

COVID-19 Response (Further Management Measures) Legislation Act (No 2) 2020

A special report

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Introduction

1. The COVID-19 Response (Further Management Measures) Legislation Act (No 2) 2020 was enacted on 6 August 2020 and contains amendments to a range of cross-government COVID-19 response measures. Four taxation matters included in the new Act introduce amendments to:
 - the power of the Commissioner of Inland Revenue to vary due dates and deadlines
 - support the implementation of the research and development loan scheme
 - the ability for the Commissioner of Inland Revenue to remit use-of-money interest for some provisional taxpayers, and
 - the qualification periods for the in-work tax credit
2. This special report provides early guidance on these tax amendments. This information will also be published in the September 2020 edition of the Tax Information Bulletin.

Remedial amendment to administrative flexibility

(Sections 6H – 6I of the Tax Administration Act 1994)

3. This amendment to the Commissioner of Inland Revenue’s existing discretion allows her to shorten a due date or deadline or otherwise modify a time period or timeframe where this is advantageous to taxpayers.
4. This amendment is intended to ensure the Commissioner has appropriate administrative flexibility where taxpayers are affected or likely to be affected by COVID-19 in a way which makes compliance with current tax obligations impossible, impractical, or unreasonable.
5. Otherwise the power for the Commissioner to make a COVID-19 variation remains unchanged.

Background

6. On 30 April 2020, as part of its response to the pandemic, the Government introduced legislation to increase the administrative flexibility for Inland Revenue to quickly modify due dates, timeframes or other procedural requirements for taxpayers impacted by COVID-19.
7. This flexibility provides the Commissioner with a more timely mechanism to assist taxpayers who encounter practical difficulties in complying or where compliance with certain requirements under the Inland Revenue Acts is impossible or unreasonable due to circumstances relating to COVID-19. The power came into force on 30 April 2020, with application from 17 March 2020.

8. Where taxpayers comply with a modified timeframe or requirement made under this power, they will be treated as if they complied with the relevant requirement that is set in legislation.

Key features

9. The amendment allows the Commissioner to vary a due date, deadline, time period or time frame to shorten or otherwise modify the time-related requirement.
10. This provides the Commissioner with the ability to respond to some cases with appropriate flexibility by shortening timeframes, for example, by reducing the time before a taxpayer may choose a new approach, the time for an election to take effect, or before a taxpayer may benefit from a provision.

Application date

11. The amendment applies from the date of application of the original legislation: 17 March 2020 in relation to requirements arising from this date.

Detailed analysis

12. Time-related requirements may be shortened or otherwise modified
13. Section 6I(1)(a) is amended to allow the Commissioner to use the discretion to shorten, reduce or otherwise modify a time-related requirement specified in 6I(1). These are due dates, deadlines, time periods or timeframes within or in relation to which:
 - a person must comply with a requirement set out in the provision
 - a person must make an election under the provision, and
 - a person's entitlements, rights or obligations are affected.
14. A new subsection 6I(1B) is inserted to clarify that for the purpose of the COVID-19 variations, "modify" is defined as including a reduction in a time period or time-frame. This is restricted to where the Commissioner considers such a reduction would be advantageous for persons generally, or for a particular class of persons.
15. In addition, the existing legislation provides that the COVID-19 variations are optional for taxpayers to apply; taxpayers may always choose to comply with the requirements as set out in legislation rather than any relevant COVID-19 variation.
16. A supporting change is made to section 6H(1) which describes the discretionary power and how it may be used.

Example 1

Onya Marx is a company that provides specialist timekeeping for sporting events. During the lockdown, live sporting events were cancelled, meaning a downturn in business for Onya Marx.

Onya Marx has elected to file information to Inland Revenue quarterly, but could choose to adopt a half-yearly approach. However, taxpayers are not able to change filing options more than once a year – that is they must wait 12 months from the last election for any subsequent change of filing period to take effect.

The Commissioner considers that the time restrictions on being able to change between filing options may be unreasonable to comply with due to circumstances relating to COVID-19. The Commissioner issues a COVID-19 variation reducing the time period that taxpayers like Onya Marx must wait between changing filing periods to three months.

Amendments in support of R&D loan scheme

(Section DF 1(1), YA 1, and schedule 21B part B clause 21 of the Income Tax Act 2007; schedule 7 part C clauses 23B and 38 of the Tax Administration Act 1994)

17. The amendments support the implementation of the R&D loan scheme intended to incentivise businesses to continue research and development programmes at risk in the current economic conditions.
18. Amendments to the Income Tax Act 2007 ensure that expenditure funded by the loan scheme is subject to the normal income tax deductibility rules and that the loan does not affect a person's entitlement to R&D tax credits.
19. An amendment to the Tax Administration Act 1994 enables information sharing between Inland Revenue, Callaghan Innovation, and the Ministry of Business, Innovation, and Employment (MBIE) to support the R&D loan scheme. It also adds Callaghan Innovation to the list of agencies with which Inland Revenue can share information if necessary for carrying out duties related to COVID-19.

Background

20. The Government considers that lifting expenditure on R&D is necessary for the growth of the economy. However, the COVID-induced economic downturn has impacted many businesses in New Zealand, forcing them to cut down on expenditure to keep afloat. R&D programmes are particularly at risk of being cut or put on hold during the crisis. The Government has therefore provided funding through the COVID-19 Response and Recovery Fund for a temporary R&D loan scheme to encourage businesses to continue with their R&D programmes.
21. The R&D loan scheme is open to all R&D-performing businesses regardless of size. However, businesses are required to prove that they have suffered a significant loss in revenue or lack access to finance. The R&D loans scheme applies similar eligibility criteria to those used for the COVID-19 wage subsidy scheme. The loan can only be spent on R&D activity, and businesses are required to account for this.

22. Although there are some key differences, the R&D loan scheme is intended to operate similarly to the Small Business Cashflow Scheme, with a similar tax treatment. It is also intended to be compatible with the R&D tax incentive. The loans will be administered by Callaghan Innovation and will only be available for the 2020–21 fiscal year.
23. The amendments described here aim to ensure the efficient functioning and appropriate tax treatment of the loans scheme.

Key features

24. The COVID-19 Response (Further Management Measures) Legislation Act (No 2) 2020 contains the following amendments to support the R&D loans scheme.
 - The amendment to section DF 1(1) of the Income Tax Act 2007 exempts expenditure funded through the R&D loan scheme (defined in a further amendment to YA 1) from being subject to the rest of DF 1, which denies a deduction for expenditure or depreciation loss where the expenditure was funded through a government grant to a business. This ensures that expenditure funded through the loan scheme is subject to the normal income tax deductibility rules.
 - The amendment to schedule 21B part B clause 21 of the Income Tax Act 2007 exempts the R&D loan scheme from the exclusion on claiming expenditure for the R&D tax credit where the expenditure relates to a government grant. Without this amendment, expenditure funded through the R&D loan scheme would likely be ineligible for the tax credit, contrary to policy intent.
 - The amendments to schedule 7 of the Tax Administration Act 1994 allow for increased information sharing between Inland Revenue, MBIE, and Callaghan Innovation for the purposes of administering measures related to R&D in general and the R&D loan scheme in particular. They also allow information to be shared with Callaghan Innovation where the information is necessary for Callaghan Innovation to carry out duties related to COVID-19.

Application date

25. The amendments apply retrospectively from 1 July 2020, which is the date on which the R&D loan scheme became available.

Detailed analysis

Deductions not disallowed for expenditure funded through R&D loan scheme (section DF 1 of the Income Tax Act 2007)

26. Section DF 1 of the Income Tax Act 2007 prevents a person from claiming a deduction for expenditure or depreciation loss where the expenditure corresponds to a payment in the nature of a government grant or subsidy to business. DF 1(2) prevents the person from claiming a deduction for expenditure to which the payment corresponds, while DF 1(4) reduces the person's expenditure for the purpose of quantifying depreciation loss to the extent to which the person's expenditure on items of depreciable property corresponds to the payment.

27. An exception exists where the payment is an amount of a loan made under the small business cashflow scheme (DF 1(1)(cb)). Expenditure that corresponds to a loan under the small business cashflow scheme is subject to the normal deductibility rules (that is, it is not disallowed under section DF 1).
28. The policy intent is that the R&D loans should be subject to the same tax rules as the small business cashflow scheme. An exception to the DF 1 rules for payments made under the R&D loan scheme thus ensures that these payments are subject to the normal deductibility rules.

Expenditure funded through R&D loan scheme still eligible for R&D tax credit (schedule 21B part B clause 21 of the Income Tax Act 2007)

29. A person cannot claim R&D tax credits for expenditure or loss to the extent that the expenditure or loss falls into any of the categories described in schedule 21B part B of the Income Tax Act 2007.
30. Clause 21 of schedule 21B part B provides that expenditure or loss is not eligible R&D expenditure where the expenditure or loss is a precondition to, subject to the terms of, required by, or otherwise related to a grant made by the Crown or a local authority. The policy intent of the R&D loan scheme, however, is that a person should be able to claim both the loan and the R&D tax incentive for the same expenditure. The amendment to clause 21 therefore creates an exception for expenditure funded through the R&D loan scheme. This allows expenditure funded through the R&D loan scheme to be eligible for the R&D tax credit (provided it meets all the other eligibility criteria).

Information sharing amendments (schedule 7 of the Tax Administration Act 1994)

31. Section 18 of the Tax Administration Act 1994 prevents Inland Revenue from disclosing any sensitive revenue information unless the disclosure is a permitted disclosure. Schedule 7 of the Tax Administration Act 1994 provides for situations in which disclosure is permitted to certain persons or agencies.
32. Amendments have been made to the provisions in schedule 7. The general effect of the amended provisions is to enable information to be shared with Callaghan Innovation where the information is reasonably necessary to perform duties related to COVID-19, and to explicitly include the R&D loan scheme in the existing information sharing provisions between Inland Revenue, Callaghan Innovation, and MBIE for R&D incentives. These amendments ensure that Inland Revenue can share information to enable Callaghan Innovation to make faster and better-informed decisions about an applicant's eligibility and to increase the efficacy of the scheme.
33. All legislative references below are to the Tax Administration Act 1994, schedule 7.

Information sharing with agencies for COVID-19 response purposes (clause 23B)

34. Clause 23B enables the Commissioner to disclose information about a person or entity to a prescribed list of government agencies for performing duties in response to the pandemic and economic crisis. The list of government agencies with which Inland Revenue can share information for these purposes is provided in clause 23B(6).

35. An amendment adds Callaghan Innovation to the list of agencies in clause 23B(6), enabling Inland Revenue to disclose information to Callaghan Innovation where the information relates to performing duties connected with COVID-19.

Information sharing with agencies for R&D purposes (clause 38)

36. Clause 38 provides the Commissioner with the ability to share information with various government agencies for specified purposes relating to developing and administering R&D incentives (in particular, the R&D tax incentive). Clause 38(2) enables the Commissioner to share information about a person or entity with Callaghan Innovation and MBIE where the information relates to offering R&D advice or government incentives.
37. New clause 38(2)(a) allows Inland Revenue to share information relating to several categories of government R&D incentive, including tax incentives, loans, grants, and any related measures. New clause 38(2)(b) specifies that Inland Revenue can share information relating to the grant and administration of loans under the R&D loan scheme.

Use of money interest remission on terminal tax

(Section 183ABAC of the Tax Administration Act 1994)

38. The amendment allows Inland Revenue to remit use of money interest (UOMI) accrued on an amount of terminal tax payable for the 2020–21 tax year where the taxpayer failed to pay the relevant portions of the amount by the provisional tax dates because their ability to reasonably accurately forecast their residual income tax has been significantly adversely affected by COVID-19.

Background

39. UOMI is charged immediately when a taxpayer fails to make a payment of tax on time. It is also charged retrospectively when a provisional taxpayer who uses the standard or estimate methods does not pay amounts sufficient to cover their instalment amount or residual income tax, depending on which method they use.
40. The purpose of UOMI is to encourage taxpayers to pay their tax on time and compensate the government for the loss of use of money from taxpayers underpaying their tax. It applies to all tax types administered by Inland Revenue. In most cases UOMI is charged immediately when taxpayers make tax payments late.
41. Section 183ABAB of the Tax Administration Act 1994 was introduced as part of the Government's response to the COVID-19 situation and gave the Commissioner the power to remit UOMI where the taxpayer's ability to make a payment was significantly adversely affected by COVID-19. This will cover the situation where a taxpayer is charged UOMI immediately on a missed payment but not in the situation where UOMI is charged retrospectively as the UOMI is not charged in respect of a "payment" that could not be made it is charged on the basis of the unpaid tax at those dates.

42. When UOMI is charged immediately the amount of actual tax owing is certain as the taxpayer has usually filed a tax return establishing the liability. With provisional tax the actual liability is not known until a taxpayer files their annual tax return sometime after their year-end so provisional instalments are calculated with reference to prior years or the taxpayer's estimate of their tax liability for the year.
43. Once a taxpayer files their tax return UOMI is charged retrospectively to compensate the government where a taxpayer underpays tax compared to their actual liability for the year or their instalment amounts depending on whether they use the standard or estimation methods.
44. A number of taxpayers have noted that because of the COVID-19 situation it is difficult for them to forecast their tax liability for the year. They know that the standard uplift multipliers of 105% of the prior year or 110% of the year before the prior year will likely be in excess of their liability for the 2020–21 year but there is uncertainty about what their tax liability may be for the year which could expose taxpayers, particularly small taxpayers, to UOMI.

Key features

Interest remission

45. New section 183ABAC allows the Commissioner of Inland Revenue to remit UOMI charged to taxpayers on an amount of terminal tax for the 2020–21 tax year if they:
 - are a provisional taxpayer in the 2020–21 tax year;
 - estimate their provisional tax;
 - use the standard method and don't pay the amount of the standard instalment on the final instalment;
 - would be a safe harbour taxpayer but they did not pay their instalments in full;
 - have residual income tax of \$1 million or less, and
 - the ability to make a reasonably accurate forecast of taxable income for the year has been significantly adversely affected by COVID-19 and that resulted in interest being charged.
46. For interest to be remitted the taxpayer must ask for it to be remitted and the Commissioner must be satisfied that the taxpayer has asked for the relief as soon as practicable and made the payment of tax.
47. This amendment is aimed at remitting UOMI for smaller business who have difficulty in accurately forecasting their residual income tax for the year and incur UOMI when their actual tax liability is higher than the amount they have estimated or paid.

Example 2

Discovery Traders Limited is an export company based in Twizel that sells high quality Manuka honey to China. Due to the closing of the borders under COVID-19 it is very uncertain when the shipping lanes to China will be fully opened to international trade and how the situation will impact sales by Discovery. Based on the information that Discovery has at the time it is due to make its first instalment of provisional tax for the 2020–21 tax year it estimates its tax liability for the year to be \$80,000 and makes its first provisional tax payment accordingly.

However, the trading lanes fully open a lot sooner than Discovery believed. They subsequently change their estimate and make increased payments at the second and third provisional tax instalment dates.

Despite this, they incur UOMI on the underpaid first instalment. They seek remission of that UOMI on the basis that at the time they had no idea that the trading lanes would open so quickly. Discovery's residual income tax is less than \$1 million and because of the uncertainty created by the COVID-19 situation their ability to accurately forecast their income has been impaired. However, as soon as Discovery realised this, they amended their estimate accordingly. Discovery would be entitled to remission under new section 183ABAC.

48. The Commissioner is unlikely to remit UOMI where a taxpayer makes no effort to forecast their residual income tax for the year or where the taxpayer has resources available to accurately forecast their tax liability for the year.

Example 3

Excelsior Exteriors Limited is a building company based in Tauranga. They have been affected by COVID-19 in two ways, firstly, there was the initial lockdown which meant that work on their current projects ceased until the alert level reduced to level 2 but then, secondly, since the reduction in alert level they have been inundated with new projects as people who cannot travel overseas decide to undertake renovations to their houses. This has seen their revenue increase over prior years.

James, the owner of Excelsior, notes that the Commissioner can now remit interest on underpayments of provisional tax so decides to make no payments of provisional tax for the year on the basis that Excelsior will get this remitted when they file their tax return notwithstanding the increase in business during the year.

In this case the Commissioner would not consider a remission of interest as Excelsior's ability to forecast their income at each instalment has not been affected by COVID-19. It was clear that Excelsior was going to have a tax liability greater than zero, yet no effort was made to make tax payments to reflect that.

Example 4

Enterprise Bank Limited is a registered bank in New Zealand and has an annual turnover of \$700 million. Its operations have been largely unaffected by COVID-19 and in some cases its profits have increased due to more lending being made to smaller businesses due to COVID-19.

Enterprise has a subsidiary V'ger Limited which sells pet insurance to Enterprise customers. V'ger outsources its accounting functions including forecasting to Enterprise. V'ger has been affected by COVID-19 as fewer people are getting pets than in a normal year.

V'ger estimates its provisional tax payable for the year, however, it incurs interest for underpaying its provisional tax compared with its actual tax liability for the year. V'ger underpaid as it made an error in their original estimate.

Although V'ger has residual income tax of less than \$1 million it has the ability to accurately forecast and adjust their provisional tax payments for the year and that ability has not been adversely affected by COVID-19. The Commissioner will not consider remitting interest for V'ger.

Application dates

49. This provision has effect from the date of Royal Assent however it will apply for UOMI accrued for the 2020–21 tax year.

Grace periods for the in-work tax credit

(Sections MD 9 and MD 10 of the Income Tax Act 2007)

50. Amendments to the Income Tax Act 2007 will allow families to continue to receive the in-work tax credit (IWTC) for a period of up to two weeks as earners transition between jobs, are unpaid for a period or leave their employment.

Background

51. Section MD 4(1) of the Income Tax Act 2007 sets out that a person is entitled to an IWTC for a child if the person meets the five requirements set out in sections MD 5 to MD 9. The fifth of these requirements (commonly referred to as the “in employment” test) requires IWTC recipients to derive income in each week they are eligible for the tax credit.
52. A longstanding issue with this requirement is that working families lose their entitlement to the IWTC over small unpaid periods even though the earner returns to paid work. Examples include teacher aides and other support staff in schools or universities employed only during the school term, workers on fixed-term contracts, and workers transitioning between jobs or taking unpaid leave.
53. As job losses increase due to the economic downturn, the amendments will ensure that families continue to receive the IWTC for two weeks as they transition between jobs, are unpaid for a period, or leave their employment. The change is intended to boost the incomes of low and middle-income working families while supporting them to stay off a main benefit as they transition between jobs or have small gaps in employment.

Key features

Two-week grace period

54. New section MD 9(6) provides an exception to the “in employment” test for a person who previously met the test within the past fortnight. The amendment provides that a person is deemed to meet the test if they do not derive income or otherwise do not meet the in employment test but have met the test within the last 14 days.
55. The off-benefit rule in section MD 8 will still apply, meaning that payments of the IWTC will stop if the earner or their spouse, civil union partner or de facto partner goes on to an income-tested benefit.

Definition of weekly periods

56. Section MD 10 defines the amount of IWTC entitlement and the number of weekly periods the earner is entitled for. The definition of “weekly periods” in section MD 10(3)(d) has been amended so that it includes whole one-week periods to which the new rule in section MD 9(6) applies. The amendment ensures that the earner is entitled to continue receiving the IWTC in each week that they have a grace period under section MD 9(6), up to a maximum of two consecutive weeks.

Application date

57. The amendments will come into force on 1 April 2021.