Hon David Parker, Minister of Revenue

Information Release

Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill

October 2021

Availability

This information release is available on Inland Revenue's tax policy website at https://taxpolicy.ird.govt.nz/publications/2021/2021-ir-argrm-bill

Documents in this information release

#	Reference	Type	Title	Date
1	IR2020/510	Tax policy report	Decommissioning petroleum exploration wells	9 December 2020
2	IR2021/060	Tax policy report	GST policy work programme	16 February 2021
3	IR2021/069	Tax policy report	Overseas donee status: New additions and removals for the next available taxation bill	23 February 2021
4	IR2021/073	Tax policy report	Tax pooling to purchase backdated tax	18 February 2021
5	IR2021/094	Tax policy report	Cabinet paper: Overseas donee status – additions for the next taxation bill	4 March 2021
6	IR2021/112	Tax policy report	Changes to the fair dividend rate foreign currency hedges rules	18 March 2021
7	IR2021/123	Tax policy report	Sales suppression software	25 March 2021
8	IR2021/138	Tax policy report	Cabinet paper – GST policy issues	31 May 2021
9	IR2021/147	Tax policy report	Overseas donee status: NZ Memorial Museum Trust – Le Quesnoy – requested extension to sunset clause	7 April 2021
10	IR2021/195	Tax policy report	Changes to the petroleum mining tax regime	8 June 2021
11	IR2021/200	Tax policy report	Cabinet paper: Overseas donee status: additions for the next omnibus taxation bill, and extending the NZMMT-Le Quesnoy's sunset clause	4 May 2021
12	IR2021/204	Tax policy report	R&D Tax Incentive: extending due dates	5 May 2021
13	IR2021/210	Tax policy report	Local authority taxation – dividends and deductions	24 May 2021
14	IR2021/218	Tax policy report	Remedial items for inclusion in the 2021 omnibus tax bill	19 May 2021

#	Reference	Type	Title	Date
15	IR2021/220	Tax policy report	Introducing an open-ended time limit on information sharing for COVID-19 response purposes	10 May 2021
16	IR2021/247	Tax policy report	Cabinet paper – Measures for inclusion in 2021 omnibus tax bill	2 June 2021
17	IR2021/248	Tax policy report	Remedial and GST policy items with fiscal implications for inclusion in the 2021 omnibus taxation bill	10 June 2021
18	IR2021/249	Tax policy report	s 9(2)(f)(iv)	8 June 2021
19	DEV-21-SUB-0119	Cabinet paper	Overseas donee status: additions for the next omnibus taxation bill, and extending the NZMMT-Le Quesnoy's sunset clause	9 June 2021
20	DEV-21-MIN-0119	Minute	Overseas donee status: additions for the next omnibus taxation bill, and extending the New Zealand Memorial Museum Trust - Le Quesnoy's sunset clause	9 June 2021
21	CAB-21-MIN-0221	Minute	Overseas donee status: additions for the next omnibus taxation bill, and extending the New Zealand Memorial Museum Trust - Le Quesnoy's sunset clause	14 June 2021
22	IR2021/263	Tax policy report	Additional remedial items for inclusion in the 2021 omnibus tax bill	17 June 2021
23	IR2021/273	Tax policy report	Amended Cabinet paper – Measures for inclusion in 2021 omnibus tax bill	17 June 2021
24	IR2021/274	Tax policy report	Remedial change to employer superannuation contribution tax on contributions for past employees	17 June 2021
25	BN2021/284	Briefing note	Speaking notes: Measures for inclusion in the 2021 Omnibus Tax Bill for consideration at Cabinet Development Committee on 30 June 2021	22 June 2021
26	DEV-21-SUB-0155	Cabinet paper	Measures for inclusion in the 2021 omnibus tax bill Note: The regulatory impact assessments and statements attached to the paper are publicly available	7 July 2021
27	DEV-21-MIN-0155	Minute	Measures for inclusion in the 2021 omnibus tax bill	7 July 2021
28	DEV-21-SUB-0157	Cabinet paper	GST policy issues Note: The regulatory impact assessments and statements attached to the paper are publicly available	7 July 2021
29	DEV-21-MIN-0157	Minute	GST policy issues	7 July 2021
30	IR2021/320	Tax policy report	Cabinet paper – Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill: Approval for introduction	5 August 2021

#	Reference	Type	Title	Date
31	BN2021/336	Briefing note	Speaking notes for Cabinet Business Committee (CBC)	12 August 2021
32	CBC-21-SUB-0085	Cabinet paper	Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill: Approval for introduction Note: The final versions of the departmental disclosure statement and Bill are publicly available	1 September 2021
33	CBC-21-MIN-0085	Cabinet minute	Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill: Approval for introduction	1 September 2021

Additional information

Cabinet paper *Overseas donee status: additions for the next omnibus taxation bill, and extending the NZMMT-Le Quesnoy's sunset clause* (DEV-21-SUB-0119) was considered by the Cabinet Economic Development Committee on 9 June 2021 and referred to Cabinet for further consideration on 14 June 2021.

Cabinet paper *Measures for inclusion in the 2021 omnibus tax bill* (DEV-21-SUB-0155) was considered by the Cabinet Economic Development Committee on 7 July 2021 and confirmed by Cabinet on 12 July 2021.

Cabinet paper *GST policy issues* (DEV-21-SUB-0157) was considered by the Cabinet Economic Development Committee on 7 July 2021 and confirmed by Cabinet on 12 July 2021.

Cabinet paper *Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill: Approval for introduction* (CBC-21-SUB-0085) was considered by the Cabinet Business Committee on 1 September 2021 and confirmed by Cabinet on 6 September 2021.

Eight attachments to Cabinet papers are not included in this information release as they are publicly available:

- Regulatory impact assessments and statements:[1]
  - Domestic transport services supplied as part of the international transport of goods (31 May 2021)
  - GST apportionment (31 May 2021)
  - Local authority taxation – dividends and deductions (17 June 2021)
  - Sales suppression software (1 June 2021)
  - Tax pooling to purchase backdated tax (31 May 2021)
  - Tax treatment of cryptocurrencies (31 May 2021)
- Departmental disclosure statement for the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill (3 September 2021)[2]
- Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill (8 September 2021)[3]

[1] Inland Revenue. (2021). *RIS Pack – Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill*. https://taxpolicy.ird.govt.nz/publications/2021/2021-ris-argrm-bill

[2] Inland Revenue. (2021). *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill*. (Departmental disclosure statement). http://disclosure.legislation.govt.nz/bill/government/2021/65/

[3] New Zealand Government. (2021). *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill*. 65-1. https://legislation.govt.nz/bill/government/2021/0065/12.0/versions.aspx

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

6(a)	to prevent prejudice to the security or defence of New Zealand or the international relations of the Government
9(2)(a)	to protect the privacy of natural persons, including deceased people
9(2)(ba)(i)	to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
9(2)(f)(iv)	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
9(2)(g)(i)	to maintain the effective conduct of public affairs through the free and frank expression of opinions
18(c)(i)	that the making available of the information requested would be contrary to the provisions of a specified enactment

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: Decommissioning petroleum exploration wells

Date:	9 December 2020	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2020/510

Action sought

	Action sought	Deadline
Minister of Revenue	**Note** the contents of this report **Refer** a copy to the Minister of Finance for his information	24 December 2020

Contact for telephone discussion (if required)

Name	Position	Telephone
Chris Gillion	Policy Lead	s 9(2)(a)
Paul Fulton	Principal Policy Advisor	

In Confidence

9 December 2020

Minister of Revenue

Decommissioning petroleum exploration wells

Purpose

1. This report briefs you on a potential issue with the tax treatment of the cost of decommissioning petroleum exploration wells.

Background

2. The tax rules for petroleum mining are split into two phases which are "exploration" and "development". Exploration is essentially searching for commercially extractable petroleum reserves while development is the extraction of these reserves for commercial production. Upon cessation of development a petroleum miner must decommission – which includes plugging and abandoning wells, removing equipment and removing installations and pipelines.

3. The petroleum decommissioning rules were revised in 2018 to allow a petroleum miner a refundable tax credit for certain expenditure on decommissioning petroleum assets. These rules replaced the previous spread-back provisions which achieved a similar purpose – to allow a tax refund for expenditure incurred on decommissioning wells after the petroleum miner had paid tax in previous years.

4. Officials consider these rules are still fit for purpose. This refundable credit recognises that petroleum miners incur significant costs in decommissioning petroleum installations near or after the end of production. In the absence of specific rules this expenditure would result in a loss carried forward that may be of limited or no value to the petroleum miner unless they had income from another source.

Exploration wells

5. The general position is that exploration wells are not eligible for a refundable tax credit. These can be considered similar to feasibility expenditure on an unsuccessful project which may be deductible against current or future income but cannot be refunded against tax paid on previous taxable income[1].

6. An exception to this is exploratory wells that have been "plugged and abandoned in a permit area together with a commercial well geologically contiguous[2] with the exploratory well as part of an arrangement". The purpose of this provision is where the petroleum miner delays abandoning the exploration well so that it can be used (or preserved for potential future use) for water or gas injection to extend production from a production well. This can create economies of scale where exploration and production wells are decommissioned as part of the same arrangement.

[1] A refund may be available through the loss carry back rules. However, these are more limited that the decommissioning refundable credit.
[2] This essentially means the two wells are accessing oil from the same reservoir.

7. This is intended to create a distinction between exploration wells that contribute to future production – which may be eligible for the refundable credit – and exploration wells that do not contribute to future production – which should not be eligible for the refundable credit.

Potential issue

8. Officials have identified a scenario where exploration wells that did not contribute to future production may be eligible for the refundable credit. The correct interpretation under the current rules is yet to be confirmed but this report is provided now as an amendment may be required to align the application with the policy intent, or to clarify this intent.

9. A petroleum miner with a field that is nearing the end of its life may drill an exploration well to confirm whether additional reserves can be extracted. As an exploration well, this expenditure is deductible in the year it is incurred. If that exploration well is unsuccessful it can be abandoned alongside the original production well that has now been exhausted. Although the exploration well did not contribute to any additional production it may also be eligible for the refundable credit provided it is geologically contiguous with the production well and they are both abandoned/decommissioned at the same time.

10. This scenario is not consistent with the policy intent of the refundable credit and is more comparable to an exploration well drilled that does not proceed to the development stage – which is not eligible for the refundable credit, or unsuccessful feasibility expenditure.

11. This position is supported by the Cabinet paper that recommended the current rules (CAB-16-Min-0580.01 refers). Paragraph 15 of that paper states:

> *Two (or more) wells in a geologically contiguous area can access the same petroleum reserves. When an exploration well is no longer required it can be suspended for possible other purposes such as gas or water injection (which increases the flow-rate of a nearby development well). It is more cost effective to abandon these wells at the same time a development well is decommissioned so that specialist vehicles only have to be mobilised to New Zealand once.*

Abandonment

12. A well can be suspended so that it does not create any environmental risks while it is decided what to do with it in the future. A well that has been suspended will need further work before it is permanently abandoned. It was not intended that expenditure on temporarily suspending a well would be eligible for the refundable credit. The legislation may already achieve this purpose, but this is still being confirmed. A minor clarification of this point may be desirable.

Potential resolution

13. Officials consider there are two possible ways to remove these exploration wells from the refundable credit.

14. Option one is to narrow the scope of exploration wells within the decommissioning definition. We consider this would be a remedial amendment consistent with the original policy intent. However, while this is relatively easy on a well-by-well basis it is difficult to create general rules that accurately define the distinction between exploration wells that should be eligible for the refundable credit and those that should not.

15. Option two is to remove exploration wells from the decommissioning definition completely. We consider this would be a minor policy change that would require Cabinet approval. This would remove any ambiguity over which exploration wells were eligible and would be consistent with the policy intent of the previous petroleum spread-back rules. While exploration wells are often significantly cheaper to abandon than the decommissioning of a production well their removal from the refundable credit is likely to be controversial amongst the petroleum mining industry.

Application date and fiscal impact

16. There are two possible application dates.

17. Option one is to apply an amendment from the enactment date of the bill it is contained in; this could be March 2022 if it was included in the first tax bill in 2021. Any abandonment of an exploration well before that date would be a normal commercial arrangement rather than a transaction structured specifically to fall within the refundable credit rules. Narrowing the scope of the refundable credit will prevent future abandonment of exploration wells from obtaining a refundable credit which could otherwise reduce net tax revenue by tens of millions or more.

18. Option two is a retrospective application date effective from 1 April 2018 to align with the original application date of these rules. As well as the impact from option one it would protect the tax base from any unintended refundable credit claims before the bill containing the amendment could be enacted. s 18(c)(i) [redacted]

Consultation

19. The Treasury has been informed on this report.

Next steps

20. This report is for your information and could be the basis for a discussion in early 2021 on whether to add this to the tax policy work programme.

Recommended action

We recommend that you:

21. **note** the contents of this report

    Noted

22. **refer** a copy of this report to the Minister of Finance for his information.

    Referred/Not referred

Paul Fulton
Principal Policy Advisor
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2020

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **GST policy work programme**

Date:	16 February 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/060

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	2 March 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Graeme Morrison	Policy Lead	s 9(2)(a)
Gordon Witte	Principal Policy Advisor	
s 9(2)(a)	Policy Advisor	

16 February 2021

Minister of Revenue

GST policy work programme

Executive summary

1. The purpose of this report is to provide you with an update on the GST policy work programme. This will cover key points raised by submitters in response to the *GST policy issues – an officials' issues paper* ("issues paper") which was consulted on in 2020, and will inform you of upcoming work regarding the GST implications of the gig and sharing economy and a new project which seeks to provide more certainty to government departments on the GST treatment of regulatory charges.

GST issues paper

2. This report seeks your agreement to progress the tax policy issues that were consulted on in the issues paper along two tranches.

3. The first tranche consists of the following proposals that officials recommend be included in the first omnibus taxation bill of 2021:

   3.1 modernising the invoicing rules so the Goods and Services Act 1985 (GST Act) reflects business practices;

   3.2 removing GST on cryptocurrencies so investors and businesses are not disadvantaged compared to using money or issuing shares;

   3.3 making it easier for domestic freight transporters to zero-rate GST on their services to non-resident freight transporters; and

   3.4 some remedial changes to the apportionment and adjustment rules, the compulsory zero-rating of land rules and other technical and remedial matters.

4. Subject to your agreement, officials will report back shortly with a Cabinet paper seeking approval for these issues to be included in the first omnibus taxation bill of 2021. None of these issues would have fiscal implications, as they simply update and align the GST legislation with current taxpayer practices, which officials consider provide the correct policy outcomes.

5. With respect to tranche two, officials intend to undertake further stakeholder consultation on GST policy issues relating to:

   5.1 the apportionment and adjustment rules;

   5.2 zero-rating GST on conferences and staff training events held in New Zealand and attended by non-resident businesses;

   5.3 managed funds; and

   5.4 insurance pay-outs to third parties.

6. This is because the submissions demonstrated that further targeted consultation with the affected stakeholder groups would be required to develop and refine the proposals.

7. These issues are discussed later in this report, and a summary of the key points raised by submitters is provided in respect of each issue.

VAT/GST implications of the gig and sharing economy

8. Inland Revenue officials have been involved in discussions at the Organisation for Economic Cooperation and Development (OECD), where a report on the VAT/GST implications of the gig and sharing economy is currently being prepared. The report, which we expect to be published in the first half of this year, will outline options for jurisdictions to consider implementing, but will not make specific recommendations. It will focus on the role that digital platforms (for example, Airbnb and Uber) could play in improving compliance with GST obligations.

9. We will report back to you with more detail on the OECD's report once this has been published. We will also seek your agreement to the development of a discussion document which would consult on more detailed proposals for collecting GST and tax information from sharing economy platforms, which could be released later this year.

GST and regulatory charges

10. In the last few years, Inland Revenue has worked with various government agencies which have been unaware or confused about the GST implications of new levies that they are introducing.

11. From a GST policy perspective, regulatory charges which are paid for goods and services should be subject to GST because they represent consideration for a supply of goods and services. Other regulatory charges such as taxes, fines and penalties do not represent consideration for a supply of goods and services and should therefore not be subject to GST from a GST policy perspective.

12. Officials at Inland Revenue and the Treasury consider that amending the GST Act so it deems newly created regulatory charges that come into force from a prospective date to be subject to GST unless they are specifically excluded through an Order in Council process. This rule would be similar to the current rule, which ensures an appropriate GST treatment of government grants and subsidies, and would provide greater certainty as to the GST treatment of regulatory charges.

13. Subject to your agreement, officials will undertake targeted consultation with other government agencies and private sector GST advisors in relation to the application of GST to regulatory charges, and we will report to you later this year with advice.

Recommended action

We recommend that you:

GST issues paper

a) **Agree** that the following proposals be progressed in the next available tax bill:

i. Modernising tax invoicing rules so that the GST Act reflects business practices

Agreed/Not agreed

ii. Removing GST on cryptocurrencies so that investors and businesses are not disadvantaged compared to using money or issuing shares

Agreed/Not agreed

iii. Making it easier for domestic freight transporters to zero-rate GST on their services to non-resident freight transporters

Agreed/Not agreed

iv. Remedial amendments in respect of the apportionment and adjustment rules

Agreed/Not agreed

v. Minor improvements in respect of the compulsory zero-rating of land rules

Agreed/Not agreed

vi. Other minor GST technical and remedial issues

Agreed/Not agreed

b) **Note** that none of the GST issues which we recommend be progressed in the next taxation bill would have fiscal implications, as they simply update and align the GST legislation with current taxpayer practices which officials consider provide the correct policy outcomes.

Noted

c) **Agree** that the following proposals be consulted on further, with the view to progress these matters in a tax bill at a later date:

i. The GST treatment of certain fees and services in the managed funds industry

Agreed/Not agreed

ii. Substantive proposals for the apportionment and adjustment rules

Agreed/Not agreed

iii. Insurance pay-outs to third parties

Agreed/Not Agreed

iv. Zero-rating conferences and staff training supplied to non-resident businesses

Agreed/Not agreed

GST and regulatory charges

d) **Agree** that officials undertake targeted consultation with other government agencies and private sector GST advisors in relation to the application of GST to regulatory charges

Agreed/Not agreed

Taxation of the gig and sharing economy

e) **Note** that officials will report to you with more information about the tax implications of the gig and sharing economy once the OECD has released its papers on this issue

Noted

Graeme Morrison
Policy Lead
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

Background

14. The current GST policy work programme currently includes the following three significant workstreams:

    14.1 Progressing the GST policy issues consulted on in the February 2020 issues paper.

    14.2 Addressing the GST and wider tax compliance issues associated with the gig and sharing economy.

    14.3 Providing certainty and education for government agencies about the correct application of GST to regulatory charges.

GST issues paper

15. Officials engaged with internal and external stakeholders to identify GST policy issues that need to be addressed by amendment to the GST Act. This work culminated in the release of the *GST policy issues – an officials' issues paper* in 2020. The issues paper sought feedback on various policy options to protect against identified gaps in the GST base and respond to changes to commercial practice and technology.

16. Officials have received 40 written submission on the proposals set out in the issues paper. A summary of the main points raised by the submitters in respect of each chapter of the paper is set out below.

Modernising tax invoice requirements

17. The GST Act requires GST registered suppliers and purchasers to issue and retain certain information on their tax invoices in order to help suppliers and purchasers to correctly account for GST. These requirements have remained largely unchanged since 1985. The proposals in the issues paper seek to modernise invoicing requirements to reflect electronic invoicing and changes in business practices.

18. Submitters generally supported the proposals. Some submitters considered that requiring tax invoices was an unnecessary compliance cost imposed by the GST system, and that compliance costs could be lowered by instead relying on retaining business records that contain all the relevant information currently required for a tax invoice.

19. Officials recommend that the tax invoice proposals be progressed in the next taxation bill.

The GST treatment of cryptocurrencies

20. The proposals in the issues paper seek to exclude cryptocurrencies ("crypto-assets") from GST and the financial arrangement rules,[1] and ensure that these rules do not impose barriers to developing new products, raising capital and investing through crypto-assets. The paper also proposes that the GST rules that allow GST registered businesses to claim input credits for their capital raising apply equally to crypto-assets as they do to debt or equity securities.

21. The submitters were supportive of the proposals raised in the issues paper. All submitters agreed that 'crypto-asset' should be widely defined and that the application date for any changes should be retrospective to the inception of bitcoin.

[1] Income tax would still apply when a person sold or exchanged a crypto-asset – this is similar to the income tax treatment of shares which are also excluded from the financial arrangement rules.

22. Most submitters also agreed that supplies of crypto-assets should be excluded from the scope of GST altogether, and that this treatment should extend to all crypto-assets.

23. Chartered Accountants Australia and New Zealand (CA ANZ) submitted an alternative reform option whereby officials would develop a coherent framework for the tax treatment of crypto-assets based on their specific characteristics. Officials consider this would be complex and difficult to apply and it would mean different types of crypto-assets could have differing GST and income tax treatments. CA ANZ supported the proposal in the issues paper of excluding all crypto-assets from the GST and financial arrangement rules as a second-best option.

24. Submitters agreed that input credits should be allowed for capital raising via cryptocurrencies. One submitter considered that this should be expanded to include fundraising involving the issue of all crypto assets generally, rather than just those involving tokens with similar features to equity or debt securities.

25. Submitters supported the proposal to exclude crypto-assets from the financial arrangement rules (except for tokens that mirror the economic function of debt arrangements).

26. A number of submitters requested clarification on the GST treatment of mining and exchange services, and further guidance on crypto-assets more generally.

27. Officials recommend that the cryptocurrency proposals in the issues paper be progressed in the next taxation bill.

Domestic legs of the international transport of goods

28. The domestic leg of the international transport of goods chapter of the issues paper proposed the broadening of an existing zero-rating rule for international transport of goods rule to accommodate subcontracting arrangements which are a common commercial practice[2]. In practice, a non-resident courier business may subcontract the domestic transport leg to a separate New Zealand courier business. Australia's GST rules allow such subcontracting arrangements to be zero-rated.

29. Submissions were generally positive towards the proposed changes, with several submitters noting the need for a clear and easily understood definition of what constitutes the international transport of goods, to ensure that the new rules do not inadvertently add another layer of complexity.

30. Several submitters noted their preference for the zero-rating treatment to be on all domestic transport services where they relate to an international transport service, instead of requiring the primary transport supplier to be a non-resident. This approach would remove complexity in determining the correct GST treatment of the transport service.

31. Officials recommend that the proposal in the issues paper be progressed in the next taxation bill.

Apportionment and adjustment rules

32. The GST Act includes a set of apportionment and adjustment rules for determining GST input tax deductions and output tax liabilities when an asset such as a vehicle, farmhouse or home office is used partly to conduct a GST registered business and partly for a private or exempt use.

---

[2] An example would be where a courier package is sent from Los Angeles to Auckland and then from Auckland to Hamilton. The current rules allow for the domestic Auckland to Hamilton leg of the transport service to be zero-rated but only in those cases where the domestic transport provider is the same taxpayer as the international transport provider.

33. The apportionment and adjustment chapter of the issues paper proposed a number of specific changes to the apportionment and adjustment rules. These changes were primarily aimed at addressing instances of the apportionment rules causing over and under taxation. The chapter also acknowledged the complexity of the rules and sought feedback on the ways in which the apportionment rules could be simplified and improved.

34. Submissions mainly focussed on the complexity of the apportionment rules, with a number of submitters recommending a comprehensive review of the rules with a view to reducing complexity. Some submitters expressed concern that the proposals contained in the chapter would merely replace a complex set of rules with another set of complex rules.

35. Submissions on most of the specific proposals in the chapter were generally favourable of either proposal, or at least its intent. However, concern was raised about the complexity of the proposals.

36. In response to these submissions, officials recommend that a broader review of the apportionment and adjustment rules should be considered for inclusion on the tax policy work programme, with an aim of reducing complexity. Most of the apportionment proposals from the issues paper could be considered further as part of that review. However, some proposals that are more remedial in nature or address obvious fairness issues without increasing complexity could be progressed sooner as part of the next taxation bill.

37. Since the submissions were received on the GST policy issues paper, Inland Revenue published some guidance in *IS20/05 (Goods and Services Tax – Supplies of residences and other real property)* on how the current GST adjustment rules apply to the sale of a farmhouse. That guidance stated that output tax applies on the disposal of a farmhouse if any business use is claimed for income tax. This guidance has been controversial and led to criticism from practitioners who are concerned that many farmers are not complying with the requirements to return GST on a farmhouse which is partly used to conduct their farm business.

38. To address these concerns, officials recommend that the broader policy review of the apportionment rules specifically consider this issue. One option that could be considered would be changing the rules to allow a registered person to elect to not claim input tax deductions on an asset such as a farmhouse or home office, and correspondingly not have to pay output tax on disposal of that asset. Singapore and the UK have a similar election under their GST rules.

Business conferences and staff training

39. The business conference and staff training chapter of the GST Issues Paper proposed to zero-rate GST charged on conferences, conventions and staff training services supplied in New Zealand to non-resident businesses (their employees). Australia and Singapore already zero-rate these types of services.

40. Submitters were very positive towards the proposed changes. Many submitters acknowledged that the proposal would make it relatively more attractive to host large international conferences in New Zealand. They noted that given the economic impact caused by COVID-19, this proposal would provide support in rebuilding the conference, convention and staff training industries, once normal international travel services have resumed.

41. Submitters had mixed views on whether zero-rating should be limited to the conference and training fees (as proposed in the issues paper), or should also apply to ancillary goods and services (such as meals, accommodation and tourist activities) received by attendees as part of their overall stay in New Zealand. These services could be considered private consumption (suggesting they should remain

taxable), however there would be boundary issues and distortions from treating them differently from a conference or training fee.

42. Officials initially scheduled this proposal for inclusion in the next omnibus tax bill. However, given the current prioritisation (including considering the potential negative fiscal cost of the proposal, and the uncertainty of the business conference and staff training industries post-COVID-19), it is suggested that this proposal instead be included in a later tax bill. During this time officials will continue to undertake policy development work and engage with industry representatives to ensure future policy proposals are fit for purpose.

Managed funds

43. The managed funds chapter noted that the GST treatment of different types of management services provided to managed funds was complex and inconsistent. It sought feedback on alternative reform options including zero-rating, exemption, and making the services taxable (subject to 15% GST), or partly taxable and partly exempt.

44. Submissions agreed that the proposed changes should provide for a certain and consistent GST treatment for all types of fund managers and investment managers. Officials agree that consistency and certainty is required, as this maintains competitive neutrality between different types of providers and funds.

45. Submissions varied on what the GST treatment should be. Zero-rating was the preferred option for the managed funds industry as it reduces their costs. However, there is no GST policy rationale for zero-rating, and it would create incentives to reclassify or bundle other services with the zero-rated services which would increase complexity and distort competition. It would also have a significant fiscal cost of about $50m per annum.

46. Officials prefer the option of making the fund management services taxable (which could raise about $150m per year). Some submitters did note that there are good GST policy reasons for this option – such as certainty, minimising compliance costs and removing biases. The main disadvantage of this option is that it could increase managed funds fees. We will do further work and targeted consultation with submitters to estimate the impact on fees of this option, as well as the main alternative option of making the relevant management services exempt.

47. Submitters supported the proposal for a gradual transition into any new rules. For example, any new rules should apply from a known date with three years of grandparenting for existing contracts that were agreed before that date.

Insurance pay outs to third parties

48. The problem outlined in the insurance chapter of the issues paper was a scenario where a GST registered third party who had suffered damage caused by an insured party did not realise their payment was covered by insurance and therefore failed to return GST on the payment. Submitters consider this rarely happens in practice. Instead, they had experienced a different problem - the failure of a few insurers to gross up the payment for GST.

49. In response to these submissions, officials will refocus the problem definition and further consult on the best way to get these insurers to gross-up their payments. A solution to this revised problem definition could potentially be achieved through guidance or an agreed industry practice, rather than through law changes to the GST Act.

50. Submissions strongly opposed the proposed option of making the insurer responsible for the GST, as this would have high compliance and systems costs for insurers and could not be implemented quickly. Officials will consult with submitters

to develop alternative options to address the revised problem (which now appears to be a few insurers not grossing up their pay-outs to third parties) in ways that should not impose high compliance costs. However, if we cannot develop other options which are suitably effective, we recommend leaving open the option of a potential law change which would place the GST obligations onto the insurer.

Compulsory zero-rating of land

51. Chapter 9 of the issues paper consulted on five technical and remedial proposals where the compulsory zero-rating of land rules appeared to produce unintended outcomes.

52. Submissions identified concerns with three of the proposals as they could, in certain cases, result in unfair outcomes for purchasers of land. In response to these submissions officials now recommend that these three proposals should no longer proceed. This outcome highlights the importance of consulting on technical amendments, as practical issues or unintended consequences can arise during the consultation process. The remaining two proposals outlined in the compulsory zero-rating of land chapter were supported as being minor improvements to the existing rules so should be included in the next taxation bill.

Technical and remedial issues

53. The proposals in this chapter of the issues paper addressed issues relating to:

    53.1 GST groups;

    53.2 input credits on goods not physically received yet at the time GST return is filed;

    53.3 second-hand goods input tax credits on supplies between associated persons;

    53.4 providing more flexibility for the Commissioner to approve the end date of a taxable period;

    53.5 members of non-regulatory boards; and

    53.6 challenge rights in relation to a decision of the Commissioner to re-open time-barred GST returns.

54. Submitters supported the proposals and suggested some minor refinements. Accordingly, we recommend the proposed amendments be included in the next taxation bill.

55. Submitters also raised two new technical issues relating to:

    55.1 the joint and several liability of members of GST groups; and

    55.2 input tax credits relating to reimbursing allowances.

56. These issues have been further considered, but we recommend that only the issue regarding joint and several liability of members of GST groups be progressed in the next taxation bill.

57. The joint and several liability issue raised is that the Income Tax Act provides the Commissioner with a discretion to grant a release from joint and several liability when a member exits a consolidated group, but the GST Act does not provide such a discretionary power. We support the submission as it would simplify the tax system to have the same discretionary power in both Acts.

58. We do not recommend progressing the submission on input tax credits relating to reimbursing allowances, as we will need to undertake further work on how this impacts on the integrity of the GST system.

GST and regulatory charges

59. New Zealand's GST applies to a broad base, meaning it generally applies to the supply of all goods and services equally. This ensures that the GST is simple and efficient.

60. Sometimes it is unclear whether GST applies to newly established regulatory charges enabled by regulations, despite the fact that those charges are often established for a particular purpose, such as being used as a method of raising funds to produce an output.

61. This results in uncertainty for those liable to pay the charges, and for government agencies responsible for developing and administering the charges. It can also result in an inconsistent application of the GST Act, as some government agencies may determine that regulatory charges they administer are subject to GST, with other government agencies not realising that their regulatory charges should be subject to GST.

62. Officials have been working with the Treasury to address the problem. If you agree, officials will undertake targeted consultation with other government agencies, the Parliamentary Counsel Office, and GST advisors in the private sector to determine the appropriateness of amending GST legislation which makes the GST treatment of regulatory charges clear.

63. Officials note one possible solution is the introduction of a deeming rule which clarifies that regulatory charges that come into force from a future date are subject to GST by default, unless excluded because of: the resemblance to fines and penalties (which are not generally subject to GST) or taxes , or through an Order in Council exclusion process. This is similar to an existing rule in the GST Act which deems grants and subsidies from the government to be subject to GST, unless excluded through an Order in Council process.

Taxation of the gig and sharing economy

64. The Organisation for Economic Cooperation and Development (OECD) are producing reports which examine the taxation of the gig and sharing economy. Inland Revenue officials have been involved in discussions at the OECD that relate to:

    64.1 developing and agreeing model reporting rules for platforms (for example, AirBnb and Uber would be required to annually report information about their suppliers (hosts or drivers) to tax authorities who would then provide the data on the New Zealand suppliers to Inland Revenue); and

    64.2 the VAT/GST implications of the gig and sharing economy.

65. Broadly speaking, these workstreams at the OECD intend to examine the role that digital platform providers could play in enhancing compliance of those who earn income (or conduct business) through them. The model reporting rules have been agreed at the OECD and have buy-in from OECD member countries and several prominent digital platforms. The OECD report on the VAT/GST implications of the gig and sharing economy is also intended to be published sometime in the first half of this year.

66. Officials will report to you with further information on these workstreams, including information on recent international developments (such as announcements made

by the United Kingdom and Canada), and options for reform in New Zealand in light of this work, once the OECD have published their reports later this year. Our report to you will also seek your agreement to the release of a discussion document which would consult on policy options for how the OECD's findings could be progressed in a New Zealand context.

Next steps

67. The Treasury has been consulted in the preparation of this report and agrees with its recommendations.

68. In respect of the GST issues paper, officials will report to you shortly with the view to obtain Cabinet approval for the agreed issues to be included in the first omnibus taxation bill of 2021. None of these issues would have fiscal implications, as they simply update and align the GST legislation with current taxpayer practices which officials consider provide the correct policy outcomes.

69. Officials will continue to consult stakeholders on GST policy issues relating to managed funds, business conferences and staff training, apportionment and insurance. This is because the submissions demonstrated that further targeted consultation with the affected stakeholder groups would be required to develop and refine the proposals.

70. With respect to the tax implications of the gig and sharing economy, officials will report to you with more information once the OECD has published its reports.

71. Subject to your agreement, officials will undertake targeted consultation in relation to the application of GST to regulatory charges and report to you once this has been completed.

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **Overseas donee status: New additions and removals for the next available taxation bill**

Date:	23 February 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/069

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	1 March 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Brandon Sloan	Principal Policy Advisor	s 9(2)(a)
Peter Frawley	Policy Lead	

23 February 2021

Minister of Revenue

Overseas donee status: New additions and removals for the next available taxation bill

Executive summary

1. This report seeks approval to give overseas donee status to eleven New Zealand charities whose purposes are directed at activities outside New Zealand. "Overseas donee status" is used to describe certain New Zealand charities with overseas purposes to which donors are eligible for tax benefits. These benefits include:

    1.1 the donation tax credit of $33^{1}/_{3}$% of the value of any monetary donations made by a New Zealand resident individual taxpayer, capped at the amount of their taxable income, and

    1.2 tax deductions if the monetary donation is from a company or Māori authority, capped at the amount of their net income.

2. Overseas donee status is an exception to the policy framework that generally limits tax benefits for donations to charities with New Zealand purposes, and involves amending the Income Tax Act 2007.

3. The charities we recommend be granted overseas donee status are:

    3.1 Community Transformation Trust

    3.2 Firefly Children's Home Charitable Trust

    3.3 Hadassah Medical Relief Association of New Zealand

    3.4 Hands Across the Water Trust

    3.5 Institute for Indian Mother and Child Aotearoa

    3.6 Medic to Medic

    3.7 Missio Benevolent Society

    3.8 Prabh Aasra Trust (New Zealand)

    3.9 Reemi Charitable Trust

    3.10 Talalelei Life Futures Fund

    3.11 YWAM Ships Aotearoa

4. Descriptions of the charities, their purposes and activities, are provided in paragraphs 27 to 37 of this report. Decisions to grant overseas donee status approvals are assessed against Cabinet criteria, which were set in 1978 (see paragraph 21).

5. The eleven charities we recommend be given overseas donee status meet Cabinet's criteria and are largely involved in the relief of poverty, the relief of sickness, or improving education outcomes in developing countries. All are registered under the Charities Act

2005. They all have adequate procedures for the accountability of funds applied to projects outside New Zealand. We recommend the charities named in paragraph 3 have overseas donee status from 1 April 2021.

6. We also recommend the following charities should no longer have overseas donee status and be removed from the Income Tax Act as they have either ceased to exist or Inland Revenue's information suggests the charity is no longer active:

   6.1 Channel 2 Cyclone Aid for Samoa

   6.2 Cyclone Ofa Relief Fund

   6.3 Cyclone Val Relief Fund

   6.4 Kyrgyzstan New Zealand Rural Trust

   6.5 L Women of Africa Fund

   6.6 The Band Aid Box

   6.7 The Serious Road Trip Charitable Trust

   6.8 The Sir Walter Nash Vietnam Appeal

7. We recommend the organisations in paragraph 6 be removed from the date the amending legislation is enacted. There are no fiscal impacts created by removing these organisations.

Financial implications

8. The revenue effect of giving overseas donee status to the eleven charities recommended in this report is estimated to be $1.788 million over the forecast period. The revenue effect is recognised as a forecasting change because it reflects an increase in the cost of the decision to allow donations to New Zealand-based charities with overseas purposes to be eligible for tax benefits. The recommendations in this report do not have an impact on the Tax Policy Scorecard.[1]

Consultation

9. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services were consulted as part of our analysis of the charities discussed in this report.

10. The Treasury has been consulted in preparing this report and agrees with its recommendations.

Next steps

11. If you agree to the recommendations in this report, officials will prepare a paper to the Cabinet Economic Development Committee seeking its approval to the additions to the list of overseas donee organisations in the Income Tax Act.

12. Officials consider the recommended removal of charities from the overseas donee status list does not require reference to Cabinet. We have however, prepared a letter to your colleague Hon Stuart Nash regarding the Sir Walter Nash Vietnam Appeal as a courtesy.

[1] The Tax Policy Scorecard is a memorandum account that records the fiscal effect of approved tax policy decisions that occur between Budgets.

13. A copy of this report should be referred to the Minister of Finance for his information.

Recommended action

We recommend that you:

(a) **Agree** that the following charities be given overseas donee status and added to schedule 32 of the Income Tax Act 2007:

(i)	Community Transformation Trust	Agreed/ Not agreed
(ii)	Firefly Children's Home Charitable Trust	Agreed/ Not agreed
(iii)	Hadassah Medical Relief Association of New Zealand	Agreed/ Not agreed
(iv)	Hands Across the Water Trust	Agreed/ Not agreed
(v)	Institute for Indian Mother and Child Aotearoa	Agreed/ Not agreed
(vi)	Medic to Medic	Agreed/ Not agreed
(vii)	Missio Benevolent Society	Agreed/ Not agreed
(viii)	Prabh Aasra Trust (New Zealand)	Agreed/ Not agreed
(ix)	Reemi Charitable Trust	Agreed/ Not agreed
(x)	Talalelei Life Futures Fund	Agreed/ Not agreed
(xi)	YWAM Ships Aotearoa	Agreed/ Not agreed

(b) **Agree** that the charities named in recommendation (a) that you have approved are given overseas donee status from 1 April 2021.

Agreed/Not agreed

(c) **Note** that agreeing to recommendations (a) and (b) will result in the following adjustments to revenue forecasts:

Vote Revenue **Minister of Revenue**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.359)	(0.419)	(0.481)	(0.529)

Noted

(d) **Agree** that the following organisations be removed from schedule 32 of the Income Tax Act with effect of the date of enactment of any amending legislation:

(i)	Channel 2 Cyclone Aid for Samoa	Agreed/ Not agreed
(ii)	Cyclone Ofa Relief Fund	Agreed/ Not agreed
(iii)	Cyclone Val Relief Fund	Agreed/ Not agreed
(iv)	Kyrgyzstan New Zealand Rural Trust	Agreed/ Not agreed
(v)	L Women of Africa Fund	Agreed/ Not agreed
(vi)	The Band Aid Box	Agreed/ Not agreed
(vii)	The Serious Road Trip Charitable Trust	Agreed/ Not agreed
(viii)	The Sir Walter Nash Vietnam Appeal	Agreed/ Not agreed

(e) **Agree** that amendments giving effect to recommendations (a), (b) and (d) are included in the next available taxation bill, scheduled for introduction in the second half of 2021.

Agreed/Not Agreed

(f) **Sign** the attached letter to the Hon Stuart Nash advising him of your decision to remove the Sir Walter Nash Vietnam Appeal from the Income Tax Act.

Signed

(g) **Direct** officials to prepare a paper to Cabinet seeking its approval for the changes recommended in this report, other than recommendation (d).

Directed

(h) **Refer** a copy of this report to the Minister of Finance for his information.

Referred

Brandon Sloan
Senior Policy Advisor
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

Purpose of this report

14. This report seeks your approval to give overseas donee status to eleven registered charities and include the required amendments in the next available omnibus taxation bill, scheduled for introduction in the second half of 2021. We also seek your agreement to remove eight organisations that are currently listed in the Income Tax Act and have overseas donee status.

Overseas donee status – new additions

Tax benefits for charities with purposes outside New Zealand

15. New Zealand charities that apply a large proportion of their funds for purposes outside New Zealand and that want their monetary donors to be eligible for tax benefits (particularly the donation tax credit) must be given overseas donee status by being listed on schedule 32 of the Income Tax Act 2007. Being given overseas donee status has no bearing on whether the charity is exempt from income tax.[2] There are 154 organisations listed in schedule 32.[3]

16. Overseas donee status and being listed on schedule 32 means that monetary donations to the charity are eligible for tax benefits. Tax benefits include:

    16.1 the donation tax credit of $33^{1}/_{3}$% of the value of any monetary donations made by a New Zealand resident individual taxpayer, capped at the amount of their taxable income; and

    16.2 tax deductions if the monetary donation is from a company or Māori authority, capped at the amount of their net income.

Policy intent

17. Since 1962, the Income Tax Act has provided tax benefits for monetary donations to New Zealand charities (including benevolent, philanthropic, or cultural organisations) whose purposes are largely limited to New Zealand. The Income Tax Act imposes certain statutory limitations on the entity's purposes and its application of funds, which must relate "wholly or mainly" to purposes in New Zealand. At the time, three charities with overseas purposes were specifically named as exceptions to the rule, and the government acknowledged that charities could be added to the list of names from time to time as comparable cases arise. In 1978, Cabinet developed criteria (see paragraph 21) to support consideration about future additions of New Zealand-based overseas aid organisations to the legislative list.

18. Supporting New Zealand charities through overseas donee status is intended to assist the New Zealand government's overseas development efforts, where aid objectives are better achieved by charitable non-government organisations (NGOs). The assistance is open-ended and less discretionary than other forms of government assistance[4] because it is delivered through the tax system using the benefits attached to monetary donations made to the named charities.

---

[2] This is dealt with elsewhere in the Income Tax Act — sections CW 41 and CW 42.

[3] The Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill proposes to add three more. For reference, Inland Revenue recognises 25,000 organisations with philanthropic, benevolent, or charitable purposes in New Zealand as having donee status (2018 figures).

[4] For example, the Ministry of Foreign Affairs and Trade's New Zealand aid programmes: the New Zealand Partnerships for International Development Fund (Partnerships Fund), the Sustainable Development Fund, the New Zealand Disaster Response Partnership (NZDRP), and the Pacific Island Countries Participation Fund (PIC Fund).

19. Broadly, governments may seek to promote charitable giving:

    19.1 to further social objectives – in this particular case, overseas development aid,

    19.2 for the wider benefits to society (externalities), which may be over and above the value of the benefit provided via the tax system, and

    19.3 because donations can be effective indicators of when extra goods and services should be provided in market conditions that might otherwise not exist – particularly the case in developing countries or when assisting individuals suffering from the effects of poverty or sickness.

20. The trade-off for these benefits is the open-ended revenue cost for as long as the charity is on the list of approved donee organisations.

Cabinet's consideration of requests for overseas donee status

21. Since 1978, Cabinet has applied the criteria below, which set the parameters of activities that may be supported by the tax system:

The basic criteria for adding an organisation to the list of approved "overseas" charities:

(i) the funds of the charity should be principally applied towards:

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries; or*

raising the educational standards of a developing country;*

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

** developing countries recognised by the United Nations.*

[CM 78/14/7 refers]

22. The eligible purposes set out in the criteria are aligned with the government's overseas development objectives (disaster relief, provision of humanitarian aid, and assisting developing countries) and narrower than the common law meaning of "charitable purpose" and the legislative framework in the Charities Act 2005. Determination of donee status, including overseas donee status, remains the responsibility of Inland Revenue because of the tax benefits that attach to monetary donations. The process does not overlap with the work of the Department of Internal Affairs – Charities Services.

23. Irrespective of whether a charity's founding documents and activities are charitable, approval for inclusion on schedule 32 is not automatic, and requests are considered on a case-by-case basis.

24. An overarching consideration is that any charity approved for overseas donee status is credible, transparent, and accountable.[5] Fiscal impacts and the integrity of the tax system are also relevant considerations. Annex A sets out the factors that officials consider and analyse in respect of each charity that seeks overseas donee status.

25. Overseas donee status is an exception to the policy that tax benefits for donations should be limited to charities with New Zealand purposes, and requires amending the Income Tax Act. In 2016, the Legislation Design and Advisory Committee provided advice to Inland

[5] *Guidelines for using the Cabinet criteria for overseas donee status*, endorsed by Cabinet in 2009 – CBC Min (09) 12/2 refers.

Revenue confirming that the use of legislation to grant overseas donee status is appropriate.

Charities recommended for overseas donee status

26. The eleven charities discussed below have purposes that come within the criteria in paragraph 21 and we recommend that they be granted overseas donee status. They all have adequate procedures for the accountability of funds applied to projects and can demonstrate a track record of activity or are connected with well-established international-based charities. All the charities discussed in this report are registered under the Charities Act 2005 and have a centre of management in New Zealand.

Community Transformation Trust

27. Community Transformation works in partnership with communities in developing countries to improve economic outcomes and the relief of poverty. It is currently supporting projects in South Sulawesi, Indonesia in partnership with Global Hope Network International that are directed at improving water quality and land use.

Firefly Children's Home Charitable Trust

28. Firefly Children’s Home supports orphaned or abandoned children including the children of prisoners in partnership with Prisoners Assistance Nepal, a registered Nepali charity. Firefly’s purposes are directed towards the relief of poverty and ensuing those in care receive adequate education and medical attention. Firefly currently supports 100 children under care and has been operating since 2008.

Hadassah Medical Relief Association of New Zealand

29. The Hadassah New Zealand Association provides financial support to Hadassah International, which operates several hospitals in Jerusalem. Hadassah International provides treatment to all people irrespective of race or religious views. Hadassah International also has an international relief focus within social-economically-deprived areas of the Middle East along with carrying out medical relief missions in Africa. It also provides international assistance by providing additional medical capacity in response to natural disasters.

Hands Across the Water New Zealand Trust

30. Hands Across the Water New Zealand Trust works in partnership with Hands Across the Water Australia to provide education and training opportunities for orphaned, abandoned, or homeless children in Thailand. It supports six homes in Thailand with around 350 children in care. In addition to the care provided by the homes, Hands Across the Water provides tuition in English and supports former residents who are seeking to attain higher education.

Institute for Indian Mother and Child Aotearoa

31. The Institute for Indian Mother and Child Aotearoa (IIMC Aotearoa) provides sponsorship support to children under the care of the Institute for Indian Mother and Child based in Kolkata, India. The Indian charity mainly provides medical support to the poor and destitute; it has also built schooling facilities in the poorest villages to provide education for primary and secondary school-aged children. IIMC Aotearoa currently sponsors 19 children, with priority given to girls, to maintain their attendance at school and ensure they receive appropriate medical support.

Medic to Medic

32. Medic to Medic is a New Zealand sister charity to similarly named charities in the United Kingdom and the United States. The purpose of Medic to Medic is to increase medical and healthcare professional capacity in developing countries by providing scholarships to students at risk of dropping out of their training due to poverty. Currently, it is supporting 66 students in Malawi and Zambia. Priority is given to women seeking to undertake medical studies.

Missio Benevolent Society

33. Missio Benevolent Society is the humanitarian aid arm of the New Zealand office providing for the Pontifical Missions Society. Missio's purposes are directed toward the relief of poverty and the advancement of education in Oceania, Africa, Asia, and South America.

Prabh Aasra Trust (New Zealand)

34. Prabh Aasra Trust New Zealand raises funds to support its Indian counterpart Prabh Aasra, which provides care and medical treatment to the homeless and destitute in North India.

Reemi Charitable Trust

35. Reemi Charitable Trust is a social enterprise whose purposes are directed at alleviating period poverty in developing countries. It is currently active in Bangladesh and seeks to improve physical and mental health outcomes for women through education and supplying culturally appropriate products such as, self-sterilising underwear and laundry bags.

Talalelei Life Futures Fund

36. Talalelei Life Futures Fund provides yearly scholarships to support academic high performers to obtain tertiary qualifications in Samoa. The Fund currently supports eight students with a further four students to receive scholarships from February 2021.

YWAM Ships Aotearoa Limited

37. Through the use of a specifically equipped medical aid ship, YWAM Ships Aotearoa undertakes health and education work in remote and isolated communities throughout the Pacific Islands, Papua New Guinea, and the Solomon Islands. YWAM Ships provides a range medical services to these communities including eye care, dental care, and immunisation and paediatrics. It also carries out developmental projects for those communities, such as water sanitation, to improve and maintain overall health outcomes.

Risks with recommended charities

38. Officials note that there are risks associated with granting donee status; these are set out in Annex B. As part of our analysis of the charities discussed in this report, we have not identified any significant risks or concerns with their activities and governance. The charities recommended in this report have adequate donor support to carry out their purposes. However, officials note:

Some of the charities are small in scale	s 9(2)(g)(i), s 18(c)(i) [redacted]
Some of the charities have a limited track record of activity	[redacted]
[redacted]	[redacted]

39. Officials have not identified any specific matters or concerns with s 18(c)(i) [redacted]

Overseas donee status: Removals from the Income Tax Act

40. Officials are aware that the current list of overseas donee organisations in the Income Tax Act contains charities that have either ceased operations or are inactive. While there are strong processes regarding the addition of charities on the list, unless the charity contacts Inland Revenue directly, it is possible for inactive charities to remain on this list. As part of our stewardship of overseas donee status Inland Revenue has examined what information it has on record about the charities that have overseas donee status. This work is ongoing and complements New Zealand’s regulatory framework to prevent overseas financing of terrorism and extremism.

41. Based on Inland Revenue’s work to date, officials recommend the charities below be removed from schedule 32 of the Income Tax Act:

Charity name	**Reason for removal**
Channel 2 Cyclone Aid for Samoa	s 18(c)(i)
Cyclone Ofa Relief Fund	
Cyclone Val Relief Fund	
Kyrgyzstan New Zealand Rural Trust	This charity has deregistered under the Charities Act 2005 and has been wound up.
L Women of Africa Fund	This charity has deregistered under the Charities Act 2005 and has been wound up.
The Band Aid Box	s 18(c)(i)
The Serious Road Trip Charitable Trust	s 18(c)(i)
The Sir Walter Nash Vietnam Appeal	s 18(c)(i)

42. Officials note there are other charities named in the Income Tax Act that have purposes that are directed at relief and recovery from natural disasters in the Pacific and one other charity has purposes directed at supporting the capacity of hospitals in Viet Nam.

Consultation with other agencies

43. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services have been consulted in the preparation of this report. The New Zealand Police’s vetting service was also used in connection with the trustees/officers of the charities recommended in this report.

44. The Treasury has also been consulted in preparing this report and agrees with its recommendations.

Charities still under consideration

45. Officials are still analysing requests from six other charities. We are waiting for additional information from the trustees and, subject to the timing of the future taxation bill, will report to you later in 2021 with our recommendations.

Legislative vehicle and application date

46. Amendments adding the eleven organisations recommended in this report to the list of donee organisations in the Income Tax Act 2007 should be included in the next omnibus taxation bill, scheduled for introduction in the second half of 2021. The amendments should apply from 1 April 2021. Monetary donations received on and after that date will be eligible for tax benefits. The recommended application date gives the charities certainty for marketing and fund-raising purposes.

47. Inland Revenue's systems can work with an application date of 1 April 2021, as individuals will be able to claim the donations tax credit for receipted monetary donations as part of Inland Revenue's 2021–22 return cycle, starting on 1 April 2022. Companies and Māori authorities will be able to recognise deductions for monetary donations made during the 2021–22 income year.

48. Amendments removing the eight organisations recommended in this report should be included in the same bill with effect from the date of enactment.

Compliance and administrative cost implications

49. No compliance or administrative cost implications arise from the recommendations in this report. The changes in this report have no implications for Inland Revenue's Business Transformation programme of work.

Financial implications

50. The estimated financial implications of adding the eleven charities recommended in this report are shown in Annex C. Over the forecast period 2020-21 to 2024-25, the expected financial impact is $1.788 million. The financial implications will be treated as a forecasting change and reflects the increasing cost of the policy to allow tax benefits for donations to New Zealand-based charitable overseas aid organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period. There is no impact on the Tax Policy Scorecard.

Next steps

51. If you agree to the recommendations in this report, officials will prepare a paper seeking Cabinet's approval for the changes, other than the charities we recommend be removed from overseas donee status.

52. We recommend that you refer a copy of the report to the Minister of Finance for his information.

Annex A: Analysis of requests for overseas donee status

53. Officials look at a number of factors when considering a charity's request to be added to the list of donee organisations in the Income Tax Act. We look to establish whether the charity is capable of meeting its purposes and is accountable for the funds it collects by:

    53.1 reviewing the charity's governing document (constitution and trust deed) to ensure the activities and purposes are consistent with Cabinet's criteria;

    53.2 requiring the purposes stated in the charity's governing document to be entirely within the scope of paragraph (i) of the Cabinet criteria and that no personal pecuniary profit can be derived;

    53.3 looking at the clauses governing the nature and extent of the trustees' discretionary powers, the winding-up clause, and the trustees' ability to amend the governing document;

    53.4 looking at the charity's past, current, and proposed activities;

    53.5 requesting that the trustees provide us with the charity's financial statements;

    53.6 considering the trustees' degree of control over the application of the charity's funds overseas, and procedures in place to ensure accountability for funds;

    53.7 considering the planning, monitoring, and evaluation processes used by the trustees regarding the application of the charity's funds, including how recipients use the funds, as well as the processes used to select beneficiaries and/or projects to support;

    53.8 asking whether the charity has a legal presence in New Zealand and if it has registered under the Charities Act 2005;

    53.9 considering each request on the basis of other generic tax policy objectives, such as fiscal implications (including risk to the New Zealand tax base), consistency with other current government policy objectives, and the precedent effect; and

    53.10 consulting with other government agencies such as the Ministry of Foreign Affairs and Trade, and the Department of Internal Affairs – Charities Services, to identify any concerns with the organisation or sensitivities with the countries in which the organisation operates. We also use the New Zealand Police's vetting service in connection with the charity's trustees or directors.

Annex B: Risks with giving overseas donee status

<table>
<tr><th>New Zealand's reputational risk</th><th>The integrity of the tax system</th><th>Precedent risk</th><th>Political risk</th></tr>
<tr><td>The Government faces a reputation risk if the "named" charity's activities:
are seen to support or encourage criminal or terrorist activities,
involve trafficking of any form (for example, but not limited to, sex, children, or drugs),
are seen to support or encourage sectarian violence,
are seen to support or encourage civil disobedience, and
contravene the prevailing laws of the country in which the donee organisation operates.</td><td>Schedule 32 of the Income Tax Act is a list of exceptions to the policy that tax benefits for donations should be limited to charities with New Zealand purposes.
The tax benefits act as non-discretionary financial support for the named charity.
This raises issues regarding:
consistency with the Government's broad-base, low-rate revenue strategy;
fiscal cost; and
tax schemes that rely on tax benefits for donations.</td><td>Approvals create expectations in the charitable sector about the way Cabinet's criteria are interpreted.
Charities' own expectations about government endorsement of their activities.</td><td>Decisions divert tax revenue that could otherwise be used on domestic spending programmes such as education and health.
It is not uncommon for Ministers and Members of Parliament to be lobbied by the trustees of charities seeking to be added to schedule 32.
Trustees of charities seeking inclusion on schedule 32 can be former Members of Parliament (or associates thereof).
Whether the charity's overseas purposes align with New Zealanders' values.</td></tr>
<tr><th colspan="4">How risk is mitigated or treated</th></tr>
<tr><td colspan="2">Officials review the charity's deed and operating model.
Consultation with other government agencies.
Recommendations to approve overseas donee status are treated as policy decisions.
Ongoing work item on the tax policy work programme.</td><td colspan="2">Approval process requires decisions at Ministerial and Cabinet levels.
Legislation is used to ensure Parliament's endorsement of approvals.</td></tr>
</table>

Annex C: Financial implications by charity

	Effect on tax revenue ($millions)				
	2020–21	**2021–22**	**2022–23**	**2023–24**	**2024–25 & outyears**
Community Transformation Trust	s 18(c)(i)				
Firefly Children's Home Charitable Trust					
Hadassah Medical Relief Association of New Zealand					
Hands Across the Water Trust					
Institute for Indian Mother and Child Aotearoa					
Medic to Medic					
Missio Benevolent Society					
Prabh Aasra Trust (New Zealand)					
Reemi Charitable Trust					
Talalelei Life Futures Fund					
YWAM Ships Aotearoa					
Total	**(0.000)**	**(0.359)**	**(0.419)**	**(0.481)**	**(0.529)**

s 18(c)(i)

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: Tax pooling to purchase backdated tax

Date:	18 February 2021	**Priority:**	Low
Security level:	In Confidence	**Report number:**	IR2021/073

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	8 March 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Mike Nutsford	Policy Lead	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

18 February 2021

Minister of Revenue

Tax pooling to purchase backdated tax

Purpose

1. This report recommends that legislative changes are made to expand the ability to use tax pooling to purchase backdated tax. This report provides you with details of this issue and seeks your agreement to progress work.

Background

2. Tax pooling was introduced to assist with uncertainties relating to provisional tax (income tax). It allows provisional tax payments from numerous taxpayers to be grouped into the account of a registered intermediary. By pooling these payments, a taxpayer can offset an underpayment against amounts within the same pool allowing them to reduce their exposure to use of money interest (UOMI).

3. The coverage of tax pooling was later extended to include historical periods and other tax types, but only in a situation of reassessment of a prior assessment or an increase of a prior obligation. This necessitates that an original assessment has been issued for that tax period or an obligation to pay tax has been quantified because a relevant tax return has already been filed. Taxpayers who have filed and who subsequently wish to make a voluntary disclosure are able to use tax pooling to satisfy the increased tax debt.

4. However, where there is no existing assessment or quantified obligation the taxpayer would be unable to use tax pooling to satisfy the debt for the same voluntary disclosure, except for certain voluntary disclosures for income tax and resident withholding tax (RWT) where no prior return had been filed and the return was provided as part of the voluntary disclosure. In these situations the use of tax pooling is subject to a Commissioner's discretion measured against specific legislative criteria.

5. There are several circumstances where a taxpayer may have unintentionally not filed a tax return for a particular tax type and tax period. An example of where a taxpayer may have unintentionally not provided a return is where a small business is unaware a benefit provided to an employee is subject to fringe benefit tax and provides no other fringe benefits.

6. Where these omissions have been made in good faith, it is disproportionally punitive to not allow taxpayers to utilise the benefits of tax pooling in these situations. It is therefore appropriate, subject to certain criteria, to allow the use of tax pooling to satisfy these tax obligations and also align the treatment for all tax types.

7. This issue was brought to officials' attention in 2018 by PwC Tax Pooling Solutions and then again in July 2020.

The case for change

8. Current rules preclude the use of tax pooling to satisfy a debt in cases where there is no original assessment or original obligation, except in the case of the limited voluntary disclosures noted above. This results in an overly punitive outcome for

many taxpayers who have found they have outstanding debts and seek to rectify them when there is no existing assessment.

9. The current bar to using tax pooling to satisfy backdated debt where there is no original assessment or obligation could also be disincentivising voluntary disclosures. Removing this barrier effectively upholds Inland Revenue's commitment to improving voluntary compliance.

10. Allowing the use of tax pooling to purchase backdated tax is an effective way of addressing these challenges without undermining the current settings.

Allowing the use of tax pooling where there is no original assessment

11. The proposed change has the following benefits.

    11.1 Removing an exception to when tax pooling can be used, simplifies the system for taxpayers.

    11.2 Taxpayers who make an error in good faith would no longer be disproportionally penalised when seeking to rectify the error. This could lead to a wider behaviour change amongst taxpayers by encouraging more voluntary disclosures.

    11.3 An increase in voluntary disclosures would increase the amount of revenue raised. Where, at present, some taxpayers who discover an error in their tax return prefer to take the chance on it not being discovered by Inland Revenue rather than facing definite penalties and UOMI.

    11.4 Increased voluntary disclosures would mean that errors are more likely to be corrected as these are not necessarily caught in the audit process.

    11.5 Providing consistency of treatment of voluntary disclosures where no return has previously been filed for all tax types that tax pooling can be used for.

    11.6 There would be increased stability for the tax base because with tax pooling, money is already collected in the pool and is therefore in the system. This means it is less likely that Inland Revenue would need to expend resources pursuing the debt or writing-off some of the outstanding amount.

12. The main disadvantage of the proposal is that allowing the use of tax pooling in such situations could encourage some taxpayers to deliberately not file. To help prevent this, officials propose that both the following criteria must be met by the taxpayer.

    12.1 The taxpayer must make a voluntary disclosure to file the original return and generate an original assessment or obligation before Inland Revenue has made any contact with the taxpayer or their agent in relation to obligations that may exist and are not satisfied for that tax type and that period.

    12.2 The voluntary disclosure must be made within a reasonable time frame of the taxpayer or their agent becoming aware of the error – with 'reasonable time frame' to be defined by guidance issued by the Commissioner of Inland Revenue or by Order in Council.

13. If Inland Revenue believes that the taxpayer is taking advantage of these concessionary rules, we are considering the introduction of new penalties that the Commissioner could impose in these circumstances. Such caveats can ensure that non-compliance is not seen as being benefited under this change, however, it may be more efficient to look to only impose these on multiple applications.

14. Legislative changes would be required to enable taxpayers to use tax pooling for a voluntary disclosure where the taxpayer has not previously filed an original return (i.e., the voluntary disclosure is not for a reassessment or amending a prior obligation). Changes are also needed to align the current Commissioner's discretion for income tax and RWT with the proposed approach set out in this report. Changes are also needed to enable the use of some form of penalty where the Commissioner is satisfied that the debt has arisen through the taxpayer choosing not to comply with their tax obligations.

15. Tax pooling intermediaries support such a change, not least because it will broaden their potential client base. Consequently, officials have concerns that such a concession to the tax pooling industry is the 'thin end of the wedge' in enabling greater use of tax pooling within the tax system. This said, officials are satisfied that the changes proposed above are the right policy outcome, protecting the integrity of the tax system whilst simplifying the system for taxpayers for greater compliance.

Fiscal Implications

16. There may be a fiscal cost to the proposals as taxpayers who can use these new provisions will no longer be charged with UOMI or late payment penalties upon voluntary disclosure. However, such amounts may be minimal. In addition, there is a potential behavioural shift in respect of this proposal which means there will be some taxpayers who may now make a voluntary disclosure rather than risking audit which could lead to a fiscal upside. Neither the downside nor the upside risk is quantifiable as they relate to taxpayer behaviours. Both effects are expected to be small.

17. Tax paid through tax pools is recognised in the government's cash accounts and needs to be allocated to a tax type. The accounting approach is to treat all pooling deposits as income tax receipts until such time as the resulting deposits are later allocated to their ultimate owners. At that point there is potentially a cash transfer from income tax to a different tax type.

18. With each expansion to the coverage of tax pooling deposits this initial treatment at the time of the deposit becomes slightly less robust. In this instance, the expansion is to use deposits to offset tax liabilities from voluntary disclosures of any tax type, where a return has not been filed. Voluntary disclosures where a return has filed are already covered. Although the increased coverage is likely to be small and mitigations to prevent abuse are being put in place, ultimately this change, like all other expansions to pooling coverage, decreases the information value of the government's cash accounts at the time each deposit is made.

Scale and Impact

19. It is difficult to put a number to those who will be impacted or benefit from this amendment. This is because such a number will depend on the behavioural response of taxpayers to the change.

20. As mentioned in above, this change is unlikely to have a measurable fiscal impact and remains the right policy outcome.

Realising change in practice

21. Administrative challenges have been considered in progressing this work with some impacts highlighted for further consideration. Chief amongst these are the changes that will need to be made to Inland Revenue's systems. Some of these are very straight-forward – for instance, enabling tax pooling payments to be applied to

original assessments rather than reassessments – but could have wider implications for the current rules and processes that govern automated actions, such as issuing letters from Inland Revenue.

22. The proposed criteria, outlined in paragraph 13, of requiring that the taxpayer has not had communications from Inland Revenue regarding the relevant tax return period or tax year may be vulnerable to the speed of administrative processes used to issue correspondence to taxpayers. If a voluntary disclosure is in the process of being prepared when Inland Revenue issues a letter in respect of the return period or tax year should this action preclude the taxpayer from qualifying for the use of tax pooling creating a risk that this amendment will not benefit those it is intended to help due to a timing issue.

23. These implications will inform policy development to ensure the final amendment is comprehensive, sustainable and fit for purpose.

Preferred option

24. Officials recommend changing legislation to allow the use of tax pooling to satisfy a tax liability subject to the safeguards outlined in paragraph 12.

Consultation

25. Treasury has not been consulted in the preparation of this report as it is a means to facilitating further work. Treasury will be involved as appropriate once next steps are agreed.

Next steps

26. Should you agree, officials will begin the process of consulting with selected stakeholders. Officials will then report back to you on the outcome of this engagement.

Recommended action

We recommend that you:

27. **agree** to allow the use of tax pooling for voluntary disclosures when there is no original assessment.

    Agree/not agree

28. **agree** to officials beginning targeted stakeholder engagement to progress this work and refine the details.

    Agree/not agree

Mike Nutsford
Policy Lead
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **Cabinet Paper: Overseas donee status – additions for the next taxation bill**

Date:	4 March 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/094

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	11 March 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Brandon Sloan	Principal Policy Advisor	s 9(2)(a)
Peter Frawley	Policy Lead	

4 March 2021

Minister of Revenue

Cabinet paper: Overseas donee status – additions for the next taxation bill

1. The attached paper to the Cabinet Economic Development Committee seeks its approval to grant overseas donee status to the 11 charities you agreed to in our earlier report IR2021/069, dated 23 February 2021.

2. We recommend that you approve the attached paper to the Cabinet Economic Development Committee and lodge it with the Cabinet Office for its meeting on 24 March 2021.

3. If Cabinet confirms the approvals, officials will advise the trustees of the outcome of their requests for overseas donee status.

Proactive release considerations

4. Officials recommend that the attached Cabinet paper should be proactively released without redaction. The release of the unredacted paper and associated Cabinet minutes should, however, be delayed until the introduction of the proposed omnibus taxation bill, scheduled for introduction in August 2021.

Consultation

5. The Treasury, the Ministry of Foreign Affairs and Trade, and the Department of Internal Affairs – Charities Services have been consulted in the preparation of the attached Cabinet paper and concur with its recommendations.

Recommended action

We recommend that you:

(a) **Approve** and **lodge** the attached paper to Cabinet Economic Development Committee for its meeting on 24 March 2021.

Approved and lodged

(b) **Agree** that when Cabinet has made a decision on granting overseas donee status, officials advise the trustees of the charities of the decision.

Agreed/Not agreed

(c) **Agree** to delay the release of the attached Cabinet paper, without redaction, and associated minutes until the bill containing the amendments giving effect to recommendations in the paper is introduced in August 2021.

Agreed/Not agreed

Brandon Sloan
Principal Policy Advisor
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Changes to the fair dividend rate foreign currency hedges rules**

Date:	18 March 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/112

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	1 April 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Kilford	Policy Lead	s 9(2)(a)
Haydn Clark	Principal Policy Advisor	
s 9(2)(a)	Policy Advisor	

18 March 2021

Minister of Revenue

Changes to the fair dividend rate foreign currency hedges rules

Purpose

1. This report seeks your agreement to include changes to the *fair dividend rate foreign currency hedges rules* in an omnibus Cabinet paper for the next tax Bill (currently scheduled to be introduced in August 2021).

Executive summary

2. Many investors who invest offshore enter into foreign currency hedges to protect themselves from fluctuations in the value of their offshore assets caused by exchange rate movements.

3. Differences in the tax treatment of the underlying assets and these foreign currency hedges can create a tax mismatch. This mismatch in treatment means that a hedge that is effective in removing the impact of unexpected currency fluctuations before tax ceases to be effective after tax.

4. The *fair dividend rate foreign currency hedges rules* (FDR FX hedges rules) were introduced in 2013 with the policy intent of eliminating this tax mismatch. The rules are optional and broadly allow a taxpayer to calculate tax on a foreign currency hedge on the same basis as the hedged offshore asset – thereby removing the tax mismatch.

5. Unfortunately, there has been little application of the FDR FX hedges rules by taxpayers since their introduction. This is due to certain restrictions and requirements in the rules imposing overly burdensome compliance costs. Therefore, effective after-tax foreign currency hedging remains an ongoing issue for taxpayers.

6. Officials have conducted a review of the FDR FX hedges rules to improve their functionality and give effect to Parliament's intended purpose of facilitating effective after-tax foreign currency hedging.

7. As part of this review officials engaged in targeted consultation with the managed funds industry, tax advisors and corporate groups. Stakeholders are very supportive of changes to the rules and their submissions on the detailed design have been incorporated into officials' final recommendations.

8. In broad terms, officials recommend a series of technical changes be made to the FDR FX hedges rules. These changes are intended to improve the clarity of the rules, reduce compliance costs and allow their application from a practical perspective - while still being mindful of integrity concerns. The changes align with the original policy intent and support the integrity of the rules.

Fiscal impact

9. While using the FDR FX hedges rules could have a material impact on the amount of tax payable by an entity on a year-on-year basis, when viewed over the long term any increased uptake of the rules following the changes will reduce revenue volatility and have no fiscal impact. This is because foreign currency hedges are expected to make a cumulative return of zero over time.

Next steps

10. If you agree to officials' recommended changes to the FDR FX hedges rules proposed in this report, the next step will be to include these changes in an omnibus Cabinet paper seeking policy approval for inclusion in the next tax Bill (currently scheduled to be introduced in August 2021).

Recommended action

11. We recommend that you:

a) **Agree** to modify the second method for determining the extent to which foreign currency hedges can be subject to FDR treatment (known as FDR hedge portions).

Agree/not agreed

b) **Agree** to introduce a de minimis threshold for non-eligible assets to ensure that immaterial foreign cash balances temporarily held do not reduce FDR hedge portions.

Agree/not agreed

c) **Agree** to introduce an optional new method (known as the portfolio method) for determining FDR hedge portions to allow taxpayers with significant hedging activity to apply the rules from a practical perspective.

Agree/not agreed

d) **Agree** to introduce an optional look-through rule to allow taxpayers who hedge indirectly owned eligible assets to apply the rules.

Agree/not agreed

e) **Agree** to allow eligible hedges to continue to be subject to FDR treatment when there is a transfer of ownership of the assets of a fund or investor class.

Agree/not agreed

f) **Agree** to make to other minor technical amendments to improve the clarity of the rules and provide certainty for taxpayers (detailed in the Appendix to this report).

Agreed/not agreed

g) **Note** that making these changes is estimated to have no fiscal cost.

Noted

h) **Agree** to include these changes in the tax Bill scheduled to be introduced in August this year.

Agree/not agreed

Paul Kilford
Policy Lead
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Purpose

12. Officials have developed solutions to a range of issues currently preventing taxpayers from applying the *fair dividend rate foreign currency hedges rules*. This report seeks your agreement to these changes and for them to be included in an omnibus Cabinet paper for the next tax Bill (currently scheduled to be introduced in August 2021).

Background

Foreign currency hedges

13. When a person invests into an offshore asset, changes in the exchange rate can affect the value of the person's investment when it is converted back to New Zealand dollars. Therefore, many people who invest offshore enter into arrangements to protect themselves from exchange rate changes. These arrangements are referred to as *foreign currency hedges*. The idea is that changes in the hedge's value due to movements in the exchange rate offset changes in the value of the underlying foreign assets due to the same movements in the exchange rate.

14. For example, say a person has an offshore asset portfolio worth $10,000 USD and the NZD/USD exchange rate unexpectedly rises from $0.75 to $0.80. In New Zealand dollars, the portfolio's value will fall by $833 NZD (from $13,333 NZD to $12,500 NZD). If the person has used a foreign currency hedge to completely remove the exchange rate risk, the hedge's value would increase by $833 NZD, which exactly offsets the change in the portfolio's value.

Tax mismatch

15. A tax mismatch arises when a person hedges an investment taxed under the fair dividend rate (FDR) method. This is because, under the FDR method, changes in an asset's value are not taxed. Instead, FDR assets are taxed on a deemed dividend return of 5% of the asset's market value at the start of the period. Conversely, changes in a hedge's value are fully taxed under the financial arrangements (FA) rules. This mismatch in tax treatment means that a hedge that is effective in removing the impact of unexpected currency fluctuations before tax ceases to be effective after tax.

16. To illustrate the mismatch, assume the example in paragraph 14 where a person's offshore assets have decreased in value by $833 NZD. Under the FDR method, no deduction is given for this decrease. Despite this, the $833 NZD increase in the hedge's value is taxable. After tax, the person has lost $833 NZD from their asset portfolio but gained only $600 NZD from their hedge; the shortfall of $233 is created by the tax payable on the gain in the hedge's value.[1] Thus while the hedge exactly cancels out the changes in the hedged asset values before tax, this is not the case after tax.

17. While taxpayers can attempt to hedge effectively on an after-tax basis, this is often not practical, especially when the taxpayer is taxed based on investors' marginal rates (for example portfolio investment entities (PIEs) which are prevalent in the managed fund industry). It also increases the hedging transaction costs for an investor.

Fair dividend rate foreign currency hedges rules

18. The *fair dividend rate foreign currency hedges rules* (the FDR FX hedges rules) were introduced in 2013 with the policy intent of eliminating this mismatch in the tax treatment of foreign currency hedges and hedged offshore assets. The rules are

[1] Assuming the company tax rate of 28% applies.

optional and allow a taxpayer to calculate tax on a foreign currency hedge on the same basis as the hedged offshore asset - by imputing taxable income of 5% of a hedge's opening market value.

19. The FDR FX hedges rules are aimed at the managed funds industry and accordingly only widely held entities can apply the rules. These investors generally have muted incentives to take aggressive tax positions (when they are investing on behalf of the general public), have investment mandates, documented investment strategies, are large and generally have close relationships with Inland Revenue. These factors limit the risks of these entities manipulating the rules.

20. The rules are only available to be applied to offshore assets that are taxed under FDR method and certain Australian listed shares. This is because these are the main types of offshore assets where the tax mismatch issue arises. These assets are referred to as *eligible assets* in the remainder of this report.

21. Only genuine foreign currency hedges that are entered into with the sole purpose of offsetting changes in eligible asset values due to foreign exchange movements qualify for FDR treatment. The rules prescribe certain requirements that foreign currency hedges must meet in order to qualify. Foreign currency hedges that meet these requirements are referred to as *eligible hedges* in the remainder of this report.

Issues with the FDR FX hedges rules

22. When designing the FDR FX hedges rules officials wanted to ensure that FDR treatment was not available for speculative hedges or hedges of non-eligible assets (offshore assets not subject to FDR). Officials also did not want to implement a regime which could be manipulated by taxpayers so that gains from hedges were taxed under the FDR method and losses incurred were taxed under the FA rules (ie gaming the system to gain a tax advantage).

23. These risks were addressed by implementing a very restrictive regime. Unfortunately, these restrictions have also meant that the rules are extremely difficult for taxpayers to apply in practice. As a result, officials have been advised that very few taxpayers have applied the FDR FX hedges rules since their introduction and the tax mismatch between foreign currency hedges and eligible assets remains an ongoing problem.

24. In order to address these issues, officials have conducted a review of the rules to improve their functionality (while still being mindful of integrity concerns) and give effect to Parliament's intended purpose of facilitating effective after-tax foreign currency hedging.

Targeted consultation

25. As part of this review, officials engaged in targeted consultation with stakeholders in the managed funds industry, tax advisors and corporate bodies. Stakeholders are very supportive of changes being made to the rules and their submissions have been incorporated into the final design of officials' recommended solutions.

Policy recommendations to improve the functionality of the rules

26. Detailed below are the major issues in the FDR FX hedges rules that prevent their application from a practical perspective and officials' recommended solutions. These changes are consistent with the original policy intent, will reduce compliance costs and, critically, we consider they will not undermine the integrity of the rules.

Second method for calculating FDR hedge portions

27. The FDR FX hedges rules include two alternative methods for taxpayers to use when determining the maximum portion of an eligible hedge that is able to be taxed under the FDR method (known as the *FDR hedge portion*). This ensures that the amount of the taxpayer's eligible hedges does not exceed the value of the underlying eligible assets.

28. Detailed below are two issues with the second method that need addressing.

Non-eligible assets fully hedged

29. The objective of the second method is to allocate a taxpayer's hedges to their non-eligible assets first, as the tax treatment of non-eligible assets generally aligns with the treatment of hedges under the FA rules.

30. However, as currently worded, application of the second method will always result in an FDR hedge portion of less than 100% of a taxpayer's eligible assets when the taxpayer also owns non-eligible assets, even when those non-eligible assets themselves are already fully hedged.

31. What this means in practice is that taxpayers will never be able to apply FDR treatment to 100% of their eligible hedges when they also own fully hedged non-eligible assets. This is contrary to the policy intent of the rules and results in the tax treatment not reflecting the underlying hedging position.

Recommended solution – modification to the second method

32. Officials have developed a modification to the second method to ensure its application does not always result in an FDR hedge portion of less than 100% when taxpayers' non-eligible assets are already fully hedged. Broadly, the modified formula would continue to allocate a taxpayer's hedges to their non-eligible assets first, consistent with the policy intent of this method, but then allow FDR treatment to be applied to 100% of a hedge once non-eligible assets are fully hedged.

Small cash balances

33. In some cases, a taxpayer's only non-eligible assets will consist of small foreign cash balances held for liquidity purposes, outstanding settlements of eligible assets and accrued dividends derived from eligible assets. Where this is the case, it is unreasonable and contrary to the policy intent of the rules for these balances to prevent a taxpayer from applying the FDR method to 100% of a hedge which only hedges eligible assets. This is because these balances often equate to an immaterial amount and are only on hand for a short period of time before being distributed to investors or reinvested.

Recommended solution – de minimis threshold

34. Officials recommend that a de minimis threshold for non-eligible assets be introduced into the FDR FX hedges rules. The effect of this threshold would be to exclude immaterial foreign cash balances (used for the purposes noted above) from the quantum of non-eligible assets. The FDR method could then be applied to 100% of a hedge of eligible assets if the total value of non-eligible assets is below the de minimis threshold.

35. After consulting with the stakeholders, officials recommend that this threshold be set as 5% of the value of a taxpayer's eligible assets. A 5% de minimis threshold is consistent with thresholds in other rules.

Rules apply on a hedge-by-hedge basis

36. The two methods for determining FDR hedge portions require the calculation to be performed at the time a hedge is entered into, and applied for the life of the hedge. Where taxpayers hold a significant number of hedges at any point in time and turnover hedges regularly, the requirement to apply the rules on a hedge by hedge basis can impose burdensome compliance costs making them impractical to apply.

Recommended solution - portfolio method

37. Officials recommend introducing an optional third method, known as the portfolio method, for calculating FDR hedge portions. This method would require taxpayers to calculate FDR hedge portions on a portfolio basis rather than on a hedge by hedge basis when a hedge is first entered into.

38. The portfolio FDR hedge portion would be calculated on a period by period basis and applied to the entire hedge portfolio. Taxpayers would be allowed to elect their own periodic basis, up to a maximum period of one month. This is to allow taxpayers some flexibility in the applying the rules while also improving accuracy of FDR hedge portions.

39. In order to maintain the integrity of the rules, there would be consistency requirements for taxpayers choosing to apply this method. Specifically, taxpayers would be required to apply the portfolio method for a minimum of four years and would not be allowed to alter the periodic basis for calculating FDR hedge portions during this time.

40. The rules currently require eligible hedges to have one "leg" in NZD. This means that eligible hedges must hedge one foreign currency back to NZD. Often taxpayers with large portfolios of hedges rebalance their hedging position of eligible currency assets denominated in two foreign currencies to NZD, by hedging one foreign currency to the other – ie entering a hedge with no NZD leg. These hedges are entered to eliminate foreign currency risk in relation to eligible currency assets but are not eligible for FDR treatment.

41. In order to address this issue, officials recommend a modification to the eligible hedge requirements for the new portfolio method, to allow hedges to have no NZD leg.

Alternative solution not recommended – determination making power

42. Officials raised an alternative solution to address this issue during targeted consultation. This was to introduce a determination making power in the FDR FX hedges rules giving the Commissioner of Inland Revenue authority to approve a taxpayer's proposed method for calculating FDR hedge portions. While stakeholders were very supportive of both the portfolio method and a determination making power, some preferred the determination making power if only one solution was to be introduced.

43. Officials do not recommend progressing this solution because the portfolio method detailed above sufficiently addresses the issue of taxpayers with significant hedging activity not being able to apply the rules. Further, a determination making power can be difficult to apply in practice, would require ongoing Inland Revenue resources to administer and would potentially open the rules up to a myriad of bespoke methods.

Hedges and assets owned by different funds

44. Taxpayers commonly invest into eligible assets indirectly through other funds and may hedge their foreign currency exposure in relation to these indirectly owned eligible assets. Currently only assets that are directly owned by a taxpayer can

qualify under the rules as eligible assets. The result being that hedges of indirectly held offshore assets are not eligible for FDR treatment.

Recommended solution – look-through rule

45. Officials recommend introducing an optional rule that would allow these indirect investors (hedging funds) to apply a look through approach to the underlying assets of the 'asset fund' for purposes of the rules.

46. This rule would only apply where a hedging fund returns the income from the indirectly owned eligible assets on a look-through basis.

47. In applying this new look-through rule, the hedging fund would need to determine the value of their ownership of eligible and non-eligible assets held in the asset fund. Therefore, the new look through rule would only be available where hedging funds are able to access the required information from assets funds.

Transfer of ownership of assets and eligible hedges

48. The rules do not currently provide for situations where ownership of assets, including eligible hedges subject to FDR treatment, is transferred between funds or sub funds. It is important that the rules clearly specify the tax treatment for these transfers because they are reasonably common within the managed funds industry.

Recommended solution

49. Officials recommend that when one qualifying entity or investor class acquires eligible hedges with an FDR hedge portion from another, the new owner should be allowed to continue to apply FDR treatment to the acquired hedges. In order to maintain the integrity of the rules, this concession should only apply where all the assets of a qualifying entity or investor class are transferred, and the new owner should be required to recalculate FDR hedge portions for the acquired eligible hedges.

Policy issues raised during consultation that officials do not support

50. The table below details issues with the FDR FX hedges rules raised by stakeholders during targeted consultation that officials do not consider require addressing.

Issue	Officials' response
Associated parties Hedges entered into with associated parties are excluded from being eligible hedges. Stakeholders have requested that hedges entered into with associated parties should be eligible hedges where the agreements are on an arm's length basis and adhere to usual commercial terms.	This issue was raised by stakeholders when the rules were first introduced. Officials decided not to treat hedges entered with associated parties, priced on an arm's length basis, as eligible hedges at the time because it would open the rules to abuse and undermine their integrity. Officials continue to have the same concerns, so recommend against treating hedges entered with associated parties as eligible hedges. Officials' concern with arm's length tests is that they are difficult to apply in practice. It can be very hard to prove that a transaction was not carried out at arm's length. Also, including hedges entered with associated in the rules could lead to a mismatch in the tax treatment amongst associated parties and create arbitrage opportunities.

Eligible entities The rules only apply to widely held investment entities, such as Portfolio Investment Entities (PIEs), public unit trusts, institutional investment entities and other similar entities. Stakeholders suggested that consideration be given to allowing additional widely held entities to apply the rules.	This issue was also raised by stakeholders when the rules were first introduced. Officials decided not to allow a broader range of entities to apply the rules at the time because it would open the rules to abuse and undermine their integrity. Officials continue to have the same concerns so recommend against allowing a broader range of entities to apply the rules at this time. The FDR FX hedges rules are intended to be a solution primarily for the managed funds industry and the current scope of eligible entities accommodates this intention. The managed funds industry is heavily regulated, has documented investment strategies and mandates and consists of large and identifiable players that have good compliance relationships with Inland Revenue. These factors mitigate the risks of the rules being misused.

Minor technical issues and recommended solutions

51. Officials recommend several minor remedials be made to improve the rules. The issues and recommended solutions are detailed in the Appendix to this report.

Fiscal impacts

52. Application of the rules materially affects the tax position of eligible foreign currency hedges because only 5% of the opening market value of a hedge is taxed rather than the total return (which may be income or a losses) under the FA rules. As a result, an increased uptake of the rules could have a large impact on tax payable by an entity when viewing each year in isolation. This effect could be both revenue positive or negative depending on foreign currency movements.

53. However, foreign currency hedges are expected to earn a cumulative return of zero over time. Therefore, an increased uptake of the rules should reduce the volatility of tax positions from year to year and have no impact on total tax revenue collected over time.

Administrative impacts

54. These changes would have no significant administrative impacts for Inland Revenue. The resulting changes to internal documentation and guides would be managed as part of business as usual processes.

Consultation

55. Officials conducted targeted consultation with the managed fund industry, tax advisors and business groups in late 2020. Stakeholders are very supportive of the proposed changes detailed in this report.

56. Treasury has been consulted on this report.

Next steps

57. If you agree to officials' recommendations, the next step will be to include the proposed changes to the rules in an omnibus Cabinet paper seeking policy approval for inclusion in the tax Bill (scheduled to be introduced in August 2021).

Appendix – minor technical issues and recommended solutions

58. The table below details a number of other minor issues in the FDR FX hedges rules and officials' recommended solutions.

Issue	Recommended solution
Hedge of a hedge A hedge of a hedge is a foreign currency hedge that effectively cancels out another foreign currency hedge. A hedge of a hedge is typically used to reduce foreign currency hedge exposure in circumstances such as a drop in the market value of eligible assets. A hedge of a hedge can currently be eligible for FDR treatment under the rules. However, the methods for calculating the FDR hedge portion do not work as intended when applied to a hedge of a hedge.	**Specify how the rules apply to a hedge of a hedge** Officials recommend that the methods for calculating an FDR hedge portion are amended to specify how they apply to a hedge of a hedge so that the formulae accurately calculate FDR hedge portions for these hedges.
Hedges entered and settled within a valuation period Taxpayers calculate their FDR income on eligible assets and eligible hedges by using their opening market value at the start of every valuation period. Eligible hedges entered and settled within a valuation period do not have an opening market value and as a result are not subject to this calculation. The result being that any gain (or loss) on these hedges is not subject to tax under either the FDR treatment or the FA rules.	**Specify the treatment of hedges entered and settled within a valuation period** Officials recommend that the formula for calculating FDR income from eligible hedges is amended to specify the treatment of hedges entered and settled within a valuation period.
Income or expenditure under other provisions or ordinary concepts Under the rules no income or expenditure from eligible hedges arises under the FA rules to the extent to which the hedges are subject to FDR treatment. However, the rules do not explicitly state that no income or expenditure arises from eligible hedges under ordinary concepts to the extent that FDR treatment applies. This opens the theoretical possibility of double tax or double deductions.	**Exempt all other income or expenditure** Officials recommend an amendment is made to the rules to explicitly clarify that no other income or expenditure arises from eligible hedges to the extent that FDR treatment applies. A similar provision is included within the core FDR rules.
Legislative wording unclear The legislation currently refers to formula rather than methods for calculating FDR hedge portions. However, the second formula is made up of two formulae. Stakeholders have suggested this wording adds confusion and complexity to the rules.	**Amend legislative wording** Officials recommend the legislative wording be amended to refer to methods.

Definition of non-eligible assets	**Technical amendments to the definition of non-eligible assets**
The definition of non-eligible assets currently includes eligible hedges. The amount of non-eligible assets is not intended to include eligible hedges. The definition of non-eligible assets also includes New Zealand securities listed on foreign exchanges that are denominated in foreign currencies. Although these assets are denominated in a foreign currency, any hedges entered in relation to them are not eligible for FDR treatment on the basis these securities are naturally hedged back to NZD. In essence, they are more akin to NZD securities than foreign currency securities and therefore should not be within the definition of non-eligible assets - which is intended to identify foreign investments that are not subject to FDR treatment.	Officials recommend excluding eligible hedges from the definition of non-eligible assets. Officials also recommend excluding from the definition of non-eligible assets, New Zealand securities listed on foreign exchanges and denominated in foreign currencies to the extent that no foreign currency hedge has been entered to hedge these assets.

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: Sales suppression software

Date:	25 March 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/123

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	8 April 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

In Confidence

25 March 2021

Minister of Revenue

Sales suppression software

Purpose

1. This report briefs you on sales suppression software, an emerging form of tax evasion which officials have reason to believe has recently arrived in New Zealand from overseas. It recommends specific penalties for producing, selling, or possessing this software and seeks your approval to prepare a draft Cabinet paper to achieve this.

The issue

2. Sales suppression software systematically alters point-of-sale data collected by a business in order to understate or completely conceal revenues for the purpose of evading tax. The OECD has identified risks for tax administrations arising from the vulnerability of electronic cash register data to sales suppression software and consequent under-reporting of income.

3. Inland Revenue has been informed by competent authorities from Australia and the United Kingdom that a UK-based company may be selling sales suppression software to hospitality businesses in New Zealand. Such software appears to be new to New Zealand and is not currently illegal here. While its use constitutes tax evasion and could be dealt with on that basis, it is not currently illegal to manufacture, sell, or possess the software. Although there is no evidence that the software is widespread in New Zealand yet, given that it presents a clear threat to the tax base, there is a strong case for moving quickly to prohibit it and establish appropriate penalties.

4. Many other jurisdictions are either taking or considering action to prohibit sales suppression software. In their March 2021 Budget, the UK announced the introduction of specific penalties for possession, manufacture, distribution or promotion of sales suppression software and hardware. As well as legislating against sales suppression software, other jurisdictions are undertaking enforcement action against sellers of the software. Some of this planned enforcement action is high-profile and intended to be carried out in the near future; this may generate public and media interest on the subject in New Zealand. The experience of other revenue jurisdictions with developing and implementing their legislation has informed our proposed response.

Definitions and penalties

5. Officials propose to follow the Australian model for defining sales suppression software. Australian legislation defines offending software, in essence, as software that can modify sales data, where a reasonable person would conclude that the main purpose of the software is to commit tax evasion. This subjective approach to defining the software avoids the issues inherent to using a highly specific definition (e.g. accidentally capturing software that modifies sales data for legitimate reasons, such as to correct input errors).

6. The penalty regime in Australia defines three offences: manufacture, sale, or supply of the software (including a right to use the software); acquisition or possession of the software (again including a right to use); and usage of the software. Australia sets the penalty for manufacture, sale, or supply of software at AU$1,111,000[1] (approximately NZ$1.2 million); for acquisition or possession at AU$111,000 (approx. NZ$120,000); and for usage at AU$222,000 (approx. NZ$240,000). These penalties are high by international standards, but as the purpose of these penalties is to act as a deterrent to using sales suppression software, officials believe there is merit to setting the penalty rates relatively high.

7. Officials propose adopting the Australian offence definitions for manufacture, sale, supply, acquisition, and possession (that is, two of the three offence definitions set out in Australian law). We believe the existing civil and criminal penalties for evasion in the Tax Administration Act 1994 adequately cover usage of the software, as it is inarguably a form of tax evasion.

8. We recommend that, in general, criminal penalties should be introduced rather than civil penalties. The reason for this is the amount of the penalty cannot be tied to the amount of tax evaded which makes it impractical to design a civil penalty that is proportionate to the offence. By imposing criminal penalties, a court can decide the appropriate level up to the legislative maximum. This approach is supported by the Ministry of Justice.

9. We recommend criminal penalties of a maximum of $250,000 for producing, selling, or providing offending software, and a maximum of $50,000 for acquiring or possessing software. Existing criminal penalties for evasion could also apply.

10. Based on advice from the Australian Taxation Office, we also recommend introducing a separate civil penalty for acquisition or possession of the software. Australian officials have found that one person selling sales suppression software may have sold the software to tens of thousands of taxpayers. Prosecuting thousands of taxpayers for possession would be prohibitively costly; a smaller civil penalty allows offenders to be penalised while minimising costs. Officials therefore also recommend introducing a civil penalty for acquisition or possession, set at $5,000.

Prior behaviour provision and using software

11. While the use of sales suppression software falls unambiguously under the definition of evasion, and therefore that existing penalties can be applied to users of the software, we recommend a minor change to the way in which evasion penalties are currently applied for software users.

12. A provision in the Tax Administration Act 1994 reduces by 50% various shortfall penalties, including the existing penalties related to evasion, where a person has not committed any previous behaviour that would result in them incurring a penalty.

13. However, using sales suppression software requires the person to have acquired the software as a premeditated act.

14. As an additional deterrent to the use of the software, officials therefore recommend disabling this provision where a person has used sales suppression software to commit evasion. This would allow the full civil evasion shortfall penalty (150% of the resultant shortfall) to be levelled against all users of sales suppression software.

15. This would not alter the existing criminal evasion penalty but would presumably already be taken into account by a court when deciding on an appropriate penalty.

---

[1] In Australian legislation, these figures are given in penalty units, not dollar values. A penalty unit is currently equivalent to AU$222 at the federal level.

Voluntary disclosure

16. The existing civil evasion penalty is reduced by 75% or 40% (for a pre-audit notification disclosure and a post-notification disclosure respectively) when a taxpayer voluntarily discloses the tax shortfall. This encourages compliance and reduces Inland Revenue's costs in reviewing these positions.

17. Consistent with this approach, we recommend the following reductions in the penalties described above when a taxpayer voluntarily discloses their acquisition, possession, and/or use of the software:

    - The civil penalty for acquisition or possession should be reduced by 100% for a pre-notification disclosure or 40% for a post-notification disclosure; and

    - The 50% prior behaviour reduction in the evasion penalty should continue to be available.

Consultation

18. Due to the sensitive nature of this issue, consultation has been limited to interested public sector bodies, rather than with the wider private sector.

19. Officials have consulted with Inland Revenue internal experts on evasion and sales suppression, the Ministry of Justice, the Department of Internal Affairs, the Treasury, and the Australian Taxation Office.

20. The Ministry of Justice recommended certain changes, which we have incorporated into our current proposal. They agree with the recommended approach.

21. Other consulted parties support the recommended approach.

Next steps

22. We recommend a Cabinet paper is prepared to include these recommendations in the next available omnibus tax bill.

Recommended action

We recommend that you:

a. **agree** to introduce penalties for production, sale, acquisition or possession of sales suppression software as set out in Appendix 1 of this report;

Agreed/Not agreed

b. **agree** that the above recommended changes should apply from the date of enactment of the bill they are included in;

Agreed/Not agreed

c. **agree** that the above recommended changes be included in the next available tax bill;

Agreed/Not agreed

d. **note** that the above recommendations do not have a fiscal impact;

Noted

e. **direct** officials to prepare a draft Cabinet paper covering the above recommendations.

Directed/Not directed

s 9(2)(a)

Paul Fulton
Principal Policy Advisor
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

Appendix 1 – Details of sales suppression software penalties

Introducing penalties for production, sale, acquisition or possession of sales suppression software (the software) will include the following items:

1. A criminal penalty for production, sale, and/or provision of the software, including a right to use the software, set at a maximum of $250,000;

2. A criminal penalty for acquisition or possession of the software, or a right to use the software, set at a maximum of $50,000;

3. A civil penalty for acquisition or possession of the software, or a right to use the software, set at $5,000;

4. The existing 50% reduction for prior behaviour of the civil evasion penalty will not be available when the evasion included use of the software;

5. If the taxpayer voluntarily discloses acquisition, possession, or use of the software, the penalty in recommendation 3 above will be reduced by:
   a. 100% for a pre-notification disclosure
   b. 40% for a post-notification disclosure

6. If the taxpayer provides a pre-notification voluntarily disclosure of acquisition, possession, or use of the software, the removal of the prior behaviour reduction in recommendation 4 above will not apply.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Cabinet paper – GST policy issues

Date:	31 May 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/138

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Authorise** the lodgement of the attached Cabinet paper	10am Thursday 24 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Graeme Morrison	Policy Lead	s 9(2)(a)
Gordon Witte	Principal Policy Advisor	
s 9(2)(a)	Policy Advisor	

31 May 2021

Minister of Revenue

Cabinet paper – GST policy issues

Executive summary

Cabinet approval for GST policy issues

1. The attached draft Cabinet paper seeks Cabinet approval to make amendments to the Goods and Services Tax Act 1985 (GST Act), which would:

   1.1 Remove crypto-assets from the GST and financial arrangement rules to ensure these tax rules are not an unreasonable barrier to investing into or using crypto-assets.

   1.2 Reduce compliance costs and improve competition for courier businesses by zero-rating the domestic leg of the international transport of goods.

   1.3 Ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, such as farmhouses and home offices, by allowing a deduction which correctly reflects the non-taxable use.

   1.4 Reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method (currently this application process is limited to large taxpayers).

   1.5 Provide the correct amount of second-hand goods input tax credits on supplies between associated persons to ensure GST registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

2. These amendments were subject to public consultation via the *GST Policy Issues: an officials' issues paper* in 2020 (IR2019/593 refers). The proposed amendments were supported by submitters.

3. A draft Cabinet paper is attached for lodgement with the Cabinet Office by 10am Thursday 24 June 2021, for consideration by the Economic Development Committee the following Wednesday (30 June). Regulatory impact statements, where required, have been prepared to accompany the Cabinet paper and they are attached to this report for your information.

4. The proposal to zero-rate the domestic leg of the international transportation of goods has a fiscal cost of $0.2m per annum. The proposal to provide the correct amount of second-hand goods input tax credits on supplies between associated persons has a fiscal cost of $2m per annum. We recommend these items are funded by the Tax Policy Scorecard. The other issues seeking Cabinet approval do not have any fiscal impacts.

Other issues

5. You have previously given high level approval to include several GST-related remedial issues in the next available tax bill (IR2021/060 refers). The amendments do not involve any significant policy change (remedial in nature), do not have a fiscal impact and do not require Cabinet approval. These amendments are listed in a table in recommendation 11 below and are explained in the body of the report.

6. We are also seeking your agreement to targeted consultation on a potential integrity remedial measure that would amend the associated persons rules in the GST Act so joint venture members would become associated with the joint venture business.

Recommended action

We recommend that you:

7. **Agree** to take the following proposals to Cabinet for their approval:

Crypto-assets

7.1 Crypto-assets should not be subject to GST or the financial arrangement rules (but will still be taxed under other ordinary tax rules) and this should apply from 1 January 2009, being the date the first crypto-asset, bitcoin, was launched.

Agreed/Not agreed

7.2 GST registered businesses that raise funds through issuing security tokens which have features that are similar to debt or equity securities should be able to claim input tax credits on their capital raising costs retrospective to 1 April 2017, being the date that the capital raising deduction rule took effect.

Agreed/Not Agreed

Domestic leg of the international transportation of goods

7.3 Freight services for the domestic leg of the international transportation of goods should be subject to a zero-rate of GST.

Agreed/Not agreed

Apportionment rules

7.4 GST apportionment rules should be amended with application from 24 February 2020 to ensure they do not overtax sales of appreciating assets which are partly used for business and partly used privately, by allowing a deduction which correctly reflects the non-taxable use.

Agreed/Not agreed

7.5 Smaller GST registered suppliers should be allowed to apply to Inland Revenue to approve an alternative apportionment method to reduce their compliance costs (currently this application process is limited to large taxpayers).

Agreed/Not agreed

Second-hand goods input tax credits on supplies between associated persons

7.6 To allow the correct amount of second-hand goods input tax credits to be claimed on supplies between associated persons.

Agreed/Not agreed

8. **Agree** that the revenue impact resulting from recommendation 7.3 be accounted for on the Tax Policy Scorecard:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Tax Revenue:	0	(0.05)	(0.2)	(0.2)	(0.2)
Total operating	**0**	**0.05**	**0.2**	**0.2**	**0.2**

Agreed/Not Agreed

9. **Agree** that the revenue impact resulting from recommendation 7.6 be accounted for on the Tax Policy Scorecard:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Tax Revenue:	0	(0.5)	(2)	(2)	(2)
Total operating	**0**	**0.5**	**2**	**2**	**2**

Agreed/Not Agreed

10. **Sign** and **refer** the attached Cabinet paper to the Cabinet Office by 10am Thursday 24 June 2021, for consideration by the Cabinet Economic Development Committee on 30 June 2021.

Signed and referred

11. **Agree** that the GST remedial issues set out in the table below, for which Cabinet approval is not required, should also be included in the next tax bill scheduled for introduction in August 2021:

Recommendations	**Minister of Revenue**
Modernise the invoicing rules so that the GST Act reflects modern business practices. The main proposal is rather than requiring the purchaser to retain an invoice which supports their GST input claim, they would instead need to retain business records that contain all the relevant information currently required for a tax invoice;	Agreed/Not Agreed
Clarify that the GST grouping rules apply before the other rules in the Act;	Agreed/Not Agreed
Clarify that input tax credits can be deducted on goods that have been purchased but not physically received yet at the time the GST return is filed;	Agreed/Not Agreed
Provide more flexibility for the Commissioner to approve the end date of a taxable period;	Agreed/Not Agreed
Exclude members of non-statutory boards from having a taxable activity (the exclusion is currently limited to statutory boards);	Agreed/Not Agreed
Provide taxpayers with challenge rights in relation to a decision of the Commissioner to re-open time-barred GST returns;	Agreed/Not Agreed
Align the application of joint and several liability of members of GST groups with those for income tax groups;	Agreed/Not Agreed
Clarify that the exemption for residential ground leases still applies when this is paid as part of the levy paid to GST registered unit title body corporates;	Agreed/Not Agreed
Reduce compliance costs for non-resident businesses by allowing them to claim input tax deductions that relate to goods that they export from New Zealand, without having to establish a New Zealand group member first.	Agreed/Not Agreed
Clarify zero-rating still applies to exports of primary products which are delivered to the recipient’s ship in New Zealand.	Agreed/Not Agreed
Ensure that the rules that apply to sales of land between GST registered persons work as intended when a person has incorrectly zero-rated the supply of land;	Agreed/Not Agreed
Clarify how a purchaser must apportion a business they bought as a going concern if they use the business assets for a partly private use;	Agreed/Not Agreed
Reduce compliance costs by turning off the requirement to continue to perform annual adjustments after a wash-up has been performed. A ‘wash up’ calculation requires a taxpayer to claim/pay full input tax credits for an asset when switch to 100% taxable or non-taxable use;	Agreed/Not Agreed

12. **Agree** that officials undertake targeted consultation on a potential integrity change to the associated persons rules in the GST Act so that joint venture members would become associated with the joint venture business.

    Agree/Not agreed

Graeme Morrison
Policy lead
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Background

13. Since 2019, officials have engaged with internal and external stakeholders to identify GST policy issues that need to be addressed by amending the Goods and Services Act 1985 (the GST Act). This work culminated in the release of the *GST policy issues – an officials' issues paper* in 2020. The issues paper sought feedback on various policy options to protect against identified gaps in the GST base as well as responding to changes to commercial practice and technology.

14. Officials reported to you in in February this year (IR2021/060 refers) recommending that the proposals in the issues paper be progressed along two tranches. The first tranche of issues are strongly supported by submitters and are issues that are included in this cover report and attached Cabinet paper for progression in the next available tax bill. The second tranche of issues are on a longer timeframe as further consultation is needed to refine the proposals.

GST proposals in the attached Cabinet paper

15. The attached Cabinet paper and draft regulatory impact statements explain the following GST proposals. All of the proposals are well-supported by submitters and will reduce compliance costs and help improve the fairness of New Zealand's GST rules. These are:

Removing crypto-assets from GST and the financial arrangement rules to ensure these tax rules are not a barrier to investing into or using crypto-assets

16. Cryptocurrencies (also known as crypto-assets) are digital assets (commonly known as coins or tokens) that use cryptography and a decentralised network of computers to secure transactions and verify the transfer of the coins and tokens between individuals. There are over 10,000 crypto-assets, with the approximate total global market value of all crypto-assets exceeding US$1.7 trillion.

17. The existing GST and financial arrangement rules do not contemplate crypto-assets and are therefore difficult to apply, involve high compliance costs, and may provide policy outcomes for some crypto-assets that lead to over-taxation compared to other alternative investment products.

18. Officials propose that crypto-assets are excluded from GST and the financial arrangement rules. Crypto-assets are a similar investment product to shares which are also excluded from these rules. This will ensure that these rules do not impose barriers to developing new products, raising capital and investing through crypto-assets. They also bring our laws into line with those in Australia and Singapore, who have already removed GST on certain types of crypto-assets.

19. It is further proposed that the GST rules that allow GST registered businesses to claim input credits for their capital raising apply equally to crypto-assets, as they do to debt or equity securities.

20. Crypto-assets will continue to be subject to income tax when they are sold or traded for other crypto-assets.

Reducing compliance costs and improving competition for courier businesses by zero-rating the domestic leg of the international transport of goods

21. Under current law, the domestic leg of the international transportation of goods can only be zero-rated (GST is charged at zero percent) where the domestic leg of the transportation is supplied by the same supplier as the international leg of transportation. The rationale for allowing zero-rating of the domestic leg is because exported goods are zero-rated, and the value of transport services is already included in the cost of imported goods which are subject to 15% GST. The problem

is that under current practice, most international transporters do not undertake the domestic leg of the transportation, and instead subcontract to an NZ-based courier.

22. Officials propose that the domestic leg of the international transportation of goods is zero-rated. This will ensure that potentially irrecoverable GST costs are not embedded in the final price of the goods paid by the consumer and will ensure the tax system does not create incentives to pick one transport carrier over another. It will bring our rules into line with Australia who have a similarly broad zero-rating treatment for the domestic leg of the international transport of goods.

Improvements to the GST apportionment rules

23. The GST Act includes a set of apportionment and adjustment rules for determining GST input tax deductions when an asset such as a vehicle, farmhouse or home office is used partly to conduct a GST registered business and partly for a private or exempt use.

24. Officials propose that two improvements to the apportionment rules be included in the next available tax bill.

25. The first proposal would ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, such as farmhouses and home offices, by allowing a deduction which correctly reflects the non-taxable use.

26. To ensure compliant taxpayers are not disadvantaged if they sell an affected property before the proposed amendment is enacted, officials recommend this amendment apply from 24 February 2020, which is the date the issue and the proposed amendment was consulted on in the GST policy issues paper.

27. The second proposal would reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method (currently this application process is limited to large taxpayers with more than $24m of annual turnover).

Second-hand goods input tax credits on supplies between associated persons

28. In circumstances where a supplier purchases an asset in which no GST has been charged on the purchase, the registered person may be denied the ability to claim any second-hand goods input tax credit. This is because no GST was charged on the sale, but it may have been embedded in the cost of the asset.

29. The proposed amendment allows a second-hand goods input tax credit on supplies between associated persons equal to the tax fraction on the original cost of the good at the time it was purchased by the first person in the chain of associated persons. This amendment ensures registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

Fiscal costs

30. As noted in the attached Cabinet paper, the proposed amendment to zero-rate the domestic leg of the international transport of goods would have a fiscal cost of $0.2m per annum. The proposal to allow the correct amount of second-hand goods input tax credits on supplies between associated persons would have a fiscal cost of $2m per annum. Both fiscal costs are recommended to be funded from the Tax Policy Scorecard. The other proposals in the Cabinet paper do not have fiscal implications.

Remedial GST matters

31. You have previously given officials broad approval to include several GST-related remedial issues in the next available tax bill (IR2021/060 refers). These amendments do not have any fiscal implications as they generally align the law to reflect business practices or simply reduce compliance costs for taxpayers. These amendments are remedial in nature and do not require Cabinet approval. The issues are therefore not discussed in the attached Cabinet paper.

Modernising the invoicing rules so that the GST Act reflects modern business practices

32. The GST Act requires GST registered suppliers and purchasers to issue and retain certain information on their tax invoices in order to help suppliers and purchasers to correctly account for GST. These requirements have remained largely unchanged since 1985. It is now proposed that these invoicing requirements are modernised to reflect electronic invoicing and changes in business practices. The main proposal is rather than requiring the purchaser to retain an invoice which supports their GST input claim, they would instead need to retain business records that contain all the relevant information currently required for a tax invoice.

GST groups

33. The GST grouping rules allow a person with many GST-registered entities to form a GST group to reduce compliance costs. The proposed amendment clarifies that the GST grouping rules apply before other rules in the GST Act.

Input credits on goods not physically received at the time GST is filed

34. The GST Act provides that where goods are acquired by a registered person, an input tax deduction is allowed to the extent to which the goods are used for, or are available for use in making taxable supplies. The issue is whether goods are "available for use" if the registered person has not yet physically acquired these goods prior to filing their GST return. The proposal clarifies that input tax credits cannot be deducted on goods that have been purchased but not yet physically received at the time the GST return is filed.

Providing more flexibility for the Commissioner to approve the end of a taxable period

35. The taxable periods for businesses' GST returns may not align with their accounting periods which increases their compliance costs. This results in businesses having to produce a different set of reports based on their GST cycle. The proposed amendment provides the Commissioner with flexibility to approve a broader range of end dates for a taxable period. This better aligns with a taxpayers accounting periods and reduces their compliance costs as there is less need to adjust this for the GST return.

Exclude members of non-statutory boards from having a taxable activity

36. Under the GST Act, members of non-statutory boards are treated differently to members of statutory boards despite the policy intent to exclude board members more generally from having a taxable activity. This amendment broadens the exclusion from the GST system to include members of non-statutory boards.

Challenge rights in relation to a decision of the Commissioner to re-open time-barred GST returns

37. A time-bar provision prevents the Commissioner from amending both an income tax and GST assessment to increase the amount assessed after a set period of time. This does not apply if the Commissioner considers the person knowingly or

fraudulently failed to disclose all of the material facts. For the purposes of an income tax assessment, a taxpayer is able to challenge the Commissioner's reassessment on the basis that the assessment was time barred and the Commissioner was incorrect in attempting to reassess it. The purpose of this amendment is to provide taxpayers with these same challenge rights for time-barred GST returns.

Joint and several liability of members of GST groups

38. The purpose of this proposed amendment is to align the application of joint and several liability of members of GST groups with those that apply for income tax groups. The amendment makes it easier for corporate groups to sell a group member to another business, by providing the Commissioner with a discretion to allow an existing company's joint and several liability to be extinguished for tax periods after their exit.

GST input tax recovery for non-resident businesses

39. Some non-resident businesses are registered for GST because they sell goods in New Zealand as well as offshore. They may incur GST on their inputs, for example by paying an unrelated New Zealand company for services to modify or finish some high-tech goods that the non-resident owns (toll manufacturing).

40. Under the current GST settings such businesses are required to set-up a New Zealand subsidiary or office as this allows their exported goods to become zero-rated supplies so they can then claim input tax deductions for all of their New Zealand expenses. This restructuring achieves the appropriate tax policy outcome of allowing businesses to recover GST on their inputs but involves high compliance costs.

41. The proposed amendment would reduce compliance costs by allowing the affected non-resident businesses to claim GST input tax deductions without having to establish a New Zealand group member.

Exports of goods which are delivered to the recipient's ship in New Zealand – clarifying these are zero-rated

42. Some New Zealand exporters deliver goods (usually primary products such as logs) to a recipient's ship which is berthed in New Zealand and the sale / time of supply subsequently occurs after the goods have left New Zealand. The current practice is to zero-rate such exported goods, however due to the way the relevant zero-rating rule is drafted it is not clear if these exporting arrangements meet the requirements. The proposed amendment would clarify that zero-rating applies to exported goods which are delivered to the recipient's ship in New Zealand.

Clarify that a GST registered unit title body corporate does not make a supply to its residential unit holders in respect of the portion of levy that it uses to pay ground rent

43. Unit title body corporates for apartments can choose to register for GST in which case they must return GST on their levies.

44. Ground rent for residential leasehold land is exempt from GST. The proposed amendment would clarify that a unit title body corporate does not make a supply to its residential unit holders in holders in respect of the portion of levy that it uses to pay ground rent.

Remedial changes to the apportionment and adjustment rules

45. Officials propose including two remedial changes to the apportionment and adjustment rules in the August tax bill. The amendments would:

45.1 Clarify how a purchaser must apportion a business they bought as a going concern if they use the business assets for a partly private use; and

45.2 Reduce compliance costs by turning off the requirement to continue to perform annual adjustments after a wash-up has been performed. A 'wash up' calculation requires a taxpayer to claim/pay full input tax credits for an asset when switch to 100% taxable or non-taxable use.

Remedial changes to the compulsory zero-rating of land rules

46. Three remedials are proposed to ensure that the compulsory zero-rating rules that apply to land work as intended. These remedials apply to situations where taxpayers incorrectly applied zero-rating and so need to make subsequent adjustments. Two of the remedials clarify the adjustment should be made in the period that the error became apparent rather than when the supply originally took place. A third remedial would allow a non-taxable supply which was incorrectly zero-rated to be correctly adjusted to be a non-taxable supply.

Targeted consultation on whether members of joint ventures should be associated with the joint venture business

47. We are also seeking your agreement to undertake targeted consultation on an integrity measure that would amend the associated persons rules in the GST Act.

48. Unincorporated bodies are deemed to be legal entities under the GST Act. This means there is no requirement to look through to the members of the unincorporated body when determining its GST obligations. This creates an integrity risk as individuals can establish an unincorporated joint venture with which to enter transactions with entities associated with the members without triggering anti-avoidance rules. To remedy this, the proposed amendment would associate members of a joint venture with the joint venture.

49. However, before we proceed with this amendment, we would like to undertake some targeted consultation to confirm it doesn't create unintended consequences for joint ventures.

50. Subject to your agreement, will report back to you with advice following the consultation and with details on the suggested legislative vehicle that we are targeting to make any amendments required.

Consultation

51. The Treasury has been consulted in the preparation of this report and agrees with its recommendations.

Next steps

52. If you agree to the recommendations in this report, the next step is to obtain Cabinets approval for the main proposals. A draft Cabinet paper is attached for lodgement with the Cabinet Office by 10am Thursday 24 June 2021 for consideration by the Economic Development Committee the following Wednesday (30 June).

53. Three draft regulatory impact statements have been prepared for the proposals in the Cabinet paper (with the exception of the proposal to provide the correct second-hand goods input tax credits on supplies between associated persons, which does not require a regulatory impact statement) and are attached to this report.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Overseas donee status: NZ Memorial Museum Trust – Le Quesnoy – requested extension to sunset clause**

Date:	7 April 2021	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2021/147

Action sought

	Action sought	**Deadline**
Minister of Revenue	Discuss with officials	30 April 2021

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
Peter Frawley	Policy Lead	s 9(2)(a)
Brandon Sloan	Principal Policy Advisor	

7 April 2021

Minister of Revenue

Overseas donee status: NZ Memorial Museum Trust – Le Quesnoy – requested extension to sunset clause

Executive Summary

1. This report recommends you decline a request from the NZ Memorial Museum Trust – Le Quesnoy to extend its overseas donee status beyond 18 March 2022. If you disagree with our recommendation, officials are available to discuss the other options presented in this report. Subject to those discussions, officials will prepare a Cabinet paper seeking approval for the Government's preferred response to the request from the Trust.

Letter from the Patron and Chair of the NZ Memorial Museum Trust – Le Quesnoy

2. You have received a letter from the Patron and Chair of the NZ Memorial Museum Trust – Le Quesnoy (the Trust) regarding an extension to a sunset clause that applies to the Trust's overseas donee status. The Patron of the Trust is the Rt Hon Helen Clark. The Chair of the Trust is Sir Don McKinnon.

3. The Trust's overseas donee status ends 18 March 2022.

4. The Trust was set up to own and operate a memorial museum and accommodation complex in Le Quesnoy, France. Le Quesnoy was the last major action by the New Zealand Division in the closing weeks of the First World War.

5. In 2018, as the Trust's purposes were outside the usual approval criteria, Cabinet agreed to grant the Trust overseas donee status as a special case.

6. Cabinet also agreed that the approval would be time limited and would represent the Government's full and final contribution to the Trust.

7. Overseas donee status means that donations to the Trust are eligible for tax benefits. Tax benefits support the ability of a donee to fundraise and meet its purposes.

8. The letter from the Trust states that s 18(c)(i) [redacted]

9. The Trust has requested an extension of their overseas donee status s 18(c)(i) [redacted]

Response to the letter

10. This report considered four options in response to the letter. The options are:

10.1 Option 1 – Decline the Trust's request to extend the sunset provision on the Trust's overseas donee status.

10.2 Option 2 – Agree to the Trust's suggestion to extend the sunset provision on the Trust's overseas donee status s 18(c)(i) [redacted]

10.3 Option 3 – Extend the sunset provision on the Trust's overseas donee status for a fixed time period with the option of renewal by way of Order in Council.

10.4 Option 4 – Appropriate upfront funding to directly support the Trust's project.

11. Officials recommend that the Trust's request be declined (option 1). Cabinet's decision in 2018 was intended to represent a time limited and one-off contribution to the Trust's project. The level of donations raised by the Trust have fallen well short of expectations and suggests the tax benefits for donations to the Trust are not providing sufficient incentive to donate. There are other concerns about the viability of the museum project more generally. s 6(a) [redacted]

12. If Ministers do wish to extend the sunset clause, Inland Revenue would recommend a further time-limited extension of the sunset clause to 2029 (option 3). This option would give the Trust and its potential donors certainty regarding the tax effect of any donations and allow time for the Trust to develop the Memorial Museum to a point of completion (donor support permitting). It would allow the Government to reassess its commitment to the project and would be broadly consistent with the principles underlying Cabinet's decision in 2018 to give the Trust overseas donee status.

13. Officials have not considered the Trust's preferred option (option 2) at length as Inland Revenue considers it could not be implemented and raises equity concerns for donors s 18(c)(i) [redacted].

14. Outside of using the tax system to support the Trust, the Government could directly fund the museum (option 4). This option raises a number of consistency issues relating to the Crown's support of New Zealand museums and whether such support is equitable given that the proposed museum would display New Zealand artefacts and taonga in a facility outside New Zealand, which would not be generally accessible except to those individuals who travel to Le Quesnoy.

15. We recommend you discuss with officials and fellow Ministers your preferred response and direct officials to prepare a Cabinet paper on that basis.

Financial implications

16. The project has only been funded until March 2022. Any extension to the sunset provisions, or alternative options, will have fiscal implications for the 2022–23 and later financial years. Subject to your decision, we will provide further detail in a separate report on the fiscal implication.

Consultation

17. The Ministry for Culture and Heritage has contributed significantly to this report, and their comments are reflected throughout. The Treasury and the Ministry of Foreign Affairs and Trade have been consulted on this report. All agencies agree with the recommendations of this report.

Next steps

18. A copy of this report should be referred to the Minister of Finance, the Minister of Foreign Affairs and Trade and the Minister for Arts, Culture and Heritage for their information.

19. A copy of this report should also be referred to the Department of the Prime Minister and Cabinet.

Recommended action

We recommend that you:

(a) Either:

(i) **Agree** to decline the NZ Memorial Museum Trust – Le Quesnoy's request for an extension to the sunset clause regarding tax benefits applicable to donations received by the Trust, ending 18 March 2022.

OR

(ii) **Discuss** your preferred option with officials.

Agreed/Not agreed/Discuss

(b) **Direct** officials to prepare a paper seeking Cabinet's approval for the option you have agreed to in recommendation (a)(ii).

Directed/Not directed

(c) **Note** that extending the sunset clause in recommendation (a) to the benefit of the NZ Memorial Museum Trust – Le Quesnoy would have financial implications for the forecast period 2022-23 to 2025-26 and funding would be required to meet the expected cost of those tax benefits.

Note

(d) **Refer** a copy of this report to the Minister of Finance, the Minister for Arts, Culture and Heritage and the Minister of Foreign Affairs and Trade for their information.

Referred/Not referred

(e) **Refer** a copy of this report to the Department for Prime Minister and Cabinet for their information

Referred/Not referred

Brandon Sloan
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Purpose

20. You have received a letter from the Patron and Chair of the NZ Memorial Museum Trust – Le Quesnoy (the Trust) regarding an extension to a sunset clause that applies to the Trust's overseas donee status. The Patron of the Trust is the Rt Hon Helen Clark. The Chair of the Trust is Sir Don McKinnon. s 18(c)(i) [redacted]

21. The Trust's overseas donee status ends 18 March 2022.

22. This report recommends you agree not to extend the Trust's overseas donee status. If you disagree with our recommendation, officials are available to discuss the other options presented in this report. Subject to those discussions, officials will prepare a Cabinet paper seeking approval for the Government's preferred response to the request from the Trust.

Background

23. The NZ Memorial Museum Trust – Le Quesnoy (the Trust) is a registered charity set up to:

    23.1 own and operate a memorial museum and accommodation complex in Le Quesnoy, France, that will provide information and learning resources to visitors and raise awareness of New Zealand's participation in and contribution to the First World War; and

    23.2 develop a programme of cultural and educational exchanges between New Zealand and Le Quesnoy, France, for all people in New Zealand and France.

24. Cabinet agreed on 29 October 2018 [CAB-18-MIN-0535 refers] to grant the Trust overseas donee status as a special case to its usual approval criteria (CM 78/14/7 refers – see annex). Typically, overseas donee status is used to support New Zealand's wider overseas aid objectives.

25. Being a special case, Cabinet granted the trust overseas donee status on the condition that:

    25.1 A sunset clause would apply, and the period would be no longer than three years after the date the measure was enacted, which was 18 March 2019.

    25.2 Granting overseas donee status was the Government's full and final contribution to the Trust.

CAB-18-MIN-0535 paragraph 6 refers

26. Cabinet's decision recognised the one-off and historic nature of the Trust's purpose to commemorate 100 years since the end of the First World War.

27. No budgetary provision was made to fund the Trust's overseas donee status from 2022-2023 and beyond.

28. Officials note that the Australian and Canadian First World War museums and visitor centres were funded through a combination of public and private funds.[1] The main difference in this instance is that the memorial museum is private sector led.

[1] The Sir John Monash Centre, at Villers-Bretonneux, is adjacent to the Australian National Memorial and commemorates Australia's presence on the Western Front in the First World War and their 11,000 missing in France. The Canadian National Vimy Memorial and visitors centre is located 8 km from Arras. The visitors' centre has an exhibition about Canada's involvement in the First World War. The Memorial (unveiled in 1936) has iconic national status.

Letter from the Patron and Chair of the Trust

29. The Patron and the Chair of the Trust have written to you requesting an extension to the sunset clause that applies to the Trust's overseas donee status.

30. The reasons given for wishing to extend the sunset clause are:

s 18(c)(i) [redacted]

31. The Patron and the Chair have asked that the Trust retain its overseas donee status s 18(c)(i) [redacted]

32. The Trust asserts that:

s 18(c)(i) [redacted]

33. s 18(c)(i) [redacted]

34. s 18(c)(i) [redacted] Based on the Trust's financial accounts, about $1.5 million has been raised over the period 1 April 2018 to 31 March 2020. The accounts for the 31 March 2021 financial year are not yet available.

35. s 18(c)(i) [redacted]

Merits of the Memorial Museum project

36. The Trust contends that unlike Canada and Australia, New Zealand does not have a purpose-built site in France to learn about the participation, contribution and sacrifice New Zealanders made on the Western Front in the First World War. s 18(c)(i) [redacted]

37. The Le Quesnoy site has been selected by the Trust as the town's liberation was the last major action by the New Zealand Division in the closing weeks of the First World

War. The Trust considers the story of the town's liberation by the New Zealand Division is compelling:

37.1 There are long-held cultural connections with Le Quesnoy, with street names in the town connected with New Zealand and annual Anzac Day services held in the town.

37.2 The Governor-General attended a significant commemoration organised by the NZ Defence Force in Le Quesnoy on 4 November 2018 to mark the centenary of the town's liberation.

38. Officials note that Le Quesnoy is an important part of New Zealand's military history and was featured in the Government's WW100 legacy project Ngā Tapuwae New Zealand First World War Trails. There is also a memorial wall at Le Quesnoy unveiled in 1923 near where the assault on the town commenced when New Zealand soldiers scaled the town's medieval ramparts with ladders.

Tax benefits for donations

39. Providing tax benefits for monetary donations to charities is intended to foster a culture of charitable giving in New Zealand. Supporting donors through the tax system can be a useful way of furthering social or government objectives.

40. The trade-off for these benefits is the revenue cost. Under New Zealand tax law, monetary donations to donee organisations, such the Trust, are eligible for:

40.1 the donation tax credit of $33^{1}/_{3}\%$ of the value of any monetary donations made by a New Zealand resident individual taxpayer, capped at the amount of their taxable income, and

40.2 tax deductions if the monetary donation is from a company or Māori authority, capped at the amount of their net income.

Comment

41. Cabinet's expectation was that granting the Trust donee status as a special case would be for a limited time and that such support would not involve additional future contributions from the Government.

42. s 18(c)(i)

43. The fundraising difficulties faced by the Trust suggests that overseas donee status is not providing the expected incentive for donors to donate.

44. In 2018, Inland Revenue advised against making the Trust a special case for overseas donee status as the purposes of the Trust were outside Cabinet's normal approval criteria. Inland Revenue also had concerns about the viability of the memorial museum and accommodation project advanced by the Trust and this was reflected in our advice to Cabinet. Specifically:

44.1 the project may not generate the donor support assumed by the trustees; and

44.2 if completed, projections regarding the expected number of visitors to the memorial museum would not be realised.

45. Correspondence from the Trust has confirmed that the project is challenging, and additional time is needed to raise the funds necessary for its completion. [redacted] s 18(c)(i) [redacted]

46. s 18(c)(i) [redacted]

47. Inland Revenue has spoken to the Chair of the Trust about its fundraising plans and target dates for completion of the project. From those conversations, we note the following:

47.1 Completion of the memorial museum project is subject to fundraising and a completion date is therefore difficult to forecast. s 18(c)(i) [redacted]

47.2 s 18(c)(i) [redacted]

47.3 The slow start to the Trust's fundraising may suggest that the tax benefits for donations are not on their own sufficient to ensure the completion of the project. In principle, giving by high-wealth individuals is sensitive to donations being eligible for tax benefits.

48. Inland Revenue considers that the current level of donor support means the Museum project is unlikely to be completed in the short to medium term. For example, the Canadian and Australian memorials were both long term efforts. Even if the accommodation facility becomes operational there are considerable costs with curation and general operation (see paragraph 81 below) that the Trust expects will be met from accumulated donations. As such, the project is likely to require a decade of fundraising. The lack of progress with developing the site in Le Quesnoy risks prolonging completion beyond that timeframe. These delays could further escalate the cost of the project and risk current donor commitments melting away.

49. Longer-term the viability of the Museum and self-catering accommodation complex is also unknown:

49.1 Le Quesnoy's population is only 5,000 people and it received approximately 40,000 visitors each year prior to the COVID-19 pandemic. The majority of these were day-trippers.

49.2 Many visitors to the region based themselves in the city of Arras, which is less than an hour away and which has more developed tourism infrastructure. The longer-term effects of the pandemic could further affect visitor numbers to the area.

49.3 The Trust's ability to finance the loan to purchase the building and to finance the alterations to the Gendarmerie as well as the museum fit-out and start-up costs s 18(c)(i) [redacted] is unclear.

Policy options

50. The Government needs to consider if its support of the Trust is still a priority and whether the financial cost associated with providing tax benefits for donations is the best use of the Government's resources.

51. There are four options available in response to the letter.

Option 1: Decline the Trust's request (Officials' preferred option)

52. Under this option, the Government does nothing, and the Trust's overseas donee status ends on 18 March 2022. Donations received after that date would not be eligible for tax benefits.

53. There are no fiscal implications under this option, although it is possible that the Trust may approach Ministers for alternative sources of funding. This option does not have any administrative implications for Inland Revenue.

54. The Trust however may not be able to fulfil its purpose and may need to wind up. If the Trust does cease operations, s 18(c)(i) [redacted] Any remaining funds are to be applied to charitable purposes in New Zealand.

55. s 6(a) [redacted]

Option 2: Extend the sunset provision until the tax benefits reach a predetermined amount (Trustees' preferred option)

56. The trustees have requested the Government support the project s 18(c)(i) [redacted]

57. This option has fiscal implications as the revenue cost for the 2022-23 financial year and beyond is not funded.

58. Inland Revenue would not be able to implement this option because there is generally an 18-month lag before donation data from individuals to specific charities can be obtained; not including donations by companies which would require an Inland Revenue audit to obtain. Inland Revenue also notes that a cap could cause equity issues between donors when it is reached.

59. Inland Revenue does not recommend this option and have not considered it at length as it cannot be implemented.

Option 3: Extend the sunset provision for a fixed period with the option to extend via Order in Council (Officials' second preferred option)

60. Under this option, an amendment would be made to the Income Tax Act 2007 extending the Trust's overseas donee status for a further period of time. Officials consider the sunset clause should be extended for another 7 years, ending 31 March 2029, the Government could include the option to further extend the sunset clause by Order in Council.

61. This option has fiscal implications as the revenue cost beyond 2022 is not funded. This option does not have any administrative implications for Inland Revenue but amending legislation would be required.

62. This option gives the Trust certainty about the Government's commitment to the project over the medium-term and allows the Government to reassess its commitment to the Trust once the museum and accommodation complex is completed during this timeframe.

63. Inland Revenue would recommend extending the sunset clause to 31 March 2029, with the option for the Government to further extend the sunset clause for a period if it wishes by way of Order in Council. This extension would:

    63.1 allow the Trust to fundraise during the commissioning and construction period, and

    63.2 give the Government an option to consider if it wishes to support the ongoing operations of the memorial museum.

64. An Order in Council process would require Inland Revenue and the trustees to periodically engage on the project's status if an extension to the Trust's overseas donee status is required.

65. This option allows for the Government to adopt a cautious approach to its financial commitment to the Trust. Officials caution, however, that if the Trust's project is to continue, there is a greater risk that a partially funded museum (or its accommodation facility) could become too big to fail and require additional Government assistance in the future.

66. Officials note that if the project is completed, the Government will need to consider its relationship with the museum. As it is a memorial museum, it represents New Zealand and the New Zealand government. It would be difficult for the Government to maintain distance and it is likely the Government would have an on-going responsibility for any artefacts and taonga held by the museum.

67. Notwithstanding that Inland Revenue considers this option to be the second-best solution, we have remaining concerns about the precedent this would set in terms of prospective requests for overseas donee status by other charities whose purposes fall outside Cabinet's usual approval criteria.

Fiscal implications

68. Extending the duration of the Trust's overseas donee status would have fiscal implications for the 2022-23 and later financial years. Subject to your decision, we will report separately about how any extension should be funded.

69. The revenue cost of extending the sunset clause is estimated for the forecast period 2022-23 to 2025-26 to be $s 18(c)(i). This figure is based on donation forecasts provided by the Trust.

Option 4: Fund the Trust directly (Officials' least preferred option)

70. Cabinet's decision in 2018 to give the Trust overseas donee status gave indirect Government financial support to the project, subject to the Trust's successful efforts in fundraising. Government oversight of this support has been limited to the usual regulatory stewardship by the Department of Internal Affairs – Charities Services and, more recently, by Inland Revenue in response to the current request for an extension to the sunset clause that applies to the Trust's donee status.

71. As an alternative or complement to option 3, the Government could make a direct full and final financial contribution to the project in the form of capital expenditure for construction and set-up. This option would:

71.1 give the Trust certainty that the project could reach completion as it would not be contingent on fundraising goals being realised; and

71.2 require the Government to take a more active part in ensuring accountability for the project's development.

72. This option would have financial implications s 18(c)(i) , the Trust's estimated cost for completion. Funding would need to be sought as part of Budget 2022, noting that this would reduce funding available for other priorities.[2] As such, this option is not favoured by officials.

73. The Government generally does not provide operational funding to museums in New Zealand, as local authorities are responsible for funding amenities that provide local benefits, any government support could only realistically be for capital works.

74. There is also an equity question. Many New Zealand museums are seeking central and local government funding and most existing sources of funding available for museum exhibits and building maintenance are already oversubscribed. Supporting an overseas museum and associated content limits access to exhibits to New Zealanders who can travel and may not be seen as the best use of Crown resources. Noting that as an alternative, the Trust could support a domestic museum to develop an exhibition that New Zealanders can more easily access.

Preferred option

75. Officials' preferred option is that the request be declined (Option 1). This is because the Trust's fundraising to date suggests the tax incentive to donate is not strong and any extension by itself is unlikely to result in the completion of the project in the foreseeable future. It also reflects the 2018 Cabinet decision that the sunset period be the Government's full and final contribution to the project and avoids the risk of further committing the Government to a project that risks failure.

76. However, if the Government considers it a priority to continue supporting the Trust, Inland Revenue recommends that the sunset provision be extended for a fixed period to 31 March 2029 (Option 3).

Consultation

Treasury comment

77. The Treasury does not support any extension to the Trust's overseas donee status. In particular, this is because Cabinet previously agreed that granting the Trust overseas donee status for a limited period of time would be the full extent of the Government's support for the project. That the Trust's fundraising has been less successful than anticipated does not seem to be a sufficient reason for departing from Cabinet's position. Indeed, it suggests that the project is less likely to be viable (even before the COVID-19 pandemic) than previously understood. The Treasury

---

[2] For comparison:
The Australian Government committed $A100 million (2018) to its memorial at The Sir John Monash Centre, at Villers-Bretonneux. The centre includes a cutting-edge multi-media facility. https://sjmc.gov.au/
The Canadian Government committed $C10 million to a visitors' centre at its memorial at Vimy. https://www.vimyfoundation.ca/learn/the-vimy-memorial/

also takes the view that extending the Trust's overseas donee status would be inconsistent with the purpose of the overseas donee status rules.

78. It would be preferable to progress this initiative through a Budget process, to ensure transparency and prioritisation against other initiatives. Such a process would likely reveal (as the Ministry of Culture and Heritage has identified) that this proposal represents poor value-for-money and is not aligned with the Government's priorities for the arts, culture and heritage sector.

Ministry for Culture and Heritage comment

79. MCH has a number of concerns with the viability of the Museum, the potential risks an overseas museum project could incur for the Government, and the inequity this would cause for local heritage projects and museums in need of funding

80. MCH's experience of the Great War Exhibition suggests that upfront sponsorship for such a large-scale capital project, in a fairly niche area of interest, is difficult to attract, even for a high-profile New Zealand-based project during the First World War centenary period.

81. MCH also considers that plans to acquire content for the museum are being developed separately and will likely increase the overall cost of the project. As many of the artefacts will be over 100 years old, they will likely be subject to the Protected Objects Act 1975 if sourced from New Zealand. While the Trust has sought the assistance of Te Papa and hopes to build a relationship with the Auckland War Memorial Museum, the sustainability of these relationships is limited to those institution's available and finite resources.

82. MCH strongly opposes Option 4 for the following reasons:

    82.1 Officials are keen to avoid creating expectations that the New Zealand Government will provide financial or other such assistance to a museum or accommodation complex in Le Quesnoy in the future.

    82.2 Direct funding by the Government may not be appropriate. MCH notes it has not seen a detailed exit plan from the Trust, should they not be able to secure sufficient funding to establish the museum. There is also a significant opportunity cost under this option if funding that could be used to enhance New Zealanders' understanding of our shared history is redirected to an overseas project, which has untested and uncertain benefits.

    82.3 MCH also notes it would be unusual and irregular for the Government to invest in an overseas museum. During the First World War centenary period, \$25 million of Lottery Grants Funding was allocated to support projects in New Zealand and overseas. s 18(c)(i) [redacted] he allocated funding is no longer available.

    82.4 Further support for the project could risk the perception of government favouritism for an overseas museum when funding is heavily oversubscribed for on-shore museums and galleries affected by the impacts of the COVID-19 pandemic, reduced visitation, and reduced funding from local government.

    82.5 MCH is not currently resourced to undertake the necessary oversight of this funding. We also understand that MFAT also does not have the necessary resources in Europe to maintain such oversight.

Ministry for Foreign Affairs and Trade comment

83. MFAT acknowledges the significant people-to-people links bolstered by the commemoration of this important and historic event. MFAT has not, however, identified any significant foreign policy benefits which would come from extending the tax donee status, or further financial support for the project.

84. s 6(a)

85. It will continue to be important to provide France with proactive reassurance about New Zealand's commitment to honouring our shared history in World War One.

Process

86. If Ministers want to extend the Trust's sunset clause, officials will prepare a paper for Cabinet to:

    86.1 rescind its earlier agreement to the sunset clause ending on 18 March 2022 (CAB-18-MIN-0535);

    86.2 seek its agreement for your preferred option;

    86.3 obtain funding for the fiscal cost connected with extending the sunset clause; and

    86.4 agree to include the relevant amendments in the taxation bill scheduled for introduction in August 2021, with effect from 1 April 2021.[3]

87. Once you have reached a decision on the extension of the Trust's overseas donee status, officials will prepare a letter for your signature informing the Patron and Chair of the Trust of your decision.

Next steps

88. Officials recommend you discuss the contents of this report with officials.

89. A copy of this report should be referred to the Minister of Finance, the Minister of Foreign Affairs and Trade and the Minister for Arts, Culture and Heritage for their information.

90. A copy of this report should also be referred to the Department of the Prime Minister and Cabinet.

[3] Cabinet is due to consider granting overseas donee status to eleven other New Zealand charities for inclusion in that proposed taxation bill.

Annex: Criteria for "overseas donee status"

Since 1978, Cabinet has applied the criteria below, which set the parameters of charitable purposes carried on outside New Zealand that may be supported by the tax system:

The basic criteria for adding an organisation to the list of approved "overseas" charities:

(i) the funds of the charity should be principally applied towards:

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries; or*

raising the educational standards of a developing country;*

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

** developing countries recognised by the United Nations.*

[CM 78/14/7 refers]

The eligible purposes set out in the criteria are aligned with the government's overseas development objectives (disaster relief, provision of humanitarian aid, and assisting developing countries) and narrower than the common law meaning of "charitable purpose" and the legislative framework in the Charities Act 2005. Determination of donee status, including overseas donee status, remains the responsibility of Inland Revenue because of the tax benefits attached to monetary donations.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Changes to the petroleum mining tax regime

Date:	8 June 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/195

Action sought

	Action sought	Deadline
Parliamentary Under-Secretary to the Minister of Revenue	**Agree** to include remedial amendments in the upcoming Bill not in scope [redacted] **Refer** a copy of this report to the Minister of Energy and Resources and the Minister of Revenue	25 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Graham Tubb	Principal Policy Advisor	s 9(2)(a) [redacted]
s 9(2)(a) [redacted]	Policy Advisor	

8 June 2021

Parliamentary Under-Secretary to the Minister of Revenue

Changes to the petroleum mining tax regime

Executive summary

Purpose

1. This report seeks your agreement to make remedial amendments to tighten the definition of decommissioning as it pertains to petroleum mining. These changes would be included in the omnibus tax Bill scheduled for introduction in August 2021.

2. not in scope

Decommissioning amendments

3. The decommissioning rules allow a petroleum miner to receive a refundable tax credit for any losses arising from certain expenditure on decommissioning petroleum mining assets (to the extent of income tax paid from the field). Only production wells, and certain exploration wells, are eligible for the refundable credit.

4. However, it is possible for exploration wells that were outside the policy intention to qualify for the credit, as the current scope of the decommissioning definition is wider than intended. We notified the Minister of Revenue of this issue in late 2020 (IR2020/510 refers) and we now make recommendations to resolve this issue.

5. Officials recommend remedial amendments to exclude exploratory wells that have not contributed to further production, and to ensure expenditure on wells only qualifies if a well has been permanently abandoned.

not in scope

Consultation

9. The Ministry of Business, Innovation and Employment was consulted on this report and agrees with its recommendations. The Treasury was informed of this report.

Next steps

10. If you agree to the decommissioning amendments, they will be included in the upcoming omnibus tax Bill that is scheduled for introduction in August 2021.

11. not in scope

Recommended action

We recommend that you:

12. **agree** to amend the definition of decommissioning in the petroleum mining rules:

    12.1 to narrow the scope of exploratory wells eligible for a refundable credit by excluding exploratory wells that have not contributed to further production;

    Agreed/Not agreed

    12.2 to specify that plugging and abandoning means permanently plugging and abandoning;

    Agreed/Not agreed

13. **note** that the amendments in recommendation 12 have a fiscal impact of zero as no decommissioning is expected to occur within the forecast period;

    Noted

14. **agree** to include the amendments in recommendation 12 in the next omnibus tax Bill, with application from the date of enactment of the Bill;

    Agreed/Not agreed

15. not in scope

16. **refer** a copy of this report to the Minister of Energy and Resources and the Minister of Revenue.

    Referred/Not referred

Graham Tubb
Principal Policy Advisor
Policy and Regulatory Stewardship

Dr Deborah Russell
Parliamentary Under-Secretary to the Minister of Revenue
/ /2021

Background

Introduction

17. This report seeks your agreement to progress two potential sets of changes to the petroleum mining tax regime:

    17.1 Remedial amendments to the definition of decommissioning in the Income Tax Act 2007. These are necessary to ensure that the availability of the refundable tax credit for decommissioning is consistent with the original policy intent. Subject to your agreement, these amendments would be included in the upcoming omnibus tax Bill.

    17.2 not in scope

18. Officials from Inland Revenue reported to the Minister of Revenue regarding the decommissioning issues in December 2020 (IR2020/510 refers). The Minister subsequently indicated that he would like to progress these changes and that any amendments should be prospective.

19. not in scope

Decommissioning amendments

Background

20. Once a petroleum miner ceases production from a well, the miner must decommission the well.[1] To the extent that this decommissioning expenditure results in a loss, the miner may be allowed a refundable credit. Without a refundable credit, a loss from decommissioning would be carried forward. This is problematic as there may not be future income to offset that loss against if production has finished. This makes the petroleum mining industry different to other industries that do not incur significant expenditure after income has ceased. The refundable credit ensures that the petroleum mining industry is not disadvantaged relative to other industries from a tax perspective.

21. Miners are generally allowed the credit for decommissioning production wells but not for expenditure on plugging and abandoning exploration wells. This is because expenditure on decommissioning exploration wells is similar to feasibility expenditure on an unsuccessful project, which may be deductible against current or future income but cannot be refunded against tax paid on previous taxable income.

Scope of eligible exploration wells

22. The decommissioning definition recognises that some exploration wells could have been used as part of the wider production process and so should be eligible for the refundable credit. To ensure this provision was limited to those exploration wells, it

[1] This includes plugging and abandoning the well, removing equipment, and removing installations and pipelines.

was constrained to plugging and abandoning exploration wells "together with a commercial well geologically contiguous with the exploratory well".

23. Further research has revealed the geologically contiguous requirement is much wider than was previously thought. This has resulted in exploration wells that are not used as part of the production process (and so not intended to qualify for the refundable credit) being able to access it.

24. Officials recommend narrowing the scope of exploration wells in the decommissioning definition by removing exploration wells that are geologically contiguous with a commercial well. Exploration wells that have been used as part of the wider production process in connection with a production well would still be eligible for the refundable credit under a different part of the decommissioning definition.

Meaning of plugging and abandoning

25. Plugging and abandoning is referred to several times in the definition of decommissioning. It is not a defined term in tax legislation and is only referred to in relation to petroleum mining decommissioning.

26. Plugging and abandoning was intended to mean permanent plugging and abandoning, as otherwise the well is not being decommissioned. However, it is possible that, under the current legislation, a petroleum miner could receive the refundable credit for expenditure on temporarily plugging and abandoning a well (which may happen for commercial reasons) so long as they meet the other decommissioning requirements.

27. Officials recommend making it explicit that plugging and abandoning means permanent plugging and abandoning.

not in scope

not in scope

Financial implications

Decommissioning amendments

38. Applying the change that officials recommend prospectively means that revenue lost as a result of the current wording since the provision was first implemented will not be recouped.

39. Officials do not anticipate any eligible petroleum decommissioning to take place within the next five years and consequently the change does not result in a fiscal gain within the forecast period. For that reason, it is not necessary to adjust the fiscal forecasts to account for the reduced revenue that could be expected as a result of the legislation's current wording. For the same reason, the change that officials recommend would not result in a fiscal uplift within the forecast period. However, the change would likely result in additional revenue when further petroleum decommissioning does take place.

not in scope

Administrative implications

42. Implementing any of the proposals outlined in this report is straightforward and will simply require communication to taxpayers and tax agents, as well as education for Inland Revenue staff. There are no systems changes required. Any implementation costs that arise can be met through baseline funding.

Consultation

43. MBIE was consulted on this report and agrees with its recommendations. The Treasury was informed of this report.

44. not in scope

Next steps

45. Subject to your agreement, the remedial amendments to the definition of decommissioning will be included in the upcoming omnibus tax Bill.

46. not in scope

47. We recommend that a copy of this report is referred to the Minister of Energy and Resources and the Minister of Revenue for their information.

not in scope

not in scope

not in scope

POLICY AND STRATEGY

Tax policy report: **Cabinet paper: Overseas donee status: Additions for the next omnibus taxation Bill, and extending the NZMMT-Le Quesnoy's sunset clause**

Date:	4 May 2021	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2021/200

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	21 May 2021
Minister of Revenue	**Agree** to recommendations **Approve** and **lodge** the attached paper to Cabinet Office	10am, 27 May 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Peter Frawley	Policy Lead	s 9(2)(a)
Brandon Sloan	Principal Policy Advisor	

4 May 2021

Minister of Finance
Minister of Revenue

Cabinet paper: Overseas donee status: Additions for the next omnibus taxation Bill, and extending the NZMMT-Le Quesnoy's sunset clause

Purpose

1. This report recommends you approve and lodge the attached paper seeking Cabinet Economic Development Committee's approval to:

   1.1 grant 11 New Zealand charities overseas donee status (IR2021/069 dated 23 February 2021 and IR2021/094, dated 4 March 2021 refers), and

   1.2 extend the sunset clause that applies to the New Zealand Memorial Museum Trust – Le Quesnoy's overseas donee status to 31 March 2029, with an option to extend by Order in Council (IR2021/147, dated 7 April 2021 refers).

2. We also recommend you agree that the fiscal impact for the proposal in 1.2 be funded as a pre-commitment to Budget 2022.

3. For the paper to be considered at Cabinet Economic Development Committee's meeting on 2 June 2021, it needs to be lodged by 10 am, 27 May 2021.

Background

4. On 7 April 2021 we reported to the Minister of Revenue on options to respond to a request from the Patron and Chair of the New Zealand Memorial Museum Trust – Le Quesnoy (the Trust) for an extension to a sunset clause that applies to its overseas donee status, which ends 18 March 2022 (IR2021/147 refers).

5. The Minister of Revenue directed officials to prepare a paper for Cabinet seeking its approval to extend the Trust's overseas donee status to 31 March 2029. We have amended an earlier Cabinet paper (IR2021/094, dated 4 March 2021) to include the proposed extension for the Trust's overseas donee status.

6. In addition to giving 11 New Zealand charities overseas donee status, the paper seeks Cabinet agreement to:

   6.1 Rescind Cabinet's earlier decision to the Trust's sunset clause ending on 18 March 2022 (CAB-18-MIN-0535 recommendation 6.1);

   6.2 Agree to extend the Trust's sunset clause to 31 March 2029, with the option for Cabinet to extend the end date by Order in Council;

   6.3 Agree that the fiscal cost of the extension be met as a pre-commitment to Budget 2022;

   6.4 Delegate to the Minister of Revenue, in consultation with the Minister of Finance, decisions regarding the design of the Trust's sunset clause in 6.2;

   6.5 Agree to include the relevant amendments in the omnibus taxation Bill scheduled for introduction in August 2021, with effect from 1 April 2021; and

6.6 Authorise the Minister of Revenue to inform the Chair of the Trust about Cabinet's decision.

Financial implications

7. Agreeing to extend the Trust's overseas donee status to 31 March 2029 has the following financial implications as shown in the table below. The financial implications for the Trust's current overseas donee status for 2020-21 and 2021-22 financial years are already in existing baselines (CAB-18-MIN-0535).

8. The revenue estimates are based on projections made by the Trust about the monetary donations it expects to receive for the forecast period. The expected fiscal cost to the end of the 2030-31 financial year is expected to be $7-8 million s 18(c)(i) . While the Trust's overseas donee status is proposed to end 31 March 2029, provision has been made for donors to the 2030-31 financial year for later filing taxpayers.

	Effect on tax revenue ($millions)					
Vote Revenue **Minister of Revenue**	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(0.750)	(1.000)	(1.000)	(1.000)
	2026–27	**2027–28**	**2028–29**	**2029-30**	**2030-31**	**2031-32**
	(1.000)	(1.000)	(1.000)	(0.750)	(0.250)	(0.000)

9. We recommend the financial cost of the extension be meet as a pre-commitment to Budget 2022. This is because:

9.1 The decision to extend the Trust's overseas donee status would amount to a policy change (as Cabinet previously agreed to provide only time-limited support) and so it would not be consistent with the financial management approach for the cost to flow-through as a forecast change.

9.2 The limited funds available in the scorecard would be best reserved for initiatives which improve the coherence, efficiency and fairness of the tax system.

9.3 The change does not affect the Crown's operating balance in the 2021/22 financial year, and so does not need to be charged against the Between-Budget Contingency.

9.4 It is, however, a suitable candidate for pre-commitment for Budget 2022, as the Trust requires certainty of funding prior to the announcement of Budget 2022.

Proactive release considerations

10. Officials recommend that the attached Cabinet paper should be proactively released without redaction following the introduction of the omnibus taxation bill scheduled for introduction in August 2021.

Consultation

11. The Treasury was consulted on the original report on funding options for the NZ Memorial Museum Trust – Le Quesnoy and on this paper. For the reasons stated in that report, officials do not support extending the Trust's overseas donee status, but recommend that, if Ministers do wish to do so, that it be funded through a precommitment against Budget 2022.

12. The Ministry of Foreign Affairs and Trade and the Ministry for Culture and Heritage have also been informed about this report and the attached Cabinet paper. Both agencies were consulted as part of Inland Revenue's original advice on whether to extend the sunset clause for the NZ Memorial Museum Trust – Le Quesnoy and they agreed with the Treasury and Inland Revenue that the Trust's request for an extension should be declined.

Next steps

13. If you agree to the recommendations in this report, we recommend you approve and lodge the attached paper with the Cabinet Office by 10am, Thursday 27 May 2021, for consideration at Cabinet Economic Development Committee's meeting on 2 June 2021.

14. A copy of this report and the attached Cabinet paper should be referred to the Minister of Foreign Affairs and Trade and the Minister for Arts, Culture and Heritage for their information.

15. A copy of this report and attached Cabinet paper should also be referred to the Department of the Prime Minister and Cabinet for their information.

Recommended action

We recommend that you:

(a) **Agree** to extend the sunset clause that applies to the New Zealand Memorial Museum Trust – Le Quesnoy overseas donee status to 31 March 2029, with the option to extend the end date by Order in Council.

Agree/Not agreed Agreed/Not agreed

(b) **Agree** that amendments giving effect to recommendation (a) be included in a taxation bill scheduled for introduction in August 2021, with effect from 1 April 2021.

Agree/Not agreed Agreed/Not agreed

(c) **Note** that the financial impact of recommendation (a) will result in the following adjustments to the Operating Balance:

	Effect on tax revenue ($millions)					
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(0.750)	(1.000)	(1.000)	(1.000)
	2026–27	**2027–28**	**2028–29**	**2029-30**	**2030-31**	**2031-32**
	(1.000)	(1.000)	(1.000)	(0.750)	(0.250)	(0.000)

Noted Noted

(d) **Agree** the that the financial impact of recommendation (a) be charged as a pre-commitment to Budget 2022.

Agreed/Not agreed Agreed/Not agreed

(e) **Approve** and **lodge** the attached paper to Cabinet Economic Development Committee for its meeting on 2 June 2021.

Approved and lodged/Not approved Approved and lodged/Not approved

(f) **Agree** to delay the release of the attached Cabinet paper, without redaction, and associated minutes until the omnibus Bill containing the amendments giving effect to recommendations in the paper is introduced in August 2021.

Agreed/Not agreed Agreed/Not agreed

(g) **Refer** a copy of this report to the Minister of Foreign Affairs and Trade and the Minister for Arts, Culture and Heritage for their information.

Referred

(h) **Refer** a copy of this report to the Department of the Prime Minister and Cabinet

Referred

Brandon Sloan
Principal Policy Advisor
Policy and Strategy, Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: R&D Tax Incentive: extending due dates

Date:	5 May 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/204

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Refer** this report to the Minister for Research, Science and Innovation	12 May 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Sam Rowe	Acting Policy Lead – Business & Entity	s 9(2)(a)
s 9(2)(a)	Senior Policy Advisor	

5 May 2021

Minister of Revenue

R&D Tax Incentive: extending due dates

Purpose

1. This report seeks your agreement to extend due dates for year one and year two Research and Development Tax Incentive (RDTI) applications. Extending the due dates will require amendments to the Tax Administration Act 1994 in the next tax omnibus Bill

Background

2. The RDTI came into effect in April 2019 and is intended to be a broad-based mechanism to support and incentivise R&D across the economy. There have been early issues for businesses trying to understand whether they are eligible for the RDTI. It is still a relatively new scheme which businesses are gradually becoming more familiar with.

3. Businesses have had to get used to the application process and eligibility criteria, which are different to the past grant-based R&D support. The Ministry of Business, Innovation and Employment (MBIE), Callaghan Innovation, and Inland Revenue have been working with businesses to understand and address their concerns. In particular, by reviewing guidance material, providing simple "how to" guides on the RDTI Hub website, and by Callaghan Innovation using their customer engagement specialists and primary relationship managers to inform and educate.

4. On 1 April 2021, refreshed guidance was published which clarifies what eligible R&D activity is. We have received some feedback from stakeholders that the updated guidance has generated renewed interest in applying for the RDTI among some businesses that otherwise had decided not to. However, many still require more time to understand how the refreshed guidance applies to their R&D activities.

5. Businesses with early (e.g., December) and standard (March) balance dates have had no, or very little, time to reconsider their eligibility based on the refreshed guidance material and to make an application by current due dates. For example, a business with a December balance date had until 7 February 2021 to apply for year two. Stakeholders, including the Research & Development Advisory Group and the Corporate Taxpayers Group, have been advocating for an extension of due dates.

Proposal

6. For the 2021 and later income years, to claim the RDTI, a business must apply for a "general approval" for each of its core R&D activities. This application must be made by the 7th day of the 2nd month after the end of the relevant income year. Significant performers[1] can apply for a "criteria and methodologies" (CAM) approval, which means they get approval for their programme of work without having to seek approval for each individual core activity. Eligible expenditure is then claimed in a "supplementary return" (R&D return) which is due 30 days after a taxpayer's normal income tax return for a year.

[1] Those with RDTI expenditure of greater than $2 million in a year.

7. Inland Revenue, MBIE, and Callaghan Innovation all agree that a one-off extension to due dates for year one supplementary returns and year two general approvals and CAMs is justifiable. Extending due dates would recognise the timing of the refreshed guidance and would further help businesses transition into what is still a very new regime.

8. We propose extending due dates for:

   8.1 Year one (2019-20 income year) supplementary returns[2] to 31 August 2021 for all businesses; and

   8.2 Year two (2020-21 income year) general approvals and criteria and methodologies (CAM) approvals to 31 August 2021 for all businesses (excluding those whose final application dates already fall after that date).

9. The extensions proposed largely mirror a recent decision by the Commissioner of Inland Revenue to exercise her discretion to extend the year one supplementary returns and year two CAM approvals[3]. However, these extensions only apply where COVID-19 has made it materially difficult to file on time. The proposal to extend due dates is to provide an unconditional extension to all businesses.

10. The COVID-19 extension provides varied dates based on the criteria under which the Commissioner can exercise her discretion. For simplicity, we propose one due date for all forms and returns. If a business has a late balance date which means their normal due date would be after 31 August 2021 then they would still be able to rely on this later due date.

11. The following table sets out the number of businesses that have enrolled for RDTI that have not yet submitted a year one or year two application. Businesses are able to enrol at any time before filing a general approval or supplementary return:

	No year one supplementary return filed	No year two general approval filed
Early balance date	72	99
Standard balance date	359	556
Late balance date	60	78
Total	**491**	**733**

12. This table shows that a significant number of businesses that have expressed interest in RDTI by enrolling, have not filed an application yet (although tax customers typically file very close to the due date, a trend we expect to see for RDTI returns as well).

13. Extending the due dates will require legislative amendments to the Tax Administration Act 1994.

[2] In year one businesses were not required to apply for a general approval.
[3] Year two general approvals were extended using the same power in September 2020.

Fiscal and administrative implications

14. There are no fiscal implications as the proposals fit within the policy intent of the scheme and cover businesses that were intended to be able to get RDTI credits from year 1. The current forecast cost for the RDTI is significantly greater than the actual cost to date.[4] The proposals would marginally close that gap between forecast and actual spend.

15. Amendments will be included in the next tax omnibus Bill scheduled to be introduced in the second half of the year. This Bill will contain annual rates and so would need to be enacted by 31 March 2022. This enactment date is after the current due dates and proposed extensions would have expired. However, the amendments would have retrospective effect to ensure that those that submit before the new due dates will be able to have their applications processed. Inland Revenue will be able to collect and consider applications submitted before the legislative change but will be prevented from formalising final approval of applications submitted in reliance of the extension until the Bill is passed. In the interim, discussions could take place with applicants.

Consultation

16. The Treasury, MBIE and Callaghan Innovation have been consulted and support the proposals.

17. The Research and Development Group Advisory Group and the Corporate Taxpayers Group have been consulted on, and support, the proposals.

Next steps

18. If approved, these amendments will be included in the next tax omnibus Bill scheduled to be introduced in the second half of the year.

19. It will be important to communicate the intention to extend due dates, subject to Parliamentary process, with businesses as soon as possible. This will give those that are unable to meet the existing legislated due dates the opportunity to submit by the proposed new due dates in anticipation of the amendments.

20. We recommend that this communication be made at the ministerial level to give maximum level of comfort possible to affected businesses. If you agree, we will liaise with your office regarding the preparation of this announcement.

Recommended action

We recommend that you:

21. **agree** to extend the due date for 2019-20 (year 1) supplementary returns to 31 August 2021;

    Agreed/Not agreed

22. **agree** to extend the due dates for 2020-21 (year 2) general approvals and criteria and methodologies approvals to 31 August 2021;

    Agreed/Not agreed

[4] Note that the majority of the large R&D companies have yet to file their final returns.

23. **agree** to include the necessary amendments to the Tax Administration Act 1994 in the next tax omnibus Bill with retrospective application to the relevant income year;

    Agreed/Not agreed

24. **agree** to announce the extension of due dates to businesses; and

    Agreed/Not agreed

25. **refer** a copy of this report to the Minister of Research, Science and Innovation for their information.

Sam Rowe
Acting Policy Lead – Business & Entity
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Local authority taxation – dividends and deductions**

Date:	24 May 2021	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2021/210

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	31 May 2021
Minister of Revenue	**Agree** to recommendations	31 May 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Peter Frawley	Policy Lead	s 9(2)(a)
Craig Phillips	Principal Policy Advisor	
s 9(2)(a)	Policy Advisor	

24 May 2021

Minister of Finance
Minister of Revenue

Local authority taxation – dividends and deductions

Executive summary

1. This report seeks your agreement to include measures to improve the integrity of local government taxation in an omnibus Cabinet paper for the tax Bill scheduled to be introduced in August 2021.

2. A local authority is tax-exempt on all income (primarily rates) derived from its core activities (such as water supply). All income derived by a local authority from a council-controlled organisation (CCO) is taxable to the local authority to prevent profit shifting from these CCOs to exempt local authorities.

Problem definition

Dividends

3. Taxing local authorities on dividends derived from their CCOs is inconsistent with similar entities, such as the Crown and State enterprises, charities, and other wholly-owned companies.

4. Officials consider that the current treatment of taxing dividends derived by a local authority from a wholly-owned CCO is an overreach. This is because a dividend is not a deductible expense of a CCO so there are no profit shifting concerns. Therefore, we recommend treating these dividends as exempt income of a local authority.

Deductions

5. Current law allows local authorities certain deductions for expenditure not incurred in deriving assessable income (such as corporate gift deductions and certain interest deductions). Access to these deductions allow local authorities to have tax losses despite being largely exempt from tax, and these losses are being used to effectively shelter their CCOs from tax.

6. Officials recommend preventing local authorities from accessing the corporate gift deduction and limiting interest deductions to expenditure incurred in deriving assessable income. This will help prevent local authorities from transferring their tax-exempt status to their CCOs contrary to the policy intent.

Imputation

7. Current tax rules allow some local authorities to satisfy their income tax liabilities on dividends without using the full amount of imputation credits attached to those dividends. This results in the local authority having excess imputation credits. The local authority can then convert the excess imputation credits to a tax loss and offset this loss against the net income of its CCO group. This allows the local authority to effectively shelter its CCOs from tax.

8. Officials propose preventing a local authority from converting unused imputation credits to a tax loss.

9. Local authorities in consolidated groups can access the group's imputation credit account (ICA) and the local authority can credit to the group's ICA all imputation

credits attached to dividends it derives from a CCO. These credits are then available for reuse by CCOs within the group. This is not an intended policy outcome.

10. We consider that the imputation settings for a local authority that is a member of a consolidated group should be amended to ensure a credit does not arise to the group's ICA for imputation credits attached to a dividend derived by a local authority from a CCO.

11. Consequential amendments are required to the consolidated group rules to ensure that they don't override any provisions relating to the deductibility of local authority expenditure.

12. We consider the recommended changes as a package. Only implementing some of the proposals risks undermining the integrity of the rules relating to local government taxation.

Financial implications

13. Exempting dividends derived by a local authority from a wholly-owned CCO from income tax will be fiscally neutral.

14. 38% of all company donations from 2016-17 to 2019-20 were made by local authorities. Over this time period, the yearly average total donations made by local authorities was $47.0m, with a tax effect of $13.2m.

15. Inland Revenue has limited data on the breakdown of which specific interest deductions are being claimed by local authorities and is unable to quantify the financial impact of the interest deduction proposals.

16. For the 2019-20 income year, the tax value of local authorities converting excess imputation credits to a tax loss was $10.6m.

17. The aggregate fiscal impact of the recommended changes is a revenue gain of approximately $23.8m per year.

18. We consider that the proposed measures are required to support the integrity of local government taxation. Although this could be seen as impacting on local government funding, officials consider it is important to ensure that the tax settings for local government are correct from a tax policy perspective.

Next steps

19. If you agree to the recommendations in this report, the next step will be to include these changes in an omnibus Cabinet paper seeking policy approval for inclusion in the tax Bill scheduled to be introduced in August 2021.

Recommended action

We recommend that you:

1. **agree** to treat dividends derived by a local authority from a wholly-owned CCO, port company, subsidiary of a port company, or energy company as exempt income;

   Agreed/Not agreed Agreed/Not agreed

2. **agree** that local authorities should not be allowed a deduction for charitable or other public benefit gifts made to donee organisations;

   Agreed/Not agreed Agreed/Not agreed

3. **agree** that a local authority should only be allowed a deduction for interest on money borrowed for the purpose of deriving assessable income or to acquire shares in a CCO if the CCO is a council-controlled trading organisation;

   Agreed/Not agreed Agreed/Not agreed

4. **agree** that local authorities may not convert unused imputation credits to a tax loss;

   Agreed/Not agreed Agreed/Not agreed

5. **agree** that a credit should not arise to a consolidated group's imputation credit account for imputation credits attached to a dividend derived by a local authority from a CCO;

   Agreed/Not agreed Agreed/Not agreed

6. **agree** that, if recommendations 1 to 5 are agreed to, these changes be included in the tax Bill scheduled for introduction in August 2021; and

   Agreed/Not agreed Agreed/Not agreed

7. **agree** that the revenue increase from these changes should be added to the tax policy scorecard; and

   Agreed/Not agreed Agreed/Not agreed

8. **note** the following changes as a result of the decisions in the recommendations above, with a corresponding impact on the operating balance and/or net core Crown debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 and outyears**
Crown Revenue and Receipts: Tax Revenue	-	23.800	23.800	23.800	23.800
Total Operating	-	(23.800)	(23.800)	(23.800)	(23.800)

   Noted Noted

9. **refer** a copy of this report to the Minister for Local Government for her information.

Referred/Not referred | Referred/Not referred

Peter Frawley
Policy Lead
Policy and Regulatory Stewardship
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

Background

1. The current tax policy settings for local authorities stem from local government reforms of the late 1980s. Broadly speaking, since these reforms the tax settings for local authorities have been as follows:

   1.1 A local authority is tax-exempt on all income (primarily rates) derived from its core activities (such as water supply).

   1.2 A local authority is taxable on all income (e.g. rent, management fees and dividends) derived from a Council-controlled organisation (CCO) or a port company (trading subsidiaries of a local authority). A CCO itself is taxable.

2. The original policy rationale for treating all income a local authority derives from a CCO as taxable was to prevent profit shifting from these taxable entities to exempt local authorities.

3. Without this provision, income from a CCO could effectively be extracted tax-free by the local authority charging the CCO excessive rental or management fees, which would be deductible to the CCO but not taxable to the local authority due to its tax-exempt status.

4. Despite the above treatment, structures can be entered into which allow local authorities to effectively transfer the benefit of their tax-exempt status to their taxable CCOs.

Dividends

5. Taxing local authorities on dividends derived from their CCOs is inconsistent with similar entities, such as the Crown and State enterprises, or charities. Inter-corporate dividends paid between New Zealand resident companies are exempt where there is 100% common ownership. This provision is switched off for dividends derived by local authorities.

6. Officials consider that the current treatment of taxing dividends derived by a local authority from a wholly-owned CCO is an overreach. As a dividend is not a deductible expense of a CCO, there are no profit shifting concerns with treating the dividend as exempt income of the local authority. Therefore, officials recommend treating these dividends as exempt income of a local authority.

7. Dividends derived by CCOs from other CCOs within the same wholly-owned group are not excluded from the inter-corporate dividend exemption, and are exempt income of the CCO.

Deductions

8. Broadly, a local authority should be allowed deductions for any expenditure incurred to the extent to which the expenditure is incurred in deriving assessable income – *not* exempt income.

9. However, current law allows local authorities certain deductions for expenditure not incurred in deriving assessable income, such as corporate gift deductions and certain interest deductions. We have identified that access to these deductions has allowed local authorities to have tax losses despite being largely exempt from tax, and these losses are being used to effectively shelter their CCOs from tax.

10. To improve the integrity of local government taxation, officials recommend preventing local authorities from accessing the corporate gift deduction and limiting

interest deductions to expenditure incurred in deriving assessable income. This will help prevent local authorities transferring their tax-exempt status to their CCOs.

Corporate gift deductions

11. Changes to the application of the corporate gift deduction provision from the 2008-09 income year allowed companies a deduction for charitable donations to donee organisations, only limited by the company's net income. It was not clear that specific consideration was given at the time to whether local authorities should have access to this provision, but technically they can as they fall within the company definition in the Income Tax Act.

12. The corporate gift deduction is intended to encourage companies to redirect part of their otherwise taxable income to charitable, benevolent, philanthropic or cultural purposes. The corporate gift deduction should not apply to primarily exempt entities like local authorities. In particular, it is inappropriate to provide a tax subsidy for donations made by local authorities whose legislated purpose is to promote the social, economic, environmental, and cultural well-being of communities. Allowing local authorities to access the corporate gift deduction effectively allows them to transfer their exempt status to their taxable CCOs, contrary to the policy intent.

13. Officials recommend that local authorities should not be allowed to access the corporate gift deduction.

Interest deductions

14. A local authority should only be allowed a deduction for interest on money borrowed for the purpose of deriving assessable income. Local authorities are also currently allowed deductions for interest on money borrowed to acquire shares in a CCO that is part of the same local authority group. These deductions are not limited to expenditure incurred in deriving assessable income. Officials recommend that these deductions be limited to interest on loans to acquire shares in a *council-controlled trading organisation* (CCTO).

15. A CCTO is a CCO that operates a trading undertaking for the purpose of making a profit. This amendment will ensure that a local authority cannot shelter taxable income streams with deductions available for capitalising a CCO that is not carrying on a business to make a profit.

16. A local authority can also enter into a hedge (a financial arrangement) in relation to a loan taken out by a CCO. A base price adjustment is a wash-up calculation for when a financial arrangement matures, is remitted, sold or otherwise transferred. The adjustment is a final calculation to ensure that all the income or expenditure in relation to the financial arrangement has been brought to tax. A negative base price adjustment is deemed to be deductible expenditure.

17. Under current rules, a local authority can receive a deduction for a negative base price adjustment for a financial arrangement in a non-trading CCO, that is, a CCO not undertaking income-generating trading activity. Officials recommend limiting a local authority's access to deductions for negative base price adjustments to financial arrangements involving a CCTO of the local authority. This will ensure a nexus exists between the deduction and the income-generating trading activity.

Imputation

18. Current tax rules allow some local authorities to satisfy their income tax liabilities on dividends without using the full amount of imputation credits attached to those dividends (e.g by using corporate gift deductions). This results in the local authority having excess imputation credits. The local authority can then convert the excess

imputation credits to a tax loss and offset the tax loss against the net income of its CCO group. This allows the local authority to shelter its CCOs from tax.

19. The purpose of converting imputation credits to a tax loss was part of the original design of the imputation system, as unused imputation credits are not refundable to the shareholder. The policy intent was to provide a mechanism for taxpayers in tax loss to carry forward the benefit of unused imputation credits to satisfy future income tax liabilities. It was never intended that an exempt shareholder would be able to convert unused imputation credits to a tax loss.

20. Officials propose preventing a local authority from converting unused imputation credits to a tax loss.

21. Similar to a final natural person shareholder, local authorities cannot operate an imputation credit account (ICA). However, through the consolidated group rules, local authorities in consolidated groups can access the group's ICA. Consequently, the local authority can credit to the group's ICA imputation credits attached to dividends it derives from a CCO. These credits are then available for reuse by CCOs within the group. This is not an intended policy outcome.

22. We consider that the imputation settings for a local authority that is a member of a consolidated group should be amended to ensure a credit does not arise to the group's ICA for a dividend derived by a local authority from a CCO.

Financial implications

23. Currently, officials expect that dividends derived by a local authority from a CCO are fully imputed. A fully imputed dividend would not result in a marginal tax effect for the local authority, as the attached imputation credit would satisfy the income tax liability on that dividend. Therefore, exempting dividends derived by a local authority from a wholly-owned CCO from income tax will be fiscally neutral.

24. A significant proportion of corporate gift deductions are claimed by local authorities – they accounted for 38% of all company donations from 2016-17 to 2019-20. Over this time period, the average yearly total donations made by local authorities was $47.0m, with a tax effect of $13.2m.

Table 1: Company gift donations from 2016-17 to 2019-20

		2016-17	2017-18	2018-19	2019-20	Total	Four-year average	Four-year average tax effect
Local authorities	Value ($m)	40.7	54.4	55.1	37.7	187.9	47.0	13.2
	% of total	38%	33%	46%	38%	38%	38%	38%
All other companies	Value ($m)	66.5	112.7	64.6	60.4	76.1	76.1	21.3
	% of total	62%	67%	54%	62%	62%	62%	62%
Total value		**107.2**	**167.1**	**119.7**	**98.1**	**492.1**	**123.0**	**34.4**

25. Inland Revenue has limited data on the breakdown of which specific interest deductions are being claimed by local authorities and is unable to quantify the financial impact of the interest deduction proposals.

26. For the 2019-20 income year, the tax value of local authorities converting excess imputation credits to a tax loss was $10.6m.

28. The aggregate fiscal impact of the changes is a revenue gain of approximately $23.8m per year, with a corresponding impact on the operating balance:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 and outyears**
Crown Revenue and Receipts: Tax Revenue	-	23.800	23.800	23.800	23.800
Total Operating	-	(23.800)	(23.800)	(23.800)	(23.800)

29. The revenue increase from these changes should be added to the tax policy scorecard.

Risks

30. The revenue gain from the proposed changes will be a funding cost to local government. The changes will increase the tax liabilities of CCOs, which will result in lower dividends to councils.

31. Officials consider that the proposed measures are necessary to support the integrity of local government taxation. Although such measures could be seen as impacting on local government funding, officials consider it is important to ensure that the tax settings for local government are correct from a tax policy perspective.

Administrative implications

32. The proposed changes to local government taxation will have negligible on-going administration and compliance costs.

Consultation

33. The Treasury was informed of this report and agrees with its contents.

34. The Department of Internal Affairs was consulted and is broadly supportive of the proposals, however they note that the impact on councils will be uneven.

35. Inland Revenue officials facilitated a workshop with the local government sector in 2019 that focused on the taxation of income – in particular dividends – paid to a local authority from a CCO, and the application of the loss grouping rules to local authorities, including those in consolidated groups.

36. We also undertook targeted consultation with the sector in the first half of 2021. The proposal to treat dividends derived by a local authority from a CCO as exempt income was widely supported.

37. As part of this targeted consultation officials also sought feedback on an earlier broader proposal to deny loss grouping between a local authority and its CCOs. Officials accepted the sector's arguments that local authorities can have some genuinely deductible expenditure and should be entitled to offset any losses arising from this expenditure against the income of other taxable entities within their group. The current proposal to deny corporate gift deductions and limit certain interest deductions has a narrower ambit.

Next steps

38. If you agree to the recommended changes to local government taxation proposed in this report, the next step will be to include these changes in an omnibus Cabinet paper seeking approval for amendments to be inserted in the tax Bill scheduled to be introduced in August 2021.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Remedial items for inclusion in the 2021 omnibus tax bill**

Date:	19 May 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/218

Action sought

	Action sought	Deadline
Parliamentary Under-Secretary to the Minister of Revenue	**Agree** to recommendations **Refer** a copy to the Minister of Revenue	3 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

19 May 2021

Parliamentary Under-Secretary to the Minister of Revenue

Remedial items for inclusion in the 2021 omnibus tax bill

Executive summary

1. This report seeks your agreement to make amendments to several Inland Revenue Acts for inclusion in the omnibus tax bill scheduled for introduction in August 2021.

2. The changes recommended in this report are remedial in nature and are intended to ensure the relevant tax law is consistent with the policy intent. The remedials seek to maintain the coherence and integrity of the tax system. The recommended changes do not give rise to any material:

   a. revenue or other fiscal cost;

   b. compliance or administrative costs; or

   c. systems or technology implications.

3. Given the above and that the proposed remedial amendments are consistent with current policy frameworks and settings, officials do not consider that Cabinet approval is necessary.

Recommended action

We recommend that you:

a. **Indicate** in the body of this report where you have agreed or not agreed with a recommendation

Indicated

b. **Agree** that, except where specified, the approved recommendations outlined in this report will apply from the date of enactment.

Agreed/Not agreed

c. **Agree** that approved amendments are included in the omnibus tax bill scheduled for introduction in August 2021

Agreed/Not agreed

d. **Refer** a copy of this report to the Minister of Revenue

Referred

Paul Fulton
Principal Policy Advisor
Policy and Strategy

Dr. Deborah Russell
Parliamentary Under-Secretary to the Minister of Revenue
/ /2021

Purpose of this report

4. The purpose of this report is to seek your agreement to remedial amendments to the Income Tax Act (ITA 2007), the Tax Administration Act 1994 (TAA 1994), the Goods and Services Tax Act 1985, the KiwiSaver Act 2006, Child Support Act 1991, and the Taxation (KiwiSaver Student Loans, and Remedial Matters) Act 2020 for inclusion in the next omnibus tax bill scheduled to be introduced in August 2021.

5. The changes recommended are designed to align the relevant legislation with the original policy intent or operational practice and do not involve alterations to policy settings. In our view, reference to Cabinet is not required.

6. None of the changes recommended in this report have fiscal implications.

7. Unless otherwise stated all recommendations should apply from the date of enactment of the omnibus tax bill.

Amendments to the Income Tax Act 2007

Amendments to the main home exclusion from the 10-year bright-line test

8. The 10-year bright-line test excludes a property which is the owner's main home for the entire period it is owned. However, the main home exclusion allows an owner to use the property otherwise than as their main home for periods of less than 12 months. This 12-month "buffer" is intended to provide leeway for moving in or out of a property, or, for example, where the taxpayer rents out their home while they are overseas for a short period. If the property is not used as a main home for a period of more than 12 months, the main home exclusion no longer applies.

9. However, the income calculation provision disregards any period of main home use and periods of 12 months or less in which the property is not used as a main home. The combined effect of these provisions is that a person is only taxed on gains made during periods of more than 12 months where the property is not used as their main home. We recommend the following amendments:

   9.1 *Two in two years rule:* A person is only allowed to use the main home exclusion twice in a 2-year period. As mentioned above, the income calculation provision disregards any period of main home use as well as periods of 12 months or less where the property is not used as the owner's main home. Officials recommend an amendment to ensure that main home periods and non-main home periods of 12 months or less are included for the purposes of calculating income where the main home exclusion does not apply because the person has used it twice in a 2-year period;

   9.2 *Construction of a main home in a period longer than 12-months*: If a taxpayer purchases land to build their main home and the building process takes more than 12 months, the taxpayer will be required to pay tax on gains made during that period (if sold within the bright-line period), despite the fact the property is only ever used as the taxpayer's main home. Officials recommend an amendment to address this issue;

9.3 *Periods of more than 12 months*: Officials recommend an amendment to put beyond doubt that a taxpayer is prevented from claiming the main home exclusion where they had a period of more than 365 days that did not meet the main home criteria (subject to a carve out for the construction of a main home mentioned above); and

9.4 *Multiple periods of less than 12 months*: A further amendment is recommended to clarify that a person may still qualify for the main home exclusion where they have multiple periods of less than 12 months that do not meet the main home criteria.

Recommendations

Agree to amend the main home exclusion from the 10-year bright-line test to:

- ensure main home periods and non-main home periods of 12 months or less are included for the purposes of calculating income where the main home exclusion does not apply because the person has used it twice in a 2-year period.

Agreed/Not agreed

- ensure a person building their main home does not have to pay tax on any gains made while the property is being built if the build process is longer than 12 months.

Agreed/Not agreed

- ensure a person cannot claim the main home exclusion where they had a period of more than 365 days that did not meet the main home criteria (subject to the above recommendation, if agreed to).

Agreed/Not agreed

- clarify that a person may still qualify for the main home exclusion where they have multiple periods of less than 12 months that do not meet the main home criteria.

Agreed/Not agreed

Residential rental property and foreign currency loans

10. Deductions for expenditure on a residential rental property are ring-fenced. This means that they can only be offset against residential income, which is defined as income derived from residential land.

11. When a foreign currency loan finances a residential rental property, any deductions relating to the loan, including foreign exchange losses, will be ring-fenced. However, foreign exchange gains in a subsequent period are not included in the definition of residential income, meaning the previous ring-fenced deductions cannot be offset against them.

12. Ministers have agreed to exclude foreign currency loans over foreign property from the interest limitation proposals so this ring-fencing issue will not be addressed by those proposals.

13. We recommend that the definition of residential income be amended to include any income from a foreign currency loan used to finance a residential rental property. This would allow ring-fenced deductions in relation to the loan in any earlier income year to be offset against any income from the loan. This amendment should apply to income years beginning after the date of enactment.

Recommendations

Agree that the definition of residential income be amended to include any income from a foreign currency loan that is used to finance a residential rental property.

Agreed/Not agreed

Agree that the recommendation above apply for income years beginning after the date of enactment.

Agreed/Not agreed

Refund of foreign tax credits

14. Where a person claims a foreign tax credit for income tax paid overseas and is then refunded the foreign tax paid, they must repay the credit to the Commissioner within 30 days of receiving either the refund or relevant notice of assessment.

15. However, where four years have passed since the end of the tax year in which the taxpayer provided the tax return, the Commissioner is unable to amend the taxpayer's income tax assessment which included the credit for the foreign tax paid. There is no suitable mechanism for a taxpayer to return the foreign tax credit.

16. We recommend that the value of the grossed-up foreign tax which has been refunded be included in the recipient's taxable income for the year the corresponding tax credit was received. This will prevent taxpayers being exposed to use of money interest (UOMI) (which would occur if the credit were reversed in the year it was claimed).

Recommendations

Agree to refunds of foreign tax credits outside of the four-year time bar being grossed up and added to taxable income in the year the refund is received.

Agreed/Not agreed

Agree that the recommendation above apply for the 2021-22 and later income years.

Agreed/Not agreed

Defining KiwiSaver and the ACC levy as ancillary taxes

17. The Commissioner may not amend an assessment to increase the amount assessed or decrease the amount of a net loss if four years have passed since the return was filed.[1] Neither can a taxpayer claim a refund for an overpayment of tax after four years have passed. Both time bars provide certainty within the tax system.

[1] There are a limited number of exceptions to this rule, most notably that it does not apply in instances of fraud.

18. Officials have identified instances where the PAYE rules are not applied to KiwiSaver or ACC levy deductions. While the definition of "tax" in the TAA 1994 includes these two deduction categories, the rules which govern the time limit on refunds for ancillary taxes such as PAYE in the ITA 2007 do not. This means there is no time bar on the reassessment and refund of KiwiSaver or ACC levy deductions. This is inconsistent with the treatment of other amounts in the tax system.

19. We recommend that deductions for KiwiSaver and the ACC levy are defined as "ancillary taxes" to bring them within the scope of the existing time bar provisions in the TAA 1994 and ITA 2007.

Recommendation

Agree that deductions for KiwiSaver and the ACC levy be added to the definition of "ancillary tax".

Agreed/Not agreed

Ability to refund ancillary taxes

20. Under the ITA 2007, refunds of overpaid tax cannot occur unless the tax was paid through the taxpayer filing an assessment. Under current law, however, the filing of an ancillary tax return is not an assessment. This means that there is currently no legislative ability to refund ancillary taxes. This is contrary to the policy intent underlying the refund rules.

21. We recommend an amendment to deem the filing of an ancillary tax return an assessment for the purposes of the ITA 2007. This will allow amounts of overpaid ancillary tax to be refunded.

Recommendation

Agree to allow Inland Revenue to refund amounts of overpaid ancillary tax from 1 April 2022.

Agreed/Not agreed

Electing into the securitisation regime

22. A securitisation occurs where a company (referred to as the originator) which owns income-producing assets (e.g. trade debts) transfers those assets to a special purpose vehicle (SPV). The SPV then borrows from third parties using the income producing assets as collateral and pays the borrowed funds to the originator as the purchase price of the assets. Securitisations can have commercial benefits compared with other funding mechanisms, such as risk management and lower cost of funding.

23. The ITA 2007 contains a specific regime for securitisations. The originator of debt assets is treated as still owning them for tax purposes following their transfer to a SPV. This allows the SPV to be tax neutral (i.e. have no net tax obligations), which is important for its credit rating. The securitisation regime requires the originator, rather than the SPV, to satisfy all the tax obligations relating to the transferred debts. This means the originator must withhold and pay any non-resident

withholding tax (NRWT) or approved issuer levy (AIL) on the interest payments by the SPV.

24. An issue has arisen concerning the date for election into the securitisation regime. Currently, this election is made by the originator when it files its tax return for the relevant year. The election then has effect for that year, so that for NRWT and AIL (which are usually payable monthly) the election effectively applies retrospectively to the start of the income year. This was done to spare the need for a separate election process, and so to reduce compliance costs. However, for the SPV, relying on the originator to elect into the securitisation regime in its tax return for the year exposes the SPV to the risk of unpaid tax plus interest and penalties if the election is not made. This risk is unacceptable to many in the private sector, who require complete certainty from day one that the SPV will not be exposed to tax liabilities. This has led to the securitisation regime being underused.

25. We recommend allowing the originator to make a separate written election from the commencement of the securitisation arrangement. This would result in a small increase in compliance and administration costs, as a small number of elections will need to be made and processed by Inland Revenue each year.

Recommendation

Agree to allow originators to elect into the securitisation regime from the commencement of their securitisation arrangements, rather than waiting until they file their income tax return.

Agreed/Not agreed

Amending memorandum accounts when making transfers from previous years

26. Generally, when taxpayers transfer tax from a previous period to the current period, the transfer is recorded in the memorandum account for the current year. However, Inland Revenue's Tax Counsel Office has recently advised that taxpayers who transfer tax between tax types (or other taxpayers) must seek the amendment of memorandum accounts which have already been filed if the tax transfers occur in a tax year before the tax year in which the transfer is requested. This creates undue administrative and compliance costs.

27. We recommend an amendment to allow taxpayers to record the transfer of tax in their memorandum account for the current year. This proposed amendment would also extend to Māori authority credit accounts. This would prevent taxpayers from having to seek the amendment of accounts filed in prior years.

Recommendation

Agree that taxpayers should not need to amend a previous year's memorandum account when transferring tax from one year to another and transferring between tax types in prior years.

Agreed/Not agreed

Updating the definition of "election day worker" to reflect changes in the electoral process

28. Election day workers are taxed through the PAYE system at a flat rate of 17.50 cents in the dollar (plus ACC earner's levy). The rationale for this flat rate of PAYE was to simplify withholding for the Electoral Commission in dealing with a temporary work force.

29. The current definition of election day worker applies to "work done or services rendered immediately before, on, or immediately after the day on which the election or poll is held". However, this definition has been outpaced by both the growth in advance voting and the fact that many election workers work throughout the voting period.

30. We recommend that the definition of "election day worker" be updated to reflect the changes in the electoral process. The Electoral Commission has been consulted on this proposal and agrees with the recommendation.

Recommendation

Agree to update the definition of "election day worker" to ensure all election day and advance voting workers are captured by the special PAYE rate.

Agreed/Not agreed

Share-for-share exchanges and ACDA

31. A share-for-share exchange involves one company (an acquirer) purchasing shares in another company (a target) in exchange for issuing shares in itself to the target's shareholders.

32. Ordinarily, when shareholders subscribe for shares in a company, this creates an amount of available subscribed capital (ASC) in the company equal to the subscription amount. ASC can be distributed tax free to shareholders in qualifying circumstances. However, when a target's shareholders subscribe for an acquirer's shares in a share-for-share exchange the ASC created in the acquirer is limited to the target's ASC instead of the subscription amount.

33. The purpose of this ASC limitation is to prevent retained earnings from being distributed to an acquirer's shareholders tax free as ASC following the share-for-share exchange. This is appropriate because a distribution of retained earnings is ordinarily taxable.

34. However, if the acquirer subsequently on-sells the target shares to a third party, the ASC limitation results in a portion of the capital gain derived from the sale being treated as a taxable dividend if the sale proceeds are distributed on the liquidation of the acquirer. This is an unintended outcome that discourages commercially sensible restructuring such as share-for-share exchanges, the on-sale of target companies acquired through a share-for-share exchange, and the liquidation of acquirer companies that have subsequently on-sold the target companies.

35. To address this issue, we recommend that where an acquirer calculates its Available Capital Distribution Amount (ACDA) from the on-sale of shares in a target that was acquired through a share-for-share exchange, the cost price of the target shares should equal the target's ASC at the time of the share for share exchange. This change will increase the ACDA by the amount of the ASC limitation

that applies at the time of a share-for-share exchange. ACDA can be distributed tax free to shareholders on liquidation.

36. We recommend this change should apply to distributions upon the liquidation of an acquirer from the date of enactment. This approach will cover distributions arising from the proceeds of the sale of a target before this date.

Recommendation

Agree that the cost of shares for calculating ACDA when a company is sold should be equal to the ASC of those shares if the company was acquired in a share-for-share exchange that was subject to the ASC limitation.

Agreed/Not agreed

Fringe benefit tax – unclassified benefits by associates

37. Employers are required to pay fringe benefit tax (FBT) on unclassified benefits except where the benefits they provide come within the *de minimis* exemption of less than $300 per individual employee per quarter, and $22,500 of total benefits in four consecutive quarters.

38. The meaning of "employer" in this section is expanded to include persons "associated" with the employer within the relevant period. This requires the employer to consider unclassified benefits provided to its employees by the employer and by an associate of the employer. However, it also includes unclassified benefits paid by all associates to that associate's employees.

39. This was intended to capture the scenario in which, a group of companies with a common ownership arranged for one of the companies to provide unclassified benefits to the employees of another company within the group. However, the issue with this approach is that it is not always possible or practical for a company to know or enquire into the affairs of an associated company before deciding whether the *de minimis* applies.

40. We recommend excluding unclassified benefits paid by an associate which is not part of a commonly owned group to that associate's employees from the calculation of the *de minimis* concession. A commonly owned group is two or more companies where a person or group of people hold at least 66% of the voting interests or market value of each company.

Recommendations

Agree to exclude unclassified benefits from an associate that is not part of a commonly owned group to the associate's own employees from the de minimis calculation.

Agreed/Not agreed

Agree that the recommendation above apply from 1 April 2022.

Agreed/Not agreed

Restricted transfer pricing – terms over five years

41. The Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 amended the restricted transfer pricing rules so an adjustment to the term of cross-border related borrowing longer than 5 years was not required, provided the term was less than the weighted average term of third party debt.

42. As with other exclusions in the restricted transfer pricing rules, this only applies where the cross-border related borrowing is less than four times the third-party debt. This prevents a small amount of expensive third-party debt being used to justify a large amount of expensive related party debt.

43. However, this restriction was inadvertently applied on a loan-by-loan basis. This would allow a taxpayer to use this exception for multiple smaller related party loans when it would not be available for a single related party loan of the same total amount.

44. We recommend the 5-year exception in the restricted transfer pricing rules be available only where total cross-border related borrowing is less than four times the third-party debt. This should apply retrospectively from 1 July 2018 to align with the original introduction of this exception.

Recommendations

Agree that the 5-year exception to the restricted transfer pricing rules be available only where the total cross-border related borrowing is less than four times the third party debt.

Agreed/Not agreed

Agree that the recommendation above apply from 1 July 2018.

Agreed/Not agreed

Tax pooling and early payment discount settings

45. Four amendments are recommended to the rules which govern the interaction between tax pooling and the early payment discount (EPD) so that the intended policy outcomes are achieved. The recommended changes are to:

    45.1 Allow the use of tax pooling to mitigate use of money interest (UOMI) in the first year as a provisional taxpayer;

    45.2 allow purchased tax pooling funds to qualify for the EPD (as currently, only own deposited funds qualify);

    45.3 restore the link between subsections RP 19(2) and RP 19(3) which has become disjointed; and

    45.4 extend the definition of small-business person to include the shareholder of a look-through company so they can qualify for the EPD.

46. The proposed amendments provide clarity to the rules and increase the integrity of the tax system by improving coherence and reducing compliance costs for taxpayers.

Recommendation **Agree** to remedial amendments to the rules around tax pooling and the early payment discount to ensure they achieve the intended policy outcome. Agreed/Not agreed

Clarify the operation of the business continuity test in part-year situations

47. The business continuity test (BCT), which was enacted in the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021, allows companies to carry forward tax losses to future years if they have a change in ownership as long as there is no major change in the nature of the business activities of the company.

48. Some technical issues have arisen since the legislation was passed relating to part-years. It was intended that tax losses incurred in an income year in which a breach of ownership continuity occurs could be considered for carry-forward under the new BCT to the extent they are incurred post-ownership breach. However, the legislation technically does not allow this in all the circumstances in which it was intended.

49. In addition, for companies relying on the BCT that have a breach in business continuity, the legislation does not currently allow companies to offset tax losses incurred in earlier years against a profit for the pre-breach part-year.

50. Amendments to address these issues will align the legislation with the original policy intent. It is proposed these amendments apply from the 2020-21 income year (i.e., from the same application date as the BCT).

Recommendation **Agree** to remedial amendments to ensure that the BCT operates appropriately in part-year situations Agreed/Not agree **Agree** that above amendments will apply for the 2020-21 and later income years Agreed/Not agreed

Amendments to the Tax Administration Act 1994

Adding new tax types to START

51. As part of Inland Revenue's Business Transformation, new tax types have been gradually incorporated into Inland Revenue's START platform. Casino duty, lottery duty and totalisator duty[2] were transitioned into START at stage 4 of Business Transformation.

52. These tax products now need to be included in the definition of "START tax type" in section 3 of the TAA 1994. This will ensure that any interest which has accrued on these tax products is cancelled where the taxpayer makes payment following

[2] This is a duty payable by the Racing Industry Transition Agency on betting profits for all racing and sports betting.

the issue of a statement or assessment. We recommend this amendment apply from 1 March 2021 to align with the date these products were shifted into START.

Recommendations
Agree to include Casino duty, lottery duty and totalisator duty as START tax types
Agreed/Not agreed
Agree that this change apply from 1 March 2021
Agreed/Not agreed

Commissioner's remedial powers – disputable decisions

53. The Commissioner has remedial powers which can be used in limited circumstances to better align tax laws with the intended policy outcomes. These powers provide the Commissioner with the discretion to grant exemptions from compliance with provisions of the Inland Revenue Acts and allow the Commissioner to shorten (or dispense with) a period of public consultation before an exemption comes into force if it is considered urgent.

54. Decisions made by the Commissioner under these powers should not be subject to the statutory disputes process, which is designed for resolving disagreements about the application of tax laws to taxpayers' assessments. We recommend an amendment to provide that the Commissioner's use of her remedial powers is not subject to the statutory disputes process.[3] This is consistent with other, similar, administrative discretions provided to the Commissioner under the Inland Revenue Acts.

Recommendation
Agree that the Commissioner's decisions use of her remedial powers should not be subject to the statutory disputes process
Agreed/Not agreed

Whether challenge notice required after partial acceptance of proposed adjustments

55. A person who disagrees with an assessment is generally required to go through the statutory disputes process. On completion of the statutory disputes process, either an amended assessment is issued (which reflects adjustments proposed by the taxpayer and which are agreed to by the Commissioner) or a challenge notice is issued informing the person that no amended assessment will be issued.[4]

56. However, it is currently unclear whether a challenge notice needs to be issued where, following the end of the statutory disputes process, the Commissioner issues an assessment which reflects some, but not all, of a taxpayer's proposed adjustments. We recommend an amendment to clarify in these circumstances that the Commissioner does not need to issue a challenge notice to mark the end of

[3] The Commissioner's use of her remedial powers remains open to review and challenge through other mechanisms such as judicial review or complaint to the Regulations Review Committee.

[4] A taxpayer may choose to then initiate challenge proceedings with the High Court or the Taxation Review Authority.

the statutory disputes process, and that challenge proceedings can be initiated on the basis of the amended assessment which the Commissioner has issued.

Recommendation

Agree that the Commissioner does not need to issue a challenge notice where she provides an amended assessment at the end of the disputes process.

Agreed/Not agreed

Investment income – custodial institutions: definition of "end investor"

57. Custodial institutions play an important role in the financial system. They act as a conduit between the payer of investment income and the ultimate owner of that income.

58. The investment income rules place the obligation for withholding tax and reporting to Inland Revenue on the custodial institution which pays or transfers investment income to an end investor. An end investor can be resident or non-resident and may be a person or an entity.

59. It is intended that, in all cases, the New Zealand custodian should withhold tax and report to Inland Revenue when it pays or transfers investment income to an end investor. Where the income passes to a non-resident custodial institution, the reporting and withholding obligations are relaxed.

60. Some custodians operate their New Zealand business as a fixed establishment in New Zealand rather than as a local subsidiary. However, the New Zealand fixed establishment is not a separate legal person from the overseas parent. As fixed establishments are excluded from the definition of an end investor, 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 and should be remedied.

61. The amendment should apply from 1 April 2020 to align with the introduction of the relevant custodian's reporting and withholding rules.

Recommendations

Agree that the definition of an end investor for non-resident custodial institutions should include non-resident entities with a fixed establishment in New Zealand.

Agreed/Not agreed

Agree that the recommendation above apply from 1 April 2020.

Agreed/Not agreed

Investment income information: aligning filing date with payment date for six monthly payers of investment income

62. Prior to 1 April 2020, taxpayers who met *de minimis* criteria were able to file and pay resident withholding tax (RWT), non-resident withholding tax (NRWT) and approved issuer levy (AIL) on a six-monthly basis. However, from 1 April 2020

these taxpayers are required to file every month. In our view, this creates an undue compliance burden for taxpayers.

63. While a variation has been granted for the 2020-21 and 2021-22 income years to allow a six-monthly filing option consistent with the rules that applied prior to 1 April 2020, we recommend reinstating the *de minimis* six month filing criteria on a permanent basis from 1 April 2022.

Recommendation

Agree that taxpayers who meet the *de minimis* criteria should be able to file and pay their investment income on a six-monthly basis from 1 April 2022.

Agreed/Not agreed

Repeal of redundant provisions related to FIRST

64. The penalties and relief regimes in the TAA 1994 contain provisions to align with how penalties and interest were determined by Inland Revenue's earlier computer system, FIRST. As new tax products were progressively introduced into Inland Revenue's new computer system, START, these provisions were amended to also include the way Inland Revenue's START system calculated penalties and interest where this differed from the treatment in FIRST.

65. As Inland Revenue's tax products will all shortly be contained within START, the provisions which specifically applied to FIRST are no longer required and will soon be redundant. We recommend the provisions which relate to FIRST are repealed and the relevant sections are redrafted.

Recommendation

Agree to repeal and redraft the provisions in the penalties and relief regimes which relate to Inland Revenue's former computer system, FIRST.

Agree/Not agreed

Non-active estates return filing

66. A non-active trust is a trust without any source of income. Trustees of non-active trusts are not required to file an income tax return. Testamentary trusts may also qualify for an exemption from this requirement where they are non-active. However, this exemption is confined to trusts and does not extend to the executors and administrators of non-active estates.

67. This creates compliance costs for executors or administrators who are required to file tax returns where no income has been received. This is particularly onerous for simple estates (i.e., those with few assets and minimal income) and life interest estates (i.e., where a spouse has been provided the right under a will to occupy the family home for life).

68. We recommend the legislation be amended to allow administrators and executors of non-active estates to obtain an exemption from the obligation to file annual returns.

Recommendation

Agree to provide executors and administrators of non-active estates the ability to apply for an exemption from the obligation to file annual tax returns

Agreed/Not agreed

Information sharing with ACC and MBIE

69. Inland Revenue is currently developing Approved Information Sharing Agreements (AISAs) with the Accident Compensation Corporation (ACC) and the Ministry of Business, Innovation, and Employment (MBIE). These two AISAs will replace existing information sharing provisions in the TAA 1994.

70. However, the Privacy Act 2020 prevents two provisions for sharing the same information from being in place at the same time. This means that the relevant information sharing provisions of the TAA 1994 will need to be repealed as the two AISAs come into force.

71. As we cannot say exactly when the new AISAs will take effect, we recommend enabling the relevant information sharing provisions of the TAA 1994 to be repealed on a date set by Order in Council ("OIC").

Recommendation

Agree to enable the relevant provisions of the TAA 1994 relating to information sharing with MBIE and ACC to be repealed by OIC.

Agreed/Not agreed

Definitions of Sensitive Revenue Information and Revenue Information

72. The TAA 1994 recognises various categories of information, with different levels of confidentiality attaching to each. However, uncertainty has arisen over the interpretation of the terms:

    72.1 "under or for the purposes of" in the definition of Revenue Information; and

    72.2 "person or entity" in the definition of Sensitive Revenue Information

73. If a court took a broad interpretation of these terms, all information held by the Commissioner (including even non-tax related information) would need to be treated as Sensitive Revenue Information. This would negatively affect the interpretation and application of the new confidentiality rules.[5] These rules are not intended to impose restrictions on information held by Inland Revenue with no real connection to either the Commissioner or to Inland Revenue's responsibility for tax law and the administration of the tax system.

74. We recommend the interpretation of the terms above be clarified to prevent them being applied too broadly. We recommend this apply retrospectively from 18

[5] As part of the modernisation of the TAA, provisions governing the collection, use and disclosure of information were brought together in a new subpart and rewritten in a more modern, navigable style. This subpart replaced sections 16 to 19 with clarified and consolidated powers governing the Commissioner's collection, use and disclosure of information.

March 2019 to align with the date the new confidentiality rules were enacted. Practically this will have no implications for taxpayers or their information.

Recommendations

Agree that the TAA 1994 be amended to clarify the definitions of "under or for the purposes of" and "person or entity".

Agreed/Not agreed

Agree that the above recommendation will apply from 18 March 2019.

Agreed/Not agreed

Amendments to the Goods and Services Tax Act 1985

Deduction notices under the Goods and Services Tax Act 1985

75. Inland Revenue uses deduction notices to recover outstanding tax debts. However, Inland Revenue cannot use a deduction notice to recover outstanding GST debts from persons who are (i) members of unincorporated bodies, and/or (ii) persons no longer registered for GST. This means that deduction notices are more limited for GST debt than for other tax types (which was not intended).

76. We recommend amendments to enable Inland Revenue to use deduction notices to collect outstanding GST debts from:

    76.1 members of unincorporated bodies (e.g. partners in partnerships and trustees of trusts); and

    76.2 persons who are no longer registered for GST, but who accumulated GST debt while registered.

77. This would ensure consistency in the rules which govern the use of deduction notice notices across all tax types.

Recommendation

Agree to allow Inland Revenue to use deduction notices to collect outstanding GST debts from members of unincorporated bodies and persons who are no longer registered for GST but accumulated GST debt while registered.

Agreed/Not agreed

Amendments to the KiwiSaver Act 2006

Preventing circularity of KiwiSaver employer contributions

78. Employers are required to pay all employer KiwiSaver contributions to the Commissioner. Where an employee opts out of KiwiSaver, Inland Revenue is required to refund that money to the employer.

79. However, in some situations, an employer may be required to pay employer KiwiSaver contributions to Inland Revenue even though the employer is aware the

employee has opted out of KiwiSaver (and that the payment they are about to make will be returned to them). This creates unnecessary costs for employers and Inland Revenue.

80. We recommend an amendment to prevent this circularity in KiwiSaver contributions from arising.

Recommendation

Agree that an employer should not be required to pay outstanding KiwiSaver employer contributions where the employer is aware that this would produce a circularity in payment.

Agreed/Not agreed

Applying employer KiwiSaver contributions to employer debt where the member opts-out

81. Inland Revenue is required to refund KiwiSaver employer contributions where an employee has opted out of KiwiSaver.

82. We recommend an amendment to allow Inland Revenue to either refund the KiwiSaver employer contribution or offset it against other employer tax debt. This would be subject to two important caveats:

82.1 Off-setting an employer contribution against an employer's tax debt would only occur with the employer's agreement; and

82.2 Off-setting would not occur where the value of the KiwiSaver Employer Contribution represented a salary sacrifice on the part of the employee.[6]

Recommendation

Agree that, where an employee opts-out of KiwiSaver, Inland Revenue may either refund an employer KiwiSaver contribution or offset it against other employer tax debt, provided the employer agrees; and the employer KiwiSaver contribution does not represent a salary sacrifice by the employee.

Agreed/Not agreed

Delaying KiwiSaver provider clawbacks

83. Each month, Inland Revenue "claws back" approximately 100,000 transactions from KiwiSaver providers. These claw backs arise primarily from adjustments to incorrect employee information lodged with Inland Revenue by employers. For example, an employer may omit to include a single employee in the relevant employer information, revoke the entirety of the employee information and re-lodge it with the previously omitted employee now included.

84. Inland Revenue is required by legislation to immediately "claw back" the funds from the provider in relation to the first piece of incorrect employee information lodged by the employer even though these funds will have to be repaid to the provider once the correct information is filed.

[6] To apply the KiwiSaver Employer Contribution to the employer's tax debt in this situation would reduce the value of employee's remuneration, thereby making the employee worse off.

85. We recommend an amendment to allow Inland Revenue to wait 7 days before commencing the "claw back" procedure in relation to information filed by employers.

Recommendation

Agree to allow Inland Revenue to wait 7-days before commencing the "claw back" of transactions from KiwiSaver providers.

Agreed/Not agreed

Amendments to the Child Support Act 1991

Administrative amendments to the Child Support Act 1991

86. The recently enacted Child Support Amendment Act 2021 contains measures to improve the child support scheme. Following enactment, officials identified a group of minor and technical remedial changes to the principal Act that are needed to give full effect to the policy intent of the recent amendments. These are:

86.1 *End-of-year reconciliation*: The definition of the new "reconciliation period" needs to be changed to enable backdated estimations to be squared up accurately.

86.2 *Declining an estimation*: An amendment is needed to allow subsequent backdated estimations to be declined because the period has ended and will be squared up.

86.3 *Notification of family circumstances at assessment:* The provision should include a requirement that the Commissioner be satisfied the circumstances existed when the initial assessment was made, and that supporting evidence may be required.

86.4 *Time bar for reassessments of child support: The* exception to the time bar for dual liability with another jurisdiction should be amended to apply on the assessment of a liability rather than its payment.

86.5 *Applications for exemption from paying child support:* The exemption for long term periods of illness should include the requirement to provide evidence that demonstrates the individual has an inability to engage in paid work.

86.6 *Offsetting of child support payments between parents:* The relevant provision should be extended to include voluntary assessments in addition to formula assessments.

86.7 *Child expenditure tables:* The words "or the oldest three" are no longer needed in the mixed age table in Schedule 3 of the Child Support Act 1991.

86.8 *Simplification of write off rules:* A minor cross reference error should be corrected.

Recommendation

Agree to the minor and technical remedial changes to the Act noted above.

Agreed/Not agreed

Amendments to the Taxation (KiwiSaver Student Loans, and Remedial Matters) Act 2020

Removal of power to repeal clause relating to information sharing with the Serious Fraud Office

87. During 2019 and 2020, officials were developing the Serious Crime Approved Information Sharing Agreement ("AISA"). The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020, enacted in March 2020, contains provisions that enable clause 7 of Schedule 7 of the TAA 1994 to be repealed, and section 143D of the TAA 1994 to be amended (to remove a cross-reference to clause 7), on a date to be set by OIC.

88. This was intended to allow the AISA to be implemented correctly and avoid conflicting provisions (i.e. clause 7 and the AISA) being in place at the same time. However, it has since become apparent that the AISA and clause 7 each allow for the sharing of different information. As both mechanisms serve a purpose, the repeal of clause 7 no longer necessary.

Recommendation

Agree to remove the ability to repeal clause 7 of Schedule 7, and amend section 143D, of the TAA 1994 by Order in Council.

Agreed/Not agreed

Administrative implications

89. The changes recommended in this report clarify and remove uncertainties around the application of the Inland Revenue Acts. They reduce administrative costs by aligning the legislation with the policy intent.

90. The recommended changes are not expected to have any material systems or technical impacts.

Consultation

91. The Treasury has been informed of the contents of this report.

Next steps

92. We recommend that the proposed amendments be included in the next omnibus taxation Bill, scheduled for introduction in August 2021.

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **Introducing an open-ended time limit on information sharing for COVID-19 response purposes**

Date:	10 May 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/220

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	21 May 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Martin Neylan	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

10 May 2021

Minister of Revenue

Introducing an open-ended time limit on information sharing for COVID-19 response purposes

Purpose

1. This report seeks your agreement to remove the current time bar on sharing information with other agencies for COVID-19 related activities.

Background

2. In March 2020, the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 introduced several urgent powers to enable government agencies to respond to the COVID-19 crisis.

3. These powers were related to the delivery of several key projects designed to support New Zealanders through the economic uncertainty that the pandemic introduced. Inland Revenue administered several of these initiatives as well as supporting other agencies in the delivery of their own projects. For this work to be possible, Inland Revenue needed to share information with other agencies.

4. Tax legislation requires Inland Revenue staff to keep taxpayer information confidential unless a specific legislative exception authorises the disclosure. There are several existing exceptions in tax legislation enabling Inland Revenue to share information with other agencies.[1]

5. Inland Revenue did not have any existing information sharing arrangements, or found the existing arrangements were not flexible enough, to allow the required sharing to occur with several relevant agencies. Consequently, an emergency provision was introduced to the Tax Administration Act 1994 (TAA) that enabled Inland Revenue to share information with other agencies for the delivery of COVID-19 specific initiatives.[2]

6. The information sharing provision includes a time limit, meaning it ceases to be in effect once 24 months have passed from the date of the clause commencing. The provision is currently due to expire in March 2022. This time limit can be extended by Order in Council (OiC) which must be made before the expiry of the 24-month period and requires the recommendation of the Minster of Revenue. This allows the Government to continue sharing information, if required, in response to COVID-19 after the initial two-year period.

Information sharing is critical to the COVID-19 response

7. To respond to the immediate and pressing challenges presented by COVID-19, agencies had to suddenly work together in entirely new ways. Information was shared under existing powers and agreements where possible (for example,

[1] Other agencies do not have equivalent requirements around secrecy, they share information with Inland Revenue under the Privacy Act 1993.
[2] Schedule 7, clause 23B. These agencies are all Government departments, the New Zealand Police, the Accident Compensation Corporation, Kāinga Ora–Homes and Communities and Callaghan Innovation.

information was shared under an existing Agreed Information Sharing Arrangement (AISA) with MSD for delivering the COVID-19 Income Relief Payment).

8. This said, existing information sharing provisions were not sufficient to ensure agencies could establish initiatives quickly enough to be effective. The delivery of several key projects relied on the emergency information sharing provision, including:

- The Small Business Cashflow (Loan) Scheme (SBCS) – information is shared with MSD to administer this scheme.
- The Wage Subsidy – information is shared with MSD to administer this scheme.
- The development and monitoring of COVID-19 related policies – information is shared with the Treasury to undertake this reporting.
- Providing targeted information about COVID-19 to businesses – information is shared with MBIE to enable targeted communication.

9. Without the ability to share information under the emergency information sharing provision, these initiatives would have been less effective, costly, slower to establish or even not possible to deliver in a timely manner.

Revisiting the information sharing provision is now appropriate

10. The economic impacts of COVID-19 will outlast the pandemic itself by several years. Mitigating these impacts will continue to require focussed initiatives from across government, with information sharing critical to effectiveness.

11. In December 2020, the Government agreed to a resurgence support package to be delivered. This package includes support such as a resurgence wage subsidy, leave subsidy scheme and short-term absence payment, amongst others. Similarly, in November 2020, Cabinet agreed to extend the SBCS for a further 3 years, with applications now due to close on 31 December 2023.

12. The unpredictability around an outbreak of COVID-19 and the form this might take means that the ability to quickly reinstate these or establish similar measures remains critical.

13. With the provisions for information sharing due to exceed their current 24-month time limit on 17 March 2022, it is timely to revisit this to ensure Inland Revenue's continued involvement in the delivery of COVID-19 related initiatives.

Audit activity will start to increase

14. As loans made under the SBCS are currently required to be repaid within 5 years, and the scheme has been in place less than a year and a half, we do not yet have a strong understanding of challenges likely to emerge around repayments. This information sharing will become more important as loans start to become due and more extensive activities around recovery and audit are likely to be required.

15. s 18(c)(i)

16. s 18(c)(i)

17. s 18(c)(i) [redacted] Eligibility for the Wage Subsidy was used to gauge eligibility for the SBCS and so where fraud is identified in an application for the SBCS, it is highly likely that fraud is also involved for that business' Wage Subsidy application also. Inland Revenue would not be able to share information on fraud with MSD without current information sharing provisions and so cases may not be identified.

18. s 18(c)(i) [redacted]

19. Not being able to share this information would mean that both Inland Revenue's and other agencies' ability to administer repayments and perform audit functions would also be limited. This could reduce the scheme amounts repaid or recovered.

Removing the time limit

20. The initial two-year period for the information sharing provisions were the result of balancing the need for information with considerations of proportionality and best practice as promoted by the Office of the Privacy Commissioner. This was agreed at the start of the outbreak where quick decisions on limited detail were needed and choices were made with due caution.

21. Officials are now proposing that the time limit be removed from the COVID-19 information sharing provisions. This will future-proof these powers, ensuring agencies can share needed information throughout the entire life cycle of the pandemic and the initiatives that support New Zealand's recovery.

22. Having an open-ended time limit on these provisions will not remove needed limitations on information sharing. The reason for this is that they will continue to be tied specifically to the delivery and administration of the relevant COVID-19 related initiatives. The provisions are therefore inherently self-limiting in the powers they provide.

23. Although there are a number of other checks and balances in place to ensure information sharing under this power is appropriate and proportional, such as being controlled by prescriptive Memorandums of Understanding, it should be noted that removing the existing time bar is to remove one of these safeguards. We do not consider this a significant increase in risk for the reason outlined above but it is appropriate to note.

24. Such an amendment will reduce the administrative cost of such information sharing, as an OiC will no longer need to be created every few years and support the ongoing integrity of COVID-19 initiatives.

Scale and impact

25. Around 100,000 businesses have received a loan under the SBCS, representing around $1.6 billion lent so far. Without a mechanism to share needed information with MSD, Inland Revenue's ability to support the administration of the scheme would be limited.

26. Over $13 billion was paid out as part of the Wage Subsidy scheme (though some has since been returned). Should there be a significant resurgence of COVID-19 in New Zealand, it is likely that similar amounts would be involved for any wage subsidy scheme, depending on the scale and duration of the outbreak.

Consultation

27. The Office of the Privacy Commissioner has been consulted and do not take issue with the proposal to remove the time limit for the reason outlined in paragraph 22.

28. The Treasury, Ministry of Business, Innovation and Employment and the Ministry for Social Development have been consulted in the preparation of this report.

Next steps

29. Should you agree, officials will include an amendment to remove the current time limit from this provision in the next omnibus tax bill due to be introduced in late August 2021. You will be provided with an omnibus Cabinet paper to lodge with LEG that includes this amendment in May/June 2021.

30. As the current information sharing provision is due to expire on 17 March 2022, and the next available revenue bill is not due to pass until the end of March 2022, it is appropriate to extend the information sharing provision by OiC in the interim.

31. Officials will draft a Cabinet paper and make an OiC to extend the existing time limit on information sharing for COVID-19 related initiatives.

Recommended action

We recommend that you:

32. **Agree** to remove the current information-sharing time limit on COVID-19 related initiatives.

    Agreed/Not agreed

33. **Agree** to Inland Revenue providing drafting instructions to the Parliamentary Council Office to draft an Order in Council in accordance with the above recommendation.

    Agreed/Not agreed

34. **Agree** to officials preparing a Cabinet paper seeking the removal of the current information sharing time limit and approving the submission of the Order in Council to the Executive Council.

    Agreed/Not agreed

Martin Neylan
Principal Policy Advisor
Policy and Strategy

Hon David Parker
Minister of Revenue
/ /2021

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Cabinet paper – Measures for inclusion in 2021 omnibus tax Bill

Date:	2 June 2021	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2021/247

Action sought

	Action sought	Deadline
Minister of Finance	**Approve** and **lodge** the attached Cabinet paper with the Cabinet Office	10 am, Thursday 24 June 2021
Minister of Revenue	**Approve** and **lodge** the attached Cabinet paper with the Cabinet Office	10 am, Thursday 24 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

2 June 2021

Minister of Finance
Minister of Revenue

Cabinet paper – Measures for inclusion in 2021 omnibus tax Bill

1. This report asks you to refer the attached Cabinet paper to the Cabinet Office by 10 a.m. Thursday 24 June 2021 so that it may be considered by Cabinet Economic Development Committee (DEV) at its meeting on Wednesday 30 June 2021.

2. The attached Cabinet paper seeks Cabinet's agreement to amendments concerning:

   2.1 Local authority taxation: dividends and deductions

   2.2 Changes to the fair dividend rate foreign currency hedges rules

   2.3 Use of tax pooling to satisfy a backdated tax liability

   2.4 Removal of the sunset clause on COVID-19 information sharing power

   2.5 Penalising the sale or possession of sales suppression software

3. Of the proposals that Treasury's Regulatory Impact Analysis Team has determined require a regulatory impact assessment (RIA):

   3.1 A RIA has been provided in connection with the proposed penalisation of the sale or possession of sales suppression software; and

   3.2 The RIAs in relation to Local Authority Taxation: dividends and deductions and the Use of taxation to satisfy a backdated tax liability will be provided before the lodgement of the Cabinet paper.

Background

4. We note that you agreed to progress the following policy measures:

   4.1 *Local authority taxation: dividends and deductions:* In report IR2021/210 the Minister of Finance and Minister of Revenue agreed to a package of measures to amend the tax rules for dividends and deductions for local authorities. These changes will improve the integrity of local government taxation and help prevent local authorities from transferring the benefit of their tax-exempt status to their council-controlled organisations.

   4.2 *Fair dividend rate foreign exchange hedges rules:* In report IR2021/112 the Minister of Revenue agreed to a series of technical amendments to the fair dividend rate foreign currency hedges (FDR FX hedges) rules. These amendments will allow taxpayers to apply the rules from a practical perspective and give effect to Parliament's intended purpose of facilitating effective after-tax hedging.

   4.3 *Use of tax pooling to satisfy a backdated tax liability:* In report IR2021/073 the Minister of Revenue agreed to allow the use of voluntary disclosures when there is no original assessment. This change will simplify tax settings and incentivise voluntary disclosures, improving compliance.

   4.4 *Removal of sunset clause on COVID-19 information sharing power:* In report IR2021/220 the Minister of Revenue agreed to the removal of a current time limit on legislation that enables information sharing for COVID-19 related initiatives. Removing the time limit will prevent the need for the legislation to be extended periodically via Order in Council, reducing administrative costs, whilst retaining appropriate checks and balances on the information shared under the provision.

4.5 *Sales suppression software:* In report IR2021/123, the Minister of Revenue agreed to introduce penalties for production, sale, acquisition or possession of sales suppression software.

5. The next step in the policy process is for you to present these proposals to Cabinet.

Timing change for local government fiscal impact

6. Since reporting on 24 May 2021, officials have revised the timing of the fiscal impact of the local government proposals. If these proposals are enacted, the first returns filed by local authorities after these changes will be filed too late to be accounted for in the 2022/23 fiscal year. However, the aggregate impact across the five-year period is unchanged.

	$m – increase/(decrease)				
	2020/21	**2021/22**	**2022/23**	**2023/24**	**2024/25 and outyears**
Originally reported impact on tax revenue (IR2021/210)	-	-	23.800	23.800	23.800
Revised impact on tax revenue	-	-	-	47.600	23.800
Revision	**-**	**-**	**(23.800)**	**23.800**	-

Next steps

7. The Cabinet paper needs to be lodged with the Cabinet Office by 10am on Thursday 24 June 20201 for consideration by the Cabinet Economic Development Committee on Wednesday 30 June 2021.

Recommended action

We recommend that you:

1. **Approve** and **lodge** the attached Cabinet paper and Regulatory Impact Assessment to the Cabinet Office by 10:00am Thursday, 24 June 2021 for the Cabinet Economic Development Committee to consider at its meeting on 30 June 2021.

Approved and lodged/Not approved Approved and lodged/Not approved

2. **Agree** to proactively release the attached Cabinet paper associated minutes and key advice papers within 30 working days of the introduction of the Bill.

Agreed/Not agreed Agreed/Not agreed

Paul Fulton
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

POLICY AND STRATEGY

Tax policy report: **Remedial and GST policy items with fiscal implications for inclusion in the 2021 omnibus taxation Bill**

Date:	10 June 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/248

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to the recommendations	25 June 2021
Minister of Revenue	**Agree** to the recommendations	25 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

In Confidence

10 June 2021

Minister of Finance
Minister of Revenue

Remedial and GST policy items with fiscal implications for inclusion in the 2021 omnibus taxation Bill

Executive summary

1. This report seeks your agreement to make amendments to the Income Tax Act 2007, the KiwiSaver Act 2006 and the Goods and Services Tax Act 1985, for inclusion in the omnibus taxation Bill scheduled for introduction in August 2021.

2. The changes to the Income Tax Act and the KiwiSaver Act recommended in this report are remedial in nature and are intended to ensure the relevant tax law is consistent with the policy intent, and assist in maintaining the coherence and integrity of the tax system. The recommended changes do give rise to a material:

    - compliance or administration costs; or
    - systems or technology implications.

3. However, as the proposed remedial amendments are consistent with current policy frameworks and settings, officials consider that Cabinet approval is not necessary.

4. This report also includes policy changes to the Goods and Services Tax Act 1985. These changes have already been agreed to by the Minister of Revenue (IR2021/138 refers). As we recommend the fiscal cost of these items be added to the Tax Policy Scorecard, these also need to be approved by the Minister of Finance before a paper can be considered by Cabinet.

Recommended action

We recommend that you:

a. **Indicate** in the body of this report where you have agreed or not agreed with a recommendation.

Indicated Indicated

b. **Agree** that, except where specified, the approved recommendations outlined in this report apply from the date of enactment.

Agreed/Not agreed Agreed/Not agreed

c. **Agree** that approved recommended amendments are included in the omnibus tax bill scheduled for introduction in August 2021.

Agreed/Not agreed Agreed/Not agreed

Paul Fulton
Principal Policy Advisor
Policy and Strategy

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

Purpose of this report

5. This report seeks your agreement to a range of remedial amendments to the Income Tax Act 2007 and the KiwiSaver Act 2006 as well as policy changes to the Goods and Services Tax Act 1985. These will be included in the next omnibus tax Bill, scheduled for introduction August 2021.

6. The remedial changes recommended are designed to align the legislation with the policy intent and operational practice, and do not involve alterations to policy settings. Therefore, we consider that reference to Cabinet is not required.

7. Additionally, a Cabinet paper for the GST policy changes has already been approved by the Minister of Revenue. However, we seek approval from the Minister of Finance to add these items to the Tax Policy Scorecard.

8. Unless otherwise stated, all recommendations should apply from the date of the enactment of the omnibus tax Bill.

Amendments to the Income Tax Act 2007

Amendment to the restricted transfer pricing rules

9. The restricted transfer pricing (RTP) rules (which are a subset of the general transfer pricing rules) require taxpayers to adjust the terms of cross-border related borrowing, so they align with the arm's length conditions that would be agreed to, and interest that would be paid, to a third party in a comparable transaction. The RTP rules are applied before the general transfer pricing rules are used to price the interest.

10. When interest is denied under the transfer pricing rules, the additional amount above the arm's length amount is treated as a deemed dividend. In some circumstances, the RTP rules deny an additional amount of interest above the arm's length amount (due to uncommercial terms or conditions being ignored).

11. As the legislation does not contemplate interest that is less than an arm's length amount being disallowed, the difference between the arm's length interest and the allowable interest under RTP rules retains its status as interest (albeit as interest which is non-deductible to the borrower). This results in the amount of denied interest and the deemed dividend not matching.

12. We recommend the amount of a deemed dividend be determined by the comparing the actual amount of interest paid with the amount calculated under the RTP rules.

13. There is a small fiscal cost for this remedial due to non-resident withholding tax no longer being collected on the difference between the arm's length interest and the allowable interest under RTP rules (as it will be reclassified from interest to a dividend so different withholding rates apply). This cost can be funded by the Tax Policy Scorecard. The fiscal effect of this recommendation may be expressed as follows:

In Confidence

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 & outyears**
Tax Revenue: Non-resident withholding tax	0.000	(0.030)	(0.200)	(0.200)	(0.200)
Total operating	**0.000**	**0.030**	**0.200**	**0.200**	**0.200**

Recommendations

Agree the amount of a deemed dividend be determined by comparing the actual amount of interest paid with the amount calculated under the RTP rules.

Agreed/Not agreed Agreed/Not agreed

Note this recommendation will have the fiscal effect set out in the table above.

Noted Noted

Agree the recommendation above apply for the 2022-23 and later income tax years.

Agreed/Not agreed Agreed/Not agreed

Agree that this fiscal effect can be accounted for on the Tax Policy Scorecard.

Agreed/Not agreed Agreed/Not agreed

Reducing the early payment discount rate

14. The early payment discount (EPD) was intended to encourage early payment of provisional tax to relieve the financial strain arising from a taxpayer having to pay both terminal and provisional tax in the second year of business.

15. Currently, the EPD rate is set at 6.7%. This rate was established when the EPD was first introduced in 2005 and was set slightly above the deposit rate of major trading banks at the time. The underlying policy intent was to ensure there was an incentive for taxpayers to use the money to pay provisional tax rather than deposit it in a bank. With major banks now offering deposit rates of less than 1%, the EPD rate of 6.7% produces a significant windfall for those who qualify for the discount.

16. We recommend the EPD rate be reduced and indexed to the Use of Money Interest (UOMI) credit rate (currently 0.0%) plus 200 basis points, which varies in line with market rates. This will prevent a windfall for qualifying taxpayers while preserving the incentive to pay provisional tax.

17. Currently, the EPD has an average fiscal cost of $370,000 per year. The change recommended above will reduce the EPD rate from 6.7% to 2.0%, resulting in a predicted fiscal saving of $385,000 in the first year following introduction, as follows:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Tax Revenue: Other persons	0.000	0.000	0.385	0.410	0.436
Total operating	**0.000**	**0.000**	**(0.385)**	**(0.410)**	**(0.436)**

Recommendations

Agree to reduce the EPD rate and index it to the UOMI credit rate plus 200 basis points.

Agreed/Not agreed Agreed/Not agreed

Note this recommendation will have the fiscal effect set out in the table above.

Noted Noted

Agree that this fiscal effect can be accounted for on the Tax Policy Scorecard.

Agreed/Not agreed Agreed/Not agreed

Corporate spin-outs

18. A corporate spin-out involves the shareholders in a parent company (the original parent) acquiring the shares in a subsidiary of the original parent (the spun-out company). There are special rules in the Act to address shareholding continuity problems of the subsidiaries of a spun-out company (the spun-out subsidiaries).

19. These problems arise due to a concession in the general shareholder continuity rules under which a company and its subsidiaries, that are ultimately held by shareholders with interests of less than 10%, are deemed to be held by a single person. An unintended consequence of this rule is that a different person is treated as owning the spun-out company and its subsidiaries before and after the spin-out, even though the ultimate shareholding has not actually changed. This can result in a breach of shareholder continuity, leading to forfeiture of losses and imputation credits.

20. The special rules address these problems for the subsidiaries of the spun-out company by deeming the interests in the spun-out subsidiaries prior to a spin-out, that are ultimately held by shareholders with interests of less than 10%, to be held by the same single person before and after the spin-out.

21. However, the special rules do not address the shareholding continuity problems of the spun-out company itself. We recommend that the special rules are updated to address these problems for the spun-out company in the same way that the spun-out subsidiary problems have been resolved.

22. There are also some technical problems with applying the special rules to a consolidated group or consolidated imputation group instead of a company, which could lead to the same kind of shareholding continuity issues for these groups when

there has been no change in ultimate ownership. We recommend that the special rules are also updated to address shareholding continuity issues for these groups.

23. These changes should apply from the date the 2021 omnibus tax Bill is introduced.

24. Corporate spin-outs rarely occur, and when they do, the existing special rules may address any shareholding continuity issues. However, officials are aware of a potential corporate spin-out transaction which could result in a loss of shareholding continuity and imputation credits due to the deficiencies in the special rules described above. There is therefore a revenue risk associated with these changes, due to foregoing a possible windfall gain from a loss of imputation credits in this transaction, even though there would be no change in ultimate ownership. The possible windfall gain is estimated at $20m.

25. This windfall gain is uncertain because the potential corporate spin-out may not proceed, and if it does proceed, it is possible that the transaction could be structured to use the existing special rules to address any shareholding continuity issues. Also, if there is a loss of shareholding continuity and imputation credits, sufficient imputation credits could be generated after the spin-out to fully impute dividends, so the timing of any windfall revenue gain would be uncertain and may never occur. Forecasts will not be updated to reflect a cost because of the high level of uncertainty.

Recommendations

Agree that a corporate spin-out should not result in a change in shareholding for a spun-out company, a consolidated group or consolidated imputation group, to the extent there has been no change in the ultimate owners.

Agreed/Not Agreed Agreed/Not Agreed

Agree that the recommendation above apply from the date the 2021 omnibus tax Bill is introduced.

Agreed/Not Agreed Agreed/Not Agreed

Note that these recommendations cause a fiscal risk, but that risk is against a potential windfall gain which has not been included in baseline forecasts due to the high level of uncertainty.

Noted Noted

Amendments to the KiwiSaver Act 2006

Writing-off KiwiSaver member account imbalances

26. KiwiSaver members have a holding account with Inland Revenue which holds funds on a temporary basis before they are transferred to their KiwiSaver provider. While a holding account can be temporarily in credit, its balance is typically zero.

27. However, due to errors arising from employer provided information or Inland Revenue's system, KiwiSaver holding accounts can occasionally present a negative value. This indicates that Inland Revenue has transferred more money to a KiwiSaver member than it should have**.** Once Inland Revenue learns that the employer provided information is incorrect, a debt is entered in Inland Revenue's system against the KiwiSaver member.

28. While money should, in principle, be collected from taxpayers when they receive money to which they are not entitled, the collection of amounts which have created member account imbalances can be legally complicated and uneconomic. Where an

error in the calculation of contributions has been made by the employer or by Inland Revenue, the Commissioner can write off such amounts if they are uneconomic to collect and Inland Revenue still holds the contribution.

29. However, if Inland Revenue has since forwarded the contribution to the provider and it is uneconomic to recover the amount, the legislation does not enable the Commissioner to write off amounts which are uneconomic to collect. This was not the intended policy outcome.

30. We recommend that Inland Revenue be permitted to choose not to collect a member imbalance where it is not feasible to do so regardless of whether it still holds the payment or whether it has been paid to the KiwiSaver provider. We also recommend that this apply to historic KiwiSaver member imbalances.

31. From 1 July 2008 – 30 June 2020, there were a total of 8,088 transactions with an average value of $93.43 each and a combined value of $755,120. We estimate that this will reach $881,000 by 30 June 2022. System changes mean that member imbalances are less likely to arise in future, meaning we project an estimated future flow of no more than $63,000 per annum.

32. The Treasury supports this change, as it would prevent uncollectable debt from accumulating in Inland Revenue's accounts. However, it would have an immediate fiscal cost of $881,000 as a result of allowing Inland Revenue to write-off debt accumulated between 1 July 2008 – 30 June 2020, and is estimated to cost no more than $63,000 each year on an ongoing basis.

33. Consequently, a decision must be made as to how to fund the change. There are two options:

    33.1. _Funding through existing baselines:_ This may be justified because it is a technical change involving a small amount of money. However, it would be inconsistent with the expectation that policy changes should be allocated to allowances; or

    33.2. _Funding through a charge against an allowance:_ To be more consistent with the fiscal management approach, the cost could be pre-committed against next year's Budget allowance, the Between-Budget Contingency ("BBC"), or Inland Revenue could submit a bid at Budget 2022 for the money.

In the Treasury's view, a case could be made for either method of funding. The fiscal effect may be expressed as follows:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25** **& outyears**
Impairment of Debt and Debt Write-Offs	0.000	0.881	0.063	0.063	0.063
Total operating	**0.000**	**0.881**	**0.063**	**0.063**	**0.063**

Recommendations

Agree to allow Inland Revenue to choose not to collect a KiwiSaver member imbalance where it is not feasible to do so.

Agreed/Not agreed	Agreed/Not agreed

Note this recommendation will have the fiscal effect expressed in the table above

Noted	Noted

Indicate whether the write-off of member imbalances should be funded from existing baselines, or against an allowance.

Existing baselines/allowances	Existing baselines/allowances

Recovery of excess employer payments from providers

34. An excess employer payment occurs where an employer has paid too much in KiwiSaver contributions to Inland Revenue. This may arise due to incorrect information having been provided to Inland Revenue by an employer. Where this occurs, the employer will usually notify Inland Revenue, who will credit the funds back to the employer and seek to recover the surplus amount from the KiwiSaver provider (to whom it has been transferred by Inland Revenue).

35. However, in some circumstances, the provider may advise that it no longer holds the surplus funds. Reasons the provider may not have the funds may include the outcome of a bad investment, or a withdrawal by a KiwiSaver member. In this situation, the funds are uncollectable. However, there is no ability for Inland Revenue to write-off such excess funds that cannot be collected.

36. We recommend Inland Revenue be permitted to not collect excess employer payments from providers where they are uncollectable, with retrospective effect. We recommend this write-off mechanism similarly apply to the historic balance of excess employer payments. For the period 1 July 2007 – 24 February 2021 we estimate an historic accumulation of $20,000, with a future flow of approximately $1,400 per annum.

37. The Treasury supports this change, as it would prevent uncollectable debt from accumulating in Inland Revenue's accounts. However, it would have an immediate fiscal cost of $20,000 as a result of allowing Inland Revenue to write-off debt accumulated between 1 July 2007 – 24 February 2021. This would cost approximately $1,400 each year on an ongoing basis.

38. Consequently, a decision must be made as to how to fund the change. There are two options:

    38.1 _Funding through existing baselines:_ This may be justified because it is a technical change involving a small amount of money. However, it would be inconsistent with the expectation that policy changes should be allocated to allowances.

    38.2 _Funding through a charge against an allowance:_ To be more consistent with the fiscal management approach, the cost could be pre-committed against next year's Budget allowance, the BBC, or Inland Revenue could submit a bid at Budget 2022 for the money.

In the Treasury's view, a case could be made for either method of funding. The fiscal effect may be expressed as follows:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Impairment of Debt and Debt Write-Offs	0.000	0.020	0.001	0.001	0.001
Total operating	0.000	**0.020**	**0.001**	**0.001**	**0.001**

Recommendations

Agree to allow Inland Revenue to not collect excess employer payments owed by a KiwiSaver provider where they are uncollectable, with retrospective effect.

Agreed/Not agreed Agreed/Not agreed

Note this change will have the fiscal effect expressed in the table above.

Noted Noted

Indicate whether the write-off of excess payments from employers should be funded from existing baselines, or against an allowance

Existing baselines/allowance Existing baselines/allowance

Amendments to the Goods and Services Tax Act 1985

GST matters with fiscal costs for Minister of Finance approval

39. We have previously reported to the Minister of Revenue (IR2021/138 refers) seeking approval for a number of GST issues to be included in the next available tax bill. Two of the proposals in that report had a fiscal cost that officials recommend be funded by the Tax Policy Scorecard. The Minister of Revenue has agreed to the recommendation that these items be funded in this manner and a Cabinet paper has been prepared that is set to be considered by the Economic Development Committee on 30 June 2021.

40. This report now seeks approval from the Minister of Finance to fund these items through the Tax Policy Scorecard.

Reducing compliance costs and improving competition for courier businesses by zero-rating the domestic leg of the international transport of goods

41. Under current law, the domestic leg of the international transportation of goods can only be zero-rated (GST is charged at zero percent) where the domestic leg of the transportation is supplied by the same supplier as the international leg of transportation. The rationale for allowing zero-rating of the domestic leg is because exported goods are zero-rated, and the value of transport services is already included in the cost of imported goods which are subject to 15% GST. The problem is that under current practice, most international transporters do not undertake the domestic leg of the transportation, and instead subcontract to an NZ-based courier.

42. Officials propose that the domestic leg of the international transportation of goods is zero-rated. This will ensure that potentially irrecoverable GST costs are not

imbedded in the final price of the goods paid by the consumer and will ensure the tax system does not create incentives to pick one transport carrier over another. It will bring our rules into line with Australia who have a similarly broad zero-rating treatment for the domestic leg of the international transport of goods.

Second-hand goods input tax credits on supplies between associated persons

43. In circumstances where a supplier purchases an asset in which no GST has been charged on the purchase, the registered person may be denied the ability to claim any second-hand goods input tax credit. This is because no GST was charged on the sale, but it may have been embedded in the cost of the asset. The proposed amendment allows a second-hand goods input tax credit on supplies between associated persons equal to the tax fraction on the original cost of the good at the time it was purchased by the first person in the chain of associated persons. This amendment ensures registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

Fiscal costs

44. The proposed amendment to zero-rate the domestic leg of the international transport of goods would have a fiscal cost of $0.2m per annum. The proposal to allow the correct amount of second-hand goods input tax credits on supplies between associated persons would have a fiscal cost of $2.0m per annum.

Domestic leg of the international transportation of goods

45. Freight services for the domestic leg of the international transportation of goods should be subject to a zero-rate of GST, with an estimated revenue cost of $0.2m per annum which can be accounted for on the Tax Policy Scorecard:

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Tax Revenue: GST	0.000	(0.050)	(0.200)	(0.200)	(0.200)
Total operating	**0.000**	**0.050**	**0.200**	**0.200**	**0.200**

Second-hand goods input tax credits on supplies between associated persons

46. The correct amount of second-hand goods input tax credits should be provided on supplies between associated persons, with an estimated revenue cost of $2m per annum which can be accounted for on the Tax Policy Scorecard:

In Confidence

	$million – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25 &outyears**
Tax Revenue: GST	0.000	(0.500)	(2.000)	(2.000)	(2.000)
Total operating	**0.000**	**0.500**	**2.000**	**2.000**	**2.000**

Recommendations

Agree to take the GST proposals to Cabinet for its approval, as previously agreed by the Minister of Revenue:

Agreed/Not agreed Noted

Note these changes will have the fiscal effect expressed in the tables above.

Noted Noted

Agree that this fiscal effect can be accounted for on the Tax Policy Scorecard, as previously agreed by the Minister of Revenue.

Agreed/Not agreed Noted

Financial implications

47. The fiscal impact of these items is noted in the paragraphs above.

Administrative implications

48. The remedial changes recommended in this report clarify and remove uncertainties in the application of the Income Tax Act 2007 and the KiwiSaver Act 2006. They reduce administration costs by aligning the legislation with the policy intent.

49. The GST policy changes recommended in this report do not have any material administrative implications for Inland Revenue

50. The recommended changes are not expected to have any material systems or technology impacts.

Consultation

51. The Treasury has been consulted on the contents of this report and agrees with its recommendations.

Next steps

52. We recommend that the proposed amendments be included in the next omnibus taxation Bill, scheduled for introduction in August 2021.

IR2021/249 – Tax policy report (8 June 2021)

Withheld in full under section 9(2)(f)(iv) of the Official Information Act 1982

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

OVERSEAS DONEE STATUS: ADDITIONS FOR THE NEXT OMNIBUS TAXATION BILL, AND EXTENDING THE NZMMT-LE QUESNOY'S SUNSET CLAUSE

Proposal

1. This paper seeks the agreement of the Cabinet Economic Development Committee to grant overseas donee status to 11 New Zealand charities whose purposes further New Zealand's international development objectives, with effect from 1 April 2021. Monetary donations to overseas donee organisations are eligible for tax benefits, such as the donation tax credit.

2. I also seek agreement to extend the NZ Memorial Museum Trust – Le Quesnoy's overseas donee status to 31 March 2029.

Executive summary

3. I recommend that the 11 New Zealand charities with overseas charitable purposes discussed in this paper be granted overseas donee status and listed in schedule 32 of the Income Tax Act 2007, with application from 1 April 2021. The necessary amendments would be included in an omnibus taxation Bill, scheduled for introduction in August 2021. The charities are discussed in paragraphs 10 to 20. The purposes and activities carried out by these charities come within Cabinet's approval criteria (CM 78/14/7), as described in paragraph 7, relating to the relief of poverty and sickness and delivering humanitarian aid and development.

4. In 2018 Cabinet agreed to give the NZ Memorial Museum Trust – Le Quesnoy overseas donee status as a special case (CAB-18-MIN-0535 refers). As a condition of that decision, a sunset clause applied to the Trust's overseas donee status and is due to expire 18 March 2022. The Trust is seeking an extension to that date as it has experienced difficulties in fundraising due to COVID-19 and the associated complications with managing the development of the project in France as a result of the outbreak. I recommend extending the sunset clause to 31 March 2029, and the change be included in the same omnibus taxation Bill.

Background

5. New Zealand charities that support activities overseas and want their donors to be eligible for tax benefits (such as the donation tax credit) must be approved for overseas donee status. Monetary donations to listed organisations entitle individual New Zealand taxpayers to a tax credit (donation tax credit) of $33^1/_3$% of the amount donated up to the level of their taxable income. Companies and Māori authorities are eligible for a deduction for cash donations up to the level of their net income.

6. Generally, the availability of tax benefits to donations is limited to charities with New Zealand purposes only. Overseas donee status is, therefore, an established exception for a specific class of charity. Granting overseas donee status requires legislative change by adding the charity to schedule 32 in the Income Tax Act. Advice from the Legislative Design and Advisory Committee in 2016 to the Inland Revenue Department has confirmed that the use of legislation to implement a decision to grant overseas donee status is appropriate. There are 154 organisations currently listed in schedule 32.

7. Cabinet has established criteria for granting overseas donee status:

The basic criteria for adding an organisation to the list of approved "overseas" charities:

(i) the funds of the charity should be principally applied towards:

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries*; or

raising the educational standards of a developing country*;

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

* developing countries recognised by the United Nations.

[CM 78/14/7 refers]

Charities to be granted overseas donee status

8. I recommend that the charities named in paragraphs 10 to 20 be granted overseas donee status. The purposes of the recommended charities come within the criteria in paragraph 7. All the charities recommended in this paper have adequate procedures for the accountability of funds applied to projects and can demonstrate a track record of activity. All are registered under the Charities Act 2005.

9. The recommended charities are managed in New Zealand and are seeking overseas donee status to grow their New Zealand donor bases and increase the scope and scale of their in-country activities.

Community Transformation Trust

10. Community Transformation works in partnership with communities in developing countries to improve economic outcomes and the relief of poverty. It is currently supporting projects that improve water quality and land use in South Sulawesi, Indonesia, in partnership with Global Hope Network International.

Firefly Children's Home Charitable Trust

11. Firefly Children's Home operates in partnership with PA Nepal (Prisoners Assistance Nepal, a registered Nepali charity) and supports orphaned or abandoned children including the children of prisoners. Firefly's purposes are directed towards relieving poverty and ensuing those in care receive adequate education and medical attention. Firefly currently supports 100 children under care.

Hadassah Medical Relief Association of New Zealand

12. The Hadassah New Zealand Association provides financial support to Hadassah International, which operates several hospitals in Jerusalem. Hadassah International provides treatment to all people irrespective of race or religious views. Hadassah International also has an international relief focus within socio-economically deprived areas of the Middle East and carries out medical relief missions in Africa. It also provides international assistance by providing additional medical capacity in response to natural disasters.

Hands Across the Water New Zealand Trust

13. Hands Across the Water New Zealand Trust works in partnership with Hands Across the Water Australia to provide education and training opportunities for orphaned, abandoned, or homeless children in Thailand. It supports six homes in Thailand and has around 350 children in care. In addition to the care provided by the homes, Hands Across the Water provides tuition in English and supports former residents seeking higher education.

Institute for Indian Mother and Child Aotearoa Charitable Trust

14. The Institute for Indian Mother and Child Aotearoa (IIMC Aotearoa) provides sponsorship support to children under the care of the Institute for Indian Mother and Child, based in Kolkata, India. The Kolkata organisation mainly provides medical support to the poor and destitute; it has also built schooling facilities in the poorest villages to provide education for primary and secondary school-aged children. IIMC Aotearoa currently sponsors 19 children, with priority given to girls, to maintain their attendance at school and ensure they receive appropriate medical support.

Medic to Medic

15. Medic to Medic is a New Zealand sister charity to similarly named charities in the United Kingdom and the United States. The purpose of Medic to Medic is to increase medical and healthcare professional capacity in developing countries by providing scholarships to students at risk of dropping out of their training due to poverty. Currently, it is supporting 66 students in Malawi and Zambia.

Missio Benevolent Society

16. Missio Benevolent Society is the humanitarian aid arm of the New Zealand office providing for the Pontifical Missions Society. Missio's activities are directed toward the relief of poverty and advancing education in Oceania, Africa, Asia and South America.

Prabh Aasra Trust (New Zealand)

17. Prabh Aasra Trust New Zealand raises funds to support its Indian counterpart Prabh Aasra, which provides care and medical treatment to the homeless and destitute in North India.

Reemi Charitable Trust

18. Reemi Charitable Trust is a social enterprise whose activities are directed at alleviating period poverty in developing countries. It is currently active in Bangladesh and seeks to improve physical and mental health outcomes for women through education and supplying culturally appropriate products such as self-sterilising underwear and laundry bags.

Talalelei Life Futures Fund

19. Talalelei Life Futures Fund provides yearly scholarships to support academic high performers to obtain tertiary qualifications in Samoa. The Fund currently supports 12 students.

YWAM Ships Aotearoa Limited

20. Using a specifically equipped medical aid ship, YWAM Ships Aotearoa undertakes health and education work in remote and isolated communities throughout the Pacific Islands, Papua New Guinea, and the Solomon Islands. YWAM Ships provides a range of medical services to these communities including eye care, dental care, and immunisation and paediatrics. It also carries out developmental projects for those communities, such as water sanitation, to improve and maintain overall health outcomes.

Financial implications

21. The estimated financial implications of adding the eleven charities recommended in this paper are shown in the table below. Over the forecast period 2020–21 to 2024–25, the expected financial impact is $1.788 million. The financial implications will be treated as a forecasting change and reflect the increasing cost of the policy to allow tax benefits for donations to New Zealand-based charitable overseas aid organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period.

	Effect on tax revenue ($millions)				
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.359)	(0.419)	(0.481)	(0.529)

NZ Memorial Museum Trust – Le Quesnoy

22. The NZ Memorial Museum Trust – Le Quesnoy (the Trust) is a registered charity set up to own and operate a memorial museum and accommodation complex in Le Quesnoy, France, that will provide information and learning resources to visitors and raise awareness of New Zealand's participation in and contribution to the First World War.

The Trust's sunset clause

23. In 2018 Cabinet agreed to give the Trust overseas donee status as a special case to its usual approval criteria (CM 78/14/7).

24. Being a special case, Cabinet granted the Trust overseas donee status on the condition that a sunset clause for the donee status would apply, and the period would be no longer than three years after 18 March 2019, the date the measure was enacted [CAB-18-MIN-0535 refers].

25. Granting overseas donee status was the Government's full and final contribution to the Trust. No budgetary provision was made to fund the Trust's overseas donee status from 2022-2023 and beyond.

26. Cabinet's decision recognised the one-off and historic nature of the Trust's purpose to commemorate 100 years since the end of the First World War.

27. The Patron and the Chair of the Trust have requested an extension to the sunset clause that applies to the Trust's overseas donee status. The Patron of the Trust is the Rt Hon Helen Clark and the Chair of the Trust is Sir Don McKinnon.

28. The Trust has offered the following reasons for wishing to extend the sunset clause:

    28.1 For various reasons, including some relating to the Trust itself, fundraising started slower than originally envisaged.

    28.2 For a number of legitimate reasons, larger donors wish to pay over a three to four-year period rather than making a single donation as originally expected.

    28.3 COVID-19 has had a negative impact on both facility development in France and on fundraising worldwide, just as the Trust's new fundraising strategy was set to begin in March 2020.

29. The Trust asserts that:

    29.1 Overseas donee status is crucial to its fundraising strategy as it cements the Government's commitment to the project and gives it a level of official endorsement, which raises donor confidence.

    29.2 Many of the potential donors it is targeting are tax-sensitive and ensuring they have access to the donation tax credit is critical to their willingness to support the project.

Proposal

30. In response to the Trust's request, I recommend extending its sunset clause for another seven years, ending 31 March 2029, with the option to further extend the sunset clause by Order in Council.

31. This proposal gives the Trust certainty about the Government's contribution to the project over the medium-term and allows the Government to reassess its contribution to the Trust once the museum and accommodation complex is completed during this timeframe.

32. This extension would:

    32.1 allow the Trust to fundraise during the commissioning and construction period, and

    32.2 give the Government an option to consider if it wishes to further support the ongoing operations of the memorial museum.

33. My recommendation allows the Government to adopt a cautious approach to its financial contribution to the Trust and is consistent with the principles of Cabinet's earlier decision in 2018.

34. This proposal requires Cabinet to rescind its decision on 29 October 2018 that the Trust's overseas donee status be subject to a sunset clause for a period no longer than three years from the date of the assent of the Bill that gave effect to the Cabinet's earlier decision.

Financial implications of extending the Trust's sunset clause

35. The estimated financial implications of extending the Trust's sunset clause is shown in the table below. The tax benefits for 2020-21 and 2021-22 financial years are already in existing baselines. I recommend that the fiscal impact of extending the duration of the Trust's overseas donee status be treated as a precommitment against the allowance for Budget 2022.

36. The revenue estimates are based on projections made by the Trust about the monetary donations it expects to receive for the forecast period. The expected fiscal cost to the end of the 2030-31 financial year is expected to be $7-8 million and is based on the Trust's estimation that $21-23 million is needed to complete the memorial museum and accommodation complex. While the Trust's overseas donee status is proposed to end 31 March 2029, provision has been made for donors to the 2030-31 financial year for later filing taxpayers.

	Effect on tax revenue ($millions)					
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(0.750)	(1.000)	(1.000)	(1.000)
	2026–27	**2027–28**	**2028–29**	**2029-30**	**2030-31**	**2031-32**
	(1.000)	(1.000)	(1.000)	(0.750)	(0.250)	(0.000)

Legislative implications

37. Granting overseas donee status to the named charities and extending the sunset clause for the NZ Memorial Museum Trust – Le Quesnoy will require changes to the Income Tax Act 2007. I recommend that the necessary amendments are included in the next omnibus taxation Bill scheduled for introduction in August 2021. The changes would have effect from 1 April 2021.

Impact analysis

Regulatory Impact Assessment

38. The Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in respect of the proposal to grant overseas donee status to 11 new charities are exempt from the requirement to provide a Regulatory Impact Assessment as they have no or minor impacts on businesses, individuals, or not-for-profit entities.

39. The Regulatory Impact Analysis Team at the Treasury has also determined that the proposal to extend the overseas donee status of the NZ Memorial Museum Trust – Le Quesnoy is exempt from the requirement to provide a Regulatory Impact Assessment on the grounds that the issue has been addressed by existing Impact Analysis ("Impact Summary: New Zealand Memorial Museum Trust – Le Quesnoy: tax benefits for monetary donations"; DEV-18-SUB-0177 refers). The Treasury notes that Inland Revenue's current recommendation remains consistent with the preferred approach identified in the previous Impact Analysis.

Climate Implications of Policy Assessment

40. In respect of the proposal to grant overseas donee status to 11 new charities the Climate Implications of Policy Assessment (CIPA) team at the Ministry for the Environment has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population implications

41. New Zealand's strategy for overseas development is underpinned by four development principles: effectiveness, inclusiveness, resilience and sustainability. The charities I am recommending be given overseas donee status exhibit these

principles by carrying out activities that directly respond to poverty, provide essential medical services to isolated or impoverished communities, and develop economic or educational capacity in developing countries.

42. Several of the charities specifically target women to ensure that communities have strong women leaders and health care practitioners. Some also prioritise the health and wellbeing of women and children.

43. There is also a focus on the Pacific and Micronesia to support health and education outcomes. Strong relationships in the Pacific are an important aspect of New Zealand's diplomatic and development strategy.

Human Rights

44. The changes I am recommending in this paper do not have any implications in relation to the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Consultation

45. The Treasury, Ministry of Foreign Affairs and Trade (Pacific and Development Group) and the Department of Internal Affairs – Charities Services were consulted as part of my officials' analysis of the 11 charities recommended in this paper.

46. The New Zealand Police's vetting service was also used in connection with the trustees/officers of the charities recommended in this paper.

47. The Ministry of Foreign Affairs and Trade (European Division) and the Ministry of Culture and Heritage were consulted as a part of Inland Revenue's analysis of the NZ Memorial Museum Trust – Le Quesnoy's request for an extension to its overseas donee status. These agencies and Inland Revenue have recommended the Trust's overseas donee status should not be extended.

48. In 2018, Inland Revenue advised against granting the Trust overseas donee status as the viability of the museum and accommodation project was doubtful. Inland Revenue was also concerned about the precedent a decision to grant the Trust overseas donee status would set in terms of prospective requests for overseas donee status by other charities whose purposes fall outside Cabinet's usual approval criteria (CM/78/14/7).

49. Inland Revenue has considered the Trust's request for an extension to its overseas donee status and still has reservations about the viability of the Trust's project:

    49.1 The Trust has not, to date, generated the level of donor support assumed by the trustees suggesting the tax benefits for donations are not providing sufficient incentive to donate, noting that the bulk of the Trust's proposed fundraising is now outside the First World War centenary period.

49.2 The longer-term viability of the Museum and accommodation complex is unknown. The Trust's assumptions on visitor numbers to the Le Quesnoy Museum remain based on pre-COVID-19 tourist movements. Even at those earlier levels, officials considered the Trust's projections were high relative to more well-known and established memorials on the Western Front.

50. The Treasury concurs with Inland Revenue's opposition to extending the Trust's overseas donee status for the reasons outlined above. However, officials agree that, if Ministers wish to support the Trust in this way, the change is best funded through a precommitment against Budget 2022.

51. More generally, officials note that the project has reputational and financial risk for the Crown. As a memorial museum it represents New Zealand and the New Zealand Government. Consequently, there is a risk that the Crown may be asked to contribute further if the Trust is unable to raise sufficient funds to construct and/or operate the museum on an ongoing basis.

Communications

52. Once Cabinet has made its decision on granting overseas donee status, officials will inform each organisation of the relevant decision. I will make an announcement about the 11 charities when the relevant taxation Bill is introduced. Inland Revenue will publish details of the new legislation in a Tax Information Bulletin once the tax Bill containing the measure is enacted.

53. I will also write to the Chair of the NZ Memorial Museum Trust informing him of Cabinet's decision.

Proactive release

54. I propose to delay the proactive release of this Cabinet paper, without redaction, and associated Cabinet minutes until the introduction of the proposed omnibus taxation Bill which contains the necessary amendments to give effect to the proposal. The expected introduction date for this Bill is August 2021.

Recommendations

The Minister of Revenue recommends that Cabinet:

Charities to be granted overseas donee status

1. **agree** that the following charities be given overseas donee status and listed in schedule 32 of the Income Tax Act 2007:

    1.1 Community Transformation Trust

    1.2 Firefly Children's Home Charitable Trust

    1.3 Hadassah Medical Relief Association of New Zealand

    1.4 Hands Across the Water Trust

1.5 Institute for Indian Mother and Child Aotearoa Charitable Trust

1.6 Medic to Medic

1.7 Missio Benevolent Society

1.8 Prabh Aasra Trust (New Zealand)

1.9 Reemi Charitable Trust

1.10 Talalelei Life Futures Fund

1.11 YWAM Ships Aotearoa

2. **agree** that the charities be given overseas donee status from 1 April 2021.

3. **note** that agreeing to recommendations 1 and 2 has the following estimated fiscal costs, which will be treated as a forecasting change on the operating balance

	Effect on tax revenue ($millions)				
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.359)	(0.419)	(0.481)	(0.529)
Operating balance impact	**0.000**	**0.359**	**0.419**	**0.481**	**0.529**

NZ Memorial Trust – Le Quesnoy – sunset extension

4. **note** that on 29 October 2018 Cabinet agreed that the Trust's overseas donee status would be subject to a 'sunset clause' for a period no longer than three years from the date of the assent of the Bill that gave effect to the proposal (CAB-18-MIN-0535 item 6.1 refers).

5. **agree** to rescind Cabinet decision CAB-18-MIN-0535 item 6.1.

6. **agree** to grant the NZ Memorial Museum Trust – Le Quesnoy overseas donee status on the condition that the period during which the Trust will be granted overseas donee status ends 31 March 2029, with the option to extend the end date by Order in Council.

7. **note** that agreeing to recommendations 5 and 6 has the following estimated change on the operating balance for the period 2022-23 to 2031-32:

	Effect on tax revenue ($millions)					
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(0.750)	(1.000)	(1.000)	(1.000)
	2026–27	**2027–28**	**2028–29**	**2029-30**	**2030-31**	**2031-32**
	(1.000)	(1.000)	(1.000)	(0.750)	(0.250)	(0.000)

8. **agree** to pre-commit the cost of recommendation 6 against the allowance for Budget 2022

Process

9. **agree** to include amendments giving effect to recommendations 1 and 2 and 6 in the next omnibus taxation Bill scheduled for introduction in August 2021, with effect from 1 April 2021

10. **note** that Inland Revenue will inform the trustees once Cabinet has made a decision about the charities in recommendations 1.

11. **authorise** the Minister of Revenue to inform the Chair of the NZ Memorial Museum Trust – Le Quesnoy of the outcome of their request consistent with recommendation 6 above.

12. **agree** to delegate to the Minister of Revenue, in consultation with the Minister of Finance, decisions on the final design of the sunset clause in recommendation 6.

Authorised for lodgement

Hon David Parker
Minister of Revenue

DEV-21-MIN-0119

Cabinet Economic Development Committee

Minute of Decision

Overseas Donee Status: Additions for the Next Omnibus Taxation Bill, and Extending the New Zealand Memorial Museum Trust - Le Quesnoy's Sunset Clause

Portfolio **Revenue**

On 9 June 2021, the Cabinet Economic Development Committee **referred** the submission under DEV-21-SUB-0119 to Cabinet on 14 June 2021 for further consideration.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Carmel Sepuloni
Hon David Parker
Hon Damien O'Connor
Hon Stuart Nash
Hon Dr David Clark
Hon Dr Ayesha Verrall
Hon Meka Whaitiri
Hon Phil Twyford
Rino Tirikatene, MP
Dr Deborah Russell, MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Cabinet

Minute of Decision

Overseas Donee Status: Additions for the Next Omnibus Taxation Bill, and Extending the New Zealand Memorial Museum Trust - Le Quesnoy's Sunset Clause

Portfolio **Revenue**

On 14 June 2021, following reference from the Cabinet Economic Development Committee, Cabinet:

Donee status

1 **agreed** that the following charities be given overseas donee status and listed in schedule 32 of the Income Tax Act 2007:

1.1 Community Transformation Trust;

1.2 Firefly Children's Home Charitable Trust;

1.3 Hadassah Medical Relief Association of New Zealand;

1.4 Hands Across the Water Trust;

1.5 Institute for Indian Mother and Child Aotearoa Charitable Trust;

1.6 Medic to Medic;

1.7 Missio Benevolent Society;

1.8 Prabh Aasra Trust (New Zealand);

1.9 Reemi Charitable Trust;

1.10 Talalelei Life Futures Fund;

1.11 YWAM Ships Aotearoa;

2 **agreed** that the charities listed above be given overseas donee status from 1 April 2021;

3 **noted** that paragraphs 1 and 2 above have the following estimated fiscal costs, which will be treated as a forecasting change on the operating balance:

	Effect on tax revenue ($millions)				
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.359)	(0.419)	(0.481)	(0.529)
Operating balance impact	0.000	0.359	0.419	0.481	0.529

New Zealand Memorial Trust – Le Quesnoy: Sunset extension

4 **noted** that on 29 October 2018, Cabinet agreed to grant the New Zealand Memorial Trust – Le Quesnoy (the Trust) overseas donee status, subject to a number of conditions, including a sunset clause for a period no longer than three years from the date of the assent of the Bill that gives effect to the proposal [CAB-18-MIN-0535, paragraph 6.1];

5 **rescinded** the decision referred to in paragraph 4 above; and instead

6 **agreed** to grant the Trust overseas donee status on the condition that the period during which the Trust will be granted overseas donee status ends on 31 March 2025;

7 **noted** that paragraphs 5 and 6 above have the following estimated change on the operating balance for the period 2022-23 to 2025-26:

	Effect on tax revenue ($millions)					
Vote Revenue Minister of Revenue	**2020–21**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025-26**
Crown Revenue and Receipts: Tax Revenue	(0.000)	(0.000)	(0.750)	(1.000)	(1.000)	(1.000)

8 **agreed** to pre-commit the cost of the decision in paragraph 6 above against the allowance for Budget 2022;

Process

9 **agreed** to include amendments giving effect to paragraphs 1, 2 and 6 above in the next omnibus taxation bill, which is scheduled for introduction in August 2021, with effect from 1 April 2021;

10 **noted** that Inland Revenue will inform the trustees of the charities listed in paragraph 1 above following Cabinet's decisions;

11 **invited** the Minister of Revenue, in consultation with the Minister for Arts, Culture and Heritage, to inform the Chair of the Trust of the outcome of its request, consistent with paragraph 6 above and to advise the chair that no further government assistance will be provided to the Trust;

12 **authorised** the Minister of Revenue, in consultation with the Minister of Finance, to make decisions on the final design of the sunset clause referred to in paragraph 6 above;

13 **invited** the Minister of Revenue to issue drafting instructions to Inland Revenue to give effect to the above paragraphs.

Michael Webster
Secretary of the Cabinet

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Additional remedial items for inclusion in the 2021 omnibus tax Bill**

Date:	17 June 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/263

Action sought

	Action sought	Deadline
Parliamentary Under-Secretary to the Minister of Revenue	**Agree** to recommendations **Refer** a copy to the Minister of Revenue **Refer** a copy to the Minister of Research, Science and Innovation	1 July 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

17 June 2021

Parliamentary Under-Secretary to the Minister of Revenue

Additional remedial items for inclusion in the 2021 omnibus tax Bill

Executive summary

1. This report seeks your agreement to make amendments to several Inland Revenue Acts for inclusion in the omnibus tax bill scheduled for introduction in August 2021. This covers additional items that were not included in the earlier report (IR2021/218 refers).

2. The changes recommended in this report are remedial in nature and are intended to ensure the relevant tax law is consistent with the policy intent. The remedials seek to maintain the coherence and integrity of the tax system. The recommended changes do not give rise to any material:

   2.1 revenue or other fiscal cost;

   2.2 compliance or administrative costs; or

   2.3 systems or technology implications.

3. Given the above and that the proposed remedial amendments are consistent with current policy frameworks and settings, officials do not consider that Cabinet approval is necessary.

Recommended action

We recommend that you:

a. **Indicate** in the body of this report where you have agreed or not agreed with a recommendation.

Indicated

b. **Agree** that, except where specified, the approved recommendations outlined in this report will apply from the date of enactment.

Agreed/Not agreed

c. **Agree** that approved amendments are included in the omnibus tax bill scheduled for introduction in August 2021.

Agreed/Not agreed

d. **Refer** a copy of this report to the Minister of Revenue

Referred

e. **Refer** a copy of this report to the Minister of Research, Science and Innovation.

Referred

Paul Fulton
Principal Policy Advisor
Policy and Strategy

Dr. Deborah Russell
Parliamentary Under-Secretary to the Minister of Revenue
/ /2021

Purpose of this report

4. The purpose of this report is to seek your agreement to remedial amendments to the Income Tax Act (ITA), the Tax Administration Act 1994 (TAA), and the Child Support Act 1991 for inclusion in the next omnibus tax bill scheduled to be introduced in August 2021.

5. The changes recommended are designed to align the relevant legislation with the original policy intent or operational practice and do not involve alterations to policy settings. In our view, reference to Cabinet is not required.

6. None of the changes recommended in this report have fiscal implications.

7. Unless otherwise stated, all recommendations should apply from the date of enactment of the omnibus tax bill.

Amendments to the Income Tax Act 2007

Security trusts and approved issuer levy

8. A borrower can pay approved issuer levy (AIL) at the rate of 2% on interest payments to non-residents. This is instead of withholding non-resident withholding tax (NRWT) at the rate of 15%. But AIL is only available if the borrower and the lender are not associated. Association for this purpose is determined under the general associated person rules, but there is an exception for security trusts. This provides that AIL is still available if the parties are associated only because the lender is a beneficiary of a trust established for the main purpose of protecting and enforcing the beneficiary's rights under the loan.

9. This exception was included because security trusts are often used for bond issues, and the limited rights they provide to the bond holders do not create the kind of commonality of interest that the associated person rules were intended to capture. Accordingly, it is appropriate for AIL to still be payable on bond issues which used a security trust to protect the rights of otherwise non-associated bond holders.

10. However, the ITA was amended in 2017 to extend AIL unavailability for "related party debts". This amendment was made as part of the rules which treated interest that was accrued under the financial arrangements rules (and thus deductible to the borrower) as paid for the purposes of NRWT. The definition of "related party debt" was mainly intended to capture indirect funding arrangements, but it also includes loans between associated persons. Associated persons for this purpose would include those associated through a security trust.

11. Consequently, the 2017 requirement in the AIL rules that a loan not be a "related party debt" effectively over-rides the exclusion from association for security trusts, making the exclusion ineffective. This was not intended. Consequently, we recommend amending the ITA to restore the exclusion. This would allow AIL to still be paid where the borrower and lender are only associated because the lender is the beneficiary of a security trust.

12. Since this amendment is reversing an unintended change, we recommend it apply retrospectively from the date the unintended change was made (i.e. 30 March 2017).

Recommendations

Agree to restore the ability to pay AIL instead of NRWT on a loan where the parties are only associated because the lender is a beneficiary of a trust established for the main purpose of protecting and enforcing the beneficiary's rights under the loan.

Agreed/Not agreed

Agree that the amendment should apply retrospectively from 30 March 2017.

Agreed/Not agreed

Debt remission within an economic group

13. Generally, when debt is remitted the debtor derives taxable income to reflect that they are better off by the amount of debt they no longer have to pay. An exception to this is the related party debt remission rule which provides that, in some circumstances, debt "forgiven" within an economic group is not income for the person who owes the debt (the debtor). This means there is no income for the debtor and no deduction for the creditor which reflects that, when considered on a group basis, net worth is unchanged from the remission.

14. **Use of terminology**: The language in the debt remission rule is centered around the word "forgiveness"; however, the rule is commonly understood to apply to all types of debt remission (for example, when debt is not forgiven but is remitted by a court order or due to the passing of time). To align with current practice, we recommend replacing references to "forgiveness" (and its derivatives) with "remissions" (and its derivatives). We recommend for this apply retrospectively from the commencement of the debt remission rule on 1 April 2008.

15. **ASC**: Where a shareholder of a company remits a debt owed by the company, an increase in available subscribed capital (ASC) is permitted to recognise that the remission of a loan is in substance a capital contribution to the company. Currently, an increase of ASC on the remission of debt within a wholly-owned group can occur in two situations:

    - If the company is tax resident in New Zealand, the company must remit the debt in exchange for shares (i.e. the debt is capitalised).
    - If the company is a non-resident, the company may simply remit the debt (and is not required to capitalise the debt).

16. Therefore, a resident company must capitalise the debt where, in the same circumstances, a non-resident is not required to do so. There seems to be no reason why the resident company within a wholly-owned group should be required to issue shares in this context. We recommend allowing the resident company to obtain an ASC increase where debt is remitted (but no shares are issued).

17. **NZ branches of non-residents**: The debt remission rule only applies in limited circumstances to debt owed by branches of non-resident companies.[1] Branches located in New Zealand are treated very similarly to New Zealand resident

[1] The rule applies to debt owed by a branch of a non-resident where the non-resident is wholly-owned by New Zealand residents or where the creditor has ownership interests in the non-resident.

subsidiaries in respect of debts owing.[2] Where a NZ branch owes money to an associate that is a NZ resident or a non-resident with a NZ branch, an asymmetrical outcome arises to the extent no deduction is provided to the creditor but debt remission income is recognised for the NZ branch.

18. We recommend that the debt remission rule should be expanded to apply to New Zealand branches (where it meets the other requirements in the debt remission rule that apply to New Zealand residents). However, this should be limited to only where the creditor does not receive a deduction on the remission of the debt (in New Zealand or offshore).

19. **Allowing debt written off prior to 1 July 2017 to be remitted and not give rise to income to the creditor**: Following the enactment of the debt remission rule on 30 March 2017 there was a transitional period until 1 July 2017 which allowed creditors to remit debt without deriving income from a deemed payment of accrued interest. This required the debt to be remitted, not just written-off. For interest accrued after the debt remission rule was enacted, deeming the accrued interest to be paid is appropriate as an integrity measure.

20. This transitional period, however, was too short for some taxpayers given the legal and administrative procedures required to remit debt, and so it did not always occur. If this debt were remitted now, the accrued interest would be deemed to be paid to the creditor resulting in taxable income. When the debtor and creditor are in the same wholly-owned group and interest was written-off but not remitted before 1 July 2017, there is an incentive to never remit this interest, even when the interest will never be paid, to prevent taxable income arising. The integrity reasons referred to above do not apply in this situation as the interest has already been accrued and written-off.

21. In order to allow creditors to remit such debt, we recommend that creditors who considered a debt would not be repaid (i.e. those who wrote it off prior to 1 July 2017) should be able to remit the outstanding loan and accrued interest without deriving income. The accrued interest able to be remitted (along with the loan) should be limited to total interest accrued at the time the interest was written off, as the debtor would have been able to claim deductions for interest that is still legally accruing (as the loan is still outstanding).

22. **Correcting an asymmetrical outcome**: The debt remission rule and the bad debt rule together operate to, on the remission of a debt, not allow a deduction to an associated creditor but also not recognise income to the debtor (thus producing a symmetrical outcome). However, where the creditor has ownership interests in the debtor but is not associated (i.e. they have less than 25% ownership) then an asymmetrical outcome arises; the creditor may receive a bad debt deduction without any corresponding income arising for the debtor.

23. We recommend not allowing a bad debt deduction to a non-associated shareholder in a debtor that remits a debt to the extent no income arises to the debtor under the debt remission rule.

[2] Payments of interest by NZ branches and NZ resident subsidiaries are both within the New Zealand tax base, generally subject to either RWT or NRWT (independent of whether the payer is a branch or resident).

Recommendations

Agree to replace references to "forgiveness" (and its derivatives) in the debt remission rule with "remissions" (and its derivatives) from 1 April 2008

Agreed/Not agreed

Agree to provide an ASC increase to a resident company within a wholly-owned group of companies where a shareholder remits a debt owed by the company without requiring the company to capitalise the debt.

Agreed/Not agreed

Agree the debt remission rule should apply to the remission of debt owed by a New Zealand branch of non-resident company to a member of the same wholly-owned group.

Agreed/Not agreed

Agree to allow a creditor to remit a debt that was written off before 1 July 2017 without the creditor deriving income from the deemed payment of interest.

Agreed/Not agreed

Agree to deny a bad debt deduction to a non-associated shareholder in a debtor that remits a debt to the extent no income arises to the debtor under the debt remission rule.

Agreed/Not agreed

RDTI tax year cut-off for claiming supporting activities

24. The Research and Development Tax Incentive (RDTI) was introduced in 2019 to provide a tax credit to firms performing R&D. A business must have commenced its R&D activity ("core activity") before it can claim the tax credit. Supporting activities (activity required for carrying out the core activity) are also claimable but only where there is a corresponding core activity. This is currently achieved by only permitting supporting activities to be claimed for income years in which there is also a core activity.

25. However, using the concept of an income year has unintentionally resulted in exclusions from eligibility where expenditure cannot be claimed because it happened to occur outside of the income year that the core activity occurred in. This can happen where supporting activity occurs either in the year prior to the core activity (pre-commencement type activity) or after the end of the core activity (termination type activity). It is recommended that this issue is addressed by amending the ITA to:

    25.1 permit supporting activity expenditure that occurs in a year without a core activity to be claimed in the subsequent income year if the core activity exists in that subsequent year; and

    25.2 permit supporting activity relating to the end of R&D activity where it occurs in a year without core activity to be claimed in the R&D claim for the prior year.

26. Amendments are needed to ensure that the supporting activity expenditure is included in the calculation of various RDTI expenditure caps for the income year it is claimed (e.g., the total expenditure cap). Further amendments will also be required to the ITA and the TAA to ensure that pre supporting activities occurring before and after the core activity can be included in a "General Approval" (all activities have to be pre-approved by Inland Revenue to be eligible for the RDTI) and expenditure claim ("supplementary return") for the relevant year. This can be achieved through including transitional variation powers.

27. Amendments should apply to supporting activity expenditure incurred from the 2019-20 income year onwards.

Recommendations

Agree to allow supporting activity expenditure incurred in an income year without a corresponding core activity to be claimed in the next income year if the core activity is performed in that year.

Agreed/Not agreed

Agree to allow supporting activity expenditure relating to the end of R&D activity to be claimed in the previous year where it arises one year after the end of the core activity.

Agreed/Not agreed

Agree that the supporting activity expenditure be included in the calculation of various RDTI expenditure caps for the income year it is claimed.

Agreed/Not agreed

Agree to create a power, for these purposes only, to vary a General Approval for R&D activities for the 2020-21 and 2021-22 years to no later than 31 August 2022 as a transitional measure, and for end of R&D supporting activity occurring in the 2022-23 and later income years, extend the power to vary for 12 months after the date which would otherwise be the last date for filing a General Approval application.

Agreed/Not agreed

Agree to extend the power to amend assessments to include supporting activities to 31 August 2022 for the 2021-22 year.

Agreed/Not agreed

Agree that the above proposals should apply for supporting activity expenditure incurred in the 2019-20 and later income years

Agreed/Not agreed

RDTI transitional support payment

28. Cabinet has agreed to an *RDTI transitional support payment* (DEV-21-MIN-0068 refers) to assist ex-Growth Grant businesses with the transition to the RDTI. The Growth Grant scheme was one of the key R&D support products pre-RDTI. The transitional support mechanism will adjust the amount of R&D support an ex-Growth Grant business gets to the level they would have expected to get if the Growth Grant scheme had continued.

29. In essence, the payment is a government grant. Under current law, government grants are not taxable and associated expenditure is non-deductible. This approach works where the expenditure is incurred in the same year as the payment is made. However, in most cases, the transitional support payment will be made after the year in which the expenditure on R&D activity has been incurred. As a result, there is a timing mismatch between deduction and income recognition. To address this, we propose making the transitional support payment taxable and the corresponding expenditure deductible. This prevents businesses having to amend past returns to account for deductions that are later disallowed because of the payment.

30. The TAA includes a schedule of expenditure that is ineligible for the RDTI. This schedule makes expenditure that is a "precondition to, subject to the terms of or otherwise required" by a grant ineligible for the RDTI. The transitional support payment is intended to assist businesses transition to the RDTI, however the exclusion in the schedule may prevent a business claiming both the RDTI and the support payment in some cases. This would undermine the policy intent. It is recommended that the schedule be amended to ensure that the transitional support payment does not make any expenditure ineligible for the RDTI.

31. Amendments would need to have retrospective application from the 2019-20 income year as some businesses will be eligible for a payment with respect to that year.

Recommendations

Agree to make the RDTI transitional support payment taxable and corresponding expenditure deductible.

Agreed/Not agreed

Agree to carve-out RDTI transitional support payments from the RDTI eligibility exclusion for R&D expenditure covered by a government grant.

Agreed/Not agreed

Agree that amendments relating to the RDTI Transitional support payment apply retrospectively from the 2019-20 income year.

Agreed/Not agreed

Depreciation cost-base integrity measure

32. The cost base for depreciation purposes where depreciable property has been acquired from an associated vendor is restricted to the cost of the property to the associate. This is an integrity measure preventing the purchaser from claiming more depreciation than was available to the associated vendor.

33. The restriction applies where the associated vendor was allowed a deduction for an amount of depreciation loss for the item in the year it was transferred to the purchaser, or in the previous income year.

34. Non-residential buildings were depreciable at a rate of 0% from the 2011-12 income year until the 2019-20 income year.

35. Therefore, it is arguable that the cost base restriction doesn't apply to a non-residential building sold to an associate during the years where non-residential buildings were depreciable at 0%, as the associated vendor was not allowed a deduction for an amount of depreciation loss in respect of the building.

36. It was always intended that the cost base restriction would apply, even when depreciation rates were set at 0%. It is therefore recommended that an amendment is made to ensure that the depreciation cost base restriction applies to assets transferred during years when non-residential buildings were depreciable at a rate of 0%.

Recommendation

Agree that the depreciation cost base restriction should apply to non-residential buildings transferred between 2011 and 2020 when the depreciation rate was 0%.

Agreed/Not agreed

Hybrid and branch mismatches

37. The New Zealand hybrid and branch mismatch rules were enacted in 2018 in response to the OECD reports "*Neutralising the Effects of Hybrid Mismatch Arrangements – Action 2: 2015 Final Report*" and "*Neutralising the Effects of Branch Mismatch Arrangements – Action 2: Inclusive Framework on BEPS*". Issues have been identified in the hybrid and branch mismatch rules, generally where New Zealand's rules do not align with the Hybrid Report and the Branch Report.

38. New Zealand's hybrid and branch mismatch rules seek to remove the tax benefit from various hybrid and branch mismatch arrangements. Hybrid and branch mismatch arrangements are cross-border arrangements that exploit differences in the tax treatment of an instrument, entity or branch under the laws of two or more countries to eliminate, defer or reduce income tax.

39. All of the remedials in this section concern the imported mismatch rule. The imported mismatch rule generally denies deductions for payments made by New Zealand taxpayers where the payment funds a "hybrid mismatch"[3] located offshore. The imported mismatch rule therefore prevents the benefit of the hybrid or branch mismatch being imported to New Zealand. It is the most complex of all of the hybrid rules, and for that reason only became fully effective for tax years beginning on or after 1 January 2020.

40. **Clarifying the hybrid and branch mismatch rules to not deny deductions under the imported mismatch rule where there is sufficient dual inclusion income**: "Dual inclusion income" is a concept used in the OECD reports to describe where an amount paid to a person is income in two jurisdictions. Deductible/not includible (D/NI) payments and double deduction (DD) payments do not result in double non-taxation if they are deducted against dual inclusion income. In New

[3] A 'hybrid mismatch' also includes a branch mismatch.

Zealand, our legislation uses the phrase "surplus assessable income" instead of "dual inclusion income".

41. The OECD Hybrid report set out that dual inclusion income can counteract an imported mismatch. Specifically, where a payment (from New Zealand) funds a mismatch located offshore, no hybrid deductions arise from the mismatch to the extent the offshore hybrid deductions are set-off against dual inclusion income. Therefore, a deduction should not be denied for the payment (from New Zealand) which funds the mismatch (as there is no double non-taxation).

42. We are seeking to align New Zealand's hybrid rules with the OECD approach – to provide that dual inclusion income can counteract an imported mismatch. However, the amount of dual inclusion income that may be offset should be limited to the extent that the NZ payment funds the total payments under the hybrid mismatch. The amendment should apply retrospectively from 1 July 2018, the date from which the hybrid and branch mismatch rules generally apply (including the imported mismatch rule in some cases).

43. **Clarifying the imported mismatch rule to not deny a deduction where it funds a mismatch that is not due to hybridity:** The imported mismatch rule could deny deductions for New Zealand payments that fund offshore payments that result in a loss of aggregate tax revenue for reasons other than hybridity. For example, a deduction may be allowed for a payment to a payee in a jurisdiction with no corporate income tax, or with a territorial tax regime (where foreign source income is not taxed). Such denial is inconsistent with the intention of the OECD reports, which was to only address mismatches that arise due to the different tax characterisations of instruments, entities or payments to branches. We seek to correct the drafting of the imported mismatch rule to reflect that intention. The amendment should apply retrospectively from 1 July 2018, the date from which the hybrid and branch mismatch rules generally apply.

44. **Clarifying that the imported mismatch rule can deny a deduction in respect of a charge to a NZ deducting branch:** The intention of the imported mismatch rule is to deny deductions where those deductions allow the benefit of an offshore hybrid mismatch to be imported into New Zealand. Where a deduction arises, even in the absence of an actual payment out of New Zealand, but the deduction would allow the tax advantage of the hybrid mismatch to be imported into New Zealand, then that deduction should be denied in New Zealand.

45. We therefore seek to deny deductions under the imported mismatch rule for a tax-deductible charge to a branch by its head office (typically for cost of goods sold, or in the case of a bank branch, interest on a notional loan). The amendment should apply from income years beginning on or after enactment.

46. **Clarifying that the imported mismatch rule should not apply where any jurisdiction(s) in a chain of payments funding a mismatch has hybrid legislation**: The imported mismatch rule can apply through a chain of any number of payments, through any number of jurisdictions and in any direction (i.e. up or down a corporate chain, or sideways). The imported mismatch rule currently does not apply to a payment where any of the following persons are in a jurisdiction that has hybrid mismatch legislation:

46.1 the recipient of the payment from the (NZ) funder;

46.2 the person who makes the payment that constitutes the hybrid mismatch (located offshore); or

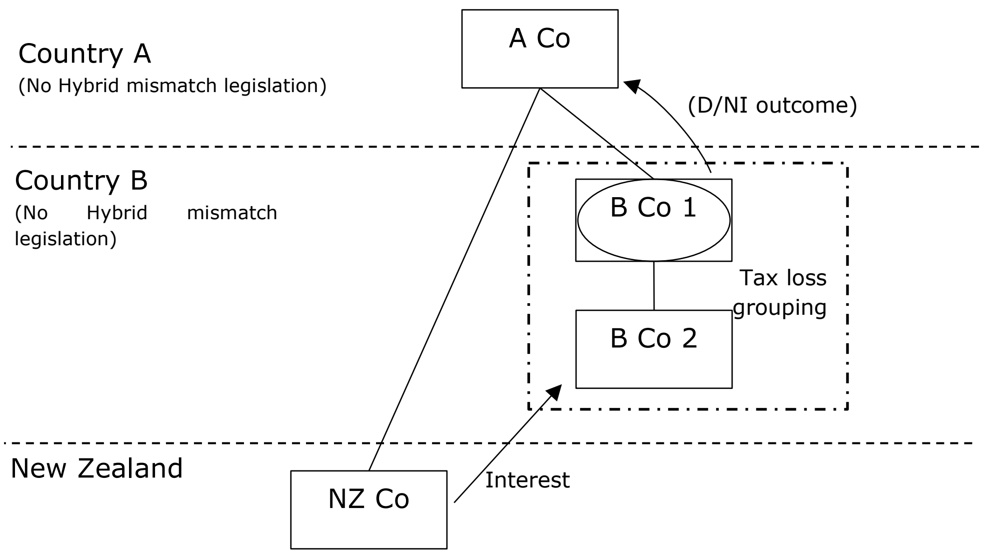
46.3 the person who receives the payment that constitutes the hybrid mismatch (located offshore).

47. In these cases, any denial of deduction in New Zealand would result in over-taxation as the other jurisdiction with hybrid legislation would have first priority to either deny deductions or recognise income in order to counteract the benefit of the mismatch.

48. However, another jurisdiction (other than those above) through which the chain of payments flows may have hybrid mismatch legislation which would deny deductions to address the mismatch (using its own imported mismatch rule). Further denial of deductions in New Zealand would result in the denial of two sets of deductions in respect of one mismatch, resulting in over-taxation. Therefore, deductions in New Zealand should not be denied for a payment that funds a hybrid mismatch through a chain of payments, where a payment along the chain of payments is from a jurisdiction that has hybrid mismatch legislation. The amendment should apply retrospectively from 1 July 2018, the date from which the hybrid and branch mismatch rules generally apply.

49. **Clarifying that the imported mismatch rule can deny deductions for payments that can be traced to a hybrid mismatch through loss grouping, group contributions of income, or consolidation**: The imported mismatch rule is intended to apply to deny deductions for a payment that funds a hybrid mismatch through a chain of payments (or imports the benefit of the hybrid into the New Zealand tax base). There may be, however, two entities along such a chain that do not make any payments between them, but may pass on the benefit of a hybrid mismatch through the use of various tax rules – such as loss grouping, group contributions of income, or consolidation regimes.

50. For example, consider the below diagram:



51. Tax loss grouping in Country B allows the benefit of the D/NI outcome to erode the New Zealand tax base:

51.1 There is a D/NI outcome between A Co and B Co 1 – there is a deduction created in Country B, without corresponding income in Country A.

51.2 The tax loss grouping available in Country B allows B Co 1's loss (generated from the deduction from the D/NI outcome) to be offset against B Co 2's income (generated from the payment from NZ Co). The payment from NZ Co to B Co 2 generates a deduction in New Zealand.

51.3 Overall, deductions are generated in New Zealand with no income elsewhere in the world. No income is generated in Country A, the income and deductions in Country B offset each other, and a deduction is generated in New Zealand.

52. Similar analysis applies where there is a consolidation regime, or a group contribution of income is allowed (a system where one entity (with taxable profit) can be treated as making a payment to another entity (with a loss), provided there is a specified degree of common ownership). Therefore, the imported mismatch rule should deny deductions for payments that can be traced to a hybrid mismatch through loss grouping, a group contribution of income, or consolidation. The amendment should apply from income years beginning on or after enactment.

53. **Insert cross-referencing definitions:** We seek to insert cross references into the definitions of "hybrid entity" and "hybrid mismatch". This is to improve readability and has no impact on how the rules operate. The amendment should apply retrospectively from 1 July 2018, the date from which the hybrid and branch mismatch rules generally apply.

Recommendations

Agree to provide that dual inclusion income arising offshore can counteract the denial of deductions in New Zealand under the imported mismatch rule (for a hybrid mismatch located offshore) to the extent that the funding payment from New Zealand funds the hybrid mismatch from 1 July 2018.

Agreed/Not agreed

Agree to amend the scope of the imported mismatch rule so that a hybrid mismatch is established in respect of a payment only where there is a conflict in the tax characterisation of the instrument or payee or there is a timing mismatch from 1 July 2018.

Agreed/Not agreed

Agree to deny deductions for deductible charges to a branch by its head office where it allows the benefit of an offshore hybrid mismatch to be imported into the New Zealand tax base from income years beginning on or after enactment.

Agreed/Not agreed

Agree to not deny deductions in New Zealand for a payment that funds a hybrid mismatch through a chain of payments, where a payment along the chain of payments is from a jurisdiction that has hybrid mismatch legislation from 1 July 2018.

Agreed/Not agreed

Agree to deny deductions for payments that can be traced to a hybrid mismatch through loss grouping, a group contribution of income, or consolidation from income years beginning on or after enactment.

Agreed/Not agreed

Agree to insert cross-references into the definitions of "hybrid entity" and "hybrid mismatch" from 1 July 2018.

Agreed/Not agreed

Amendments to the Tax Administration Act 1994

Repealing the definition of START tax type

54. Inland Revenue has been progressively adding tax products from its previous computer system FIRST into its new computer system START as part of Business Transformation (BT).

55. Once a new tax type was added to START, the definition of "START tax type" was amended so that the cancellation of interest could be applied to the added START tax types. In October 2021, at the second phase of BT Stage 4, Inland Revenue will complete shifting of all tax types to START and there will be only one platform. Therefore, there would be no need to make an explicit reference of START tax type in the TAA after the completion of BT. The TAA needs to be amended to repeal the definition of "START tax type" for various penalties from 1 April 2022.

Recommendations

Agree to repeal the definition of START tax type.

Agreed/Not agreed

Agree that this change apply from 1 April 2022.

Agreed/Not agreed

Penalty for failure to keep taxpayer information confidential

56. Inland Revenue currently shares taxpayer information with 28 other agencies to assist those agencies in providing public services. Employees of these other agencies are required to keep this taxpayer information confidential under the TAA. Before March 2019, failure by an employee of another agency to keep information confidential was an offence, punishable by a maximum penalty of $15,000 and/or a term of imprisonment of up to 6 months. Inland Revenue employees are also subject to the same confidential obligation and penalty.

57. With the enactment of the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019, changes were made to the offence provisions in the TAA. However, an unintended outcome of these changes was that one of the offence provisions relating to failing to maintain confidentiality was omitted. This was a legislative oversight and Officials recommend that an amendment be made to reinsert the penalty provision for offences for failure by an employee of another agency to maintain taxpayer confidentiality. This change reflects the original policy intent of the legislation.

58. Officials also recommend that the amendment apply from 18 March 2019, being the date that the previous penalty provision was omitted from the Act.

Recommendations

Agree to reinsert the penalty provision for failure of employees of other agencies to maintain taxpayer confidentiality.

Agreed/Not agreed

Agree that the recommendation above apply from 18 March 2019.

Agreed/Not agreed

Removing fax as a mode of communication

59. Taxpayers can choose a range of ways to communicate with Inland Revenue either by personal delivery, post, fax, or electronic means.

60. Our vendor has no ability to extend the life of copper circuits, which are utilised by faxes. The cost of designing, building and implementing a paperless fax has been considered too high given that our fax usage has decreased significantly. Given the cost and the increasingly digital way we work, Inland Revenue has decided to shift to digital channels and no longer accept faxes.

61. Inland Revenue will no longer accept inbound faxes from 1 July, with faxes no longer being supported by our technology partners from 31 August 2021.

62. To support this change, we recommend the modes of communication set out in the Inland Revenue Acts be amended to remove fax as an option.

Recommendation

Agree to remove references to fax as a mode of communication from the relevant Inland Revenue Acts.

Agreed/Not agreed

Amendments to the Child Support Act 1991

Administrative amendments to the Child Support Act 1991

63. The recently enacted Child Support Amendment Act 2021 contains measures to improve the child support scheme. The previous omnibus report (IR2021/218 refers) identified a group of minor and technical remedial changes to the principal Act that are needed to give full effect to the policy intent of the recent amendments. Three further amendments are also recommended.

64. ***Time bar for reassessments of child support*****:** An amendment is needed so that the time bar begins from the beginning of the child support year rather than when notification of the assessment is given. This will ensure that it covers the intended four-year period. Parents and carers are sent notification of their child support assessment in February each year and that assessment relates to the child support year starting on 1 April. As currently drafted the time bar will start from the notification rather than the beginning of the relevant child support year.

65. ***Election period for backdated estimations*****:** The Child Support Amendment Act 2021 allows newly liable parents to backdate their estimations (provided the estimation is made within 28 days of the notification of the assessment). It was intended that the backdating would cover both estimations over back years and within the current child support year. However, the amendment only allows estimations over back years. An amendment is needed to allow backdated estimations within the current child support year.

66. ***Notice of family circumstances at time of assessment*****:** An amendment is needed to clarify that the circumstances are those that existed when an assessment began as opposed to when it was generated. It is possible that family circumstances change between a child support application beginning and when the child support notification is generated. The amendment is necessary to clarify that the relevant circumstances are those that existed when the assessment begins.

Recommendation

Agree to the additional minor and technical remedial changes to the Act noted above.

Agreed/Not agreed

Administrative implications

67. The changes recommended in this report clarify and remove uncertainties around the application of the Inland Revenue Acts. They reduce administrative costs by aligning the legislation with the policy intent.

68. The recommended changes are not expected to have any material systems or technical impacts.

Consultation

69. The Treasury has been informed of the contents of this report.

Next steps

70. We recommend that the proposed amendments be included in the next omnibus taxation Bill, scheduled for introduction in August 2021.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Amended Cabinet paper – Measures for inclusion in 2021 omnibus tax Bill**

Date:	17 June 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/273

Action sought

	Action sought	Deadline
Minister of Revenue	**Approve** and **lodge** the attached Cabinet paper with the Cabinet Office **Refer** a copy to the Minister of Finance	10 am, Thursday 24 June 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a) [redacted]
s 9(2)(a) [redacted]	Policy Advisor	

17 June 2021

Minister of Revenue

Amended Cabinet paper – Measures for inclusion in the 2021 omnibus tax Bill

1. On 2 June 2021, we provided you with a report (IR2021/247 refers) ("Report") and draft Cabinet paper on the following policy items to be included in the upcoming 2021 omnibus tax Bill:

    1.1 Local authority taxation: dividends and deductions

    1.2 Changes to the fair dividend rate foreign currency hedges rules

    1.3 Use of tax pooling to satisfy a backdated tax liability

    1.4 Removal of the sunset clause on COVID-19 information sharing power

    1.5 Penalising the sale or possession of sales suppression software

2. The Report advised that Treasury's Regulatory Impact Analysis Team had determined items 1.1, 1.3 and 1.5 required a regulatory impact assessment (RIA). Enclosed with the Report was a RIA in connection with item 1.5. We advised you that the RIAs for the remaining policy items 1.1 and 1.3 would be provided to you prior to the lodgement of the Cabinet paper.

3. Please find enclosed the RIAs relating to policy items 1.1 and 1.3. Additionally, as these items partially meet the Quality Assurance criteria, we have amended the Cabinet paper earlier supplied to reflect this assessment.

Next steps

4. The Cabinet paper needs to be lodged with the Cabinet Office by 10 a.m. 24 June 2021 for consideration by the Cabinet Economic Development Committee (DEV), on Wednesday 30 June 2021.

Recommended action

We recommend that you:

1. **Note** the provision of the enclosed RIAs in connection with policy items 1.1 and 1.3, above

Noted

2. **Approve** and **lodge** the attached amended Cabinet paper and Regulatory Impact Assessments to the Cabinet Office by 10:00am Thursday, 24 June 2021 for the Cabinet Economic Development Committee to consider at its meeting on 30 June 2021.

Approved and lodged/Not approved and lodged

3. **Refer** a copy of this report to the Minister of Finance for his information.

Referred

Paul Fulton
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Remedial change to employer superannuation contribution tax on contributions for past employees**

Date:	17 June 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/274

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	1 July 2021
Minister of Finance	**Agree** to recommendations	1 July 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Peter Frawley	Policy Lead	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

[17 June 2021]

Minister of Revenue

Remedial change to employer superannuation contribution tax on contributions for past employees

Summary

1. This report seeks to make a remedial change to the employer's superannuation contribution tax (ESCT) regime to ensure that contributions for past employees are charged at a flat rate of 33%. The rate was increased to 39% as a consequential amendment in the Taxation (Income Tax Rate and Other Amendments) Act 2020.

Purpose

2. This report seeks your agreement to reduce the rate of ESCT on contributions made for past employees to 33%, for such contributions made on or after 1 April 2022.

Background

3. The Taxation (Income Tax Rate and Other Amendments) Act 2020 implemented a new top personal income tax rate of 39% on annual income exceeding $180,000. The previous top rate of 33% now applies for annual income between $70,001 and $180,000. A number of associated rates were also aligned to ensure the integrity of the tax system, including employer's superannuation contribution tax (ESCT) rates.

4. ESCT is a tax deducted from an employer's contributions to an employee's KiwiSaver or other complying superannuation fund. ESCT rates follow the personal income tax rates but only one single ESCT rate applies to the total amount of the contribution.[1] The ESCT thresholds are therefore grossed up to minimise the risk that superannuation contributions are taxed at a higher rate than the rest of an employee's salary and wages. For example, if the thresholds were not adjusted someone with a salary of $47,500 and whose marginal income tax rate is 17.5% could get pushed in to the $48,000-$70,000 income range by their superannuation contributions and then have all their superannuation contributions taxed at a flat rate of 30%.

Employee's annual income	ESCT rate
$0 to $16,800	10.5%
$16,801 to $57,600	17.5%
$57,601 to $84,00	30%
$84,001 to $216,000	33%
$216,000+	39%

5. While ESCT rates are designed to match an individual's marginal income tax rate, there are a couple of exceptions where it is not practical to do so. While it is not

[1] New Zealand's personal income tax rates, on the other hand, apply on a marginal basis so different rates apply to different amounts of income

common, some employers continue to make contributions after an individual leaves their employment. This is usually when the employee is a member of a defined benefit scheme.[2] Individuals generally do not have individual accounts as they would in a KiwiSaver scheme, for example, and instead the payments are funded out of a general scheme.

6. Where the contributions are to a defined benefit scheme (and the contribution is not for a past employee), the employer can elect to apply the top ESCT rate. We understand that where possible, employers will attribute the contributions to specific individuals and only make an election to apply the top rate where it is not possible. Where the contribution is made in respect of a past employee, the employer must apply the top ESCT rate.

7. Currently the amount of tax on the employer's superannuation cash contribution is a flat rate of 39% if the contribution is made for the benefit of a past employee; the previous rate was 33%. The rationale for this is that an employer will not have up-to-date information for past employees and so a flat rate aligned with the top ESCT rate would be more practical while maintaining integrity. However, alignment with the new top 39% rate results in over-taxation in nearly all past employee cases.

8. Limited data was available to Inland Revenue at the time policy decisions on the 39% rate were taken and engagement with external stakeholders was not possible. The original rationale behind aligning the ESCT rate for past employees (and the rate for defined benefit schemes, where the employer chooses to) with the new top rate was that defined benefit schemes are generally legacy schemes no longer open to new employees and members tend to be on higher incomes compared with the standard population. In the absence of detailed information on such contributions, officials considered that not aligning the past employee ESCT rate with the top rate would create an integrity risk.

9. More recent data shared with us from the Workplace Savings Committee of the Financial Services Council shows that the weighted average employee salary of members of defined benefit schemes is s 9(2)(ba)(i). Available data on past employees shows average salary of s 9(2)(ba)(i) immediately pre-retirement. While these figures are higher than the average income in New Zealand, members of the defined benefit schemes surveyed are unlikely to be on the 39% tax rate. These figures suggest there are minimal integrity risks associated with reducing the rate to 33%.

10. We recommend that where an employer's superannuation cash contribution is made for the benefit of a past employee, the ESCT rate should be 33%. The amendment should apply to contributions made on or after 1 April 2022.

Financial implications

11. The current Budget 2021 forecast baselines include the fiscal impact of the 39% rate change for ESCT on the assumption that contributions will be taxed at the right individual rate for the relevant taxpayer based on the individual's income. This does not incorporate potential over-taxation when ESCT is payable for employer contributions to past employees. The baselines will be adjusted to reflect what is happening under the current law, estimated to be over-taxation of $3,400 per year. The fiscal impact of the remedial policy change is relative to the adjusted baselines.

12. The cost of the forecasting change to the Budget 2021 baselines is represented below:

[2] Defined benefit schemes guarantee a set pension on retirement, normally linked to the individual's employment income. Defined benefit schemes are no longer common in New Zealand and many are legacy schemes that are no longer open to new members.

	$ million– increase/(decrease)				
Minister of Revenue Vote Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax Revenue	0.001	0.003	0.003	0.003	0.003
Total Operating	(**0.001)**	**(0.003)**	**(0.003)**	**(0.003)**	**(0.003)**

13. The policy cost of decreasing the rate over the forecasting period is as follows:

	$million– increase/(decrease)				
Minister of Revenue Vote Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax Revenue	0	0	(0.001)	(0.003)	(0.003)
Total Operating	**0**	**0**	**0.001**	**0.003**	**0.003**

Consultation

14. Treasury was consulted in the preparation of this report and agrees with its recommendations.

Next steps

15. This proposed change should be included in the omnibus taxation Bill scheduled for introduction in August 2021.

Recommended action

We recommend that you:

16. **Note** the forecast change shown in the table below, reflecting an increase to existing baselines as a result of superannuation contributions to past employees currently being taxed at 39%, rather than at marginal rates as forecast.

	$ million– increase/(decrease)				
Minister of Revenue Vote Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax Revenue	0.001	0.003	0.003	0.003	0.003
Total Operating	**(0.001)**	**(0.003)**	**(0.003)**	**(0.003)**	**(0.003)**

Noted Noted

17. **Agree** that the employer's superannuation contribution tax rate for contributions made for the benefit of past employees should be 33%.

Agreed/Not agreed Agreed/Not agreed

18. **Agree** that the amendment should apply to contributions made on or after 1 April 2022.

Agreed/Not agreed   Agreed/Not agreed

19. **Note** that agreeing to recommendations 2 and 3 above will have the following impact on tax revenue, with an ongoing impact beyond the forecast period

	$– increase/(decrease)				
Minister of Revenue Vote Revenue	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Tax Revenue	0	0	(0.001)	(0.003)	(0.003)
Total Operating	**0**	**0**	**0.001**	**0.003**	**0.003**

Noted   Noted

s 9(2)(a)

Peter Frawley
Policy Lead
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /2021

Hon David Parker
Minister of Revenue
/ /2021

Inland Revenue
Te Tari Taake

Policy and Strategy
Te Wāhanga o te Rautaki me te Kaupapa
55 Featherston Street
PO Box 2198
Wellington 6140
New Zealand

T. 04 890 1500
F. 04 903 2413

Briefing note

Reference:	BN2021/284
Date:	22 June 2021
To:	Revenue Advisor, Minister of Revenue – s 9(2)(a) [redacted] Private Secretary, Minister of Revenue
cc:	Naomi Ferguson, Commissioner David Carrigan, Deputy Commissioner Emma Grigg, Policy Director Kerryn McIntosh-Watt, Policy Director Phil Whittington, Chief Economist s 9(2)(a) [redacted], Executive Support Advisor to the Commissioner PA to Deputy Commissioner Government & Executive Services (Ministerial Services)
From:	s 9(2)(a) [redacted]
Subject:	**Speaking notes: *Measures for inclusion in the 2021 Omnibus Tax Bill* for consideration at Cabinet Development Committee on 30 June 2021**

Speaking notes

1. This briefing note contains speaking notes on the Cabinet Paper *Measures for inclusion in the 2021 Omnibus Tax Bill* for consideration by Cabinet Economic Development Committee (DEV) at its meeting on 30 June 2021.

Consultation with Treasury

2. Treasury was informed about this briefing note.

s 9(2)(a) [redacted]

Policy Advisor
s 9(2)(a) [redacted]

Speaking notes

Cabinet Economic Development Committee (DEV)

Measures for inclusion in the 2021 Omnibus Tax Bill

Recommended actions:

- Approval is sought for five miscellaneous measures that require changes to the Income Tax Act 2007 and the Tax Administration Act 1994.
- The changes would be included in the Government's next omnibus tax Bill (expected to be introduced in August 2021).
- The specific measures are set out below.

Local authority taxation: dividends and deductions (paragraphs 7 to 18)

Purpose

- I recommend a package of changes to improve the integrity of local government taxation.

Background

- Council-controlled organisations (CCOs) are treated as ordinary companies and are taxed to ensure competitive neutrality with the private sector.
- Current tax law allows tax-exempt local authorities to partially shelter their CCOs from tax.
- This undermines the integrity of the tax system by allowing local authorities to effectively transfer their exempt status to their CCOs.

Proposal/Key points

- To address this integrity risk I propose to:
  - exempt dividends derived by local authorities from wholly-owned CCOs;
  - prevent local authorities accessing the corporate gift deduction;
  - limit local authorities' access to interest deductions; and
  - amend the imputation rules.

Consultation

- My officials undertook targeted consultation with the local government sector on these issues.
- The dividends and imputation proposals were supported. The proposal to limit certain deductions was developed by officials following feedback from submitters.

Fiscals

- The aggregate fiscal impact of these changes is expected to be a revenue gain of $24 million per year.
- The surplus for all local authority groups was $2.3 billion in 2020. Since the tax increases are relatively small, the flow-on economic impacts are expected to be relatively small.

Key Risks

- These changes will have an uneven impact on local government funding.
- This reflects that the current integrity risks are being taken advantage of to varying degrees across the local government sector.
- Three councils accounted for 30% of all corporate gift deductions claimed by all NZ companies from 2016 to 2020.

Changes to the fair dividend rate foreign currency hedges rules (FDR FX hedges rules) (paragraphs 19 to 26)

Purpose

- I recommend a series of technical changes be made to improve the FDR FX hedges rules.
- These are existing rules that help to eliminate a tax mismatch between foreign currency hedges and the foreign assets they hedge.

Background

- Many investors enter into foreign currency hedges to protect themselves from fluctuations in the value of their offshore assets caused by exchange rate movements.
- Differences in the tax treatment of the hedged assets and these foreign currency hedges create a tax mismatch. This mismatch means that a hedge that is effective in removing the impact of unexpected currency fluctuations before tax ceases to be effective after tax.
- The FDR FX hedges rules are optional and allow investors to apply the same tax treatment to a foreign currency hedge that is applied to the hedged offshore asset, thereby removing the tax mismatch.
- Unfortunately, there has been little application of the FDR FX hedges rules since their 2013 introduction and this tax mismatch remains an ongoing issue.

Proposal/Key points

- The recommended technical changes are required to simplify the FDR FX hedges rules, reduce compliance costs for investors, and allow their application from a practical perspective.

- The changes are within the spirit of the original policy intent, and critically, do not undermine the integrity of the rules by opening them up for manipulation.

Consultation

- My officials engaged in targeted consultation with the managed funds industry, tax advisors and corporate groups. All stakeholders were very supportive of the proposed changes.

Fiscals

- These changes will reduce revenue volatility and have no fiscal impact over the long term. This is because foreign currency hedges are expected to make a cumulative return of zero over time.

Key Risks

- No key risks have been identified.

Use of tax pooling to satisfy backdated tax liability (paragraphs 27 to 29)

Purpose

- I propose to enable the use of tax pooling to satisfy tax liabilities arising from a voluntary disclosure where there is no existing assessment.

- This will remove a barrier to voluntary disclosures and improve system integrity.

Background

- Currently, where there is no existing assessment, tax pooling can only be used to satisfy a tax liability from a voluntary disclosure of Income Tax or Resident Withholding Tax.

- However, there are several circumstances where a taxpayer may have unintentionally not filed a tax return for a particular tax type and tax period.
- For example, a small business may be unaware that an employee benefit it provides is subject to fringe benefit tax and so does not provide a return where it is required to.
- Where these omissions have been made in good faith, it is disproportionally punitive to not allow taxpayers to obtain the benefits of tax pooling where they want to do so.

Proposal/Key points

- I recommend that existing provisions which enable the use of tax pooling where there is no existing assessment be extended to all tax types.
- Using tax pooling to satisfy liabilities arising from a voluntary disclosure will continue to be subject to integrity criteria and the discretion of the Commissioner of Inland Revenue to maintain system integrity.

Consultation

- My officials engaged in targeted consultation with tax advisors, corporate groups and tax pool providers.
- Stakeholders were supportive of the proposed changes.

Fiscals

- The fiscal implications of this change cannot be defined.
- The reason for this is that both costs (from reduced Use of Money Interest) and savings (from increased voluntary disclosures) are dependent on behavioural change which cannot be predicted.

Key Risks

- This change could be perceived as rewarding non-filing. However, I wish to emphasise that there is a zero-tolerance stance on such behaviour.

- This change will be accompanied by the requirement for key criteria to be met in order to utilise tax pooling.
- Underpinning these criteria will be the Commissioner's ability to impose penalties where she is satisfied that the omission is the product of a taxpayer choosing not to comply.

Removal of sunset clause on COVID-19 information sharing power (paragraphs 30 to 34)

Purpose

- I propose that the current time-limit relating to legislation that enables information sharing for COVID-19 related purposes be removed.

Background

- The ability to share information for COVID-19 related purposes was introduced quickly at the start of the pandemic.
- The uncertainty of the unusual circumstances and speed with which the provision was introduced resulted in it, rightly, being drafted with an abundance of caution.
- One of the safeguards introduced was the requirement that the legislation be in place for two years with the ability to extend this period by Order in Council.

Proposal/Key points

- I am now proposing this time limit be removed as I am satisfied that the powers offered by the legislation are sufficiently safeguarded.
- Removing the need to periodically extend this provision via Order in Council will prevent unnecessary administrative cost.

Consultation

- My officials undertook targeted consultation with peers across government including the Ministry of Business, Innovation and

Employment, the Ministry of Social Development and the Treasury.

- The Office of the Privacy Commissioner has been consulted and does not take issue with the proposal.

Fiscals

- There are no fiscal costs associated with this work.

Key Risks

- No key risks have been identified.

Penalise the sale or possession of sales suppression software (paragraphs 35 to 39)

Purpose

- I propose a series of amendments to penalise the manufacture, sale, and possession of sales suppression software.

Background

- Sales suppression software is software that can be used to alter point-of-sales data collected by a business for the purpose of evading tax in a manner that is easy to use and difficult to trace.
- Use of this software has been responsible for material revenue losses overseas, and the OECD considers it a growing threat to revenue collection worldwide. Authorities in the UK and Australia, which have been dealing with this issue for a number of years, have recently informed us that a UK-based company may be marketing it to New Zealand businesses.

- This software is not currently considered under New Zealand tax law. While using it to suppress sales data is a form of tax evasion, and could be dealt with using existing law, it is not currently an offence in New Zealand to make, sell, buy, or possess sales suppression software.

Proposal/Key points

- I propose to introduce new criminal penalties covering making or selling sales suppression software, with a maximum penalty of $250,000, and buying or possessing the software, with a maximum penalty of $50,000. These penalties can be applied alongside the existing criminal evasion penalty.

- Additionally, I propose a smaller civil penalty for buying or possessing the software, to be set at $5,000, which can be applied in addition to existing civil evasion penalties. This will give Inland Revenue the flexibility to penalise smaller offenders without the need to individually prosecute them.

- I also propose removing the existing 50% reduction of the civil evasion penalty for taxpayers with no prior history of non-compliance when the evasion included use of sales suppression software. This is as evasion involving sales suppression software requires the taxpayer to first acquire the software which is itself a premeditated act of non-compliance.

- These penalties will act as a deterrent to stop the spread of this software among New Zealand businesses and protect the integrity of the tax base. They also send a clear message to the public that providing or possessing sales suppression software is unacceptable in New Zealand.

Consultation

- My officials undertook targeted consultation with the Treasury, the Ministry of Justice, the Department of Internal Affairs, and internal Inland Revenue experts on evasion. They also consulted the New Zealand Law Society and Chartered Accountants Australia and New Zealand.
- All consulted parties were supportive of action being taken and broadly support the proposed approach.

Fiscals

- There are no fiscal costs associated with this work.

Key Risks

- No key risks have been identified.

In Confidence

Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

MEASURES FOR INCLUSION IN THE 2021 OMNIBUS TAX BILL

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to five general policy measures that require changes to tax legislation.

2. If approved, we propose including the necessary legislative amendments in the next omnibus tax Bill, scheduled for introduction in August 2021.

Relation to Government Priorities

3. The measures in this paper promote Government priorities by maintaining the integrity of the tax system and making it easier for taxpayers to meet their obligations.

Executive Summary

4. This paper has been prepared to obtain approval to include five policy matters in the 2021 omnibus tax Bill. We recommend the following amendments to the Income Tax Act 2007 and Tax Administration Act 1994

    4.1 Local authority taxation: dividends and deductions.

    4.2 Changes to the fair dividend rate foreign currency hedges rules.

    4.3 Use of tax pooling to satisfy backdated tax liability.

    4.4 Removal of sunset clause on COVID-19 information sharing power.

    4.5 Penalise the sale or possession of sales suppression software.

5. These issues have been covered in the same paper for efficiency.

Local authority taxation: dividends and deductions

Background

6. A local authority is tax-exempt on all income derived from its core activities (e.g. water supply).

7. However, income derived by a local authority from a Council-Controlled Organisation (CCO) is taxable. This is designed to prevent profit shifting from taxable CCOs to tax exempt local authorities.

Problem definition

Dividends

8. Inter-corporate dividends paid between New Zealand resident companies are tax exempt where there is 100% common ownership. Dividends paid between the Crown and State enterprises, and charities and their wholly-owned companies, are similarly tax-exempt.

9. However, this tax exemption does not apply to dividends derived by local authorities from their wholly-owned CCOs. There is no reason for this difference in tax treatment. Since a dividend is not a deductible expense of a CCO, no risk of profit shifting arises.

Deductions

10. Current law allows local authorities tax deductions for some expenditure not incurred in deriving assessable income (such as corporate gift deductions and certain interest deductions). These deductions allow local authorities to have tax losses despite being largely exempt from tax. These losses are being used to shelter their CCOs from tax.

Corporate gift deductions

11. The corporate gift deduction is intended to encourage companies to redirect part of their otherwise taxable income to charitable, benevolent, philanthropic or cultural purposes. The corporate gift deduction should not apply to primarily exempt entities like local authorities. In particular, it is inappropriate to provide a tax subsidy for donations made by local authorities whose legislated purpose is to promote the social, economic, environmental, and cultural well-being of communities. Allowing local authorities to access the corporate gift deduction effectively allows them to transfer the benefit of their exempt status to their taxable CCOs, contrary to the policy intent.

Interest deductions and hedging

12. A local authority should only be allowed a deduction for interest on money borrowed for the purpose of deriving assessable income. However, local authorities are currently allowed deductions for interest on money borrowed to acquire shares in a CCO that is part of the same local authority group. This allows local authorities to shelter taxable income streams with deductions available for capitalising a CCO that is not carrying on a business to make a profit.

13. A local authority can also enter into a hedge (a financial arrangement) in relation to a loan taken out by a CCO. A base price adjustment is a wash-up calculation for when a financial arrangement matures, is remitted, sold or otherwise transferred. The adjustment is a final calculation to ensure that all income or expenditure in relation to the financial arrangement has been brought to tax. A positive base price adjustment is tax-exempt income of a local authority and a negative base price adjustment is deemed to be deductible expenditure.

14. Under current rules, a local authority can receive a deduction for a negative base price adjustment for a financial arrangement relating to a non-trading CCO (i.e. a CCO not undertaking income-generating trading activity).

Imputation

15. Current tax rules allow some local authorities to satisfy their income tax liabilities on dividends without using all the imputation credits attached to those dividends. This results in the local authority having excess imputation credits which the local authority can convert to a tax loss and offset it against the net income of its CCO group. This effectively allows the local authority to shelter its CCOs from liability to tax.

16. Local authorities in consolidated groups can access the group's imputation credit account (ICA) and the local authority can credit to the group's ICA all imputation credits attached to dividends it derives from a CCO. These credits are then available for reuse by CCOs within the group. This is not an intended policy outcome.

Proposed solution

17. We recommend introducing the following measures to improve the integrity of local government taxation and help prevent local authorities from effectively transferring the benefit of their exempt status to their taxable CCOs. These measures would:

17.1 Treat dividends derived by a local authority from a wholly-owned CCO, port company, subsidiary of a port company, or energy company as exempt income.

17.2 Prevent local authorities from receiving a deduction for charitable or other public benefit gifts made to donee organisations.

17.3 Ensure that local authorities are only allowed a deduction for interest on borrowings for the purpose of deriving assessable income or to acquire shares in a CCO that is a council-controlled trading organisation (a CCO that operates a trading undertaking for the purpose of making a profit).

17.4 Limit a local authority's access to deductions for negative base price adjustments to financial arrangements involving a CCTO of the local authority.

17.5 Prevent local authorities converting unused imputation credits to a tax loss.

17.6 Ensure that a credit does not arise to a consolidated group's imputation credit account for imputation credits attached to a dividend derived by a local authority.\

Fair dividend rate foreign exchange hedges rules

18. We recommend a series of technical amendments be made to the fair dividend rate foreign currency hedges rules (FDR FX hedges rules) to give effect to their intended purpose of facilitating effective after-tax foreign currency hedging.

Background

19. When a person invests in an offshore asset, changes in the exchange rate can affect the value of the person's investment when it is converted back to New Zealand dollars. Many people who invest offshore enter into arrangements to protect themselves from exchange rate changes. These arrangements are referred to as foreign currency hedges. The idea is that changes in the hedge's value due to movements in the exchange rate offset equal and opposite changes in the value of the hedged foreign assets due to the same movements in the exchange rate.

20. A tax mismatch arises when a person hedges an offshore investment taxed under the fair dividend rate (FDR) method. This is because, under the FDR method, changes in an asset's value are not taxed. Instead, these assets are taxed on an imputed return of 5% of their opening market value. Conversely, changes in a hedge's value are fully taxed under the financial arrangements (FA) rules. This mismatch in tax treatment means that a hedge that is effective in removing the impact of unexpected currency fluctuations before tax, ceases to be effective after tax.

21. The FDR FX hedges rules were introduced in 2013 to eliminate this tax mismatch for managed funds. The rules are optional and broadly allow an eligible taxpayer to calculate income from a foreign currency hedge on the same basis as the hedged offshore asset (by imputing taxable income of 5% of a hedge's opening market value) – thereby removing the tax mismatch.

Problem definition

22. Since their introduction, few taxpayers have used the FDR FX hedges rules. This is because the rules impose significant compliance costs. Although the rules are intended to stop manipulation by taxpayers, they are very restrictive and have limited application from a practical perspective. Therefore, effective after-tax foreign currency hedging remains an ongoing issue for taxpayers.

23. Specifically, the issues are:

23.1 The rules include two methods for calculating the portion of a hedge that is eligible for FDR treatment (known as the FDR hedge portion). As currently designed, the second method always results in an FDR hedge portion of less than 100%, even when non-eligible assets are already fully hedged.

23.2 In some cases, a taxpayer's only non-eligible assets are immaterial cash balances (held for liquidity purposes or from outstanding settlements and dividends), which prevent a taxpayer from applying the FDR method to 100% of a hedge of eligible assets.

23.3 Both methods require the FDR hedge portion calculation to be performed when each hedge is entered into. This imposes burdensome compliance costs for taxpayers with a significant number of hedges at any point in time and that turnover hedges regularly.

23.4 Currently only assets that are directly owned by a taxpayer can qualify under the rules as eligible assets resulting in hedges of indirectly held offshore assets not being eligible for FDR treatment.

23.5 The rules currently do not provide for ownership of assets, including eligible hedges, being transferred between funds or sub funds, despite these transfers being reasonably common within the managed funds industry.

Proposed solution

24. We recommend a series of technical amendments be made to the FDR FX hedges rules. These changes are intended to improve the clarity of the rules, reduce compliance costs and allow their application from a practical perspective. The changes are within the spirit of the original policy intent and, critically, do not undermine the integrity of the rules by opening them up for manipulation.

25. Specifically, these technical amendments:

25.1 Modify the second method for determining the extent to which foreign currency hedges can be subject to FDR treatment, to ensure that the FDR method can be applied to 100% of a foreign currency hedge of eligible assets when non-eligible assets are already fully hedged.

25.2 Introduce a de minimis for non-eligible assets.

25.3 Introduce an optional new method for determining FDR hedge portions on a portfolio basis instead of a hedge-by-hedge basis.

25.4 Introduce an optional look-through rule to allow taxpayers who hedge indirectly owned eligible assets to apply the rules in certain circumstances.

25.5 Allow eligible hedges to continue to be subject to FDR treatment when ownership of the assets of a fund/investor class is transferred.

Use of tax pooling to satisfy backdated tax liability

Background

26. Under current settings, tax pooling cannot be used where there is no existing assessment or quantified obligation. The only exception is certain voluntary disclosures for income tax and resident withholding tax where no prior return was filed and the return was provided as part of the voluntary disclosure. In these situations, use of tax pooling is subject to a Commissioner’s discretion measured against specific legislative criteria.

Problem definition

27. In some circumstances, a taxpayer may have unintentionally not filed a tax return for a particular tax type and tax period. For example, a small business may be unaware that an employee benefit it provides is subject to fringe benefit tax and so does not provide a return. Where these omissions have been made in good faith, it is disproportionally punitive to not allow taxpayers to use tax pooling

Proposed solution

28. We propose an amendment to allow the use of tax pooling to satisfy these tax obligations. To prevent incentivising non-filing, safeguards will be established to ensure voluntary compliance without widening the scope for abuse. The following safeguards must be met to allow the use of tax pooling:

28.1 The taxpayer must make a voluntary disclosure to file the original return and generate an original assessment or obligation before Inland Revenue has made any contact with the taxpayer or their agent.

28.2 The voluntary disclosure must be made within a reasonable time frame of the taxpayer or their agent becoming aware of the error, with “reasonable time frame" to be defined by guidance issued by the Commissioner of Inland Revenue or by Order in Council.

Removal of sunset clause on COVID-19 information sharing power

Background

29. In March 2020, an emergency provision was introduced to enable Inland Revenue to share information with other agencies for the delivery of COVID-19 specific initiatives.

30. The information sharing provision includes a sunset clause, meaning it ceases to be in effect once 24 months have passed from the date of the clause commencing. The provision is currently due to expire in March 2022. This time limit can be extended by Order in Council which must be made before the expiry of the 24-month period.

Problem definition

31. This time limit was included in the provision as a safeguard, in light of the speed and uncertainty with which the provision was created. It is now apparent that the safeguard increases administrative burden, by requiring periodic extension via Order in Council, as well as the risk that the provision will be allowed to lapse as unneeded ahead of an unexpected resurgence of COVID-19.

Proposed solution

32. We propose an amendment to remove the time limit from the COVID-19 information sharing provisions meaning it will remain in effect without the need for repeat extension via Order in Council. This will future-proof these powers, ensuring agencies can share needed information throughout the entire life cycle of the pandemic and the initiatives that support New Zealand’s recovery.

33. Having an open-ended time limit on these provisions will not remove current limitations on information sharing. They will continue to be tied specifically to the delivery and administration of relevant COVID-19 related initiatives. The provision is therefore inherently self-limiting in the powers it provides.

Sales suppression software

34. We recommend that measures be taken to curtail the spread of sales suppression software (software which alters sales data to facilitate tax evasion) by introducing penalties on making, selling, providing, acquiring, or possessing such software.

Background

35. Sales suppression software systematically alters point-of-sale data collected by a business to understate or completely conceal revenues for the purpose of evading tax. The OECD has identified risks for tax administrations arising from the vulnerability of electronic cash register data to sales suppression software and consequent under-reporting of income.

36. Overseas jurisdictions have been attempting to deal with this issue for many years. The software has been responsible for significant revenue losses from business income tax and GST overseas and can be very difficult to extirpate from the tax base once it has gained a foothold. Action is required to prevent the software from gaining such a foothold in the New Zealand tax base.

Problem definition

37. Sales suppression software is not currently illegal under New Zealand law. While using the software to manipulate sales data for the purposes of underreporting income is a form of tax evasion and could be dealt with under existing anti-evasion provisions, it is not currently illegal to make, sell, or possess the software. Our current ability to prevent the spread of this software within the New Zealand tax base is therefore limited.

Proposed solution

38. We recommend the introduction of:

38.1 Criminal penalties for the production, sale, and/or provision of sales suppression software, including a right to use the software, set at a maximum of $250,000.

38.2 Civil and criminal penalties for acquisition or possession of the software, or a right to use the software. The criminal penalty is to be set at a maximum of $50,000, while the civil penalty is to be set at $5,000. If a taxpayer voluntarily discloses acquisition, possession, or use of the software, the civil penalty above will be reduced by 100% for a pre-notification disclosure or 40% for a post-notification disclosure.

38.3 A further amendment to disable the existing 50% reduction of the civil evasion penalty for prior behaviour when the evasion included use of sales suppression software. However, if the taxpayer provides a pre-notification voluntary disclosure of acquisition, possession, or use of the software, the reduction will still apply.

Implementation

39. The local body recommendations should apply from the beginning of the 2022-23 income year.

40. The recommendations relating to the fair dividend rate foreign currency hedges rules, the use of tax pooling to satisfy a backdated tax liability and the removal of the sunset clause on COVID-19 information sharing power in this paper should apply to income years beginning 1 April 2022.

41. The recommended introduction of penalties for sales suppression software should apply from the date of enactment.

Financial Implications

Local authority taxation: dividends and deductions

42. Exempting dividends derived by a local authority from a wholly-owned CCO from income tax will be fiscally neutral.

43. Inland Revenue has limited data on the breakdown of which specific interest deductions are being claimed by local authorities and is unable to quantify the financial impact of the interest deduction proposals.

44. 38% of all company donations from 2016-17 to 2019-20 were made by local authorities. Over this time period, the yearly average total donations made by local authorities was $47.0m, with a tax effect of $13.2m.

45. For the 2019-20 income year, the tax value of local authorities converting excess imputation credits to a tax loss was $10.6m.

46. The aggregate fiscal impact of the recommended local authority taxation changes is a revenue gain of approximately $23.8 million a year. Due to when the first returns will be filed by local authorities following these changes, the initial impact on the operating balance will be uneven:

	$m – increase/(decrease)			
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25 and outyears**
Crown Revenue and Receipts: Tax Revenue	-	-	47.600	23.800
Total Operating	**-**	**-**	**(47.600)**	**(23.800)**

47. The revenue increase from these changes would be added to the tax policy scorecard. The tax policy scorecard is an accounting mechanism designed to ensure the cumulative net revenue impacts of non-significant tax policy changes are considered in aggregate. It acts as a memorandum account attached to the Between-Budget Contingency.

Use of tax pooling to satisfy backdated tax liability

48. While there may be a fiscal cost or saving to these proposals, neither the downside nor the upside risk is quantifiable as they relate to taxpayer behaviour. Both effects are in any event expected to be small.

Other proposals

49. There are no fiscal implications for the other recommended changes in this paper.

Legislative Implications

50. Implementing the recommended changes in this paper requires amendments to the Income Tax Act 2007 and the Tax Administration Act 1994.

51. If approved, we propose including the legislative changes resulting from these recommendations in the next omnibus tax Bill, scheduled for introduction in August 2021.

Impact Analysis

Regulatory Impact Assessment

Local authority taxation: dividends and deductions

52. The Quality Assurance reviewer at Inland Revenue has reviewed the Local authority taxation – dividends and deductions Regulatory Impact Statement prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Statement **partially meets** the quality assurance criteria.

53. This is because the affected stakeholders have not yet had an opportunity to submit on how they would be affected by two of the specific options (denying deductions for donations to donee organisations and denying interest deductions incurred in earning exempt income). Accordingly, the analysis of how these stakeholders would be affected is limited and uncertain.

Fair dividend rate foreign exchange hedges rules

54. The Regulatory Impact Analysis Team at the Treasury has determined that the regulatory proposals for the FDR FX hedges rules are exempt from the requirement to provide a Regulatory Impact Statement on the basis that the substantive issues have been addressed by previous impact analysis.

Use of tax pooling to satisfy a backdated tax liability

55. The Quality Assurance reviewer at Inland Revenue has reviewed the Tax Pooling to purchase backdated tax Impact Summary and considers that the information and analysis summarised in it **partially meets** the quality criteria of the Regulatory Impact Analysis framework.

56. This is because, as identified in the Key Limitations or Constraints on Analysis section, there is no data to support the current scale of the problem or the impact of the proposed changes if they were enacted. However, the Impact Summary sets out the rationale for why the status quo is an issue and why a regulatory change is preferred, and identifies the main risks and uncertainties.

Removal of sunset clause on COVID-19 information sharing power

57. Treasury's Regulatory Impact Analysis Team has determined that the proposal to remove the sunset provision on Clause 23B, Schedule 7 of the Tax Administration Act 1994 is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor impacts on businesses, individuals and not-for-profit entities.

Sales suppression software

58. The Quality Assurance reviewer at Inland Revenue has reviewed the Sales suppression software RIA prepared by Inland Revenue and considers that the information and analysis summarised in the RIA **meets** the quality assurance criteria.

Climate Implications of Policy Assessment

59. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to any of the proposals in this paper as the threshold for significance has not been met.

Population Implications

60. The recommended changes in this paper are not expected to have any undue implications for specific demographics in New Zealand.

Human rights

61. There are no human rights implications associated with the recommended changes in this paper.

Consultation

Local authority taxation: dividends and deductions

62. Officials undertook targeted consultation with the local government sector in 2019 and early 2021 on some of these proposals. The sector was broadly supportive of the proposals relating to dividends and imputation.

63. As part of the targeted consultation in 2021, officials also sought feedback on an earlier broader proposal to deny loss grouping between a local authority and its CCOs. Officials accepted the sector's arguments that local authorities can have some genuinely deductible expenditure and should be entitled to offset any losses arising from this expenditure against the income of other taxable entities within their group. The recommended changes to deny corporate gift deductions and limit certain interest deductions have a narrower ambit.

Fair dividend rate foreign exchange hedges rules

64. Officials conducted targeted consultation with the managed fund industry, tax advisors and business groups in late 2020 on the recommended changes to the FDR FX hedges rules. Stakeholders are supportive of the recommended changes.

Use of tax pooling to satisfy backdated tax liability

65. Chartered Accountants Australia and New Zealand, and PwC were consulted and are supportive of the proposal.

Removal of sunset clause on COVID-19 information sharing power

66. The Office of the Privacy Commissioner, the Treasury, Ministry of Business, Innovation and Employment and the Ministry for Social Development were consulted and have no issue with this proposal.

Sales suppression software

67. The Ministry of Justice, the Department of Internal Affairs, and the Treasury were consulted and support this proposal. Chartered Accountants Australia and New Zealand and the New Zealand Law Society were also consulted and support the direction of the proposals with detailed comments that will be incorporated into the design of the proposed legislation.

68. Inland Revenue internal experts on evasion and sales suppression were also consulted, as was the Australian Tax Office. Their advice has informed this proposal.

Communications

69. The Minister of Revenue will make an announcement on the contents of the Bill, including these proposals, when the Annual Rates, GST and Remedial Matters Bill 2021 is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a Tax Information Bulletin after the Bill is enacted.

Proactive release

70. We propose to proactively release this Cabinet paper, associated minutes and key advice papers within 30 working days of the introduction of the Bill.

Recommendations

The Minister of Finance and the Minister of Revenue recommend that the Cabinet Economic Development Committee:

Local authority taxation: dividends and deductions

1. **agree** to treat dividends derived by a local authority from a wholly-owned CCO, port company, subsidiary of a port company, or energy company as exempt income.

2. **agree** that local authorities should not be allowed a deduction for charitable or other public benefit gifts made to donee organisations.

3. **agree** that a local authority should only be allowed a deduction for interest on borrowing (for the purpose of deriving assessable income or) to acquire shares in a CCO if the CCO is a council-controlled trading organisation.

4. **agree** that a local authority should only be allowed a deduction for a negative base price adjustment to a financial arrangement involving a council-controlled trading organisation of the local authority.

5. **agree** that local authorities may not convert unused imputation credits to a tax loss.

6. **agree** that a credit should not arise to a consolidated group's imputation credit account for imputation credits attached to a dividend derived by a local authority.

7. **agree** that the above recommendations will apply from the beginning of the 2022-23 income year.

8. **note** the following changes as a result of the decisions in recommendations 1 to 7 above, with a corresponding impact on the operating balance and/or net core Crown debt:

	$m – increase/(decrease)			
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25 and outyears**
Crown Revenue and Receipts: Tax Revenue	- -	 -	 47.600	 23.800
Total Operating	**-**	**-**	**(47.600)**	**(23.800)**

Fair dividend rate foreign exchange hedges rules

9. **agree** to make the series of technical amendments to the FDR FX hedges rules, detailed in this paper, to allow the application of the rules from a practical perspective and facilitate effective after-tax foreign currency hedging.

10. **agree** that the above recommendation will apply to income years beginning 1 April 2022.

Use of tax pooling to satisfy backdated tax liability

11. **agree** to allow the use of tax pooling to satisfy back-dated tax obligations, subject to certain criteria.

12. **agree** to align the current Commissioner's discretion for income tax and RWT with this change.

13. **agree** to create a penalty that can be applied where the Commissioner is satisfied that debt has arisen through the taxpayer choosing not to comply with their tax obligations.

14. **agree** that the above recommendations will apply to income years beginning 1 April 2022.

Removal of sunset clause on COVID-19 information sharing power

15. **agree** to remove the current information-sharing time limit on COVID-19 related initiatives.

16. **agree** that the above recommendation will apply to income years beginning 1 April 2022.

Sales suppression software

17. **agree** to introduce penalties for production, sale, acquisition or possession of sales suppression software.

18. **agree** that the above recommendation will apply from the date of enactment.

Process

19. **Agree** that the above recommendations be included in the tax Bill scheduled to be introduced in August 2021.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Hon David Parker
Minister of Revenue

Cabinet Economic Development Committee

Minute of Decision

Measures for Inclusion in the 2021 Omnibus Tax Bill

Portfolios **Finance / Revenue**

On 7 July 2021, the Cabinet Economic Development Committee:

Local authority taxation: dividends and deductions

1 **agreed** to treat dividends derived by a local authority from a wholly-owned council-controlled organisation (CCO), port company, subsidiary of a port company, or energy company as exempt income;

2 **agreed** that local authorities should not be allowed a deduction for charitable or other public benefit gifts made to donee organisations;

3 **agreed** that a local authority should only be allowed a deduction for interest on borrowing (for the purpose of deriving assessable income or) to acquire shares in a CCO if the CCO is a council-controlled trading organisation;

4 **agreed** that a local authority should only be allowed a deduction for a negative base price adjustment to a financial arrangement involving a council-controlled trading organisation of the local authority;

5 **agreed** that local authorities may not convert unused imputation credits to a tax loss;

6 **agreed** that a credit should not arise to a consolidated group's imputation credit account for imputation credits attached to a dividend derived by a local authority;

7 **agreed** that the above proposals will apply from the beginning of the 2022-23 income year;

8 **noted** the following changes as a result of the decisions in paragraphs 1 to 7 above, with a corresponding impact on the operating balance and/or net core Crown debt:

	$m – increase/(decrease)			
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25 and outyears**
Crown Revenue and Receipts: Tax Revenue	-	-	47.600	23.800
Total Operating	-	-	(47.600)	(23.800)

Fair dividend rate foreign exchange hedges rules

9 **agreed** to make the series of technical amendments to the fair dividend rate foreign currency hedges rules, detailed in the paper under DEV-21-SUB-0155, to allow the application of the rules from a practical perspective and facilitate effective after-tax foreign currency hedging;

10 **agreed** that the above proposal will apply to income years beginning 1 April 2022;

Use of tax pooling to satisfy backdated tax liability

11 **agreed** to allow the use of tax pooling to satisfy back-dated tax obligations, subject to certain criteria;

12 **agreed** to align the current Commissioner's discretion for income tax and resident withholding tax with the above change;

13 **agreed** to create a penalty that can be applied where the Commissioner is satisfied that debt has arisen through the taxpayer choosing not to comply with their tax obligations;

14 **agreed** that the above proposals will apply to income years beginning 1 April 2022;

Removal of sunset clause on COVID-19 information sharing power

15 **agreed** to remove the current information-sharing time limit on COVID-19 related initiatives;

16 **agreed** that the above proposal will apply to income years beginning 1 April 2022;

Sales suppression software

17 **agreed** to introduce penalties for production, sale, acquisition or possession of sales suppression software;

18 **agreed** that the above proposal will apply from the date of enactment;

Process

19 **agreed** that the above proposals be included in the omnibus tax Bill scheduled to be introduced in August 2021.

Janine Harvey
Committee Secretary

Present: (see over)

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon Chris Hipkins
Hon Carmel Sepuloni
Hon David Parker
Hon Nanaia Mahuta (via zoom)
Hon Poto Williams
Hon Damien O'Connor (via zoom)
Hon Stuart Nash
Hon Michael Wood
Hon Dr David Clark
Hon Dr Ayesha Verrall
Rino Tirikatene MP
Dr Deborah Russell MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

GST POLICY ISSUES

Proposal

1. This paper seeks the Cabinet Economic Development Committee's approval to proposed amendments to the Goods and Services Tax Act 1985 (the GST Act), which would:

   - Remove crypto-assets from the GST and financial arrangement rules.
   - Reduce compliance costs and improve competition for courier businesses by zero-rating the domestic leg of the international transport of goods.
   - Ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately.
   - Reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method.
   - Provide the correct amount of second-hand goods input tax credits on supplies between associated persons.

2. These proposed amendments were publicly consulted on in a 2020 GST policy issues paper and were supported by submitters.

Relation to Government Priorities

3. The Government's tax policy work programme allocates policy resource to maintaining the tax system to ensure that Taxation Acts are updated to reflect changes in technology, business practices, jurisprudence or other factors. This supports the health of the tax system by ensuring that laws are working as intended. The proposals in this paper are required for these reasons.

Executive Summary

4. A number of GST-related issues, mainly technical in nature, have been raised regarding the GST Act. These issues need to be addressed to maintain the certainty, efficiency and fairness of the tax system.

5. Solutions to these issues would require legislative change and amendments could be included in the Taxation (Annual Rates for 2021-22, GST and Remedial Matters)

Bill (the Bill), scheduled to be introduced into the House in August 2021. The issues and suggested solutions are as follows:

5.1 Removing crypto-assets from the GST and financial arrangement rules to ensure these tax rules are not a barrier to investing into or using crypto-assets.

5.2 Zero-rating the domestic leg of the international transport of goods. This will ensure the tax system does not create incentives to pick one transport carrier over another and bring our rules into line with Australia.

5.3 Ensuring the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, such as farmhouses and home offices, by allowing a deduction which correctly reflects the non-taxable use.

5.4 Reducing compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method (currently this application process is limited to large taxpayers).

5.5 Provide the correct amount of second-hand goods input tax credits on supplies between associated persons to ensure GST registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

Fiscal costs

6. The proposal to zero-rate the domestic leg of the international transportation of goods has a fiscal cost of $0.2m per annum. The proposal to provide the correct amount of second-hands goods input tax credits on supplies between associated persons has a fiscal cost of $2m per annum. The revenue implications will not, however, impact the between-Budget spending contingency directly.

Other minor GST issues

7. In my capacity as Minister of Revenue I have also approved some other technical and remedial GST amendments for inclusion in the Bill. The amendments do not involve any significant policy change, do not have any fiscal impacts, and do not require Cabinet approval.

Background

8. GST is a tax on the consumption of goods and services in New Zealand. Consistent with New Zealand’s general tax policy settings, GST is imposed on a broad base of goods and services, and at a single low rate. This ensures that GST is simple, fair, and efficient.

9. Key principles underlying GST include that it is imposed on the supply of goods and services in New Zealand; that it taxes consumption, rather than business use; and that the goods and services that are taxed are consumed in New Zealand. New Zealand’s GST is highly efficient and accounts for about thirty percent of tax revenues.

10. A number of issues have been identified where the GST legislation produces an outcome that does not reflect the underlying policy intent. These issues should be addressed to maintain the certainty, efficiency and fairness of the tax system. Cabinet previously agreed to the release of GST Policy Issues: an officials' issues paper, which discussed a number of matters relating to the current GST legislation, and sought comment on the issues and suggested solutions (CAB-20-MIN-0031 refers). I now seek Cabinet's approval of my finalised policy proposals relating to:

- crypto-assets;
- the domestic leg of the international transport of goods;
- improvements to the GST apportionment rules; and
- second-hand goods input tax credits on supplies between associated persons.

Comment

Crypto-assets

11. Cryptocurrencies (also known as crypto-assets) are digital assets (commonly known as coins or tokens) that use cryptography and a decentralised network of computers to secure transactions and verify the transfer of the coins and tokens between individuals. There are over 10,000 crypto-assets, with the approximate total global market value of all crypto-assets exceeding US$1.7 trillion.

12. The existing GST and financial arrangement rules do not contemplate crypto-assets and are therefore difficult to apply, involve high compliance costs, and may provide policy outcomes for some crypto-assets that lead to over-taxation compared to other alternative investment products.

13. I propose that crypto-assets are excluded from GST and the financial arrangement rules. Crypto-assets are a similar investment product to shares which are also excluded from these rules. This will ensure that these rules do not impose barriers to developing new products, raising capital, and investing through crypto-assets. They also bring our laws into line with those in Australia and Singapore, who have already removed GST on certain types of crypto-assets.

14. I further propose that the GST rules that allow GST registered businesses to claim input credits for their capital raising costs apply equally to crypto-assets, as they do to debt or equity securities.

15. It should be noted that crypto-assets will continue to be subject to income tax when they are sold or traded for other crypto-assets.

Domestic legs of the international transport of goods

16. Under current law, the domestic leg of the international transportation of goods can only be zero-rated (GST is charged at zero percent) where the domestic leg of the transportation is supplied by the same supplier as the international leg of transportation. The rationale for allowing zero-rating of the domestic leg is because exported goods are zero-rated, and the value of transport services is already

included in the cost of imported goods which are subject to 15% GST. The problem is that, under current practice, most international transporters do not undertake the domestic leg of the transportation, and instead subcontract to an NZ-based courier.

17. I propose that the domestic leg of the international transportation of goods is zero-rated. This will ensure that potentially irrecoverable GST costs are not imbedded in the final price of the goods paid by the consumer and will ensure the tax system does not create incentives to pick one transport carrier over another. It will bring our rules into line with Australia who have a similarly broad zero-rating treatment for the domestic leg of the international transport of goods.

18. This proposal has a fiscal cost of $0.2m per annum.

Improvements to the GST apportionment rules

19. The GST Act includes a set of apportionment and adjustment rules for determining GST input tax deductions when an asset such as a vehicle, farmhouse or home office is used partly to conduct a GST registered business and partly for a private or exempt use.

20. I propose that two improvements to the apportionment rules be included in the Bill.

21. The first proposal would ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, such as farmhouses and home offices, by allowing a deduction which correctly reflects the non-taxable use. To ensure compliant taxpayers are not disadvantaged if they sell an affected property before the proposed amendment is enacted, I propose this amendment apply from 24 February 2020, which is the date the issue and the proposed amendment was consulted on in the GST policy issues paper.

22. The second proposal would reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method (currently this application process is limited to large taxpayers with more than $24m of annual turnover).

Second-hand goods input tax credits on supplies between associated persons

23. In circumstances where a supplier purchases an asset from an associated person in which no GST has been charged on the purchase, the registered person may be denied the ability to claim any second-hand goods input tax credit. This is because no GST was charged on the sale, but it may have been embedded in the cost of the asset.

24. I propose an amendment to allow a second-hand goods input tax credit on supplies between associated persons equal to the tax fraction on the original cost of the good at the time it was purchased by the first person in the chain of associated persons. This will ensure registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

25. This proposal has a fiscal cost of $2m per annum.

Other issues

26. In my capacity as Minister of Revenue I have also approved a number of GST-related remedial matters for inclusion in the Bill. The amendments cover a range of tax issues and typically ensure that the relevant tax laws are consistent with their policy intent. The amendments do not involve any significant policy change and do not require Cabinet approval. None of these amendments have any fiscal costs.

Consultation

27. The crypto-asset, apportionment and domestic leg of the international transport of goods proposals were consulted on as part of the release of the *GST policy issues – an officials' issues paper* in 2020. Officials received 40 written submissions on the proposals. Submitters were supportive of the proposals in this Cabinet paper regarding the taxation of crypto-assets, the domestic leg of the international transport of goods, and the proposed improvements to the apportionment rules.

28. The Treasury was consulted in the preparation of this paper and agree with its recommendations.

Financial Implications

29. The proposal to zero-rate the domestic leg of the international transport of goods has a fiscal cost of $0.2m per annum.

30. The proposal to provide the correct amount of second-hands goods input tax credits on supplies between associated persons has a fiscal cost of $2m per annum.

31. The revenue implications of these proposed changes will not impact the between-Budget spending contingency directly. Minor revenue impacts of items on the tax policy work programme are aggregated, with any revenue gains being retained for offset against future revenue-negative policy changes – as agreed jointly by myself and the Minister of Finance.

Legislative Implications

32. Implementing these proposals requires changes to the Goods and Services Tax Act 1985.

33. If approved, I propose including the legislative changes resulting from these recommendations in the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill (the Bill), scheduled to be introduced into the House in August 2021.

Impact Analysis

Regulatory Impact Assessment

34. The Quality Assurance reviewer at Inland Revenue has reviewed the *Tax treatment of cryptocurrencies* Regulatory Impact Assessment prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

35. The Quality Assurance reviewer at Inland Revenue has reviewed the *Domestic transport services supplied as part of the international transport of goods* Regulatory Impact Assessment prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

36. The Quality Assurance reviewer at Inland Revenue has reviewed the *GST apportionment* Regulatory Impact Assessment prepared by Inland Revenue, and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

37. A regulatory impact statement is not required for the proposal relating to *second-hand goods input tax credits on supplies between associated persons* as its remedial in nature.

Climate Implications of Policy Assessment

38. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to these proposals as the threshold for significance is not met.

Population Implications

39. There are no population implications arising from these proposals.

Human Rights

40. The proposed solutions do not give rise to any human rights implications.

Communications

41. I will make an announcement on the contents of the Bill, including this proposal, when the Bill is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

Proactive Release

42. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Cabinet Economic Development Committee:

Crypto-assets

1. **agree** that crypto-assets should not be subject to GST or the financial arrangement rules (but will still be taxed under other ordinary tax rules) and this should apply from 1 January 2009, being the date the first crypto-asset, bitcoin, was launched.

2. **agree** that GST registered businesses that raise funds through issuing security tokens which have features that are similar to debt or equity securities should be able to claim input tax credits on their capital raising costs retrospective to 1 April 2017, being the date that the capital raising deduction rule took effect.

Domestic leg of the international transportation of goods

3. **agree** that the freight services for the domestic leg of the international transportation of goods should be subject to a zero-rate of GST.

GST apportionment rules

4. **agree** to an amendment with application from 24 February 2020 to ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, by allowing a deduction which correctly reflects the non-taxable use.

5. **agree** to reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an apportionment method (currently this application process is limited to large taxpayers).

Second-hand goods input tax credits on supplies between associated persons

6. **agree** to provide the correct amount of second-hand goods input tax credits on supplies between associated persons.

Fiscal costs

7. **note** that the package of GST items proposed for inclusion in the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill will have a fiscal cost of $2.2m pa but will not impact the between-Budget spending contingency directly.

Process and application date

8. **agree** that the above recommendations be included in the tax Bill scheduled to be introduced in August 2021.

9. **agree** that, unless otherwise stated, the above recommendations will apply from date of assent.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Cabinet Economic Development Committee

Minute of Decision

GST Policy Issues

Portfolio **Revenue**

On 7 July 2021, the Cabinet Economic Development Committee:

Crypto-assets

1 **agreed** that:

1.1 crypto-assets should not be subject to GST or the financial arrangement rules (but will still be taxed under other ordinary tax rules);

1.2 this should apply from 1 January 2009, being the date the first crypto-asset, bitcoin, was launched;

2 **agreed** that GST registered businesses that raise funds through issuing security tokens that have features that are similar to debt or equity securities should be able to claim input tax credits on their capital raising costs retrospective to 1 April 2017, being the date that the capital raising deduction rule took effect;

Domestic leg of the international transportation of goods

3 **agreed** that the freight services for the domestic leg of the international transportation of goods should be subject to a zero-rate of GST;

GST apportionment rules

4 **agreed** to an amendment, with application from 24 February 2020, to ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, by allowing a deduction which correctly reflects the non-taxable use;

5 **agreed** to reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an apportionment method (currently this application process is limited to large taxpayers);

Second-hand goods input tax credits on supplies between associated persons

6 **agreed** to provide the correct amount of second-hand goods input tax credits on supplies between associated persons;

General

7 **agreed** that the above proposals be included in the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill, which is scheduled to be introduced in August 2021;

8 **invited** the Minister of Revenue to issue drafting instructions to give effect to the above proposals;

9 **noted** that the package of GST items proposed for inclusion in the Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill will have a fiscal cost of $2.2 million per annum, but will not impact the between-Budget spending contingency directly;

10 **agreed** that, unless otherwise stated, the above proposals will apply from date of assent.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon Chris Hipkins
Hon David Parker
Hon Nanaia Mahuta (via zoom)
Hon Poto Williams
Hon Damien O'Connor (via zoom)
Hon Stuart Nash
Hon Michael Wood
Hon Dr David Clark
Hon Dr Ayesha Verrall
Hon Phil Twyford
Hon Meka Whaitiri
Rino Tirikatene MP
Dr Deborah Russell MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

POLICY AND REGULATORY STEWARDSHIP

Tax policy report:	**Cabinet paper – Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill: Approval for introduction**

Date:	5 August 2021	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2021/320

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Authorise** the lodgement of the attached Cabinet paper	10am, Thursday 19 August 2021

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a)
s 9(2)(a)	Policy Advisor	

5 August 2021

Minister of Revenue

Cabinet paper – Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill: Approval for introduction

Executive summary

1. This report asks you to approve and lodge the attached Cabinet Legislation Committee paper for consideration at the Cabinet Legislation Committee meeting on Thursday 26 August 2021.

2. The Cabinet paper seeks approval to introduce the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill on 31 August 2021.

3. The Bill is currently with the Ministry of Justice for its Bill of Rights Act vet. We will advise if any issues arise from this process.

4. This report also seeks your agreement to include the setting of the annual rax rates for the 2021-22 tax year in the Cabinet paper for Cabinet approval. It is proposed that these tax rates are the same as currently specified in Part A of Schedule 1 of the Income Tax Act 2007. This Schedule was changed on 1 April 2021 to include a tax rate of 0.390 for taxable income of $180,001 upwards.

5. The draft Cabinet paper also seeks Cabinet approval to include an FBT amendment in the upcoming Supplementary Order Paper (SOP) to the Bill. This relates to the report you received last week (IR2021/326 refers) and is necessary as the SOP will be released by you under delegated Cabinet authority. The SOP will also contain an amendment to the business continuity test for carrying forward losses previously agreed in report IR2021/218.

6. We have drafted the Cabinet paper and the Bill on the basis you agree to the recommendations to this report. Please advise if there are any changes to the Cabinet paper or Bill that you would like to make.

Recommended action

We recommend that you:

7. **Note** the contents of this report, the attached Cabinet Legislation Committee paper, draft Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill, and associated draft disclosure statement.

   Noted

8. **Note** certain items previously agreed to by yourself and the Under Secretary to the Minister of Revenue have been removed from the Bill.

   Noted

9. **Agree** that the income tax rates for the 2021-22 tax year be set at the rates specified in Part A of Schedule 1 of the Income Tax Act 2007.

   Agreed/Not agreed

10. **Agree** with the recommendations previously agreed to by the Under-Secretary to the Minister of Revenue for inclusion in this Bill, as set out in this report.

    Agreed/Not agreed

11. **Agree** that a number of minor maintenance items that have arisen during the Bill's compilation (for example correcting minor faults of expression, reader's aids, incorrect cross-references, and repeal of a redundant provision) be included in the Bill.

    Agreed/Not agreed

12. **Agree** to seek delegated authority from Cabinet to include (if necessary) a change to the FBT rules and the Business Continuity test in the upcoming housing SOP.

    Agreed/Not agreed

13. **Agree** to the proactive release of the Cabinet paper, Cabinet minutes and key advice papers after the Bill is introduced.

    Agreed/Not agreed

14. **Sign** and **lodge** the attached Cabinet Legislation Committee paper with the Cabinet Office by **10 am Thursday 19 August 2021**.

    Signed and referred/Not signed and referred

s 9(2)(a)

Paul Fulton
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2021

Items for inclusion in the Bill

15. The items proposed for inclusion in the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill, scheduled for introduction on or soon after 31 August 2021, are as follows.

Policy items previously agreed by Cabinet

16. The Bill contains amendments on the following matters, as previously agreed by Cabinet:

- GST: Crypto assets (DEV-21-MIN-0157 and CAB-21-MIN-0267)
- GST: Domestic leg of international transport (DEV-21-MIN-0157 and CAB-21-MIN-0267)
- GST: Apportionment of appreciating assets (DEV-21-MIN-0157 and CAB-21-MIN-0267)
- GST: Alternative apportionment methods (DEV-21-MIN-0157 and CAB-21-MIN-0267)
- Local authority taxation: dividends and deductions (DEV-21-MIN-0155 and CAB-21-MIN-0267)
- Changes to the fair dividend rate foreign currency hedges rules (DEV-21-MIN-0155 and CAB-21-MIN-0267)
- Use of tax pooling to satisfy backdated tax liability (DEV-21-MIN-0155 and CAB-21-MIN-0267))
- Removal of sunset clause on COVID-19 information sharing power (DEV-21-MIN-0155 and CAB-21-MIN-0267))
- Penalise the sale or possession of sales suppression software (DEV-21-MIN-0155 and CAB-21-MIN-0267)
- Schedule 32 (CAB-21-MIN-0221)

Remedial items previously approved by Minister of Revenue

17. The Bill contains several remedial amendments to the Inland Revenue Acts you have previously agreed to.

18. Report IR2021/204 on 5 May 2021 included:

- Extension of due dates for years 1 and 2 of the R&D Tax Incentive (RDTI)

19. Report IR 2021/138 on 31 May 2021 included:

- Modernisation of invoicing rules
- Allowing the correct amount of second-hand goods input tax credits to be claimed on supplies between associated persons
- Clarifying the application of the GST group rules

- Input tax credits on purchased goods not physically received prior to end of taxable period
- Increased flexibility for approving end dates of taxable periods
- Excluding members of non-statutory boards from having a taxable activity consistent with treatment for members of statutory boards
- Providing challenge rights for decisions of the Commissioner to re-open time-barred GST returns
- Aligning the application of joint and several liability of members of a GST group with those for income tax groups
- Clarifying that the exemption for residential ground leases still applies when this is paid as part of the levy paid to GST registered unit title body corporates
- Reducing compliance costs for non-resident businesses by allowing them to claim input tax deductions that relate to goods that they export from New Zealand, without having to establish a New Zealand group member first
- Clarifying zero-rating still applies to exports of primary products which are delivered to the recipient's ship in New Zealand
- Ensuring that the rules that apply to sales of land between GST registered persons work as intended when a person has incorrectly zero-rated the supply of land
- Clarifying how a purchaser must apportion a business they bought as a going concern if they use the business assets for a partly private use
- Reduce compliance costs by turning off the requirement to continue to perform annual adjustments after a wash-up has been performed. A 'wash up' calculation requires a taxpayer to claim/pay full input tax credits for an asset when switch to 100% taxable or non-taxable use

20. Report IR2021/249 on 8 June 2021 included:
    - Extending use of money interest relief during COVID-19

21. Report IR2021/248 on 10 June 2021 included:
    - Amending the restricted transfer pricing rules
    - Reducing the early payment discount rate
    - Corporate spin-outs
    - Writing-off KiwiSaver member account imbalances
    - Recovery of excess employer payments from providers

22. Report IR2021/274 on 17 June 2021 included:
    - Reducing the rate of employer superannuation contribution tax to 33% on contributions made for past employees.

23. A number of minor maintenance items have also arisen during the Bill's compilation. These correct minor faults of expression, reader's aids, and incorrect cross-references and a repeal of a redundant provision in the GST Act. It is proposed that these be included in the Bill.

Remedial items previously approved by the Under-Secretary to the Minister of Revenue

24. The Bill contains remedial amendments to the Inland Revenue Acts approved in three reports to the Under-Secretary to the Minister of Revenue. A recommendation is included above for you to support the recommendations agreed to in these reports.

25. Report IR2021/218 on 19 May 2021 included:

- Amendments to the main home exclusion from the 10-year bright-line test
- Residential rental property and foreign currency loans
- Defining KiwiSaver and the ACC levy as ancillary taxes
- Ability to refund ancillary taxes
- Electing into the securitisation regime
- Amending memorandum accounts when making transfers from previous years
- Updating the definition of "election day worker" to reflect changes in the electoral process
- Share-for-share exchanges and ACDA
- Fringe benefit tax – unclassified benefits by associates
- Restricted transfer pricing – terms over five years
- Tax pooling and early payment discount settings
- Clarifying the operation of the business continuity test in part-year situations
- Adding new tax types to START
- Commissioner's remedial powers – disputable decisions
- Whether challenge notice required after partial acceptance of proposed adjustments
- Investment income – custodial institutions: definition of "end investor"
- Investment income information: aligning filing date with payment date for six monthly payers of investment income
- Repeal of redundant provisions related to FIRST
- Non-active estates return filing
- Information sharing with ACC and MBIE
- Definitions of Sensitive Revenue Information and Revenue Information
- Deduction notices under the Goods and Services Tax Act 1985
- Preventing circularity of KiwiSaver employer contributions
- Applying employer KiwiSaver contributions to employer debt where the member opts-out

- Delaying KiwiSaver provider clawbacks
- Administrative amendments to the Child Support Act 1991
- Removal of power to repeal clause relating to information sharing with the Serious Fraud Office

26. Report IR2021/195 on 8 June 2021 included:
    - Petroleum decommissioning amendments

27. Report IR2021/263 on 17 June 2021 included:
    - Security trusts and approved issuer levy
    - Debt remission within an economic group
    - RDTI tax year cut-off for claiming supporting activities
    - RDTI transitional support payment
    - Depreciation cost-base integrity measure
    - Hybrid and branch mismatches
    - Repealing the definition of START tax type
    - Penalty for failure to keep taxpayer information confidential
    - Removing fax as a mode of communication
    - Administrative amendments to the Child Support Act 1991

Items that require Cabinet approval

Setting the annual rates for income tax for the 2021-22 tax year

28. The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act.

29. We recommend that Cabinet approval is sought to set the annual rates for the 2021-22 tax year in this Bill. It is proposed that the annual rates of income tax for the 2021-22 tax year are the rates currently specified in Part A of Schedule 1 of the Income Tax Act 2007. This schedule was amended with effect from 1 April 2021 by the Taxation (Income Tax Rate and Other Amendments) Act 2020 to include a tax rate of 0.390 on taxable income of $180,001 upwards.

Fringe benefit tax and the 39% rate

30. You have recently received a report on a potential FBT over-taxation issue with the new top FBT rate of 63.93% which was introduced as part of introducing the new top personal tax rate of 39% (IR2021/326 refers). This report recommended changes to the FBT rules to be included in a SOP to this Bill alongside the housing interest limitation proposals. Although these FBT recommendations do not require Cabinet approval, introducing them as draft legislation still requires Cabinet approval.

31. Normally this approval is obtained in a LEG paper. However, the housing policy approval to be sought from Cabinet will include delegated authority to release the SOP so the SOP itself will not be considered by Cabinet. Therefore, the attached draft Cabinet paper seeks agreement from Cabinet to delegate authority to the Minister of Revenue, in consultation with the Minister of Finance and the Leader of the House, to include an FBT remedial provision in the housing SOP.

Loss continuity

32. The Under-Secretary to the Minister of Revenue previously agreed to an amendment to clarify the operation of the business continuity test in part-year situations (IR2021/218 refers). Officials need additional time to ensure this is drafted correctly so now recommend this is included in the Bill via the SOP rather than at introduction. The Cabinet paper also seeks agreement to delegate authority to include this in the housing SOP.

Items which have not been included in the Bill

33. The following remedial items that were previously approved by the Minister of Revenue or the Under-Secretary have not been included in the Bill:

- Refund of foreign tax credits. Drafting this item revealed that the current legislation is sufficient to allow for the refund of foreign tax credits where the refund is received more than four years after the tax year in which the initial credit was paid. (IR2021/218 refers)
- Three BT related KiwiSaver amendments, because the issues can be achieved administratively or require further consideration. (IR2021/218 and IR2021/248 refer)
- Changes to the corporate spin-outs rules have been included in the Bill for spun-out companies but not for consolidated groups. Changes for consolidated groups would require more legislative changes than initially expected and would not currently apply to any taxpayers so have not been progressed. (IR2021/248 refers)
- Two of the five "debt remission within an economic group" items have not been included. Drafting these items revealed the additional complexity for taxpayers who the rules already applied correctly to outweighed the small number of potentially affected taxpayers. (IR2021/263 refers)
- RDTI grandparenting for miners has not been included as it was not agreed to by the Minister for Research, Science and Innovation. (~~IR2021/263~~ refers)

Note: The report reference should be IR2021/287 (Note added on 2021-09-10)

Disclosure statement

34. Draft copies of the Bill and disclosure statement are attached to this report. When finalised, these items will accompany the Cabinet paper, in accordance with Cabinet guidelines, to the Cabinet Legislation Committee.

35. The disclosure statement must be finalised by Inland Revenue and sent to the Parliamentary Counsel Office at least two working days before the introduction of the Bill. The disclosure statement will be publicly available when the Bill is introduced.

New Zealand Bill of Rights Act 1990

36. Officials believe the provisions in the proposed Bill are consistent with the rights and freedoms affirmed by the New Zealand Bill of Rights Act 1990 (BORA). The Ministry of Justice is currently undertaking the required BORA vetting. Although not expected, we will advise if any issues arise from this process.

Proactive release

37. We propose to proactively release the Cabinet paper, Cabinet minutes and key advice after the Bill is introduced into the House of Representatives.

Cabinet Legislation Committee paper

38. We have drafted the attached Cabinet Legislation Committee paper and associated documents on the basis that you agree to the recommendations in this report. Please advise if there are any changes to the paper that you wish to make.

39. The Cabinet paper is required to be lodged with the Cabinet Office by 10am on Thursday 19 August 2021.

Treasury consultation

40. Treasury were informed about this report.

Caucus consultation

41. Caucus consultation is undertaken before the Bill is introduced into the House of Representatives.

42. Officials can provide additional information on the content of the Bill to support your office's caucus consultation in relation to the introduction of the Bill.

Inland Revenue
Te Tari Taake

Policy and Strategy
Te Wāhanga o te Rautaki me te Kaupapa
55 Featherston Street
PO Box 2198
Wellington 6140
New Zealand

T. 04 890 1500
F. 04 903 2413

Briefing note

Reference: BN2021/336

Date: 12 August 2021

To: Revenue Advisor, Minister of Revenue – s 9(2)(a) [redacted]
Private Secretary, Minister of Revenue – [redacted]

cc: Naomi Ferguson, Commissioner
David Carrigan, Deputy Commissioner
Emma Grigg, Policy Director
Kerryn McIntosh-Watt, Policy Director
Phil Whittington, Chief Economist
s 9(2)(a) [redacted] Executive Support Advisor to the Commissioner
[redacted] PA to Deputy Commissioner
Government & Executive Services (Ministerial Services)

From: s 9(2)(a) [redacted]

Subject: **Speaking notes for Cabinet Business Committee (CBC)**

Speaking notes

This briefing note contains speaking notes on the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill for the Minister of Revenue at the Cabinet Business Committee (CBC) on 1 September 2021.

Consultation with Treasury

Treasury was informed about this briefing note.

s 9(2)(a) [redacted]
Policy Advisor
s 9(2)(a) [redacted]

Speaking notes

Cabinet Legislation Committee (LEG)

Taxation (Annual Rates for 2021-22, GST and Remedial Matters) Bill: Approval for introduction

Recommended actions:

- I seek approval for the introduction of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill.
- I seek agreement that the Bill be:
    - Introduced on 31 August 2021;
    - Referred to the Finance and Expenditure Committee after its first reading;
    - Reported back to the House by March 2022;
    - Enacted by 31 March 2022.
- The Bill has been given a category 4 priority (to be referred to a select committee in 2021) on the 2021 Legislation Programme.

Introductory comments

- This Bill gives effect to several policy initiatives already approved by the Cabinet Economic Development Committee and Cabinet.

Confirmation of annual rates for income tax

- The Bill also includes setting the annual rates of income tax for the 2021-22 tax year at the rates currently specified in Schedule 1 of the Income Tax Act 2007. This includes the 39% rate for taxable income above $180,000.

- This proposal requires Cabinet confirmation.

Bill content

- The Bill makes substantive, remedial and technical amendments to the following legislation:
    - Goods and Services Tax Act 1985;
    - Income Tax Act 2007;
    - Tax Administration Act 1994;
    - Child Support Act 1991;
    - KiwiSaver Act 2006;
    - Student Loan Scheme Act 2011;
    - Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

- This Bill also revokes three redundant regulations.

Major items

Exclusion of crypto assets from GST and the financial arrangements rules

- The Bill proposes the exclusion of crypto-assets from GST and the financial arrangements rules. This will ensure these rules do not impose barriers to developing new products, raising capital and investing through crypto-assets.

- The Bill also proposes allowing GST registered businesses who raise funds through issuing crypto-assets to claim input credits for their capital costs.

Domestic leg of the international transport of goods

- The Bill proposes that the domestic leg of the international transportation of goods be zero rated. This will ensure that the tax system does not create incentives to choose one transport carrier over another. This will bring New Zealand's rules into line with those of Australia.

Improvements to the GST apportionment rules

- The Bill proposes improvements to the GST apportionment rules, which are used to determine GST input tax deductions for mixed use assets. The proposals will:

    - Ensure the GST apportionment rules do not overtax the sales of appreciating mixed use assets;

    - Reduce compliance costs for smaller registered GST suppliers by allowing Inland Revenue to approve an alternative apportionment method.

Second-hand input tax credits on supplies between associated persons

- The Bill proposes an amendment to allow a second-hand goods input tax credit on supplies between associated persons equal to the tax fraction on the original cost of the good at the time it was purchased by the first person in the chain of associated persons.

Local authority taxation: dividends and deductions

- The Bill proposes measures designed to improve the integrity of local government taxation and help prevent local authorities from effectively transferring the benefit of their exempt status to their taxable Council-Controlled Organisations (CCOs).

- The proposed amendments will:
    - Treat dividends derived by a local authority from a wholly-owned CCO, port company, subsidiary or a port company, or energy company as exempt income;
    - Prevent local authorities from receiving a deduction for charitable or other public benefit gifts made to donee organisations;
    - Prevent local authorities converting unused imputation credits into a tax loss.

Changes to the fair dividend rate foreign currency hedges rules

- The Bill proposes a series of technical amendments to the fair dividend rate foreign currency hedges rules (FDR FX hedges rules). These are intended to reduce compliance costs and improve their functionality.

Use of tax pooling to satisfy backdated tax liability

- The Bill proposes allowing the use of tax pooling to satisfy a tax obligation where there is no existing tax assessment or the tax obligation has not been quantified. This would contain safeguards to prevent incentivising the non-filing of tax returns.

Removal of sunset clause on COVID-19 information sharing power

- The Bill proposes an amendment which will remove the time limit from the COVID-19 information sharing provisions. This means the provisions will remain in effect without the need for repeat extension via Order in Council.

Penalise the sale or possession of sales suppression software

- The Bill proposes the introduction of penalties on the sale and acquisition of sales suppression software.

Other items

- The Bill also contains a number of other technical and remedial items.

Consultation

- The Treasury was consulted in the development of many of the proposals in the Bill.
- Other government departments and public bodies were also consulted on relevant aspects of the proposals where appropriate, including the Department of Internal Affairs, the Ministry of Justice, the Ministry of Business, Innovation & Employment, Callaghan Innovation, the Ministry of Foreign Affairs and Trade and the Ministry for Culture and Heritage.
- Submissions on the various consultation documents as well as meetings with relevant stakeholders have informed the recommendations in this paper.
- The substantive policy initiatives to which this Bill is intended to give effect were subject to public and other consultations in accordance with the Generic Tax Policy Process (GTTP).

Consistency with Bill of Rights Act

- The Bill complies with the rights and freedoms in the New Zealand Bill of Rights Act 1990 (BORA).

Timing considerations

- The Bill should be reported back by the Finance and Expenditure Committee by March 2022.
- As the proposals in the Bill will set the income tax rates for the 2021-22 income tax year, the Bill should be enacted by the end of March 2022 at the very latest.

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

TAXATION (ANNUAL RATES FOR 2021-22, GST, AND REMEDIAL MATTERS) BILL: APPROVAL FOR INTRODUCTION

Proposal

1. This paper seeks the Cabinet Legislation Committee's agreement to introduce the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill on 7 September 2021.

2. This paper also seeks Cabinet's agreement to set the annual tax rates for the 2021-22 tax year.

3. The Bill introduces amendments to the:

   3.1 Income Tax Act 2007;

   3.2 Tax Administration Act 1994;

   3.3 Goods and Services Act 1985;

   3.4 KiwiSaver Act 2006;

   3.5 Child Support Act 1991;

   3.6 Student Loan Scheme Act 2011;

   3.7 Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

4. The Bill also revokes the:

   4.1 Co-operative Dairy Companies Income Tax Regulations 1955;

   4.2 Cooperative Milk Marketing Companies Income Tax Regulations 1960;

   4.3 Cooperative Pig Marketing Companies Income Tax Regulations 1964.

5. The Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill holds a Category 4 priority on the 2021 Legislative Programme (to be referred to a select committee in 2021).

Policy

6. The Bill will implement the policy items listed below. The Bill is made up of policy items that require Cabinet approval, policy items that already have Cabinet approval, and items that have been approved by me in my capacity as the Minister of Revenue. A Bill is necessary as amendments to existing legislation are required to implement the proposals.

Policy proposals requiring Cabinet approval in this paper

Setting the annual rates for income tax for the 2021-22 tax year

7. The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act.

8. It is proposed that this Bill set the annual rates of income tax for the 2021-22 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007. This Schedule has been amended effective from 1 April 2021 to include a tax rate of 0.390 for taxable income of $180,001 upwards.

Policy items that already have Cabinet approval

Granting 11 charities overseas donee status [CAB-21-MIN-0221 (14 June 2021)]

9. The Bill proposes that 11 New Zealand charities with overseas charitable purposes be granted overseas donee status and listed in schedule 32 of the Income Tax Act 2007 with effect from 1 April 2021.

10. The Bill additionally proposes a change to the sunset clause for the New Zealand Memorial Trust – Le Quesnoy's donee status, which is set to end on 18 March 2022. The Bill will extend the Trust's overseas donee status until 31 March 2025.

Local authority taxation: dividends and deductions [DEV-21-MIN-0155 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

11. The Bill proposes a series of measures to improve the integrity of local government taxation and help prevent local authorities from effectively transferring the benefit of their exempt status to their taxable Council-Controlled Organisations (CCOs).

12. The proposals will:

    12.1 Treat dividends derived by a local authority from a wholly-owned CCO, port company, subsidiary of a port company, or energy company as exempt income;

    12.2 Prevent local authorities from receiving a deduction for charitable or other public benefit gifts made to donee organisations;

    12.3 Ensure that local authorities are only allowed a deduction for interest on borrowings for the purpose of deriving assessable income or to acquire shares in a CCO that is a council-controlled trading organisation (a CCO that operates a trading undertaking for the purpose of making a profit, referred to as a CCTO);

12.4 Limit a local authority's access to deductions for negative base price adjustments to financial arrangements involving a CCTO of the local authority;

12.5 Prevent local authorities converting unused imputation credits to a tax loss;

12.6 Ensure that a credit does not arise to a consolidated group's imputation credit account for imputation credits attached to a dividend derived by a local authority.

Changes to the fair dividend rate foreign currency hedges rules [DEV-21-MIN-0155 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

13. The Bill proposes a series of technical amendments to the fair dividend rate foreign currency hedges rules (FDR FX hedges rules). These are intended to reduce compliance costs and improve their functionality. The proposals will:

13.1 Modify the second method for determining the extent to which foreign currency hedges can be subject to FDR treatment, to ensure that the FDR method can be applied to 100% of a foreign currency hedge of eligible assets when non-eligible assets are already fully hedged;

13.2 Introduce a de minimis for non-eligible assets;

13.3 Allow eligible hedges to have no NZD leg subject to certain requirements;

13.4 Introduce an optional new method for determining FDR hedge portions on a portfolio basis instead of a hedge-by-hedge basis;

13.5 Introduce an optional look-through rule to allow taxpayers who hedge indirectly owned eligible assets to apply the rules in certain circumstances;

13.6 Allow eligible hedges to continue to be subject to FDR treatment when ownership of the assets of a fund/investor class is transferred.

Use of tax pooling to satisfy backdated tax liability [DEV-21-MIN-0155 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

14. The Bill proposes allowing the use of tax pooling to satisfy a tax obligation where there is no existing tax assessment or the tax obligation has not been quantified. To avoid incentivising non-filing of tax returns, the following safeguards will apply:

14.1 The taxpayer must make a voluntary disclosure to file the original return and generate an original assessment or obligation before Inland Revenue has made any contact with the taxpayer or their agent;

14.2 The voluntary disclosure must be made within a reasonable time frame of the taxpayer or their agent becoming aware of the error, with "reasonable time frame" to be defined by guidance issued by the Commissioner of Inland Revenue or by Order in Council.

Removal of sunset clause on COVID-19 information sharing power [DEV-21-MIN-0155 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

15. In March 2020, an emergency provision was introduced to enable Inland Revenue to share information with other agencies for the delivery of COVID-19 specific initiatives.

16. The information sharing provision includes a sunset clause, meaning it ceases to be in effect once 24 months have passed from the date of the clause commencing. The provision is currently due to expire in March 2022. This time limit can be extended by Order in Council which must be made before the expiry of the 24-month period.

17. The Bill proposes an amendment to remove the time limit from the COVID-19 information sharing provisions, meaning it will remain in effect without the need for repeat extension via Order in Council. This will future-proof these powers, ensuring agencies can share needed information throughout the entire life cycle of the pandemic and the initiatives that support New Zealand's recovery.

Penalise the sale or possession of sales suppression software [DEV-21-MIN-0155 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

18. The Bill proposes curtailing the spread of sales suppression software by introducing penalties on the sale and acquisition of this software. The proposals will introduce:

    18.1 Criminal penalties for the production, sale, and/or provision of sales suppression software, including a right to use the software, set at a maximum of $250,000;

    18.2 Civil and criminal penalties for acquisition or possession of the software, or a right to use the software. The criminal penalty is to be set at a maximum of $50,000, while the civil penalty is to be set at $5,000. If a taxpayer voluntarily discloses acquisition, possession, or use of the software, the civil penalty above will be reduced by 100% for a pre-notification disclosure or 40% for a post-notification disclosure;

    18.3 A further amendment to disable the existing 50% reduction of the civil evasion penalty for prior behaviour when the evasion included use of sales suppression software. However, if the taxpayer provides a pre-notification voluntary disclosure of acquisition, possession, or use of the software, the reduction will still apply.

Exclusion of cryptoassets from GST and the financial arrangements rules [DEV-21-MIN-0157 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

19. The Bill proposes the exclusion of cryptoassets from GST and the financial arrangements rules to ensure that these rules do not impose barriers to developing new products, raising capital and investing through cryptoassets. The Bill additionally proposes allowing GST registered businesses to claim input credits for their capital raising costs.

Domestic leg of the international transport of goods [DEV-21-MIN-0157 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

20. The Bill proposes that the domestic leg of the international transportation of goods be zero-rated. This is intended to ensure that partially irrecoverable GST costs are not imbedded in the final price of the goods paid by the consumer and that the tax system does not create incentives to pick one transport carrier over another. This will bring New Zealand's rules into line with those of Australia, which similarly zero-rate the domestic leg of the international transport of goods.

Improvements to the GST apportionment rules [DEV-21-MIN-0157 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]

21. The Bill proposes two improvements to the GST apportionment rules in the GST Act 1985. The GST apportionment rules are used to determine GST input tax deductions when an asset is used partly to conduct a GST registered business and partly for a private or exempt use. The Bill proposes reforms which:

    21.1 Ensure the GST apportionment rules do not overtax sales of appreciating assets which are partly used for business and partly used privately, such as farmhouses and home offices, by allowing a deduction which correctly reflects the non-taxable use;

    21.2 Reduce compliance costs for smaller GST registered suppliers by allowing them to apply to Inland Revenue to approve an alternative apportionment method (currently this application process is limited to large taxpayers with more than $24m of annual turnover).

Second-hand goods input tax credits on supplies between associated persons *[DEV-21-MIN-0157 (7 July 2021) and CAB-21-MIN-0267 (12 July 2021)]*

22. The Bill proposes an amendment to allow a second-hand goods input tax credit on supplies between associated persons equal to the tax fraction on the original cost of the good at the time it was purchased by the first person in the chain of associated persons. This will ensure registered persons are not unfairly overtaxed in respect of land they purchased from an unregistered associated person.

Items Not Requiring Cabinet approval

23. The Bill also includes a range of remedial amendments that I recommend be included in the Bill. These cover a range of tax issues and typically ensure that the relevant tax laws are consistent with their policy intent. The amendments do not involve any significant policy change and do not require Cabinet approval. The amendments do not have any material revenue or other fiscal effects.

Minor remedial and maintenance items

24. The Bill also contains a number of minor remedial and maintenance items. These correct minor faults of expression, reader's aids, and incorrect cross-references.

Delegated authority for items to be included in a Supplementary Order Paper

25. This paper also seeks agreement from Cabinet to delegate authority to the Minister of Revenue, in consultation with the Minister of Finance and the Leader of the House, to include remedial amendments related to fringe benefit tax and loss continuity into a planned Supplementary Order Paper to this Bill. Time constraints prevent these items from being included in the Bill at introduction.

Impact Analysis

Existing regulatory impact assessments

26. Regulatory impact assessments were prepared, where required, for several policy items in the Bill. These were submitted at the time that Cabinet Committee approval for the policy items was sought. These RIAs are:

    26.1 *Domestic transport services supplied as part of the international transport of goods*, Inland Revenue, 31 May 2021;

    26.2 *GST apportionment*, Inland Revenue, 31 May 2021;

    26.3 *Tax pooling to purchase backdated tax*, Inland Revenue, 31 May 2021;

    26.4 *Tax treatment of cryptocurrencies*, Inland Revenue, 31 May 2021;

    26.5 *Sales suppression software*, Inland Revenue, 1 June 2021;

    26.6 *Local authority taxation – dividends and deductions*, Inland Revenue, 17 June 2021.

Remaining proposals in the Bill

27. A number of the items (particularly those of a remedial nature) involve technical revisions or consolidations that substantially re-enact the current law to improve legislative clarity and understanding (including the fixing of errors, the clarification of the existing legislative intent, and the reconciliation of inconsistencies). Other items repeal or remove redundant legislative provisions, or have no or only minor impacts on businesses, individuals or not-for-profit entities.

Climate Implications of Policy Assessment

28. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the COPA requirements do not apply to any of the proposals in this paper as the threshold for significance has not been met.

Compliance

29. The Bill complies with:

    29.1 the principles of the Treaty of Waitangi;

29.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

29.3 the disclosure statement requirements (the draft disclosure statement is attached);

29.4 the principles and guidelines set out in the Privacy Act 1993;

29.5 relevant international standards and obligations;

29.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

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

Relevant Government Departments or Other Public Bodies

31. The Treasury was consulted on the development of many of the proposals in the Bill. Other government departments and public bodies were also consulted on relevant aspects of the proposals where appropriate, including the Ministry of Business, Innovation and Development, the Department of Internal Affairs, and the Ministry of Justice. Feedback from government departments and public bodies was used to develop and refine these proposals.

Relevant Private Sector Organisations and Public Consultation Processes

32. A number of the proposals in the Bill were subject to public consultation, which was undertaken in various forms. In addition, private sector organisations were consulted on specific matters of relevance to them. The feedback provided by these stakeholders was taken into account when finalising policy proposals. The attached draft disclosure statement provides further information on the various parties consulted and the form in which consultation was undertaken for the policy items in the Bill.

The Government Caucus and Other Parties Represented in Parliament

33. The Government caucus will be consulted on this Bill prior to its proposed introduction.

Binding on the Crown

34. A number of Inland Revenue Acts currently bind the Crown (including the Income Tax Act 2007). This amending Bill does not alter the status quo in this respect – the amendments follow the position of the principal Acts.

Creating New Agencies or Amending Law Relating to Existing Agencies

35. The Bill will not create a new agency.

36. The Bill will not amend the existing coverage of the Ombudsman Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of Decision-Making Powers

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

Associated Regulations

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

39. Two subclauses in the Bill would repeal existing information sharing clauses with ACC and the Ministry of Business Innovation and Employment when they are replaced by Approved Information Sharing Agreements (AISAs). As the date of these AISAs is not yet known these clauses would be brought into force by an Order in Council.

Definition of Minister/Department

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

Commencement of Legislation

41. Each provision of the Bill comes into force on the date specified in the Bill for that provision. One exception is the repeal of two information sharing clauses as referred to above.

Parliamentary Stages

42. The Bill should be introduced on 7 September 2021, referred to the Finance and Expenditure Select Committee and reported back to the House in early 2022.

43. As the Bill includes setting the annual income tax rates for the 2021–22 tax year, and because a number of the proposals in the Bill have an application date of 1 April 2022, the Bill should be enacted by the end of March 2022 at the latest.

Publicity

44. I will make an announcement about the proposals in the Bill when it is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

Proactive Release

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

Recommendations

The Minister of Revenue recommends that the Committee:

1. **note** the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill holds a Category 4 priority on the 2021 Legislative Programme (to be referred to a select committee in 2021).

2. **note** that the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill makes substantive, remedial, and technical amendments to the:

    2.1 Income Tax Act 2007;

    2.2 Tax Administration Act 1994;

    2.3 Goods and Services Act 1985;

    2.4 KiwiSaver Act 2006;

    2.5 Child Support Act 1991;

    2.6 Student Loan Scheme Act 2011

    2.7 Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

3. **note** that the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters Bill revokes the:

    3.1 Co-operative Dairy Companies Income Tax Regulations 1955;

    3.2 Cooperative Milk Marketing Companies Income Tax Regulations 1960;

    3.3 Cooperative Pig Marketing Companies Income Tax Regulations 1964.

4. **agree** that the income tax rates for the 2021–22 tax year be the same as the rates currently specified in Part A of Schedule 1 of the Income Tax Act 2007.

5. **agree** to the content of the Bill as contained in this paper.

6. **approve** the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives.

7. **agree** that the Bill be introduced on 7 September 2021.

8. **agree** that the government propose that the Bill be:

    8.1 referred to the Finance and Expenditure Committee for consideration;

    8.2 reported back to the House by early March 2022;

    8.3 enacted by 31 March 2022.

9. **agree** that Cabinet delegate authority to the Minister of Revenue, in consultation with the Minister of Finance and the Leader of the House, to include proposed remedial amendments relating to fringe benefit tax and loss continuity in a Supplementary Order Paper to the Bill.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Cabinet Business Committee

Minute of Decision

Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill: Approval for Introduction

Portfolio **Revenue**

On 1 September 2021, the Cabinet Business Committee:

1 **noted** that the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill holds a category 4 priority on the 2021 Legislation Programme (to be referred to a select committee in 2021);

2 **noted** that the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill makes substantive, remedial, and technical amendments to the:

2.1 Income Tax Act 2007;

2.2 Tax Administration Act 1994;

2.3 Goods and Services Act 1985;

2.4 KiwiSaver Act 2006;

2.5 Child Support Act 1991;

2.6 Taxation (Kiwi Saver Student Loans, and Remedial Matters) Act 2020;

3 **noted** that the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters Bill revokes the:

3.1 Co-operative Dairy Companies Income Tax Regulations 1955;

3.2 Cooperative Milk Marketing Companies Income Tax Regulations 1960;

3.3 Cooperative Pig Marketing Companies Income Tax Regulations 1964;

4 **agreed** that the income tax rates for the 2021–22 tax year be the same as the rates currently specified in Part A of Schedule 1 of the Income Tax Act 2007;

5 **agreed** to the content of the Bill as contained in the paper under CBC-21-SUB-0085;

6 **approved** the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill [IRD 22632/6.0] for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives;

7 **agreed** that the Bill be introduced as soon as is practicable;

8 **agreed** that the government propose that the Bill be:

8.1 referred to the Finance and Expenditure Committee for consideration;

8.2 reported back to the House by early March 2022;

8.3 enacted by 31 March 2022;

9 **authorised** the Minister of Revenue, in consultation with the Minister of Finance and the Leader of the House, to include proposed remedial amendments relating to fringe benefit tax and loss continuity in a Supplementary Order Paper to the Bill.

Jenny Vickers
Committee Secretary

Present:
Rt Hon Jacinda Ardern (Chair)
Hon Grant Robertson
Hon Kelvin Davis
Hon Dr Megan Woods
Hon Carmel Sepuloni
Hon Andrew Little
Hon David Parker
Hon Nanaia Mahuta
Hon Poto Williams
Hon Damien O'Connor
Hon Stuart Nash
Hon Kris Faafoi
Hon Dr David Clark
Hon Aupito William Sio

Officials present from:
Office of the Prime Minister
Department of the Prime Minister and Cabinet