties. In example 10, if Mr and Mrs A's daughter and son-in-law, Mr and Mrs B, lived with them in the second property for a year and then moved into their own home, Mr and Mrs B's separate home would not form part of the pattern when it is sold because Mr and Mrs A did not occupy that property, and Mr and Mrs B did not occupy all of the other properties.

For the business premises exclusion, a group of persons will be treated as undertaking buying and selling activities together where:

- all persons in the group occupy premises mainly to carry on a substantial business, irrespective of the nature of any business carried on; and
- a person, whether or not they also occupy land as a business premises, has significant involvement in, or control of, the activities of all those in the group.

Example 11 illustrates a regular pattern involving a group of persons for the business premises exclusion.

Example 11: Business premises exclusion



Companies A, B, C and D all occupy their land as business premises mainly to carry on a substantial business. (It does not matter whether the businesses are related.) The same persons have significant involvement in, or control of, the activities of all of the companies (for example, all the companies have the same shareholders). Therefore, companies A, B, C and D form a group of persons who are treated as undertaking buying and selling activities together. Because those buying and selling activities form a regular pattern (the properties are sold at regular intervals), they will be subject to the regular pattern restriction (assuming all the properties were acquired with an intention of resale (see below)).

The terms “significant involvement” and “control” are used in other parts of the Act. In this context these terms indicate that the relevant person is able to direct, alone or as part of a group, the relevant trust or entity’s decision-making process.

Regular pattern of buying and selling

For the residential exclusion the regular pattern restriction currently applies when a person has engaged in a regular pattern of acquiring and disposing of, or erecting and disposing of, dwellinghouses occupied mainly as a residence by the person. For the business premises exclusion the regular pattern restriction currently applies when a person has engaged in a regular pattern of acquiring and disposing of, or erecting and disposing of, premises used by the person for a substantial business.

In contrast, the regular pattern restriction for the main home exclusion applies when the person has engaged in a regular pattern of acquiring and disposing of residential land used as their main home.

Because of the language used in the residential exclusion and the business premises exclusion, the regular pattern restrictions in those provisions have been interpreted very narrowly to apply only when there is a similarity or likeness between the transactions (for example, a pattern of buying land, building a home on the land and then selling). This means that the regular pattern restrictions do not apply if a person has a pattern of buying and selling land that they occupy as a residence or business premises and they carry out different activities on the land while they hold it. For example, the restriction would not currently apply where the first property is bought, lived in and sold, the second is renovated while it is lived in and sold, or the third is a bare section where a house is built and occupied then sold. This problem does not appear to arise from the more general wording used in the main home exclusion.

The proposed amendments will expand the regular pattern restrictions in the residential and business premises exclusions to align them with the main home exclusion. This will ensure they apply to any regular pattern of buying and selling land used as a residence or business premises, with a focus on the regularity of the transactions rather than on what is done on the land while it is held.

Purpose or intention

Expanding the regular pattern restrictions gives rise to an increased risk that they could catch ordinary residential transactions that occur for family reasons, and small businesses that are upgrading premises as the business grows. In particular, this risk arises for people who are associated with a person in a business involving land (such as a dealer, developer or divider, or builder). This is because they are, prima facie, subject to tax on all sales of land within ten years of acquisition, whether or not the land is used in a business or other income-earning scheme. Such people are entitled to rely on the exclusions to ensure their genuine homes and business premises are not taxed on sale.

Therefore, the proposed amendments clarify that the regular pattern restrictions in the residential and business premises exclusions apply only when the land was acquired with a purpose or intention of disposal. This ensures that the restrictions are better targeted at people who regularly buy and sell land on a speculative basis.

COST OF REVENUE ACCOUNT PROPERTY

(Clause 14)

Summary of proposed amendment

The proposed amendment clarifies that the cost of revenue account property is deductible even if it was not known when the costs were incurred that the property would be subject to tax on sale, or if the property was used privately while it was held.

Application date

The proposed amendment would apply from 1 April 2008, being the commencement date of the Income Tax Act 2007.

Key features

The proposed amendment clarifies that section DB 23, which allows a deduction for the cost of revenue account property, supplements the general permission and overrides the private limitation.

Background

In most cases, there has to be sufficient connection between expenditure and income, or between expenditure and a business carried on for the purpose of deriving income before expenditure can be deducted. This is known as the general permission (section DA 1). Whether the general permission has been satisfied is judged at the time the expenditure is incurred.

Section DB 23, which allows a deduction for the cost of revenue account property, is currently subject to the general permission. However, in some situations involving land subject to the land sale rules there may not be the required connection between expenditure on acquiring or improving the land and income. This is because, at the time the expenditure is incurred, it may not be known whether the disposal of the land will be taxed. This may be the case for land that is taxed if sold within a particular timeframe (for example, land sold within five years for the bright-line test), or if certain circumstances eventuate during the time the land is held (for example, if a division or development is carried on).

In addition, section DB 23 is currently subject to the private limitation. This means that technically, where there is private use of land that is subject to tax on sale, part of the costs of acquisition and improvements should also be denied to take into account the private benefit received.

It was clearly intended that the cost of acquiring and improving land that is taxed under any of the land sale rules would be fully deductible to ensure that only the net proceeds are income (or a loss). That is how the provisions operated before the rewrite of the Act, under the “profits or gains” approach. However, it seems that the splitting out of income and deductions into separate provisions may have inadvertently created some uncertainty in respect of land taxed under some of the land sales provisions.

CONTENT OF THE LAND TRANSFER TAX STATEMENT

(Clauses 95 to 100)

Summary of proposed amendment

The Bill proposes changes to the Land Transfer Act 2017 to move the content of the Land transfer tax statement (LTTS) to regulations. This change will make it easier to amend the LTTS in the future, for example to make changes that would reduce compliance costs for property transfers.

All references are to the Land Transfer Act 2017 unless otherwise stated.

Application date

The proposed amendment would apply from the date of enactment.

The current requirements in section 79 of the Act will apply until the first regulations which prescribe the content for the LTTS come into force.

Key features

The amendments propose that the content of the LTTS will be set by regulation. This will enable the content of the LTTS to be updated more easily and enable streamlining of property transfer information requirements.

The framework around the LTTS, for example, the rules around disclosure and use of information, are unchanged and remain in the Act.

Background

From 1 October 2015, sellers and purchasers of land have been required to complete an LTTS at the time of transfer. The LTTS collects information used for assessing compliance with tax obligations. It also gathers statistics for use in housing policy. People buying and selling property may also have to complete:

- a residential land withholding tax declaration, for sellers of property sold within the bright-line period; and
- a residential land statement, for buyers of residential land acquired after 22 October 2018.

The content of the LTTS is currently largely prescribed by the Act. Making any changes to the information required on the form currently requires an amendment to the Act.

Detailed analysis

Amendments are proposed to section 77 to refer to tax information as that which is specified in a tax statement under the Act.

Section 79 is replaced with proposed new section 79 which requires that the tax statement must contain the prescribed information. Section 227(1)(3) provides that the Governor General may make regulations prescribing information to be contained in, and documents that must accompany, any instrument, application, notice, certificate, record, or any other thing for the purposes of the Act. A clarification is proposed to section 227 for the avoidance of doubt, to insert a reference to “statement” to make it clear that regulations can be made to prescribe information requirements for the LTTS.

Amendments are also proposed to section 83 to update the references to the types of information which may be released under this section. The purpose of this section is to continue the current rules regarding disclosure of information in aggregate form. This is achieved by including a definition of identifying information and allowing future regulations to deem any further information as identifying information.

Transitional provisions are proposed to specify that the current LTTS requirements apply until the new regulations are made.

Purchase price allocation

PURCHASE PRICE ALLOCATION

(Clause 40)

Summary of proposed amendments

The proposed amendments tighten the rules that govern how parties to a sale of two or more assets with different tax treatments (a "mixed supply") allocate the total price between the assets, for income tax purposes. The amendments do not affect existing law relating to the determination of the price when the purchaser assumes any vendor liabilities. The objective of the amendments is to prevent an overall revenue loss when vendors and purchasers adopt different price allocations that minimise their own tax liabilities.

Application date

The proposed amendments would apply to agreements for the disposal and acquisition of property entered into on or after 1 April 2021.

Key features

The core elements of the proposal are:

- If the parties agree an allocation, they must follow it in their tax returns.
- If the parties do not agree an allocation, the vendor is entitled to determine the allocation, and must notify both the purchaser and the Commissioner of it within two months of the change in ownership of the assets. However, the vendor must allocate amounts to taxable property (depreciable property, revenue account property, financial arrangements) such that there is no additional loss on the sale of that property.
- If the vendor does not make an allocation within the two-month timeframe, the purchaser is entitled to determine the allocation, and notify both the vendor and the Commissioner of it.
- The Commissioner may challenge an allocation if she considers it does not reflect market values.
- The purchase price allocation rules will not apply to a transaction if the total purchase price is less than $1 million, or the purchaser's total allocation to taxable property is less than $100,000.

Background

When a bundle of assets is sold, and not all the assets have the same tax treatment for a party, that party must allocate the total transaction price between the various assets for tax purposes. The allocation determines the vendor's tax liability from the sale, and the purchaser's cost base for claiming deductions over time.

Under the current law, the parties are generally required to ascribe market values to the assets. However, market value is a range, and other than for trading stock there is no requirement for the vendor and purchaser to use the same market value. This means that the two parties can adopt different allocations which minimise their own respective tax liabilities and are therefore detrimental to the government's revenue base overall. Such discrepancies have been identified in a number of large commercial property transactions and sales of going concern businesses, with the total revenue loss sometimes being in the millions of dollars.

The proposed amendments are designed to improve the integrity of the income tax rules by requiring consistency between the parties' allocations, and to reinforce the existing requirement that the allocation be based on relative market values.

Detailed analysis

The purchase price allocation reforms are proposed to be implemented by two new sections in subpart GC of the Income Tax Act 2007.

Proposed section GC 20 applies when the vendor and purchaser (person A and person B) in a mixed supply have agreed an allocation to the property before filing their respective returns of income in relation to the transaction. The parties must file in accordance with the agreed allocation. There is no de minimis for this requirement, because a threshold would undermine the expectation that parties who have agreed an allocation should always adhere to that agreement.

Proposed section GC 21 applies when the vendor and purchaser have *not* agreed an allocation to the property before filing their returns of income in relation to the transaction. The objective of the section is to ensure that a single allocation is made, and that the allocation is followed by both parties when they file their tax returns.

The vendor is required, within two months after the change in ownership of the property, to determine the allocation, and must notify both the purchaser and the Commissioner of its allocation. Both the vendor and the purchaser must then file on the basis of that allocation.

In making the allocation, the vendor is subject to one constraint that over-rides the market value requirement: it must allocate amounts to taxable property such that there is no additional loss on the sale of that property. The vendor cannot, therefore, allocate to an item of depreciable property an amount that is less than its adjusted tax value (adjusted for a pro rata portion of the depreciation in the year of sale). This constraint is included to protect the purchaser from an unreasonably low allocation that might not be challenged by the Commissioner.

It is possible that in some cases, despite the obligation on it to do so, the vendor will not make an allocation. For example, it may be in liquidation and decide that making an allocation is not necessary for practical reasons. If the vendor fails to make an allocation within the two-month timeframe, the obligation to determine the allocation is transferred to the purchaser. The purchaser must notify both the vendor and the Commissioner of its allocation. Both the purchaser and the vendor must then file on the basis of that allocation. There is no constraint on the purchaser's allocation other than the requirement for relative market values to be used.

Whether the allocation is agreed between the parties or made unilaterally by the vendor or the purchaser under section GC 21, the Commissioner has the power to require the parties to adopt a different allocation if she considers the allocation does not reflect relative market value.

It is not intended that parties have to allocate an amount to every individual item. It will be sufficient for the allocation to be made at the level of asset categories subject to particular income or deduction rules – for example, depreciable property, buildings, revenue account property, financial arrangements, land, and so on. This eliminates most of the scope for tax manipulation without imposing unrealistic compliance costs. Of course, more detailed allocations are also acceptable.

De minimis thresholds apply to the consistency rules outlined above. These thresholds are included so that parties to small transactions, in which the scope for tax manipulation is small, do not have to bear any extra compliance costs that might arise from being required to notify an allocation, or follow one notified by the other party. These de minimises only apply where the parties have *not* agreed an allocation; if the parties have agreed an allocation, they must file their returns on the basis of it, regardless of the transaction size.

The thresholds are a total sale/purchase price of $1 million and an allocation by the purchaser to taxable property of $100,000. If the transaction falls below either of the two thresholds, the proposed consistency requirements will not apply to the parties. Because the second threshold depends on the purchaser's allocation, the vendor may require an undertaking from the purchaser before relying on it.

There is one other de minimis threshold, which applies to the Commissioner's ability to replace an agreed or vendor's allocation with a market value allocation. The Commissioner cannot challenge an allocation to an item of depreciable property if:

- the original cost of the property to the vendor is less than $10,000;
- the allocation to the property is no less than its adjusted tax value and no greater than its original cost; and
- where there are multiple identical assets each with an original cost of less than $10,000, the total amount allocated to those assets is less than $1 million.

This de minimis is included to provide additional certainty to vendors that are adopting a simple method of ascribing values to low-value depreciable assets.

In the unlikely event that neither party makes an allocation, the vendor is treated as disposing of the property for its relative market value, and the purchaser is treated as acquiring the property for nil consideration. The effect of this is that the purchaser is unable to claim depreciation or other deductions in relation to the property until it has made an allocation, so it has an incentive to do so before it files its tax return.

There is a specific rule, which applies to both the vendor and purchaser, for allocations to agricultural, aquacultural and forestry improvements that are amortisable under sections DO 4, DO 12 and DP 3 respectively. In line with the existing law, the amount that must be allocated to these improvements is the diminished value amount under the relevant section. The vendor is obliged to provide this figure to the purchaser. If the diminished value cannot be determined, the purchaser is treated as acquiring the improvement for nil consideration, and therefore cannot claim deductions for it going forward.

Section EB 24, which requires the purchaser to use the vendor's allocation for trading stock, will be redundant once the proposed purchase price allocation rules are implemented, and is therefore being repealed.

Other policy items

GST ON OUTBOUND MOBILE ROAMING SERVICES

(Clauses 86, 87, 89 and 91)

Summary of proposed amendment

These amendments would result in outbound mobile roaming services used by a person with a New Zealand mobile device while they are outside New Zealand becoming subject to GST at the standard rate of 15%. Currently, outbound mobile roaming services are either zero-rated (subject to GST at the rate of 0%) or not subject to GST.

These amendments would also ensure that inbound mobile roaming services used by a non-resident in New Zealand would be zero-rated or not subject to GST. Currently, inbound mobile roaming services may be subject to GST at the standard rate of 15% but are generally not subject to GST.

Application date

The proposed amendment would apply from 1 April 2022.

Key features

The amendment would add a definition to the Goods and Services Tax Act 1985 for mobile roaming services. These would be mobile telecommunications services supplied to a person's mobile device while they are outside the country of their usual mobile network. The country of a person's usual mobile network would be determined by the country code of the subscriber identity module (SIM) used in their mobile device.

Outbound mobile roaming services would mean mobile roaming services used by a person whole usual mobile network is in New Zealand. The amendments would result in these services becoming subject to GST at the standard rate of 15%.

Inbound mobile roaming services would refer to mobile roaming services used by a person who is in New Zealand and whose usual mobile network is outside New Zealand. The amendments would result in inbound mobile roaming services supplied to non-residents being zero-rated if supplied by a resident, or treated as being made outside New Zealand (and therefore not subject to GST) if supplied by a non-resident.

Background

In 2003 special GST rules for cross-border supplies of telecommunications services were introduced to address concerns around how the GST rules at that time applied to these services, such as mobile roaming services. These special rules use the location of the person who initiates the supply from a telecommunications supplier as a proxy for determining the place of consumption of these services.

Under the current rules for telecommunications services, outbound mobile roaming services used by a New Zealand resident travelling overseas are either zero-rated or not subject to GST. Conversely, inbound mobile roaming services used by non-residents travelling in New

Zealand may be subject to GST at the standard rate of 15%. However, a special registration rule for non-resident telecommunications suppliers means inbound mobile roaming services are generally not subject to GST.[4] This non-application of GST to both outbound and inbound mobile roaming services is contrary to New Zealand's broad-based GST framework.

Since the rules for telecommunications services were introduced, the OECD has developed the *International VAT/GST Guidelines*, which provide proxies for determining the place of consumption of cross-border services and intangibles. For "on-the-spot" services, where the supplier and the consumer need to be in the same place (for example, a haircut), the Guidelines suggest a place of performance test for determining the place of consumption. For remote services and intangibles, where it is not necessary for the supplier and the consumer to be in the same place (for example, a digital download), the Guidelines suggest the consumer's usual place of residence as the test for determining the place of consumption.

The Guidelines adopt a broad definition of what is a remote service, including supplies of telecommunications services. In light of the Guidelines, the European Union and the United Kingdom both now apply VAT to outbound mobile roaming services used by their residents while overseas.

Detailed analysis

Definition of mobile roaming services

The amendments would add a definition to the GST Act for mobile roaming services. These would be mobile telecommunications services supplied to a person's mobile device while they are outside the country of their usual mobile network. The country of a person's usual mobile network would be determined by the country code of the subscriber identity module (SIM) used in their mobile device.

Paragraph (c)(ii) of the definition would define outbound mobile roaming services as roaming services received by a person whose usual mobile network is in New Zealand.

Example 12: Outbound mobile roaming service

Kelvin-Kyle is a New Zealand resident visiting his friend Raymond in the town of Stewart, Minnesota. While there he uses his mobile phone for calls, texts and data. Kelvin-Kyle's SIM has a New Zealand country code, which means that while he's overseas he is using outbound mobile roaming services.

Paragraph (c)(i) of the definition would define inbound mobile roaming services as services received by a person who is in New Zealand and whose usual mobile network is outside New Zealand.

[4] See section 51(1)(e).

Example 13: Inbound mobile roaming service

Graeme is a Scottish resident visiting New Zealand. While in New Zealand he uses his mobile phone to make calls. His SIM has a British country code, which means that while he is in New Zealand he is using inbound mobile roaming services.

The definition of mobile roaming services would also include services supplied to enable a person to receive mobile telecommunications services when they are outside the country of their usual mobile network. This is intended to capture roaming deals offered by telecommunications suppliers that enable their customers to continue using their regular mobile plan while overseas for a flat daily or weekly fee.

Example 14: Services to enable mobile roaming

Kiwiphone is a New Zealand telecommunications supplier that allows its customers to continue using their regular mobile plan while travelling overseas for a fee of $5 per day. This service is an outbound mobile roaming service as it enables Kiwiphone's customers to receive mobile telecommunications services while outside New Zealand.

If a person travelling overseas uses a local SIM in their mobile device, they would not be using mobile roaming services. This is because their usual mobile network would be determined by the country code of the SIM – which in this case would be the country they are travelling in.

Example 15: Local SIM

Emmett is an Australian resident on holiday in New Zealand and he purchases a New Zealand SIM card to use in his mobile device. Because the country code of the SIM is New Zealand, that is considered to be the country of his usual mobile network. So Emmett is not using mobile roaming services.

Outbound mobile roaming services

Currently, outbound mobile roaming services are zero-rated if supplied by a resident, and treated as being made outside New Zealand (and therefore not subject to GST) if supplied by a non-resident. The amendments would result in outbound mobile roaming services becoming subject to GST at the standard rate of 15%. This would be achieved by:

- new section 11AB(2) preventing the zero-rating provision in paragraph (1)(b) from applying to outbound mobile roaming services; and
- new section 8(8B) treating supplies by non-residents of outbound mobile roaming services as being made in New Zealand.

Inbound mobile roaming services

Currently, inbound mobile roaming services are subject to GST at 15%. The amendments would result in inbound mobile roaming services supplied to non-residents becoming zero-rated if supplied by a resident, and treated as being made outside New Zealand if supplied by a non-resident. This would be achieved by:

- new section 11AB(1)(c) adding a zero-rating provision for inbound mobile roaming services supplied to non-residents; and

- amending section 8(7) by moving the existing subsection to new paragraph (a) and adding paragraph (b) to treat inbound mobile roaming services supplied to non-residents by a non-resident as being made outside New Zealand (and therefore not subject to GST).

Section 51(1)(e) would also be repealed by the amendments. This paragraph ensured that non-residents whose only supplies in New Zealand were inbound mobile roaming services were not required to register for GST. The amendments would make this paragraph unnecessary as inbound mobile roaming services supplied by a non-resident to non-residents travelling in New Zealand would no longer be treated as being made in New Zealand.

INCOME TAX TREATMENT OF LEASES SUBJECT TO NZ IFRS 16

(Clauses 8, 15, 22, 23, 26, 58 (lease (10), NZ IAS 17 (11), NZ IFRS 16 (12)))

Summary of proposed amendment

The Bill proposes changes to allow taxpayers with certain leases accounted for under *New Zealand Equivalent to International Financial Reporting Standard 16 Leases* (NZ IFRS 16) to choose to more closely follow their accounting treatment for tax purposes.

The proposed tax changes result from the replacement of the previous accounting standard for leases, *New Zealand Equivalent to International Accounting Standard 17 Leases* (NZ IAS 17), with NZ IFRS 16, which applies to income years starting on or after 1 January 2019.

Application date

The proposed amendment would apply for balance dates starting on or after 1 January 2019, to align with the application date of NZ IFRS 16.

Key features

The Bill proposes to allow lessees who use NZ IFRS 16 a one-off choice to more closely follow their accounting treatment for tax. For the purpose of this commentary making this choice is referred to as "applying NZ IFRS 16 for tax" and the date it is done is called the "tax transition date".

Income and expenditure arising from a lease would be calculated under proposed new section EJ 10B, which will apply only if the taxpayer elects to apply NZ IFRS 16 for tax under proposed section EJ 10B(1)(d). Expenditure would be deductible under proposed section DB 51C and income would be assessable under proposed section CC 14. Most amounts calculated under section EJ 10B are expected to be expenditure, but income can arise in some circumstances, such as when an impairment adjustment from a previous year is reversed through profit and loss for accounting purposes.

NZ IFRS 16 is proposed to apply for tax purposes for all operating leases of personal property that meet the proposed criteria to be an IFRS lease in section EJ 10B(1), which are that:

- the person applies NZ IFRS 16 for accounting and has chosen to apply NZ IFRS 16 for tax;
- the lessor and lessee are not associated; and
- the asset is not subleased to another person.

NZ IFRS 16 spreads certain lease expenditure, including provisions, in a way that results in the timing of recognition of this expenditure for accounting purposes being significantly different to when it would be incurred for tax purposes. Proposed section EJ 10B(2) to (4) requires adjustments to ensure this expenditure is deductible for tax at a similar time to when it would be deductible for a taxpayer not applying NZ IFRS 16 for tax.

When an IFRS lease ends, either because the lease itself ends or because it no longer qualifies to be an IFRS lease, proposed section EJ 10B(5) and (6) requires a wash-up to ensure that total deductions over the term of the lease match those that would have been deductible for a taxpayer not applying NZ IFRS 16 for tax.

Proposed section EJ 10B(7) and (8) includes transitional adjustments for certain leases when NZ IFRS 16 applies for tax after the original start of the lease. This can arise in the year a taxpayer first chooses to apply NZ IFRS 16 for tax, or in a later year for an individual lease that did not meet the IFRS lease requirements but subsequently does.

Background

Under a lease, one person (the lessor) who owns (or otherwise holds) an asset provides it to another person (the lessee) to use in exchange for payment over the term of the lease. For entities with NZ IFRS reporting obligations, the accounting treatment was previously determined under NZ IAS 17. This standard has been replaced by NZ IFRS 16 for years starting on or after 1 January 2019. It was also possible to apply the standard before this and officials are aware that some taxpayers did so.

Under NZ IAS 17, there was a difference in the accounting treatment for operating and finance leases for both lessors and lessees. NZ IAS 17 defined the distinction as:

> *A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.*

For lessees, NZ IFRS 16 removes the distinction between operating and finance leases for accounting purposes. Under NZ IFRS 16, lessees are required to include all leases on their balance sheet by recognising both an asset, being the right to use the leased asset for the lease term, and a lease liability, representing the obligation to pay rentals.

NZ IFRS 16 also changes the timing of accounting expenditure for lessees compared to the previous treatment, but total deductions are unchanged over the life of the lease. This can be shown in the simplified example in table 1 for a five-year lease, that was an operating lease under NZ IAS 17, with $100,000 per year of lease payments and a 3.7237%[5] discount rate.

[5] This interest rate has been chosen as a representative rate as it was the NZ dollar five-year BBB+ rate on a particular day when officials were considering this project. This rate is used in all NZ IFRS 16 examples in this commentary. The actual interest rate is determined for each individual lease, based on its specific terms and features, following the requirements set by IFRS 16.

Table 1: Simplified example for a five-year lease

Year	NZIAS 17 expenses	IFRS 16 expenses
1	$100,000	$106,439
2	$100,000	$103,337
3	$100,000	$100,120
4	$100,000	$96,783
5	$100,000	$93,322
Total	$500,000	$500,000

NZ IFRS 16 does not significantly change the accounting treatment of leases for the lessor. The lessor will continue to show the leased asset on their balance sheet for operating leases.

The Bill does not propose any changes for the tax treatment of lessors. Nor does it propose any changes for the tax treatment of leases for taxpayers that do not have NZ IFRS reporting obligations.

The Income Tax Act 2007 requires a different tax treatment for operating and finance leases. The tax definitions of operating and finance leases are similar but not identical to the accounting definitions. The Bill does not propose to change these tax definitions.

Detailed analysis

Updates to the tax definition of finance leases and operating leases

The definition of finance lease in section YA 1 of the Income Tax Act 2007 refers to NZ IAS 17. The Bill proposes to update the definition to refer to NZ IFRS 16.

No changes are proposed to the existing distinction between finance leases and operating leases for tax purposes.

Finance leases and the yield to maturity method

Section EW 15I allows a person who has a tax finance lease that is classified as an operating lease under NZ IAS 17 to apply the yield to maturity method. NZ IFRS 16 has removed the accounting distinction between operating and finance leases for lessees. However, the yield to maturity method will continue to be available for these leases by applying section EW 15E.

The Bill proposes updating section EW 15I to refer to NZ IFRS 16 rather than NZ IAS 17, as a lessor applying NZ IFRS 16 may still have a tax finance lease that is classified as an operating lease for accounting.

Lessors under tax operating leases for NZ IFRS taxpayers

No changes are proposed to the tax treatment of lessors.

__Lessees under tax operating leases for NZ IFRS taxpayers__

The changes proposed in the Bill are optional. NZ IFRS taxpayers who choose not to apply NZ IFRS 16 for tax will be able to continue to follow their existing treatment.

Optional election

The Bill proposes that a taxpayer that applies NZ IFRS 16 for accounting can make a one-off choice in section EJ 10B(1)(d) to apply NZ IFRS 16 for tax.

The Bill proposes that the election would be made by calculating deductions under the proposed rules in the income tax return for the income year the choice is made. No separate election would be required. Once a taxpayer makes this choice they would use this method for all future years that they apply NZ IFRS 16 for accounting purposes.

This election is proposed to be available in any income year, so a taxpayer can choose to first apply NZ IFRS 16 for tax in a year later than when they first apply NZ IFRS 16 for accounting.

Leases within the scope of the proposed rules

A taxpayer choosing to apply NZ IFRS 16 for tax would be required to follow the proposed rules for all qualifying tax operating leases where they are the lessee. This would apply to all new and existing leases from the start of the first year the election is made. Such leases are defined in proposed section EJ 10B(1) as an IFRS lease.

However, the Bill proposes that a taxpayer would continue to apply their existing treatment for the following tax operating leases:

- a lease of real property;
- a lease from an associated party; and
- a lease where the asset is subleased.

Real property

The Act already treats all leases of real property as an operating lease. The proposed rules mean that a lease of real property will continue to follow the existing treatment even if a taxpayer has chosen to apply NZ IFRS 16 for tax for other leases.

The existing definition of a finance lease in the Income Tax Act 2007 applies only to personal property lease assets, so that a lease of real property cannot be a finance lease. The Bill proposes to apply this same approach to exclude real property from being an IFRS lease. Real property leases will continue to be subject to the existing tax treatment.

Associated parties

The different treatment between lessors and lessees under NZ IFRS 16 means that if a taxpayer could choose to apply NZ IFRS 16 for tax for an asset they lease from an associated party, it would result in a tax timing advantage compared to purchasing it directly. To prevent this scenario the Bill proposes to continue using the existing tax treatment for all operating leases from an associated party as such a lease will not come under proposed section EJ 10B(1)(b).

Two unassociated parties might enter into an operating lease under the proposed rules and then subsequently become associated, for example because of a change in shareholding. It is proposed that the lease would no longer qualify as an IFRS lease, and the tax treatment of that lease would revert to the existing treatment including a wash-up as described below.

Subleases

Under NZ IFRS 16, when an asset is subleased to a second person, and the sublease of the lessor is a finance lease for accounting, the asset in the first person's balance sheet changes from a right-of-use asset to a finance lease receivable. If the tax treatment followed the accounting treatment, the lessor would not be entitled to deductions for the amortisation of a right-of-use asset. To resolve this situation the Bill proposes to continue the existing tax treatment for all operating leases when the asset is subleased to another person, as such a lease will not come under proposed section EJ 10B(1)(c).

If an asset is subleased to another person part-way through a lease term, it is proposed that the lease would no longer qualify as an IFRS lease, and the tax treatment of that lease would revert to the standard treatment and include a wash-up as described below. The exclusion of real property leases from the proposed rules is expected to significantly reduce this situation occurring.

Leases that previously did not meet the definition of an IFRS lease

For a lease that would not have qualified before the tax transition date but does qualify at the transition date there are no additional complications. In other words, this lease will transition into applying NZ IFRS 16 for tax in the same way as leases that have always qualified.

For a lease that did not qualify after the tax transition date (either because it never met the definition of an IFRS lease or because it no longer met the definition and was therefore subject to a wash-up as described below) but that subsequently meets the IFRS lease definition (for example, the lessee and lessor are no longer associated and therefore the lease is not excluded under proposed section EJ 10B(1)(c)) the lessee will apply NZ IFRS 16 for tax from the date it meets the definition but will be required to apply the transitional adjustment in proposed section EJ 10B(7) and (8).

Leases that do not follow NZ IFRS 16

A lessee that follows NZ IFRS 16 for accounting may have individual leases that are not accounted for on their balance sheet. Examples of this could include short-term or low-value leases. The accounting treatment of these leases will still be in accordance with NZ IFRS 16, and any accounting expenditure recognised through the profit and loss account will be deductible. The accounting treatment for these specific leases is expected to be similar to the existing tax treatment.

Adjustments

The proposed rules are not intended to significantly accelerate tax deductions compared to those available under the existing rules.

It is proposed that tax adjustments set out in table 2 may be required when a taxpayer chooses to apply NZ IFRS 16 for tax.

Table 2: Results of spreading and the proposed tax adjustments that may be required

If the spreading results in accounting deductions that are…	...then it is proposed that a tax adjustment is made
before the expenditure is incurred (for example, impairment or revaluation amounts, or make-good costs)	• to ensure that tax deductions are only available in a similar period to when the expenditure is incurred.
later than when the expenditure is incurred (for example, certain direct or mobilisation costs)	• to ensure tax deductions are available in a similar period to when the expenditure is incurred, and • it would be optional, so that a taxpayer who would incur higher compliance costs in making the adjustment than the perceived value of that adjustment will not be required to do so.

The formula in proposed section EJ 10B(2) includes three adjustment amounts: add-back adjustment, impairment and revaluation adjustment, and make-good and direct costs adjustment:

- **Add-back adjustment** decreases the tax deduction by the total increase in impairment or revaluation adjustments for a lease when they are recorded or amended through profit and loss (and likewise increases the tax deduction if these impairment or revaluation adjustments are reversed through profit and loss). This is necessary as these impairment or revaluation adjustments do not reflect expenditure that has been incurred. These adjustments are referred to in paragraphs 33 and 35 of NZ IFRS 16. There is no equivalent adjustment for fair value movements referred to in paragraph 34 of NZ IFRS 16 as these relate to investment property, which will be excluded from applying NZ IFRS 16 for tax as it is real property.
- **Impairment and revaluation adjustment** increases the tax deduction by the amount of the add-back adjustment spread in equal proportions over the remaining term of the lease, taking into account part-years on a pro rata basis (and likewise decreases the tax deduction if the add-back adjustment increases the tax deduction). This is designed to approximate the accounting (and therefore tax) deductions that would have been available had the impairment or revaluation adjustment not been made.
- **Make-good and direct costs adjustment** realigns the tax impact of these costs that are required to be spread over the lease term under NZ IFRS 16 but are incurred at a single point (or points) for tax purposes. The adjustment decreases the tax deduction by the amount of make-good costs described in paragraph 24(d) and the amount of direct costs described in paragraph 24(c) of NZ IFRS 16. These are nominal amounts (not discounted). The amounts are spread in equal proportions over the remaining term of the lease, taking into account part-years on a pro rata basis. Make-good costs are the costs of restoring the leased asset and are spread over the term of the lease under NZ IFRS 16 but are tax deductible when they are incurred, which is typically at or near the end of the lease. A make-good cost adjustment is proposed to be compulsory to prevent expenditure being deductible before it is incurred. Direct costs are the costs of obtaining or setting up the leased asset and are spread over the term of the lease under NZ IFRS 16 but, in some circumstances when they are not required to be capitalised into the asset value, would be tax deductible when they are incurred, which is typically at or near the beginning of the lease. A direct cost adjustment is proposed to be

optional, so if a taxpayer would incur greater compliance costs in calculating the adjustment than they would benefit from making it, they can choose to continue following their accounting treatment.

An equal spread of either the impairment and revaluation adjustment or the make-good and direct costs adjustment may not exactly replicate the accounting spread of these adjustments but is intended to be easier for taxpayers to calculate and will total to the same amount over the term of the lease.

Proposed section EJ 10B(4) allows a deduction for make-good costs and direct costs when they are incurred. To ensure all direct costs incurred are deductible only once, this will apply only when the taxpayers has chosen to include direct costs in the formula in proposed section EJ 10B(2).

Example 16: Impairment

On 1 April 2022, A Co enters into a five-year equipment lease with payments of $100,000 at the end of each year. Its expected deductions are shown in the table.

Year ended 31 March	Accounting expenditure	Add-back adjustment	Impairment and revaluation adjustment	Make-good and direct costs adjustment	Tax deduction
2023	$106,439	$0	$0	$0	$106,439
2024	$103,337	$0	$0	$0	$103,337
2025	$100,120	$0	$0	$0	$100,120
2026	$96,783	$0	$0	$0	$96,783
2027	$93,322	$0	$0	$0	$93,322
Total	$500,000	$0	$0	$0	$500,000

On 31 March 2024, A Co recognises that a change in their business model makes the equipment less valuable to them than it previously had been and records a $200,000 impairment charge. The altered deductions are shown in the table.

Year ended 31 March	Accounting expenditure	Add-back adjustment	Impairment and revaluation adjustment	Make-good and direct costs adjustment	Tax deduction
2023	$106,439	$0	$0	$0	$106,439
2024	$303,337	$200,000	$0	$0	$103,337
2025	$33,453	$0	$66,667	$0	$100,120
2026	$30,116	$0	$66,667	$0	$96,783
2027	$26,655	$0	$66,667	$0	$93,322
Total	$500,000	$0	$200,000	$0	$500,000

Example 17: Make-good costs

On 1 April 2022, B Co enters into a five-year equipment lease with payments of $100,000 at the end of each year. They also expect to have to spend $125,000 restoring the asset at the end of the lease. Its deductions are shown in the table.

Year ended 31 March	Accounting expenditure	Add-back adjustment	Impairment and revaluation adjustment	Make-good and direct costs adjustment	Tax deduction
2023	$131,139	$0	$0	$25,000	$106,139
2024	$128,182	$0	$0	$25,000	$103,182
2025	$125,114	$0	$0	$25,000	$100,114
2026	$121,933	$0	$0	$25,000	$96,933
2027	$118,633	$0	$0	$25,000	$93,633
Total	$625,000	$0	$0	$125,000	$500,000

B Co is also entitled to a tax deduction for any costs incurred in restoring the asset under proposed section EJ 10B(4)(a).

Cumulative adjustments

An impairment and revaluation adjustment and a make-good and direct costs adjustment must be carried forward into the remaining income years of the lease term when applying the formula in proposed section EJ 10B(2). This means there may be more than one impairment and revaluation adjustment or make-good and direct costs adjustment in a year.

Example 18: Cumulative adjustments

Continuing the scenario in example 17, on 1 April 2024 B Co decides that the estimated make-good costs should be increased by $30,000 to $155,000. Its revised deductions are shown in the table.

Year ended 31 March	Accounting expenditure	Original make-good costs adjustment	New make-good costs adjustment	Total make-good and direct costs adjustment	Tax deduction
2023	$131,139	$25,000		$25,000	$106,139
2024	$128,182	$25,000		$25,000	$103,182
2025	$135,077	$25,000	$10,000	$35,000	$100,077
2026	$131,932	$25,000	$10,000	$35,000	$96,932
2027	$128,671	$25,000	$10,000	$35,000	$93,671
Total	$655,000	$125,000	$30,000	$155,000	$500,000

B Co is also entitled to a deduction for any costs incurred in restoring the asset under proposed section EJ 10B(4)(a).

Lease term

The impairment and revaluation adjustment and make-good and direct costs adjustment in proposed section EJ 10B(3) are both required to be spread in equal proportions over the remaining income years of the lease term. NZ IFRS 16 requires a specific lease term for each lease but this can change over time, for example when an entity decides they will take up an option to extend a lease that they previously had not planned to do. The lease term referred to in these proposed adjustments is the lease term recognised by NZ IFRS 16 at the time of the initial adjustment, but this is not updated if the lease term recognised by NZ IFRS 16 subsequently changes. By not having to change the tax adjustments to reflect the change in lease term, compliance costs are expected to be minimised.

The consequence of this approach is if the lease term shortens the full amount of adjustments will not be made before the maturity of the lease so these will be covered by the wash-up calculation described below. Likewise, if the lease term extends, the full amount of adjustments will be made before the maturity of the lease so there may not be adjustments in the final years. In either case, on an individual year basis the tax adjustments will not match the accounting consequences arising from the change in lease term. However, over the full term of the lease these differences will net to zero.

Example 19: Extended lease term

Continuing the scenario in example 17, on 1 April 2025 B Co agrees with the lessor to extend the lease to seven years. Lease payments remain at $100,000 per year and make-good costs are estimated to increase by $20,000 to $145,000. They are now incurred in March 2029 instead of 2027. B Co's deductions are shown in the table.

Year ended 31 March	Accounting expenditure	Original make-good costs adjustment	New make-good costs adjustment	Total make-good and direct costs adjustment	Tax deduction
2023	$131,139	$25,000		$25,000	$106,139
2024	$128,182	$25,000		$25,000	$103,182
2025	$125,114	$25,000		$25,000	$100,114
2026	$119,821	$25,000	$5,000	$30,000	$89,821
2027	$116,777	$25,000	$5,000	$30,000	$86,777
2028	$113,621		$5,000	$5,000	$108,621
2029	$110,346		$5,000	$5,000	$105,346
Total	$845,000	$125,000	$20,000	$145,000	$700,000

B Co is also entitled to a deduction for any costs incurred in restoring the asset under proposed section EJ 10B(4)(a).

Transitional adjustment

Appendix C of NZ IFRS 16 sets out the accounting transition for entities applying NZ IFRS 16 for the first time. The two possible transition approaches in paragraph C5 allow taxpayers to choose between applying NZ IFRS 16:

- retrospectively to each prior period's profit and loss account, which will result in a movement (positive or, more commonly, negative) to the entity's opening retained earnings in the year of transition; and
- to the remaining lease term at the date of initial application of NZ IFRS 16, which will not affect the opening retained earnings in the year of transition.

The Bill includes proposed section EJ 10B(7) and (8) to ensure the correct tax deductions are available for any leases outstanding when the entity transitions to applying NZ IFRS 16 for tax. A tax transitional adjustment could be necessary in one of three scenarios.

- A taxpayer has applied NZ IFRS 16 retrospectively to ensure any movements to retained earnings upon to the year of tax transition[6] are correctly deductible.
- A taxpayer chooses to apply NZ IFRS 16 for tax one or more years after they started following NZ IFRS 16 for accounting, to ensure any difference between NZ IFRS 16 deductions and tax deductions under the existing rules are correctly deductible.
- A taxpayer is already applying NZ IFRS 16 for tax and has one or more leases that previously did not meet the requirements to be an IFRS lease but subsequently does qualify. The transitional adjustment will ensure any difference between NZ IFRS 16 deductions and tax deductions before applying NZ IFRS 16 for tax is correctly deductible.

The tax transitional adjustment is calculated for each lease at the date of tax transition using the formula in proposed section EJ 10B(7):

$$\textit{retrospective accounting expenditure} - \\ \textit{retrospective tax adjustments} - \textit{previous tax deductions}$$

Each of these terms is defined in proposed section EJ 10B(8):

- **Retrospective accounting expenditure** is the total expenditure or loss recognised under NZ IFRS 16 for the income years that a person has applied NZ IFRS retrospectively.
- **Retrospective tax adjustments** is the total tax adjustments that would have been required in relation to the total expenditure or loss recognised under NZ IFRS 16 for the income years that a person has applied NZ IFRS 16 retrospectively, if the entity had applied proposed section EJ 10B.
- **Previous tax deductions** is the total tax deductions incurred from entering into the lease until the tax transition date.

The proposed transitional adjustment may be deductible expenditure or assessable income. In either case this should be spread equally over the tax transition year and the four subsequent years. When a transitional adjustment arises due to an election to apply NZ IFRS 16 for tax it will arise at the start of an income year and apply evenly across these five years. When a transitional adjustment arises because an existing lease newly meets the IFRS lease definition, the transitional adjustment could first arise in the middle of an income year; however, it should still be spread evenly across the five income years even if the

[6] The year of accounting transition and tax transition will usually be the same, but if tax transition happens in a subsequent year the tax transitional adjustment will also need to include the retained earnings impact of the years when the entity follows NZ IFRS 16 for accounting and not for tax.

remaining period of the first income year is shorter than a full year. This is in contrast to the impairment and make-good costs adjustments referred to above which would take into account part-years on a pro rata basis.

In many instances an existing lease will mature before the end of this five-year spreading period. The Bill proposes that any undeducted expenditure or unreturned income would be incorporated into the wash-up calculation discussed below.

Example 20: Retrospective transition

C Co entered into a seven-year equipment lease with $100,000 annual payments on 1 April 2017. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. Its accounting entries are shown in the table.

Year ended 31 March	NZ IAS 17 accounting expenditure	NZ IFRS 16 accounting expenditure	NZ IFRS 16 retained earnings adjustment
2018	$100,000		
2019	$100,000		
2020		$103,333	$15,529
2021		$100,231	
2022		$97,014	
2023		$93,677	
2024		$90,216	
Total	$200,000	$484,471	$15,529
Grand total	$700,000		

As there are no adjustments for impairment, revaluation or direct costs the total tax transitional adjustment is equal to the NZ IFRS 16 retained earnings amount of $15,529. When this is spread equally over five income years the tax transitional adjustment is $3,106 per year. C Co's tax deductions are shown in the table.

Year ended 31 March	Tax deduction pre-transitional adjustment	Tax transitional adjustment	Total tax deduction
2018	$100,000		$100,000
2019	$100,000		$100,000
2020	$103,333	$3,106	$106,439
2021	$100,231	$3,106	$103,337
2022	$97,014	$3,106	$100,120
2023	$93,677	$3,106	$96,783
2024	$90,216	$3,106	$93,322
Total	$684,471	$15,529	$700,000

Example 21: Retrospective transition with delayed tax transition

D Co entered into a seven-year equipment lease with $100,000 annual payments on 1 April 2017. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. Its accounting entries are identical to those for C Co in example 20.

D Co chooses not to apply NZ IFRS 16 for tax in its year beginning 1 April 2019 and instead chooses to apply NZ IFRS 16 for tax in its year beginning 1 April 2020. Again, there are no adjustments for impairment, revaluation or direct costs so the total tax transitional adjustment is $3,333 + $15,529 = $18,862, as shown in the table.

Year ended 31 March	Tax deduction	NZ IFRS 16 accounting expenditure	NZ IFRS 16 retained earnings adjustment
2018	$100,000		
2019	$100,000		
2020	$100,000	$103,333	$15,529
Total	$300,000	$103,333	$15,529

When this is spread equally over five income years the tax transitional adjustment is $3,772 per year. D Co's tax deductions are shown in the table.

Year ended 31 March	Tax deduction pre-transitional adjustment	Tax transitional adjustment	Total tax deduction
2018	$100,000		$100,000
2019	$100,000		$100,000
2020	$100,000		$100,000
2021	$100,231	$3,772	$104,003
2022	$97,014	$3,772	$100,786
2023	$93,677	$3,772	$97,449
2024	$90,216	$3,772	$93,988
Total	$681,138	$15,089	$696,228

As the fifth-year transitional adjustment deduction is not available before the maturity of the lease, it is incorporated into the wash-up calculation (described below). D Co will get a wash-up deduction of $3,772 and total tax deductions will be $700,000.

Example 22: Non-retrospective transition

E Co entered into a seven-year equipment lease with $100,000 annual payments on 1 April 2017. It adopted NZ IFRS 16 without using the retrospective transition approach on 1 April 2019. There is no adjustment to the 1 April 2019 retained earnings, and subsequent lease expenditure is calculated as though there was a five-year lease starting on 1 April 2019. No tax transitional adjustment is required. E Co's tax deductions are shown in the table.

Year ended 31 March	NZ IAS 17 accounting expenditure	NZ IFRS 16 accounting expenditure	Tax deduction
2018	$100,000		$100,000
2019	$100,000		$100,000
2020		$106,439	$106,439
2021		$103,337	$103,337
2022		$100,120	$100,120
2023		$96,783	$96,783
2024		$93,322	$93,322
Total	$200,000	$500,000	$700,000

Example 23: Non-retrospective delayed transition

F Co entered into a seven-year equipment lease with $100,000 annual payments on 1 April 2017. It adopted NZ IFRS 16 without using the retrospective transition approach on 1 April 2019. Its accounting expenditure is identical to E Co in example 22. However, F Co chooses not to apply NZ IFRS 16 for tax in its year beginning 1 April 2019 and instead chooses to apply NZ IFRS 16 for tax in its year beginning 1 April 2020.

Again, there are no adjustments for impairment, revaluation or direct costs so the total tax transitional adjustment is $6,439, as shown in the table.

Year ended 31 March	Tax deduction	Accounting expenditure
2018	$100,000	$100,000
2019	$100,000	$100,000
2020	$100,000	$106,439
Total	$300,000	$306,439

Year ended 31 March	Tax deduction pre-transitional adjustment	Tax transitional adjustment	Total tax deduction
2018	$100,000		$100,000
2019	$100,000		$100,000
2020	$100,000		$100,000
2021	$103,337	$1,288	$104,625
2022	$100,120	$1,288	$101,408
2023	$96,783	$1,288	$98,071
2024	$93,322	$1,288	$94,610
Total	$693,561	$5,151	$698,713

When this is spread equally over five income years the tax transitional adjustment is $1,288 per year. F Co's tax deductions are shown in the table.

As the fifth-year transitional adjustment deduction is not available before the maturity of the lease, it is incorporated into the wash-up calculation (described below). F Co will get a wash-up deduction of $1,288 and total tax deductions will be $700,000.

Wash-up

When a taxpayer is no longer a lessee in an IFRS lease, either because it no longer meets the IFRS lease requirements in proposed section EJ 10B(1) or because the lease itself ends, proposed section EJ 10B(5) and (6) require a wash-up calculation to ensure total deductions match what would have been available under the existing tax treatment. This adjustment is conceptually similar to a base price adjustment under the financial arrangements rules.

The lease will no longer be an IFRS lease when:

- the lease matures;
- the lessee and lessor have become associated;
- the asset has been subleased to another person; or
- the lessee stops following NZ IFRS 16 for accounting.

This wash-up is typically expected to be zero when a lease runs its full term and NZ IFRS 16 has been applied for tax for at least five years so that the transitional adjustment spreading period in proposed section EJ 10B(7) is exhausted. If a lease existed before NZ IFRS 16 was adopted for tax, and it runs for its full term, which is less than 5 years after NZ IFRS 16 is adopted, the wash up will typically be equal to any undeducted expenditure or unreturned income under the transitional adjustment.

The wash-up adjustment is calculated for each lease using the formula in proposed section EJ 10B(5):

$$\textit{IFRS deductions} - \textit{IFRS income} - \textit{expenditure}$$

Each of these terms is defined in proposed section EJ 10B(6):

- **IFRS deductions** is the total amount deducted for tax for the lease for all income years, including the year in which the lease stops being an IFRS lease but excluding the wash-up adjustment. This may include deductions in years when section EJ 10B was not applied.
- **IFRS income** is the total amount of income returned for tax for the lease for all income years, including the year in which the lease stops being an IFRS lease but excluding the wash-up adjustment. This may include income in years when section EJ 10B was not applied.
- **Expenditure** is the total expenditure incurred since entering into the lease until the wash-up date, ignoring proposed section EJ 10B.

The wash-up adjustment may be deductible expenditure or assessable income.

Example 24: Full-term wash-up

G Co entered into a five-year equipment lease with $100,000 annual payments on 1 April 2017. It adopted NZ IFRS 16 using the retrospective transition approach on 1 April 2019. G Co's deductions excluding the wash-up calculation are shown in the table.

Year ended 31 March	NZ IAS 17 accounting deduction	NZ IFRS 16 accounting deduction	NZ IFRS 16 retained earnings adjustment	Tax deduction excluding transitional adjustment	Tax transitional adjustment	Total tax deduction
2018	$100,000			$100,000		$100,000
2019	$100,000			$100,000		$100,000
2020		$100,120	$9,775	$100,120	$1,955	$102,075
2021		$96,783		$96,783	$1,955	$98,738
2022		$93,322		$93,322	$1,955	$95,277
Total	$200,000	$290,225	$9,775	$490,225	$5,865	$496,090

G Co calculates its wash-up as:

- IFRS deductions = $496,090
- IFRS income = $0
- Expenditure = $500,000
- $496,090 – $0 – $500,000 = -$3,910

G Co has an additional deduction available in the year ended 31 March 2022 of $3,910. This amount is equal to the two remaining years of transitional adjustment that were unclaimed when the lease matured.

Example 25: Part-term wash-up example

H Co entered into a five-year equipment lease with $100,000 annual payments on 1 April 2019. On 31 March 2021 they agree with the lessor to terminate the lease early with no further payments owing. H Co's deductions are shown in the table.

Year ended 31 March	Payments	Accounting expenditure and tax deduction
2019	$100,000	$106,439
2020	$100,000	$103,337
2021	$100,000	$100,120
Total	$300,000	$309,895

H Co calculates its wash-up as:

- IFRS deductions = $309,895
- IFRS income = $0
- Expenditure = $300,000
- $309,895 – $0 – $300,000 = $9,895

H Co has additional income in the year ended 31 March 2021 of $9,895. This is the amount its deductions in the 2019–2021 years exceeded the expenditure it incurred, ignoring section EJ 10B.

SCHEDULE 32 OVERSEAS DONEE STATUS

(Clause 62)

Summary of proposed amendment

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

Application date

The proposed amendments would apply from 1 April 2020.

Key features

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

Background

Donations in money made by individuals to organisations listed in schedule 32 can receive a tax credit of 33⅓% of the donation, 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 three charitable organisations being added to schedule 32 are engaged in the following activities:

Active Hearts Foundation

Active Hearts Foundation formalised in 2017 the charitable activities of a group of New Zealand trekking guides, which were directed at improving living conditions and education outcomes in Nepalese villages in the Himalayas. Key projects to date have involved disaster relief following the 2015, 2018 and 2019 earthquakes, refitting and resourcing school libraries, resourcing community health clinics, and ensuring the resilience of local infrastructure, including an irrigation pipeline for food production.

Kiwilink

Kiwilink was formally established as a charitable trust in August 2018 to separate humanitarian projects formerly undertaken within the Associated Churches of Christ New Zealand, and continue to undertake missions with a particular focus on Zimbabwe and Vanuatu. Recent work undertaken by the Trust in Zimbabwe includes collaborating with local charities to provide orphan care, student bursaries, and water borehole drilling in the

Zvishavane region in South Western Zimbabwe. In Vanuatu, the Trust has worked on relocating people in the Ambae region displaced by volcanic activity, and providing first-aid supplies and a water storage tank at the Noui Noui Hospital.

Shimshal Trust

Shimshal Trust was set up in 2003 to support education outcomes and the relief of poverty for communities and villages in the northern region of Pakistan (Shimshal). The principal focus of the Trust is to fund scholarships to help local students with promising ability but no financial support, to attend high school or university. The Trust also provides financial support to community aid and development projects in the region.

GST CREDIT NOTES

(Clause 90)

Two amendments are proposed to ensure that a supplier that issues a GST credit note to correct a previous mistake in a GST return receives similar outcomes to a supplier that applies to the Commissioner to amend the original GST return. All section references are to the Goods and Services Tax Act 1985 unless otherwise stated.

Using a credit note to correct an invoice when 15% GST was incorrectly charged on a zero-rated supply or an exempt supply

Summary of proposed amendment

A supplier may have issued an incorrect invoice charging 15% GST on a supply of goods or services which was actually zero-rated supply (such as an export) or an exempt supply (such as a financial service). The proposed amendment to insert new subparagraph 25(1)(aaa) would allow the supplier to issue a credit note to correct the mistake.

The supplier can then include an adjustment for the correct amount of GST in the GST return for the taxable period in which the credit note was issued.

Application date

In order to align with existing commercial practices, the proposed amendments would apply retrospectively from 1 April 2012.

Background

A GST-registered supplier that supplied goods or services and incorrectly charged GST (because the supply was either zero-rated or exempt) needs to correct the error. For example, if the invoice was for $100 supply plus $15 of GST that was incorrectly charged, it would be common commercial practice to issue a credit note for the full value of the original invoice ($115), and then issue a new invoice for the correct amount ($100). This method is used for many reasons, including that it is more practical and provides a better audit trail.

It also involves fewer compliance and administrative costs than alternatives for correcting the GST, such as the supplier asking Inland Revenue under section 113 of the Tax Administration Act 1994 to amend the GST return in which the supply occurred.

Suppliers issuing a credit note in situations whereby 15% GST was incorrectly charged on a supply which actually zero-rated or exempt are currently relying on paragraph 25(1)(b) to allow them to do so. However, it is not clear that this provision was intended to be used for issuing a credit note in these situations.

Section 25(1)(b) was mainly designed to apply when the supplier subsequently offered a discount. For example, if a price is discounted from $230 to $200 the deduction allowed by section 25(2)(b) in a subsequent GST return will be 3/23 of the $30 discount: $3.91.

If the relevant supply was for consideration of $200 plus $30 of GST that was incorrectly charged, an adjustment of $30 (rather than $3.91) would be required to correctly account for the overpayment of GST.

The proposed amendment would insert a new section 25(1)(aaa) which will explicitly allow the supplier to issue a credit note when 15% GST was incorrectly charged on an exempt or zero-rated supply.

After issuing the credit note, the supplier could then include an adjustment for the correct amount of overpaid GST ($30 in the preceding example) in the GST return for the taxable period in which the credit note was issued.

Time limit for issuing a credit note for a supply made in an earlier period

Summary of proposed amendment

Proposed new section 25(3)(f) sets time limits for issuing a credit note for a supply made in an earlier period.

The proposed time limit for issuing a credit note is intended to align with the "time bar" that applies to GST refunds made through amendments to GST returns, which is generally four years from the end of the taxable period. The time limits for refunds are referred to in sections 45(1), (2) and (3) of the GST Act.

Proposed section 25(3)(f)(iii) provides the same four-year time limit for issuing a credit note that relates to a supply which was included in a previous GST return. The time limit is measured from the end of the taxable period for the earlier return.

Under section 45(4) an extra four years may be available to adjust a GST return to correct an overpayment of tax that resulted from a clear mistake or simple oversight. This effectively provides an eight-year time bar in these circumstances.

Proposed section 25(3)(f)(ii) provides the same additional time limit for issuing a credit note. This means the total of eight years is only available when the overpayment of tax, which the credit note is being issued to correct, was due to the result of a clear mistake or simple oversight.

Existing section 25(3)(f) provides a seven-year time limit for credit notes issued under section 25(1)(ab) for supplies of land which were incorrectly standard-rated rather than zero-rated. Proposed section 25(3)(f)(i) of the Bill duplicates and retains that existing section. This is because it involves a different time limit (seven years) and applies from the date of settlement, which is different to the end of the taxable period that the supply was included in a GST return.

The shorter of the new proposed limits, or the existing seven year limit for credit notes issued under section 25(1)(ab), would be used to limit the time for issuing a credit note.

Application date

The proposed amendment to impose a time limit on issuing a credit note would apply from the date that the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill was introduced.

This is necessary as there is a potential fiscal risk from publicising the fact that the current time bar may be ineffective for credit notes.

Background

The existing time limits on GST refunds in section 45 may be ineffective when a credit note is issued to provide the adjustment. This is because a credit note amends the current GST return, even though the original supply to which the credit note relates was included in an earlier GST return.

This poses a potentially large fiscal risk as it means a GST registered person may be able to use credit notes to claim GST refunds if they discovered they had been applying an incorrect GST treatment for a long time.

This would undermine the policy intent and effectiveness of the time limits for GST refunds.

PORTABILITY OF AUSTRALIAN UNCLAIMED SUPERANNUATION MONEY

(Clauses 58(3) and 93)

Summary of proposed amendment

The proposed amendments would support an enhancement to Trans-Tasman retirement savings portability, to enable the direct transfer of New Zealanders' Australian unclaimed superannuation money (USM) from the Australian Tax Office (ATO) to a KiwiSaver scheme.

In addition to the amendments proposed in this Bill, this enhancement requires amendments to Australian legislation and to the Trans-Tasman Retirement Savings Portability Arrangement between New Zealand and Australia (the Arrangement).

Application date

The proposed amendments would come into force on the same date as amendments to the Arrangement. The Arrangement will be amended through an exchange of diplomatic notes between the Governments of Australia and New Zealand, with these notes stipulating when the amendments to the Arrangement, and therefore the amendments in this Bill, will come into force.

Before amendments are made to the Arrangement, amendments to legislation in New Zealand (in this Bill) and legislation in Australia first need to have been passed into law. It is unlikely that both New Zealand and Australian amendments will be passed until late 2021, at the earliest.

Inland Revenue officials will provide further guidance on the date the amendments in the Bill would come into force when these prerequisites are closer to being met.

Key features

The proposed amendments would extend the definition of "Australian complying superannuation scheme" in the KiwiSaver Act 2006 and Income Tax Act 2007 to include the Australian Commissioner of Tax in their capacity as the holder of USM. This would mean the rules that currently apply to retirement savings transferred from Australian superannuation schemes to KiwiSaver schemes, would apply to USM transferred from the ATO to KiwiSaver schemes.

Background

The Arrangement came into effect from 1 July 2013 and allows for the transfer of retirement savings between certain Australian superannuation schemes and New Zealand KiwiSaver schemes. It reflects the special relationship between New Zealand and Australia and removes an impediment to labour movement.

A number of provisions in the KiwiSaver and Income Tax Acts give effect to the Arrangement in New Zealand.

An unresolved portability issue relates to "lost" Australian retirement savings. Under Australian law a superannuation account is generally considered to be lost when the account is inactive and the member uncontactable. Eventually, under the Australian Superannuation (Unclaimed Money and Lost Members) Act 1999, Australian superannuation schemes are required to transfer savings from lost superannuation accounts to the ATO. These savings are then commonly referred to as USM.

The Arrangement does not currently enable the direct transfer of USM from the ATO to New Zealand KiwiSaver schemes. Domestic legislation in Australia and New Zealand also does not permit this. Instead, New Zealanders currently wanting to recoup USM held by the ATO must first transfer these savings to an Australian superannuation scheme before they can be transferred to a KiwiSaver scheme. As many affected New Zealanders will no longer have an Australian superannuation account, this acts as a significant hurdle to the repatriation of USM to New Zealand.

Detailed analysis

The amendments in this Bill would regulate how USM would be treated in New Zealand after being transferred from the ATO to KiwiSaver schemes.

Under the proposal it would be voluntary for KiwiSaver members, or KiwiSaver scheme providers on their behalf, to request the transfer of USM from the ATO. The ATO would then be required to transfer the USM to the member's KiwiSaver scheme provider.

More detailed guidance on operational matters relating to the transfer of USM from the ATO to KiwiSaver schemes would be provided closer to the start date for transfers.

Rules applying to transferred savings

The proposed amendments would extend the definition of "Australian complying superannuation scheme" in section 4 of the KiwiSaver Act and section YA 1 of the Income Tax Act to include the Australian Commissioner of Tax in their capacity under the Australian Superannuation (Unclaimed Money and Lost Members) Act 1999. Therefore, transferred USM would be covered by the existing rules applying to retirement savings transferred from an Australian superannuation scheme to a KiwiSaver scheme.

Generally, this would mean USM transferred from the ATO to a KiwiSaver scheme would be subject to the same KiwiSaver rules as New Zealand-sourced retirement savings. However, a number of special rules apply to transferred savings, which are set out below. These special rules are intended to ensure individuals transferring their retirement savings across the Tasman are neither advantaged nor disadvantaged by differences between Australian and New Zealand superannuation settings.

Withdrawal of savings for retirement: under clause 4B of schedule 1 of the KiwiSaver Act, transferred USM could be withdrawn from KiwiSaver when the member is 60 years or older and satisfies the Australian definition of retirement.

First home withdrawal: clause 8(4) of schedule 1 of the KiwiSaver Act would prevent transferred USM from being withdrawn from KiwiSaver for the purchase of a first home in New Zealand.

Permanent emigration: after being transferred to KiwiSaver, clauses 14(1)(b) and 14(2)(b) of schedule 1 of the KiwiSaver Act would prevent USM from subsequently being transferred to a third country if the member permanently emigrates.

Invalid enrolment: if a person's membership in KiwiSaver is discovered to be invalid, transferred USM would be returned to an Australian superannuation scheme selected by the person under section 59D(2)(c)(ii) of the KiwiSaver Act or by the Commissioner of Inland Revenue under section 59D(2)(c)(iii). (The option under section 59D(c)(i) of the KiwiSaver Act to have savings refunded to the scheme they were transferred from would not apply in relation to USM, as it would not be appropriate for USM to be refunded back to the ATO.)

Government contribution: USM would not count towards a member's entitlement to the annual $521.43 Government contribution in the year it was transferred to New Zealand. (Amounts transferred from an Australian complying superannuation scheme are specifically excluded from the definition of "member credit contribution" in section YA 1 of the Income Tax Act; this definition is used to determine what payments count towards the Government contribution entitlement.)

Tax treatment: under section CW 29B of the Income Tax Act, USM would be treated as exempt income on entry into New Zealand (after being transferred to New Zealand, any subsequent earnings on transferred savings would be taxed under the portfolio investment entity rules).

Clause 14B of schedule 1 of the KiwiSaver Act currently sets out the portability rules applying to the transfer of savings from a KiwiSaver scheme to an Australian complying superannuation scheme. Although the proposed amendments would bring USM within the definition of Australian complying superannuation scheme for the purpose of transferring USM to KiwiSaver, this would not make it possible for a transfer in reverse (that is, a transfer from a KiwiSaver scheme to the ATO). A transfer from KiwiSaver to the ATO would not involve USM.

MYCOPLASMA BOVIS TAX ISSUE

(Clause 33)

Summary of proposed amendment

The proposed amendments would enable the taxable income arising from the culling of certain qualifying Mycoplasma bovis affected livestock to be spread over six income years.

Application date

The proposed amendments would apply for the 2017–18 and later income years.

Key features

The income would only be able to be spread if:

- The business has been subject to Biosecurity Security New Zealand requiring a cull of Mycoplasma bovis affected stock.
- The business is a dairy or a beef breeding operation, with the breeding stock that is culled being valued under NSC or self-assessed cost. The expectation is that the breeding stock that is culled would comprise mainly mixed-aged cows, in combination with any other class of breeding stock.
- The stock is substantially replaced through purchasing equivalent breeding stock by the end of the income year following the cull year.
- The replacement stock continues to be valued using, as relevant, NSC or the cost price method. This is to ensure that farmers cannot enter the herd scheme on more advantageous terms than those not affected by Mycoplasma bovis.

Given that a livestock owner might use a couple of valuation methods in combination,[7] not all of the breeding stock might be valued at cost. However, only the income derived from the culling of the breeding stock valued under NSC or the self-assessed cost scheme would be able to be spread. For this purpose, breeding stock would include immature female stock intended for future breeding in the business.

Owners of the affected livestock, including sharemilkers, would be covered, that is, the ability to spread income from the cull is not be limited to just the owners of farmland with livestock.

The qualifying proceeds from the cull would comprise payments from the slaughterhouse, top-up compensation from the government for the difference between the normal market value for the stock and the payments from the slaughterhouse, and in some cases, further compensation to cover the additional cost of purchasing equivalent replacement stock.

The income arising from the culling of stock valued under another valuation method, or stock culled from a fattening stock business valued under NSC, would not qualify for this

[7] For example, an owner might use the herd scheme in conjunction with NSC (the alternative valuation option).

spreading provision. The Income Equalisation Scheme is available in those circumstances to mitigate the income implications of the cull.

Background

Some farmers have significant unexpected taxable income through their herds being culled following a primary sector and government decision to eradicate Mycoplasma bovis in New Zealand.

Federated Farmers requested an amendment to ensure there would be no income tax implications from culling and replacing dairy and beef cattle impacted by Mycoplasma bovis. They cited the special treatment given to depreciation recovery income on buildings damaged by the Christchurch and the Hurunui-Kaikōura earthquakes as a precedent.

The issue arises for farmers who have used a cost-based method (that is, the national standard cost scheme (NSC) and self-assessed cost scheme)[8] to value their breeding stock on hand for tax purposes. This is because the difference between the total proceeds received from the cull and the cost of the stock is income. This creates a cash-flow issue for those farmers who purchase replacement livestock after the cull. Those replacement stock are valued at their purchase price and cannot, for tax purposes, be immediately written down to the homebred cost to offset the income.

To avoid this outcome, the proposed legislative changes would enable the proceeds from the cull to be transferred from the year of the cull and spread evenly over the following six income years. This ability to spread will be optional.

Detailed analysis

Relevant current legislation

The livestock valuation rules are contained in subpart EC of the Income Tax Act 2007, including the requirements that apply when using multiple valuation options and the restrictions on switching between valuation options. These rules ensure that the cost of stock on hand is valued appropriately and that the cost of purchases is not deducted ahead of their being sold.

Precondition for the spread

Proposed section EZ 4B(1) sets out the following preconditions:

- A person would have to have, as part of their business, mixed-age cows on hand at the start of the cull year and those cows would need to be valued under either NSC or the cost price method at the end of the income year before the cull year. The cull year would need to be before the 2028–29 income year. (The focus on mixed-age cows is to ensure that the spread is provided to those who have sizeable additional income as a result of the cull given that female breeding stock make up a high proportion of a

[8] The NSC scheme values the animals at, if the animal is homebred, a standard cost (determined by the Commissioner of Inland Revenue) for the respective age and type of animal that reflects that animal's average costs of production, or at its purchase cost if the stock is purchased. The self-assessed cost scheme (a cost price method) involves farmers using their own farm costs rather than standard costs.

standard herd. The 2028–29 income year cut-off is in the expectation that Mycoplasma bovis should be less significant by that stage).

- In the cull year, some or all of the person's cattle would need to be destroyed, because of Mycoplasma bovis, using the powers in either sections 121 or 122 of the Biosecurity Act 1993 that enable Biosecurity New Zealand to examine organisms and give directions. (Normally the whole herd is destroyed but in some isolated cases only a portion needs to be destroyed).
- A significant portion of the culled stock would need to be replaced by the end of the income year following the cull year. The expectation is that the culled livestock are replaced with purchased stock. Specifically, the requirement is that the number of mixed-age cows valued under the national standard cost scheme or the cost price method that the person has on hand (or expects to have on hand) at the end of the income year following the cull year is at least seventy five percent of the number of mixed-age cows valued under the national standard cost scheme or the cost price method that the person had on hand at the start of the cull year.

The spread

There are two parts to the spread. Proposed section EZ 4B(2) would enable the income calculated under proposed section EZ 4B(5) to be spread evenly over the six income years following the cull year. Proposed section EZ 4B(3) would spread the deduction that the livestock owner would otherwise be able to claim under section EC 2 for the equivalent number of stock.[9] Their combined effect is that the net income arising from the culling of the relevant livestock would be spread.

For the income spread component, the formula in proposed section EZ 4B(5) is:

$$\Sigma(\textit{number} \times (\textit{sale proceeds} + \textit{compensation}) \div \textit{culled stock})$$

This formula works on a livestock class basis, where:

- **Σ** is the summation of the amounts calculated using the formula for each of the following classes of each of the beef cattle and dairy cattle types of livestock:

  (a) rising 1 year heifers;

  (b) rising 2 year heifers;

  (c) mixed-age cows; and

  (d) breeding bulls.
- **Number**, for a class of livestock, is the number that is the lesser of:

  (a) the number calculated using the formula in proposed EZ4B(12):

  $$\textit{valuation method breeding stock} + \textit{culled stock} - \textit{opening stock}$$

  (b) the number of livestock of that class that are part of the destroyed cattle (*culled stock*).

[9] Section EC 2 provides a deduction at the beginning of the cull year for the value of stock on hand at the end of the preceding income year).

- **Sale proceeds**, for a class of livestock, is the amount of income the person derives from the disposal of the livestock of that class that are part of the destroyed cattle.
- **Compensation**, for a class of livestock, is the amount of compensation which the person is entitled to under section 162A of the Biosecurity Act 1993 and that the person receives by the end of the income year following the cull year for:

  (a) the difference between the stock's market value and the sale proceeds; and

  (b) the cost of the replacement cattle of the same class being greater than the total amount received in relation to the stock it replaces.
- **Culled stock**, for a class of livestock, is the number of livestock of that class that are part of the destroyed cattle.
- **Valuation method breeding stock** is the number of livestock of that class that:

  (i) were breeding stock or stock that the person expected to be capable of, and intended be used for, breeding upon reaching maturity; and

  (ii) the person valued under NSC or the cost price method in the income year before the cull year.
- **Opening stock** is the number of livestock of that class that the person had on hand at the start of the cull year.

The formula takes into account the possibility that a livestock owner might be using more than one valuation method to value the stock, and might reduce the number on NSC or the cost price method between the start of the cull year and the cull date. When all the stock are on NSC or the cost price method, stock numbers are constant and all stock is culled, then the formula simplifies to just the sales proceeds plus compensation.

Ceasing business

Should the business cease, or the owner of the business die, proposed section EZ 4B(4) would require any unallocated amount of spread income and deduction to be allocated to the "cessation" year.

Already filed income tax returns

For those taxpayers that have already filed their 2018–19 income tax returns, once the legislation has been enacted they can apply for a reassessment under section 113 of the Tax Administration Act. In the meantime, Inland Revenue is allowing instalment arrangements to be entered into, in relation to the tax due to match the proposed spread. No legislative amendment is necessary for this to occur.

Since the proposed spread would apply from the 2017–18 income year, some taxpayers would also be eligible to apply for reassessment of their 2017–18 income tax returns once the legislation has been enacted.

Notification

Those taking up the spreading option need to notify Inland Revenue in writing. This can be done electronically.

Proposed section EZ 4B(14) requires an election to be made by the date of filing of the taxpayer's return of income for the 2020–21 income year, if the cull year is the 2020–21 income year or earlier, and by the date of filing their return for the cull year in any other case.

The additional compliance costs from this notification requirement would be small given the anticipated small number of farmers affected by Mycoplasma bovis and the fact that many will need to contact Inland Revenue anyway in the interim period before the legislation is enacted to arrange instalment arrangements. The amount of income and tax involved is significant for each affected taxpayer so knowing who has taken up this option will also be helpful from a compliance perspective.

The election would be irrevocable, but would not be treated as being made if, at the end of the income year following the cull year, the number of mixed-age cows on hand that were valued under one of the cost schemes was less than seventy five percent of the equivalent pre-cull levels.

Table 3: Income spread

	Opening numbers for cull year					Cull numbers		Income spread					
	Total for class A	Valued in cost B	Held in herd scheme A − B C	Held for breeding D	Breeding in NSC D − C E	Number culled F	Valued in NSC E + F − A G	Spread based on smaller of F or G H	Cull proceeds per class I	Compo per class J	Gross cull income I + J K	Cull income per head K ÷ F L	Income to spread H × I
R1 heifers	0												
R2 heifers (AVO in use)	20	5	15	20	5	19	4	4	$15,200	$7,600	$22,800	$1,200	$4,800
MA cows	100	100	0	100	100	80	80	80	$95,000	$55,000	$150,000	$1,875	$150,000
Breeding bulls	0												
												Total income spread	**$154,800**

Presumed that when the alternative valuation option (AVO) is in use, the herd scheme animals are the breeding or replacement animals.

Table 4: Deduction spread

	Spread based on smaller of F or G **H**	**Last year NSC per class** **M**	**Spread H × M** **N**
R1 heifers	0		
R2 heifers	4	$845	$3,380
MA cows	80	$925	$74,000
Breeding bulls	0		
	Total deduction spread	**$77,380**	

Remedial items

AMENDMENT TO DEFINITION OF ELIGIBLE R&D EXPENDITURE

(Clause 45)

Summary of proposed amendment

For expenditure to be eligible for the R&D tax incentive, it must be on an eligible R&D activity. This amendment proposes a clarification to ensure that expenditure must be closely connected with conducting an R&D activity to be eligible. The changes proposed are in line with the original policy intent, and are not intended to change how the expenditure rules work but instead are intended as a clarification so that claimants apply the law correctly.

Application date

The proposed amendment would apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

Key features

It is proposed that the definition of eligible R&D expenditure for the R&D tax incentive, as prescribed in section LY 5 of the Income Tax Act 2007, be amended to clarify that only expenditure that is directly connected with an eligible R&D activity is eligible.

To be eligible, it is proposed that expenditure must be:

- **required for** conducting an R&D activity;
- **integral to** conducting an R&D activity; and
- **directly related** to conducting an R&D activity.

The existing requirement that expenditure must be listed in schedule 21B, part A and not in schedule 21B, part B also applies.

All section references are to the Income Tax Act 2007 unless otherwise stated.

Background

The legislation currently requires that expenditure be on an activity, but does not give direction as to how closely the expenditure must be connected to the activity. Section LY 5(1) defines eligible R&D expenditure, so that expenditure or loss (“expenditure”) is eligible to the extent to which it is:

- incurred on an eligible R&D activity in the relevant income year; and
- described in schedule 21B, part A (which lists the categories of expenditure that are eligible for R&D tax credits); and
- not described in schedule 21B, part B (which lists the categories of expenditure that are ineligible for R&D tax credits).

In addition to these requirements, to ensure that expenditure claimed has sufficient nexus with the eligible R&D being conducted, the proposed amendment clarifies that expenditure is only eligible if it is directly related to the R&D taking place.

Detailed analysis

The proposed amendment to section LY 5(1)(a) inserts a requirement that expenditure must be *required for, integral to*, and *directly related to* an eligible R&D activity to be eligible for the credit. These are in addition to the existing requirements that expenditure must be listed in schedule 21B, part A and not described by schedule 21B, part B to be eligible for the credit.

Directly relates to (proposed new section LY 5(1)(a)(i))

The "directly relates to" requirement clarifies that expenditure must have a direct connection to an R&D activity to be eligible. A person must make a reasonable assessment of whether their expenditure has a sufficiently close connection to R&D to be eligible. If a person's expenditure relates to an R&D activity, but also relates to another purpose, the person must apportion the expenditure accordingly.

This requirement is intended to ensure that expenditure that is too remote from the R&D activity to which it relates is not eligible for the credit. Requiring expenditure to directly relate to an R&D activity clarifies the policy intent, which is that only expenditure that closely relates to an R&D activity should be eligible.

Example 26: Expenditure must directly relate to R&D to be eligible for the credit

LiamCo operates a mixed-use facility in Auckland, where fifty percent of the facility is devoted to R&D, while the other fifty percent is used for HR for LiamCo's operations across New Zealand.

Expenditure on cleaning products used to clean the R&D area of the facility (while used for eligible R&D) would be eligible expenditure, because it directly relates to performing eligible R&D. However, expenditure on products used while cleaning the HR work area would not be eligible, even though HR spends some time supporting R&D staff, because these costs have no direct connection with performing R&D.

Required for and integral to (proposed new section LY 5(1)(a)(ii) and (iii))

The "required for" requirement clarifies that expenditure is only eligible to the degree it is necessary to support an R&D activity. The "integral to" requirement clarifies that expenditure must be essential to an R&D activity to be eligible. That is, the activity could not be performed or completed without the expenditure.

Similarities with supporting activity limb

These two requirements are taken from the definition of supporting R&D activity in section LY 2(3)(a). A supporting R&D activity is an activity that contributes to and is necessary for a core R&D activity (an activity that resolves scientific or technological uncertainty via a systematic method in order to produce new knowledge or things). The policy intent is that supporting activities must be very closely connected to a core activity in order to be eligible, and the tests required by the supporting R&D activity definition are designed to necessitate this close connection.

The policy intent for R&D expenditure is likewise that it must be closely connected with an eligible R&D activity to be eligible for the credit. Replicating part of the supporting R&D activity tests for the definition of eligible R&D expenditure clarifies that there must be a close connection between expenditure and an R&D activity for the expenditure to be eligible. This ensures the legislation matches the policy intent.

Example 27: Expenditure must be required for and integral to the R&D

To the extent that their duties relate to eligible R&D, expenditure on the salaries of staff at LiamCo's Auckland facility is eligible for the credit, as it is required for and integral to the R&D taking place. This includes the salaries of LiamCo's R&D staff, but also the salaries of the HR staff inasmuch as their duties relate to the R&D staff, as this expenditure is considered required for and integral to R&D (it relates to the performance of R&D and the R&D could not be performed without it).

However, the HR staff at the Auckland facility also perform HR duties for LiamCo's operations nationwide. The salaries of the HR staff cannot be claimed to the extent that their duties do not relate to R&D staff, as this expenditure is not required for R&D.

In addition to their salaries, staff at the facility receive a number of employee benefits, such as discounted gym subscriptions and on-site childcare facilities. These benefits are optional and are not factored into an employee's remuneration package. While some R&D staff may use these facilities, they are not integral to the R&D taking place; R&D could still be performed even if these benefits were not provided. Expenditure on these benefits is therefore not eligible.

"Only or main purpose" test not included

It is not proposed that all of the supporting activity tests are included in the amended eligible expenditure definition in section LY 5. In particular, it is not proposed that the "only or main purpose" requirement be included. The "only or main purpose" test would go beyond the policy intent, by requiring that expenditure be incurred only or mainly for the purpose of supporting an R&D activity to be eligible.

For example, a business does R&D in a lab, which forms part of a larger complex that also includes non-R&D facilities. The R&D portion of the total complex is twenty five percent. The policy intent is that twenty five percent of the rent be eligible for the credit; however, an "only or main purpose" test may completely exclude the rent. Therefore, the "only or main purpose" has not been included in the proposed amendment.

Businesses not obligated to minimise expenditure

As with the supporting R&D activity tests, the proposed new "required for" and "integral to" expenditure tests do not obligate a business to adopt the cheapest possible approach to its R&D. For instance, one business may want the highest possible quality for materials and equipment used in R&D, while another may be satisfied with a lower standard. In both cases the expenditure required for and integral to the R&D activity would be eligible.

Similarly, businesses may go about their research in different ways. Expenditure that is required for an approach that a business has chosen will not be disqualified simply because another business might have chosen a cheaper option.

Example 28: Business not obligated to minimise expenditure

Loud Co is performing eligible R&D to develop new drilling equipment for use in constructing tunnels. Their equipment emits noise at a volume damaging to human hearing, so, to protect its employees' (and future customers') health and safety, Loud Co incorporates noise-reducing technologies into the design of its drilling equipment.

At the same time, Equally Loud Co is performing R&D on similar equipment. Rather than altering the design of the equipment, Equally Loud Co addresses the problem more cheaply by buying noise-cancelling earmuffs for all of its employees working on the drill.

Both Loud Co's expenditure on reducing the noise of the drill and Equally Loud Co's expenditure on earmuffs are eligible for the credit. It does not matter that Loud Co could have taken a cheaper approach to solve the issue.

Existing requirements in section LY 5(1)(a) and (b) still apply

Schedule 21B, part A

To be eligible, expenditure must be described in schedule 21B, part A, which provides a list of expenditure that may be eligible for the R&D tax credit (section LY 5(1)(a)). It is proposed that this requirement continue to apply (that is, the proposed amendments to this section would not affect this requirement).

Schedule 21B, part B

If expenditure is described in schedule 21B, part B, then it is not eligible for the R&D tax credit (section LY 5(1)(b)). It is proposed that this requirement continue to apply (that is, the proposed amendments to section LY 5 would not affect this requirement).

"To the extent" test still applies

The amendment removes the "to the extent" test (which ensures that expenditure is only eligible to the extent to which it is incurred on an R&D activity) from LY 5(1)(a). The test still applies to R&D expenditure, however, because it is explicitly referred to in each of the clauses in schedule 21B, part A. Each of the clauses in this schedule stipulates that expenditure in that category is only eligible to the extent to which this expenditure relates to performing an R&D activity.

Example 29: Eligible R&D expenditure under the new requirements

GeneriCo is a company whose main business activity is performing R&D. It files its supplementary return for the 2020–21 income year.

GeneriCo can claim the costs of employees performing eligible R&D, as well as costs for other staff to the extent that their duties are required for and integral to performing R&D. For instance, GeneriCo can claim the cost of HR staff to the extent that they are supporting R&D staff, cleaning staff to the extent that they are cleaning facilities used for R&D, and payroll staff to the extent that they are paying R&D staff.

However, GeneriCo cannot claim expenditure with a less direct connection to R&D. For instance, it cannot claim the cost of payroll staff to the extent that they are paying HR staff who are supporting R&D staff, or cleaning staff to the extent that they are cleaning the offices of payroll staff who are paying R&D staff, and so on. This is because these costs do not directly relate to an R&D activity.

GeneriCo can claim rent, utilities, insurance, and other expenses necessary to operate its R&D-performing facility in Christchurch, to the extent that the expenses relate to the performance of eligible R&D activities. However, GeneriCo cannot claim the costs of its on-site cafeteria or grounds maintenance costs at the facility. These costs are not required for or integral to the performance of R&D – R&D could still take place at the facility even in the absence of these costs.

Variation of facts: Under the current expenditure rules

The legislation currently only requires that expenditure be on an activity, but does not give direction as to how closely the expenditure must be connected to the activity. Without the clarification provided by this amendment, this could allow GeneriCo to claim costs that are only loosely connected with R&D, contrary to the policy intent (which is that only expenditure that closely relates to and is reasonably necessary for performing R&D should be eligible).

For instance, GeneriCo might interpret the law in a way that allows it to claim the full cost of its staff for the credit; as GeneriCo's main business is performing R&D, all staff costs could be considered as necessary to support the performance of R&D activities. Likewise, as they are part of the costs of a facility used solely for R&D activities, GeneriCo might interpret the law in a way that allows it to claim the costs of the staff cafeteria or maintaining the grounds at its Christchurch facility.

Application date

It is proposed that this amendment would apply from the beginning of the R&D tax credit regime, which is the 2019–20 income year. The proposed amendment is a simple clarification that expenditure must be directly connected with R&D to be eligible and is not intended as a change in policy, or to change the way the law currently operates. It should therefore not affect R&D tax credit claims already filed, and should provide future claimants with more explicit legislative direction regarding what expenditure may be eligible for the credit.

MINING DEVELOPMENT ACTIVITIES EXCLUSION

(Clause 59)

Summary of proposed amendment

The proposed amendment clarifies the current exclusions on mining activities to make it explicit that they also cover development activities relating to mining minerals, petroleum, natural gas, or geothermal energy.

Application date

The proposed amendment would apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

Key features

Prospecting, exploring, and drilling for minerals, petroleum, natural gas, or geothermal energy are excluded from being core or supporting R&D activities (schedule 21, parts A and B, clause 5). It is proposed that development activities be added to the existing core and supporting activity exclusions.

Background

Schedule 21 of the Income Tax Act 2007 lists activities that are ineligible for the R&D tax credit. It is divided into two parts. Part A lists activities that are excluded from being core R&D activities. Part B lists activities that are excluded from being supporting R&D activities. The existing mining exclusion excludes such activities from being both core and supporting activities for the tax credit.

The policy intent is for mining activities in and of themselves to be ineligible for the credit. The proposed amendment expands on this by further excluding development activities such as developing land for the purposes of mining. This exclusion only targets development activities in and of themselves. R&D that relates to such activities may still qualify for the credit, provided it meets the other eligibility criteria.

It is not proposed that development activities be explicitly defined for the purposes of the R&D tax credit regime, although there are various related definitions in the Income Tax Act 2007 (like petroleum development expenditure, which covers activities such as acquiring or constructing petroleum mining assets). These existing definitions would help inform what is considered a development activity, and additional guidance will be published with more information on what is considered a development activity for the purposes of the R&D tax credit regime.

AMENDMENT TO TANGIBLE DEPRECIABLE PROPERTY EXCLUSION

(Clause 60(2) and (7))

Summary of proposed amendment

It is proposed that schedule 21B, part B, clause 3 be amended so that, other than expenditure/loss on developing prototypes or on employees doing core R&D, expenditure that contributes to the cost of tangible depreciable property is ineligible for the credit when it is incurred. Depreciation loss on the property may be eligible, however, if the property is subsequently used in R&D.

Application date

The proposed amendment would apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

Key features

This proposed amendment would make two changes to the existing exclusion on expenditure or loss that contributes to the cost of tangible depreciable property (schedule 21B, part B, clause 3 of the Income Tax Act 2007).

First, a change is proposed to clarify the scope of the exception for expenditure that contributes to the cost of property intended for use as a prototype ("prototype exception"), by adding further requirements that:

- the property must only be intended for use in performing R&D in the future; and
- creating the property must involve a core R&D activity.

This proposed amendment would ensure the provision operates consistently with the policy intent, which is for expenditure on tangible depreciable property to be ineligible unless it is on a prototype (property that is developed through R&D, and is only used in R&D).

Second, a change is proposed to allow expenditure/loss on employees doing core R&D to be eligible for the credit, despite the exclusion for costs that contribute to tangible depreciable property ("employee cost carve-in").

Background

Schedule 21B, part B, clause 3 currently excludes expenditure or loss that contributes to the cost of tangible depreciable property. An exception exists for expenditure that contributes to the cost of property intended for use solely in performing an R&D activity. This prototype exception is intended to capture expenditure required to produce items created by and solely used in core R&D activities, such as prototypes. Expenditure on tangible depreciable property that meets this test is still eligible for the tax credit.

This amendment proposes two changes to the exclusion. The first change would amend the prototype exception. The second would allow certain employee costs to be eligible, even if they contribute to the cost of tangible depreciable property.

Prototype exception

In addition to the current requirement that the property must only be used in performing R&D, the proposed amendment requires that the property must only be intended for use in performing R&D in the future, and that creating the property must involve a core R&D activity. This is consistent with the policy intent, which the current legislation does not satisfy.

The policy intent of the prototype exception is to allow expenditure or loss on items of tangible depreciable property created through R&D and used solely in R&D throughout their lifetime to be eligible. However, the current wording of the exception may include a greater range of expenditure than is intended. There is a risk that expenditure on assets whose construction involves some core R&D and which are used solely for that purpose in the year in which the expenditure in incurred, but which are not solely intended for use in R&D throughout their lifetime, or assets which involve no core R&D in their construction but which are intended for use in R&D, may be eligible through the exception.

Employee cost carve-in

The proposed second change would allow expenditure or loss on an item of tangible depreciable property to be eligible for the tax credit, regardless of whether it meets the above tests, to the extent to which it relates to the cost of employees performing core R&D activity. This means that a business could claim expenditure on employees that contributes to the cost of an item of tangible depreciable property for the tax credit, even where the item of property is not intended as a prototype, to the extent that the employees are performing a core R&D activity. Usually this means an identifiable separate activity incidental to the creation of a larger item of tangible depreciable property.

This is consistent with the existing inclusion for labour costs for R&D undertaken in commercial production environments, and recognises that it should be easier to identify whether labour costs directly relate to R&D compared with non-labour costs, such as electricity costs. The proposed amendment would allow more genuine R&D costs to be eligible while still ensuring any fiscal risk posed by R&D projects involving significant tangible depreciable assets is minimised.

Detailed analysis

Clarifying the prototype exception

The proposed amendment would add further tests into the clause that ensure the exception is better targeted towards the concept of a prototype. In addition to the current requirement that an item of property is only used in R&D, these tests would require that the property's sole intended future use is in performing R&D, and that the creation of the item involves a core R&D activity:

- **Sole intended future use is in performing R&D** means that a person's intent must be that the item of property will only ever be used in performing R&D activities, and never be used for any other purpose.

- **Creation involves a core R&D activity** means that, for expenditure or loss on an item of property to be eligible, the expenditure or loss must also be incurred on performing a core R&D activity (that is, the creation of the item involves resolving a scientific or technological uncertainty via a systematic method).

For expenditure or loss on an item of tangible depreciable property to be eligible, all three tests must be met.

New exception for employee costs on core R&D activity

The proposed amendment would also allows expenditure or loss on an item of tangible depreciable property to be eligible for the tax credit, regardless of whether it meets the above tests, to the extent to which it relates to employee costs on core R&D activity.

Expenditure or loss on employee costs for an item of tangible depreciable property is ineligible to the extent to which the costs do not relate to performing a core R&D activity (unless the item of property meets the tests required by the prototype exception).

> **Example 30: Tangible depreciable property exclusion and employee costs**
>
> Claire's Construction is experimenting with new construction materials that would allow the construction of lighter yet sturdier bridges. The construction of their first bridge involves some eligible R&D as it requires the resolution of scientific or technological uncertainty. Assuming the R&D is successful, Claire's Construction intends that the bridge be used for commercial transport once it is complete.
>
> Under the new amendment, the cost of the scientists and engineers employed by Claire's Construction to resolve the scientific or technological uncertainty involved in creating the bridge is eligible expenditure for the tax credit. However, Claire's Construction cannot claim the cost of the workers building the bridge, nor any of the costs of materials or equipment.

OTHER AMENDMENTS TO SCHEDULE OF EXCLUDED EXPENDITURE

(Clause 60(1), (3), (4), (5), (6), (7))

Summary of proposed amendments

Various amendments are proposed to schedule 21B, part B of the Income Tax Act 2007, to clarify what expenditure is excluded from the R&D tax credit.

Application date

The proposed amendments would apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

Key features

Several additions or changes are proposed to the categories of expenditure ineligible for the R&D tax credit set out in schedule 21B, part B. These are:

- Changing the word "purchase" in the existing exclusion on expenditure to purchase land (clause 10) to "acquire".
- Changing the exclusion on professional fees incurred in determining a person's entitlement to the tax credit (clause 13) to also cover in-house expenditure incurred in determining a person's entitlement.
- Inserting new clause 2B, which excludes expenditure or loss on acquiring property where the property would have been depreciable in the absence of an election to treat it as non-depreciable under section EE 8 of the Income Tax Act 2007.
- Inserting new clause 13B, which excludes expenditure or loss incurred in performing corporate governance activities.
- Inserting new clause 20B, which excludes expenditure or loss incurred in decommissioning.
- Inserting new clause 20C, which excludes expenditure or loss incurred in remediating land.

Background

Changing "purchase" to "acquire" (clause 10)

Clause 10 currently excludes expenditure to purchase land. It is not appropriate to give an R&D tax credit for land acquired for use in R&D for two reasons. The first is that it is difficult to apportion what cost of the land relates to R&D, given the land could be used for non-R&D purposes later. The second reason is that land generally increases in value and therefore can be sold to recoup the cost.

This amendment would broaden the scope of clause 10 so that it excludes expenditure to *acquire* land, rather than merely to *purchase* it. This is consistent with the policy intent of the original exclusion, which is intended to exclude expenditure on obtaining land regardless of the method used to obtain it.

Excluding in-house costs on determining tax credit entitlement (clause 13)

Clause 13 currently excludes professional fees incurred in determining a person's entitlement, or lack of entitlement, to an R&D tax credit. This exclusion covers fees paid to determine the eligibility of a person, activity, or amount of expenditure, such as amounts paid to an accounting firm to prepare a person's R&D claim.

The proposed amendment broadens the scope of clause 13 to cover all expenditure or loss incurred in determining a person's entitlement to the tax credit by replacing the words "professional fees" with "expenditure or loss." This is intended to exclude in-house expenditure on determining entitlements, as well as the fees currently targeted by the exclusion. These amounts should be ineligible under current legislation because they do not directly relate to R&D (they do not relate to resolving scientific or technological uncertainty), but the proposed amendment to clause 13 provides explicit legislative guidance that these costs are not eligible for the R&D tax credit.

Exclusion of expenditure where election made under section EE 8 (new clause 2B)

Proposed new clause 2B excludes expenditure or loss on acquiring an item of property that would have been depreciable in the absence of an election under section EE 8 of the Income Tax Act 2007. The policy intent is that expenditure on the upfront cost of large capital assets generally be ineligible for the credit. Instead, it is intended that depreciation loss on these assets over time be eligible (to the extent the assets are used in R&D), similar to the tax treatment of these assets.

Section EE 8 allows a taxpayer to elect that an item of property be treated as non-depreciable property (where, in the absence of this election, it would otherwise be depreciable property) upon acquisition or, in limited circumstances, a change in use. This could potentially allow taxpayers to bypass the exclusions for the upfront cost of depreciable property, and claim the full upfront cost of their property as eligible expenditure. This is contrary to the policy intent. The proposed amendment will ensure the legislation better satisfies the policy intent by excluding expenditure on property that would have been depreciable absent an election under section EE 8.

Exclusion of expenditure on corporate governance activities (new clause 13B)

Proposed new clause 13B excludes expenditure or loss on performing corporate governance activities. These costs should already be ineligible under current legislation, but the proposed new exclusion is intended to provide certainty and clarity to firms that they cannot claim these costs. These amounts are excluded because they do not directly relate to R&D. They are costs that have to be incurred regardless of whether R&D takes place.

Exclusion of decommissioning expenditure (new clause 20B)

Proposed new clause 20B excludes expenditure on decommissioning, such as decommissioning plant, structures, and sites. This expenditure, in and of itself, should largely already be excluded from the credit as it is unlikely to relate to resolving scientific or technological uncertainty. The intent of this exclusion is to clarify that expenditure on decommissioning is not eligible for the credit.

Note that the exclusion only relates to expenditure on the act of decommissioning itself. Expenditure on R&D relating to decommissioning is potentially eligible for the credit, providing it meets the other eligibility criteria, is an identifiable separate activity, and is incidental to the decommissioning activity.

Exclusion of expenditure on remediating land (new clause 20C)

Proposed new clause 20C excludes expenditure on remediating land. This expenditure, in and of itself, should largely already be excluded from the credit as it is unlikely to relate to resolving scientific or technological uncertainty. The proposed clause clarifies this by explicitly excluding expenditure on remediating land from the credit.

Note again that the exclusion only relates to expenditure on the act of remediating land itself. Expenditure on R&D relating to remediation could still be eligible for the credit, providing it meets the other eligibility criteria, is an identifiable separate activity, and is incidental to the decommissioning activity.

CRITERIA AND METHODOLOGIES APPLICATION DUE DATE CHANGE

(Clause 76)

Summary of proposed amendment

The proposed amendment brings forward the due date for submitting an application for criteria and methodologies (CAM) approval to six months before the end of a person's income year.

Application date

The proposed amendment would apply from the 2021–22 income year (1 April 2021 for most taxpayers).

Key features

It is proposed that the CAM due date in section 68CC(3) of the Tax Administration Act 1994 be amended, so that CAM approval applications must be submitted on or before the last day of the 6th month before the end of the first income year to which the CAM applies (30 September for most taxpayers). Applications submitted after that date will not be considered for the relevant income year.

Background

From the 2020–21 income year, businesses must obtain either general approval or criteria and methodologies (CAM) approval. Under general approval, a business must apply for approval of each of its core and supporting R&D activities. Businesses which expect to spend more than $2m on R&D in a given year can opt out of general approval and into CAM approval. Under CAM approval, a business instead applies for approval of the criteria and methodologies it uses to determine the eligibility of its R&D activities and expenditure.

Currently, CAM approval applications are due after the end of the income year. The amendment proposes amending the due date for applying for CAM approvals, so that these are due six months before the end of the first income year to which a CAM relates (CAM approvals can be obtained for up to three income years). So, for a standard balance date (31 March) claimant in the 2021–22 income year, their year-end would be 31 March 2022, and their CAM approval application would be due on 30 September 2021 under the proposed new due date. This amendment does not require that the CAM approval process be completed by the above due date, only submitted.

The proposed earlier due date would ensure businesses have the correct R&D processes and methodologies in place when their R&D is actually occurring (during the relevant income year). This would reduce the need for businesses to have to retrospectively amend their processes and methodologies to ensure their R&D claims are correct. In addition, an earlier due date means businesses would have more time to seek general approval should their CAM approval application be declined (or only cover part of their R&D). This is important, because without general or CAM approval, a person is not eligible for the R&D tax credit regime from the 2020–21 income year.

The proposed amendment would apply prospectively from the 2021–22 income year (from 1 April 2021 for most claimants). This would ensure taxpayers (particularly those with early balance dates) intending to apply for CAM approval for the 2020–21 income year have sufficient time to plan for the new due date.

MORE TIME TO CONSIDER REQUESTS TO INCREASE R&D CLAIMS

(Clause 79)

Summary of proposed amendment

The proposed amendment would provide the Commissioner with more time to consider section 113 requests to increase claims in a taxpayer's favour. The current legislation imposes a time bar that prevents the Commissioner from considering requests if more than a year has passed since a taxpayer's income tax return due date for the relevant year.

Application date

The proposed amendment would apply from the beginning of the R&D tax credit scheme, which is the 2019–20 income year (1 April 2019 for most taxpayers).

Key features

It is proposed that section 108(1E) 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 made a section 113 request within a year of their income tax return due date. Provided a request is initiated within this timeframe, the Commissioner could consider the request.

Background

A person can only file a request to increase their R&D tax credit claim once for each R&D tax credit claim they make (section 113E of the Tax Administration Act 1994), whether through a section 113 request or a notice of proposed adjustment (NOPA). A time bar prevents the Commissioner from increasing a person's R&D tax credit claim if the person fails to make the request to increase their claim within a year of their income tax return due date (section 108(1E)).

The legislation currently requires a section 113 request to increase an R&D tax credit claim to be initiated and processed within a year of the relevant taxpayer's income tax return due date. This is contrary to the policy intent, which is simply that the person must initiate the disputes process within that timeframe. By requiring the request to be processed within that timeframe, the Commissioner may not have enough time to fully consider requests.

This proposed legislative amendment would remove the requirement that the request be fully processed within that timeframe, while still requiring the request be initiated within a year of the relevant taxpayer's income tax return due date. This would make the time bar which applies to section 113 requests consistent with the rules that apply for NOPAs, which were amended by the Taxation (KiwiSaver, Student Loans and Remedial Matters) Act 2020 in a similar way. The proposed amendment would ensure the Commissioner has enough time to consider requests consistent with the policy intent.

CONFIRMING HOUSING NEW ZEALAND BUILD LIMITED SUBJECT TO INCOME TAX

(Clause 63)

Summary of proposed amendment

The proposal is to add Housing New Zealand Build Limited, a subsidiary of Kāinga Ora – Homes and Communities, to the schedule of state enterprises in the Income Tax Act 2007, to confirm that it is subject to income tax.

Application date

The proposed amendment would apply from 23 May 2018, when Housing New Zealand Build Limited was incorporated.

Key features

Schedule 36, part A of the Income Tax Act 2007 would be amended.

Background

The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 updated the list of state enterprises in schedule 36 of the Income Tax Act 2007 to replace Housing Zealand Corporation with Kāinga – Homes and Communities. This change simply reflected that Kāinga Ora had absorbed the functions of Housing Zealand Corporation and like the Corporation, is subject to income tax. In the absence of being listed in schedule 36, Kāinga Ora, as a statutory entity, would be exempt from income tax.

Interpretative advice received by officials is that Kāinga Ora's subsidiaries should also be listed in schedule 36. Therefore, a further amendment to schedule 36 is proposed to similarly confirm that its subsidiary, Housing New Zealand Build Limited, is also subject to income tax. This is not a change in tax status as the company is already being treated as taxable.

Kāinga Ora's other current subsidiary, Housing New Zealand Limited, is already listed in schedule 36.

CHANGING THE DUE DATE FOR LOCKED-IN PORTFOLIO INVESTMENT ENTITIES

(Clauses 70, 71, 72 and 75)

Summary of proposed amendment

The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 introduced a year-end square-up of the tax on income from multi-rate portfolio investment entities (PIEs) for natural persons. This PIE tax square-up happens alongside the year-end process for income tax. The result of the square-up is applied to the person's end-of-year income tax position, resulting in one overall tax refund or bill, if any.

The proposed amendment brings forward the filing due date by which multi-rate PIEs that are a superannuation fund or retirement savings scheme are required to file detailed income information for their investors to 15 May, to align with that of other multi-rate PIEs.

Application date

The proposed amendment would apply retrospectively from the 2020–21 income year to align with the application date of the new PIE rules, with the first filing due date under the change being 15 May 2021.

Key features

The proposed amendment would bring forward the date by which multi-rate PIEs that are a superannuation fund or retirement savings scheme are required to file detailed income information for their investors each year to 15 May, to align with the filing due date of other multi-rate PIEs.

Detailed analysis

The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 amended the Income Tax Act 2007 and the Tax Administration Act 1994 to provide for a year-end square-up of the tax on income from multi-rate PIEs for natural persons. This PIE tax square-up happens at the same time as the year-end process for income tax. The result of the square-up is applied to the person's end-of-year income tax position, resulting in one overall tax refund or bill if any.

For individuals who only have reportable income,[10] the year-end process for tax on PIE income is an automated process at the same time as the auto-calculation process for income tax.

However, currently section 25K of the Tax Administration Act 1994 requires multi-rate PIEs that are a superannuation fund or retirement savings scheme to file the detailed income

[10] Reportable income is income that Inland Revenue receives regular information about, typically from third-party payers such as employers. It is defined in section 22D(3) of the Tax Administration Act 1994 for the purposes of this Act and the Income Tax Act 2007.

information for their investors by 30 June each year, whereas all other PIEs are required to file the information by 15 May each year under section 25J. This would mean that the income tax auto-calculation process including any amount resulting from the PIE tax square-up in future would have to be run much later (after 30 June) after Inland Revenue receives the PIE income details for the investors. This would affect a considerable number of individuals, as the 30 June due date applies to KiwiSaver PIEs.

The proposed amendment brings forward the filing due date for multi-rate PIEs that are a superannuation fund or retirement savings scheme from 30 June to 15 May to align with that of other multi-rate PIEs. This would avoid a delay to the year-end income tax auto-calculation process for a large number of individuals under the new PIE tax square-up.

PIE INVESTOR INTEREST EXEMPTION FOR LINES TRUSTS

(Clause 61)

Summary of proposed amendment

The Bill proposes to add lines trusts to schedule 29, part A of the Income Tax Act 2007.

Application date

The proposed amendment would apply from the date of enactment.

Key feature

It is proposed that lines trusts would be able to own up to one hundred percent of a PIE without the PIE breaching its minimum number of investor or maximum investor interest requirements.

Background

A lines trust is an existing defined term used in the associated persons rules. This definition covers trusts established under the Energy Companies Act 1992 or the Southland Electricity Act 1993. These lines trusts are commonly referred to as energy consumer trusts.

The Bill proposes to add lines trusts to schedule 29, part A of the Income Tax Act 2007. This will allow lines trusts to own up to 100 percent of a PIE without the PIE breaching their minimum number of investor or maximum investor interest requirements, which are normally 20 investors and no investor with more than twenty percent respectively.

A lines trust invests for the benefit of electricity customers and communities within its local area. Its holding of a majority interest in a PIE is therefore equivalent to the PIE itself being widely held. Schedule 29 part A already includes a number of similar vehicles, including local authorities and the New Zealand Superannuation Fund.

CUSTODIAL INSTITUTIONS: APPLICATION OF DEFINITION TO FIXED ESTABLISHMENTS

(Clauses 56 and 73)

Summary of proposed amendment

An amendment is proposed to the definition of a "custodial institution" to ensure that custodians whose New Zealand operation is a fixed establishment of a non-resident entity is able to access the investment income withholding and reporting obligations as intended.

Application date

The proposed amendment would apply from 1 April 2020.

Background

Custodial institutions act as a conduit between the payer of investment income and the ultimate owner of that income. Changes to clarify the investment income withholding and reporting obligations imposed on custodians were introduced by the Taxation (KiwiSaver and Student Loans) Act 2020 with effect from 1 April 2020. The rules also provide relaxations to the strict requirements of the withholding and reporting rules.

Only entities which meet the definition of a custodial institution may access the specific reporting and withholding rules for custodians. In order to meet the definition, a custodial institution must be able to show that its activities are regulated or supervised under New Zealand's laws, or similar overseas laws. The applicable law will depend on whether the custodian is resident in New Zealand or in another jurisdiction.

Some custodians operate their New Zealand business by way of a fixed establishment in New Zealand. The overseas entity may meet the definition of a non-resident custodial institution, but the New Zealand fixed establishment is excluded from the non-resident limb of the definition of a custodial institution. This is because although a fixed establishment is not a resident in New Zealand for tax purposes, its activities are regulated under New Zealand's financial markets legislation.

The exclusion of fixed establishments from the non-resident limb of the test means that those custodial institutions which use this business model are unable to access the relaxations available to other custodians. This outcome is contrary to the policy intent.

CUSTODIAL INSTITUTIONS: NON-RESIDENT WITHHOLDING TAX OBLIGATION

(Clause 56)

Summary of proposed amendment

Custodial institutions may be required to withhold resident withholding tax (RWT) or non-resident withholding tax (NRWT) when they pay or transfer investment income to the end investor. Rules which provide a framework for the withholding obligation were introduced by the Taxation (KiwiSaver and Student Loans) Act 2020, with effect from 1 April 2020.

The obligation to withhold currently refers to RWT only. The exclusion of NRWT was inadvertent. Officials propose an amendment to clarify that custodial institutions should withhold RWT or NRWT as applicable.

Application date

The proposed amendment would apply from 1 April 2020.

BENEFICIARIES AS SETTLORS

(Clause 43)

Summary of proposed amendment

This amendment would ensure that if, at the end of an income year, a beneficiary of a trust is owed more than $25,000 by the trustee and interest has not been paid on this amount at the prescribed or market rate, then the beneficiary will become a settlor of the trust.

Application date

The proposed amendment would apply from 1 April 2020.

Key features

Under section HC 27(6), if a trustee of a trust owes an amount to a beneficiary of the trust, the beneficiary will not become a settlor of the trust if the amount owed at the end of the income year is $25,000 or less or the beneficiary is paid interest on the amount at a rate equal to the prescribed rate of interest or the market rate.

New section HC 27(2)(bb) clarifies that a beneficiary that is owed money by a trust will always become a settlor if they do not meet the requirements of subsection (6). As such, a beneficiary that is owed more than $25,000 on which interest has not been paid at the prescribed or market rate will become a settlor of the trust.

Background

A settlor of a trust is typically someone that transfers value to the trust. As such, a beneficiary of a trust may become a settlor if they are owed money by the trustee and are not paid interest on this amount at the prescribed or market rate of interest.

Being a settlor of a trust has consequences for a person in a number of areas, including for social assistance and student loan repayments. As such, an amendment was made in the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 to clarify that beneficiaries only owed small amounts by the trustee ($25,000 or less) would not become settlors regardless of whether they were paid interest. This amendment was clarified further in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 and has applied since 1 April 2020.

It was always intended that beneficiaries owed more than $25,000 on which interest has not been paid would become settlors of the trust. However, a beneficiary owed more than $25,000 on which interest has not been paid may not become a settlor if they do not have sufficient knowledge of the amount they are owed or how it is being used by the trustee. While the Commissioner of Inland Revenue can determine the amount owed to a beneficiary and whether interest is being paid, it can be difficult for the Commissioner to ascertain the beneficiary's level of knowledge. Therefore, the Bill proposes to amend the definition of a settlor so that a beneficiary owed more than $25,000 by the trustee on which adequate interest has not been paid, is deemed to be a settlor of a trust, regardless of their level of knowledge.

SETTLOR OF A TRUST MIGRATING TO NEW ZEALAND

(Clauses 41 and 44)

Summary of proposed amendment

The proposed amendments confirm that where a settlor of a trust has migrated to New Zealand, a trustee of the trust may distribute accumulated trustee income to a beneficiary as exempt income. The amendments apply if the trustee has satisfied their New Zealand tax obligations for world-wide trustee income in either of the following circumstances:

- for an assessment of tax on world-wide trustee income arising under a voluntary disclosure; or
- for an assessment of tax on world-wide trustee income arising under an election to pay tax on world-wide trustee income.

Application date

The proposed amendments would apply as follows:

- for a voluntary disclosure made on, before or after 23 March 2020; and
- for an election made under section HC 33, from 23 March 2020.

Key features

The proposed amendments would apply for a trust of which a settlor has migrated to New Zealand and:

- has not made an election to pay tax on world-wide trustee income within a prescribed period; but
- has taken steps under either the voluntary disclosure rules or the voluntary election rules to pay tax on world-wide trustee income for past years after the prescribed period has ended.

Voluntary disclosure

Under the voluntary disclosure process, New Zealand tax (including penalties and interest) has been assessed and paid for the earlier period or periods to which the voluntary disclosure relates.

In this circumstance, the intent of the voluntary disclosure rules is that a distribution from tax-paid accumulated trustee income for those past years is exempt to a beneficiary. However, it is possible that such a distribution may still be taxed at 45% under current law. The proposed amendment would ensure the law works as intended with effect from 1 April 2008 to protect tax positions assessed under such voluntary disclosures.

Voluntary election

A settlor of a foreign trust that migrates to New Zealand may elect to pay New Zealand tax on worldwide trustee income from a specified date. The main benefit of making this election is that there is no additional layer of tax when the tax-paid trustee income is distributed to a beneficiary. If this election is not made, distributions from the trust to a beneficiary may be taxed at 45%.

Under recent amendments, it is now clear that a trust of which a settlor has migrated to New Zealand within the previous four years may make a retrospective election to pay New Zealand tax on up to four years of earlier worldwide trustee income. However, it is unclear if this election results in an additional layer of tax when this trustee income is distributed to beneficiaries. The proposed amendment would ensure that distributions to beneficiaries from New Zealand-taxed worldwide trustee income is tax free.

Background

Voluntary disclosure

The voluntary disclosure rules permit the Commissioner to assess tax on past incorrect tax positions that have been voluntarily disclosed to Inland Revenue. A purpose of the voluntary disclosure rules is to allow the taxpayer to "put right" their past tax position, subject to appropriate penalties and interest being imposed.

The definition of complying trust in the Income Tax Act 2007 does not currently address the voluntary disclosure situation for an assessment made under voluntary disclosure for a trust of which a settlor has migrated to New Zealand and had not elected to pay tax on worldwide trustee income. The proposed amendment would confirm that a trust of this nature that has made a voluntary disclosure and satisfied the related New Zealand tax obligations can be a complying trust for those periods to which the voluntary disclosure relates.

An election under section HC 33

Recent amendments to the Income Tax Act 2007 clarified that an election may be made to pay tax on worldwide trustee income, and this may be retrospective for up to four earlier years. However, the effects of this election for a trust of which a settlor has migrated to New Zealand did not explicitly ensure that a retrospective election can result in distribution of accumulated trustee income being exempt income for the beneficiary. The proposed amendment would achieve this intended effect.

NOMINEE TREATMENT FOR TRUSTEE OF EXEMPT EMPLOYEE SHARE SCHEME

(Clause 10)

Summary of proposed amendment

The proposed amendment to section CE 6 of the Income Tax Act 2007 clarifies that a trustee of an exempt employee share scheme (ESS) can be treated as a nominee of the company providing the scheme.

Application date

The proposed amendment would apply from the date of enactment.

Key features

Section CE 6 is amended so that a trustee is treated as the nominee of a company to the extent that the trustee's activities relate to an ESS or an exempt ESS (and as long as the other criteria of the section are met).

Background

Under section CE 6, if a trustee carries out activities related to a company's ESS, and shares or related rights are issued or transferred under the ESS, the trustee is treated as the nominee of the company to the extent of those activities. As a nominee, the trustee acts for the company and is therefore treated the same way the company would be treated if the company were carrying out the ESS activities. This prevents tax being triggered when shares and other rights are passed between the trustee and company in legal terms but there is no substance to the transactions because the trustee is performing the role of the company itself.

Under the current wording of section CE 6, a trustee is only treated as a nominee to the extent that its activities relate to an "employee share scheme". An "exempt employee share scheme" is not an "employee share scheme" (section CE 7(b)(i)).

There is no policy reason why, in this context, a trustee of an exempt ESS should not be treated the same way for tax purposes as the trustee of an ESS. The only difference between taxable schemes and exempt schemes is that exempt schemes allow the employer to grant tax-exempt share scheme benefits. This should not have a bearing on the tax treatment of a trustee administering the scheme on the company's behalf. Therefore, the proposed amendment extends nominee treatment to trustees of exempt ESSs.

DISPOSAL OF COMPANY'S OWN SHARES BY EMPLOYEE SHARE SCHEME TRUSTEE

(Clause 13)

Summary of proposed amendment

The proposed amendment to section CW 58 of the Income Tax Act 2007 clarifies that if a trustee of an employee share scheme (ESS), while acting as a nominee for the company offering the scheme, disposes of shares the company holds in itself ("treasury stock"), any income the trustee derives from the disposal is exempt.

Application date

The proposed amendment would apply from the date of enactment.

Key features

Amended section CW 58 includes an explicit reference to section CE 6 (Trusts are nominees). If a company disposes of its own shares as the result of the application of section CE 6 – that is, through a trustee nominee – any income the trustee derives from the disposal is exempt.

Background

Under section CW 58, if a company disposes of its own shares, having acquired them without cancelling them, any income the company derives from that disposal is exempt. This is because the disposal is a partial transfer of ownership of the company to shareholders, not a sale that produces any economic gain or loss.

A company that offers an ESS may nominate a trustee to carry out activities related to the scheme, such as holding shares on trust for employees, transferring shares to employees, or reacquiring shares from employees if the company wishes to hold them as treasury stock. As a nominee of the company under section CE 6, the trustee effectively acts as the company, and should therefore be treated in that capacity the same way the company would be treated.

Since income derived by a company from disposing of its own shares is exempt, income derived by a trustee from disposing of the company's shares while acting in its capacity as nominee of the company should also be exempt. However, the current wording of section CW 58 does not explicitly contemplate the possibility of a trustee nominee. Consequently, the section could be interpreted as not exempting that trustee income.

The proposed amendment to section CW 58 resolves this ambiguity by including a reference to section CE 6.

USE OF PRE-CONSOLIDATION IMPUTATION CREDITS

(Clauses 48 to 51)

Summary of proposed amendment

This amendment clarifies that the use of pre-consolidation imputation credits by a consolidated imputation group (CIG) is consistent with the use of pre-amalgamation imputation credits by an amalgamated company and the use of imputation credits by an individual company, which is on a first-in first-out (FIFO) basis.

Under the proposed legislation, a CIG is permitted to use pre-consolidation imputation credits of individual member companies (group companies) before using group credits, as long as shareholder continuity requirements are met.

Application date

The proposed amendment would apply for the 2008–09 and later income years.

Key features

Amended section OP 22 applies when:

- a CIG has an imputation debit (normally because a group company is paying a dividend and wishes to attach imputation credits);
- a group company has an imputation credit balance (pre-consolidation imputation credits); and
- the group company's credit balance existed before the CIG's debit arose.

The CIG may make an election to transfer some or all of the credit balance in a group company's imputation credit account (ICA) to the ICA of the group. This election is made by a nominated company recording the amount of the credit balance transferred as a debit in the group company's ICA (under section OB 52), and as a credit in the group's ICA.

Three restrictions apply:

- The CIG and the group company must meet the shareholder continuity requirements for the carrying forward of imputation credits until the end of the day on which the debit arises in the group ICA (section OA 8).
- Credits of the group and all group companies must be used to reduce the debit in the order in which the credits arose (FIFO).
- The amount of credits that can be transferred from group companies to the group is limited to the amount of the imputation debit to the group's ICA.

Background

The Commissioner's view and practice is that current section OP 22 and its corresponding provisions in earlier legislation have always required a CIG to exhaust all its group imputation credits before it can draw on the pre-consolidation credits of the individual group companies. *Tax Information Bulletin* Vol 16, No 1 (February 2004) explained the policy and practice for the use of pre-consolidation imputation credits for CIGs:

> As with the original consolidation provisions, the existing pre-consolidation balances of the members' individual imputation credit accounts are not transferred to the imputation group's consolidated imputation credit account, but continue to remain separate until such time as the imputation credit account of the imputation group has a debit to its account which it cannot offset by an existing credit within the group ICA.

This view has been contested by stakeholders from the private sector, who have argued that:

- the general legislative framework for individual companies requires imputation credits to be used on a FIFO basis;
- imputation credits of an amalgamated company include the pre-amalgamation credits of amalgamating companies and these may be used on a FIFO basis; and
- there is no policy reason to depart from this principle when addressing the use of pre-consolidation imputation credits by a CIG.

Detailed analysis

Under the proposed amendment to section OP 22, a CIG may use pre-consolidation imputation credit balances in a group company's ICA before it uses group credits. This means that imputation credits generally will be used on a FIFO basis, which is in line with the wider imputation framework.

To be used by the CIG, the pre-consolidation imputation credit balance of the group company must exist at the date of the debit to the group ICA (so shareholder continuity must be satisfied for the amount to be transferred).

The amount of the credit balance that can be transferred from group companies to the group is limited to the amount of the group's imputation debit. This is because, when an imputation credit is transferred from a group company's ICA to the CIG's ICA, the date for the credit becomes the day of the credit transfer, rather than the day the tax was paid. Consequently, if the credit transfer were not limited to the CIG's debit, credits could be carried forward that would (and should) otherwise have been extinguished due to changes in shareholder continuity calculated by reference to the date the credit originally arose.

COMPULSORY ZERO-RATING OF COMMERCIAL LAND LEASES

(Clause 88)

Remedial amendments are proposed to ensure that the compulsory zero-rating rules that apply to leases of land work as intended. All section references are to the Goods and Services Tax Act 1985 unless otherwise stated.

Remedial amendment to section 11(8D)(a) to remove "paragraph (b) does not apply"

Summary of proposed amendment

An amendment is proposed to section 11(8D)(a) to ensure that all assignments or surrenders of a lease agreement for land that meet the criteria in section 11(1)(mb)[11] are zero-rated.

Application date

The proposed amendment would apply retrospectively from 30 June 2014, being the date that amended section 11(8D) came into force under the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

However, as there may be instances where the relevant supplies were standard-rated, a savings provision is proposed to preserve tax positions taken under the existing section 11(8D)(a) prior to the proposed amendments being enacted.

Background

Section 11(8D)(a) ensures that lease assignments and surrenders are subject to compulsory zero-rating if they meet the requirements of section 11(1)(mb). Section 11(8D)(a) was amended in 2017, by inserting the words "and paragraph (b) does not apply" at the end of paragraph (a). This addition has significantly changed the scope of section 11(8D)(a). The change was unintended and was not referred to in any of the guidance materials.

The effect of the 2017 change seems to be that only assignments or surrenders of leases that have failed the 25 percent bright-line test in section 11(8D)(b) will be zero-rated (as opposed to all leases that met the section 11(1)(mb) criteria). Assignments or surrenders of leases that have not failed the bright-line test would be standard-rated (subject to GST at 15%).

The proposed amendment would delete the reference to "and paragraph (b) does not apply" in section 11(8D)(a). This would achieve the original policy intent which is that all assignments or surrenders of a lease agreement for land that meet the criteria in section 11(1)(mb) should be zero-rated.

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[11] This section provides, in broad terms, that a supply of land between registered persons used for the intention of making taxable supplies is zero-rated for GST purposes.

Zero-rating business assets when a business is sold and the vendor's lease is transferred or the vendor arranges a new lease

Summary of proposed amendments

Amendments are proposed to sections 11(8D)(a), (ab), (b) and (c) to clarify that, in the context of business sales, that involve a zero-rated supply relating to land leases under these provisions, any business assets that are transferred as part of that same supply or arrangement should also be zero-rated.

The proposed amendments insert references to "the supply wholly or partly consists of" and "the arrangement wholly or partly consists of". This replicates the opening words of section 11(1)(mb) which refers to "the supply wholly or partly consists of land."

Application date

The proposed amendments would apply retrospectively from 30 June 2014, being the date that amended section 11(8D) came into force under the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

However, as there may be instances where the relevant supplies were standard-rated, a savings provision is proposed to preserve tax positions taken under the existing section 11(8D) before the proposed amendments are enacted.

Background

When a registered person sells a business which includes land and other assets to another registered person, the zero-rating of land rules will zero-rate both the supply of land and the other business assets. This is achieved by section 11(1)(mb) referring to "the supply wholly or partly consists of land". Alternatively, the sale of the business may be zero-rated as a going concern under section 11(1)(m).

The policy intent was that because the transfer of a commercial lease could be economically equivalent to a transfer of land, these transfers should also be zero-rated and should produce similar GST outcomes. So any business assets that are transferred as part of the same overall arrangement as the transfer of a lease should also be zero-rated supplies.

However, there is uncertainty as to whether the current section 11(8D) achieves this intended policy outcome.

Some taxpayers or practitioners may consider that the rules in section 11(8D) which apply to certain lease arrangements have a limited scope so that they only zero-rate the supply of the lease procurement or arranging services. This approach could mean that, in the context of a business sale, if a vendor (previous lessee) supplies other business assets to a purchaser (new lessee) alongside the services in section 11(8D), these business assets may potentially be regarded as a separate, standard-rated supply subject to GST at 15%. Standard-rating the business assets in these circumstances would represent aa different GST outcome to similar business sales where land was supplied or if an entire business was sold and zero-rated as a going concern. In both of these cases, the supplies of the business assets would be zero-rated.

Amendments are therefore proposed to sections 11(8D)(a), (ab), (b) and (c) to clarify that, in the context of business sales, that involve a zero-rated supply relating to land leases under these provisions, any business assets that are transferred as part of that same supply or arrangement should also be zero-rated.

Lease is cancelled by lessor, but lessee helps arrange a new lease for a new lessee

Summary of proposed amendment

An amendment to section 11(8D)(c) is proposed so compulsory zero-rating will apply when a lease is cancelled by the lessor and the previous lessee arranges a new lease for a new lessee.

Currently, section 11(8D)(c) only applies if the lessee cancels the lease and then provides this service.

Application date

The proposed amendments would apply retrospectively from 30 June 2014, being the date that amended section 11(8D) came into force under the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

However, as there may be instances where the relevant supplies were standard-rated, a savings provision is proposed to preserve tax positions taken under the existing section 11(8D)(c) before the proposed amendment is enacted.

Background

Under current law, section 11(8D)(c) applies in the context of a business sale to zero-rate the service of arranging a new lease when the old lease is surrendered by the lessee. However, the law currently doesn't apply compulsory zero-rating to similar scenarios when the lessor has cancelled the lease. An amendment is required to ensure that the service of arranging a new lease will be zero-rated in both situations.

This accords with the policy intent which is that the same GST outcome (zero-rating) should arise regardless of whether the old lease was surrendered by the lessee (tenant) or cancelled by the lessor (landlord).

CLARIFYING THAT DIVIDENDS ARE DERIVED ON A CASH BASIS

(Clause 9)

Summary of proposed amendment

This is a minor amendment to clarify that a cash dividend (a dividend other than a non-cash dividend) is allocated to the income year in which the person receives it.

Application date

The proposed amendment would apply from the 2020–21 income year.

Key features

Dividends paid in money are assessable on a cash basis and not on an accrual basis.

Detailed analysis

This issue was raised in a "Questions We've Been Asked" item: When is income from a cash dividend paid on ordinary shares derived? The draft answer was that for shareholders accounting for tax on an accrual basis, the dividend will be derived when a debt in their favour is established. When the draft was sent out for comment, feedback was that the draft answer was not in line with general practice.

Currently, dividends paid in money are assessable on a cash or accrual basis (depending on which best reflects the taxpayer's income). Many external stakeholders consider that dividends paid in money should only be assessable on a cash basis. Allowing this would simplify filing, reduce compliance costs, and better align with other legal requirements.

The proposed amendment would add a subsection to section CD 1 stating that cash dividend (a dividend other than a non-cash dividend) income is allocated to the income year in which the person receives it. This does not change when the dividend is derived, but affects when the income is allocated.

NON-RESIDENT CONTRACTORS’ TAX

(Clause 54)

Summary of proposed amendment

The amendment clarifies that when a non-resident contractor seeks an exemption from income tax for a payment, they must show that the amount derived from that payment is not “assessable income”. The section previously required them to show that the payment was not “income”.

Application date

The proposed amendment would apply from the date of enactment.

Background

This amendment relates to non-resident contractors who perform or supply services or property in New Zealand, such as someone who travels to New Zealand to provide IT services on a short-term basis to a local company. However, due to their limited links to New Zealand, there is a risk of revenue loss – the contractor may not be aware of, or comply with, New Zealand tax laws. For that reason, income received by contractors is ordinarily subject to PAYE.

A contractor may apply to the Commissioner for an exemption from PAYE under section RD 24 of the Income Tax Act 2007, as long as one or more conditions are met. Under section RD 24(1)(a) the contractor must show that the payment is not “income” and therefore no tax is payable on it. Typically, this will be because a double tax agreement exempts the payment from tax.

Arguably, a payment will be income even if it is not subject to tax. The previous formulation of the test required the contractor to demonstrate that the “income derived” was not “subject to income tax”.[12] The change to “income” was unintended. The amendment confirms that the correct test is “assessable income”. This change will clarify that Inland Revenue does not seek to withhold tax from payments to contractors if no tax is ultimately due.

[12] Income Tax (Withholding Payments) Regulations 1979, cl 5(1A)(a).

RESTRICTED TRANSFER PRICING: THIRD PARTY TEST FOR EXOTIC FEATURES

(Clause 39)

Summary of proposed amendment

The third-party test in section GC 18 allows exotic features (such as subordination or terms longer than five years) in cross-border related borrowing if those features are present in significant third-party borrowing. This test effectively treats all debt other than borrowing from associated persons as third-party debt. However, cross-border related borrowing is wider than associated persons including funding such as from a non-resident owning body or a back-to-back loan. The Bill proposes to amend the test so that cross border related borrowing that is not from an associated person cannot be used to justify an exotic feature of related party debt.

Application date

The proposed amendment would apply from 1 July 2018 to align with the introduction of the restricted transfer pricing rules. However, a savings provision is proposed to apply for any taxpayer that has filed a return under the existing rules before the introduction of the Bill.

Key features

There are 12 instances of "associated persons" in section GC 18(5), (7), (8) and (9). The Bill proposes to amend each of these references so that, in these provisions, cross-border related borrowing is treated consistent with loans from an associated person. For the avoidance of doubt, these proposals do not affect which loans are covered by the restricted transfer pricing rules, which continue to apply to cross-border related borrowing.

Detailed analysis

Section GC 18(3) provides a list of features that cannot be included when pricing cross-border related borrowing. However, there is an exception to this restriction so that these features can still be included if they are also present in significant third-party debt. If a feature is present in significant third-party debt this supports there being a commercial reason for the feature's existence.

However, the definition of a cross-border related borrowing includes loans made by lenders that are not associated with the borrower. The definition of cross-border related borrowing is in section GC 6(3B). Associated persons are covered by section GC 6(3B)(a)(i) but there are additional categories in section GC 6(3B)(a)(ii) to (iv).

The consequence of the current law is that a cross-border related borrowing that is not from an associated lender is included in the category of loans from non-associates that determines whether exotic terms can be included in that cross-border related borrowing. This creates two issues when a group has lending that is cross-border related borrowing that is not from an associated person:

- The features of that loan partially or fully determine the appropriate features of that same loan.
- The features of a loan within the control of people controlling the borrower are included within a third-party test to determine appropriate exotic features.

THIN CAPITALISATION REMEDIALS

(Clauses 34, 35 and 36)

Summary of proposed amendment

The Bill proposes three remedial amendments to the thin capitalisation rules. These amendments would:

- remove certain New Zealand resident trusts from the inbound thin capitalisation rules when the only reason they were included was because a New Zealand resident settlor is associated with a non-resident company or trust;
- introduce a separate formula for calculating apportionment of interest by an excess debt entity controlled by a non-resident owning body or trustee; and
- update a cross-reference as a consequential amendment to one made in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

Application date

The first two proposed amendments would apply from the date of enactment. The updated cross-reference would apply for income years starting on or after 1 July 2018 to align with the original amendment in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

Key features

Inbound thin cap scope

Proposed new section FE 2(4B) would treat a New Zealand resident as not being associated with certain non-resident companies or trusts when determining whether a trust has been settled by a non-resident or an associated person of a non-resident. This means a New Zealand trust with a New Zealand resident settlor will not be subject to the inbound thin capitalisation rules just because that New Zealand resident settlor also has an interest in a non-resident company or trust.

Interest apportionment formula

Proposed new section FE 6(3B) and (3C) introduces a new formula for calculating the income of an excess debt entity that is controlled by a non-resident owning body or trustee. For these entities this proposed formula will apply instead of the existing formula in section FE 6(2).

Consequential to this is a change to sections FE 6(4) and (5). These subsections allow an excess debt entity with income calculated under the formula in section FE 6(2) to allocate that income to another member of their group up to the amount of interest that member has incurred. Proposed changes to section FE 6(4) and (5) will continue this position for income calculated under proposed section FE 6(3B), except that the amount able to be allocated will be limited to interest on debt owed to related parties.

Cross-reference

Section FE 12(2) sets the requirements for a worldwide group when the debt percentage of the New Zealand group is more than sixty percent, as described in section FE 5(1)(a), or seventy five percent, as described in section FE 5(1)(b). The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 introduced section FE 5(1)(ab) for worldwide groups given by section FE 31D. However, it did not update the reference in section FE 12(2). The Bill proposes to update section FE 12(2) by replacing the reference to section FE 5(1)(a) with a reference to section FE 5(1)(a) and (ab) so the worldwide group requirements apply correctly to these groups.

Detailed analysis

Inbound thin capitalisation scope

A trust is subject to the inbound thin capitalisation rules if it satisfies section FE 2(1)(d)(i). This occurs when fifty percent or more of the value of settlements on the trust are made by a non-resident or a person associated with a non-resident.

Existing section FE 2(4)(b) treats a New Zealand resident as not being associated with a non-resident relative for the purpose of section FE 2(1)(d)(i), provided that the non-resident has not also made a settlement on the trust. For example, a family trust will not be subject to the thin capitalisation rules just because the New Zealand resident settlor has a sibling who lives outside New Zealand, unless that sibling has also made a settlement on the trust.

Proposed section FE 2(4B) extends this treatment. It provides that for the purpose of the inbound thin capitalisation rules, a New Zealand resident settlor will not be associated with a non-resident company they have made an investment in, or a non-resident trust they have made a settlement on, unless that non-resident entity has also made a settlement on the New Zealand trust. The intention of this amendment is to carve out trusts with New Zealand resident settlors that are currently only subject to thin capitalisation because the settlor is associated with a non-resident if that non-resident has no investment in or control over the trust.

Interest apportionment formula

Since the extension of the thin capitalisation rules to groups controlled by a non-resident owning body from 1 April 2015, the thin capitalisation limit for these groups has been the greater of a sixty percent debt percentage or a percentage[13] of their debt with unrelated parties. The principle is that the thin capitalisation rules should not limit deductibility of debt paid by such groups to unrelated lenders.

If the thin capitalisation debt percentage threshold is breached, income is derived by applying the formula in section FE 6(2). This formula essentially calculates the proportion of allowable debt then multiplies this proportion by total deductible interest. While this works correctly for the usual case – when there is no distinction between debt owed to related parties and unrelated parties – if it is applied to a group controlled by a non-resident owning

[13] This percentage was originally 110% but was reduced to 100% by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 with effect from income years beginning on or after 1 July 2018.

body it implicitly assumes that the same interest rate applies to both related-party debt and unrelated-party debt.

This will often not be the case, for example because the related-party debt and unrelated-party debt were entered into at different times. In these circumstances interest that should be deductible (because it is paid to unrelated lenders) can be disallowed, or interest that should be disallowed (because it is paid to related lenders and the sixty percent debt threshold is exceeded) can remain deductible.

The Bill proposes a new formula that generates an amount of income to the extent that interest is paid to related parties on debt that is above the sixty percent threshold. This formula is:

$$(\textit{related interest} - \textit{mismatch} + \textit{FRD2}) \times \frac{\textit{total debt} - \textit{concession}}{\textit{total debt}} \times \frac{\textit{group NZ debt percentage} - 60\%}{(\textit{group NZ debt percentage} - \textit{group world debt percentage})}$$

This formula essentially multiplies pre-thin capitalisation deductible related-party interest by the proportion of total debt not eligible for the on-lending concession and by the proportion of related-party debt that is deductible under the thin capitalisation rules.

The individual terms in the formula can be described as:

- **Related interest** is the equivalent of **total deduction** in existing section FE 6(3)(a), except it is limited to debt with counterparties that would be excluded from the worldwide group under existing section FE 18(3B).
- **FRD2** is the equivalent of **FRD** in existing section FE 6(3)(ab), except it is limited to fixed-rate foreign equity or fixed-rate shares that would be excluded from the worldwide group under existing section FE 18(3B) if that section applied to fixed rate foreign equity or fixed-rate shares instead of just financial arrangements.
- **Group NZ debt percentage** is the total debt percentage and is identical to the **group debt percentage** in existing section FE 6(3)(d).
- **Group world debt percentage** is the debt percentage for debt with counterparties that would not be excluded under existing section FE 18(3B).
- **Mismatch, total debt and concession** are worded identically to the equivalent term in existing section FE 6(3)(aba), (b) and (c) respectively.

NRFAI DEFERRAL CALCULATION FORMULA CONSEQUENTIAL AMENDMENT

(Clause 57)

Summary of proposed amendment

The proposed amendment to section RF 2C(6)(a) of the Income Tax Act 2007 (ITA) would ensure the non-resident financial arrangement income (NRFAI) deferral calculation formula cannot produce an undefined outcome as a consequence of the insertion of the "hybrid deductions" item in this formula.

Application date

The proposed amendment would apply for income years beginning on or after 1 July 2018. This would align the application date for the amendment with that of the relevant sections in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

Background

The NRFAI rules address situations where there is a sufficient degree of deferral between deductions and payments under a financial arrangement between associated parties so that non-resident withholding tax should be imposed on an accrual basis, rather than a cash basis. This ensures there is better matching between deductions for the borrower and the imposition of non-resident withholding tax on the lender.

The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 inserted the "hybrid deduction" item in the NRFAI deferral calculation formula in section RF 2C(4) of the ITA. This amendment ensures that expenditure for which a deduction is denied under the hybrid mismatch rules in subpart FH of the ITA, is not taken into account in determining whether a loan gives rise to NRFAI. However, as a consequence of this change it is possible for the NRFAI deferral calculation formula to produce an undefined outcome. This would occur if a borrower is denied deductions for all of their relevant expenditure by the hybrid mismatch rules, resulting in a zero denominator in the NRFAI deferral calculation formula.

Section RF 2C(6)(a) of the ITA currently specifies that if the deferral calculation formula item "accumulated accruals" results in a zero denominator NRFAI will not arise. However, this rule has not been updated to take in to account the "hybrid deduction" item in the calculation of the denominator. The proposed amendment would address this gap.

FERTILISER COSTS

(Clause 21)

Summary of proposed amendment

The proposed amendment clarifies the position for a taxpayer who wishes to spread a tax deduction for fertiliser costs over one to four years under section EJ 3(5) of the Income Tax Act 2007. The proposed amendment provides the notice requirements of section EJ 3(5) will be considered satisfied when the taxpayer files their tax return on that basis.

Application date

The proposed amendment would apply from the 2020–21 income year.

Background

Section EJ 3 currently allows taxpayers to spread the cost of fertiliser over one to four years. This attempts to align the cost of fertiliser with the benefits provided by it, and is known as the "spreading" method. The section requires the taxpayer to provide "notice" to the Commissioner that they are using the spreading method but does not specifically state what form that notice should take.

Detailed analysis

The problem with the current law is that it does not specify what constitutes "notice" for the purposes of section EJ 3(5). While section 14B of the Tax Administration Act 1994 does contain some guidance on what forms notification can take, it doesn't specifically assist with the fertiliser spreading notice.

The preference under self-assessment is to allow taxpayers to provide notice by filing their return of income for the year in which the election is made. Under the proposed amendment, doing this would satisfy the notice requirement of section EJ 3.

APPLICATION OF THE MINORS' INCOME TAX EXEMPTION TO MINOR BENEFICIARY INCOME

(Clause 12)

Summary of proposed amendment

The proposed amendment would clarify that beneficiary income of a minor is not exempt income under the minors' income tax exemption rule in section CW 55BB of the Income Tax Act 2007.

Application date

The proposed amendments would apply from 29 May 2012, this being the original start date of the minors' income tax exemption.

A savings provision will apply for people who took a tax position relying on the current law in a return filed before this Bill was introduced into Parliament.

Key features

Proposed new section CW 55BB(2)(a)(iiib) would provide that income derived by a beneficiary of a trust who is a minor does not qualify for the income tax exemption in section CW 55BB (the minors' income tax exemption).

This amendment would address the current gap in the law which allows minor beneficiaries to access the tax exemption, despite trustees being in a position to pay tax on their behalf.

Background

Referred to as the minors' income tax exemption, section CW 55BB provides school children with an income tax exemption on income up to $2,340 each year which is not taxed at source (such as money for mowing a neighbour's lawns). The exemption is intended as a compliance cost savings measure, which ensures children who meet the criteria do not have to file an income tax return.

The exemption is not intended to apply when there is a someone in a position to pay tax on behalf of the child. Accordingly, section CW 55BB(2)(a) sets out situations where the exemption will not apply, such as when a minor derives salary or wages, dividends or interest income.

Generally, under section HC 35, beneficiary income derived by a minor is treated as trustee income and taxed at the trustee tax rate, with the amount being excluded income to the minor. For the purpose of the trust tax rules a minor is someone who is under the age of 16 on the date of the trust's balance date.

Section HC 35(4) sets out certain exceptions to this general rule. These include if:

- the minor's total beneficiary income in the tax year is $1,000 or less; or
- no settlements on the trust have been made by the minor's relative or guardian (or any person associated with them).

In these situations, tax should be paid at the beneficiary's marginal tax rate. Section HC 32(3) provides that it is the trustee's responsibility to pay this on behalf of the beneficiary.

It is possible under the current law for a minor's beneficiary income to be treated as exempt income under section CW 55BB (as long as the payment was not in the nature of salary or wages, a dividend or interest income). However, it was never the policy intent for beneficiary income to qualify for this income tax exemption, given that trustees have an obligation to pay tax on the beneficiary's behalf.

NZ SUPERANNUITANTS AND THE END OF YEAR AUTO-CALCULATION PROCESS

(Clause 84)

Summary of proposed amendment

The proposed amendment clarifies that New Zealand Superannuation or Veteran's Pension recipients who incur a tax liability through the auto-calculation process as a result of the use of a tailored tax code are limited to a write-off of the amount specified in schedule 8, part B 1(a) of the Tax Administration Act 1994, which is currently $50.

Application date

The proposed amendment would apply from the 2020–21 income year.

Key features

The amendment means that any write-off of a New Zealand Superannuation or Veteran's Pension recipient's tax liability incurred through the auto-calculation process as a result of the use of a tailored tax code is limited to $50, as specified in schedule 8, part B 1(a) of the Tax Administration Act 1994.

Background

The new end-of-year auto-calculation rules allow taxpayers who only receive New Zealand Superannuation or Veteran's Pension income and have a tax liability (perhaps through the under-deduction of PAYE) to have this tax liability written off. This also applies if the taxpayer has used a tailored tax code (for example, a taxpayer with tax losses carried forward that reduce their overall taxable income can get a tailored tax code to reflect that).

The underlying policy intent of these rules is that anyone using a tailored tax code should be entitled to a tax liability write-off that is limited in the same way as for the general tax codes. This is because a tailored tax code is based on a taxpayer's estimate of their income for the year.

Schedule 8, part B, clause 1(a) of the Tax Administration Act 1994 will be amended to clarify that recipients of New Zealand Superannuation and Veteran's Pension are limited to a $50 write-off if they have used a tailored tax code.

REMOVAL OF THE THREE-YEARLY PARENTAL TAX CREDIT REVIEW

(Clauses 46 and 47)

Summary of proposed amendment

The proposed amendment will remove the requirement to review the rate of parental tax credit (PTC) every three years, as PTC is not available for babies born on or after 1 July 2018.

Application date

The proposed amendment would apply from the date of enactment.

Key features

The requirement to review the amount of the PTC every three years would be removed as it is no longer required.

Background

Section MF 7(4) requires the Minister of Revenue, in consultation with the Minister for Social Development, to cause a review into the amounts of in-work tax credit and PTC by 30 June. The first review was in 2008 and each subsequent review is at three-year intervals.

The government stopped paying PTC for babies born on or after 1 July 2018 when it put in place the new Best Start tax credit. PTC can now only be claimed in submitting or finalising returns for previous tax years. Inland Revenue may also amend a person's entitlement if fraud or mistakes are discovered in past years' returns. The payment for those years would be the amount that applied then. It is extremely unlikely these amounts will be retrospectively changed. Therefore, the need to review the amount of PTC is now redundant.

BRINGING KIWISAVER EMPLOYER CONTRIBUTIONS INTO THE PENALTIES, RECOVERY AND USE-OF-MONEY INTEREST REGIMES

(Clauses 67(4), 68, 80 and 83)

Summary of proposed amendments

Amendments are proposed to the Tax Administration Act 1994 in response to legislative changes to the operation of KiwiSaver.

From 1 April 2020 the government will pay compulsory and voluntary KiwiSaver employer contributions to KiwiSaver scheme providers before the employer pays the amounts to Inland Revenue.

Voluntary employer contributions are currently not subject to the same penalties, debt collection and interest that apply to compulsory employer contributions.

The proposed amendments ensure that the same penalties and debt collection mechanisms apply to both voluntary and compulsory employer KiwiSaver contributions. It also updates a number of existing cross-references in the Act.

Application date

The proposed amendments would apply from 1 April 2021.

Key features

Voluntary employer KiwiSaver contributions are brought within the penalties, recoveries and use of money interest regimes.

Detailed analysis

Bringing voluntary KiwiSaver contributions within the penalties regime

The proposed amendment is designed to bring voluntary employer KiwiSaver contributions within the penalties regime in Part 9 of the Act.

This would be achieved by amending the definition of "tax" in section 3(1) of the Act. The proposed amendment would replace the specific reference to "compulsory employer contribution[s]" with the more generic "KiwiSaver Act 2006 employer contributions", so it includes both compulsory and voluntary employer KiwiSaver contributions.

Additionally, in order to not imply the exclusion of voluntary employer KiwiSaver contributions, it is proposed that paragraph (a)(viii) of the definition be repealed.

Bringing voluntary employer KiwiSaver contributions within the PAYE deduction rules

The propsoed amendment is designed to ensure that the PAYE administration provisions of the Act would apply to voluntary employer KiwiSaver contributions.

Section 4A(3) of the Act extends the PAYE withholding and deduction rules to a range of deductions prescribed under other pieces of legislation. While section 4A(3)(bc) includes compulsory employer KiwiSaver contributions, it does not mention voluntary employer KiwiSaver contributions.

The proposed amendment would replace the current reference to "compulsory employer contributions" with the more generic "KiwiSaver Act 2006 employer contributions".

Bringing voluntary employer KiwiSaver contributions within the recoveries rules

The recoveries provision in section 157 of the Act allows the Commissioner to make deductions from any amounts payable to a taxpayer who has overdue income tax. Section 157(10) includes its own definition of "income tax".

This definition includes compulsory employer contributions, but not voluntary. The proposed amendment would add "KiwiSaver Act 2006 employer contributions" to the definition, thus extending it to include voluntary KiwiSaver employer contributions.

Bringing voluntary KiwiSaver employer contributions within the use of money interest regime

Use of money interest (UOMI) compensates the Commissioner when taxpayers either pay less tax than they are required to or delay payments to Inland Revenue.

Part 7 of the Act contains the UOMI rules, but section 120B(bb) specifically excludes unpaid compulsory employer KiwiSaver contributions.

The proposed amendment to section 120B(bb) repeals this exclusion. This, coupled with the amendment to the definition of "tax" (above), will bring both compulsory and voluntary employer KiwiSaver contributions under the UOMI regime.

Minor cross-referencing error corrected

It is proposed that reference to section 101I(5) of the KiwiSaver Act 2006 in paragraph (a)(iii)(CD) of the definition of tax in section 3(1) of the Act be replaced with section 141(5) of the KiwiSaver Act 2006. The same amendment is made to sections 120B(bb) and 157(10) of the Act, which also refer to section 101Iof the KiwiSaver Act 2006.

The reason for this amendment is that section 101I was repealed on 1 December 2014 by section 90 of the Financial Markets (Repeals and Amendments) Act 2013. The equivalent section is now section 141(5) of the KiwiSaver Act 2006.

AMEND THE DEFINITION OF DEFERRABLE TAX

(Clause 67(2))

Summary of proposed amendment

The proposed amendment alters the definition of "deferrable tax" to include consequential amendments from an amended assessment.

Application date

The proposed amendment would apply from the date of enactment.

Key features

The definition of deferrable tax would be changed to include consequential amendments from an amended assessment that is in the disputes process.

This would reduce the compliance and administrative costs of also challenging those consequential assessments.

Background

When a taxpayer has a dispute with Inland Revenue, they are only required to pay a proportion of the tax owing until the dispute is settled. The current rules do not deal well with the situation where an amendment to the liability of one taxpayer affects an associated taxpayer.

For example, a company may have part of its expenditure disallowed as a deduction, which alters the amount of a loss offset made to another company in the same group. In that situation both entities must object or challenge the assessments. This imposes undue compliance and administrative costs and lengthens the dispute process.

Detailed analysis

Sections 128 and 138I of the Tax Administration Act 1994 state that a taxpayer is not liable to pay deferrable tax related to tax in dispute.

However, the current rules mean that when there are consequential amendments to related taxpayers, those taxpayers cannot defer their tax. They are required to object or otherwise challenge that consequential assessment. This results in increased administrative and compliance costs for those taxpayers.

The proposed amendment would alter the definition of deferrable tax to include consequential amendments resulting from an amended assessment that is in the disputes process.

RESTRICTING THE ABILITY TO CHALLENGE A TAX POSITION

(Clauses 77 and 78)

Summary of proposed amendment

The proposed amendment closes a potential loophole in the disputes rules whereby taxpayers could circumvent the time limit for challenging an assessment. Under the current rules, taxpayers could attempt to reopen an entire tax assessment by making a voluntary disclosure for a particular item within the period.

Application date

The proposed amendment would apply from the date of enactment.

Background

There is arguably a loophole in the current disputes procedures which allows a taxpayer to circumvent the time limit for challenging an assessment. This involves the taxpayer making a voluntary disclosure for a particular item, which arguably, could allow them to reopen the entire original assessment. This would have the effect of circumventing the four-month time limit for challenging an assessment.

Detailed analysis

Section 89D of the Tax Administration Act 1994 outlines when a taxpayer can issue a notice of proposed adjustment (NOPA). Section 89D(1) states:

> *If the Commissioner-*
>
> *(a) Issues a notice of assessment to a taxpayer; and*
>
> *(b) Has not previously issued a notice of proposed adjustment to the taxpayer in respect of the assessment, whether or not in breach of section 89C,-*
>
> *The taxpayer may, subject to subsection (2), issue a notice of proposed adjustment in respect of the assessment except to the extent to which the assessment takes into account amounts arising under subpart HB of the Income Tax Act 2007.*

This means that if a taxpayer issues a voluntary disclosure and then receives a notice of assessment when they have not previously been issued a NOPA, they can then issue a NOPA for the entire return even if they are outside the four-month time limit for issuing a NOPA.

A similar rule is contained in section 89DA.

Example 31

Kstew Winers Limited (KWL) is a company that specialises in the sale of cheap imported wine. KWL files its 2020 tax return and receives an assessment on 20 April 2021. KWL has four months to object to or challenge the assessment, which expires on 24 August 2021.

On 6 October 2021 KWL makes a voluntary disclosure for the 2020 tax return indicating it had overclaimed expenses of $5,000 relating to personal air travel to Paris. The Commissioner accepts the voluntary disclosure and issues an amended assessment on 4 February 2022. On 11 March KWL files a notice of proposed adjustment to the Commissioner's assessment arguing that some unrelated income is not taxable as it was a capital gain.

By making the voluntary disclosure KWL has been able to extend the four-month challenge time limit for its original tax return.

In the reverse circumstance the Commissioner is prevented from doing this by section 138B(1) which restricts the Commissioner to the "particular" of the amended assessment.

The proposed amendment would mean that if a taxpayer issues a NOPA for an assessment from a voluntary disclosure they are limited to the issues raised in the voluntary disclosure, which is identical to the position that applies to the Commissioner.

ALIGNING THE DEFINITION OF BENEFIT

(Clauses 58(13), 64 and 65)

Summary of proposed amendment

The proposed amendment would align the definition of a main benefit in the Acts administered by Inland Revenue with that used in the Social Security Act 2018.

Application date

The proposed amendment would apply from the date of enactment.

Key features

The proposed amendment would align the definition of a main benefit in the tax Acts with that used in the Social Security Act 2018. The proposed amendment:

- adds a new definition of main benefit in section YA 1 of the Income Tax Act 2007;
- removes the definition of "specified living allowance" as it is redundant; and
- makes consequential amendments.

Background

The tax Acts and the Social Security Act both contain lists of various benefit payments in their definition sections. However, the defined terms are different for the same list of payments.

Aligning the definitions between the Acts would reduce confusion and misunderstanding of the law.

CLARIFYING THE COMMISSIONER'S POWERS TO TAKE COPIES OF DOCUMENTS

(Clause 69)

Summary of proposed amendments

The proposed amendment would clarify that the Commissioner's powers to take copies and the like in relation to documents produced under various sections of the Tax Administration Act 1994 (the Act) also extend to documents produced in the course of the Commissioner's inquiries under section 17I of the Act.

Application date

The proposed amendments would apply from the date of enactment.

Key features

The proposed amendment would extend the Commissioner's powers under section 17C to take copies and the like in relation to documents provided under other sections of the Act to documents which are produced in the course of the Commissioner's inquiries under section 17I.

The proposed amendment would also make minor changes to better reflect the interaction of the sections with one another.

Background

The various information collection provisions in the Act were rewritten and consolidated as part of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019. As part of this exercise, section 17C was introduced to consolidate the various provisions relating to the ability of the Commissioner to take extracts from documents and the like.

Section 17I (which allows the Commissioner to conduct inquiries to obtain information) did not contain rules for taking extracts and the like and therefore was not included within the scope of section 17C.

There is no policy reason why the Commissioner should not have the power to take an extract from a document, make a copy of a document, or remove a document from a place for inspection as part of her inquiry powers.

Detailed analysis

All section references are to the Tax Administration Act 1994.

Sections 17 to 17M primarily deal with the collection of information. These provide the Commissioner with broad and wide-ranging powers to obtain information in specific circumstances. For example:

- section 17B allows the Commissioner to require information or the production of documents;
- section 17G allows the Commissioner to obtain information from large multinational groups; and
- section 17H permits the Commissioner to apply to the District Court for an order requiring the provision of information.

Operating in concert with these sections is section 17C(1). This section provides the Commissioner with the power to take extracts or copies of documents produced by a person under sections 17, 17B, 17G and 17H.

However, there is another section under which the Commissioner may require a person to produce documents. Section 17I allows the Commissioner to conduct inquiries in relation to a person's tax liability. Under this section, the Commissioner may require a person to produce documents in their position or control.

Unfortunately, section 17C(1) does not contain an explicit reference to section 17I. The absence of a reference to section 17I within section 17C(1) makes it unclear whether the Commissioner has the same powers over documents produced under section 17I such that she is able to, for example, take extracts or copies of documents produced under section 17I in the same way as she is under sections 17, 17B, 17G and 17H.

The proposed amendment to section 17C(1) would address this issue by incorporating a specific reference to section 17I within section 17C(1). This would make it clear that the Commissioner is able to take extracts or copies of documents produced under section 17I.

Minor amendments

The proposed amendment would also make minor changes to better reflect the interaction of the sections with one another. These are:

- replacement of the term "provided" with "produced" in section 17C(5);
- replacing the reference within section 17C(1) to section 17H with the more specific, section 17H(6); and
- repealing the reference within section 17C(1) to section 17G as documents are not provided or produced under this section.

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

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

Minor maintenance items

The proposed amendments in table 5 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; and
- inconsistent use of terminology and definitions.

Table 5: Maintenance amendments

Enactment	Clause	Section	Amendment	Application date
Income Tax Act 2007	18	ED 3	Correction of terminology	2 November 2012
	19	EE 40	Correction to cross-reference	1 April 2008
	24	EL 2(5)	Correction of terminology	1 April 2019
	25	EL 3(c)	Correction to cross-reference	1 April 2019
	26	EW 15I	Correction to cross-reference	1 January 2019
	28	EX 21(6)	Correction of terminology	2 November 2012
	29	EX 28(c)	Correction of terminology	2 November 2012
	30	EY 5(2)	Correction of terminology	1 July 2010
	31	EY 7(1)	Correction of terminology	1 July 2010

Enactment	Clause	Section	Amendment	Application date
	32	EY 11(8)	Correction of terminology	2 November 2012
	37	FE 22	Correction of grammar	1 April 2008
	38	GB 20	Correction of grammar	1 April 2014
	42	HC 24	Correct defined terms list	1 April 2009
	52	RA 1(gb)	Correction to cross-reference	1 July 2016
	53	RC 5(8)	Correction of terminology	2 November 2012
	55	RE 2(5)	Correction of terminology	1 April 2008
	58(2)	YA 1	Correction to cross-reference	1 July 2012
	58(4)	YA 1	Correction of terminology	Assent
	58(5)	YA 1	Correction of terminology	2 November 2012
	58(6)	YA 1	Correction of terminology	1 April 2008
	58(7)	YA 1	Correction of terminology	1 April 2008
	58(8)	YA 1	Correction of terminology	1 July 2010
Tax Administration Act 1994	67(2)	3	Correction of terminology	Assent
	67(4)(b)	3	Correction to cross-reference	1 April 2020
	81	139A	Correction to cross-reference	Assent
	82	139AB	Correction to cross-reference	18 March 2019
	83	157	Correction to cross-reference and terminology	1 April 2020
Student Loan Scheme Act 2011	92	34	Correction of terminology	1 April 2012
KiwiSaver Act 2006	93(3)	4	Correction of terminology	Assent