

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

*Officials' report to the Finance and Expenditure Committee on
submissions on the Bill*

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Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill – officials’ report to the Finance and Expenditure Committee on submissions on the Bill

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Annual rates for 2020–21

ANNUAL RATES OF INCOME TAX

(Clause 3)

Issue: Support annual rates

Submission

(Chartered Accountants Australia and New Zealand, Navtej Singh)

The submitters support the annual income tax rates for the 2020–21 tax year remaining the same as for the 2019–20 tax year as specified in schedule 1, part A of the Income Tax Act 2007.

Comments

Officials note the submissions.

Recommendation

That the submission be noted.

Feasibility expenditure

OVERVIEW

Businesses in New Zealand can generally claim a tax deduction for business expenses. Feasibility expenditure is expenditure that is undertaken to determine the practicability of a new proposal. Not all such expenditure is currently deductible and where a deduction is denied, this can deter a firm from investing in that proposal. The August 2016 Supreme Court ruling in *Trustpower v Commissioner of Inland Revenue (Trustpower)* limited the deductibility of costs incurred to evaluate the feasibility of a project that is later abandoned.

Following that decision, the Bill proposes greater deductibility of feasibility expenditure to encourage business innovation and investment, specifically where expenditure is incurred in developing assets where that expenditure does not result in a completed asset. The proposed changes in the Bill would enable deductions to be spread over a five-year period, with de minimis amounts of expenditure of less than \$10,000 being able to be immediately deducted.

The proposals would come into effect for expenditure incurred in the 2020–21 income year.

There were 10 submissions received on the proposals. There was broad support for the main thrust of the proposals, but there was also significant concern that the proposals did not go far enough.

All legislative references in this report refer to the Income Tax Act 2007, unless otherwise noted.

Glossary

Abandonment costs – in the course of abandoning a project, a business could incur further costs relating to remediation or terminating contracts. For example, the cost of restoring a river where work had commenced to dam it.

Balance date – means the last date of a person’s income year. Many New Zealand-owned companies will have a 31 March balance date, while many foreign-owned companies will have a different balance date that is consistent with the wider international group’s reporting and filing obligations.

General permission – The “general permission” allows a deduction where a sufficient link exists between the expenditure and the taxpayer’s business or income-earning activity. That is, a deduction can be claimed for expenditure or loss incurred in the course of earning assessable income or while carrying on a business in order to earn assessable income.

Income year – means the period for which a person’s income tax liability is calculated. This period is generally for 12 months.

APPLICATION DATE

(Clauses 11 and 16)

Issue: Proposal should be backdated

Submission

(Auckland Airport, Corporate Taxpayers Group, Deloitte, EY, PwC)

The submitters consider that application of the feasibility expenditure proposals should be backdated. Submitters have suggested a range of application dates and a range of reasons for backdating.

- a) The amendments should be backdated to the *Trustpower* decision given that the Court overruled an established position, creating uncertainty as to the point at which costs must be capitalised. Although there is a need to carefully manage the fiscal impacts of any law change, especially in the current environment, the proposals can effectively achieve that balance. *(EY)*
- b) The application date should be brought forward to the 2019–20 income year to allow taxpayers to utilise the rules where projects have been abandoned due to COVID-19. *(Corporate Taxpayers Group, Deloitte)*
- c) Implementing tax policy changes based on an income year will usually provide a fair and consistent outcome. However, projects cancelled or deferred as a result of COVID-19 may produce arbitrary and unfair outcomes based on a taxpayer's balance date. For example, taxpayers with a 31 March balance date may be able to claim deductions for projects abandoned due to COVID-19 between 1 April 2020 and 30 June 2020, while taxpayers with a 30 June balance date would not be able to claim a deduction under the proposed rules for projects abandoned during the same period. The application date should be brought forward to ensure that it covers all expenditure incurred in relation to qualifying capital projects that are abandoned as a result of the impact of COVID-19, not just expenditure incurred after the date the rules take effect. *(Auckland Airport, PwC)*
- d) Deductions should be allowed for projects that are abandoned on or after 23 March 2020, being the date of the Prime Minister's announcement of Alert Level 4. *(Auckland Airport, PwC)*

Comment

The rules are proposed to apply to expenditure incurred in the 2020–21 or later income years for projects that are abandoned during or after the 2020–21 income year.

Officials do not favour backdating the application of the proposals to the Supreme Court's decision in *Trustpower* or by a full year (submission points a) and b) above). Either of these approaches would have a significant fiscal cost, as would allowing a deduction for all past expenditure incurred in relation to capital projects abandoned due to COVID-19. Backdating will also not address any economic distortion created by the current law, as taxpayers have already made the relevant investment decisions.

Officials do not consider that taxpayers with early or standard balance dates (for example, 31 March) and who have abandoned capital projects after the announcement of the Alert Level 4 lockdown will generally be significantly advantaged relative to taxpayers with late balance dates (for example, 30 June) who have also abandoned projects around the same timeframe. To qualify for a deduction, the expenditure must have been incurred by the taxpayer in the 2020–21 income year or a later income year (which is unlikely to be the case for a project abandoned due to COVID-19, even for a taxpayer with an early or standard balance date). On this basis, officials do not recommend any backdating.

However, there could be a significant advantage for early and standard balance date taxpayers compared to late balance date taxpayers if the matter raised below by submitters on widening the scope to include costs in abandoning property is accepted (see Issue: Abandonment costs). This is because costs in abandoning property may be incurred for income tax purposes in the period between the Level 4 lockdown announcement and the beginning of the 2020–21 income year for a late balance date taxpayer. As noted below, officials consider that further work is required to understand the impact of including abandonment costs within the scope of the measures. This work could also take into account the interaction between these costs and backdating the proposals to the Level 4 lockdown announcement. However, any work would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be declined.

Issue: Timing of deduction

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)

The timing of the deduction should be clarified in the legislation to confirm that if the decision to abandon the property is made before the tax return for the previous income year has been filed, the deduction can be taken in that tax return, rather than waiting another year to take the deduction in the return relating to the income year in which the property was abandoned.

Comment

The policy intent is for the first deduction under proposed section DB 66 to be taken in the income year in which the property is abandoned. This outcome should not change simply because an income tax return has not been filed for a previous income year. Officials consider this outcome is clear in the draft legislation and no further changes are required to the legislation.

Recommendation

That the submission be declined.

PRE-COMMENCEMENT EXPENDITURE

(Clause 16)

Issue: Deductibility of pre-commencement feasibility expenditure

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, KPMG)

- a) The scope of the proposals should be expanded beyond abandoned capital projects to include expenditure incurred to explore the viability of investing in a new business asset, property, opportunity or model. In particular, the proposals should apply to “pre-commencement expenditure” (expenditure incurred prior to the underlying business being carried on and that would be currently denied a deduction because it does not satisfy the general permission for deductibility in section DA 1). The general permission should not apply where expenditure meets the proposed feasibility cost definition. This also applies where businesses are “pivoting” in new directions due to COVID-19. *(Deloitte, KPMG)*
- b) The feasibility rules should provide support to start-ups in particular. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)*
- c) As long as a person is in business and earning section CB 1 business income, they should be allowed a deduction for pre-commencement expenditure. The link to earning business income along with the private limitation should prevent deductions from being taken inappropriately (for example by taxpayers claiming they were exploring a business by incurring expenditure of a private nature). If this is considered insufficient, the Australian “non-commercial loss rules” for individuals could be adapted to only allow a deduction where certain objective tests are met. *(Corporate Taxpayers Group)*
- d) An issue is where there is no depreciable asset, but a change to business processes, and progress in relation to a new business process is abandoned (for example a new process is explored in relation to keeping food warm for delivery). It is unclear whether the scope of the rules is wide enough to cover consideration of new business models/services. *(Corporate Taxpayers Group)*
- e) The legislation or guidance should confirm whether or not an expense incurred that was non-deductible at that time (because, for example, it did not satisfy the general permission) but is later applied towards completing, creating or acquiring property will be deductible under the feasibility rules. *(Chartered Accountants Australia and New Zealand)*

Comment

The general permission requires there to be a nexus between the expenditure and the derivation of income, or for the expenditure to have been incurred in the course of the person carrying on a business for the purposes of deriving income. In the case of a start-up activity, the general permission is not satisfied means that any expenditure relating to the activity incurred before an actual business has materialised is not deductible.

For a taxpayer with an existing business who is looking to diversify into new product offerings, it means that the proposed change to the taxpayer's business model has to be very minor for any expenditure incurred in investigating the feasibility of the proposed change to be deductible.

Officials agree there are good reasons for deductions for pre-commencement feasibility expenditure to generally be available to taxpayers with existing businesses. However, expanding the scope of the feasibility proposals to override the general permission in any circumstance is a significant change involving fiscal and integrity risks. Officials refer to a submission to this effect (see Issue: Support for retaining the general permission). A concern (which is particularly relevant in the case of start-ups but in some cases may also apply to taxpayers with existing businesses) is that some taxpayers may claim deductions for expenditure that is of a private rather than business nature, such as for a hobby.

Officials acknowledge that submitters have suggested a range of measures aimed at minimising this risk, but consider that it would nevertheless be inappropriate to make such a significant change without properly working through the detail and consulting on it. Therefore, officials consider it would be better to introduce a fully worked-through proposal for allowing deductions for pre-commencement expenditure for taxpayers with existing businesses at a later stage, rather than attempt to make such a change now. However, further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Officials disagree with expanding the scope of the proposal to include new business models or processes. This is because the policy intent of the proposed rules is to allow deductions for expenditure that is related to making progress towards acquiring or creating property that, if acquired or completed, would be taxable on disposal (revenue account property) or that would provide benefits that decline in value over time and for which depreciation or amortisation deductions would be available.

Finally, officials consider that the appropriate time for considering whether the general permission is satisfied is at the time the expenditure is incurred, rather than when the property is abandoned. Officials consider that this position is reflected in the proposed legislation. In agreement with the submission at paragraph e), guidance will be provided in the *Tax Information Bulletin* on this outcome.

Recommendation

That submission points a), b), c) and d) be declined, but agree with submission e) that guidance will be provided in the *Tax Information Bulletin*.

Issue: Support for retaining general permission

Submission

(EY)

We strongly support the need to maintain a nexus with an established business or income generating activity, and therefore agree with the proposals in so far as they maintain the need to satisfy the general permission for deductibility. An alternate approach risks the tax system

being used to subsidise hobbies and business ventures that are not genuine income-earning activities.

Comment

Officials note the submitter's support for retaining the requirement that the expenditure satisfy the general permission.

Recommendation

That the submission be noted.

GAP BETWEEN PROPOSAL AND COST BASE FOR DEPRECIATION

(Clause 16)

Issue: Indirect expenditure

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG)

- a) The wording of the proposed legislation should be wide enough to include indirect expenditure that may be ancillary to the creation of the property. All costs should be captured within proposed section DB 66 in order to prevent any black hole expenditure, even if it would not be able to be capitalised to the cost of property if completed, created or acquired. It would be useful if the legislation included a specific rule to determine the expenditure, both direct and indirect, that would qualify for the deduction. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG)*
- b) Alternatively, detailed guidance should be published on the Inland Revenue website and in the *Tax Information Bulletin* or in an Interpretation Statement. *(Chartered Accountants Australia and New Zealand)*

Comment

- a) Officials consider that the wording of the proposed provisions is broad and captures expenditure that is incurred in relation to making progress towards creating, completing or acquiring property that would be depreciable property or revenue account property, which would include both direct and indirect costs.
- b) In line with standard procedure, following enactment of the Bill, guidance and examples of the types of expenditure within the scope of the proposal will be provided in the *Tax Information Bulletin*.

Recommendation

- a) That the submission be declined.
 - b) That the submission be accepted, noting that guidance will be provided.
-

Issue: Asymmetry between feasibility proposals and depreciation

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG)

There is a potential difference between the expenditure that can be deducted if a capital project is abandoned compared with the counterfactual scenario where the same project is successful.

The scope of the provision in the Bill is too narrow and does not align with the announcements made by the Ministers of Revenue and Finance, which indicated that a deduction would be allowed for feasibility expenditure regardless of whether the project is abandoned. (*Chartered Accountants Australia and New Zealand*)

Submitters have made some suggestions to address this asymmetry.

- a) Proposed section DB 66(1) could be amended to read: “This section applies when a person has—(a) incurred expenditure for the income year in relation to materially advancing, or tangibly progressing, a specific capital project or depreciable asset, that if it were to be completed, created, or acquired, the property would be...”. This would ensure there is no distinction between a successful and unsuccessful project. The definition of “cost” for depreciation purposes should be amended so that it includes indirect costs that are not otherwise deductible, and which are incurred in relation to making progress towards completing, creating or acquiring the property. Taking this approach should mean that there is no gap where expenditure becomes non-deductible black hole expenditure. (*Corporate Taxpayers Group*)
- b) The cost of depreciable and revenue account property should be defined consistently in the proposals to ensure there is no residual “black hole” expenditure if the project is successful because the expenditure cannot be capitalised into the cost base of the property. (*KPMG*)

Comment

- a) Officials acknowledge the matter raised in submissions but consider that the current drafting is broad and sufficient to ensure a broad range of feasibility expenditure will be deductible. The current proposals provide an appropriate balance between fiscal cost considerations and removing tax barriers for investment caused by the non-deductibility of black hole expenditure. In many cases, where property is completed/created/acquired, expenditure on capital account will be able to be capitalised to the cost of the property and be deductible over time.
- b) Officials also note that changing what is included in the cost of depreciable or revenue account property would be a significant change that ought to be fully consulted on. Further consideration of this matter would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be declined.

CLAWBACK

(Clause 11)

Issue: Scope of clawback provision

Submission

(Matter raised by officials)

There is a potential asymmetry between the expenditure that can be deducted under the proposal for feasibility expenditure if the property is abandoned and the expenditure previously deducted that would be returned as income under the clawback provision if the capital project is reinstated (as the clawback provision requires that the expenditure is “directly for the property”). Officials consider that all expenditure deducted under proposed section DB 66 should be returned as income under the clawback if the project is reinstated or the expenditure is used to create, complete or acquire similar property.

Comment

The clawback is an integrity measure directed at situations where taxpayers may be incentivised to unnecessarily abandon work on property, then subsequently reinstate it in order to obtain greater deductions. In order for the clawback to be effective in ensuring there is no incentive for such behaviour, all of the deductions relating to the abandoned property made under proposed section DB 66 need to be clawed back if the project is reinstated or if the expenditure is used to create, complete or acquire similar property. This would ensure that the taxpayer cannot achieve a more favourable tax outcome by prematurely abandoning and then reinstating the project compared with seeing the project through to completion the first time.

Clawing back all expenditure claimed would not undermine the policy intent of the proposals, which would still result in a wide range of costs being deductible for tax purposes and thereby improve productivity and encourage growth.

Recommendation

That the submission be accepted.

Issue: Clawback of deductions – technical/interpretation issues

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG, New Zealand Law Society, PwC)

Submitters have raised a number of technical and interpretation issues with the clawback provision in proposed section CH 13.

- a) References to “or similar property” in proposed section CH 13 should be deleted as this wording is superfluous, may result in overreach and reduces clarity in how the clawback would apply. (*Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, KPMG*)
- b) While there is a need for this integrity measure, clarity is needed as to what is meant by “similar property” which is acquired later. The legislation should provide clarity and Inland Revenue should issue specific guidance as to what is sufficiently similar for the purposes of proposed section CH 13. (*EY*)
- c) The types of expenditure incurred that may be “directly for the property” are likely to be uncertain and a source of debate. The meaning of deductions that are “directly for the property” should be clarified in the Bill. Failing this, detailed guidance on the types of expenses that would be considered by Inland Revenue to be “directly for the property” should be published on Inland Revenue’s website and in the *Tax Information Bulletin*. (*Chartered Accountants Australia and New Zealand*)
- d) The deductions that are “directly” for the property that are subject to the clawback should be more specific, namely those deductions that on subsequent completion or creation of the property are deductible under the depreciation regime or under section DB 23 (as a cost of revenue account property). (*New Zealand Law Society*)
- e) Guidance should be provided on what factors will be considered when determining whether a project represents the restart of an earlier abandoned project. (*PwC*)

Comment

In relation to points a) and b) above, officials acknowledge the points raised by submitters about the need for clarity but consider that the “or similar property” wording in proposed section CH 13 is necessary and should be retained. The clawback is an important integrity measure and it would likely be rare for the property that is eventually created, completed or acquired after reinstating a previously abandoned project to be exactly the same as what the taxpayer originally intended to create, complete or acquire, even though it might be very similar. Guidance on the meaning of “similar property” will be provided in the *Tax Information Bulletin*.

In the preceding item in this report (see Issue: Scope of clawback provision), officials recommend that the scope of the clawback be widened to ensure that all expenditure previously deducted under proposed section DB 66 related to the property is returned as income under the clawback if the project is reinstated. Officials note that if this recommendation is accepted by the Committee, the “directly for the property” wording in the clawback provision noted by submitters in points c) and d) above would no longer need to be clarified as accepting officials’ recommendation would see this wording removed from the provision. As per officials’ comments under Issue: Scope of clawback provision, we do not consider that the deductions clawed back upon reinstatement of the project should be limited to just those expenditures that would form part of the cost base of depreciable property or revenue account property.

In relation to point e), officials agree that guidance on what factors will be considered when determining whether a project represents the restart of an earlier abandoned project would be useful. This guidance will be provided in the *Tax Information Bulletin*.

Recommendation

That the submission points a), c) and d) be declined, but points b) and e) be accepted and to note that guidance will be provided on the meaning of “similar property” and on what factors would be considered when determining whether a project represents the restart of an earlier abandoned project.

Issue: Clawback – requirement to return income in period of reinstatement

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY)

Deductions should not be required to be returned as income in the period the asset is reinstated. This can result in a high upfront cost which could make restarting a project prohibitively expensive and encourage businesses not to go back to previous projects. A more sensible and compliance cost friendly approach would be for the reinstated asset to simply have a lower cost base for tax depreciation purposes, which ultimately achieves the same outcome and is merely a matter of timing. *(Corporate Taxpayers Group, Deloitte, EY)*

Alternatively, the income arising under the clawback should be able to be spread over five years at the option of the taxpayer to match the period of deductions. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group)*

Comment

The clawback is an important integrity measure. Without it, taxpayers could potentially accelerate depreciation deductions by prematurely “abandoning” and then reinstating capital projects. Although having a lower cost base for the reinstated property for tax depreciation purposes would ultimately achieve the same outcome in terms of the amount of expenditure deducted, timing is important. To avoid incentivising taxpayers to prematurely abandon and then reinstate projects, the taxpayer’s previous position needs to be reinstated before the property begins to be depreciated.

Although officials note the potential cash flow impact of the clawback, it effectively puts a taxpayer back in the position they would have been had they not abandoned the asset. It is important to recognise that the taxpayer would have received a timing benefit from the expenditure claimed under the proposals.

Officials also note that spreading the clawback income over five years as suggested by submitters would create complexity.

Recommendation

That the submission be declined.

Issue: Lack of time limit for clawback

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, Powerco, PwC)

Several submitters considered that the clawback should be time limited. A number of different approaches were suggested.

- a) The clawback should only apply where property is subsequently completed, created or acquired within five years after the original project was abandoned. *(Chartered Accountants Australia and New Zealand)*
- b) The period for which the clawback should apply should be limited to the existing time bar period in section 108 of the Tax Administration Act 1994 (which in practice would be a period of four to five years). *(Powerco)*
- c) At a maximum, the time limit should be no more than seven years (being the period of time for which taxpayers must retain records under the general record keeping rules) *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, PwC)*. This seven-year time period should begin at the end of the income tax year that the first one-fifth deduction relates to. *(Corporate Taxpayers Group)*
- d) The clawback should apply only when an acquisition/project is subsequently completed within two years of the end of the proposed five-year spreading period or where there is a regular pattern of abandoned acquisitions/projects being reinstated. *(KPMG)*

Comment

Officials have concerns that it may be possible for expenditure to remain useful and be utilised many years in the future in relation to similar property. However, it is important to balance this against genuine business concerns about the availability of information required to make an adjustment under the clawback.

A reasonable compromise in this instance would be to impose a seven-year time limit on the clawback following the end of the income year in which the final deduction is claimed under the five-year spreading method in proposed section DB 66.

Recommendation

That the submission that the clawback be time limited be accepted subject to officials' comments.

Issue: Interaction between clawback and deductibility proposals

Submission

(Matter raised by officials)

Officials have identified a risk that expenditure could be spread to periods subsequent to the period in which the feasibility expenditure clawback applies. This could result in the clawback potentially not applying to all expenditure claimed under proposed section DB 66.

For example, work is abandoned in Year 1 on property that would have been depreciable property if completed. The taxpayer is allowed a deduction for relevant expenditure over a five-year period. The taxpayer subsequently reinstates work on the property, which is completed in Year 3. Proposed section CH 13 would apply in Year 3 to clawback income based on the amount of expenditure claimed in Years 1 to 3. However, section DB 66 would continue to spread deductions into Years 4 and 5, with no corresponding clawback in those years or subsequently.

Comment

Once property is reinstated, a taxpayer should be brought back to the position they would be in if they had not abandoned the property. This means that clawback should apply to all prior year deductions under proposed section DB 66 and no further deductions should be available under the proposals.

Any lack of clarity can be addressed by preventing the spreading of expenditure under proposed section DB 66 to any periods in which the underlying property has been completed, created or acquired.

Recommendation

That the submission be accepted.

OTHER SCOPE AND TECHNICAL ISSUES

(Clause 16)

Issue: Abandonment costs

Submission

(Auckland Airport, New Zealand Law Society, Powerco, PwC)

The scope of the proposals should be reviewed to ensure the deductibility of expenditure incurred in the course of abandoning projects, such as termination and remediation costs. While some of the expenditure may be deductible under ordinary principles, material amounts would be treated as non-deductible capital expenditure and this gives rise to the same policy concerns as the current treatment of expenditure on feasibility and abandoned capital projects.

Comment

Officials acknowledge the policy argument for allowing taxpayers to deduct abandonment costs. However, officials note that there would be a potentially significant fiscal cost involved in allowing these expenditures to be deducted.

It is further noted that some abandonment costs (such as termination fees for cancelling contracts) may in some instances be capital in nature and not give rise to taxable income to the supplier. In this situation, allowing the other party to the contract to take a deduction for the expenditure creates a potential asymmetry.

Officials consider that further work is required to understand the impact of including abandonment costs within the scope of the measures. However, any work would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Partial abandonment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

Where expenditure incurred relates to a component of an item of depreciable property, and the component itself is abandoned but the item of depreciable property is completed (with an alternative component), it is unclear whether a deduction would be allowed for expenditure relating to the abandoned component under these measures or whether expenditure relating to the abandoned component should be capitalised to the cost of the depreciable property and depreciated. Submitters have requested that a clarification be made to the legislation to address this issue.

Alternatively, this uncertainty in treatment should be addressed by issuing guidance on this matter. (*Corporate Taxpayers Group, Deloitte*)

As a compliance cost measure where taxpayers have capitalised these costs to the cost of the final depreciable property, they should be allowed to retain this treatment rather than have to separate out the costs and treat them as a separate deduction under proposed section DB 66. A taxpayer election in this respect is consistent with the approach taken for capital contributions where taxpayers can either elect to apply a statutory set spreading period or exclude it from the depreciation base of the asset. (*Corporate Taxpayers Group*)

Comment

It is possible that exploring the feasibility project may produce a number of distinct items of property that together make a larger item of property (with the larger item of property being the overall objective of the project). An example of this may be an electricity lines network where various options exist for a new transmission line route. In this situation it would not be unusual for a part or parts of property to be abandoned.

Officials consider that if the costs that were incurred in exploring the viability of the abandoned property cannot be capitalised to the cost of the overall project in this situation and are otherwise not deductible, a deduction for the expenditure relating to the abandoned option would be available under the proposals as currently drafted. Guidance clarifying this position will be provided in the *Tax Information Bulletin*.

Recommendation

That the request for the legislation to be amended be declined, but the point about the need for clarity as to what happens when there is partial abandonment be noted. Guidance will be provided on this issue.

Issue: Improvements to farmland

Submission

(*Chartered Accountants Australia and New Zealand*)

Deductibility should be extended to expenditure incurred in relation to abandoned improvements to farmland that, if acquired, created or completed, would have been amortisable under section DO 4 of the Income Tax Act 2007.

Comment

The submitter points out that feasibility expenditure is commonly incurred by taxpayers in the agricultural sector. Examples given by the submitter are boring wells, small dams and small-scale irrigation.

Officials acknowledge the issue raised by the submitter and note that further work is required to understand the impact of including improvements to farmland within the scope of the proposals. Officials consider it would be better to make this change after having properly

worked through its implications. Further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Costs of assessing feasibility of takeover/merger activities

Submission

(EY)

Under the proposed rules no deduction is available for costs incurred in assessing the feasibility of a take-over/merger with another business if the business seeks to acquire the shares (as shares are not a depreciable asset). Given the widespread economic impacts of the COVID-19 pandemic, due diligence is more important than ever. Deductions related to studying options in cases where the expenditure would not produce a depreciable asset should be deductible. *(EY)*

Comment

Deductions should only be available under the feasibility expenditure proposal insofar as the expenditure is related to making progress towards acquiring or creating property that, if acquired or completed, would be taxable on disposal (revenue account property), or that would provide benefits that decline in value over time and for which depreciation or amortisation deductions would be available. As the submitter has noted, shares are not a depreciable asset. On this basis, it would not be appropriate to expand the scope of the proposal to include costs incurred in assessing the feasibility of a company take-over or merger to the extent the costs relate to the acquisition of shares.

Recommendation

That the submission be declined.

Issue: Property depreciated at a rate of zero percent

Submission

(Deloitte)

These rules should apply to the subset of property that is depreciated at the rate of zero percent. Providing tax relief for this expenditure is consistent with addressing the housing shortage.

Comment

Deductions should only be available under the feasibility expenditure proposal insofar as the expenditure is related to making progress towards acquiring or creating property that, if acquired or completed, would be taxable on disposal (revenue account property) or for which depreciation or amortisation deductions would be available. Providing deductions for expenditure relating to abandoned property that, if completed or acquired, would be depreciated at the rate of zero percent is inconsistent with this policy intention.

Recommendation

That the submission be declined.

Issue: Guidance and examples are needed

Submission

(Corporate Taxpayers Group, Deloitte)

- a) Guidance and examples should be provided to give context to the rules. Examples that consider broader project costs and other expenditures that sit in a more “grey” area would be useful, and situations where apportionment may be required due to the feasibility expenditure being directed towards both depreciable/revenue account property and other property would be useful.
- b) Alternatively, the uncertainty in situations where apportionment may be required could be resolved by further clarifying the legislation. *(Deloitte)*

Comment

Officials agree that guidance and examples in this area would be useful to taxpayers. This will be provided in the *Tax Information Bulletin* in line with standard procedure on enactment of the Bill.

Recommendation

- a) That the submission be accepted, noting that guidance will be provided.
 - b) That the submission be declined.
-

Issue: Clarification of example in commentary

Submission

(Corporate Taxpayers Group)

Example 3 in the Commentary should be clarified. It is the Group’s understanding that where costs are capitalised towards a depreciable intangible asset which is subsequently abandoned before completion, those costs are included within the scope of these proposals and can be

spread and deducted over five years. Example 3 seems to suggest that because the design expenditure is incurred in relation to depreciable intangible property, it is subject to tax depreciation and therefore cannot be deducted under proposed section DB 66 (as a deduction is already being taken). The position in Example 3 should be that the design expenditure should be spread and deducted over five years under section DB 66, unless a more immediate deduction is available as depreciable intangible property.

Comment

Officials agree that the example could have been clearer and it has since been clarified. A similar example with additional context will also be provided in the *Tax Information Bulletin*.

Recommendation

That the submission be accepted, noting that guidance will be provided.

Issue: Drafting issue

Submission

(Corporate Taxpayers Group)

As the legislation currently stands, the de minimis may be read as being on a project-by-project basis. This is on the basis that subsection DB 67(2) refers back to subsection DB 67(1) as the object of the deduction and subsection DB 67(1) is drafted on the basis of a single item of property. The Group understands this is not the intention of the legislation, therefore this should be clarified.

Comment

Officials will draft changes to the wording of the proposed legislation to make it clearer that the de minimis does not apply on the basis of a single capital project or item of property, and will consult with the submitter on the revised drafting.

Recommendation

That the submission be accepted.

Issue: De minimis should be increased

Submission

(EY, PwC)

At the current proposed level, the threshold for proposed section DB 67 is too low and will not materially ease compliance or provide much benefit to small taxpayers. In the current COVID-19 context, a higher value threshold (even a temporary one) would provide a better

incentive to undertake the necessary investigations to look to transform or develop a business to survive the recession. The threshold should be set at \$50,000.

Comment

Officials note that proposed section DB 67 is a de minimis rule to reduce compliance costs for taxpayers with very low amounts of feasibility expenditure. This rule is broader in scope than proposed section DB 66 (as it does not require the abandonment of property) and is also not subject to the claw-back rule, meaning that it is important to exercise care in how widely the rule is applied. Officials also note that the \$10,000 threshold is consistent with the current threshold for non-deductible legal fees in the income tax legislation.

Recommendation

That the submission be declined.

Issue: Separately identifiable assets and goodwill

Submission

(Matter raised by officials)

The current drafting of proposed sections DB 66 and DB 67 is intentionally wide in order to achieve the policy intent of reducing tax barriers for business investment. However, it is possible that the drafting may unintentionally provide deductions for expenditure on separately identifiable assets (such as shares and goodwill) that would otherwise not be deductible.

Comment

The proposed rules provide an opportunity for a wider range of expenditure to be deductible, and it is important that they contain appropriate integrity measures to ensure they do not give rise to unintended outcomes. For example, in the course of a capital project, a person could acquire shares in a business that holds assets (for example, intellectual property) that it needs in order to make progress towards creating an item of depreciable property. It is not intended that expenditure incurred on shares would be deductible under the proposals, but there is a risk that the current drafting would allow such a deduction. This problem could be remedied by including a list of expenditure (for example, on separately identifiable assets acquired in the course of completing/creating/acquiring property that is abandoned) that would not be deductible under the proposals.

Recommendation

That the submission be accepted.

Land

OVERVIEW

Existing provisions in the Income Tax Act 2007 tax sales of land by land developers, dealers, builders, and connected persons. In addition, there is the so-called “intention test”, which applies to all taxpayers. If a person sells a property that was acquired with the purpose or intention of disposal, they are taxed on the income arising from that disposal. There are limited exclusions for properties used as a residence or business premises. However, these exclusions do not apply if the person has a regular pattern of buying and selling land (“regular pattern restriction”).

The bright-line test was introduced in 2015 as an additional charging provision in the land sale rules, with the aim of buttressing the intention test. Initially, it applied to disposals of residential land made within two years of acquisition but has since been extended to five years for land acquired on or after 28 March 2018.

At the same time as the introduction of the bright-line test, additional reporting requirements were introduced for land transactions – in particular, the introduction of the Land Transfer Tax Statement, which must be completed by buyers and sellers alike.

The Bill includes proposals that emerged out of the first tranche of the previous Government’s review of the current land rules undertaken in 2019. In particular, the Bill proposes:

- to amend the regular pattern restriction outlined above to ensure that it cannot be circumvented simply by changing ownership patterns and what is done to the land. At the same time, the proposal limits the regular pattern restriction to those who acquire land with a purpose or intention of disposal. The proposal would apply to land acquired on or after the enactment of the Bill, but land acquired before this date could be considered for determining whether there is a pattern;
- to clarify that the cost of revenue account property is deductible, even if, at the time the costs were incurred, it was not known that the disposal would be taxed or if the property was used privately. This is particularly relevant in the context of the land sale rules, as someone may not know at the time they purchase a property or make improvements that they will sell it within the bright-line period. This proposal would apply from 1 April 2008, being the commencement date of the Income Tax Act 2007, as it is a taxpayer-friendly measure that would align the law with current practice; and
- to relocate the content of the Land Transfer Tax Statement to regulations. The content is currently prescribed in primary legislation in the Land Transfer Act 2017. The proposed change would enable the content of the form to be updated in the future in a timely manner.

In this report, officials recommend a technical amendment to the definition of “dwelling” to ensure that vacant properties are within the scope of the term. This proposed amendment should be retrospective to the introduction of the bright-line test, 1 October 2015, to ensure that the law aligns with the practical application to date.

Overall, there were nine submissions that covered the land sale rules. Four submitters explicitly expressed support for the first proposal (regular pattern restriction), three for the second (deductibility of revenue account property), and one for the third (relocating the contents of the Land Transfer Tax Statement).

Regarding the regular pattern restriction proposal, three submitters do not consider that it should impact the business premises exclusion. Officials consider that there needs to be consistency with the other exclusions, and note that genuine commercial transactions would not be caught as the proposal would also require that the land be acquired with a purpose or intention of disposal.

No submitters were opposed to the proposals regarding the deductibility of revenue account property and relocating the contents of the Land Transfer Tax Statement.

Technical submissions were made on proposed new terms and how they are defined. For example, four submitters considered that the term “significant involvement” used in the regular pattern restriction should be defined. However, as an anti-avoidance rule, it would not be appropriate to have a prescriptive test as it could be easily structured around. Three submitters suggested that instead of referring to a group of persons, it would be better to have an explicit link to the established “associated persons” rules. The intent of the rule is to capture slightly different relationships than those provided for in the associated persons rules.

A number of submissions were made in relation to aspects of the land sale rules that are not within scope of the proposals contained in the Bill. Officials note that these issues would require prioritising and resourcing as part of the Government’s tax policy work programme but could be considered as the land review progresses.

HABITUAL BUYING AND SELLING OF LAND

(Clauses 5, 6 and 7)

Issue: Support for the amendments

Submission

(Corporate Taxpayers Group, Deloitte, EY, Navtej Singh)

Four submitters support the proposed amendments. The submitters note that the amendments are aimed at ensuring the land sales rules are suitably robust, are reasonable and in line with the intention of the overall legislative change in this area, proactively address abuse of the regular pattern rules, which is crucial without a broad-based capital gains tax, and will bring more opportunities for first home buyers.

Recommendation

That the submissions be noted.

Issue: Support for purpose of disposal limitation

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

Three submitters support the proposal that land must be acquired for a purpose or intention of disposal before the regular pattern restrictions will apply. The submitters note this will ensure that the rules are suitably targeted in the first instance and should help ensure that genuine transactions are not unintentionally captured by the proposed rules.

Recommendation

That the submissions be noted.

Issue: Amendment to business premises exclusion not necessary

Submission

(Chartered Accountants Australia and New Zealand, EY, KPMG)

The proposed amendments should not be made to the business premises exclusion in section CB 19.

There is no evidence to suggest that the current regular pattern restrictions in the business premises exclusion are not operating as intended. The requirement in the business premises

exclusion that the land must be used for a substantial business already provides sufficient restriction.

Larger taxpayer groups are likely to be disadvantaged by the proposed grouping rule since transaction frequency can be expected to be higher across more related/controlled entities.

Any specific concerns regarding a person or group and their pattern of behaviour should be addressed under the current anti-avoidance provisions in Part G of the Income Tax Act 2007.

Comment

The substantial business requirement in the business premises exclusion does restrict a taxpayer's ability to rely on that exclusion. However, the current business premises exclusion also already contains a regular pattern restriction. To clarify – the amendments do not propose to change that overall policy setting.

Instead, the proposal to amend the regular pattern restriction in the business premises exclusion aims to ensure that there is consistency with the other regular pattern restrictions. It also ensures that the current regular pattern restriction cannot be structured around by, for example, using subsidiaries to carry out different transactions in order to avoid a pattern being established. This ensures that the current restriction operates as intended.

The inclusion of the requirement that the regular pattern restrictions will not operate unless land is acquired with a purpose or intention of disposal will ensure that large taxpayer groups will not be disadvantaged by this amendment simply due to the scale of their transactions. The regular pattern restrictions are not intended to capture genuine commercial transactions where there was no intention to dispose of the land when it was acquired.

Recommendation

That the submissions be declined.

Issue: Group of persons – clarify “significant involvement or control”

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, New Zealand Law Society)

The term “significant involvement” should be defined.

The word “significant” is imprecise and it is not clear what type of involvement is required. The word “control” is also imprecise, and it is not clear what type of control is required (*New Zealand Law Society*).

Comment

Given the context of the regular pattern restrictions as anti-avoidance provisions, it is considered appropriate not to have a prescriptive test that could be structured around. The ordinary meaning of the words “significant involvement” and “control” provide sufficient guidance as to the types of relationships that will give rise to a “group of persons”. As stated

in the Commentary to the Bill, in this context these terms indicate that the relevant person is able to direct, alone or as part of a group, the relevant trust or entity's decision-making.

Recommendation

That the submissions be declined.

Issue: Group of persons – “significant involvement” is not necessary

Submission

(KPMG)

The term “significant involvement” should be omitted from the definition of a “group of persons”, or the definition should be modified so that it reads “significant involvement, *and* control in”, similar to section CW 12 of the Income Tax Act 2007.

If a person is “able to direct, alone or as part of a group, the relevant trust or entity’s decision-making process”, it appears to us that the person would have “control” of the relevant trust or entity and therefore the term “significant involvement” is redundant.

It is possible for a person to have “significant involvement” in a trust or entity and not have control of the trust or entity. The term materially expands the meaning of “a group of persons” without clear definition.

Comment

The use of both “significant involvement” and “control” in the definition of “a group of persons” was intended, as the terms can differ in meaning. As an anti-avoidance rule, the proposed definition of “group of persons” should refer to both.

The use of the terms in section CW 12 of the Income Tax Act 2007 arises in a slightly different context. The provision provides for an exemption from tax for share disposals by certain foreign investors. For a foreign partnership to qualify for the tax exemption, there needs to be at least one general partner who has significant involvement in, and control of, the business activities.

Tax exemptions are generally naturally tighter in scope to ensure they are contained, while anti-avoidance rules need to be broader to ensure they cannot be structured around. Therefore, although requiring both significant involvement in business activities and control thereof may be appropriate for a tax exemption, officials do not consider this appropriate for the “group of persons” definition and it should continue to refer to “significant involvement in, or control of”.

Recommendation

That the submission be declined.

Issue: Group of persons – better to use associated person test

Submission

(Corporate Taxpayers Group, Deloitte, KPMG)

It would be better to have a clear link to the associated person rules. As currently drafted, the “group of persons” test could capture situations where people are not associated, such as where entities have a common employee but no common ownership, or where a parent and adult child own and occupy a series of properties.

Comment

It is intended that the “group of persons” test capture relationships where people would not ordinarily be “associated persons”, such as those raised in the submissions. The purpose of extending the regular pattern restrictions to a “group of persons” is to capture situations where people are acting together in a way that results in land being regularly bought and sold without being taxed. This requires capturing different relationships from those already caught by the associated person rules. Concerns about the test being broader than the associated person rules should be mitigated by the requirement that land must first be acquired for the purpose of disposal before the regular pattern restrictions apply.

Recommendation

That the submission be declined.

Issue: Meaning of “regular pattern” – term does not achieve policy intent

Submission

(KPMG)

The High Court considered the meaning of “regular pattern” in *Parry v Commissioner of Inland Revenue* and considered that it “denotes a similarity or likeness in the transactions”. The Bill commentary states that the policy intent is that the transactions are not required to be similar, so the use of the term “regular pattern” would not achieve this outcome. The word “pattern” should be deleted and the phrase “regularly engaged” should be used instead.

Comment

The concern being addressed by the current amendment is not the fact that the term “regular pattern” requires a similarity or likeness, but the fact that the current definition, and that considered by the High Court in *Parry*, required a regular pattern of either acquiring and disposing, or erecting and disposing of dwellinghouses. This led the Court in *Parry* to consider whether there was a regular pattern of erecting dwellinghouses, rather than focusing on whether there was a regular pattern of acquisition and disposal of land.

It is considered that amending the regular pattern restrictions in sections CB 16 and CB 19 to only refer to acquiring and disposing of land used as a residence or business premises will ensure that the focus is on the similarity or likeness of the acquisition and disposal

transactions, rather than on whether similar activities (for example, building, renovating, etc) have been done on each piece of land while it is owned.

Recommendation

That the submission be declined.

Issue: Group of persons – minor clarification

Submission

(Matter raised by officials)

As currently drafted, the reference to a “trustee of a trust or another entity” in the second limb of the definition of “group of persons” in the regular pattern restrictions for the main home exclusion (section CB 16A) and the residential exclusion (section CB 16) could give rise to confusion because a trustee of a trust is not a legal entity.

Comment

The second limb of the definition of “group of persons” in the main home and residential exclusions is intended to ensure that persons who are not natural persons can form part of the group of persons where a natural person living in the property has significant involvement in, or control of, the activities of the non-natural person. The reference to a “trustee of a trust or another entity” should be amended to refer to a person that is not a natural person to provide more clarity that this covers all non-natural persons (including persons in their capacity as trustees), whether or not they can be described as an entity.

Recommendation

That the submission be accepted.

Issue: Sale and leaseback transactions

Submission

(EY)

The proposed changes should specifically exclude sale and leaseback arrangements from the intention test for the purposes of the business premises exclusion. Large retail businesses are often required to acquire land and undertake the development of their own business premises because of the scarcity of capital and development capability in the New Zealand market. Sometimes land will be acquired and developed with an intention that once the development is complete, the land will be sold to a third-party landlord and leased back to the retailer. Given the land can be acquired with an intention of disposal, and these types of transactions can be repeated, these transactions could fall outside of the amended business premises exclusion in section CB 19. Such transactions should be considered acceptable and within

the business premises exclusion provided there is a substantial business that continues to operate on the premises which is not centred on property development/improvement.

Comment

The current business premises exclusion contains a regular pattern restriction. Under that restriction, a large retail business is not entitled to rely on the business premises exclusion if it regularly acquires land with an intention of entering sale and leaseback transactions once the land is developed. There is no intention to change this policy setting. The amendments simply ensure that large retail businesses that undertake such transactions cannot avoid this outcome by using separate subsidiaries to enter into each transaction.

Recommendation

That the submission be declined.

Issue: Guidance

Submission

(Chartered Accountants Australia and New Zealand, EY)

An education campaign should be undertaken when the legislation is introduced, including publication of the policy intent and examples illustrating the application of the legislation.

Comment

Officials note that following enactment of the proposed amendments, Inland Revenue will provide guidance through a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, noting that guidance will be provided.

COST OF REVENUE ACCOUNT PROPERTY

(Clause 14)

Issue: Support for the amendment

Submission

(Corporate Taxpayers Group, Deloitte, Chartered Accountants Australia and New Zealand)

Three submitters support the proposed amendment.

Comment

Officials note that the proposed amendment would have retrospective effect from 1 April 2008, to coincide with the introduction of the Income Tax Act 2007. The proposed amendment ensures that the legislation aligns with the policy intent and how deductions are currently being allowed. The proposed amendment should therefore not have any real impact on taxpayers.

Recommendation

That the submissions be noted.

LAND TRANSFER TAX STATEMENT

Issue: Direct information sharing between LINZ and Statistics NZ

Submission

(Matter raised by officials)

The Bill proposes changes to the Land Transfer Act 2017 to amend the Land Transfer Tax Statement provisions to allow the content of the Land Transfer Tax Statement (LTTS) to be set by regulations.

The LTTS is used to collect tax details and residency information of transferors and transferees of property in New Zealand. This information is provided to Land Information New Zealand (LINZ) at the point of property transfer. LINZ provides this information to Inland Revenue to assist in administering the tax system, particularly in relation to compliance with tax obligations.

The information is also used to prepare quarterly releases on property transfers. The releases include information on the citizenship, visa status, or tax residency of people and companies involved in property transfers. The role of preparing these releases moved from LINZ to Statistics NZ in May 2018.

Currently LINZ is only able to share the data collected from the LTTS with Inland Revenue in accordance with the legislative provisions set out in the Land Transfer Act 2017. To facilitate Statistics NZ's role in preparing the quarterly releases, Inland Revenue currently on-shares the information collected on the LTTS with Statistics NZ under information sharing provisions contained in the Tax Administration Act 1994.

Officials recommend that an amendment be made to the Land Transfer Act 2017 to allow LINZ to share the information collected on the LTTS with Statistics NZ directly.

Comment

This amendment will improve the information flows between agencies using the data collected on the LTTS by allowing LINZ as the agency collecting the information, to share this directly with Statistics NZ.

Permitting direct information sharing in the Land Transfer Act 2017 is more transparent and will reduce the double handling of information.

LINZ and Statistics NZ have an existing information sharing Memorandum of Understanding (MOU), and currently share other data. Following this amendment, the information-sharing MOU would be amended to facilitate this information sharing.

Officials consulted with the Office of the Privacy Commissioner on this item, which did not have any issues with the proposed change.

Recommendation

That the submission be accepted.

Issue: Support for the amendment to move LTTS content to regulations

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the amendments to the Land Transfer Act 2017 to allow the content of the Land Transfer Tax Statement to be moved to regulations.

Recommendation

That the submission be noted.

OTHER ISSUES

Issue: Definition of “dwelling” and related terms

Submission

(Matter raised by officials)

The definition of “dwelling” and related terms in the Income Tax Act 2007 should be amended to ensure that vacant residential properties are subject to the same tax rules as occupied residential properties, consistent with the policy intent.

Comment

The term “dwelling” is used in the definition of other terms such as “residential land” and “residential building” to determine whether a property is subject to the bright-line test, residential land withholding tax and the residential rental loss ring-fencing rules, and whether building depreciation and separate depreciation of commercial fit-out are available.

The bright-line test taxes sales of residential property that occur within five years of acquisition, and the residential rental loss ring-fencing rules ensure that a property owner is not able to use losses arising from rental properties to offset other income tax liabilities. It was intended that these rules apply, broadly speaking, to land with a house on it regardless of whether the house is used or not used at all. The bright-line test uses the concept of “residential land”, which relies on the term “dwelling” with a few modifications.

The existing definition of “dwelling” requires that a property be used predominantly as a place of residence or abode. There are concerns that the focus on actual use as a residence excludes residential properties that are predominantly vacant. This means they would not be subject to the bright-line test and rental loss ring-fencing rules, which is not consistent with the policy intent.

Officials consider that the definition of “dwelling”, and potentially “residential building” and “residential land”, should be amended to include vacant residential properties.

As this was an unintended oversight in the original drafting and it was never intended that a property could be outside the scope of the bright-line test by keeping it vacant, the amendment should be retrospective to the introduction of the bright-line test, 1 October 2015, to ensure that the law aligns with the practical application to date.

Recommendation

That the submission be accepted.

Issue: Future amendments

Submission

(Corporate Taxpayers Group, PwC, EY, Chartered Accountants Australia and New Zealand, Russell McVeagh)

It is important that a comprehensive review of the rules be undertaken in the future to address distortions which may have arisen from ad hoc amendments over time, and to ensure that the rules are both coherent and fit for purpose. *(Chartered Accountants Australia and New Zealand)*

In particular, the following issues are raised for future consideration:

- The business premises exclusion should be extended to apply where:
 - Premises are leased to, and occupied by, a company in the same wholly owned group as the landowner. *(Corporate Taxpayers Group, PwC)*
 - Franchisees should be counted as agents for the purpose of “occupied” in section CB 19. *(Corporate Taxpayers Group)*
 - Space leased and occupied by third parties who provide services integral to the operation of the landowner’s business (for example, a hotel) should not be apportioned out under section CB 19, if these spaces are only a small part of the overall property. *(Corporate Taxpayers Group)*
- A specific disclosure regime should be introduced to monitor land transactions and provide evidence of a purpose or intention of disposal. *(EY)*
- The bright-line test in section CB 6A should be amended to disregard transfers of land by a person to the trustee of a trust of which the person is a beneficiary and the principal settlor. *(Russell McVeagh)*

Comment

Officials acknowledge the matters raised in these submissions but note that it would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submissions be declined, subject to officials’ comments.

Purchase price allocation

OVERVIEW

The proposal is to insert sections GC 20 and GC 21. These sections will apply to sales of commercial property, businesses, and other bundles of assets, if entered into on or after 1 April 2021.

The purpose of the proposal is to require a buyer and seller to make the same allocation of the total purchase price to the different assets (or classes of assets) sold. For example, in a purchase of commercial property, the proposal requires that the seller and buyer allocate the same amount to the land, the building, and the fit-out.

This prevents the parties making inconsistent allocations which in aggregate result in a loss of revenue. This can happen, for example, if the seller allocates less of the sale price to fit-out than the buyer does.

The proposal requires parties who agree an allocation between themselves to follow that allocation in their respective tax returns. If they do not agree, the vendor may notify an allocation to the buyer and the Commissioner. The allocation binds both the vendor and the purchaser. If the vendor does not make an allocation within two months of the transaction, the purchaser can notify an allocation, which binds both the purchaser and the vendor.

Submissions were received, from business groups, advisors and an individual. Only one submitter was explicitly in favour of inconsistent allocations being allowed, but no submitters supported the proposed solution. Some argued that the required level of consistency could be achieved without legislative change, using increased information gathering and case intervention by the Commissioner. Others argued that any legislative change should involve empowering the Commissioner to resolve inconsistencies, rather than giving the seller the power to make a unilateral binding allocation. Yet others argued that the power to make the allocation should first be given to the buyer.

As set out below, various technical changes have been recommended in response to submissions, but officials remain of the view that the basic approach adopted in the Bill is sound.

COMMENTS ON PROPOSAL AS A WHOLE

(Clause 40)

Issue: Support for proposal

Submission

(Navtej Singh)

This submission supports the purchase price allocation amendments, as they will help to address the tax mismatches resulting from different price allocations by vendors and purchasers in asset sales.

Recommendation

That the submission be noted.

Issue: Support for requirement that parties follow agreement in tax returns

Submission

(Chartered Accountants Australia and New Zealand, EY)

If parties agree a purchase price allocation, they should be required to follow that agreed allocation in their tax returns.

Recommendation

That the submission be noted.

Issue: Legislative changes are unnecessary and disproportionate to mischief; operational approach is more appropriate

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, Russell McVeagh, PwC)

Purchasers and vendors will often have different views of the value of a business and its assets – this is a normal and expected outcome of well-functioning markets. Tax law should not interfere with it. *(EY, Chartered Accountants Australia and New Zealand)*.

The proposals create a compliance burden for virtually the entire transaction market. The proposed rules in section GC 21 are not practical, do not reflect the intricacies of commercial negotiations, and do not appropriately accommodate situations where parties do not or cannot agree an allocation within the timeframe for the transaction.

A targeted operational approach would be more appropriate; Inland Revenue should conduct compliance audit activity to estimate the true extent of the problem. It should issue an operational statement outlining that where parties adopt different values, or non-market values, they risk costly and time-consuming disputes with the Commissioner. Also, Inland Revenue should use enforcement action to modify behaviour.

Given that in most mixed-asset transactions the parties already agree an allocation, it is not clear that the rules in GC 21 are required. *(PwC)*

Inland Revenue's concern about the Commissioner's lack of valuation expertise is inconsistent with the myriad of rules and Commissioner overrides that already exist and require the use of market (or other) values. The Commissioner will challenge some cases, argue valuation and obtain expert advice. Examples of areas in which this occurs are: transfer pricing, dividends, trading stock, and fringe benefit tax. Also section BG 1. The Commissioner sees both sides of a transaction and has access to an unrivalled base of asset sale transactions. *(Russell McVeagh)*

The Government's aims would be largely achieved by simply requiring written agreement between the vendor and purchaser. The incentive to comply with the rules would be the risk of challenge by Inland Revenue. This could be made even more effective by placing a requirement on the parties to notify Inland Revenue of their agreed allocation. Written agreement between transacting parties has become more common, partly due to increased audit activity in the area, and the suggestion of law change. *(PwC)* Parties are typically advised to agree an allocation in their documentation, and typically do agree one. The best evidence of what a vendor has received or a purchaser has paid is the contract under which the asset was sold. *(Russell McVeagh)*

Only if that does not work should a legislative approach be considered. Inland Revenue should utilise new systems and processes from BT – Inland Revenue has not grasped the new capabilities of its system. Policy and operational practice should evolve. This legislative approach eschews intelligence gathering, development of commercial capabilities, and fails to enforce existing Income Tax Act rules. It may cause collateral damage and drive bad behaviour.

The proposals appear to be based on the troubling premise that existing law is not being enforced. The remedy for this should be to improve enforcement practices, not to introduce new and prescriptive rules that may unnecessarily complicate and in some cases confer on one party a unilateral power to vary commercial arrangements, which is unprecedented in the tax laws. In a self-assessment-based tax system, the fact that Inland Revenue scrutiny is unlikely to occur or result in adjustment is concerning. If this is true, the resource-intensive process of reviewing and amending the law will be somewhat futile. The taxpayers who were not complying with the old law will not, in an environment in which scrutiny is unlikely, comply with the new law *(Russell McVeagh)* – particularly taxpayers that are currently taking tax positions counter to what they have agreed in a legally binding transaction. *(Deloitte)*

An operational approach should be taken alongside appropriate remedial amendments. *(Deloitte)*

The only law change should be to clarify that purchasers must allocate purchase price based on the market values of the assets acquired. *(Corporate Taxpayers Group)*

Symmetrical treatment in all transactions is not the right focus. The real issue is that the Commissioner is not able to monitor which asymmetric allocations are problematic and which ones are justifiable. If parties do not agree an allocation, they should be able to adopt different allocations, but be required to provide electronic disclosures to the Commissioner to justify their allocations and reasons for disagreement. Inland Revenue is underestimating the significant deterrent effect such disclosure requirements would have. The Department can use analytic tools

to identify material discrepancies and examine valuations for genuine avoidance. (*EY, Chartered Accountants Australia and New Zealand*)

Comment

Officials agree and acknowledge that purchasers and vendors will usually have different views of the value of a business and its assets. Commercially, a vendor will not generally sell assets unless the vendor thinks they are worth less than the purchaser is paying for them, and a purchaser will not buy the assets unless the purchaser thinks the opposite – notwithstanding distressed sales. But if only one asset is sold, it is bought and sold for a single price, and that price is the value of the asset for both parties for tax purposes. Officials see no reason why this consistency principle should be departed from where two or more assets with different tax treatments are sold together. Section GC 21 is not a case of the tax law interfering with markets – it is a case of the tax system not tacitly subsidising commercial transactions by allowing parties to treat an asset as bought for one price and sold for another, in order to minimise their respective tax liabilities.

With regard to evidence of the problem, audit activity undertaken by investigators is what spurred the development of these proposals in the first place. The evidence base includes a number of large commercial property transactions and sales of going-concern businesses. Furthermore, anecdotal evidence from some tax advisors suggests that inconsistent allocations are a frequent occurrence, due to parties asserting different views of market value.

There will always be a debate around how much audit evidence is required for a policy response – whether operational or legislative – to be regarded as necessary. The Commissioner has, on multiple occasions, taken cases against vendors and purchasers adopting inconsistent allocations and has frequently failed to drive the parties to agreement – an unsurprising outcome, given the lack of a statutory requirement for consistency, other than in relation to trading stock. The fact that consistency cannot be reliably achieved, even with considerable resource outlay from Inland Revenue, suggests that a more fundamental change to the regulatory framework is warranted.

Officials do not consider the additional compliance burden of a consistency requirement for purchase price allocation to be substantial. Price negotiation may be more protracted in some cases, but business practices can be expected to adapt.

The current tax law does not require a vendor or purchaser to file its tax return on the basis of an allocation it agreed with the other transacting party as part of the sale and purchase. This is a gap in the law and is the reason for proposed section GC 20. Some parties may continue to ignore an agreed allocation despite the proposed law change, but if they do, they will be non-compliant and the Commissioner will have a legislative basis for amending their returns. Moreover, parties can be expected to comply with the new law, because they have an incentive to do so.

A requirement for disclosure will persuade some taxpayers to agree an allocation. However, Inland Revenue's experience is that it will not persuade all to do so, and where it does not, existing law makes it difficult, time consuming and in many cases impossible to bring the parties together.

Finally, the power to allocate is not the power to vary a commercial arrangement. If the parties agree, they must follow their agreement. If they do not agree, there is no arrangement with respect to the allocation, and the purchase price allocation rules will apply as appropriate.

Recommendation

That the submission be declined.

Issue: Lack of evidence for applying rules to business sales

Submission

(Corporate Taxpayers Group)

The rules, if they proceed, should not apply to business sales. There is a lack of evidence about the scale of the issue with businesses. The rules should be restricted to sales of commercial and residential property. Requiring all transactions to comply with highly complex and detailed rules to address an issue caused by a subset of bad taxpayers comes at the expense of all taxpayers. We note:

- Commercial property is where most discrepancies have been identified.
- Information is provided to Inland Revenue about real property transfer (under the Land Transfer Act).
- Most real property transactions are undertaken with a standard form (Auckland District Law Society), which can be updated to specify purchase price allocation rules.
- Focusing on property negates many practical issues.
- Issues relating to transacting through auctions can be managed to ensure fair outcomes.

Comment

Officials are aware of a number of transactions involving inconsistent allocation of the purchase price in business sales, some of them very large. Officials have also been told that the requirement for consistency for trading stock is often ignored in practice.

Recommendation

That the submission be declined.

Issue: Stakeholder feedback should have greater bearing on proposed amendments

Submission

(Deloitte, Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd)

Given the extent of disagreement with the proposals, stakeholder feedback should have a greater bearing on the proposed amendments and ensure they reflect commercial reality, and that the compliance burden is in line with the scale of the problem.

The proposals should be withdrawn for further consultation, and then brought back to Parliament.
(Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd)

Comment

Stakeholders have provided much useful feedback on the proposals throughout the policy development process – in submissions on the officials’ issues paper, in meetings with officials, and most recently in submissions on the Bill – and officials have made a number of changes in response. Many of these changes have been aimed at reducing compliance costs and

acknowledging commercial realities: requiring consistency only at an asset class level rather than asset-by-asset; making the backstop rules for non-agreement more neutral by putting a tax book-value floor on a unilateral allocation by the vendor; and so on. Given the extent of consultation undertaken, in line with the Generic Tax Policy Process, officials do not consider it is necessary to withdraw the proposed amendments from the legislation for later reintroduction. However, officials will continue to engage and consult with stakeholders as the Bill progresses.

Recommendation

That the submission be declined.

Issue: Tax not the only driver of purchase price allocation

Submission

(Corporate Taxpayers Group)

Tax is not the only driver of a purchase price allocation. There are other areas of commercial significance that are relevant for purchase price allocation, including insurance cover terms, caps on damages that can be claimed for a breach of contract, and other regulations.

Comment

Officials acknowledge that a purchase price allocation can have relevance for non-tax reasons in some cases. However, that is true only for a limited set of transactions, and even then, tax is usually much more significant. For example, it seems unlikely that the amount allocated by a vendor to an asset for tax purposes would limit the amount the purchaser could then insure that asset for. Nor would an excessive tax allocation by a purchaser mean that an insurer was bound to accept that figure as the appropriate replacement value for the asset. Commercial considerations are no more than a weak constraint, if any, on tax-optimising allocations.

Recommendation

That the submission be noted.

Issue: Impact of proposals on commercial transactions in COVID-19 context

Submission

(EY)

The impact of the proposals on commercial transactions should not be ignored in the current COVID-19 context, in which there will be more transactions involving distressed businesses, with vendors and purchasers having different views of the value of business assets.

Comment

Officials consider that the rules will be equally workable for distressed sales as for normal transactions. Inland Revenue will monitor the performance of the rules.

Recommendation

That the submission be noted.

Issue: Amendment of disputes regime in the Tax Administration Act to enable three-way dispute would be a better way to achieve consistency

Submission

(Corporate Taxpayers Group)

The disputes regime in the Tax Administration Act 1994 should be amended to clarify that the Commissioner can enter a three-way dispute involving a vendor and purchaser if the parties do not file tax returns with the same allocation. A joint dispute is most efficient.

Comment

Officials carefully considered the option of amending the disputes regime, and had discussions with legal sections of Inland Revenue. The approach would require the development of a bespoke disputes process, which would most likely have been rarely used and would be unlikely to apply correctly in all situations. The process would generate significant costs on both sides. It is unlikely to be feasible, and the benefits would be outweighed by the costs.

Recommendation

That the submission be declined.

Issue: Degree of acceptable asymmetry should be allowed

Submission

(EY)

There should be some degree of acceptable asymmetry, as there may be genuine reasons for parties to have divergent views as to relative price allocations. Seeking symmetry in all cases is overcorrection. Not all asymmetry is due to tax avoidance.

For example:

- a) Taxpayers could fall outside the proposed rules where the discrepancy in allocations has a tax effect of less than \$500,000.
- b) Alternatively, the law could provide the Commissioner with the discretion to accept an asymmetric allocation under certain conditions.

Comment

- a) The proposal already contains de minimis (though officials are proposing to remove the \$100,000 taxable/deductible property threshold – see Issue: “Consistency thresholds too low”). If a transaction falls below the de minimis, the parties are not required to allocate consistently, notwithstanding that they must still allocate based on market values. If an additional de minimis for asymmetry is introduced, parties will simply ensure that they agree divergent allocations equal to the de minimis. Some kind of agreement would still be required between the parties so that they ensured the de minimis would not be exceeded. It is simpler and more effective to have no such de minimis.
- b) Officials do not consider that a Commissioner discretion in relation to asymmetric allocations would be desirable. The rules are designed to avoid Commissioner intervention in transactions except as a last resort, for reasons set out in officials’ response to the Issue: “Proposal gives vendor incentive not to agree to an allocation”.

Recommendation

- a) That the submission be declined.
 - b) That the submission be declined.
-

Issue: Lack of international precedent for approach

Submission

(PwC)

Other jurisdictions facing the same problems do not seem to have introduced the hierarchy of rules proposed for New Zealand.

Comment

Many other jurisdictions (for example, the United States, the United Kingdom, Australia) have a comprehensive capital gains tax (albeit frequently at discounted rates), which reduces the degree to which vendors and purchasers can gain tax advantages through price apportionment. It presents a stronger risk in New Zealand, which lacks a general capital gains tax.

Even so, some countries have made efforts to ensure consistency, though they have not taken precisely the same approach as proposed here. The proposed approach is intended to minimise the need for Inland Revenue intervention.

Regardless, although international precedent can be a helpful source of information and insight, its absence should not necessarily preclude New Zealand from implementing a desirable reform.

Recommendation

That the submission be noted.

Issue: Rules will create issues in competitive bids and auctions

Submission

(Corporate Taxpayers Group, PwC)

The rules will create issues in competitive bid processes, where purchasers must submit bids prior to advancing to a full due diligence process. The outcome of the initial bidding process could be materially influenced by whether particular bidders have specified a potential purchase price allocation (because it could impact on the vendor's returns).

In a competitive bid process where an overseas vendor is bidding against a New Zealand purchaser, the New Zealand purchaser is in a weaker bargaining position because the overseas vendor may care less about the allocation, depending on the tax rules in its home jurisdiction.

Comment

Market participants will be able to deal with issues arising in competitive bid processes in a number of ways. Bids may be expressed by the bidder to be conditional on a specified allocation, for example. Or the person requesting bids may specify an allocation, in order to ensure that all the bids are made on an even footing.

In terms of cross-border transactions, foreign bidders will be subject to a range of regulatory requirements in New Zealand and in their home country, which may improve or worsen their competitive position. Free trade or investment agreements may go some way towards levelling the playing field. New Zealand domestic tax rules should be set with a view to reducing distortions for participants in the domestic economy, and not to accommodate possible cross-border concerns.

Recommendation

That the submission be noted.

Issue: Operation of rules unclear where there is foreign purchaser

Submission

(Deloitte)

The operation of proposed section GC 21 is unclear where there is a foreign purchaser. An allocation could be agreed in relation to assets that will remain in New Zealand post-completion but not in relation to assets that will leave New Zealand post-completion (because the foreign purchaser has no incentive to agree an allocation to those assets).

Comment

If an allocation is agreed in relation to some assets and not others, then the purchase price allocation rules will apply to each bundle of assets separately. In this case, section GC 20 would apply to the agreed allocation for assets that are to remain in New Zealand post-completion, requiring the parties to file on the basis of their agreement. Section GC 21 would apply to the assets that are to leave New Zealand post-completion. The vendor would determine an allocation,

and that allocation would have no impact on the purchaser, for whom the assets will not be in the New Zealand tax base going forward.

In practice, however, if the purchaser is indifferent to the allocation to some assets, the vendor should not have a problem getting the purchaser to agree with the vendor's allocation to them.

Recommendation

That the submission be noted.

Issue: GST implications of proposals have not been considered

Submission

(Chartered Accountants Australia and New Zealand, nsaTax Limited)

Consideration should be given to the GST consequences of the purchase price allocation when a transaction is not zero-rated, and particular categories have different GST treatments – for example, a taxable supply versus a GST exempt supply. When a transaction includes both taxable and exempt supplies and the parties have not agreed an allocation, it will be important to take GST into account in determining the allocation. *(Chartered Accountants Australia and New Zealand)*.

Under section GC 20, the purchase price allocation needs to be agreed before either party files an income tax return for the year. This is several months after the filing of GST returns for which the allocation could be pertinent. *(nsaTax Limited)*

Comment

It is unusual for a transaction subject to GST to require apportionment. Sales of businesses are generally entirely zero rated as sales of a going concern. Most sales involving land are subject to compulsory zero rating. In the rare situations where an apportionment between taxable and exempt supplies is required, it will be a unilateral apportionment by the vendor, as the vendor will provide a tax invoice to the purchaser. The purchaser will then claim input tax credits in accordance with its intended use of the supplies going forward.

In most cases, the values used in the GST apportionment will be consistent with the values allocated for income tax purposes, as parties will either have agreed on the values, or the vendor will do the income tax allocation unilaterally and so will naturally be using the same values as for its unilateral GST apportionment. An inconsistency might arise if the vendor sets the GST apportionment but does not agree an income tax allocation with the purchaser or notify it of a binding allocation within the timeframe for doing so. In that case, the purchaser may conceivably notify the vendor a binding allocation on the basis of values that differ from the GST values set by the vendor. Officials consider that this would be a fringe case, and the tax implications of the inconsistency are unlikely to be material. There may be none, if the vendor subsequently issues the purchaser a GST credit or debit note to align the GST values with the income tax values.

It is not proposed that the purchase price allocation rules have any effect on, or be affected by, the GST valuation rules.

Officials consider that the impact of the proposals on GST is minimal, and no amendments are required.

Recommendation

That the submissions be declined.

Issue: Rules need to accommodate price adjustments

Submission

(Chartered Accountants Australia and New Zealand, New Zealand Law Society, PwC)

The rules should be flexible enough to cover purchase price adjustments; earn-outs; warranty claims; later disbursement of funds held in escrow, where the funds are ultimately paid back to the purchaser rather than across to the vendor; other contractual recourse the purchaser has against the vendor, and so on. Consideration may not be finally determined until months or years after the transaction.

The legislation could allow for the same rules to apply at the time any further consideration is paid. *(New Zealand Law Society)*

Comment

Officials agree that a consistent allocation of price adjustments would also be desirable. However, the basis for allocation may not simply be the relative market value of the property. For example, the nature of the adjustment may mean that it is clearly allocable to one asset or class of assets (for example, a payment for breach of a warranty in relation to a defect in an item of property sold). Accordingly, a further consultation process would seem desirable before drafting such rules.

Recommendation

That the submission be noted.

Issue: Inland Revenue should educate taxpayers about new rules

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY)

Inland Revenue should take a proactive approach to educating taxpayers and tax agents about the new rules.

The rules are more likely to be successful if Inland Revenue proactively educates taxpayers, particularly smaller businesses and tax agents. Not all taxpayers seek advice from an accountant or tax agent before entering into a transaction. An education campaign will make smaller taxpayers aware of new requirements and avoid the consequence of no deductions for the purchaser.

Inland Revenue could advocate for standard form sale and purchase agreements that reference the need for parties to agree an allocation. It should also issue guidance.

Comment

Officials acknowledge that it is important for taxpayers to be aware of the new purchase price allocation rules and will undertake an education campaign to achieve this.

Recommendation

That the submission be accepted, noting that guidance will be provided.

Issue: Time required for taxpayer education and update of standard form agreements

Submission

(nsaTax Limited)

Any law change should be effected in close consultation with the Real Estate Institute of New Zealand (REINZ), the Law Society, and the Auckland District Law Society (ADLS), so that there is sufficient time for the ADLS standard form agreements to be available, and adequate education for their respective members before the new rules come in.

Comment

Officials recognise that these organisations have an important role to play in taxpayer education and compliance, and will ensure these groups are informed about the progress of the proposals.

Recommendation

That the submission be accepted, noting that guidance will be provided.

LEVEL OF ALLOCATION

(Clause 40)

Issue: Required level of allocation unclear

Submission

(Corporate Taxpayers Group, Deloitte, nsaTax Limited)

The Bill commentary states that parties do not have to allocate an amount to every individual item – they can allocate at a high level of asset categories. This is not clear in the wording of the legislation and should be added.

As the draft legislation refers to “items of depreciable property”, is the required level of allocation for asset categories or individual items? Under the proposals as currently drafted, vendors and purchasers are required to agree an allocation for every item of depreciable property. *(nsaTax Limited)*

Comment

Officials agree that the wording of the legislation with respect to the required level of allocation is unclear, and propose that the provisions be rewritten accordingly. Officials note that the existing provisions in the Income Tax Act, requiring individual assets to be valued at market rate, still apply in a mixed supply. However, these need to be modified if the individual assets are part of a class that has been treated as sold for the vendor’s tax book value.

Recommendation

That the submission be accepted.

VENDOR'S POWER TO DETERMINE ALLOCATION

(Clause 40)

Issue: Proposal gives vendor incentive not to agree to an allocation

Submission

(Russell McVeagh, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, PwC, Navtej Singh, Jim Gordon Tax Ltd, Federated Farmers of New Zealand Incorporated)

The proposal fundamentally impacts the relative commercial bargaining position of the parties involved, in favour of the vendor. Allowing either party to determine the allocation will lead to inappropriate valuations which favour the party that sets them.

It is fundamentally wrong to give primary power to the vendor. A vendor could use the rules to their own bargaining advantage, and refuse to agree to an allocation with the purchaser, knowing that it will get the power to allocate if it does not (a particular risk where there are multiple possible purchasers). The vendor might wait until the last minute to allocate a price, giving the purchaser less time to negotiate.

The onus of proof for a particular purchase price allocation is on the taxpayer (see *Buckley v Young Ltd (1978) 3 NZTC 61,271 (CA)*). Currently, both parties have an equal incentive to agree an allocation to avoid risk and uncertainty as to their tax position. New section GC 21(2) would change that by giving the vendor an incentive not to agree an allocation, so they can unilaterally determine it instead. Whether or not the purchaser can deal with this by negotiating the price will depend on the strength of the parties' bargaining positions. There are flow-on effects from this that could negatively impact commercial activity in New Zealand.

While in theory the purchaser could refuse to go ahead with the deal until an allocation has been agreed, commercial pressures or a lack of tax advice prior to negotiations could mean that the purchaser is unaware of the importance of agreeing an allocation before the deal is finalised, or is unable to do so. In reality, a number of factors mean allocations are not agreed on or even considered before the sale and purchase agreement is signed, so allocations are often decided afterwards.

Comment

The vendor will have no incentive not to agree an allocation if by agreeing one it can get a better price. A purchaser faced with a vendor that will not agree an allocation in advance can either refuse to transact, or significantly discount the price.

Market value is a range, and naturally the party that allocates will tend to make an allocation favouring itself. Giving priority to one of the parties to unilaterally determine the allocation where the parties have not agreed one, is the only way for consistency to be achieved that does not require the Commissioner's intervention.

The Commissioner knows less about the transaction than the parties, has little valuation expertise, and is generally indifferent to what allocation is chosen, provided it is a single allocation. It would be administratively burdensome, and uncertain for the parties, for the Commissioner to be charged

with determining a unilateral allocation in the first instance any time the parties could not agree one themselves. Similar issues would arise with the use of an independent arbitrator.

The tax book value floor protects purchasers that are unable to agree an allocation with the vendor as part of the sale and purchase. The floor also means that if the vendor wishes to allocate less than tax book value to taxable property, it must agree an allocation with the purchaser. Officials consider the floor is a useful compromise to improve the neutrality of the consistency rule.

Officials note that under section EB 24 the purchaser already has to use the vendor's allocation for trading stock, and trading stock is defined widely for this purpose to include most assets in the tax base, other than depreciable property and financial arrangements. It has not been made clear to officials why the existing trading stock rule is seemingly unproblematic, but the extension of it to depreciable property and financial arrangements is unacceptable (though officials are aware that some advisors operate on the basis that the provision does not require consistency).

Commercial negotiations vary widely depending on the market power and sophistication of the parties. The allocation will be one issue amongst many for negotiation. The parties will be significantly more likely to agree an allocation once the new rules come into effect.

Recommendation

That the submission be noted.

Issue: Purchaser allocation would be more appropriate

Submission

(Chartered Accountants Australia and New Zealand, EY, PwC)

If one of the parties is given the right to unilaterally allocate (in the event the parties fail to agree), the purchaser's allocation should be given primacy, since the purchaser intends to continue the business and therefore sees the value in the assets going forward. Vendor valuations may misconceive how the business will be used in the future.

Moreover, the purchaser is less likely to adopt an unjustifiable price allocation for tax purposes because it will carry an ongoing risk. Some purchasers are required to comply with acquisition accounting and so are more likely to adopt fair values, or risk audit.

Comment

Officials acknowledge the case for purchaser priority, and consider that it would also be tenable. A purchaser allocation might also be likely to accelerate the recognition of taxable income in some cases, as it would create more income for the vendor.

However, there are a number of reasons for preferring a vendor allocation:

- Only the vendor will know its tax book value. If tax book value is a useful compromise in cases of no agreement, this supports a vendor allocation.
- Adopting a vendor-first approach is consistent with the existing rule for trading stock (section EB 24).

- The vendor may wind up its business shortly after the transaction occurs. In the case of a corporate or trust vendor, the sale proceeds, net of income tax, may have been removed by the owner. If the vendor has been left with insufficient funds to pay tax on the basis of a purchaser valuation, the Commissioner will be left with an uncollectable tax debt. Vendor allocation is less likely to have this outcome.

Officials also note that there is no reason for preferring the future value the purchaser sees in the assets over the value the vendor places on the assets.

Recommendation

That the submission be declined.

Issue: Safeguard allowing purchaser to allocate if vendor does not is illusory

Submission

(Chartered Accountants Australia and New Zealand)

The safeguard allowing the purchaser to set values if the vendor fails to do so is more illusory than real.

Comment

The purchaser allocation is not intended to be a safeguard – it is intended to give an engaged purchaser a way to make an allocation if the vendor does not notify one on a timely basis.

Recommendation

That the submission be noted.

Issue: Some vendors may be difficult to engage with post-transaction

Submission

(Corporate Taxpayers Group)

Where assets are transferred ahead of liquidation, receivership or similar event, the vendor may be difficult to engage with post-transaction. In these situations, it may be more appropriate to provide priority to the allocation of the purchaser.

Comment

If the parties have not agreed an allocation and the vendor does not notify an allocation to the purchaser within three months of settlement, the Bill provides that the purchaser will then have three months to notify the vendor of a binding allocation. This will always give the purchaser sufficient time to make an allocation before it has to file a tax return. More details on timeframes are given in the section “Allocation Timeframes”.

Recommendation

That the submission be noted.

Issue: Default allocation to depreciable property in absence of agreement should be tax book value

Submission

(Corporate Taxpayers Group)

Rather than the vendor's value having precedence over the purchaser's, if the parties do not agree an allocation, the default should be that the depreciable property is transferred at tax book value. The Commissioner will then be in a neutral or more favourable position, compared with the vendor keeping and continuing to depreciate the assets.

The purchaser will be restarting depreciation with a lower cost base than the vendor, so annual depreciation deductions will be lower.

However, where the market value is clearly less than the tax book value, that value and allocation should be allowed.

Comment

In effect, section GC 21(8) already provides for a tax book value default (for all classes of property – not just depreciable property) by imposing a tax book value minimum on a vendor's unilateral allocation. The vendor may choose to allocate a higher than tax book value to depreciable property or other property if it considers that value to be more accurate, though it will not generally be incentivised to do so.

Recommendation

That the submission be noted.

Issue: Purchaser may ignore vendor's allocation if outcome unrealistic or inequitable

(Jim Gordon Tax Ltd)

The small to medium enterprise (SME) sector already ignores tax legislation that it considers inappropriate (for example, fringe benefit tax). There is a real risk that a purchaser will ignore a vendor allocation of values in order to secure a more realistic outcome that is based on the economics of the transaction and the market values of the assets.

Rather than allow the vendor to allocate non-market values to assets, and risk the purchaser ignoring those values and instead using market values, there should be a compulsory requirement for an independent valuation to be obtained for assets in the tax base whose value exceeds a certain minimum amount, and for that valuation to be followed by both parties in their allocations.

Comment

If parties are unable to agree values between themselves but find the statutory hierarchy of unilateral party allocation rules unacceptable, they may make contractual provision for asset values to be determined by an independent valuer. Nothing in the statute will preclude such an arrangement. During policy development, officials considered the submitter's suggestion of a mandatory independent valuation to resolve cases of non-agreement. However, this approach would impose an additional valuation cost on parties in all cases where an allocation has not been agreed – as well as a burden on whomever is required to choose the valuer – and parties may not always consider these costs to be warranted. There would be no guarantee that the valuation would produce a more favourable outcome for the purchaser than a vendor allocation or an agreement between the two parties.

If the purchaser thinks it is likely to lose more by following a vendor allocation (which in many cases will be tax book value) than by contributing to the cost of a binding independent valuation, it may insist on the latter as part of the sale and purchase agreement. Conversely, if the tax at stake does not justify the costs and uncertainty associated with obtaining a valuation, the purchaser may settle for the statutory backstop of vendor allocation.

Recommendation

That the submission be declined.

TAX BOOK VALUE FLOOR ON VENDOR'S UNILATERAL ALLOCATION

(Clause 40)

Issue: Tax book value floor on vendor's allocation should be omitted

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, nsaTax Limited,)

- a) Proposed section GC 21(8) – the rule stipulating that the vendor cannot unilaterally allocate less than carrying values to taxable property, resulting in an additional loss on its sale – should be omitted. The rule is arbitrary, anti-avoidance in nature, and shows that the vendor allocation process is flawed. *(Chartered Accountants Australia and New Zealand, EY)*

In a distressed sale, the rule does not reflect commercial reality. In these situations, the actual market value of property being sold will be less than its adjusted tax value or cost, and the vendor will suffer a real loss on the sale of the property. *(Chartered Accountants Australia and New Zealand, EY, nsaTax Limited)*

The rule may be impossible to comply with. The total purchase price may not allow the allocation required under GC 21(8), where a sale is made at a genuine commercial loss. *(Deloitte)*

- b) Use of an allocation floor will mean that excess proceeds will be added to remaining assets, inflating their market value. *(Chartered Accountants Australia and New Zealand)*
- c) The rule is inconsistent with the wider intent of the proposals that market values should always be used. *(Corporate Taxpayers Group, nsaTax Limited)*

Comment

- a) Officials agree that there will be many transactions where the actual market value of taxable property being sold is less than its tax book value, and the vendor will suffer a real loss on that property, even if the transaction as a whole shows a profit. The vendor can recognise this loss by agreeing an allocation with the purchaser. The vendor is only restricted to tax book value if it and the purchaser do not agree an allocation, and the vendor is in the position of unilaterally allocating the purchase price.

Officials note that, in a sale where the total sale proceeds are less than the sum of the vendor's tax book values for all the taxable assets, the vendor will not be able to comply with a tax book value floor. Accordingly, officials recommend amending the legislation to provide that, in such a case, the vendor's allocation to taxable property will be its tax book value reduced (pro rata) in proportion to the difference between the aggregate tax book value of the taxable property and the purchase price. This pro rata will only be applicable once the value ascribed to property outside the tax base is zero; to the extent that the value is greater than zero, it can be reduced to absorb some or all of the vendor's loss. The pro rata only applies for the taxable property.

- b) The argument that the allocation floor will cause "excess proceeds" to be added to remaining assets, inflating their market value, is unclear or incomplete. If the vendor thinks a taxable asset is worth less than its tax book value, then the requirement for the vendor to allocate a

minimum of tax book value means that the proceeds remaining to allocate to non-taxable assets will be less than the vendor would otherwise think appropriate. The value of non-taxable assets will only be “inflated” if the vendor believes the value of the taxable assets is higher than their tax book values, but allocates book values anyway. That would be a choice by the vendor, which could be challenged by the Commissioner.

- c) Officials accept that the tax book value floor is inconsistent with the requirement in the proposals that market values should always be used. As a general principle, the use of market values should be favoured, because they reflect commercial realities. However, officials consider that, in the context of a unilateral vendor allocation, an exception to the principle can be justified.

The primary objective of the purchase price allocation proposals is to ensure that vendors and purchasers adopt the same allocation, as the loss to the revenue base arises predominantly from the use of different values, rather than from the use of non-market values per se. The desired outcome under the proposals is that parties agree a market value allocation between themselves, rather than resort to the unilateral allocation rules in section GC 21. The vendor allocation is intended only as a backstop if the parties cannot agree an allocation, and officials consider that improving the neutrality of this backstop with the imposition of a tax book value floor takes precedence over ensuring the allocation is market value. The floor provides some protection for a purchaser that is unable to agree an allocation with the vendor, and has the effect that in most cases, the purchaser will effectively step into the vendor’s shoes.

Officials reiterate that a vendor can avoid the tax book value restriction by agreeing an allocation with the purchaser. Agreement is always the desired outcome, and will be respected by the Commissioner in almost all cases.

Recommendation

- a) That the submission be accepted, subject to officials’ comments.
- b) That the submission be declined.
- c) That the submission be noted.

AMORTISABLE IMPROVEMENTS RULE

(Clause 40)

Issue: Rule for allocation to amortisable improvements unnecessary / problematic

Submission

(Chartered Accountants Australia and New Zealand, Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd)

Proposed section GC 21(9), which provides that improvements amortised under section DO 4, DO 12 or DP 3 must be allocated their diminished value, should be omitted. Although a purchaser is only allowed to amortise from the diminished value of the improvement, parties should still be permitted to allocate a different value to it if they think the true market value is different.

The proposed rule is inconsistent with the market value requirement, and will interfere with true market value allocations to other items.

Comment

Officials agree that, provided the purchaser is only allowed to amortise from the diminished value (in accordance with tax law), it should not be problematic for the parties to allocate a different value to the improvement in order to better reflect its true market value – and better reflect a market value allocation to the other assets being sold. The relevant section will be removed.

Recommendation

That the submission be accepted.

ALLOCATION TIMEFRAMES

(Clause 40)

Issue: Timeframe for vendor allocation insufficient

Submission

(Deloitte, KPMG, EY)

- a) Two months may not be sufficient for a vendor to make an allocation, particularly if attention has not previously been given to the issue during the transaction process, or where pricing was changing. The vendor will often need to obtain new valuation guidance, which may be difficult to finalise within two months of change of ownership. A minimum of three months is more reasonable, and was suggested in the issues paper on the proposal.
- b) The timing for notification of the tax allocation should be extended to align with the existing timeframe for financial reporting and filing of income tax returns. There is no justification for a truncated timeframe for the allocation ahead of the assessment to which the notification relates. *(EY)*

Comment

- a) Officials recommend extending the period for a vendor to make an allocation from two months to three months post-settlement. Officials also note that the vendor will have time to work on its allocation in the period between execution of an agreement and settlement.
- b) The justification for a truncated allocation timeframe ahead of filing due dates is twofold. First, the behavioural objective of the purchase price allocation proposals is for parties to agree an allocation before completing their transaction, so the allocation can be factored into the negotiations. This is the optimal outcome from a revenue and commercial perspective, but is clearly predicated on the parties making an allocation well before filing their tax returns for the transaction.

Second, the backstop rules in section GC 21 for determining an allocation in the absence of agreement are intended to give both parties an opportunity to determine the allocation before tax returns are due, notwithstanding that one of the parties (the vendor) is necessarily given the first opportunity. It is possible for a vendor or purchaser to have to file a tax return for a transaction as soon as six months post-settlement, if the transaction was settled on the last day of an income year, and the taxpayer has a late balance date. Accordingly, officials recommend to reformulate the backstop rules so that the vendor has three months post-settlement to notify an allocation and, if it fails to do so, the purchaser has three months. These symmetrical allocation windows total the minimum amount of time a party might have to prepare a tax return for its transaction.

Allowing the vendor until the first filing date to make an allocation would mean taking away any ability for the purchaser to make a binding allocation before tax returns are due. Officials consider that it is more equitable and practical to give the purchaser the opportunity to determine the allocation if the vendor fails to use it. This is likely to promote a timelier resolution of allocation in cases where the vendor is disengaged.

Recommendation

- a) That the submission be accepted.
 - b) That the submission be declined.
-

Issue: Timeframe for purchaser allocation unclear

Submission

(Corporate Taxpayers Group, KPMG)

Under section GC 21, when the vendor does not allocate and the responsibility falls to the purchaser, there is no timeframe given to the purchaser to make the allocation. The position should be clarified.

For example, if a deal is settled on day 1 of an income year, the tax return would not need to be filed until two years later. In this case, the vendor would have two months to make an allocation, and then if it failed to make one, the purchaser would have 22 months.

For clarity, section GC 21(3) should require the purchaser to notify the Commissioner and vendor of its allocation within six months of the change of ownership (though the section probably will not be applied very often). *(KPMG)*

Comment

As noted in the comment on the previous submission, officials recommend modifying the provisions here. The purchaser will have three months to notify the vendor of a binding allocation – that is, until six months after the transaction.

After six months, the Commissioner will have a discretion to achieve consistency as they see fit. The parties may still make and notify allocations (as though they had done them unilaterally within six months of settlement), but the Commissioner may choose whether to bind the vendor to a late purchaser allocation, bind the purchaser to a late vendor allocation, or impose her own allocation (on audit or otherwise). The rationale for this approach is that if an allocation has not been notified by six months post-settlement, it is likely that the parties are either unaware of the purchase price allocation rules or have been deliberately non-compliant, and some level of Commissioner intervention is necessary. Officials consider that it is unlikely parties will get to this point without knowing about the rules, since standard form sale and purchase agreements will be updated to include provisions for the rules, and many small transactions – where parties may have weaker tax knowledge – should be excluded by the de minimis thresholds. However, officials are investigating more ways to improve the visibility of the rules.

Lastly, if the parties ignore the rules and file their returns with different allocations, then on audit, the Commissioner may require allocations to be furnished, and may determine the allocation at that time, with all the usual consequences of non-compliance and reassessment.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Vendor could be left with no way to comply with rules

Submission

(Deloitte)

Poorly advised vendors could be left with no way to adhere to the proposed rules if their obligations are only discovered after the two-month period expires and the purchaser is indifferent or sour.

This may occur especially with foreign bidders, who will often be indifferent to purchase price allocation due to taxpayer-friendly income tax treatments for some assets (for example, goodwill) in their home jurisdiction.

Comment

Vendors that fail to notify the purchaser within the recommend three-month time frame, and do not themselves receive a purchaser notification within the three-to-six month period, will be able to notify an allocation to the Commissioner that complies with the tax book value floor, just as they would have done if they had notified the allocation within three months of settlement. Whether that allocation binds the purchaser or is over-ruled in favour of a binding purchaser or Commissioner allocation will be at the Commissioner's discretion, as explained in officials' response to the previous submission.

Recommendation

That the submission be noted.

Issue: Rules will increase divergence between tax and accounting

Submission

(Chartered Accountants Australia and New Zealand, EY)

The proposed rules will increase the divergence between tax and accounting balance sheets. Tax will be done quickly – within the two-month period – while accounting, under IFRS 3 or similar, can be done up to a year post-transaction. Given the increasing reliance on the IFRS balance sheet (which is subject to strict regulations) for tax, this divergence seems an odd outcome for Inland Revenue to be enabling. Parties should be allowed to follow the IFRS 3 accounting treatment for tax purposes. Though admittedly this issue will only affect a small number of taxpayers.

Comment

Tax/book differences are common. For example, there are differences in when depreciation can start, what depreciation rates are, what expenses are included in cost, etc. As the submission notes, this will only affect a small number of taxpayers. Presumably, the period of time required to undertake an IFRS 3 valuation may mean it cannot always be used even by the purchaser for tax purposes.

Recommendation

That the submission be declined.

DENIAL OF PURCHASER DEDUCTIONS

(Clause 40)

Issue: Denying purchaser deductions if it does not make/notify an allocation is overly punitive

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd, PwC)

- a) Denying the purchaser deductions if it does not make and notify an allocation is overly punitive. Less sophisticated parties may not be aware of the law change and may find themselves unintentionally subject to this rule. Even an indifferent purchaser could be taxed on gross sale proceeds when it in turn comes to sell.
- b) The purchaser should be treated as acquiring the property for market value. *(Chartered Accountants Australia and New Zealand)*
- c) If the rule (section GC 21(7)) proceeds, it should be amended so it does not override the de minimis exception (GC 21(5)) or the low value depreciable property exception (GC 21(6)).
- d) It is not clear what would happen if the ability of the purchaser to notify its allocation was frustrated – for example, if the vendor no longer exists, due to being liquidated following a business sale. The purchaser could lose its cost base in this situation, which seems unreasonably harsh. *(PwC)*

Comment

- a) The intent of this rule is to defer deductions rather than deny them entirely, though officials recognise that this is not clear in the legislation as drafted. Officials recommend that the purchaser's deductions be deferred until the earlier of:
 - the time when the purchaser notifies an allocation to the Commissioner; and
 - the time when the Commissioner notifies a binding allocation to the purchaser.

The purchaser will then become entitled to claim, in the next tax return filed, the deductions it was denied in the year/s in which it and/or the vendor failed to notify an allocation. This approach fits the updated unilateral allocation scheme proposed by officials, set out in the previous section of this officials' report ("Allocation timeframes").

- b) Officials consider that the rule deferring deductions is necessary to incentivise the purchaser to make and notify an allocation, rather than ignore the consistency requirement and file a different allocation from the vendor (if any). Treating the purchaser as acquiring the property for market value would not provide this incentive. Officials understand that, under current section EB 24, purchasers often take the view that the Commissioner is unlikely to penalise them for simply making a market value allocation, even if it is not consistent with the vendor's allocation. Deferring deductions provides a clear signal to the purchaser that it is expected to notify an allocation so that consistency can be enforced. If, under the proposed rules, the purchaser does ignore the consistency requirement and files a different allocation from the vendor, it will face use-of-money interest and penalties on audit.

To address the concern about parties not being aware of the rules, officials are investigating ways to prompt parties to consider their compliance.

- c) Officials agree that this deduction deferral rule clearly should not override the de minimis exception for consistency (section GC 21(5)), and recommend amending section GC 21(7) accordingly.

The deduction deferral rule should be applied in relation to low value depreciable property. The deduction deferral applies where no allocation has been notified to the Commissioner, while the depreciable property safe harbour provides protection to parties from a Commissioner challenge in relation to that property. The objective of the deduction deferral rule is to drive the purchaser to notify an allocation, so that the Commissioner can ensure the purchaser and vendor adopt the same allocation – the presence or absence of low value depreciable property in the transaction is irrelevant to the desirability of that objective. If the transaction is above the de minimis thresholds and the parties have not agreed an allocation, the Commissioner should be notified of an allocation. It is not clear what would be achieved by carving deductions for low value depreciable property out of the deferral rule.

- d) In terms of what would happen if the purchaser's ability to notify its allocation was frustrated, due to a vendor no longer existing (for example) then, as a practical matter the purchaser would only have to notify the Commissioner. The purchaser will not be denied deductions merely because it is technically unable to notify its allocation to a vendor that no longer exists. Officials will clarify this in their guidance.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Purchaser's acquisition for nil not symmetrical with vendor

Submission

(nsaTax Limited)

There is a value inconsistency in section GC 21(7): in the absence of an allocated amount, the vendor disposal is treated as occurring at market value, but the purchaser is treated as having acquired the same property for nil. This clearly gives rise to a mismatch, which the proposed amendments are supposedly designed to address.

Comment

As clarified in comments on the previous submission, officials propose to reframe this rule – which is needed to incentivise the purchaser to notify the Commissioner of a non-agreed allocation – as a deferral of deductions, rather than a denial. In most cases, officials expect the purchaser will eventually notify an allocation, which will either bind the vendor, or – if notified more than six months after settlement – possibly be disregarded in favour of a vendor or Commissioner allocation, at the Commissioner's discretion. In either case, the final result will be symmetry between the parties. The interim position may be asymmetry where the parties have not been complying with the rules, but that would be a problem under any other possible formulation of the rules.

Recommendation

That the submission be accepted, subjected to officials' comments.

Issue: Timing of deductions unclear where purchaser makes late allocation

Submission

(New Zealand Law Society, PwC)

It is not clear how a purchaser's allocation made late (under section GC 21(7)) will work with respect to the timing of the purchaser's deductions. This should be clarified.

Under proposed section GC 21(7), if neither party makes an allocation, the vendor is deemed to dispose of the property at market value, and the purchaser is deemed to acquire it for nil consideration, meaning they gets no deductions. It is intended that the purchaser can change this at any time by making an allocation, but the timing of deductions in that case needs to be further considered.

For example, if a purchaser acquires a financial arrangement or revenue account property in one accounting period but no allocation is made until the next period, do the relevant deductions/adjustments apply in the year of disposal or the year the allocation is made? Base price adjustments under the financial arrangement rules (EW 31(2)) should occur in the year of disposal. Deductions for revenue account property and trading stock must be taken in the year of disposal (EA 1 & 2). If a deduction does not arise until the allocation is made, it may be too late for the purchaser to actually claim it. Also, the purchaser might manipulate the timing of deductions.

The new rules could include a discretion for the Commissioner to agree a reasonable approach with a purchaser where an allocation has not been made, but an unreasonably harsh outcome for the purchaser has arisen. *(PwC)*

Comment

Officials recommend clarifying in the legislation that the purchaser's deductions will be allowed in the income year for which a return is filed, after either the purchaser has notified an allocation to the Commissioner, or the Commissioner has notified a binding allocation to the purchaser – whichever is earlier.

Recommendation

That the submission be accepted.

MARKET VALUE AND COMMISSIONER CHALLENGE

(Clause 40)

Issue: Unclear whether discounts permissible

Submission

(Corporate Taxpayers Group)

It should be clarified that discounts can be applied as appropriate, where there is bargaining, a fire sale etc, and the Commissioner should not unduly question these transactions.

Comment

Officials consider that the concept of “respective market values” allows for a discounted purchase price and allocation. However, officials recommend amending the wording to “relative market values” to allow for discounted asset values.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Agreed allocation should not be challenged absent sham or avoidance

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG)

Proposed section GC 20(2) should be amended. The Commissioner should be bound by an agreed allocation where negotiations are conducted at arm’s length, absent sham or tax avoidance. Market value is a range, and an allocation within this range should be respected.

At the very least, further guidance should be provided, outlining the circumstances in which the Commissioner can challenge an allocation that has been agreed by an unrelated vendor and purchaser. *(KPMG)*

Comment

Officials agree and acknowledge that market value is a range. Having regard to their care and management responsibilities under the Tax Administration Act, the Commissioner will not invest resources in challenging an agreed allocation unless she believes there is sham, tax avoidance, or otherwise significantly unrealistic values. The Commissioner will need a reason to challenge. It would not be useful to legislate an additional criteria for the Commissioner to meet.

Recommendation

That the submission be declined.

Issue: Pro-rata based on vendor’s tax book values should be market

Submission

(Chartered Accountants Australia and New Zealand)

Where parties have allocated the purchase price to specified asset categories, but based the price on a global market value for each category, a pro-rata allocation of the agreed value to each asset in that category based on the vendor’s net tax book value or cost should be deemed to be market value for the individual depreciable assets.

Comment

The proposed rules are not intended to require agreement to an allocation to individual assets within an asset class. However, the Commissioner will retain the power to challenge an allocation that is not market value. Parties using sensible methods to allocate an agreed allocation to individual assets – noting the existing provisions that require market value allocations to individual assets – should be safe from challenge. There is no need for a special rule for this.

Recommendation

That the submission be declined.

Issue: Unclear how fluctuation in market value during negotiation dealt with

Submission

(Deloitte)

Where a transaction is being negotiated over a period of time (for example, two years), the market value of the global purchase price may have fluctuated, whereas the taxpayer’s purchase price allocation was based on an earlier valuation of the assets at the start of the negotiation.

How to deal with this is not currently clear in the rules, but could be addressed through guidance.

Comment

Parties will have practices to deal with potential fluctuations in market value between the time an allocation is agreed and the time the transaction is completed, if they wish to do so. A simple solution would be for the parties to scale an agreed allocation up or down pro rata to equal the final purchase price. Officials will address this question in their guidance.

Recommendation

That the submission be noted.

Issue: Commissioner should issue guidance on market value

Submission

(EY)

The Commissioner should issue guidance on the process for determining “market value”, to provide certainty for transacting parties.

Comment

Taxpayers may find the Commissioner’s Statement for determining the market value of employee share scheme shares (CS 17/01) helpful. The Commissioner may issue more guidance on market value in the future.

Recommendation

That the submission be noted.

Issue: Interaction of proposed rules with existing market value provisions unclear

Submission

(New Zealand Law Society)

There are numerous provisions in the Income Tax Act that deem assets to be disposed of at market value. The proposed rules do not specify that an agreed allocation applies for all purposes. The interaction of the purchase price allocation rules with the various market value deeming sections should be clarified.

For example, depreciable property, carbon units, revenue account property, trading stock must all be disposed of at market value. See sections GC 1, EE 45(3), EB 24 etc.

Comment

Officials recognise that, although proposed sections GC 20 and GC 21 will ensure consistency of allocations at the level of the specified asset categories, they will not ensure that the amount allocated to a category is allocated to the assets within that category at market value. Existing rules deal with the valuation of individual assets. These general market value provisions will co-exist with the proposed purchase price allocation rules, with the combined effect that vendors and purchasers must use market values at both an individual asset and asset class level.

Officials recommend amendments to make it clear that the total amount allocated to the assets within a class must equal the amount allocated to that class under section GC 20 or GC 21 as applicable. This will be relevant if a vendor is making a unilateral allocation under section GC 21 and is being required to use tax book values at a minimum, even though it considers the market value of the taxable property to be lower.

Recommendation

That the submission be accepted.

Issue: Unclear whether tax-accounting divergence indicative of non-market transaction

Submission

(Corporate Taxpayers Group)

The purchase price allocation for financial reporting/accounting may differ from the allocation for tax (accounting normally done post-transaction), for example, to recognise assets fair value, which could include asset impairment, goodwill etc. Officials should form a view on whether such a divergence would be treated as an indication that a transaction occurred on a non-market basis.

The allocation for the financial statements is normally audited some time after the transaction.

Comment

Officials do not consider that a discrepancy between accounting and tax would necessarily cause the Commissioner to treat the tax allocation as not being at arms-length. However, if the discrepancy is material, and there is no explanation for it, then the Commissioner may well make an enquiry, and the accounting valuation might be used as evidence in support of an adjustment.

Recommendation

That the submission be noted.

Issue: Commissioner currently not required to notify other party of challenge

Submission

(PwC, Corporate Taxpayers Group)

There is currently no requirement on the Commissioner to notify the other party if a party's allocation has been challenged, so the other party might not know about the challenge. There is also no mechanism for the other party to adjust its allocation when the Commissioner is successful in a challenge.

If there is a dispute which leads to a different value being allocated than the value in the parties' tax returns, the Commissioner should use section 113 of the Tax Administration Act 1994 (TAA) to amend the value in the tax returns. This is compliance-friendly. *(Corporate Taxpayers Group)*

The legislation should be amended to require the Commissioner to inform a party if an allocation is altered as a result of a challenge to the other party, and to allow the first party to amend its tax return to reflect the new allocation. *(PwC)*

Comment

If the Commissioner is challenging an allocation, they will take the operational steps necessary to ensure any new allocation is adopted by both parties, as consistency is required by the new purchase price allocation rules.

The Commissioner would inform the other party of the new allocation and allow it to adjust its tax return accordingly. For example, if the Commissioner successfully challenges a purchaser's allocation to depreciable property as too high, the Commissioner would inform the vendor and allow it to adjust its return also (assuming it has adopted the purchaser's allocation). This could be done under section 113 of the TAA.

Recommendation

That the submission be declined.

Issue: Transfers within wholly owned groups exposed to risk

Submission

(Corporate Taxpayers Group)

Where a business is sold within a wholly owned group, a taxpayer should be able to allocate on the basis of tax book value or cost with no ability for the Commissioner to challenge. This would allow wholly owned groups to restructure without risk.

Tax book value and cost are not arbitrary figures – they are already the basis for the business's tax position. But the taxpayer could apply to the Commissioner for a higher cost base if it wanted to. There is precedent for this in section EB 5 – trading stock transferred within wholly owned groups can be valued at cost.

The consolidation regime can be used to get around valuation issues with intra-group transfers, but the regime comes with its own issues, such as removing an entity from the consolidated group.

Comment

The focus of these amendments is consistent allocation. They are not concerned with the issue of non-recognition for transactions between associated parties. That may be an appropriate subject for a further reform. Officials note that there are already ways for corporate groups to achieve non-recognition treatment.

Recommendation

That the submission be declined.

DE MINIMIS/SAFE HARBOUR THRESHOLDS

(Clause 40)

Issue: Consistency de minimis incomplete

Submission

(EY, KPMG, New Zealand Law Society)

The de minimis in section GC 21(5), which is intended to exclude parties from the consistency requirement, is incomplete. It only overrides some of the consistency requirements, not all of them. The de minimis needs to override GC 21(7) (“No allocated amount”) etc.

Comment

This is a drafting error and officials recommend this be addressed.

Recommendation

That the submission be accepted.

Issue: Consistency thresholds too low

Submission

(Corporate Taxpayers Group, PwC)

The \$1 million total purchase price threshold and the \$100,000 threshold for the purchaser’s allocation to taxable property should be increased. These thresholds are too low to be of practical use, particularly for transactions involving land and buildings. Most commercial property transactions that will fall under the new rules will exceed \$1 million of consideration, with a large amount of the consideration attributable to land outside the tax base. The amount attributable to depreciable property will usually exceed \$100,000. The threshold should be materially increased (to say \$5 million), where significant value is from land outside the tax base.

Comment

The de minimis thresholds are intended to exclude small transactions where the amount of tax at stake is low enough for there not to be material discrepancies between parties’ tax positions, and where parties may be relatively unsophisticated in their tax compliance. Although buildings are now depreciable property, residential buildings remain non-depreciable. Accordingly, few sales of residential rental property will be caught by the new rules. Sales of commercial property are unlikely to be made without advice.

However, officials recommend two changes to the de minimis thresholds.

First, officials recommend removing the \$100,000 deductible property threshold. We consider it may be problematic for transactions over \$1 million where a vendor assumes the purchaser’s allocation to deductible property will be well under \$100,000, and therefore disregards the

consistency rules, but then three-to-six months after the transaction the purchaser notifies the vendor of a binding allocation with an allocation to deductible property that is higher than \$100,000. The total transaction price threshold is easily evaluated by both parties and is therefore less likely to lead to unexpected outcomes.

Second, officials recommend introducing a separate transaction price threshold of \$7.5 million for residential property transactions. Residential buildings and most residential fitout are non-depreciable, so in most cases the only taxable/deductible property in residential property transactions will be chattels such as whiteware (if any), which are unlikely to have a high value in aggregate. This makes residential property a low revenue risk area, and a higher de minimis for these transactions is therefore appropriate. This change is unlikely to have a material fiscal impact.

Officials recommend keeping the de minimis for all other transactions at \$1 million.

Recommendation

That the submission be declined, subject to officials' comments.

Issue: Low-value depreciable property threshold incorrectly based on tax book value

Submission

(Matter raised by officials)

The submission is to correct a drafting error from adjusted tax book value to original cost.

Comment

Proposed sections GC 20(3)(c) and GC 21(6)(c) refer to the “adjusted tax value” of the purchased property being \$10,000 or less, while the Commentary refers to the “original cost” of the property being “less than \$10,000”. This is a drafting error. The policy intent is for the threshold amount to be original cost, since that is the true upper bound for depreciation planning.

For example, a piece of industrial equipment might have an adjusted tax value of \$8,000, but an original cost of \$80,000 – it has simply been depreciated for the past nine years, and would be fully written-off the next year (if the depreciation rate is 10% straight-line). A tax book value allocation by the vendor may potentially understate the vendor's true taxable income by tens of thousands of dollars, since the value of the machine could be closer to its original value of \$80,000. The corresponding tax effect of this undervaluation could then be thousands or tens of thousands of dollars. Thus, if the Commissioner cannot challenge the allocation because the adjusted tax value of the machine is less than \$10,000, the revenue loss from that single asset could be significant.

Recommendation

That the submission be accepted.

Issue: Low-value depreciable property threshold should also apply to purchaser

Submission

(Deloitte, PwC)

The safe harbour for low-value depreciable property in proposed section GC 21(6) should also reference subsection GC 21(3) – currently, the safe harbour does not appear to apply to the purchaser’s allocation. Parties should be able to gain the benefit of certainty if an allocation made under section GC 21(3) meets the GC 21(6) requirements. Not allowing the same protection to purchasers’ allocations further disincentivises vendors to reach an agreed allocation with the purchaser.

Comment

The safe harbour will be of no value to the purchaser when it is making a unilateral allocation. The Commissioner will generally only challenge an allocation to depreciable property if it is too low, and if they substitute a higher value, it will be favourable for the purchaser, because the purchaser will then get higher depreciation deductions going forward.

The other situation in which the Commissioner may challenge the allocation is if it is substantially above the original cost of the property to the vendor; in that case, the purchaser is getting stepped up depreciation with no additional tax consequences for the vendor (the amount above original cost is a capital gain), and for most depreciable assets it would be rare for such a high value to be accurate. But because of that asymmetry, the safe harbour does not protect allocations above original cost. So overall, the safe harbour has no real utility for the purchaser.

However, for the sake of simplicity, officials recommend redrafting the legislation so that the safe harbour applies to an allocation by either party.

Recommendation

That the submission be accepted.

Issue: Low-value depreciable property threshold should be relative or increased

Submission

(Chartered Accountants Australia and New Zealand, EY)

The \$10,000 original cost threshold in section GC 20(3) for allocations to depreciable property ranging from adjusted tax value to original cost should be made relative.

Ten thousand dollars is insufficient and should be increased to reduce unnecessary compliance costs for assets which have a low risk of mis-valuation. The amount should be relative – it could be a percentage of the transaction value, to avoid issues with large-scale transactions.

Alternatively, the \$10,000 threshold should be increased significantly, to at least \$100,000.

Comment

This rule is intended to allow the vendor's tax book value to be allocated to low-value assets such as office equipment with assurance that this allocation will not be challenged. It would not be appropriate to extend the safe harbour to higher value assets, where discrepancies between tax book value and market value could be material.

Recommendation

That the submission be declined.

APPLICATION DATE

(Clauses 40 and 2(22))

Issue: Application date too early

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Russell McVeagh, Jim Gordon Tax Ltd, Federated Farmers of New Zealand)

The application date should be extended to 12 months after the date of enactment (that is, 1 April 2022).

This would allow time for the Auckland District Law Society's standard sale and purchase agreement, and other standard agreements, to be changed. It would also allow time for an education campaign covering all potentially impacted taxpayers.

The proposal will significantly affect the primary sector, and there is a risk one or both parties to a primary sector sale and purchase agreement will ignore the new rules if the private sector is not given a chance to understand the rules before they become effective. *(Jim Gordon Tax Ltd)*

Alternatively, as a compromise, the application date for smaller transactions (say below \$15 million) could be deferred for three months. This should not adversely affect the Government's forecasts. Moreover, farmland did not appear to be considered when forecasts were prepared, so any gain from transfers of farmland were likely not included in the forecasts. A window to allow for taxpayer education is necessary to encourage compliant behaviour by SMEs, and farmers in particular. *(Federated Farmers of New Zealand)*

The current application date is too early for parties to prepare for the changes.

Comment

Changing the application date would have fiscal consequences. Officials consider that a 1 April 2021 enactment date will be feasible for taxpayers, as we are working with private and public-sector organisations to promote these changes.

Recommendation

That the submission be declined.

VARIOUS DRAFTING ISSUES

(Clause 40)

Issue: Provisions not appropriately located in legislation

Submission

(Chartered Accountants Australia and New Zealand)

The provisions should be in part F (recharacterisation of certain transactions), not part G (avoidance and non-market transactions).

Comment

Officials acknowledge that the provisions could be located in part F. However, it is not inappropriate that they are located in part G. The purpose of the rules is to prevent property being treated as bought for one price and sold for another in order to minimise tax. In this regard, the rules have an anti-avoidance dimension.

Recommendation

That the submission be declined.

Issue: Unilateral allocations should be worded as optional and not mandatory

Submission

(Deloitte)

The obligations in proposed sections GC 21(2) and (3) should be expressed with the word “may” instead of “must”; the existing wording strictly makes the obligation for a unilateral allocation to be made mandatory, when this is at odds with the wider proposal.

Comment

Officials agree that the unilateral allocation rules should be expressed as optional, as it should be clear that the parties can agree an allocation at any time before the first tax return for the transaction is filed.

Recommendation

That the submission be accepted.

Issue: Term “respective market value” ambiguous

Submission

(Deloitte)

The reference to “respective market value” in sections GC 21(2) and (3) is ambiguous, and a clear definition should be provided in the legislation.

Comment

Officials recommend changing this wording to “relative market value”. Officials consider that it is clear from the plain meaning of the words in the context that this term means the market value of a class of property in relation to the market values of the other classes of property. “Relative market value” contemplates transactions where the total purchase price is higher or lower than the price that would be calculated as the sum of the market values of all the assets if they were bought and sold individually – that is, where the parties are placing either a premium or a discount on the transfer of the assets as a bundle.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Tax book value floor for vendor should apply as if section EE 11 did not apply

Submission

(Deloitte)

Proposed section GC 21(8)(a) should be amended to clearly state that it is intended to operate as if section EE 11 did not apply.

Comment

Officials do not see the need for this clarification; section EE 11(4) allows for part-year depreciation loss, so is not in contradiction with proposed section GC 21(8)(a). Officials note that this section will be simplified to refer to “tax book value”.

Recommendation

That the submission be declined.

Issue: References to “person A” and “person B” difficult to follow

Submission

(EY)

The references to “person A” and “person B” throughout the proposed sections GC 20 and 21 make the legislation difficult to follow. It would be easier to read if the parties were referred to as the “vendor” and “purchaser” throughout.

Comment

“Vendor” and “purchaser” are possible synonyms, but would require definition, and may carry legal connotations that unintentionally limit the application of the rules. “Person A” and “person B” are more neutral terms, and their meaning is clear from the context.

Recommendation

That the submission be declined.

Issue: Phrase “to which other income or deduction provisions of this Act apply or don’t apply at all” unclear

Submission

(EY)

It is not clear what is meant by the phrase “...to which other income or deduction provisions of this Act apply or do not apply at all.”

Comment

Officials agree that this phrase is unclear and recommend amending it.

Recommendation

That the submission be accepted.

Issue: Heading to section GC 21 unclear

Submission

(EY)

The heading to section GC 21 is not reflective of the content and does not adequately differentiate between sections GC 20 and 21. The heading could be better phrased as “Effect of parties not agreeing to a purchase price allocation.”

Comment

Officials agree that the heading could be clearer and recommend amending it to distinguish it more from section GC 20.

Recommendation

That the submission be accepted.

Issue: Use of word “disposes” misleading

Submission

(nsaTax Limited)

Sections GC 20 and 21 apply “when a person (person A) disposes of, to another person (person B), property (the purchased property)”. This wording should be clarified to ensure the rules only apply to sale and purchase situations. The use of the word “disposes” is misleading, as there are many disposal provisions in the Income Tax Act which could result in the new rules having unintended application. For example, trust resettlements, inheritances, disposal of assets to a partnership on formation etc.

Comment

Officials recommend clarifying that the rules apply to disposals for consideration. Further limitations on the application of the rules are not desirable.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Standard of identity in phrase “materially identical” unclear

Submission

(nsaTax Limited)

In sections GC 20(3) and GC 21 (6), the word “identical” in the phrase “materially identical” would indicate that the assets are not just similar or of the same class. What is the standard?

For example, a car yard is sold with a total value of ten vehicles exceeding \$1 million. If the vehicles are not materially identical because they are a different make and model, does the de minimis provision apply or not?

Comment

Officials recommend simplifying the phrase to “identical”.

Taxpayers will make a reasonable assessment of identity. Items that are interchangeable and are ascribed the same per item value by the parties will be identical. For example, a fleet of Priuses which are ascribed the same or a similar value may be identical. A Prius and a Lamborghini would not be.

Recommendation

That the submission be noted.

Unclaimed monies

GENERAL SUBMISSIONS

Issue: Support for reforms

Submission

(Corporate Taxpayers Group, Bank of New Zealand, Financial Services Council of New Zealand Incorporated, New Zealand Law Society)

General support for the reforms.

Recommendation

That the submission be noted.

Issue: Application of the Unclaimed Money Act 1971 to crypto assets

Submission

(Chartered Accountants Australia and New Zealand)

The amended definition of unclaimed money focuses on “amounts payable” and would seem to apply to cryptocurrencies and other crypto assets. We believe this is appropriate but would welcome confirmation, particularly if it is not intended that the proposals apply to amounts denominated in cryptocurrency.

Comment

In the Commissioner’s view, crypto assets are property rather than money (as commonly understood). However, as an “amount payable” can include an amount in money’s worth, it is possible that crypto assets could come within the existing definition contained within proposals.

It is not intended that crypto assets be brought within the ambit of the Unclaimed Money Act 1971. Officials recommend that the legislation refer to money rather than amounts payable.

Recommendation

That the submission be noted subject to officials’ recommendation.

Issue: Extension of binding rulings regime

Submission

(Russell McVeagh)

The binding rulings regime within the Tax Administration Act 1994 should be extended to include the Unclaimed Money Act 1971. This would allow Inland Revenue to make binding rulings in respect of matters affected by the Unclaimed Money Act 1971.

Comment

Officials recommend that the binding rulings regime, including the short binding ruling process regime, be extended to the Unclaimed Money Act 1971.

Recommendation

That the submission be accepted.

Issue: Transitional period

Submission

(Bank of New Zealand, Financial Services Council of New Zealand Incorporated)

The two-year transitional period should be extended by an additional 12 months to allow holders sufficient time to update their systems.

Comment

The proposed reforms allow holders up to two years to transfer amounts of unclaimed money that fall between the current deeming periods of six and 25 years. However, the reforms are scheduled to come into force from the date of assent for money that becomes unclaimed money after that date.

Holders of unclaimed money may require more time to update their systems to comply with the new rules. Officials recommend that a transitional variation provision be added. This would allow holders the ability to apply to the Commissioner for up to two years to implement the reforms where required.

This allows the Commissioner to work with holders to update their systems on a case-by-case basis. Holders who are able to comply immediately with the reforms would be able to do so, while holders who require further time to update their systems would be accommodated.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Reduction of de minimis threshold of \$100 to one cent

Submission

(New Zealand Law Society)

Lawyers can be left with small balances in a trust account without the ability to locate a rightful payee. Under the proposals, amounts below \$100 do not qualify as unclaimed money unless the Commissioner exercises a discretion to accept the amount as unclaimed money. The submitter requests that the de minimis threshold for unclaimed money should be reduced from the proposed \$100 (or less if the Commissioner agrees), to one cent.

If the \$100 threshold is to be retained, holders of unclaimed money would welcome clear guidance from Inland Revenue in dealing with amounts below the \$100 threshold, including the circumstances in which the Commissioner's discretion to accept lesser amounts will be exercised.

Comment

Following stakeholder feedback, officials recommend the inclusion of an alternative use proviso to the existing reforms. This will allow holders to submit any amount of money as unclaimed money to the Commissioner. This will also mean that the Commissioner's discretion in accepting amounts below \$100 is no longer required.

This will be the subject of further guidance from Inland Revenue in a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Retention of an alternative use proviso for amounts under \$100

Submission

(KPMG, Financial Services Council of New Zealand Incorporated)

Section 4(1)(e)(ii) of the Unclaimed Money Act 1971 specifies that amounts under \$100 can be applied for the benefit of the holder or for other purposes. The current proposals remove this.

Companies need the ability to pay unclaimed monies to Inland Revenue so they can be wound up. Some institutions donate funds under \$100 to charity. It may be helpful if this is mandated or the money is paid to Inland Revenue and forfeited, with the holder relieved of any obligation.

The existing \$100 de minimis should be subject to a proviso allowing a holder to put amounts below \$100 to some other purpose. An equivalent proviso exists within the current Unclaimed Money Act 1971.

Comment

Officials recommend that an alternative use proviso to the de minimis threshold of \$100 should be retained in the proposals. This will allow holders the continued option to apply amounts of unclaimed money below the de minimis threshold of \$100 to other purposes.

The retention of the alternative use proviso will mean that the Commissioner will no longer need the discretion to accept amounts under \$100 as there will continue to be a distinction between amounts under \$100 that are applied to another purpose (and are therefore not unclaimed money), and other amounts of money, which are under \$100 and are not applied to another purpose (and are unclaimed money).

Recommendation

That the submission be accepted.

Issue: Institutional approach to “account activity”

Submission

(Chartered Accountants Australia and New Zealand, Bank of New Zealand, Financial Services Council of New Zealand Incorporated)

Further guidance should be provided on the concept of “account activity” and an institutional approach should be applied to account interaction.

Currently, the treatment of on-call bank accounts which have been set up for the benefit of a third party is unclear and could negatively impact customers (for example, a compounding term deposit set up by grandparents for a grandchild). Without activity on the account, the amount will become “unclaimed money” after five years.

- a) An “institutional” approach to account activity should be adopted to address situations where a customer deposits funds for the benefit of a third party. This would result in activity on one account held by the customer at an institution being deemed activity on any of their accounts held at that institution, thus avoiding funds being deemed unclaimed when the customer is still “active”.
- b) Inland Revenue should work with holders to ensure that they have robust procedures in place for contacting owners every five years. Inland Revenue should educate owners of money on the importance of maintaining accurate contact information with holders.

Comment

- a) Officials recommend that an institutional approach to account activity be adopted. This would prevent money within an account from being treated as unclaimed money where it is among the accounts held by an owner at the same institution. Officials also recommend this approach should extend to joint accounts and other products held with the same institution (for example, an account holder’s cash-PIE investment).
- b) Officials note that on enactment of the proposed amendments, guidance will be provided through a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, subject to officials’ comments.

Issue: Incorporation of portfolio investment entities

Submission

(KPMG)

A clear treatment for Portfolio Investment Entities (PIE) interests is required. The unclear treatment of PIE interests can prevent PIEs being wound up and investors' funds being distributed. Including PIEs within the Unclaimed Money Act 1971 would allow PIEs to be more efficiently managed while protecting investors funds (as they will need to be paid to Inland Revenue).

Officials should be instructed to consult with the funds industry to confirm that a clear regime for dealing with unclaimed money for PIE interests would assist PIEs while protecting investors' funds.

Comment

Currently, PIE fund managers choose between transferring unclaimed money to Inland Revenue under the Unclaimed Money Act 1971 or to the Crown under the Trustees Act 1956.¹

Although there is merit to allowing fund managers flexibility in transferring unclaimed money under either the Trustees Act 1956 or the Unclaimed Money Act 1971, it is not intended that units in PIEs should come within the definition of unclaimed money. Rather officials consider it should be possible for fund managers to transfer the proceeds of the redemption of the units (in money) to Inland Revenue once the money has remained in the holder's possession for the five-year deeming period.

The Unclaimed Money Act 1971 excludes the proceeds of pension and superannuation funds. This exception is also present in the KiwiSaver Act 2006. The current proposals maintain this position and officials consider this is the preferred treatment.

Officials will provide guidance on the treatment of unclaimed interests in PIE investments in a *Tax Information Bulletin*.

Recommendation

That the submission be declined, subject to officials' comments.

Issue: Information exchange with holders

Submission

(KPMG)

¹ The Trustee Act 1956 is being replaced by the Trusts Act 2019 from 30 January 2021.

An ability for Inland Revenue and holders to match IRD numbers should be considered. This would:

- stop unclaimed money potentially being paid by Inland Revenue to the wrong person; and/or
- enable a holder to track an investor.

Although the first objective would not raise privacy concerns if only IRD numbers were matched, the second would require personal information to be provided by Inland Revenue to a holder.

A specific information-exchange rule to facilitate the objectives of the Unclaimed Money Act 1971 should be considered.

Comment

Inland Revenue offers banks and employers access to an Application Program Interface (API). This allows banks and employers to validate whether existing IRD number information held by an institution which is believed to be associated with an individual taxpayer, is correct. Inland Revenue is considering expanding access to the API to a broader range of institutions in future.

However, the current tax confidentiality framework does not permit Inland Revenue to provide institutions with individual taxpayers' IRD number information where this is not already held by an institution.

Officials acknowledge the matter raised in this submission; however, further work on IRD information exchange will require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That submission be declined.

Issue: Minor drafting amendment

Submission

(KPMG)

There is a circular reference in proposed section 8(1).

Comment

Officials recommend the drafting of proposed subsection (1) be amended to avoid the circular reference identified by the submitter.

Recommendation

That the submission be accepted.

Issue: Length of deeming period

Submission

(Financial Services Council of New Zealand Incorporated)

Support for a reduction in the deeming period from 25 to five years, but it should be possible for unclaimed money to be paid to Inland Revenue at any time, provided that a proper process has been followed to locate the owners of the money.

Further clarification as to what would constitute a period of less than five years, which is acceptable to the Commissioner, should be made.

Inland Revenue should work with institutions to determine the data fields that will be required as part of the new reporting, with clear instructions on file type and formatting requirements.

Comment

Proposed subsection 4(2)(d) provides the ability for holders to, in limited circumstances, pay funds to the Commissioner before the five-year deeming period has passed.

Following enactment, further guidance will be provided in a *Tax Information Bulletin*.

Officials will continue to work with account holders to ensure that data submission requirements are clear.

Recommendation

That the submission be noted, with further guidance will be provided.

Issue: Guidance on “reasonable efforts”

Submission

(Financial Services Council of New Zealand Incorporated)

Specific guidance should be provided as to what constitutes “reasonable efforts” in attempting to locate the owner of unclaimed money. This should encourage an approach that allows alignment with existing processes within the financial institution for finding customers.

A standardised approach for locating customers across various functions should result. This should involve up to three attempts via phone, and email with a physical postal address being the last resort.

Comment

Requiring a holder of unclaimed money to make “reasonable efforts” to locate an owner of unclaimed money is not intended to increase compliance costs for holders.

Provided the holder has taken active steps to locate the owner, using the contact details the holder has available, officials consider that the obligation to make “reasonable efforts” will have been met. Officials expect that most holders will have met this requirement by the time the proposed five-year deeming period has expired.

However, holders are not expected to use avenues of contact that they know will prove unproductive (for example, an invalid physical address), or to identify and pursue other avenues of contact beyond those they have available. For this reason, officials do not consider it is appropriate to specify a series of formal criteria that must be satisfied. Instead, holders should use their judgment and acumen in making “reasonable efforts” to contact the owner of the funds.

Following enactment, further guidance will be provided in a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, noting that guidance will be provided.

Issue: Data collection amendment

Submission

(Bank of New Zealand)

The data collection requirements in proposed subsection 4(7) should be limited to those which are in a “readily retrievable electronic format”.

This would clarify that the reforms are not intended to impose new information collection costs on holders of unclaimed money, but are directed towards encouraging holders to provide Inland Revenue with information in their possession which may assist the Commissioner in locating the owner of the money.

Comment

Officials agree that the existing proposed data collection requirements could increase compliance costs for holders of unclaimed money and recommend the proposed amendment.

Recommendation

That the submission be accepted.

Issue: Definition of unclaimed money

Submission

(Bank of New Zealand)

The proposed definition of money is difficult to follow and apply to practical situations. It is not clear whether subsection (4)(2)(c)(ii) allows the holder and owner to agree at the outset a standing instruction to automatically roll over term deposits, or whether this requires an explicit instruction from the owner at the expiry of the first term.

A strict interpretation of subsection 4(2)(c)(ii) would mean that holders would be required to categorise all term deposits that have rolled beyond 10 years as unclaimed money unless they had a positive agreement at the end of every period to extend the term. This would be exacerbated if a holder cannot rely on other activity the customer has with the bank as evidence of continued engagement.

A requirement to seek new instructions near the end of every fixed-rate term deposit to avoid the funds being classified as unclaimed money would introduce significant complexity into a regime which the proposed reforms seek to simplify. Automatically rolling term deposits should not be unintentionally caught by the definition of “unclaimed money” as this would not be the customer’s expectation. If this is the intention, it should be clearly communicated and sufficient time should be allowed within the transition period.

Clarity is sought on the meaning of proposed subsection (4)(2)(d).

Comment

Officials have previously recommended an institutional approach to account interaction. Under this approach, the five-year deeming period would not begin in connection with any account where the customer continues to interact with at least one other account that the customer holds at the institution.

For customers with only one term deposit account at an institution, officials agree that these customers could expect their term deposit to be rolled over without an express instruction where this is in keeping with the originating term deposit agreement.

Officials have consulted with stakeholders and recommend that term deposits that are made under an agreement which provides they are to be automatically reinvested, only come within the definition of unclaimed money five years after the maturation of the first term. This means that the five-year deeming period would only commence at the beginning of the second term of the deposit.

However, in order to avoid breaking a term deposit mid-term, officials recommend that the proposals should provide that a term deposit should be deemed unclaimed money after five years, or at the conclusion of the term the five-year deeming period falls within, whichever is the later.

Additionally, officials recommend that the drafting of proposed subsections 4(2)(c) and 4(2)(d) should be clarified.

Following enactment, further guidance will be provided in a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, subject to officials’ comments.

MATTERS RAISED BY OFFICIALS

Issue: Commencement date of clause 83B

Submission

(Matter raised by officials)

The effective date for the Unclaimed Money Act 1971 to become an Inland Revenue Act should be 1 March 2021.

Comment

Changing the effective date for the Unclaimed Money Act 1971 to become an Inland Revenue Act to 1 March 2021 would allow the administration of unclaimed money to synchronise with Inland Revenue's next phase of its business transformation programme, and improve the ability for unclaimed money to be matched to owners. The current effective date in the Bill is the date of Royal assent. Officials recommend clause 83B be amended to effect this change.

Recommendation

That the submission be accepted.

Issue: Gender-neutral drafting

Submission

(Matter raised by officials)

Officials recommend that the drafting of the Unclaimed Money Act 1971 be updated to include gender-neutral language. This will have no practical implications for claimants or holders.

Comment

Updating the Unclaimed Money Act 1971 to gender-neutral language will have no practical implications for claimants or holders.

Recommendation

That the submission be accepted.

Issue: Repeal of secrecy provision**Submission**

(Matter raised by officials)

Section 12 of the Unclaimed Money Act 1971 should be repealed.

Comment

The Unclaimed Money Act 1971 contains a bespoke secrecy provision in section 12. This requires officials to keep matters relating to the unclaimed money confidential. However, as the Unclaimed Money Act 1971 will become an Inland Revenue Act under the proposals, administrative matters will be covered by the general confidentiality provisions of the Tax Administration Act 1994. This means the bespoke secrecy provision in the Unclaimed Money Act 1971 is no longer necessary.

Recommendation

That the submission be accepted.

Issue: Publication of unclaimed money data**Submission**

(Matter raised by officials)

A specific exclusion from the confidentiality of information provisions in the Tax Administration Act 1994 should be enacted, which will allow for the publication of unclaimed money data.

Comment

When the Unclaimed Money Act 1971 becomes an Inland Revenue Act, Inland Revenue intends to provide searchable information on its website to make it easier for people to find and claim funds.

Under current law, the Commissioner is able to publish only the names of the owners of unclaimed money and the amounts received.

A specific exclusion from the confidentiality of information provisions in the Tax Administration Act 1994 will allow for the publication of unclaimed money data. This disclosure would permit the publication of information that would assist owners in being reunited with their money. Publishing additional information aligns with the approach taken in other jurisdictions and by the Treasury for Trustees Act 1956.

Recommendation

That the submission be accepted.

Issue: Allowing use of unclaimed money to offset a liability**Submission**

(Matter raised by officials)

Claimants of unclaimed money should be able to offset those funds to a liability they may owe to Inland Revenue on a voluntary basis.

Comment

On some occasions, customers may owe money to Inland Revenue and also be entitled to claim unclaimed money. These customers should have the ability to apply any amount of unclaimed money against a liability that they may owe to Inland Revenue. This option would be available to taxpayers on a voluntary basis.

Recommendation

That the submission be accepted.

Issue: Alignment of KiwiSaver Act 2006 with proposed reforms**Submission**

(Matter raised by officials)

The current, six-year deeming period mandated in the KiwiSaver Act 2006 be reduced to a period of five years, to align with the time period proposed for the Unclaimed Money Act 1971.

Comment

Section 83 of the KiwiSaver Act 2006 deals with KiwiSaver contributions that the Commissioner is unable to process in accordance with that Act due to insufficient information. These are contributions that are not paid to a fund due to lack of information as to where the funds should be directed.

As the proposed reforms to the Unclaimed Money Act 1971 will reduce the current six- and 25-year deeming periods to a single, uniform period of five years, officials recommend aligning section 83 of the KiwiSaver Act 2006 with the proposed five-year rule.

Recommendation

That the submission be accepted.

Issue: Withdrawal of minor data collection requirement proposal

Submission

(Matter raised by officials)

The proposed subsection 4(7)(d) be withdrawn from the Supplementary Order Paper (SOP).

Comment

Tracking a holder's efforts in seeking to reunite owners with their funds would impose compliance costs in transferring funds and data to Inland Revenue.

Following enactment, further guidance on what efforts would be expected of holders to reunite funds with their owners will be provided in a *Tax Information Bulletin*.

Recommendation

That the submission be accepted, noting that guidance will be provided.

Issue: Flexible filing and payment regime

Submission

(Matter raised by officials)

Holders be permitted to file on a quarterly basis with the ability to apply to the Commissioner for a variation, which would allow a longer period to suit their organisational needs.

Comment

Officials recommend flexibility in filing frequency for unclaimed money holders, due to varying operational constraints. Where some holders have indicated a willingness to file money and information with Inland Revenue immediately upon it qualifying as unclaimed money, others have expressed a preference for filing these in "batches", on a quarterly or even six-monthly basis.

Filing would be required by one month and 20 days after the conclusion of the chosen period. It is intended that the filing of unclaimed money related information and the payment of unclaimed money should occur concurrently.

Recommendation

That the submission be accepted.

Issue: Definition of unclaimed money

Submission

(Matter raised by officials)

The definition of unclaimed money should be re-drafted to focus on “money” rather than “an amount”.

Comment

The proposed amended definition of unclaimed money defines unclaimed money in terms of “an amount”. This differs from the current definition within the Act, which focuses on money.

Although the intention had been to update the language of the Act, officials are concerned that reference to “an amount” may substantially extend the application of the Act to various investment vehicles or other stores of value.

Additionally, officials recommend that a minor amendment to the proposed section 4(2)(d)(e), to ensure that amounts of exactly \$100 are governed by the Unclaimed Money Act 1971.

Recommendation

That the submission be accepted.

Issue: Consolidation of deeming period under KiwiSaver Act 2006

Submission

(Matter raised by officials)

Where it has not been possible to associate an employee or employer contribution with a customer, the date that the money is in the Commissioner’s possession for the purposes of section 83 of the KiwiSaver Act 2006 should be deemed to be the last day of the month to which the employment income information applies.

Comment

Section 83 of the KiwiSaver Act 2006 provides that any money which the Commissioner is unable to administer will become unclaimed money once it has been in the Commissioner’s possession for a period of no less than six years.

Under the KiwiSaver Act 2006, different dates can apply to determine when employee and employer KiwiSaver contributions are deemed to be in the Commissioner’s possession.

This creates administrative issues where it is not possible to associate a contribution with a particular customer. To simplify the administration of unclaimed money, officials recommend that where it has not been possible to associate an employee or employer contribution with a customer, the date that the money is in the Commissioner’s possession

for the purposes of section 83 of the KiwiSaver Act 2006 will be deemed to be the last day of the month to which the employment income information applies.

Recommendation

That the submission be accepted.

Other policy and remedial changes

GST ON OUTBOUND MOBILE ROAMING SERVICES

(Clauses 86, 87, 89 and 91)

Issue: Opposition to the proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC, Deloitte and Deloitte on behalf of Vodafone New Zealand Limited, Spark New Zealand Limited and 2degrees Mobile Limited)

Most submitters expressed strong opposition to the proposed changes. The reasons provided include:

- The changes are inconsistent with the “destination principle”. *(Chartered Accountants Australia and New Zealand)*
- The proposals seek to impose GST on a supply which is consumed outside of New Zealand. *(Deloitte)*
- The changes will result in costly software upgrades for the telecommunications industry. *(Corporate Taxpayers Group)*
- The revenue that may be obtained from this measure is minimal and not commensurate with the costs involved. *(Deloitte)*

One submitter stated that the implementation of these changes will not achieve the intended outcome in the short-to-medium term, and recommended the proposal be withdrawn from the Bill and reconsidered for the Tax Policy Work Programme at a later date when COVID-19 is controlled and there is greater certainty with regards to international travel. *(Deloitte on behalf of Vodafone New Zealand Limited, Spark New Zealand Limited and 2degrees Mobile Limited)*

One submitter expressed support in principle, where the changes are consistent with the Organisation of Economic Co-operation and Development International VAT/GST Guidelines 2017 (“OECD VAT/GST Guidelines”) and where double taxation could be avoided. *(PwC)*

Comment

New Zealand’s existing rules are inconsistent with international best practice. The rules should be modernised to reflect modern use of mobile phone technology, and alignment with the OECD’s VAT/GST guidelines which are considered to be international best practice. Currently, there are instances of non-taxation of New Zealand residents’ consumption of mobile roaming services.

The status quo is not a principled option under a broad-based GST framework, as neither outbound nor inbound mobile roaming services are subject to New Zealand GST. Imposing GST on outbound roaming services will resolve the issue of the potential non-taxation of mobile roaming services - recognising that New Zealand residents are purchasing mobile roaming services via their New Zealand-based mobile service provider. Compared to taxing

inbound mobile roaming services, imposing GST on outbound mobile roaming services will minimise compliance costs, as a whole.

Additionally, as other countries adopt the OECD VAT/GST Guidelines, the instances of non-taxation and double taxation will reduce.

Officials acknowledge submitters' concerns that the proposed application date of the changes will result in the imposition of additional compliance costs on telecommunication service providers at a time where there is currently, significant uncertainty as to when New Zealanders will be able to travel internationally freely. Further consideration of this specific issue is discussed in other sections of this report.

Recommendation

That the submission be noted, but the proposal still proceed, subject to officials' comments above.

Issue: Alignment with the OECD's VAT/GST Guidelines and overseas jurisdictions

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG and PwC)

There should be a greater focus on alignment with Australia, rather than with the OECD VAT/GST Guidelines, the European Union and the United Kingdom. This is because there is little to gain for New Zealand with aligning with the OECD VAT/GST Guidelines ahead of Australia.

Additionally, comparisons should not be drawn with the European Union and the United Kingdom, as these jurisdictions operate in an essentially "borderless" way and operate in a very different landscape to New Zealand.

One submitter did note that alignment with the OECD VAT/GST Guidelines will minimise the instances of double taxation or double non-taxation (*PwC*).

Comment

Alignment with the OECD VAT/GST Guidelines represents a move to international best practice. The guidelines (finalised in 2015) are a set of principles and standards, with a particular focus on the trade in services and intangibles, which seek to minimise inconsistencies in the application of GST where goods and services are exchanged between jurisdictions (cross-border), with a view to reducing uncertainty and risks of double taxation and non-taxation. The guidelines are known to have significant influence when tax jurisdictions are seeking to modernise their VAT/GST rules. The benefits of alignment can be significant and enduring.

Aligning New Zealand's GST mobile roaming services rules with the OECD's VAT/GST Guidelines will reduce the instances of double taxation and double non-taxation, globally, and officials consider this is where New Zealand's focus should lie.

Recommendation

That the submission be declined.

Issue: Application date

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, Deloitte, Deloitte on behalf of Vodafone New Zealand Limited, Spark New Zealand Limited and 2degrees Mobile Limited)

Almost all submitters supported a delay in the proposal's application date to beyond 1 April 2022, with Deloitte and the telecommunication industry submitting that, as a minimum, the proposal should be delayed until 1 April 2024. The reasons provided include the adverse impact of COVID-19 on New Zealanders' ability to travel overseas, and the expected lead time required for the telecommunications industry to prepare their IT systems (in particular their real-time customer billing systems) to administer these GST changes.

Comment

When the proposal was first announced as part of Budget 2019, it had an application date of 1 October 2020. Subsequent to this, in part to provide more time for telecommunication services suppliers to implement the proposal, the application date was delayed by six months to 1 April 2021. In April 2020, in light of the growing impact of COVID-19 on New Zealanders' ability to travel overseas, a decision was made to further delay the proposal's application date by 12 months to 1 April 2022. This is the application date in the draft legislation before the Committee.

Officials acknowledge submitters' concerns for the continuing uncertainty created by COVID-19 and, consequently, the limitations on New Zealanders' ability to travel overseas freely. The likely continuing overseas travel restrictions during 2021 was one of the reasons why the proposal's application date was delayed to 1 April 2022.

However, since April 2020, in light of recent announcements regarding successful COVID-19 vaccines, and an increased likelihood of travel "bubbles" with Australia and the South Pacific in the short-to-medium term, there is growing confidence that New Zealanders will be able to travel overseas freely (particularly to Australia) in the near future, and well before 1 April 2024.

Although telecommunication services suppliers have stated that their IT systems are complex, telecommunication services suppliers will have approximately 12 months to implement the proposed changes before 1 April 2022. It is unclear why the telecommunication services suppliers would require an additional two years (from 1 April 2022 to 1 April 2024) to complete the necessary IT changes required.

Therefore, officials do not support a further delay in the application date.

It is important to note that any further delay to the proposal's application date would likely have a fiscal cost to the Government.

Recommendation

That the submission be declined.

Issue: GST revenue collected by the proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Deloitte and Deloitte on behalf of Vodafone New Zealand Limited, Spark New Zealand Limited and 2degrees Mobile Limited)

Due to the impact of COVID-19, the proposal is unlikely to collect the forecasted \$7 million per annum in revenue, in the short-to-medium term.

The revenue collected would, in the short-to-medium term, be disproportionate to the implementation costs expected to be borne by the telecommunication industry (estimated to be approximately \$1 million). *(Deloitte)*

Comment

The forecasted GST revenue of \$7 million represents the net GST collected as a result of the proposal and is stated as a "per annum" figure. Therefore, over the four-year forecast period, the proposal was estimated to collect approximately \$22.88 million. The forecasted amount of \$7 million per annum was provided by representatives of the telecommunication industry.

Officials acknowledge that, due to the impact and uncertainty created by COVID-19 and New Zealanders travelling abroad, the GST revenue collected is likely to be less than forecasted in the short-to-medium term (after the proposed application date of 1 April 2022).

However, some GST revenue is expected to be collected in the short-to-medium term because, as acknowledged by one submitter, overseas travel is expected to rebound after a successful vaccine rollout, and a sufficient portion of the population is expected to become immune to the virus. Also, in the interim, an increased likelihood of travel "bubbles" with Australia and the South Pacific means there is likely to be an opportunity for New Zealanders to travel and consume mobile outbound roaming services.

In addition, the implementation costs should be considered in the context of total long-term revenues (and not just revenue for one year), which are expected to be relatively stable once "normal" overseas travel resumes in due course.

Recommendation

That the submission be noted.

Issue: Proposals do not adhere to the destination principle and New Zealand's GST system

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, and KPMG)

Submitters noted that the proposal is inconsistent with the “destination principle”. This is because New Zealand GST will be charged when the recipient is receiving the mobile roaming service while outside New Zealand. Likewise, GST will not be charged when mobile roaming services are received by international travellers visiting New Zealand.

Comment

One of the principles of a VAT/GST system is where to levy a tax on the final consumption of a good or service. The *destination principle* refers to the location where the tax should be levied (that is, the jurisdiction where the person receives the goods or services, rather than the jurisdiction where those goods or services were dispatched from).

The destination principle covers a vast majority of goods and services supplied to consumers. However, for certain services where the supplier and the consumer are not necessarily in the same place, the OECD VAT/GST Guidelines suggest that the consumer's usual place of residence can be used as a proxy for determining the place of consumption.

The OECD VAT/GST Guidelines explicitly include *telecommunication services* as an example of a service that can be subject to this proxy for determining the place of consumption. This is because it is usually more practical (and minimises compliance costs for telecommunication suppliers) for such services to be subject to GST in the consumer's usual place of residence, compared to the alternative of applying VAT or GST on the same service at different points in time, as the consumer travels between countries.

There are other examples of services that do not adhere to the destination principle, such as remote services (digital content and other forms of intangible goods).

Recommendation

That the submission be declined.

Issue: The proposal should instead be included within the remote services rules

Submission

(Chartered Accountants Australia and New Zealand and PwC)

Rather than continuing with the use of special GST rules for telecommunications services, the proposal should be embedded within the remote services rules, as consulted on as part of the policy development process.

Continuing with separate rules for telecommunication services (including mobile roaming services) will create boundary issues and may be confusing for taxpayers to determine the

correct GST treatment of services, whether they relate to mobile roaming, telecommunication services and remote services.

Comment

As part of the policy consultation process, officials examined the various ways that the proposal could be legislatively drafted, including potentially embedding the rules within the GST remote services rules.

Representatives of the telecommunication industry advised officials that, rather than embedding the proposal within the remote services rules, the use of special rules for telecommunications services, and in particular, mobile roaming services, should be retained. Including the proposed rules within the remote services rules would add complexity to both the remote services rules and also the proposed mobile roaming services rules. The draft legislation in the Bill reflects this feedback.

Additionally, although the proposal seeks to amend the existing special rules, the GST Act has included special rules for telecommunication services since 2003, and so it is likely that New Zealand-based telecommunication suppliers have experience in accurately determining the GST treatment of a particular type of service.

Recommendation

That the submission be declined.

Issue: Definition of telecommunication services includes mobile roaming services

Submission

(Chartered Accountants Australia and New Zealand)

The definition of “telecommunications services” would include “mobile roaming services”. This means the proposed rules overlap with other rules in the Goods and Services Act 1985 and must be removed.

Comment

The GST Act has an existing definition for telecommunication services that is widely understood. The proposal seeks to amend the definition by adding new rules for both outbound and inbound mobile roaming services. Officials do not believe that the overlap creates any definitional issues.

Recommendation

That the submission be declined.

Issue: Definition of remote services includes mobile roaming services

Submission

(Chartered Accountants Australia and New Zealand)

The definition of “remote services” arguably also includes “mobile roaming services”. This overlap results in the proposed rules overlapping with other rules in the Goods and Services Act 1985 and must be removed.

Comment

Section 8(5) of the GST Act states that sections relating to the remote services rules do not apply to telecommunication services. This means that there is no overlap between the remote services rules and the telecommunication services rules, which includes mobile roaming services.

Recommendation

That the submission be declined.

(Clause 86)

Issue: Definition of “mobile roaming services”

Submission

(Chartered Accountants Australia and New Zealand)

Notwithstanding the issues above regarding the overlap with the remote services rules and the definition of telecommunication services, the submitter supported the proposed definition of mobile roaming services.

Recommendation

That the support for the proposed definition be noted.

(Clause 89)

Issue: Inbound mobile roaming services being zero-rated

Submission

(Chartered Accountants Australia and New Zealand and KPMG)

The proposal provides for symmetry between inbound and outbound roaming services, whereby inbound mobile roaming services supplied to a non-resident while visiting New Zealand will be zero-rated.

Comment

Officials agree that if a resident of another country that has adopted the OECD VAT/GST Guidelines for mobile roaming services, uses their mobile phone service while visiting New Zealand, any mobile roaming charges they incur will be subject to VAT or GST in their home country.

Recommendation

That the support for this issue be noted.

Issue: Double taxation issues

Submission

(Chartered Accountants Australia and New Zealand and PwC)

Submitters are concerned that, for some countries that continue to impose GST on inbound mobile roaming services, there is a risk that double taxation may be incurred on a single supply of mobile roaming services.

This could occur where a New Zealand-based telecommunications services supplier is considered to provide outbound mobile roaming services to a New Zealand resident travelling overseas, and the New Zealand resident is receiving these mobile services in a foreign country where inbound mobile roaming services are subject to VAT or GST. In these circumstances, GST would be charged twice on the single supply of telecommunication services.

The issue of double taxation must be avoided for the new rules to be a success. *(PwC)*

Comment

The proposed rules are not intended to apply double taxation to mobile roaming services and, where they do give rise to double taxation, this should be avoided, where practicable.

With regard to the issue of double taxation with mobile roaming services, officials support, in theory, a non-double taxation rule that limits the overall VAT/GST paid on mobile roaming services. This could potentially be achieved, for example, by effectively providing an input credit for the amount of “consumption tax” paid in the other country, in recognition of the double tax effect.

Further consultation with stakeholders is required to develop a policy solution that will resolve this issue. This also gives stakeholders time in which to plan and implement any systems changes that may be required. Officials note that this would require prioritising and resourcing as part of the Government’s Tax Policy Work Programme.

Recommendation

That the submission be noted, subject to officials’ comments.

Issue: Withdraw the proposal and reconsider post COVID-19

Submission

(Deloitte on behalf of Vodafone New Zealand Limited, Spark New Zealand Limited and 2degrees Mobile Limited)

Due to the uncertainty caused by COVID-19 and the likely minimal GST revenue collected for the short-to-medium term, the proposal should be removed from the Bill and reconsidered for the Tax Policy Work Programme at a later date, when the COVID-19 pandemic is controlled and there is greater certainty in the international travel industry.

Comment

Officials acknowledge that COVID-19 has had a significant impact on New Zealanders' ability to travel overseas, and it is currently difficult to accurately predict when international travel will resume.

However, the proposal is based around the modernisation of New Zealand's mobile outbound roaming services rules and resolving a misalignment with the OECD's VAT/GST Guidelines. Officials do not believe that the impact of COVID-19 means the proposal should be withdrawn from the Bill.

The proposal should proceed, as current information suggests that it is likely there will be New Zealand travellers moving freely across international borders by April 2022.

Recommendation

That the submission be declined.

INCOME TAX TREATMENT OF LEASES SUBJECT TO NZ IFRS 16

(Clauses 8, 15, 22, 23, 26 and 58)

Issue: Alignment with accounting

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG, PwC)

Submitters supported closer alignment between accounting and tax for lease expenditure.

Recommendation

That the submission be noted.

Issue: Optional application

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

Submitters supported the IFRS 16 tax rules being optional for taxpayers to apply.

Recommendation

That the submission be noted.

Issue: Timing of proposals

Submission

(Corporate Taxpayers Group, Deloitte, EY)

The delay in introducing the proposals means many taxpayers have already had to develop systems to unwind the impact of NZ IFRS 16. This will reduce the number of people choosing to adopt NZ IFRS 16 for tax. In the future, tax legislation should be more closely aligned to timings on change in accounting policy.

Comment

Officials agree it is beneficial to align the timing of changes in tax rules with changes in accounting policies to the extent possible. These proposals have been in development for some time and there have also been delays in the Bill, due, for example to COVID-19. Officials note that the proposals have benefited from the greater understanding that arose from taxpayers having to apply the accounting standard.

Recommendation

That the submission be noted.

Issue: Adjustments should not be required

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC)

Impairment, revaluation, make good and direct costs adjustments, which are only timing in nature, will negate the proposed compliance cost benefits. Practically, entities will have to maintain separate tax schedules recording the original interest and accounting amortisation to ensure the correct tax deduction.

Officials should explore how any adverse impacts that may arise can be managed if there are no, or minimal tax adjustments, if the leasing tax rules are fully aligned with NZ IFRS 16.

Comment

Officials are aware that the requirement to make adjustments increases complexity, but have attempted to minimise compliance costs in the design of adjustments. For example, when an adjustment is made, this will be on a straight-line basis, with no recalculation required for events such as an extension of the lease term. This means a recurring annual adjustment will only need to be calculated once. The direct cost adjustment is also optional for taxpayers who wish to forego the timing advantage of bringing forward the deduction if the compliance costs of doing so are considered too high.

It is a general principle of the Income Tax Act that business expenditure is deductible when it is incurred rather than when an impairment or revaluation provision is created. If adjustments were not made to reverse these provisions for tax purposes, this would provide a significant timing advantage for taxpayers applying the new rules compared with non-IFRS taxpayers. Accordingly, officials do not consider it would be appropriate to have a full alignment without impairment and revaluation adjustments.

However, we acknowledge the timing impact of these adjustments may be small for certain lower value and/or shorter term leases, so officials recommend de minimis thresholds below which fewer adjustments will be necessary. These are considered separately below.

Recommendation

That the submission be declined.

Issue: Adjustments for low-value assets and short-term leases

Submission

(Jim Gordon Tax Ltd)

It is understandable that tax policy officials want certain NZ IFRS adjustments to be reversed for tax purposes. This, however, has the effect of reducing, and in some cases significantly so, the simplification that can be achieved by having tax follow the financial reporting treatment. A half-way house is needed whereby only major accounting adjustments that significantly affect tax are reversed for tax purposes. However, for low value or shorter-term leases, where the effect of the NZ IFRS adjustment is less material, there seems to be no real problem in following the NZ IFRS treatment, with the proviso that a wash-up is necessary to make sure that the aggregate tax treatment over the term of the lease is appropriate.

Comment

NZ IFRS 16 already has a different treatment for low value and short-term leases which will minimise compliance costs for the lowest value leases. This is explained on page 43 of the Bill Commentary. However, officials agree that the compliance costs of the NZ IFRS 16 proposals could be reduced if certain adjustments were not required for shorter-term and lower-value leases beyond that contemplated by NZ IFRS 16. This could potentially make the new rules more concessionary than the rules applied by non-IFRS taxpayers, so should only apply where the timing difference is relatively immaterial.

While any distinction between shorter-term and longer-term leases or low and high value leases is necessarily arbitrary, officials have discussed with submitters where these thresholds should be set.

Officials recommend that the add-back adjustment, impairment and revaluation adjustment and the make-good and direct costs adjustment should not be made for an IFRS lease that has an initial right of use asset value of \$100,000 and a term of four years or less. Officials note these thresholds are significantly above the value and term thresholds in NZ IFRS 16 referred to above, which are approximately a US\$5,000 asset value and terms less than 12 months respectively. Officials expect this concession will cover the majority of personal property leases businesses enter into, for example, motor vehicles. Typically few, if any, adjustments would be expected for these leases, however introducing a de minimis will increase certainty for taxpayers that adjustments will not be necessary.

Recommendation

That the submission be accepted.

Issue: Carve out for real property

Submission

(Corporate Taxpayers Group, KPMG, PwC)

The carve out for real property will result in many taxpayers being less likely to adopt NZ IFRS 16 for tax. Where a taxpayer has several leases that are real property and several that are not, the processes required to determine the differences between accounting and tax will differ between the lease assets.

Comment

Real property leases are generally of higher value and for longer terms than other assets. Therefore, the fiscal cost of accelerating deductions for real property by adopting NZ IFRS 16 for tax, for real property, is significantly higher. Furthermore, real property is more likely to have impairment and revaluation adjustments, meaning the compliance costs of applying NZ IFRS 16 for tax are likely to be higher than for shorter term, lower-value assets.

Recommendation

That the submission be declined.

Issue: Irrevocable election

Submission

(EY)

Taxpayers should be allowed to cease to follow NZ IFRS 16 for tax if they perform a wash-up calculation at exit, and account appropriately for any income/expenditure that arises.

Comment

Officials consider it is appropriate for a taxpayer that elects to follow NZ IFRS 16 for tax to be required to continue to follow it for the remainder of that lease. This will prevent taxpayers going into and out of the rules to gain a favourable tax outcome. This will also minimise the number of adjustments and wash-ups required.

However, to reduce the barriers to entry to these rules, officials consider that a taxpayer should be able to choose whether to apply the new rules on a lease-by-lease basis. The consequence of this choosing to apply the new rules to some or all current leases would not prevent the taxpayer choosing not to apply it for other leases. This is covered further separately below.

Recommendation

That the submission be declined.

Issue: Transitional adjustment for early adopters

Submission

(EY)

In cases where taxpayers adopted NZ IFRS 15 and 16 early, it is possible they will have already filed at least their 2019 and 2020 income tax returns before the Bill is enacted. In order to reduce compliance costs, the proposals should allow a transitional adjustment. We suggest that the proposed spread of the transitional adjustment over a four-year period should be reduced to two years for these early adopters.

Comment

The proposed four-year spread of the transitional adjustment is designed to spread the fiscal cost of deductions being brought forward on adoption of NZ IFRS 16. If the adjustment period were reduced to two years, this would increase the fiscal cost of the proposals without significantly reducing the compliance costs of early adopters.

Officials note that the updated proposal covered below, to allow taxpayers to choose to apply the new rules on a lease-by-lease basis, will provide greater flexibility for early adopters of NZ IFRS 16 who wish to apply the new rules.

Recommendation

That the submission be declined.

Issue: Certain leases should be excluded from wash-up calculation

Submission

(EY)

A wash-up calculation will currently be required for leases that cease to qualify for the proposed treatment. Concessionary carve outs should apply to remove the need to perform a wash-up calculation in the following scenarios:

- when leased assets are on-leased or sub-leased between New Zealand group entities with at least 66% commonality of ownership;
- any sub-leasing between members of a tax consolidated group; and
- any short-term sub-leasing to a person.

Comment

The proposed new rules align the timing of deductions for certain operating lease expenditure more closely with accounting. The purpose of the wash-up calculation is to ensure that, where deductions claimed based on this modified timing are above or below the expenditure incurred, an adjustment is made to align deductions claimed with the amount incurred. If no wash-up adjustment is made, some expenditure incurred may be deducted twice, or not deducted, in certain circumstances. The policy intention is that total deductions claimed in relation to a lease until the point of wash-up should equal the deduction available to non-IFRS taxpayers. Removing the need to perform a wash-up calculation in certain circumstances will undermine the integrity of the new rules.

Recommendation

That the submission be declined.

Issue: Effect on thin capitalisation

Submission

(EY)

The NZ IFRS 16 treatment could negatively impact thin capitalisation ratios, resulting in interest disallowances beyond the intended scope of those rules. The proposals in the Bill do not exclude the right-of-use assets and lease liabilities recognised on the balance sheet as a consequence of NZ IFRS 16 from thin capitalisation calculations. Deferred tax in relation to leases will also be included in debt-to-asset ratio calculations.

The proposals should be amended to include confirmation that thin capitalisation calculations should exclude the right-of-use asset, lease liability and associated deferred tax components; or alternatively should include a mechanism to remove any net impact of NZ IFRS 16.

Comment

The thin capitalisation debt percentage calculation is based on the accounting balance sheet using the formula:–

$$\text{group debt}/(\text{group assets} - \text{non-debt liabilities})$$

A group's balance sheet position is impacted by the right-of-use asset and the lease liability recognised under NZ IFRS 16. These amounts increase group assets and non-debt liabilities respectively. Accordingly, when the two amounts are equal, there is no impact on the thin capitalisation debt percentage.

However, officials acknowledge that there will be differences between the amount of a right-of-use asset and lease liability, and lease-related deferred tax assets or liabilities, that flow through to the debt percentage calculation. These impacts arise as a result of adopting NZ IFRS 16 for accounting, rather than any of the proposed tax changes in the Bill.

From time to time, existing accounting standards are updated, and new standards are introduced, that impact a taxpayer's balance sheet, and these changes flow through to their thin capitalisation debt percentage calculations. As a test based on accounting information, the policy intent is that the debt percentage calculation is affected by these changes and the formula is not updated to reverse their impact. Officials do not support a special treatment for NZ IFRS 16.

Recommendation

That the submission be declined.

Issue: Dedicated IFRS resource

Submission

(EY)

NZ IFRS standards should be pro-actively reviewed for tax impacts ahead of the change in the standard applying, to provide NZ IFRS taxpayers with certainty on the related tax consequences. Inland Revenue should establish a dedicated project on its Policy Work Programme on NZ IFRS-related impacts.

Comment

Inland Revenue considers information from a variety of sources, including consultation with the private sector, when advising the Government on the Tax Policy Work Programme. There have been numerous legislative updates to reflect changes in NZ IFRS, and officials will continue to monitor NZ IFRS to determine further legislative change is required. This can be achieved without establishing a dedicated NZ IFRS resource.

Recommendation

That the submission be declined.

Issue: Election process

Submission

(Matter raised by officials)

Taxpayers should be able to apply the new rules on a lease-by-lease basis.

Comment

Under the rules proposed in the Bill, once a taxpayer has elected to follow NZ IFRS 16 for tax it must continue to do so for all eligible leases for all future periods. Officials now consider that this is more restrictive than necessary. Officials recommend taxpayers should be able to choose whether to follow NZ IFRS 16 for tax for each eligible lease. This would allow taxpayers to follow NZ IFRS 16 for tax for an individual lease, while continuing to follow the standard rules for other leases. Once a taxpayer chooses to follow NZ IFRS 16 for tax for a particular lease, it should continue to follow this for the life of the lease, provided the lease remains eligible under the originally proposed criteria.

Recommendation

That the submission be accepted.

Issue: Minor drafting improvements

Submission

(Matter raised by officials)

Minor drafting changes should be made to the proposed provisions as follows:

- The words “other than subsection (5)” should be deleted from subsection EJ 10B(1) to clarify that the wash-up rule in subsections EJ 10B(5) and (6) applies for the income year in which an IFRS lease ends or ceases to be an IFRS lease.
- The word “accounts” in subsection EJ 10B(1)(a) should be replaced with “financial statements” to align with the term used in NZ IFRS.
- The words “or would use NZ IFRS 16 if that lease met the materiality thresholds for NZ IFRS 16” should be deleted from subsection EJ 10B(1)(a) because the treatment of low value and short-term leases is specified within NZ IFRS 16, so the standard will be used for these leases.
- The words “leases described in paragraphs (a) to (c)” in subsection EJ 10B(1)(d) should be replaced with “IFRS lease” to simplify the drafting.
- The words “a deduction for an income year for the IFRS lease equal to the amount calculated using the formula” in subsection EJ 10B(2) should be replaced with “for an income year, a deduction for a positive amount, and has income for a negative amount, for amounts calculated using the formula” to clarify that the formula result can be the amount of a deduction or income.
- The term “accounting expenditure” in the formula in subsection EJ 10B(2) and in subsection EJ 10B(3)(a) should be changed to “accounting amount” because the accounting amount could be accounting expenditure or income.
- The words “relevant positive or negative” should be deleted from subsection EJ 10B(3)(b) and (d) to simplify the drafting.
- The words “for any income year” should be inserted after the words “add-back adjustment” in subsection EJ 10B(3)(c) to improve clarity.
- The words “an amount of income or deduction” in subsection EJ 10B(5) should be replaced with “a deduction for a positive amount, and has income for a negative amount” to improve clarity.
- The word “or” should be replaced with “and has” in subsection EJ 10B(7) to improve clarity.

Comment

Officials recommend these drafting changes as they will improve the clarity of the legislation.

Recommendation

That the submission be accepted.

SCHEDULE 32 OVERSEAS DONEE STATUS

(Clause 62)

Issue: Support for proposed additions

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the addition of Active Hearts Foundation, Kiwilink and Shimshal Trust to schedule 32 of the Income Tax Act 2007, with effect 1 April 2020.

Recommendation

That the submission be noted.

GST CREDIT NOTES

(Clause 90)

Issue: The proposed amendment to allow a supplier to issue a credit note when 15% GST was incorrectly charged is unnecessary

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

We disagree with Inland Revenue's interpretation of the current law. Section 25 already allows an adjustment of the full amount of the reduction in consideration. The proposed change is being enacted to achieve an outcome that is achieved with the current GST legislation. *(Chartered Accountants Australia and New Zealand, KPMG)*

Comment

Officials consider the amendment is necessary. Even if the same outcome can already be achieved under the current law, it is still useful to explicitly clarify in the legislation that a credit note can be issued to adjust GST in the scenario when a zero rated or exempt supply was incorrectly standard rated. The amendment is designed to accommodate existing business practices so should increase certainty and reduce compliance costs.

Recommendation

That the submission be declined.

Issue: Supports proposal to allow a supplier to issue a credit note when 15% GST was incorrectly charged

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, PwC, EY)

If Inland Revenue continues to take the view that the legislation as it stands is unclear, then the change is welcome. *(Chartered Accountants Australia and New Zealand)*

Supports the proposal to align this process with business practice and the proposal for retrospective application. *(Deloitte, PwC)*

We support the proposed simplifications that seek to align the issuing of credit notes to the assessment amendment approach, currently available. *(EY)*

Comment

Most submitters support the proposed amendment.

Recommendation

That the submissions should be noted.

Issue: Supports proposal, but further amendments are required to align provisions with modern business practices

Submission

(Corporate Taxpayers Group, Deloitte)

The Group submits that the suggestions it made to improve credit note requirements in its submission on the officials' issues paper *GST policy issues* should be considered and implemented as part of the modifications to section 25 contained in this Bill.

The legislation should be modernised to explicitly allow a document to simultaneously be a tax invoice, credit note and debit note. This would align with common business practice which is designed to ensure invoicing documentation is streamlined and one document can deal with all scenarios.

Although the intention to align the legislation with modern business practice is commendable, section 25 will still remain outdated and not fit for purpose after this amendment is made. For example, it is not technically possible to issue a valid credit note if there is an error on the corresponding tax invoice (that is, the wrong entity is being invoiced) but the consideration and GST amounts on the tax invoice are correct. *(Corporate Taxpayers Group, Deloitte)*

Comment

The points raised by submitters require wider reforms to modernise the invoicing provisions. Proposed reforms to modernise invoicing are intended to be introduced in the next omnibus taxation bill. The submitters' points will be considered for inclusion in that Bill. As with other policy reforms, inclusion in the Bill will require officials' consideration, ministerial approval and finally Cabinet approval.

Recommendation

That these submissions be noted, subject to officials' comments.

Issue: Scope of the proposed provision should be broadened

Submission

(PwC)

A further amendment should be made to clarify that a credit note can also be issued for a transaction where GST was inadvertently charged despite there being no supply at all. For

example, if GST was charged in error in relation to a compensation payment not subject to GST.

Comment

Under the current GST Act, a credit note can only be issued when a GST-registered person has made a supply of goods and services. Allowing a credit note to be issued when there has in fact been no supply would require a complete redrafting of the credit note provisions, so could be considered as part of the package of changes to modernise the invoicing provisions, which are planned to be included in a subsequent taxation Bill.

In considering this submission, officials have identified that the proposed specific provision that was included in the Bill as introduced is too narrow, as it is limited to credit notes issued when a supplier has mistakenly charged GST on an exempt or zero-rated supply. The intended policy outcome would be better achieved by a more general provision which clarifies that a credit or debit note can be issued for any supply of goods of services where an incorrect GST treatment was applied to the supply. Officials recommend including this more general provision in the current Bill.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Consequential amendments to similar provisions

Submission

(PwC)

Existing sections 25(1)(ab) and (abb) allow a credit note to be issued in relation to a supply which should have been zero rated under two specific zero-rating rules. Following the introduction of new section 25(1)(aaa), consideration should be given to amending sections 25(1)(ab) and (abb), as the supplies to which these subsections apply may now be adjusted under the new, more general section 25(1)(aaa).

Comment

Officials note that the proposed general provision will make the existing specific provisions in sections 25(1)(ab) and (abb) effectively redundant. Officials recommend amendments that would allow those specific provisions to be replaced by the new general provision.

Recommendation

That the submission be accepted.

Issue: Proposed time limit on issuing a credit note

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY)

The change should not proceed. The Commentary to the Bill states that the amendment is being introduced because there is a fiscal risk to the current rules. We question the size of such a risk. Any GST input tax claimed is merely passed on to the recipient and is not retained by the supplier. The supplier would be able to retain the refund if the price paid was GST-inclusive, but this will be determined by the original agreements, not by any subsequent decision to issue a credit note. The issue of a credit note remains the most practical means for correcting an error in the pricing of the supply. To require suppliers to apply to the Commissioner to obtain a refund would create additional compliance costs. Conversely, to not allow the supplier to obtain a refund would be inequitable. *(Chartered Accountants Australia and New Zealand)*

The Group does not support the proposal to align the time limit for issuing a credit note with the time bar that applies to GST refunds. The reason for this is that it is not uncommon for an amount of an invoice to remain in dispute for an extended period of time, which may exceed four years. Taxpayers should retain the ability to correct tax invoicing, via a credit note, at the conclusion of a commercial dispute. If a time limit is to be placed on credit notes, this should be a period of eight years. This would align with the rules for GST returns which are incorrect due to a clear mistake or simple oversight. *(Corporate Taxpayers Group, Deloitte)*

Although we recognise the Government's concern around the fiscal risks of unlimited ability to issue credit notes, we do not support the proposed time limits as they are currently drafted. A better outcome would be to align the time limit for issuing credit notes consistent with the input tax rules; that there be no time limit where a credit note is required to be issued due to a simple mistake or oversight. If Inland Revenue is worried about the integrity of the system, we recommend that officials consider whether increased disclosures could alleviate the risk to the tax base. *(EY)*

Comment

Officials consider it is necessary to provide a time limit on issuing a credit note to limit the potential fiscal risks from a change in how the GST treatment of a supply is interpreted by the GST-registered person or Inland Revenue. The proposed time limits are four years or eight years (when the credit note is issued to correct a clear mistake or simple oversight) and are consistent with the corresponding time limits for amending the original GST return that the relevant supply had been included in. This time bar on amending tax returns is an accepted approach of providing certainty for taxpayers and Inland Revenue, and in the absence of a similar time limit on credit notes, the credit note provisions could be used to defeat the intent of the time bar.

Without a time limit on credit notes, it would be possible for GST-registered persons to claim large tax refunds in relation to positions taken more than four or eight years ago. Other options for addressing this fiscal risk, such as increased disclosures or a value-based limit could be ineffective or unfair.

Recommendation

That the submissions be declined.

PORTABILITY OF AUSTRALIAN UNCLAIMED SUPERANNUATION MONEY

(Clauses 58(3) and 93)

Issue: Support for proposed amendments

Submission

(Anthony Harper, Chartered Accountants Australia and New Zealand, Financial Services Council of New Zealand Incorporated, and Navtej Singh)

The submitters voiced their support for the proposed amendments.

Recommendation

That the submission be noted.

Issue: Commencement date

Submission

(Anthony Harper, Financial Services Council of New Zealand Incorporated)

Two of the submitters noted that the proposed commencement date for the amendments is the date that relevant amendments to the Trans-Tasman Retirement Savings Portability Arrangement between Australia and New Zealand (the Arrangement) come into effect. Amendments to this Arrangement will be made only once reciprocal changes are made to Australian domestic legislation. The submitters encouraged New Zealand and Australian Governments to pursue these changes as soon as practicable.

Comment

The relevant Australian legislation was passed on 11 December 2020. New Zealand officials will continue to engage with their Australian counterparts as changes to the Trans-Tasman Retirement Savings Portability Arrangement are agreed.

Recommendation

That the submission be noted.

Issue: Implementation implications

Submission

(Financial Services Council of New Zealand Incorporated)

Open dialogue with the KiwiSaver scheme provider industry must be maintained to ensure that any implementation issues (examples of possible issues the submitter provided relate to system changes, possible anti-money laundering issues and ensuring funds are correctly applied to the right member) are appropriately worked through, and suitable implementation timeframes are provided prior to commencement.

Comment

Officials agree that it is important to work closely with KiwiSaver scheme providers on the implementation of the proposed amendments.

With both nations progressing the needed legislative changes domestically, it is not possible to include a specific date for commencement in this legislation. It would not be appropriate to have a commencement date that does not match Australia's. However, in order to increase certainty for taxpayers, officials are recommending a time limit to the commencement of this provision. This would specify that the relevant amendments would commence with the exchanging of diplomatic notes or 12 months after the legislation receives Royal Assent. Such an approach would echo that taken by Australia in introducing their complementary legislative changes and increase certainty for KiwiSaver scheme providers. Officials also note that linking the commencement date for the amendments to the date diplomatic notes are exchanged between Australia and New Zealand (rather than prescribing a set application date at this time) will ensure that there is the flexibility to set a commencement date that gives scheme providers sufficient lead-in time to implement the changes. It is also possible to defer the date of application for a set time after the notes have been exchanged.

The application date for the original portability legislative amendments was similarly linked to the date that an exchange of diplomatic notes brought the Trans-Tasman Retirement Savings Portability Arrangement into effect (see: *section 2(25) of the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010*).

Recommendation

That the submission be noted.

MYCOPLASMA BOVIS TAX ISSUE

(Clause 33)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand, Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd, Navtej Singh)

That the proposal is supported and should proceed.

Comment

Officials note the general support for the proposal. Some of the submitters made further points which are dealt with below.

Recommendation

That the submission be noted.

Issue: Retrospective application

Submission

(Chartered Accountants Australia and New Zealand)

It is appropriate that the legislation be backdated to the 2017–18 income year, given some farmers may have had to cull livestock in the 2017–18 income year because of *Mycoplasma bovis*.

Comment

Officials note the general support for the proposed retrospective application date.

Recommendation

That the submission be noted.

Issue: Generic provision

Submission

(Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd)

That either the *Mycoplasma bovis* proposal be made generic to all biosecurity events, or that all event-specific relief legislation for adverse events be reconsidered with a view to making it generic, and applicable to *Mycoplasma bovis* impacted situations.

Comment

The current proposal is confined to the culling of livestock as part of eradicating *Mycoplasma bovis* in New Zealand and therefore terminates before the 2028–29 income year. Officials agree in principle that there should be an equivalent generic provision to cover future biosecurity events that lead to the culling of livestock valued under the national standard cost scheme or cost price method. This would expedite addressing the tax implications of such events and create more certainty for livestock owners.

Officials have discussed the possible criteria for a separate generic provision with submitters, and the matter has been included on the tax policy work programme. It may therefore be feasible to include a generic provision covering future biosecurity events in a tax bill in 2021, which would enable wider public submissions on the proposal. In the meantime, the *Mycoplasma bovis* specific provision should proceed.

Recommendation

That the submission be noted.

Issue: Unwinding of income equalisation deposits

Submission

(Chartered Accountants Australia and New Zealand, Federated Farmers of New Zealand Incorporated, Jim Gordon Tax Ltd)

Mycoplasma bovis affected farmers should be allowed to reconsider past income equalisation deposits if they retrospectively elect to use the *Mycoplasma bovis* spread.

Comment

Income equalisation deposits are a way of smoothing farmers' incomes. This is achieved by deposits being deductible for tax purposes, and withdrawals being income. Deposits in any one income year are capped at the amount of net income from the qualifying activity for that year.

Some farmers whose herds have been affected by *Mycoplasma bovis* will have, in the absence of other options, made deposits into the scheme to mitigate the income arising from their herds being culled.

Income equalisation deposits are, however, not an effective mechanism to mitigate the unexpected income effects when farmers need the cash to restock their breeding herds, as the deferred income is then brought to account around a year later. The proposed six-year spread will be far more effective in such cases. Therefore, some farmers will now prefer to retrospectively unwind the tax effects of their earlier income equalisation deposits and instead take up the income-spreading option. Unwinding the tax effects of a deposit requires

specific additional legislation. However, it does not involve unwinding the deposit, on which interest would have likely already been paid.

Points of difference

In principle, officials agree with the submission but the matter is still under consideration given that there are some fiscal implications.

Recommendation

That the submission be noted.

Issue: Removal of reference to “owner” in proposed section EZ 4B(1)

Submission

(Chartered Accountants Australia and New Zealand)

That the proposed section EZ 4B(1) should apply to farming businesses, rather than the owners, and that the section should be rewritten to reflect this.

Comment

Proposed section EZ 4B(1) begins with the wording: “This section applies when a person who owns or carries on a business has mixed-age cows on hand at the start of the income year”. The submitter is concerned that this proposed wording by referring to “owners”, will encompass the shareholders of a company when it is the company, not the shareholders, that returns the income. Officials consider that this interpretation is not correct. In the example, the company is the “person” carrying on the business and will be entitled to use the spread, provided the various other criteria are met.

Officials note that section EZ 4B(1) is based on wording already used in those parts of the Income Tax Act that deal with the valuation of livestock and trading stock in general. It is difficult to envisage a scenario in which a business is not being carried on, even in the case of a trust or individual. However, officials are reluctant to recommend what could prove to be narrower wording that inadvertently precludes someone from being able to use the spread.

Recommendation

That the submission be declined.

Issue: Generally rewording proposed section EZ 4B(1)

Submission

(Chartered Accountants Australia and New Zealand, Jim Gordon Tax Ltd)

That the eligibility criteria in proposed section EZ 4B(1)(a)(i) should be reworded to better reflect the criteria for spreading, or alternatively deleted.

Comment

Currently, proposed section EZ 4B(1)(a)(i) refers to mixed-age cows held “for the purposes of sale or exchange in the ordinary course of business”. Officials recommend that the proposed provision should be reworded to better reflect the intended coverage of the spread, which is stock used for breeding.

Officials do not recommend that the provision should be deleted, as it is necessary to have a reference to using the livestock in the business. Being clearer on the intended type of business should be sufficient.

Recommendation

That the submission to amend the wording of section EZ 4B(1)(a)(i) to more specifically reflect the intended coverage of the spread be accepted, but the submission to delete section EZ 4B(1)(a)(i) be declined.

Issue: Use of the word “choose” rather than “elect” in section EZ 4B(2)

Submission

(Chartered Accountants Australia and New Zealand)

That the word “choose” in proposed section EZ 4B(2) should be replaced with “elect”.

Comment

Taxpayers will need to make an election to use the income spread. Proposed section EZ 4B(2) sets out the requirement. It is standard drafting style to use “choose” as the verb rather than “elect” when referring to an election in the Tax Acts. Therefore, officials do not agree with the submission.

Recommendation

That the submission be declined.

Issue: Business cessation

Submission

(Chartered Accountants Australia and New Zealand)

That the requirement for allocation on death of a business owner is unnecessary and the draft section EZ 4B(4) should be reworded.

Comment

The proposed provision spreads the income evenly over a six-year period. However, proposed section EZ 4B(4) requires that, if a business ceases or a natural person owner dies, any remaining spread income at the time of cessation or death is allocated to the year of cessation or death. This is consistent with the standard requirement for tax matters to be brought to account on death or cessation of business.

The submitters are concerned that the reference to death of an owner will mean that companies that continue after the death of one of their owners will be required to bring the unallocated spread income to account at that stage. Officials agree that the crucial test is whether the person stops owning or carrying on the business, and the provision should just reflect that. For example, the death of a sole trader will mean that the person has stopped owning or ceased their business. Officials recommend the draft legislation should be clarified in this area.

Recommendation

That the submission be accepted.

Issue: Shareholder salaries

Submission

(Chartered Accountants Australia and New Zealand)

That taxpayers who meet the criteria to use the spreading method should be able to adjust prior year shareholder salaries to reflect the spreads impact on business profits. In particular, Inland Revenue should consider whether a change to the tax position as a result of a legislative change falls within the parameters of Standard Practice Statement (SPS 18/01): *Retrospective adjustments to salaries paid to shareholder employees*.

Comment

Many farming businesses pay shareholder-employees a salary, which may be linked to the level of business profits. The submission notes that Inland Revenue's Standard Practice Statement outlined the circumstances in which the Commissioner will allow a retrospective adjustment of previously paid shareholder salaries. Those circumstances focus on when the company profit can be shown to be in error, or when the salary shown in the company accounts was not the amount agreed at the time of the salary and wages. An error in the company profit can include when a company has a policy of declaring salaries at no more than the company's profit in any year, and it is found, subsequent to declaring a salary, that the company's profit was overstated. The Standard Practice Statement may, therefore, enable some companies who can apply the spread retrospectively to also make retrospective adjustments to salaries, as past profits will then have been overstated.

Officials therefore recommend reminding taxpayers of the Standard Practice Statement through the *Tax Information Bulletin* following enactment.

Officials recommend any retrospective adjustment of salaries should be limited to the circumstances specified in the Standard Practice Statement.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Amendment to spread formula term “number”

Submission

(Matter raised by officials)

That proposed section EZ 4B(8)(b) be revised to refer to the number of livestock of that class that the person had on hand at the start of the cull year and valued under the national standard cost scheme or the cost price method, in the income year before the cull.

Comment

Proposed section EZ 4B(8) defines the term “number” for the purposes of the spread formula. “Number” is the number of livestock that are eligible to be included in the spread calculation. Officials are suggesting a change to this term to ensure the spread formula works as intended when there are additional livestock numbers in the cull year. The change would exclude those additional livestock from the spread by limiting “number” to being no more than the number of livestock of that class that the person had on hand at the start of the cull year, which were valued under either the national standard cost scheme or the cost price method.

Officials have discussed this submission with Federated Farmers of New Zealand Incorporated, who confirm that it would be an unnecessary complication for the spread to factor in adjustments for expanding herds in the cull year, and that, in practice herd numbers have been generally stable or contracting.

Recommendation

That the submission be accepted.

INDIVIDUAL TAX WRITE-OFF THRESHOLD

Issue: Temporary increase to the automatically calculated individual income tax write-off threshold

Submission

(Chartered Accountants Australia and New Zealand)

That the amendment is supported but the write-off should be extended to all individuals with tax to pay of less than \$200.

The amendment applies only to those individuals whose assessments are automatically calculated by Inland Revenue. For those whose assessments are not automatically calculated, such as those who are required to file an IR 3 return, the measure will not apply.

The rationale for the change is to ease financial pressure for individuals following COVID-19. Return filers are under the same financial pressure as those whose assessments are calculated automatically.

Comment

The current \$50 write-off threshold only applies to individuals whose assessments are automatically calculated, not all taxpayers, so this temporary change targets individuals who received only reportable income (that is, income that has already had tax withheld at source). In such cases, income tax obligations are automatically calculated by Inland Revenue and any assessed refund or tax to pay would be due to the income payer not withholding the correct amount of tax. By contrast, other taxpayers' tax assessments are due to their income that may not be taxed at source at all.

Officials note that increasing the write-off threshold was designed both to remove compliance costs for taxpayers seeking to have the tax written off under the financial hardship rules and to reduce the administrative burden for Inland Revenue who were under pressure with regular work and implementing COVID-19 measures. As part of the auto-calculation process, Inland Revenue calculated around 154,000 tax assessments for tax liabilities of between \$50 and \$200 and, as a result of the increased write-off threshold, did not have to deal with customer contacts about these liabilities. Inland Revenue knows from previous experience that auto-calculation customers who receive a tax bill contact Inland Revenue to understand why. Taxpayers who do not qualify for the automatic write-off can still use the current mechanisms available to help people in financial hardship. Extending the write-off threshold increase to all taxpayers will also have a fiscal cost.

Recommendation

That the submission be declined.

Remedials

GENERAL COMMENTS

(Clauses 45, 59, 60, 76, 79)

Issue: General support

Submission

(Chartered Accountants Australia and New Zealand, EY)

The submitters expressed support for the proposals.

Recommendation

That the submission be noted.

Issue: Changes appear more than merely remedial

Submission

(Corporate Taxpayers Group)

We are concerned about changes being made to the schedules of eligible activities and expenditure types which are presented as “remedial” or as “clarifications.” While they may appear minor in nature, the R&D tax credit legislation is very prescriptive and even small changes can have a major impact on what is or is not eligible. Presenting these changes as “remedial” is disingenuous.

Comment

Officials consider that the changes to the schedules mentioned by the submitter are remedial in nature. These amendments are based on evidence and advice that the legislation is being interpreted, or could be interpreted, in a manner that is clearly beyond the original policy intent. The amendments seek to address these potential interpretation issues and ensure the legislation gives effect to the policy intent.

There is one change to the schedules that reflects a policy change (the carve-in for labour expenditure on core R&D that contributes to the cost of tangible depreciable property). This amendment is taxpayer-friendly in nature and explicitly supported by all submitters. Aside from this, officials believe all changes to the schedules do not alter the intent of the regime, but confirm and clarify it; as such, officials expect the effect on taxpayers filing within the policy intent will be minimal.

Recommendation

That the submission be declined.

Issue: Changes not based on evidence

Submission

(Corporate Taxpayers Group)

As most R&D claims for the 2019–20 income year have not yet been made, we do not believe that the changes are based on actual evidence of any issues with the application of the regime.

Comment

Many proposals in the Bill are based on operational experience from the R&D tax incentive's pilot regime, which ran from November 2019 to June 2020. The pilot was intended to trial the in-year approval regime in advance of its deployment in the 2020–21 income year, but also to give officials advance indication of areas where issues may arise around interpretation before the majority of claims are filed for the 2019–20 income year (the first year of the regime), as it took place before applications for that year are due. This design meant that the scheme would evolve as new challenges came to light through the pilot. Officials consider evidence from the pilot justifies clarification in certain areas to ensure the original policy intent is being met.

Other proposals concern areas where officials have considered certain issues and received both legal advice and public feedback to the effect that the current legislation could be interpreted inconsistently with the original intent, or evidence from tax incentive regimes overseas that legislation similar to our own could be interpreted in ways contrary to the original intent.

Recommendation

That the submission be declined.

Issue: Changes decrease certainty

Submission

(Corporate Taxpayers Group)

We are concerned that there seem to be constant changes to the R&D tax credit regime, when returns have not yet been filed. This makes it hard for taxpayers who are claiming or wishing to claim, as the rules are being amended relatively often.

Comment

Evidence from the pilot regime (see Issue: Changes not based on evidence for more information) and from overseas jurisdictions has highlighted some areas of the regime where there are potential interpretations of the existing legislation that are inconsistent with those policy decisions. The amendments are primarily aimed at clarifying or tightening up the language around some of the activity or expenditure exclusions to bring them in line with the original policy intent.

We expect that applications should be made in good faith in line with the policy intent of those exclusions. Applicants acting in this way will not be affected by any of the proposed changes.

Recommendation

That the submission be declined.

Issue: Approach is counter to original intent

Submission

(Corporate Taxpayers Group)

The process being adopted in this Bill is counter to the process which was legislated via the Taxation (Research and Development Tax Credits) Act 2019. Section LY 9 of the Income Tax Act 2007 provides for an Order in Council process for making prospective changes to schedules 21 and 21B with effect from the tax year following the tax year in which the amendment is made (with a requirement to convert this to legislation within a period of three years). This approach is fairer than the proposed approach.

Comment

The mechanism provided for in section LY 9 is intended to allow officials to respond quickly to emerging areas of risk that might arise out of changes in the business R&D environment. The tax incentive is intended to be sustainable and provide certainty for businesses. To maintain this intent, the policy intent of the regime is to allow for minor amendments on a regular basis to address emerging areas of risk. This is key to ensuring a sustainable credit regime and avoiding the sudden major changes officials have observed in other jurisdictions. Overall, this provides more certainty for applicants in the long run.

The proposed changes are not responses to newly-identified risks or changes in the business R&D environment and do not represent a new policy decision. Instead, they address areas of the existing legislation where evidence shows there is potential for interpretations that are inconsistent with the original policy intent. Officials do not believe it is appropriate to generalise the intent of section LY 9 to cover all legislative changes to the R&D tax credit regime, regardless of their purpose.

Recommendation

That the submission be declined.

Issue: Retrospective application dates

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

- a) We support the retrospective application dates for the proposed amendments. (*Chartered Accountants Australia and New Zealand*)
- b) The proposed amendments should not take effect retrospectively, unless they are taxpayer-friendly, particularly where exclusions are broadened or definitions changed. Making the amendments fully retrospective increases the compliance burden on taxpayers who will have to reassess based on these changes (which may not be enacted prior to taxpayers needing to lodge R&D tax credit returns). This imposes an unfair burden on taxpayers. A prospective change would be fairer. (*Corporate Taxpayers Group, Deloitte*)

Comment

The fully retrospective application date of (most of) the amendments is intended to address areas where the effect of the legislation does not match the original policy intent of the regime. Officials do not believe the proposals alter the intended effect of the regime, but either close unintended gaps in the legislation or clarify certain aspects of the policy intent for the avoidance of doubt. As such, it is not anticipated that most taxpayers will need to re-evaluate their claims based on these amendments.

However, officials acknowledge that this is likely the last tax bill that will pass before the bulk of year one claims have been filed. Officials therefore concur that, after this Bill, any changes made to the regime ought not to be retrospective to the start of the regime (unless the change is to correct a major gap between the policy intent and the legislation), as this undermines the intent of providing certainty to applicants.

Recommendation

- a) That the submission be noted.
- b) That the submission be declined.

DEFINITION OF ELIGIBLE R&D EXPENDITURE

(Clause 45)

Issue: Support the amendment

Submission

(EY)

We support the intent of this amendment. The regime needs to remain robust. Identifying and addressing risks early will support the longevity of the scheme.

Recommendation

That the submission be noted.

Issue: Amendment may overreach

Submission

(Corporate Taxpayers Group, EY)

The Bill commentary suggests the proposed changes clarify existing requirements. We believe, however, that the changes go further and require a closer nexus between activity and expenditure than was originally intended. As the nexus appears to be tighter, some costs that were previously eligible will fall out of the regime. *(Corporate Taxpayers Group)*

While we acknowledge the Government is merely trying to protect the tax base, we are also concerned that the intended policy could overreach. Without robust guidance as to the intended scope of these words, the tests could be read too narrowly. *(EY)*

Comment

From the inception of the R&D scheme, it has always been a policy principle that in order for the scheme to be sustainable, it had to have strong integrity measures to prevent expenditure on activities unrelated to R&D being claimed. The intent therefore has always been that expenditure must have a close nexus with an R&D activity to be claimable for the incentive. However, the current legislative requirements require only a relatively loose nexus. Expenditure on R&D activities is claimable to the extent that it relates to an R&D activity (whether core or supporting), as long as it is not listed in the schedules of ineligible expenditure.

When the policy was being formulated, it was contemplated that activities that did not relate directly to the core R&D being conducted, such as cleaning, HR or payroll activities, or procurement, would only be eligible if they satisfied the supporting R&D activity test. The test stipulates that an activity be “integral to” or for the “only or main purpose of” supporting a core R&D activity to be eligible as a supporting activity and requires a close connection between a supporting activity and a core activity. As expenditure must be on an approved

activity to be eligible, it was initially envisaged that expenditure on activities not directly related to core R&D would effectively be covered by the supporting activity tests (as the activity itself must first meet the requirements before expenditure on it can be claimed), and therefore no comparable test requiring expenditure to be closely related to core R&D was needed.

However, it has come to officials' attention that the nexus requirement can be circumvented, and the policy intent defeated, by simply characterising indirect activities as "overhead" expenditure on core R&D activities rather than an activity at all. To remove this opportunity for exploitation, the proposed amendment effectively brings the supporting activity requirements into the definition of eligible expenditure. This will ensure that expenditure that is not directly related to R&D will be subject to the supporting activity tests, regardless of whether it is claimed as a supporting activity or as overhead expenditure on a core activity. This confirms the policy intent as these requirements were always intended to apply to this kind of expenditure. It is not proposed that the intended nexus test between activities and expenditure will change.

Officials understand the concern that, although they are intended to confirm the policy intent, the tests may be read more narrowly than intended. Officials agree that clear guidance is necessary to allay these concerns. Following enactment of the Bill, guidance will be provided in a *Tax Information Bulletin*, and Inland Revenue's official guidance material will be updated to clarify the intended meaning of the tests.

Recommendation

That the submission be declined.

Issue: Potential for government interference

Submission

(EY)

The wording creates a risk that the government could narrow what expenditure will be considered eligible. Further consideration is required to ensure the wording does not open up an opportunity for officials to debate or influence how R&D is being conducted within a business. This includes references to expenditure being "required for" and "integral to" the activity. For example, some expenditure may make the R&D more efficient or may be linked to a business strategy, but if it cannot be directly related to the R&D activity and be considered integral and required, then it would not be eligible.

To address this risk, the provisions should make it clear that the taxpayer's assessment of whether the expenditure is required or integral takes primacy. The onus should be on IR to argue the contrary.

Comment

Officials understand the concern, but do not believe the risk of this interference is high. The proposed tests simply reinforce the supporting R&D activity requirements already present in the regime, which do not force businesses to adopt a certain approach to their expenditure

on R&D, but only require that the expenditure has a reasonably close connection with R&D. Guidance material on these existing tests makes it clear that they are not intended to tell businesses how to do their R&D or obligate them to carry out R&D in the simplest or cheapest manner possible; they only require that a supporting R&D activity has a certain degree of closeness to an approved core R&D activity. Officials fully intend this approach to be transferred to the proposed expenditure tests.

In keeping with New Zealand's self-assessment system, the more efficient approach is for taxpayers to keep and provide records detailing the purpose of their expenditure and its connection with their R&D activities, rather than requiring the Commissioner to provide proof for any expenditure she considers not to meet the proposed tests. This is consistent with the design of the regime, which is that the taxpayer should have to keep records that adequately detail the particulars of their claim and demonstrate that it meets legislative requirements. It is also consistent with the general tax provisions in the context of resolving disputes.

Officials instead believe that this issue is best addressed by making the meaning of the proposed tests as clear as possible in supporting material. Following the enactment of the Bill, guidance will be provided in a *Tax Information Bulletin* and Inland Revenue's official guidance material.

Recommendation

That the submission be declined.

MINING DEVELOPMENT ACTIVITY EXCLUSION

(Clause 59)

Issue: Support the amendment

Submission

(Chartered Accountants Australia and New Zealand)

We support the amendment.

Recommendation

That the submission be noted.

Issue: Changes not necessary

Submission

(Deloitte)

We do not consider that a mining development exclusion is necessary. There is no evidence of taxpayers in these industries taking aggressive approaches to making R&D tax credit claims.

Comment

The objective of this exclusion is not to address any perceived exploitative behaviour but to address an inconsistency between the policy intent of the tax credit and the legislative treatment of assets used in the petroleum and mineral mining industries.

The upfront cost of capital assets should, in most cases, be ineligible for the credit. These assets come with high associated costs that threaten the sustainability of the regime, but they also generally have a long lifetime and commercial uses beyond R&D. The objective of the credit is to incentivise R&D expenditure, not to subsidise high-cost capital assets that the claimant can then use in their commercial activities.

Aside from industry-specific activity exclusions in Schedule 21, this is largely addressed by excluding expenditure on most tangible depreciable assets. However, officials do not consider that the present legislation adequately gives effect to this intent when it comes to the petroleum or mineral mining industries. The existing exclusions are tied to depreciable property, but the tax rules affecting the petroleum and mineral mining industries do not use the depreciation rules. Instead, they have separate treatments for their assets in part D of the Income Tax Act, and are thus not technically depreciable.

While an activity exclusion exists for some phases of the mining lifecycle, assets used in the development phase (essentially the production phase of mining) are not caught by the existing exclusions, and the upfront cost of these assets may be claimable for the credit. This

is counter to the policy intent and the intended treatment of the upfront cost of capital assets within the regime. It could lead to unintended and inequitable outcomes between different sectors within the regime and could reduce the sustainability of the regime. Amendments to remove this risk and bring the treatment of mining assets closer to the treatment of other assets are therefore necessary.

Recommendation

That the submission be declined.

Issue: Further clarity needed on amendment's scope

Submission

(Corporate Taxpayers Group, Deloitte)

It needs to be made clear that the exclusion only targets development activity itself, and R&D related to the development activity may still be eligible.

Comment

Officials agree that it is important that taxpayers have clarity around the intended effect of the amendment. Following enactment of the Bill, guidance will be provided in a *Tax Information Bulletin* and Inland Revenue's official guidance material.

Recommendation

That the submission be noted.

Issue: Amendment may impact New Zealand's emissions targets

Submission

(Corporate Taxpayers Group)

The industries affected by this change need R&D investment to help New Zealand move towards its goal of being carbon-neutral by 2050. Making this exclusion casts doubt for the industry as to what support will actually be available to make the transition.

Comment

The intent of the proposed amendment is not to cut out expenditure on R&D to do with mining development, but only expenditure on development activities themselves. If a mining business is performing R&D that will assist its transition to carbon-neutral status, it will still be able to claim a credit for this R&D (provided it meets the legislative criteria).

Recommendation

That the submission be noted.

Issue: Amendment should be aligned with existing tax treatment

Submission

(Matter raised by officials)

- a) The exclusion on petroleum and mining development should be redrafted to exclude development as eligible expenditure rather than as an eligible activity, using language which aligns with the petroleum and mining tax regimes that already exist in the Income Tax Act 2007 (the Act). This should be achieved by refocussing the exclusion to exclude expenditure or loss by a “petroleum miner” or “mineral miner” (as defined in section YA 1 of the Act).
- b) The new exclusion should include exceptions for labour costs that contribute to core R&D and for prototypes (parallel to the treatment of tangible depreciable property).
- c) The new exclusion should also include miners of “minerals” (as defined in section YA 1 of the Act) and geothermal energy.
- d) As its intent will be covered by the new exclusion, clause 5 of schedule 21 parts A and B of the Act (which excludes “prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy”) should be repealed.

Comment

Clause 59 seeks to exclude mining development activities in relation to minerals, petroleum, natural gas, or geothermal energy from the tax credit as activities. This would prevent a taxpayer from seeking approval for such activities, meaning they also cannot claim a credit for any expenditure associated with the activities. The purpose of this exclusion is to ensure that the upfront costs of assets used in the mining industry, which are not covered by the depreciation rules and which are therefore not currently covered by the expenditure exclusions in the R&D tax credit regime, are not inappropriately eligible for the credit.

Assets used in petroleum and mineral mining have their own tax regimes in the Act. These regimes centre on the terms “petroleum miner” and “mineral miner,” as defined in the Act. These terms are linked to a number of expenditure-related defined terms, such as “mining development expenditure” and “petroleum development expenditure,” which provide for the alternative tax treatment of assets created and used by miners when undertaking mining activities. Anchoring the amendment to these pre-existing definitions by refocussing the exclusion on petroleum and mineral miners would provide further certainty for taxpayers around what is covered by this exclusion. As these pre-existing definitions centre on expenditure, it is conceptually simpler to align the proposed exclusion with these definitions by targeting it towards expenditure rather than activities.

Excluding expenditure incurred by a miner is also more targeted than excluding mining development as an activity, as currently proposed in the Bill. Any R&D activities performed by a business involved in mining that meet the other legislative requirements could potentially be claimed for the credit, so long as it is not performed by the business in their

capacity as a miner. This is more in line with the policy intent, which is to exclude the cost of assets used in the mining industries from the tax credit while still allowing a credit for R&D performed in these industries (see Issue: Changes not necessary for rationale).

The clause should be redrafted as an expenditure exclusion rather than an activity exclusion, with wording that incorporates the petroleum miner and mineral miner definitions for consistency within the Act. As its intent and function would be similar to existing exclusions on tangible depreciable property, the new expenditure exclusion should contain similar exceptions for labour costs that contribute to core R&D and for prototypes only used in R&D (see Tangible depreciable property expenditure exclusion, Issue: Scope of amendment should be expanded and Issue: Prototype exemption amendment for more information on these exceptions). This will bring the treatment of expenditure on assets in the affected industries fully into line with the treatment of expenditure on depreciable tangible property in other industries.

However, the term “mineral miner” and the terms associated with it in the Act (for example, “mining prospecting expenditure,” “mining exploration expenditure”) refer only to “listed industrial minerals,” rather than minerals in the broader sense. The definition of “listed industrial minerals” in the Act does not cover some minerals intended to be covered by the exclusion, such as coal. Geothermal energy, which is also covered by the present exclusion, would not be covered. To achieve the policy intent, the new clause should also deem miners of “minerals” (as defined in the Act) and geothermal energy to be “miners”.

The mining regimes in the Act include terminology that covers the intent of clause 5 of schedule 21 parts A and B (which excludes “prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy”). If the amendment proceeds in the form proposed by officials, this clause should be removed.

Recommendation

- a) That the submission be accepted.
- b) That the submission be accepted.
- c) That the submission be accepted.
- d) That the submission be accepted.

TANGIBLE DEPRECIABLE PROPERTY EXPENDITURE EXCLUSION

(Clause 60(2))

Issue: Support the amendment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG)

We support the proposed amendment to include expenditure on employees performing core R&D activity that contributes to the cost of an item of tangible depreciable property as eligible expenditure for the tax credit.

Recommendation

That the submission be noted.

Issue: Scope of amendment should be expanded

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG)

- a) While we support the amendment, we believe its scope needs to be expanded. External labour costs that are capitalised should also be eligible for the regime. R&D work lends itself to having more outsourced labour costs, particularly in asset-heavy industries, and excluding these costs from the regime disadvantages these industries. The proposal as drafted creates a bias against using contractor labour and will lead to arbitrary outcomes. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG)*
- b) Additionally, we do not agree with restricting the amendment to only include capitalised expenditure on core R&D activities. Allowing only capitalised core R&D costs while excluding capitalised supporting R&D costs will create arbitrary outcomes. The amendment should include capitalised labour expenditure on both core and supporting activities. *(EY, KPMG)*
- c) To achieve the above proposals, we suggest the amendment be redrafted as follows: “Expenditure or loss, other than for amounts for employees or services provided by contractors in relation to research and development activities, to the extent to which...” *(KPMG)*

Comment

- a) The amendment as proposed only allows capitalised expenditure on employees performing core R&D activity to be claimed for the credit. Officials acknowledge that excluding contracted labour costs may disadvantage asset-heavy industries. The

original intent behind only allowing employee expenditure was a concern about having less visibility over contracted expenditure, which might allow other costs unrelated to labour included in contractors' invoices to be claimed for the credit. However, officials have talked to industry experts (advisors and businesses) about this issue, and agree that these risks can be addressed through disclosure requirements (for example, claimants requiring that their contractors separate out their labour costs from other costs when submitting invoices in order to provide clear records for their tax incentive claim). Officials therefore accept that contracted labour costs should be included, and will recommend an amendment to the legislation on this basis.

- b) Officials do not accept that labour on supporting R&D activities should also be eligible. Restricting the amendment to labour costs that directly contribute to core R&D activities (that is, activities that resolve scientific or technological uncertainty) allows genuine R&D that contributes to the cost of tangible depreciable property to be recognised by the regime, while minimising fiscal risks associated with the high construction cost of these assets. Allowing all labour on an asset that involves R&D to be claimed brings in a significant amount of these costs and may reduce the integrity of the regime.
- c) Officials believe the proposed wording to incorporate contractor costs ("services provided by contractors") is too broad and may allow costs beyond labour expenditure (such as materials provided by contractors) into the regime, contrary to the policy intent. This is covered in (a) above. Officials will recommend an amendment to the legislation that ensures clarity and maintains the policy intent.

Recommendation

- a) That the submission be accepted.
 - b) That the submission be declined.
 - c) That the submission be declined.
-

Issue: Prototype exemption amendment

Submission

(Corporate Taxpayers Group, KPMG)

- a) We agree with the prototype exemption amendment, as it confirms what was initially intended when the law was enacted. *(KPMG)*
- b) We agree with the intent of the prototype exemption. Expenditure on prototypes should be eligible for the credit. However, one of the proposed requirements for the prototype exemption (that the property never be intended for any purpose other than R&D) seems like a very high test to meet. It is not in line with the policy intent of the R&D tax credit regime to exclude legitimate R&D expenditure based on a (potential) later use of the property when the initial activity qualified. *(Corporate Taxpayers Group)*

Comment

The policy intent of the exclusion on expenditure that contributes to the cost of tangible depreciable property is to keep the cost of large capital assets out of the regime (see Mining

development activity exclusion, Issue: Changes not necessary for rationale). An exemption exists for expenditure that contributes to an asset that is solely used in R&D. The intent of this is to allow the credit for assets solely used for R&D throughout their lifetime (that is, prototypes). As these assets would only be used for R&D and have no subsequent commercial use, the cost of producing them is plainly R&D expenditure and falls within the intent of the credit.

The amendment in the Bill clarifies this intent, as the current wording of the prototype exemption could be read as only requiring that the asset be used solely for R&D during the relevant income year, but not for any subsequent years. As the exemption allows an applicant to claim the incentive on the entire upfront cost of such an asset, officials believe it is appropriate that the threshold for accessing it be correspondingly high.

Recommendation

- a) That the submission be noted.
- b) That the submission be declined.

OTHER EXPENDITURE EXCLUSIONS

(Clause 60)

Issue: Support the amendments

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposed amendments.

Recommendation

That the submission be noted.

Issue: Unclear why amendments are required

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The stated intent of clauses 13B, 20B, and 20C (which exclude expenditure on corporate governance costs, decommissioning, and remediating land) is to clarify areas already excluded under current legislation. If these areas are already excluded, it's unclear why the amendments are needed. *(Corporate Taxpayers Group)*

We do not consider clauses 20B and 20C necessary. *(Deloitte)*

Comment

The purpose of clauses 13B, 20B, and 20C is to clarify that certain types of expenditure are ineligible for the credit for the avoidance of doubt. Officials believe it is arguable that the areas covered by these clauses are already excluded from the credit, as was the original policy intent. However, experience from the pilot suggested that some taxpayers were unsure about whether corporate governance costs were eligible or not, while clauses 20B and 20C are intended as a response to recent overseas experience that suggests legislation similar to our own does not effectively keep out these costs.

As none of these costs are intended to be eligible, the proposals make it clear for the avoidance of doubt that a taxpayer cannot claim them, ensuring the integrity of the regime and improving certainty for applicants.

Recommendation

That the submission be declined.

Issue: Better fit as activity exclusions

Submission

(Corporate Taxpayers Group)

New clauses 13B, 20B, and 20C may fit better as activity exclusions, rather than expenditure exclusions.

Comment

The intention of the proposed clauses is to provide more certainty about areas meant to be ineligible under the existing policy intent. As the pre-existing definitions of remediation and decommissioning in the Income Tax Act 2007 are predicated on expenditure, rather than activity as such, officials consider that aligning the exclusions with these existing definitions by using the expenditure schedule is conceptually simpler and provides more certainty for taxpayers.

While corporate governance could be excluded as an activity rather than as expenditure, officials believe the intent of the exclusion is better served as an expenditure exclusion. Officials do not consider that corporate governance costs should be eligible as they would have been incurred regardless of whether the R&D took place. Excluding these costs as an activity would have left it ambiguous as to whether they could be claimed as overhead expenditure on an eligible activity, contrary to the policy intent.

Recommendation

That the submission be declined.

Issue: Further clarity needed

Submission

(Corporate Taxpayers Group, Deloitte)

The concepts of “decommissioning” and “remediating land” are very broad. Further clarity is required on what this relates to, as some legitimate R&D exists in this space.

If new clauses 20B and 20C proceed, it’s important that the intention stated in the commentary (that R&D on decommissioning and/or remediating land should still be eligible) be reflected in guidance. *(Deloitte)*

Comment

Officials agree with the submitters. More clarity on the intended meaning of the exclusions will be provided in a *Tax Information Bulletin* and Inland Revenue’s official guidance material. The intention that R&D in these areas remain eligible will be preserved.

Recommendation

That the submission be noted.

ADMINISTRATION

(Clauses 76, 79)

Issue: Criteria and methodologies application due date change

Submission

(Corporate Taxpayers Group, EY)

Support the amendment to bring the due date for applying for criteria and methodologies (CAM) approval to six months before the end of the first income year to which the approval relates.

Comment

The proposal amends the due date for applying for CAM approvals to six months before the end of the first income year to which a CAM approval relates (CAM approvals can be obtained for up to three years).

The earlier due date ensures businesses have the correct R&D processes and methodologies in place during the relevant income year and reduces the need to retrospectively amend their processes to ensure their claims are correct. In addition, an earlier due date means businesses have more time to seek general approval should their CAM approval application be declined or only cover part of their R&D.

Recommendation

That the submission be noted.

Issue: Important that responses are timely

Submission

(Corporate Taxpayers Group)

It is important that responses to CAM approval applications are provided in a timely manner. Many of our members will need this to satisfy their auditors on their tax positions.

Comment

Officials agree that it is important that applications be completed in a timely manner. CAM approval applications are likely to take longer than general approval applications, as they involve the taxpayer and the Commissioner agreeing on a bespoke set of criteria and methodologies which the taxpayer will use to determine the eligibility of their R&D activities and expenditure. Requiring the application to be submitted earlier will allow the taxpayer and the Commissioner to agree on these criteria sooner, so that tax positions can be taken in the annual and supplementary returns with much greater confidence. This should also assist in any future audit process.

Recommendation

That the submission be noted.

Issue: Discretion for companies with balance date changes

Submission

(EY)

The amendment should allow for adjusted timeframes for a taxpayer who has a transitional tax year due to a change in their balance date. The Commissioner could be given a discretion to allow a different timeframe for these taxpayers on an application basis.

Comment

The intent of this amendment is defeated if a taxpayer becomes unable to apply for CAM approval in a timely manner due to their balance date being brought forward. In such cases, officials believe it is appropriate that the Commissioner have discretion to allow a different timeframe for the taxpayer to submit their application.

Recommendation

That the submission be accepted.

Issue: Example should be provided in the legislation

Submission

(EY)

It is not clear which income year is being referred to in the CAM due date amendment as currently drafted. An example should be included in the legislation to help clarify this for taxpayers.

Comment

Officials agree that further clarification would be useful for taxpayers. However, the R&D tax credit already has comprehensive guidance material for taxpayers seeking to understand how the regime operates in practice. Officials believe that the appropriate place for an example of how the proposed change will work is in the official guidance material, rather than the legislation.

Recommendation

That the submission be declined.

Issue: Timeframe for completing disputes process**Submission**

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

We support the amendment around the timeframe for completing the disputes process.

Comment

The legislation currently requires a section 113 request to increase an R&D tax credit claim to be initiated and processed within a year of the relevant taxpayer's income tax return due date. This is contrary to the policy intent, which is simply that the person must initiate the disputes process within that timeframe.

The proposed amendment would remove the requirement that the request be fully processed within that timeframe, while still requiring the request to be initiated within a year of the relevant taxpayer's income tax return due date.

Recommendation

That the submission be noted.

OTHER R&D SUBMISSIONS

(Clause 76)

Issue: Drafting corrections

Submission

(EY, matter raised by officials)

- a) There is a drafting error in clause 76 of the Taxation (Annual Rates, Feasibility Expenditure, and Remedial Matters) Bill, which states that section 68CC(3) of the Tax Administration Act 1994 currently reads “*before* the end of the first income year.” However, the legislation actually reads “*after* the end of the first income year.”
- b) There is a drafting error in section 68CC(2)(iv) of the Tax Administration Act 1994. This section is intended to require that a person applying for criteria and methodologies approval must submit an R&D certificate to the Commissioner with their R&D supplementary return. However, the words “the person” are missing from the section, making 68CC(2)(iv) effectively meaningless.

Comment

Officials agree that these should be corrected.

Recommendation

- a) That the submission be accepted.
- b) That the submission be accepted.

Issue: Growth Grant exclusion – association test should be removed

Submission

(Corporate Taxpayers Group, Deloitte)

- a) The association test should be removed from the Callaghan Innovation Growth Grant exclusion rules. We do not support the outcome that shareholders in a Growth Grant recipient or two or more companies who share a common 50% shareholder(s) will be ineligible for the credit. The rule makes it difficult for Growth Grant recipients to obtain capital needed to expand. *(Corporate Taxpayers Group, Deloitte)*
- b) There are already rules in the R&D tax credit regime that prevent a person from “double-dipping” on Government R&D funding. These rules make the association test unnecessary. *(Deloitte)*

Comment

The policy intent is that a person can only claim either the credit or the Growth Grant, because the credit is intended to replace the Growth Grant regime. The association test was

introduced at the Select Committee stage of the Taxation (Research and Development Tax Credits) Act 2019 to prevent Growth Grant recipients from artificially structuring their businesses so that they could claim both the credit and the Growth Grant at the same time.

During the Select Committee phase of the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020, the Corporate Taxpayers Group and Deloitte raised an essentially identical submission to this one. Officials' response at the time was that the association rule is necessary to prevent businesses deliberately structuring themselves so that they can claim both the credit and the Growth Grant. Officials' position on this matter is unchanged. The association rule is still vital for preventing artificial restructuring in order to claim both the credit and the Growth Grant; no other part of the legislation fulfils a similar purpose.

At the time, as the association test was not one of the measures contained in the Taxation (Research and Development Tax Credits) Bill as introduced, officials proposed a grandfathering approach. This would allow claims submitted before the report-back date by the Select Committee to use the rules without the association test, while those submitted after that date would have to use it. This approach, and the taxpayers' suggestion that the test be removed altogether, were both rejected by Select Committee on the grounds that a business can decide to return its Growth Grant, including its subsidiaries' Growth Grants, if it wishes to be eligible for the credit.

The intent is that a business must choose between the Growth Grant and the credit. The provisions in the legislation that prevent taxpayers from claiming multiple forms of government R&D funding for the same expenditure are more limited in scope and would not prevent taxpayers from claiming the credit for some R&D activities and the Growth Grant for others. If the association test were to be removed, nothing would prevent a company from structuring itself to claim both the Growth Grant and the credit at once, contrary to the policy intent.

Recommendation

That the submission be declined.

Issue: Partnerships and receiving the credit

Submission

(KPMG)

We recommend an amendment to ensure the tax credit is received by a limited partnership or general partnership (rather than by the partners). This will ensure the R&D tax credit is available for the partnership to use in its R&D, rather than being diverted to the partners, and will also reduce the risk of abuse, as the credit will be claimed in a single return rather than across multiple partners' returns. Additionally, administering the pass-through of the credit from the partnership to its partners is administratively cumbersome. This is important as limited partnerships are a common vehicle for start-up R&D.

Comment

Currently, while certain entity eligibility requirements can be met collectively by a partnership, most eligibility and filing requirements must be met by the individual members of the partnership. This includes filing applications for pre-approval and submitting returns to claim the credit.

In the cases of partnerships with a high number of members, this may be administratively onerous. However, officials do not consider that this justifies allowing partnerships to claim the credit at the partnership level. Requiring members of a partnership to claim at the individual level is an integrity measure that prevents ineligible entities (such as non-resident partners) or partners who are not eligible for refunds in their own right from claiming refundable credits. Allowing refunds to be claimed at the partnership level would remove this oversight and create an integrity risk.

Officials believe, however, that work could be done to streamline the pre-approval application process for partnerships. Allowing partnerships to submit a joint pre-approval application poses far fewer integrity risks than partnership-level refundability and would significantly reduce the compliance burden on taxpayers conducting R&D through a partnership. Officials will consider this further.

Recommendation

That the submission be declined.

Issue: Meaning of “acquire” in R&D expenditure exclusions

Submission

(Matter raised by officials)

A remedial amendment should be made to clause 2 of schedule 21B part B of the Income Tax Act 2007, clarifying that “acquiring depreciable property,” in relation to clause 2, does not include making depreciable property.

Comment

Schedule 21B part B of the Income Tax Act 2007 lists types of expenditure that are ineligible for the tax credit. Clause 2 renders “expenditure or loss incurred in acquiring depreciable property” ineligible. The intent of clause 2 is to exclude expenditure or loss incurred on obtaining depreciable property through any method other than making the property.

However, “acquire” is defined in subpart YA 1, in the context of depreciable property, to include “make”. Clause 2 thus has a much greater reach than intended, effectively cutting all expenditure on depreciable property out of the regime. This is contrary to the policy intent, which is that some expenditure incurred on making depreciable property should be eligible (provided it is not covered by any other exclusion in schedule 21B part B), and should be corrected.

Recommendation

That the submission be accepted.

Issue: Scope of grant-related expenditure exclusion should be narrowed

Submission

(Matter raised by officials)

A remedial amendment should be made to clause 21 of schedule 21B part B of the Income Tax Act 2007, allowing R&D expenditure not supported through other government funding sources to be claimed for the credit.

Comment

Schedule 21B part B of the Income Tax Act 2007 lists types of expenditure that are ineligible for the tax credit. Clause 21 renders “expenditure or loss that is a precondition to, subject to the terms of, required by, or otherwise related to a grant made by the Crown or a local authority” ineligible, except where the expenditure relates to loans under the R&D loan scheme. The intent of this exclusion is to prevent a person from claiming multiple forms of government R&D funding for the same expenditure.

However, officials have become aware of circumstances where the exclusion means that expenditure can become ineligible where the R&D performer receives some government funding, such as a Callaghan Innovation Project Grant, even if the expenditure in question is not itself supported through that funding. A person claiming a Project Grant provides an estimate of the total project expenditure to Callaghan Innovation, and can receive up to 40% of that estimate as a grant (with the remaining 60% being required co-funding). Should the actual expenditure on the project exceed this estimate, any cost overruns are not eligible for further Grant funding. However, they are also not eligible for support through the tax incentive under the exclusion as currently written; the Grant funding agreement requires the person to complete their project, and as the cost overrun is technically required for the completion of the project, it is covered by the funding agreement (and therefore excluded by clause 21).

This outcome is contrary to the broader policy intent of the tax incentive, which is to incentivise and support businesses to increase their expenditure on R&D. Officials consider that the exclusion should be clarified to allow genuine R&D expenditure that is not being supported through other government funding to be eligible for the credit.

Recommendation

That the submission be accepted.

HYBRID RULES REMEDIALS

A submitter raised a number of issues in relation to the hybrid and branch mismatch rules in the Income Tax Act 2007, which do not relate to any specific amendments currently included in the Bill. These submissions are summarised below, alongside officials' recommendations on them.

Issue: Non-resident group members should be able to group surplus assessable income

Submission

(PwC)

The submitter proposes that the New Zealand residency requirement in section FH 12(10) of the Income Tax Act 2007 should be removed. As a result of this requirement, currently only New Zealand-resident companies are able to group their surplus assessable income (SAI), non-resident companies paying tax in New Zealand are not. As a consequence of this limitation, the SAI of a non-resident company may go unused, while another non-resident in the same group is denied New Zealand deductions (where the non-resident company's SAI could have otherwise been used to offset the denied deductions). This could result in over-taxation of the group as a whole.

Comment

The policy intent of the SAI grouping mechanism in section FH 12(10) of the Income Tax Act 2007 is to ensure that the right economic outcome is reached for the group as a whole (that is, if one group company has more SAI than it can use, it can make its SAI available to another wholly owned group member who has a hybrid or branch mismatch for which a deduction would otherwise be denied). Officials agree that the current limitation, which prevents non-resident companies paying tax in New Zealand (such as a non-resident company with a New Zealand branch) from grouping SAI with other group members, is inconsistent with the policy intent of this section.

Officials recommend that section FH 12(10) be amended to remove the requirement that companies eligible to group SAI must be resident in New Zealand.

The amendment is a taxpayer-friendly measure that ensures the provision does not result in over-taxation for a corporate group. Although officials are not aware of the number of taxpayers affected by the amendment, it is an issue raised by a tax adviser based on a real-life example faced by at least one of their clients. To ensure the provision applies appropriately, the amendment should be retrospective to the application date of the provision. That is, it should apply for income years beginning on or after 1 July 2018. Taxpayers who have taken a tax position under the existing law would, if relevant, be able to request the Commissioner amend the assessment in order to take advantage of the recommended change. The rationale above for retrospective law change is equally applicable to the other recommended changes to the hybrid and branch mismatch rules below.

Recommendation

That the submission be accepted.

Issue: Payments made within a consolidated group should be included in SAI calculation

Submission

(PwC)

The submitter proposes that section FH 12(4)(c) of the Income Tax Act 2007 should be amended so that excluded payments between members of a New Zealand consolidated group that are taxable to a non-resident group parent are included in the calculation of SAI.

Currently, the SAI calculation formula includes an exempt item, which covers exempt dividends between two New Zealand members of a 100% commonly owned group that are taxable to a foreign owner. The inclusion of these dividends in the formula is to reflect that the hybrid nature of an entity may cause a payment to be taxable in another jurisdiction, with no corresponding deduction for the payer in New Zealand.

This same hybridity issue can arise in relation to payments made within a New Zealand consolidated group. Such a payment will be excluded income in New Zealand and no deduction will be permitted for the payer. However, if the payee is fiscally transparent in another country, income may be recognised in that country in relation to the consolidated group transaction. Currently, such a payment would not be captured in the SAI calculation formula, despite the same income potentially being subject to tax in two jurisdictions: first in New Zealand to the consolidated group on recipient of a third-party payment, and second in the parent jurisdiction, as a regarded transaction between New Zealand companies in the same consolidated group.

Comment

Officials recommended that the SAI, calculation formula be amended to include payments made within a New Zealand consolidated group, where certain conditions are satisfied. To be included as SAI officials consider that a payment would need to meet the following conditions:

- is both excluded income and non-deductible in New Zealand, due to being paid between consolidated group members (that would have been assessable income in New Zealand in the absence of consolidation), and
- is taxable and non-deductible in the jurisdiction of a non-resident group parent of the consolidated group.

For the same reasons as those discussed above (in relation to Issue: Non-resident group members should be able to group surplus assessable income), officials recommend the amendment be retrospective to the application date of section FH 12 of the Income Tax Act 2007. That is, it should apply for income years beginning on or after 1 July 2018.

To ensure that this change operates as intended, officials also recommend that amendments be made to address remedial issues in section CX 60 of the Income Tax Act 2007. (Section CX 60(1) currently contains an incorrect cross-reference to section FM 8(3), and it is not necessary to have both section CX 60(1B) and section CX 60(2), as both provisions are expressing the same concept.) Section CX 60 is intended to have the effect of treating payments made between companies in consolidated groups as excluded income, so this section should be referenced as part of the amendment to the SAI calculation formula to achieve the outcome outlined above.

Officials recommend the amendments apply for the 2019–20 and later income years, this being the application date for the previous amendments to section CX 60, which resulted in the current errors. It is not anticipated that many taxpayers will be impacted by this change, nor that it will have a fiscal impact. Taxpayers who have relied on the current law are not expected to be advantaged or disadvantaged as a result of correcting the current legislative errors.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Hybrid financial instrument rule should not apply to income fully taxed in New Zealand

Submission

(PwC)

The submitter considers that the hybrid financial instrument rule (section FH 3 of the Income Tax Act 2007) should be amended, so that it does not apply where any country or territory (including New Zealand) recognises the relevant payment as giving rise to ordinary income (that is, income taxed at the recipient's full applicable tax rate).

As currently drafted, section FH 3 does not apply where a country or territory outside New Zealand recognises the income. However, the section could still apply to deny a deduction where New Zealand taxes a payment received by the payee at the full applicable tax rate.

Comment

As there is no deduction/no-inclusion hybrid mismatch if a payment is taxed as ordinary income of the payee in New Zealand, this is not a situation that should be captured by the hybrid rules. Therefore, officials recommend section FH 3 be amended so that the section does not apply to a payment taxed at a payee's full applicable rate in any country or territory, including New Zealand.

For the same reasons as those discussed above (in relation to Issue: Non-resident group members should be able to group surplus assessable income), officials recommend the amendment be retrospective to the application date of the provision. That is, it should apply for income years beginning on or after 1 July 2018.

Recommendation

That the submission be accepted.

Issue: Transfer pricing deemed arm's length amount – exception should be extended to deductions denied under the hybrid rules

Submission

(PwC)

The submitter proposes that the exception to the deemed arm's length amount rule in section GC 8(2) – which currently applies where an amount would be deductible but for the application of the thin capitalisation rules – should be extended to cover deductions denied under the hybrid rules.

The submitter notes that, as section GC 8(2) currently does not take into account the hybrid rules, section GC 8 would deem a non-resident payee to have transfer pricing taxable income in New Zealand in relation to an interest free loan where the payer would be denied a deduction for any interest that was paid under the hybrid rules.

Comment

Where inadequate consideration is received under a transfer pricing arrangement, section GC 8(1) deems an arm's length amount to have been received by the payee for income and withholding tax purposes. Section GC 8(2) contains an exception to this rule, where the general rule in section GC 8(1) will not apply and the below arm's length consideration will stand (non-resident's exemption: deduction to the payer).

Section GC 8(2)(b) currently does not account for the hybrid rules, meaning section GC 8(1) could deem a taxpayer to have income taxable in New Zealand under the transfer pricing rules, in circumstances where the hybrid rules could then deny or limit deductions for expenses arising in relation to that income. This is an issue for interest-free loans, where if a deemed arm's length amount of interest were to be substituted under section GC 8(1), then the hybrid rules could apply to deny a deduction for the deemed amount (that is, non-resident withholding tax would be payable on a deemed interest payment, with the payment not being deductible to the payer). This is an unintended outcome.

In relation to interest-bearing loans, section GC 8(2) also currently does not take into account disallowances under the hybrid rules where, from a policy perspective, the focus of the rule is on deferring – not permanently denying – a deduction, as is the case under sections FH 5, FH 8 and FH 9 (in these cases, the interest may still be deductible in future if there is sufficient “surplus assessable income”). As a deduction may become available for the interest payment in these instances, the original policy rationale for section GC 8(2) outlined above would apply and section GC 8(1) should not apply.

For the same reasons as those discussed above (in relation to Issue: Non-resident group members should be able to group surplus assessable income), officials recommend the amendments be retrospective to the general application date for the hybrid rules. That is, they should apply for income years beginning on or after 1 July 2018.

Officials recommend the above amendments.

Officials have also identified an error in section GC 8(2)(b) in the reference to deductions being denied under “subpart FE (Interest apportionment on thin capitalisation)”. The thin capitalisation rules do not deny deductions but rather deem additional income. It is likely that this reference was missed when the thin capitalisation regime moved from a deduction denial mechanism to the current income deeming method. Officials recommend this omission be corrected.

Recommendation

That the submission be accepted.

Issue: Reverse hybrid rule should be clarified in how it applies to hybrid entities and branches

Submission

(PwC)

The submitter considers that, under section FH 7, deductions may be denied to hybrid entities in circumstances where the relevant income is received, but is not taxable due to the application of exemptions (and not the non-recognition of income) in the recipient jurisdiction.

The intended scope of this provision in *Inland Revenue’s Special Report (page 41)* on the hybrid and branch mismatch rules provides that the appropriate application of the rules depends on whether a branch or hybrid entity is involved in the transaction.

Comment

Section FH 7 is intended to deny a deduction for a payment in two separate situations:

- where the payment is not taxable because of a branch mismatch
- where the payment is not taxable because it is made to a reverse hybrid.

A payment will be non-taxable because of a branch mismatch if paragraphs (a), (b)(i), (c), (d) and (e)(i) are met. A payment will be non-taxable because it is made to a reverse hybrid if paragraphs (a), (b)(ii), (c), (d) and (e)(ii) are met.

There are three issues with the section.

- As drafted, the section can apply if paragraphs (a), (b)(i), (c), (d) and (e)(ii) are met, or if paragraphs (a), (b)(ii), (c), (d) and (e)(i) are met. This was not intended.
- With respect to (b)(ii), it should only apply if the amount is treated under the law of the payee country as being income of a person who is in the same control group as the payer and is not the payee. If the income is income of the payee, the payment will not be to a reverse hybrid. However, the subparagraph currently could apply if the income is income of the payee.

- Also with respect to paragraph (b)(ii), it should be met if: (a), the person treated as deriving the income under the law of the payee country is a person in the payer’s control group who is not the payee; or (b), the arrangement is a structured arrangement (regardless of whether or not that last mentioned person is in the same control group as the payer).

For the same reasons as those discussed above (in relation to Issue: Non-resident group members should be able to group surplus assessable income), officials recommend the amendments be retrospective to the application date of the provision. That is, they should apply for income years beginning on or after 1 July 2018.

Officials recommend the above amendments.

Recommendation

That the submission be accepted.

Issue: The disregarded payments rule should not apply where the end investor is exempt from tax

Submission

(PwC)

The submission proposes that there is a risk that section FH 5 could deny deductions where the income would not be subject to tax in the hands of the recipient due to jurisdiction-specific tax exemptions (for example, due to the source of income or an exemption for pension funds).

The hybrid rules should only operate to deny deductions for payments that are not subject to tax as a result of a hybrid mismatch. The rules should not deny deductions where the hybridity of an entity has no overall impact on the tax outcome of the payment (that is, where the income is not taxable due to specific legislation in the recipient jurisdiction).

Comment

Officials understand that the issue raised by the submitters relates to a specific structure that involves an intermediary foreign entity between the ultimate investor and the New Zealand payer. In this scenario, the investor elects to treat the intermediary entity as “disregarded” for tax purposes in the payee jurisdiction, meaning that, for tax purposes, the intermediary is not treated as a separate person from the investor.

Officials understand the technical issue raised, but consider that the issue could be resolved by removing the intermediary entity from the particular structure, or inserting an entity that New Zealand would not see as fiscally transparent for tax purposes.

Recommendation

That the submission be declined.

Issue: Definition of “hybrid mismatch” should clarify the payee

Submission

(PwC)

The definition of hybrid mismatch in section FH 15(a)(ii) should be amended to clarify that the relevant amount need only be recognised by a person or entity as ordinary income (and not a person or entity “in the payee jurisdiction”).

Comment

As the provision is currently drafted, a payment will fall outside the definition of hybrid mismatch if the relevant amount is recognised as ordinary income of a person or other entity in the payee jurisdiction. It is possible that this definition could cause a hybrid mismatch to arise for payments that are recognised as ordinary income, but are attributable to branches. Therefore, the definition of hybrid mismatch may be met even if the payment is subject to tax as ordinary income in the branch jurisdiction, because it will not be subject to tax in the payee jurisdiction. However, further work on this matter requires prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be noted, subject to officials’ comments.

Issue: Reverse hybrid rule should only apply where a mismatch in tax outcome arises due to differences in tax treatment of relevant entities

Submission

(PwC)

The submission suggests that section FH 7 should be amended so that it only captures branch mismatches (where relevant), and not mismatches that happen to involve a branch.

The risk identified is that the provision might apply to deny deductions in relation to structures that involve a branch and produce mismatched tax outcomes, despite those outcomes not arising from a branch mismatch. For example, the provision may apply due to the tax regime of the branch jurisdiction (in which case there should be no hybrid mismatch), or due to the payer being disregarded in the branch jurisdiction (in which case section FH 5 should apply). From a policy perspective, it is suggested that section FH 7 should be limited to situations where the mismatch arises due to differences in: (a) the characterisation of the branch (disregarded branch structure), or (b) the attribution of profits to the branch (diverted branch payments), and not merely because a structure includes a branch.

Further work on this matter requires prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be noted, subject to officials’ comments.

Issue: Domestic transactions should not be denied by the imported hybrid mismatch rule

Submission

(PwC)

The submitter has raised an issue that may arise where both a New Zealand resident company and a non-resident company (through a New Zealand deducting branch) claim New Zealand deductions in relation to a payment that funds a mismatch higher in the global chain. In this situation, it is considered that section FH 11 could apply to deny the New Zealand deductions from both the New Zealand resident company and the New Zealand-deducting branch of the non-resident company. Only one of these deductions should be denied.

It would be preferable to have legislative certainty that only one deduction will be disallowed. It is suggested that the deduction denial in this scenario should be for the deduction claimed by the non-resident company with the New Zealand-deducting branch. Officials expect that at an operational level, only one deduction would be allowed.

Further work on this matter requires prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be noted, subject to officials' comments.

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

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

Issue: General support for reform

Submission

(Chartered Accountants Australia and New Zealand)

We support the reform. The amendment would bring voluntary employer contributions within the same penalty and debt collections rules as compulsory contributions. This is appropriate.

Comment

Clause 67 in the Bill is intended to ensure that compulsory and voluntary employer KiwiSaver contributions are treated consistently under the penalties, recoveries and Use-of-Money-Interest (UOMI) regimes.

In March 2019, Cabinet agreed that Inland Revenue would pay an amount of employer contribution to a KiwiSaver scheme in advance of the contribution being received by Inland Revenue. This payment would be based on the employer information filed with Inland Revenue which stated that an employer contribution had been made. This meant that the Crown would provide a limited guarantee to recipients of compulsory and voluntary KiwiSaver employer contributions.

However, the Crown's provision of a limited guarantee exposes it to fiscal risk. While, in the case of compulsory employer KiwiSaver contributions, this risk is mitigated by the application of the penalties and recoveries regimes, these regimes do not currently apply to voluntary employer contributions. Additionally, the UOMI regime currently does not apply to either category of employer contribution (that is, compulsory or voluntary).

It is not intended that the KiwiSaver funds which are received by an employee's scheme provider be used to satisfy a tax obligation owed by the employee to the Commissioner. The intention of the amendments is to allow the Commissioner to ensure that employers meet their obligations to pay contributions which the Crown has guaranteed.

Additionally, under section 73 of the KiwiSaver Act 2006, once the Commissioner has received employment income information relating to an employee or employer KiwiSaver contribution, they must enter this amount into the Inland Revenue KiwiSaver Holding Account. This amount must then be transferred to the KiwiSaver member's scheme provider. This means the Commissioner does not have the ability to apply KiwiSaver contributions to another purpose (for example, an individual taxpayer's tax liability). It was not considered necessary to consult the Ministry of Justice on this item as it is remedial in nature.

Recommendation

That the submission be noted.

CONFIRMING HOUSING NEW ZEALAND BUILD LIMITED SUBJECT TO INCOME TAX

(Clause 63)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand)

That the remedial proposal to confirm that Housing New Zealand Build Limited is subject to income tax is supported.

Recommendation

That the submission be noted.

CHANGING THE DUE DATE FOR LOCKED-IN PORTFOLIO INVESTMENT ENTITIES

(Clauses 70, 71, 72 and 75)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposals to bring forward the date of reporting to the Commissioner by a portfolio investment entity (PIE) that is a superannuation fund or retirement saving scheme, which will align reporting by locked-in and non locked-in funds.

Recommendation

That the submission be noted.

(Clauses 70, 71, 72 and 75)

Issue: Discretion when applying late filing penalties on income information filed by locked-in portfolio investment entities

Submission

(Deloitte)

The legislation proposes bringing forward the filing date by which multi-rate PIEs with locked-in funds are required to file detailed income information for their investors to 15 May. This relates to multi-rate PIEs that are a superannuation fund or retirement saving scheme. Some PIEs may not be able to meet the proposed amended date, and in these situations a longer time period may be needed. Appropriate discretion must be applied to late filing penalties in these situations.

Comment

The filing date was brought forward from 30 June to 15 May for locked-in PIE funds to align information reporting on investors with non-locked-in PIE funds. This is to allow Inland Revenue to undertake the PIE end-of-year square-up process as part of the auto- calculation process for individual income tax assessments. In further correspondence, the submitter noted that there are alternatives available, such as allocating PIE income and deductions. Officials note that late filing penalties may be waived if there is reasonable cause to do so.

Recommendation

That the submission be declined.

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

(Clause 12)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand)

We support the amendment.

Comment

Section CW 55BB provides school children with an income tax exemption on up to \$2,340 of income. This is a compliance cost measure preventing them from having to file a return. The exemption is not intended to apply where there is someone in a position to pay tax on behalf of the child – for example, it does not apply where tax has been withheld at source such as on investment income or salary and wages.

Beneficiary income up to \$1,000 paid to a minor is taxed at the beneficiary's tax rate. Under current law, this \$1,000 distribution would be eligible to be exempt under CW 55BB. This is contrary to the policy intent as the trustee is in a position to pay tax on behalf of the beneficiary.

The proposed amendment therefore provides that income derived by a minor beneficiary does not qualify for the income tax exemption in section CW 55BB, and is taxed at the beneficiary's marginal rate.

This amendment is retrospective to 29 May 2012 (the date the minors' income tax exemption was introduced), with a savings provision for people who took a tax position relying on the current law in a return filed before the Bill was introduced into Parliament. The savings provision allows taxpayers who filed a return before the Bill was introduced into Parliament to rely on the current law. It is limited to the date the Bill was introduced because from that point taxpayers will be aware of an impending amendment. The provision only applies to those who have already filed a return, in order to prevent taxpayers from amending a previous return and getting a windfall gain.

The amendment will prevent minors from reopening returns and claiming an exemption on the up to \$1,000 of beneficiary income already allocated, as well as preventing them from claiming the \$1,000 exemption going forward. This is expected to affect approximately 9,000 minor beneficiaries – 2,675 beneficiaries who paid tax and would be prevented from reopening a return, and 6,258 who previously did not pay tax on distributions received but who would be required to do so going forward.

Recommendation

That the submission be noted.

NOMINEE TREATMENT FOR TRUSTEE OF EXEMPT EMPLOYEE SHARE SCHEME (ESS)

(Clauses 2(1) and 10)

Issue: Support for amendment

Submission

(Chartered Accountants Australia and New Zealand)

We support the clarification that a trustee of an exempt employee share scheme can be treated as a nominee of a company providing the scheme. We also support the amendment applying from the date of enactment.

Recommendation

That the submission be noted.

Issue: Transitional effects of section CE 6 (trusts are nominees)

Submission

(Russell McVeagh)

The consequences of the existing section CE 6 are uncertain in various respects, and may result in unexpected tax liabilities.

- a) There is a question as to whether section CE 6 is intended to apply to a trustee of a taxable ESS that is grandparented under section CZ 1. The application of section CE 6 to a taxable ESS – including a grandparented ESS – and an exempt ESS should be optional, as taxpayers may have taken, or wish to take, different approaches.
- b) There is a question as to the transitional consequences for the trustee of becoming a nominee. For example, it is unclear whether the trustee is treated as disposing of any unallocated shares to the company. It is also unclear whether the trustee is treated as being relieved of any financial arrangements liabilities it owes, such that debt remission income arises. A taxpayer should be entitled to elect to treat assets or liabilities as transferred at cost, or otherwise on a basis that does not give rise to an income tax liability for the trust purely by virtue of the application of section CE 6. This could be similar to the approach adopted for a solvent company under a resident's restricted amalgamation, for example.
- c) Where section CE 6 applies, unallocated shares held by the trust are treated as treasury stock of the company. If shares remain unallocated after one year, the company has a reduction in available subscribed capital (ASC), under section CD 25(4). It should be clarified that if the trust subsequently allocates or disposes of the shares, an amount the trust receives is included in "subscriptions" (in section CD 43), increasing the company's ASC. Otherwise the reduction in ASC under section CD 25(4) would be permanent.

Comment

- a) Section CE 6 applies to a person who is a trustee of an employee share scheme. An employee share scheme is defined in section CE 7. This definition includes a scheme that provides benefits which are, by virtue of section CZ 1(2), subject to section CE 2 before its amendment in 2018. In officials' view, it is employee share scheme benefits that are grandparented, not particular schemes. Therefore, section CE 6 applies to a trustee of an employee share scheme that provides benefits; some or all of which are grandparented by section CZ 1. Officials consider it is simpler for nominee treatment to apply to all ESS/exempt ESS trustees, rather than for trustees to have to determine their own status.
- b) Officials have discussed with the submitter and others the effect of deeming trustees to be nominees to the extent provided for by section CE 6. The purpose of this deeming provision was to simplify compliance for employee share schemes. Officials appreciate that, in the absence of detailed provisions, such as those that apply to amalgamations in subpart FO of the Act, there may be a slightly untidy transition for trustees of some schemes. However, given that the issue is very technical and is not a recurring one, officials at this stage do not believe that it is a good use of resources to give detailed consideration to the development of a suite of rules for this purpose. As a general proposition, and in the absence of any firm evidence to the contrary, we believe that any difficult issues should be resolvable on an administrative basis.
- c) An issue of treasury stock by a company is included in available subscribed capital simply because it is an amount received by a company from the issue of shares (section CD 43(2)(b)). However, officials recommend amending the definition of "subscriptions" to clarify that consideration received by the company for the issue of shares as a result of the application of section CE 6 is included.

Recommendation

- a) That the submission be declined.
- b) That the submission be declined.
- c) That the submission be accepted.

Issue: Typo in section CW 26C(7)(a)(ii) should be corrected

Submission

(Matter raised by officials)

There is a typographical error in section CW 26C(7)(a)(ii), which deals with the period of restriction for the exempt ESS rules. The word "employer" (the eighth word of the subsection) should be "employee", as it is the date of the employee's acquisition of the shares that is relevant to the period of restriction.

Comment

Officials recommend this error be corrected.

Recommendation

That the submission be accepted.

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

(Clauses 2(1) and 13)

Issue: Support for amendment

Submission

(Chartered Accountants Australia and New Zealand)

We support the clarification that income derived by a trustee of an ESS from disposing of the company's own shares (treasury stock), while acting in its capacity as nominee of the company, is exempt. We also support the amendment applying from the date of enactment.

Recommendation

That the submission be noted.

GST COMPULSORY ZERO RATING OF COMMERCIAL LAND LEASES

(Clause 88)

Issue: Supports proposal

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

Support the changes as they ensure that the compulsory zero rating rules achieve the intended policy outcome in relation to land leases, and validates how these rules have been applied by many (if not most) taxpayers and practitioners. *(KPMG)*

Recommendation

That the submission be noted.

Issue: One of the proposed amendments is unnecessary

Submission

(Chartered Accountants Australia and New Zealand)

One of the proposed amendments, which would zero-rate business assets where a business sale that includes a zero-rated supply of a land lease is unnecessary as the legislation already provides this outcome.

Comment

Officials consider that the proposed amendment is a useful clarification that the relevant supply will still be zero-rated if it includes a lease assignment or surrender and other business assets.

Recommendation

That the submission be declined.

WHEN INCOME IS DERIVED FROM A CASH DIVIDEND

(Clause 9)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

The submitters support the proposed change.

Recommendation

That the submission be noted.

Issue: Replace “received” with “paid”

Submission

(Chartered Accountants Australia and New Zealand)

The use of the term “received” does not align with concepts in the Inland Revenue Acts.

The concept of “pay” or “paid” is the correct approach and should be adopted in the amendment. The term “pay” is defined in section YA 1 of the Income Tax Act 2007. The salient part of the definition relevant for the purposes of the proposed amendment is, broadly, an amount that is distributed, credited, or dealt with on a person’s behalf. It is generally well understood by practitioners and taxpayers.

The objective that the amendment is seeking to achieve is to change the timing of when a cash dividend will be assessable, effectively overriding accrual treatment. This can be done under current concepts by a “pay” or “paid” approach.

Comment

Officials note that the term “received” is not a defined term in the Income Tax Act 2007. However, it is a well-understood term and is defined in case law. “Received” is the standard term used in the timing rules where income is to be returned on a cash basis, which is the policy intent of this clause. The term “received” is used multiple times throughout the Income Tax Act 2007, for example in sections CC 2, CG 5, CG 5B, and CG 6 when describing the timing of income from superannuation schemes and insurance.

The policy intent is to simplify the process for accrual-based taxpayers to be able to account for cash dividends on a cash basis. The issue identified was that taxpayers who accounted for their business income on an accrual basis would also have to accrue any business-related dividends, which officials understand is contrary to existing practice. The simpler approach is for taxpayers to allocate the income when they receive the dividend, rather than having to determine when the dividend has been accrued.

Officials consider the use of that the term “paid” could also create further confusion, as the person receiving the dividend may not know the date the dividend was paid by the payer if they have yet to receive the amount. Officials therefore prefer the use of “received”.

Recommendation

That the submission be declined.

Issue: Clarify application to company paying dividend by resolution

Submission

(Chartered Accountants Australia and New Zealand)

The proposed amendment should clarify how the rule would apply to small-to-medium sized companies that resolve to pay a dividend before year-end, where the amount of the dividend is quantified after year-end.

Comment

The proposal in the Bill clarifies that a person who receives a dividend is treated as deriving it on a cash basis. This means that a dividend cannot be treated as derived if a company resolves to pay a dividend but does not pay it – if it is not paid, it cannot be received. Officials therefore consider it unnecessary for amendments that address the circumstances where a company makes a resolution to pay a dividend, but that dividend is not paid until a later time. In that situation, the dividend cannot be treated as “received” by the recipient.

Officials acknowledge the matter raised in this submission, but note that further clarification would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be noted, subject to officials’ comments.

Issue: Clarify interaction with investment income reporting rules

Submission

(Chartered Accountants Australia and New Zealand)

The legislation should clarify how the investment income reporting rules apply to a payment of a dividend that is deemed to be paid in an earlier income year.

It is timely to clarify in the Income Tax Act 2007 how the investment income rules apply to a dividend paid by resolution before the end of an income year but quantified after that date.

Comment

Officials acknowledge the matter raised in this submission, but note that it would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Availability of tax credits should be confirmed

Submission

(Chartered Accountants Australia and New Zealand)

The legislation should confirm that the associated imputation credits and resident withholding tax credits will be available to the shareholder in the income year that the dividend is assessable.

The availability of imputation credits and resident withholding tax credits on dividends that are paid with retrospective effect can be uncertain.

Comment

Officials consider that the law is clear regarding this practice and therefore does not need further clarification. However, officials will look to provide some confirmation of the position in a future *Tax Information Bulletin* following the enactment of this Bill.

Recommendation

That the submission be noted.

Issue: Amendment more appropriate in Part E of the Income Tax Act 2007

Submission

(Chartered Accountants Australia and New Zealand)

The amendment may be more appropriate in Part E of the Income Tax Act 2007. The intention of the amendment is to change the timing of the assessment of a cash dividend. Therefore, the amendment may be more appropriately placed in Part E of the Income Tax Act 2007 (timing and quantifying rules).

Comment

Officials note that the Income Tax Act 2007 contemplates the fact that the provisions dealing with the timing of income are included in Parts C and E to I. This is reflected in section BD 3(2), which deals with the allocation of income to particular years, and states: "An

amount of income is allocated to the income year in which the amount is derived, unless a provision in any of Parts C or E to I provides for allocation on another basis”. On this basis, it would not be unprecedented for a provision in Part C to contain a timing rule, such as the case proposed in the Bill and the amendments proposed to section CD 1.

Recommendation

That the submission be declined.

Issue: Assurance that the Commissioner will not seek to review prior tax positions taken on basis of previous law

Submission

(Chartered Accountants Australia and New Zealand)

The Commissioner should assure taxpayers that resources will not be employed to review the tax treatment of dividends derived before the 2020–21 income year. Although we broadly support the policy intent of the amendment, it would be helpful if the Commissioner assured taxpayers that resources will not be employed to review the past tax treatment of dividends derived before the 2020–21 income year.

Comment

Inland Revenue will consider this operational matter.

Recommendation

That the submission be noted.

NRFAI DEFERRAL CALCULATION FORMULA – HYBRID DEDUCTION ITEM

Issue: Amendment may result in formula producing an undefined outcome

Submission

(PwC)

The submitter proposes that the amendment could result in the non-resident financial arrangement income (NRFAI) formula producing an undefined answer where the accumulated accruals figure is reduced to zero for a reason other than by operation of the hybrid rules (such as transfer pricing). The submitter recommends that the proposed amendment to section RF 2C(6)(a) of the Income Tax Act 2007 (which would specify if “the item accumulated accruals is equal to the item hybrid deductions” then NRFAI would not arise) should be changed to read: “the item accumulated accruals is equal to the item hybrid deductions, or zero”.

Comment

In the situation the submitter is referring to, where the hybrid deduction item is not the cause of the accumulated accruals item being reduced to zero, the hybrid deduction item must itself be zero. This would mean that the accumulated accruals item would be equal to the hybrid deduction item (that is, they would both be zero). Therefore, officials are of the view that the proposed amendment would not produce an undefined answer in situations where the accumulated accruals figure was reduced to zero for reasons outside of the hybrid rules.

Recommendation

That the submission be declined.

THIN CAPITALISATION REMEDIALS

(Clauses 34 and 35)

Issue: Support for carve out

Submission

(Chapman Tripp, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)

Submitters supported the insertion of proposed section FE 2(4B).

Recommendation

That the submission be noted.

Issue: Scope of carve out should be extended

Submission

(Chapman Tripp)

Sections FE 6 and FE 7 of the Income Tax Act contain interest apportionment rules. Section FE 2(1)(d)(i) states that these may apply to a trust settled by a non-resident or an associated person of a non-resident. Proposed section FE 2(4B) should be amended so that it carves out from the meaning of “associated person” for the purpose of section FE 2(1)(d)(i) all associations between a New Zealand-resident settlor of a trust and a non-resident that has not made a settlement on the trust.

Due to the breadth of the association rules in subpart YB, there are many other scenarios in which a resident settlor of a trust would be associated with a non-resident but it is not intended that the trust be brought within the ambit of the thin capitalisation rules solely by reason of that association because the non-resident is not itself a settlor of the trust.

Examples of trusts that would not be saved from inadvertent/unintended application of section FE 2(1)(d)(i) by the current drafting of proposed section FE 2(4B) include:

- where a New Zealand-resident company settlor of a trust has a non-resident sister company that it is associated with under section YB 2 but the sister company does not make a settlement on the trust; and
- where a beneficiary of a trust, who is associated with the New Zealand-resident settlor under section YB 9, moves overseas and becomes a non-resident but the beneficiary does not make a settlement on the trust.

Comment

Officials agree that the proposed carve outs do not cover all possible scenarios where certain trusts with a New Zealand resident settlor should not be subject to thin capitalisation.

Section FE 2(1)(d)(i) was intended to cover settlements by a non-resident as well as any New Zealand resident associates of that non-resident. However, the current provision is much wider than this. It includes a trust settled by any New Zealand resident who is associated with a non-resident, unless that associate is specifically carved out.

Points of difference

Officials agree with the submitter's proposal with the following adjustment.

Rather than further extending the scope of the carve outs, officials recommend section FE 2(1)(d)(i) is narrowed so that it only covers settlements by a non-resident, or an associate of that non-resident and that proposed section FE 2(4B) be removed.

It would also remove the need for existing section FE 2(4)(b), as a non-resident relative would only be covered by the revised section FE 2(1)(d)(i) if they had also made a settlement on the trust, in which case section FE 2(4)(b) would already not apply to them.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Resident and non-resident trusts

Submission

(Chapman Tripp, Russell McVeagh)

References to resident/non-resident trusts in proposed section FE 2(4B) should be consistent with existing terminology in the Income Tax Act for trusts and trustees.

Comment

Officials agree that the terms used in this provision should be consistent with the existing terminology and concepts used in the trust rules that describe the relationship of trusts, trustees, and settlors with tax residence.

However, the recommendation above to remove proposed section FE 2(4B) deletes the issue.

Recommendation

That the submission be noted.

Issue: Application date of section FE 2(4B)

Submission

(Chapman Tripp, Chartered Accountants Australia and New Zealand)

- a) Proposed section FE 2(4B) should have retrospective effect from the 2015–16 income year. This is because it is a remedial amendment to correct a mistake in the current drafting of section FE 2(1)(d)(i), which arose when the section was amended in 2014 by the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014 with effect from the 2015–16 income year. If desired, a savings provision could be added to preserve tax positions taken under the existing provision. (*Chapman Tripp*)
- b) It is appropriate that section FE 2(4B) should apply to income years beginning on or after the date of enactment. (*Chartered Accountants Australia and New Zealand*)

Comment

A prospective application date was considered appropriate, as proposed section FE 2(4B) would extend the scope of carve outs from section FE 2(1)(d)(i) in a way that had not previously been contemplated, rather than correcting a previous error.

However, officials' recommendation above, to narrow the scope of section FE 2(1)(d)(i) rather than proceed with proposed section FE 2(4B), reflects that the original scope of section FE 2(1)(d)(i) brought trusts with a New Zealand settlor within the thin capitalisation rules in a way that was not intended.

Officials do not support a savings provision, as this would provide a benefit to trusts that had not complied with the current rules over trusts that had applied thin capitalisation consistent with the current rules. Instead, officials recommend that the revised position is applied effective from 1 April 2015 to align with the original amendments.

Recommendation

- a) That the submission be accepted.
- b) That the submission be noted.

Issue: Support for new apportionment formula

Submission

(*Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Powerco*)

Submitters supported the introduction of a new formula for calculating apportionment of interest by an excess debt entity that is controlled by a non-resident owning body or trustee.

Recommendation

That the submission be noted.

Issue: “Group world debt percentages” higher than 60%

Submission

(Corporate Taxpayers Group, Deloitte, EY, Powerco, PwC)

The proposed formula should be amended to work in situations where the “group world debt percentage” is higher than the 60% threshold, as the deemed income is overstated under the proposed formula.

Comment

The formula proposed in the Bill includes:

$$\frac{(\text{group NZ debt percentage} - 60\%)}{(\text{group NZ debt percentage} - \text{group world debt percentage})}$$

Provided that the group world debt percentage is below 60%, this will result in a fraction between zero and one, so the taxpayer derives an amount of income that is a fraction of their total interest expenditure that would be excluded from their worldwide group (essentially related party interest). However, when the group world debt percentage is greater than 60% the fraction will be greater than one meaning the taxpayer could derive an amount of income greater than their total interest expenditure that would be excluded from their worldwide group. Officials recommend that this should be corrected.

Recommendation

That the submission be accepted.

Issue: Negative total assets

Submission

(KPMG)

The introduction of the non-debt liabilities adjustment for income years commencing on or after 1 July 2018 can, in rare cases, result in the denominator of the thin capitalisation safe harbour calculation being negative (for example, a company has non-debt liabilities exceeding its total assets).

It is unclear what a negative debt percentage means for interest limitation under the thin capitalisation rules. When the non-debt liabilities adjustment to total assets results in a negative debt percentage, for thin capitalisation purposes, the interest limitation should be the total interest expense for the year.

Comment

Under the current law, when there is a negative debt percentage, two possible interpretations are that interest-income arising due to breaching the thin capitalisation safe harbour could be either zero or larger than total interest expense. Neither of these outcomes are appropriate.

The submitter is correct that when the debt percentage is negative, the amount of income derived by the taxpayer should be equal to their total interest expense for the year.

Officials recommend amendments to clarify this situation.

Officials note that this outcome should also apply to the restricted transfer pricing rules, so that a taxpayer with a negative debt percentage should be treated as having a debt percentage of greater than 40% for the purpose of applying the group credit rating and restricted credit rating.

Officials also recommend similar amendments be made to apply to the restricted transfer pricing rules.

Recommendation

That the submission be accepted.

TAX RULES RELATING TO CUSTODIAL INSTITUTIONS

(Clauses 56 and 73)

Issue: Extending the definition of custodial institutions

Submissions

(Chartered Accountants Australia and New Zealand, Deloitte, HSBC, KPMG)

The submitters support the proposals that the definition of a “custodial institution” be extended to include a New Zealand operation that is a fixed establishment of a non-resident entity. The amendment would apply from 1 April 2020. This aligns the date of the amendment with the commencement date of the investment income reporting rules, in particular the rules for custodial institutions. The amendment is taxpayer friendly.

Recommendation

That the submission be noted.

Issue: Clarifying the withholding obligations of custodial institutions

Submissions

(Chartered Accountants Australia and New Zealand, Deloitte)

The submitters support the proposals that the requirement for custodial institutions to withhold RWT be extended to include NRWT as applicable.

Recommendation

That the submission be noted.

Issue: Foreign currency and resident withholding tax

Submissions

(Deloitte)

The submitter suggests that there should be further alignments of the options for converting foreign currency for investment income payers and investors, which refers to subsections RE 4(5), (6) and (7) of the Income Tax Act 2007. This submission was made in relation to custodial institutions but relates to all investment income payers.

The option for investment income payers to use the foreign exchange conversion rate on the date the payment of income is received is not matched with the conversion rate with the options for RWT credits.

Investment income payers may not be able to use the exchange rate for the day the income is received, as their systems process conversions on a different date.

Comment

Officials acknowledge the matter raised in this submission; however, further work requires prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be noted.

Issue: Amending the definition of “end investor”

Submission

(KPMG, HSBC NZ)

The exclusion of a non-resident custodial institution which carries on business in New Zealand through a fixed establishment in New Zealand should be removed from the definition of an “end investor”. The requirement prevents custodians caught by the exclusion from being able to withhold and report investment income on an aggregated basis. This is contrary to the policy intention.

The fixed establishment requirement should be modified to permit foreign custodians to be treated as end investors, to the extent that the underlying clients of the custodian are not clients of the foreign custodian's New Zealand fixed establishment. This should apply retrospectively from 1 April 2020. *(HSBC NZ)*

Comment

Officials agree that the policy intention was to allow reporting and withholding on an aggregated basis where a payment of investment income passes to a non-resident custodian. It was not intended that a non-resident custodian's New Zealand business model should affect reporting and withholding requirements.

The normal reporting rules require detailed information which is used to pre-populate New Zealand investors' myIR account. Aggregation is intended to relax the normal rules where a New Zealand custodial institution passes a payment of investment income to a non-resident custodial institution. This means that information in respect of non-New Zealand resident individual investors (who may be many steps further along an investment chain) is not required by Inland Revenue.

Officials note the difficulties that have arisen with definitions involving non-resident custodial institutions, and ensuring that obligations are clear and unambiguous. In consequence, officials' view is that the proposed amendment would benefit from further work.

Recommendation

That the submission be noted.

BENEFICIARIES AS SETTLORS

(Clause 43)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand)

We support the amendment.

Recommendation

That the submission be noted.

Issue: Beneficiaries owed money by a trust should not be deemed settlors where they have no knowledge of the debt

Submission

(PwC)

A beneficiary owed more than \$25,000 by a trust should not be deemed a settlor where they have no knowledge of the debt. This could have significant tax consequences – for example, if the beneficiary acquires land during a period in which the trust is in the business of developing land, that land may be subject to tax if sold within 10 years.

Comment

Section HC 27(2) provides that a person who transfers value to a trust is a settlor. A beneficiary can become a settlor when money is paid out to them but is retained in their current account with the trust. This is because they “transfer value” to the trust by leaving money in the trust interest-free.

A recent legislative amendment to section HC 27(6) aimed to ensure that beneficiaries with current account balances below \$25,000, or on which the prescribed or market rate of interest has been paid, do not become settlors. This was a taxpayer-friendly amendment, ensuring that beneficiaries with modest current account balances do not become settlors. Being a settlor has implications in numerous areas, such as social assistance and student loan repayment obligations.

It has become apparent that this amendment may be ineffective because, from a legal point of view, a beneficiary’s knowledge as to the way the trustee is using the money is required for a transfer of value to occur. Therefore, a beneficiary could be owed any amount by the trust but not be a settlor if the beneficiary had no knowledge of the debt. The amendments in the Bill ensure the original policy intent is achieved by providing that a beneficiary of a trust who is owed money by the trustee and does not meet the requirements of subsection (6) is a settlor, regardless of knowledge.

Officials disagree with the submitter that a beneficiary should only be treated as a settlor where they have knowledge of the debt. It would be difficult for the Commissioner to ascertain the beneficiary's level of knowledge. To introduce such a requirement would also be inconsistent with other aspects of the tax system, such as the bright-line test for residential property, which replaced a test that was based on the taxpayer's purpose or intent.

As the trustee deciding on the use of a trust's funds is often a family member, it is expected that the trustee would inform the beneficiary of the debt. The additional disclosure requirements to beneficiaries in the Trust Act 2019 may assist in keeping beneficiaries more informed. Alternatively, the beneficiary being deemed a settlor can be prevented by the trustee paying market interest or ensuring the amount owed to the beneficiary is not more than \$25,000.

It was always intended that beneficiaries who owed more than \$25,000 on which interest has not been paid would become settlors of the trust, regardless of knowledge. The Bill as currently drafted is consistent with this intent.

Recommendation

That the submission be declined.

MIGRATING SETTLOR OF A TRUST

(Clauses 41, 42, and 44)

Issue: Electing to pay New Zealand tax on world-wide trustee income

Submission

(Chartered Accountants Australia and New Zealand)

The proposed amendments to allow a distribution of tax-paid income to be exempt to the beneficiary, following a voluntary disclosure or an election to pay tax on world-wide trustee income, are supported.

Recommendation

That the submission be noted.

Issue: Distributions from trusts – terminology used inconsistent with policy purpose

Submission

(Wallis Tax Advisory Ltd)

That the reference to “a distribution from income” in clause 44 should refer to the term “a distribution of an amount”, to ensure that a distribution of a capital gain from a trust can be treated as being made from a complying trust.

Comment

A complying trust is a trust for which the trustee has paid tax on world-wide trustee income. However, such a trust may make a capital gain, which is not taxable under the Income Tax Act 2007, and the non-taxation of such a gain is not intended to affect the complying trust status. A distribution of a capital gain from such a trust is also intended to be exempt to the beneficiary. Officials recommend the submission be accepted.

Recommendation

That the submission be accepted.

Issue: Taxation of trusts and interaction with Double Taxation Agreements

Submission

(Wallis Tax Advisory Ltd)

That the provision allowing an election to pay tax on world-wide trustee income explicitly provide an override of the allocation of taxing rights under a double taxation agreement (DTA).

Comment

When a person makes an election for a trust to pay tax under section HC 33, the trustee is, by choice, agreeing to pay New Zealand tax at the trustee rate on their world-wide trustee income, without reference to any DTA. The purpose of this election is to permit the trust to be treated as a complying trust for distributions from the trust fund of amounts derived after the effective date of the election. These distributions are tax-exempt to the beneficiary.

Officials consider that this policy, and the associated legislative outcome, is supported by the general principle of the OECD commentary on tax treaties which states that countries are free to tax their own residents as they choose. Article 11 of the multilateral convention to implement tax treaty-related measures that address base erosion and profit shifting clarifies that a DTA generally does not restrict a country's ability to tax its own residents, except in certain listed circumstances. Taxing a trust based on an election to pay tax on world-wide trustee income is not one of those listed circumstances.

Therefore, officials consider that the suggested change is unnecessary, as officials are concerned that a specific override in the election rules for tax treaties may create an adverse inference for other trust provisions that are intended to override tax treaties.

Recommendation

That the submission be declined.

RESTRICTED TRANSFER PRICING

(Clause 39)

Issue: Support for proposal

Submission

(Chartered Accountants Australia and New Zealand, EY, PwC)

Submitters supported replacing references to “associated persons” so that cross-border related borrowing is treated consistently with loans from an associated person.

Recommendation

That the submission be noted.

Issue: Cross-border related borrowing with terms greater than five years

Submission

(PwC)

The calculation to allow for exotic features seen in third-party debt to be “regarded” under the restricted transfer pricing rule should be simplified.

Where taxpayers have significant third-party funding arrangements with terms longer than five years, there is limited practical ability for such features to be regarded under the restricted transfer pricing rule. This is on the basis that, in order for this feature to apply, the rules effectively require related-party debt to be executed in tranches with differing loan terms. Specifically, the requirement to calculate and adjust for the threshold fraction prohibits the ability to recognise third-party debt with a threshold term longer than five years where a taxpayer only has one tranche of related party debt (which is common in order to manage compliance obligation). Effectively, where there is only one tranche of related-party debt, the taxpayer will never be able to apply the threshold term.

Comment

Section GC 18 removes terms of greater than five years from being included in pricing cross-border related borrowing unless the New Zealand group or the worldwide group has significant third-party debt with a term that is equal or greater than five years. These rules were explained on page 24 of the *BEPS interest limitation special report* and page 113 of *Tax Information Bulletin Volume 31, No 3, April 2019*.

The threshold fraction calculates third-party debt with a term over five years as a proportion of total third-party debt. This was intended to require a group to have terms for cross-border related borrowing that resembled their third-party funding. For example, if a group had 50% of its funding with a term of two years and 50% of its funding with a term of 10 years, it could also have 50% of its cross-border related borrowing with a term of 10 years. Although

the rules operate correctly when a group structures itself in this way, as noted by the submitter, groups may prefer to have a single cross-border related borrowing rather than splitting it into below-five-year and above-five-year components. For example, instead of the two loans above, they could have a single loan with a term of six years for the same average maturity. When a group has a single cross-border related borrowing with a term of greater than five years, they will only satisfy the threshold term if they have no third-party debt with a term of less than five years.

Officials recommend that an alternative approach should be added to the restricted transfer pricing rules, so that cross-border related borrowing can have a term of greater than five years without having to satisfy the threshold term if:

- the term is less than the weighted average of all third-party debt, and
- total cross-border related borrowing is less than four times the third-party debt.

Recommendation

That the submission be accepted.

Issue: Notching for group credit rating

Submission

(EY)

We understand that section GC 16(10) was intended to provide for downward notching adjustments under both paragraphs (a) and (ab), rather than only under paragraph (a) as the section currently stands. This inconsistency should be addressed.

Comment

Section GC 16(10)(ab) was introduced by the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 to cover situations where the group credit rating could not be applied as the group had no external debt. As the submitter notes, it was not intended that a taxpayer relying on this provision would not be able to apply the same one- or two-notch adjustment that is already available for a taxpayer relying on section GC 16(10)(a).

Officials recommend correcting this error and the amendment should apply from 1 July 2018 to align with the start of the Restricted Transfer Pricing rules and the previous amendment.

Recommendation

That the submission be accepted.

NZ SUPERANNUITANTS AND THE END-OF-YEAR AUTO-CALCULATION PROCESS

(Clause 84)

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed change to clarify that recipients of New Zealand Superannuation and Veteran's Pension are limited to a \$50 write-off if they have used a tailored tax code.

Recommendation

That the submission be noted.

(Clause 84)

Issue: Clarification that clause 1(b) of Part B of schedule 8 is subject to the same limitation

Submission

(Matter raised by officials)

An amendment should be made to clause 84 to include clause (1)(b) of Part B of Schedule 8 of the Income Tax Act 2007 in order to effectively limit the proposed write off to New Zealand superannuation and veterans pension precipitants who use a tailored tax code.

Comments

Part B of Schedule 8 to the Income Tax Act 2007 outlines when the Commissioner must write off certain amounts of tax. The write off is available under both clauses 1(a) and 1(b) of Part B. The current proposal in clause 84 of this Bill aims to limit the write off available to taxpayers that use a tailored tax code and receive New Zealand superannuation or veteran's pension through an amendment to clause 1(a). However, a write off is also available under clause 1(b). Accordingly, an amendment should also be made to clause 1(b) in order to also limit the write-off amount under that clause.

Recommendation

That the submission be accepted.

THE COMMITTEE'S ASSURANCE PROCESSES

Issue: The Committee's assurance processes

Submission

(KPMG)

The submitter raised an issue in relation to withholding tax rules for custodians and a square-up mechanism for PIE tax contained in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill. The submitter expressed the view that a change to the proposals had not been fully considered by the Select Committee. The Committee should consider whether and when further assurance is required for changes to a tax bill before it is reported back.

Comment

Officials acknowledge the matters raised in this submission, being the development of:

- amendments to the withholding and reporting rules for custodial institutions (“custodians’ rules”); and
- refundability of overpaid portfolio investment entity (PIE) tax.

As the submitter notes, the development of the custodians’ rules was subject to external consultation. This consisted of an initial survey of issues facing custodians, targeted consultation to develop the solution and early-stage consultation on the draft provision. This was intended to provide an opportunity for subject matter experts to comment on the wording of the draft provisions. Officials acknowledge that the timeframe was short and that additional time for consideration may have enabled earlier identification and addressing of potential issues.

Officials have reviewed the process and confirm the change was made in response to feedback received from external stakeholders. When the errors were identified, administrative flexibility was used to enable those custodians who were inadvertently excluded from the rules to access them. This enabled the correction of the provision to be further consulted on as part of the current Bill.

The policy to allow for the refundability of overpaid tax on PIE income was developed quickly in response to data showing that a large number of individuals (approximately 950,000) overpay tax. The legislation did not allow for a refund of any overpayment. The policy development involved targeted consultation and the proposal was discussed with the Committee’s specialist advisor.

Implementation of the PIE tax square-up required embedding of the square-up calculation and refund process into existing income tax year-end processes provisions throughout the tax Acts. Due to the way the square-up calculation and definitions were drafted in the new legislation, a supplementary order paper at the Committee of the Whole House stage of the Taxation (KiwiSaver, Student Loan and Remedial Matters) Bill clarified that the calculation allowed a credit for PIE tax paid, which had been a part of the square-up policy from the start.

Recommendation

That the submission be noted.

General support for proposed amendments

(Clause 61)

Issue: PIE investor interest exemption for lines trusts

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposed amendment.

Recommendation

That the submission be noted.

(Clauses 48, 49, 50, and 51)

Issue: Pre-consolidation imputation credits – Clarifying the imputation rules for the use of pre-consolidation imputation credits by corporate groups

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, KPMG)

The proposed changes to clarify the use of pre-consolidation imputation credits are welcomed and supported.

Recommendation

That the submissions be noted.

(Clause 67(2))

Issue: Amend the definition of deferrable tax

Submission

(Chartered Accountants Australia and New Zealand)

Support for the reform.

Recommendation

That the submission be noted.

(Clauses 77 and 78)

Issue: Restricting the ability to challenge a tax position

Submission

(Chartered Accountants Australia and New Zealand)

Support for the reform.

Recommendation

That the submission be noted.

(Clause 21)

Issue: Spreading forward of fertiliser expenditure

Submission

(Chartered Accountants Australia and New Zealand)

Support for the reform.

Recommendation

That the submission be noted.

(Clause 54)

Issue: Non-resident contractors' tax

Submission

(Chartered Accountants Australia and New Zealand)

The amendment, which requires a non-resident contractor seeking an exemption from income tax for a payment to show that the amount derived from that payment is not "assessable income", and the application date of the amendment, is supported.

Recommendation

That the submission be noted.

(Clauses 46 and 47)

Issue: Removal of the three-yearly parental tax credit review

Submission

(Chartered Accountants Australia and New Zealand)

Comment

The submitter supports the proposed amendment to remove the requirement to review the parental tax credit every three years.

Recommendation

That the submission be noted.

(Clauses 58(13), 64 and 65)

Issue: Aligning the definition of benefit

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendments to align the definition of a main benefit in the Acts administered by Inland Revenue with that used in the Social Security Act 2018.

Recommendation

That the submission be noted.

(Clause 69)

Issue: Clarifying the Commissioner's powers to take copies of documents

Submission

(Chartered Accountants Australia and New Zealand)

We support the reform. The amendment will extend the Commissioner's powers under section 17C of the Tax Administration Act 1994 (TAA) to take copies and the like in relation to documents provided under other sections of the TAA, to documents that are produced in the course of the Commissioner's inquiries under section 17I.

Recommendation

That the submission be noted.

Items raised by officials

DEPRECIATION ON NON-RESIDENTIAL BUILDINGS

Issue: Restrictions on depreciation rates for depreciable property transferred to an associate

Submission

(Matter raised by officials)

Section EE 40 should be amended to allow a new owner of an asset to change depreciation rates where the depreciation rate has changed in legislation.

Comment

Non-residential buildings are depreciable at a rate of 1.5% or 2% from the 2020–21 income year, as opposed to the 0% that applied from the 2011–12 income year.

The depreciation rate that can apply where a person has acquired depreciable property from an associate is restricted by section EE 40 to the rate used by the associate. As a result, a purchaser who acquired a non-residential building from an associate could be restricted to a 0% depreciation rate, rather than the allowable rate of 1.5% or 2%.

Section EE 40 is intended to ensure that the purchaser is unable to claim more depreciation for the item than the associated person would have been able to claim had they retained the item. However, it was not intended to limit a purchaser's use of a depreciation rate where the rate has been changed by legislation as this is a change clearly intended by Parliament.

Recommendation

That the submission be accepted.

Issue: Application date of repeal for building fit-out transitional rule

Submission

(Matter raised by officials)

Section DB 65, which provided a transitional rule for fit-out depreciated as part of a building, should be repealed with effect from the 2020–21 and later income years.

Comment

Section DB 65 was repealed with effect from 1 April 2020 by the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020, as a result of depreciation for non-residential buildings being reinstated.

The section should have been repealed with effect from the 2020–21 and later income years, to match the reinstatement of depreciation on non-residential buildings.

Recommendation

That the submission be accepted.

PORTFOLIO INVESTMENT ENTITY SCHEDULAR INCOME

Changes to the portfolio investment entity (PIE) rules made in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 introduced a year-end adjustment process to allow for refundability of overpaid tax on multi-rate PIE income of individuals from the 2020–21 tax year. These changes require some remedial amendments and clarifications to ensure that the PIE year-end process works with the existing provisions in the Income Tax Act 2007 and the year-end income tax processes for individuals.

The changes should apply retrospectively to the 2020–21 tax year, the first year of the PIE year-end adjustments. Auto-calculated year-end processes for individuals for the 2020–21 tax year are planned to commence from late May 2021.

Issue: Simplifying the PIE schedular income year-end adjustment calculation

Submission

(Matter raised by officials)

The prescriptive calculation in subsections HM 36B(2) and (3) of the Income Tax Act 2007 should be changed to an outline of the items that should be taken into account when calculating PIE schedular income.

Comment

The current prescriptive calculation in subsections HM 36B(2) and (3) of the Income Tax Act 2007 can result in situations where the calculation may not include some attributed tax credits for the future benefit of the investor. Moving from a prescriptive formula to an outline of what the Commissioner needs to take into account when calculating PIE schedular income adjustments simplifies the subsections. It also future-proofs the calculation, enabling the Commissioner to incorporate any improved data reporting on credits.

Recommendation

That the submission be accepted.

Issue: Clarifying that PIE losses and loss tax credits are incorporated when calculating a person's income tax adjustment

Submission

(Matter raised by officials)

PIE schedular income adjustments calculated under section HM 36B only refer to attributed PIE income. The provision should be clarified to specifically include attributed losses and resulting tax credits when calculating the PIE schedular income tax adjustment.

Comment

Including attributed losses and resulting tax credits in the calculation of PIE schedular income would clarify that a natural person investor who is attributed a loss, and who has or is entitled to have a tax credit calculated on the loss using their prescribed investor rate, can also receive an adjustment where the rate used during the tax year was incorrect.

Recommendation

That the submission be accepted.

Issue: Clarifying that a natural person investor is a New Zealand resident

Submission

(Matter raised by officials)

It should be clarified that the PIE schedular income tax adjustment only applies to natural person New Zealand residents.

Comment

Specific rules apply to non-resident investors in a multi-rate PIE. Section HM 36B of the Income Tax Act 2007 introduced a process to calculate PIE schedular income tax adjustments for a natural person investor. However, the process was not intended to make any changes to these rules. It should be clarified that the new adjustment only applies to a natural person investor who is resident in New Zealand.

Recommendation

That the submission be accepted.

Issue: Clarifying that the adjustment does not apply to a trustee of a trust

Submission

(Matter raised by officials)

It should be clarified that the PIE schedular income tax adjustment does not apply to a trustee of a trust.

Comment

Specific legislative rules apply in relation to a trustee of a trust investing in a multi-rate PIE. The new year-end PIE schedular tax adjustment was not intended to make any changes to these rules.

Section HM 36B of the income Tax Act 2007 should be clarified to ensure that the new year-end adjustment does not apply to a person who is an investor in a multi-rate PIE and derives income as a trustee of a trust.

Recommendation

That the submission be accepted.

Issue: Limiting the removal of excluded income status for multi-rate PIE income

Submission

(Matter raised by officials)

The removal of the excluded income status for natural person multi-rate PIE income should be limited to the calculation of the PIE schedular tax adjustment.

Comment

Before the introduction of the new year-end adjustment rules income from multi-rate PIEs was largely considered to be the excluded income of a natural person. This meant that it did not flow through to the person's income tax return and assessment. To better incorporate the new year-end adjustment process into existing year-end income tax processes, this excluded income status was removed entirely.

However, this may have unintended flow-on consequences for loss offsets, and added complications for Working for Families tax credit, student loans and child support. To avoid this, the removal of the excluded income status for natural person multi-rate PIE income should be limited to the calculation of the PIE schedular tax adjustment.

Recommendation

That the submission be accepted.

Issue: Tax adjustments for under- and over-payments of tax on PIE income are included when calculating residual income tax

Submission

(Matter raised by officials)

To simplify the PIE adjustment process, the year-end adjustment rules should be changed so that any PIE adjustment (debit or credit) is included in the person's final income tax calculation and therefore residual income tax.

Comment

As currently drafted, any PIE tax payable or refundable as a result of the year-end adjustment is initially included in the calculation of the person's tax due, then backed-out for the calculation of their residual income tax. This adjustment, or PIE square-up, will happen alongside the year-end process for income tax. This creates two different end-of-year amounts that need to be used for establishing due dates for any late payment or use-of-money interest for the current year's income tax, and as the basis for next year's provisional tax. This different treatment increases complexity for taxpayers and Inland Revenue's systems.

To simplify the adjustment process, the year-end adjustment rules should be changed so that any PIE adjustment (debit or credit) is included in the person's final income tax calculation and therefore residual income tax. This would result in one tax liability figure for the year-end tax payment, which would also be the basis for provisional tax for the following year.

Recommendation

That the submission be accepted.

SMALL BUSINESS CASHFLOW (LOAN) SCHEME

Issue: Ability to transfer tax refunds to an amount borrowed under the Small Business Cashflow (Loan) Scheme

Submission

(Matter raised by officials)

The definition of “tax” for the purpose of Part 10B in the Tax Administration Act 1994 should be widened to include a loan advanced to a taxpayer under the Small Business Cashflow (Loan) Scheme (SBCS), to enable tax refunds owed to that taxpayer to be transferred to their loan balance.

Comment

Currently, if a borrower is owed a tax refund, they are unable to request that Inland Revenue transfer this amount toward paying down their SBCS balance. This is because a loan under the SBCS is not included in the definition of “tax” for the purpose of Part 10B of the Tax Administration Act 1994, where transfers of excess tax can be made to another tax type or to another amount due.

At the moment, any tax refund must be made to the borrower’s bank account, so the borrower then has to make a manual repayment to repay their loan under the SBCS. The widened definition would simplify this transaction by allowing Inland Revenue to apply a taxpayer’s tax refund to their loan balance if requested to do so.

Recommendation

That the submission be accepted.

OTHER MATTERS

Issue: Initial provisional tax liability definition

Submission

(Matter raised by officials)

The provisional tax threshold increased from \$2,500 to \$5,000 following amendments contained in the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020. To do this, all references to the old threshold of \$2,500 were changed to \$5,000.

In doing this, a change was made to the definition of “initial provisional tax liability” in section YA 1 of the Income Tax Act 2007, which could adversely affect some taxpayers. To correct this, officials recommend adding a transitional provision to the definition of “initial provisional tax liability”, so that taxpayers who were over the old threshold but were not over the new threshold do not become initial provisional taxpayers again.

Comment

An initial provisional taxpayer is a taxpayer who has not been required to pay provisional tax in the previous four years because their residual income tax is beneath the threshold for paying provisional tax.

It was not intended for a person to become a person with an “initial provisional tax liability” under the old threshold and the new threshold. Without an amending transitional provision, a person who has previously had residual income tax of more than \$2,500 but not more than \$5,000 could meet the definition again. This could give them an adverse outcome compared to someone who does not have an initial provisional tax liability.

The transitional provision would provide that a person who, in the previous four years, had residual income tax of more than \$2,500 but not more than \$5,000 does not have an initial provisional tax liability.

Recommendation

That the submission be accepted.

Issue: Foreign trust registration and annual return fees

Submission

(Matter raised by officials)

The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 brought in new disclosure rules for foreign trusts. Those rules included fees for registering a foreign trust (section 59B of the Tax Administration Act 1994) and for filing its annual return (section 59D).

Technically, these fees are a “tax” under section 3(1) of the Tax Administration Act 1994, as they are payable to the Commissioner under a tax law and are not explicitly excluded from being a “tax”. This has unintended consequences, such as late payment penalties and use-of-money interest applying when the fees are not paid.

It was never intended that these fees be “taxes”. Officials therefore recommend carving the fees out of the definition of “tax”, retrospectively to 21 February 2017, when the disclosure rules came into force.

Recommendation

That the submission be accepted.

Issue: Using passport numbers in the student loan customs information match

Submission

(Matter raised by officials)

A student loan borrower who is New Zealand-based is entitled to an interest-free student loan and loan repayments are based on their income. Interest is payable on student loans for borrowers who are based overseas.

Currently, Inland Revenue undertakes an information match with the New Zealand Customs Service (Customs) for the purpose of verifying whether a borrower is in New Zealand or overseas. This information allows Inland Revenue to ensure that borrowers are correctly treated as New Zealand or overseas-based, and to identify borrowers in serious default when they leave or enter New Zealand.

The legislation governing this match currently allows Inland Revenue to share the borrower’s name, date of birth and IRD number with Customs. Inland Revenue would like to improve the accuracy of this match by adding the borrower’s passport number to this information. Officials propose an application date of 1 October 2021 to align with planned system changes as part of Inland Revenue’s business transformation programme.

Comment

Adding the passport number to the match will improve the accuracy of the match because passport numbers are a unique identifier used by Customs. This in turn improves the integrity of the student loans system by reducing the possibility that borrowers could be overseas without Inland Revenue being aware of this.

Recommendation

That the submission be accepted.

Issue: Tax treatment of distributions on wind-up of an approved unit trust

Submission

(Matter raised by officials)

All distributions by an approved unit trust should be treated as trustee income.

Comment

An approved unit trust is a special type of unit trust that is declared not to be a unit trust for tax purposes under the Income Tax Act (Exempt Unit Trusts) Order 1990. An approved unit trust is instead treated as a trust for tax purposes. Trustee income of an approved unit trust is taxed at a rate of 28%. Bonus Bonds is the only approved unit trust. It pays prizes out of prior year after-tax earnings, as tax-free distributions to beneficiaries.

On 26 August 2020, it was announced that Bonus Bonds would stop accepting new investments, with the intention of being wound up. In the year Bonus Bonds winds up, it will have to distribute income derived to beneficiaries. Under current law, income derived in an income year is beneficiary income to the extent to which it vests in a beneficiary in the income year, or is paid to a beneficiary in the income year or within a certain period after the end of the income year, and as such will be taxed at beneficiaries' marginal tax rates.

The recommended change will ensure that all income of an approved unit trust that would have been beneficiary income, including income derived in the year Bonus Bonds is wound up, will be taxed consistently with other income derived over the life of the trust: as trustee income. This is in line with the policy intent and will deliver compliance cost savings for bondholders, Bonus Bonds and Inland Revenue.

Recommendation

That the submission be accepted.

Issue: Direct crediting of Problem Gambling Levy

Submission

(Matter raised by officials)

Officials recommend including the Problem Gambling Levy within the meaning of tax for the purpose of section 184A(5) of the Tax Administration Act 1994, to allow Inland Revenue to make refunds by direct credit.

Comment

As part of Inland Revenue's business transformation, the administration of the Problem Gambling Levy will transition to Inland Revenue's new technology platform in March 2021. The Problem Gambling Levy is not considered to be a tax for the purpose of section 184A(5) of the Tax Administration Act 1994. The Gambling Act 2003 makes clear that the levy is neither a tax nor a duty under the Act except for the purposes of "collection, recovery and enforcement" – there is no mention of refunding.

Section 184A of the Tax Administration Act (which only applies to the refunding of tax) cannot apply to the Problem Gambling Levy if this amendment is not made. Therefore, section 184A(5) of the Tax Administration Act needs an amendment to include the levy within the meaning of tax. This will allow direct crediting of overpaid levy by gaming machine and casino operators into a bank account.

The recommended amendment will apply from the date of assent.

Recommendation

That the submission be accepted.

Issue: Temporary loss carry-back remedial to enable loss grouping for groups that are not wholly owned

Submission

(Matter raised by officials)

Officials recommend amending section IZ 8 of the Income Tax Act 2007, so that a company that is 66% or more commonly owned with another company is able to carry losses back to offset against the income of the other company if it meets certain criteria. The amendment would be backdated so that it applies for the duration of the temporary loss carry-back.

Comment

Section IZ 8 of the Income Tax Act 2007 contains the temporary loss carry-back rules. The rules allow a company with net losses in the 2019–20 or 2020–21 income years to carry losses back to offset taxable income in the immediately preceding income year. Special rules apply for companies that are part of wholly owned corporate groups.

To be eligible for the loss carry-back, a company that is not in a wholly owned corporate group must have net loss in the 2019–20 or 2020–21 income years (the “loss year”) and must also have taxable income in the income year immediately preceding the loss year (the “profit year”).

This rule applies as intended to companies using the loss carry-back individually but is problematic for some companies that are in non-wholly owned corporate groups (companies with at least 66%, but less than 100%, common ownership). Under current rules, a company that is in losses in both the loss and profit years cannot use the carry-back to offset its losses against the taxable income of a (non-wholly owned) group member in the profit year. This is contrary to the policy intent expressed in the COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Bill Commentary, which is for a company that has 66% or more common ownership with another company to be able to carry back and offset its losses against the other company’s taxable income in the profit year.

Officials recommend the legislation be amended so that it satisfies the policy intent.

Example

Mippy Co and Speckles Co are 80% commonly owned. In 2018–19, Mippy Co has net income of \$100k and Speckles Co has \$50k of losses. Speckles Co decides to offset its \$50k of losses against Mippy Co’s income that year, so Mippy Co has taxable income of \$50k.

In 2019–20, Mippy Co has net income of \$50k and Speckles Co has net losses of \$75k. After offsetting Speckles Co’s losses against Mippy Co’s net income,* Speckles Co still has \$25k of losses remaining. It decides to use the temporary loss carry-back so that it can offset its remaining \$25k of losses against Mippy Co’s 2018–19 taxable income.

Speckles Co carries its remaining \$25k of losses back to 2018–19, and offsets the losses against Mippy Co’s 2018–19 taxable income of \$50k. Mippy Co receives a tax refund of \$7,000 (\$25k x 28%, which is the corporate tax rate). After using the loss carry-back, Mippy Co still has \$25k of taxable income remaining in 2018–19. Speckles has \$0 losses remaining in 2019–20 after using the loss carry-back.

2018–19 income year	Mippy Co	Speckles Co
Net income/(loss) (before offsets and loss carry-back)	\$100k	(\$50k)
Taxable income/(loss) (after offsets but before loss carry-back)	\$50k	\$0
2019–20 income year		
Net income/loss (before offsets and loss carry-back)	\$50k	(\$75k)
Taxable income/loss (after offsets but before loss carry-back)	\$0	(\$25k)
Temporary loss carry-back		
2018–19 taxable income/(loss) (after loss carry-back)	\$25k	\$0
2019–20 taxable income/(loss) (after loss carry-back)	\$0	\$0
Amount refunded under loss carry-back	\$7k	\$0

**In this example the two companies have chosen to offset losses within the group in the loss year before using the loss carry-back. This is not a requirement for groups that are not wholly owned.*

The remedial amendment would apply for the duration of the temporary scheme, so would apply to two pairs of income years: the 2018–19/2019–20 and 2019–20/2020–21 profit/loss years.

Recommendation

That the submission be accepted.

Maintenance items

MAINTENANCE ITEMS

(Clauses 18, 19, 24, 25, 26, 28–32, 37, 38, 42, 43, 52, 53, 55, 58(2), 58(4), 58(5), 58(6), 58(7), 58(8), 67(2), 67(4)(b), 81, 82, 83, 92, 93(3), and 94)

Submission

(Chartered Accountants Australia and New Zealand)

The maintenance items in all clauses except for clause 83 are supported.

That clause 83 contains a drafting error that requires correction.

Comment

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

The submitter comments that clause 83 proposes to insert a new paragraph (j) in section 157(10) after paragraph (i). As section 157(10)(j) already exists, we agree with the submission that the insertion should be renumbered appropriately.

Recommendation

That the first submission be noted.

That the submission on clause 83 be accepted.

Summary of recommendations

SUMMARY OF RECOMMENDATIONS

Feasibility Expenditure

Rec #	Recommendation description	Submitter	Page #
1.	Provide guidance on deductibility of pre-commencement feasibility expenditure	4 submitters	28
2.	Provide guidance on indirect expenditure	3 submitters	31
3.	Enlarge the scope of the clawback provision	Officials	33
4.	Provide guidance on the clawback of deductions	5 submitters	33
5.	Impose a seven-year time limit on the clawback provision	6 submitters	36
6.	Improve the interaction between clawback and deductibility proposals	Officials	36
7.	Provide guidance on feasibility expenditure	2 submitters	41
8.	Clarify example 3 in the commentary	Corporate Taxpayers Group	41
9.	Resolve the de minimis drafting issue	Corporate Taxpayers Group	42
10.	List expenditure that would not be deductible	Officials	43

Land

Rec #	Recommendation description	Submitter	Page #
11.	Amend the definition of a “group of persons”	Officials	53
12.	Provide guidance on the proposed amendments through a Tax Information Bulletin	2 submitters	54
13.	Allow direct information sharing between LINZ and Stats NZ	Officials	56
14.	Amend the definition of “dwelling” and related terms	Officials	58

Purchase Price Allocation

Rec #	Recommendation description	Submitter	Page #
15.	Educate taxpayers about new PPA rules	3 submitters	73

Rec #	Recommendation description	Submitter	Page #
16.	Inform and educate relevant organisations on the amendments	nSaTax Limited	74
17.	Clarify the required level of allocation	3 submitters	75
18.	Pro rate tax book value where total purchase price is less than total tax book value	4 submitters	81
19.	Remove the rule for allocation to amortisable improvements	3 submitters	83
20.	Extend the timeframe for vendor allocation to three months post-settlement	3 submitters	84
21.	Clarify the timeframe for purchaser allocation	2 submitters	85
22.	Clarify the provisions only delay purchaser deductions	6 submitters	88
23.	Reframe the provisions only delay purchaser deductions to ensure the result will be symmetrical	nSaTax Limited	89
24.	Clarify the timing of deductions for purchasers making late allocations	2 submitters	90
25.	Amend the wording related to discounted asset values	Corporate Taxpayers Group	91
26.	Clarify the interaction of proposed rules with existing market value provisions	NZ Law Society	93
27.	Address the drafting error relating to the consistency of de minimis	3 submitters	96
28.	Correct the low-value depreciable property threshold	Officials	97
29.	The safe harbour for low-value depreciable property should apply to both vendor and purchaser	2 submissions	98
30.	Express unilateral allocation rules as optional	Deloitte	101
31.	Change the term “respective market value” to “relative market value”	Deloitte	102
32.	Clarify the phrase “to which other income or deduction provisions of this Act apply or don’t apply at all”	EY	103
33.	Clarify the heading to section GC 21	EY	103
34.	Clarify that the rules apply to disposals for consideration	nSaTax Limited	104

Unclaimed Monies

Rec #	Recommendation description	Submitter	Page #
35.	Extend the binding rulings regime to the Unclaimed Money Act 1971	Russell McVeagh	109

Rec #	Recommendation description	Submitter	Page #
36.	Include a transitional variation provision	2 submitters	110
37.	Include an alternative use proviso to allow holders to submit any amount of money as unclaimed money to the Commissioner	New Zealand Law Society	110
38.	Retain an alternative use proviso to the de minimis threshold of \$100	2 submitters	111
39.	Take an institutional approach to “account activity”	3 submitters	112
40.	Amend section 8(1) to avoid the circular reference	KPMG	114
41.	Provide guidance on what constitutes “reasonable efforts” when attempting to locate the owner of unclaimed money	Financial Services Council of New Zealand Incorporated	115
42.	Limit the data collection requirements in subsection 4(7) to those which are in “readily retrievable electronic format”	BNZ	116
43.	Clarify the definition of unclaimed money in relation to term deposits	BNZ	116
44.	Amend clause 83B so that the effective date that the Unclaimed Money Act 1971 becomes an Inland Revenue Act is 1 March 2021	Officials	118
45.	Update the drafting of the Unclaimed Money Act 1971 to include gender-neutral language	Officials	118
46.	Repeal the secrecy provision of the Unclaimed Money Act 1971	Officials	119
47.	Allow for the publication of unclaimed money data	Officials	119
48.	Allow the use of unclaimed money to offset a liability	Officials	120
49.	Align the deeming period in the Kiwisaver Act 2006 with proposed reforms	Officials	120
50.	Withdraw the minor data collection requirement proposal	Officials	121
51.	Allow for a more flexible filing and payment regime	Officials	121
52.	Redraft the definition of unclaimed money to focus on “money” rather than on “an amount”	Officials	122
53.	Consolidate the deeming period under the Kiwisaver Act 2006	Officials	122

Other Policy and Remedial Changes

Rec #	Recommendation description	Submitter	Page #
54.	Make adjustments for low-value assets and short-term leases	Jim Gordon Tax Ltd	138
55.	Allow taxpayers to apply the new rules on a lease-by-lease basis	Officials	142

Rec #	Recommendation description	Submitter	Page #
56.	Apply minor drafting improvements	Officials	143
57.	Broaden the scope of the provision relating to incorrect GST treatment	2 submitters	147
58.	Amend similar provisions to align with the broadened scope of the provision relating to incorrect GST treatment	PwC	147
59.	Amend the wording of section EZ 4B(1(a)(i) to better reflect the criteria for spreading	2 submitters	154
60.	Clarify the wording of section EZ 4B(4) in relation to business cessation	2 submitters	155
61.	Allow the use of the spreading method in relation to shareholder salaries under the circumstances specified in the Standard Practice Statement	CAANZ	156
62.	Amend the spread formula term “number”	CAANZ	157

Remedials

Rec #	Recommendation description	Submitter	Page #
63.	Align the amendment with existing tax treatment	Officials	170
64.	Include contracted labour costs in the scope of the amendment	5 submitters	172
65.	Allow Commissioner discretion on timeframes when taxpayers face balance date changes	EY	178
66.	Correct drafting errors	EY	180
67.	Clarify the meaning of “acquire” in R&D expenditure exclusions	Officials	182
68.	Narrow the scope of the grant-related expenditure exclusion	Officials	183
69.	Remove the requirement that companies eligible to group SAI must be resident in New Zealand	PwC	184
70.	Amend the SAI calculation formula to include payments made within a New Zealand consolidated group, where certain conditions are satisfied	PwC	185
71.	Amend the hybrid financial instrument rule	PwC	186
72.	Transfer pricing deemed arm’s length amount exception	PwC	187
73.	Clarify how the reverse hybrid rule applies to hybrid entities and branches	PwC	188
74.	Amend a transitional effect of section CE 6	Russell McVeagh	196
75.	Correct a typo in section CW 26C(7)(a)(ii)	Officials	197
76.	Narrow section FE 2(1)(d)(i)	Chapman Tripp	206

Rec #	Recommendation description	Submitter	Page #
77.	Retroactively apply section FE 2(4B) from 1 April 2015	2 submitters	207
78.	Amend the formula for group world debt percentages when higher than 60%	5 submitters	209
79.	Clarify meaning of negative total assets	KPMG	209
80.	Correct the terminology surrounding distributions from trusts	Wallis Tax Advisory Ltd	215
81.	Simplify the cross-border related borrowing feature in the restricted transfer pricing rule	PwC	217
82.	Address the inconsistency in the notching for group credit rating	EY	218
83.	Amend clause 84 to include clause (1)(b) of Part B of Schedule 8 of the Income Tax Act 2007	Officials	219

Items Raised by Officials

Rec #	Recommendation description	Submitter	Page #
84.	Amend section EE 40 relating to restrictions on depreciation rates	Officials	231
85.	Repeal the building fit-out transitional rule from the 2020-21 income year	Officials	231
86.	Simplify the PIE schedular income year-end adjustment calculation	Officials	233
87.	Clarify that PIE losses and loss tax credits are incorporated when calculating a person's income tax adjustment	Officials	233
88.	Clarify that a natural person investor is a New Zealand resident	Officials	234
89.	Clarify that the adjustment does not apply to a trustee of a trust	Officials	234
90.	Limit the removal of excluded income status for multi-rate PIE income	Officials	235
91.	Include tax adjustments for under- and over-payments of tax on PIE income when calculating residual income tax	Officials	235
92.	Allow transfer tax refunds to an amount borrowed under the Small Business Cashflow (Loan) Scheme	Officials	237
93.	Add a transitional provision to the definition of "initial provisional tax liability"	Officials	238
94.	Retrospectively carve foreign trust registration and annual return fees out of the definition of "tax"	Officials	238
95.	Allow the use of passport numbers in the student loan customs information match	Officials	239
96.	Treat all distributions by an approved unit trust as trustee income	Officials	240

Rec #	Recommendation description	Submitter	Page #
97.	Include the Problem Gambling Levy within the meaning of “tax”	Officials	240
98.	Allow temporary loss carry-back to enable loss grouping for groups that are not wholly owned	Officials	241

Maintenance items

Rec #	Recommendation description	Submitter	Page #
99.	Correct a drafting error in the maintenance item in clause 83	CAANZ	245