# Hon Simon Watts, Minister of Revenue

## Information Release

## Advice relating to the Departmental Report and Amendment Paper 20 to the Taxation (Annual Rates for 2023–24, Multinational Tax and Remedial Matters) Bill

## May 2024

**Availability**

This information release is available on Inland Revenue's tax policy website at https://www.taxpolicy.ird.govt.nz/publications/2024/2024-ir-multinational-tax-bill

**Documents in this information release**

| # | Reference | Type | Title | Date |
|---|---|---|---|---|
| 1 | CBC-24-SUB-0012 | Paper | Proposed changes to the 39% trustee tax rate | 25 January 2024 |
| 2 | CBC-214-SUB-0012 | RIS | 39% trustee rate Changes to the Multinational Tax Bill | 17 January 2024 |
| 3 | CBC-24-MIN-0012 | Minute | Proposed changes to the 39% trustee tax rate | 25 January 2024 |
| 4 | IR2023/291 | Report | 39% trustee tax rate – recommended changes to the Multinational Tax Bill | 20 December 2023 |
| 5 | IR2023/221 | Report | Departmental Report on the Taxation (Annual Rates for 2023–24, Multinational Tax and Remedial Matters) Bill | 20 December 2023 |
| 6 | IR2023/261 | Report | Setting Effective Dates for Global Anti-Base Erosion Tax ("GloBE Rules") | 20 December 2023 |
| 7 | IR2023/178 | Report | Platform Economy: Remedial measures for inclusion in current Tax Bill | 23 June 2023 |
| 8 | IR2023/259 | Report | Disposals of trading stock at below market value | 20 December 2023 |
| 9 | ECO-24-SUB-0004 | Paper | Disposals of trading stock at below market value | 21 February 2024 |
| 10 | ECO-24-MIN-0004 | Minute | Disposals of trading stock at below market value | 21 February 2024 |
| 11 | IR2023/273 | Report | Interest deductibility phasing options | 30 November 2023 |
| 12 | BN2023/284 | Briefing note | Confirmation of fiscal estimate for interest limitation changes | 6 December 2023 |

| # | Reference | Type | Title | Date |
|---|---|---|---|---|
| 13 | IR2023/279 | Report | Tax policy options for Mini Budget | 5 December 2023 |
| 14 | IR2024/015 | Report | New bright-line test and removing building depreciation | 13 February 2024 |
| 15 | IR2024/027 | Report | Restoring interest deductibility for residential property | 1 February 2024 |
| 16 | CAB-24-SUB-0054 | Paper | Restoring interest deductibility for residential property | 28 February 2024 |
| 17 | ECO-24-MIN-0011 | Minute | Restoring Interest Deductibility for Residential Property | 28 February 2024 |
| 18 | CAB-24-MIN-0054 | Minute | Restoring Interest Deductibility for Residential Property | 4 March 2024 |
| 19 | IR2023/296 | Report | Options to regulate and tax online casino gambling | 18 December 2023 |
| 20 | IR2024/061 | Report | Further information on online casino gambling | 16 February 2024 |
| 21 | IR2024/029 | Report | Online Casino Gaming Duty and Regulation Cabinet paper | 23 February 2024 |
| 22 | CAB-24-SUB-0072 | Paper | Online Casino Gaming Duty and Regulation | 11 March 2024 |
| 23 | ECO-24-MIN-0018 | Minute | Online Casino Gaming Duty and Regulation | 6 March 2024 |
| 24 | CAB-24-MIN-0072 | Minute | Online Casino Gaming Duty and Regulation | 11 March 2024 |
| 25 | IR2024/071 | Report | Platform Economy: Transitional GST rule | 27 February 2024 |

**Additional information**

The Cabinet paper *Proposed changes to the 39% trustee tax rate* (CBC-24-MIN-0012) was considered by the Cabinet Business Committee on 25 January 2024 and confirmed by Cabinet on 30 January 2024.

The Cabinet paper *Disposals of trading stock at below market value* (ECO-24-SUB-0004) was considered by the Cabinet Economic Policy Committee on 21 February 2024 [] and confirmed by Cabinet on 26 February 2024.

The Cabinet paper *Restoring interest deductibility for residential property* (ECO-24-MIN-0011) was considered by the Cabinet Economic Policy Committee on 28 February 2024 and confirmed by Cabinet on 4 March 2024.

The Cabinet paper *Online Casino Gaming Duty and Regulation Cabinet paper* (ECO-24-MIN-0018) was considered by the Cabinet Economic Policy Committee on 6 March 2024 and confirmed by Cabinet on 11 March 2024.

The Cabinet paper *Fiscal Management: Mini Budget, Budget 2024 and the Fiscal Sustainability Programme* (CAB-23-MIN-0490) which was considered by Cabinet on 11 December 2023. This paper will be separately released by The Treasury as part of their mini-budget release, however, some of the key advice reports are included in this release

The following Regulatory Impact Statements are not included in this information release as they are publicly available:

1. Reducing the bright-line period for taxing residential property, 8 December 2023
2. Reintroducing interest deductibility on residential investment property, 8 December 2023
3. Removing building depreciation, 7 December 2023
4. Disposals of trading stock at below market value, 20 December 2023
5. Online Casino Taxes, 21 February 2024

## Information withheld

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

Sections of the OIA under which information was withheld:

9(2)(a) to protect the privacy of natural persons, including deceased people

9(2)(f)(iv) to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

9(2)(h) to maintain legal professional privilege

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Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet Business Committee

# Proposed changes to the 39% trustee tax rate

## Proposal

1 This paper seeks the Cabinet Business Committee's agreement to amend the proposal to increase the trustee tax rate to 39% from 1 April 2024. The amendments mitigate the risk of over-taxation of trust income and simplify the rate increase.

2 The existing proposals for increasing the trustee tax rate are included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill ("the Bill"). The Bill is currently before the Finance and Expenditure Committee.

## Relation to government priorities

3 Given the current fiscal environment, the coalition Government has agreed to proceed with the increase in the trustee rate to 39%. These proposals reduce compliance costs and ensure 27,000 trusts will not be affected by the rate increase and reduce the over-taxation of beneficiaries of trusts.

## Executive summary

4 The current 33% trustee tax rate means that individuals that earn tax-paid trustee income from a trust are not subject to the 39% personal tax rate on such distributions, even if they earn over the 39% personal tax rate threshold of $180,000 in personal income and distributed tax-paid trustee income.

5 While the proposals to increase the trustee rate to 39% aim to address the under-taxation of individuals on higher incomes, they also may result in the over-taxation of beneficiaries on lower income tax rates.

6 The risk of over-taxation can currently be mitigated in many situations by the ability of trustees to allocate income to beneficiaries (which is taxed at the personal tax rate of the beneficiary). However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to.

7 The Bill already contains proposals to mitigate the risk of over-taxation of deceased estates and disabled beneficiary trusts. However, there was no public consultation at the time the proposals were introduced in May 2023. Since then, officials have undertaken consultation with a large number of stakeholders. Feedback from most stakeholders and submitters on the Bill have focused on the risk of over-taxation of trust income, and the proposed changes in this paper address those submissions.



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8 The additional proposed changes to the 39% trustee tax rate proposal would further minimise compliance costs and the risks of over-taxation by:

8.1 **Introducing a $10,000 trustee income de minimis** which would ensure that 36% of trusts (27,000 trusts) with some trustee income would not be affected by the proposed 39% trustee tax rate. These trusts would continue to be subject to a 33% trustee tax rate. Given the concentration of trustee income in a relatively small number of trusts, this would reduce the over-taxation of many trusts while still addressing most of the under-taxation of trust income.

8.2 **Simplifying and expanding the proposals relating to deceased estates and disabled beneficiary trusts** which would reduce the risk of over-taxation and the costs of complying with the proposals.

8.3 **Excluding energy consumer trusts and legacy superannuation funds from the 39% trustee tax rate** which would reduce the risk of over-taxation. These trusts have limited ability to mitigate over-taxation.

8.4 **Making other technical amendments** to ensure a proposed integrity rule targeted at the use of companies to shelter trust income from the 39% tax rate works as intended.

9 The total fiscal cost of these proposals is $12 million across the forecast period (to 2027/28). This would be charged against the Tax Policy Scorecard.

10 Subject to Cabinet agreement, these proposals will be included in the departmental report on the Bill to be sent to the Finance and Expenditure Committee on 9 February 2024 and enacted by 31 March 2024 so that the proposed trustee rate increase, as amended by the changes in this paper, is in force from 1 April 2024.

## Background

11 The Bill proposes aligning the trustee tax rate with the 39% personal tax rate for the 2024–25 and later income years (beginning on 1 April 2024 for most trusts). Special rules were also proposed to buttress the 39% rate and help mitigate over-taxation that could arise for disabled beneficiary trusts and deceased estates. These changes were agreed by the previous Government in April 2023 (CAB-23-MIN-0142 refers). The current coalition Government has agreed to proceed with the increase in the trustee tax rate given the current fiscal environment.

12 The trustee tax rate is a final tax, meaning that distributions of tax-paid trustee income to beneficiaries are not subject to any further tax. The current 33% trustee tax rate means that individuals are not subject to the 39% personal tax rate on the distributed tax-paid trustee income, even if they earn over $180,000 in (combined) personal income and distributed tax-paid trustee income. This **under-taxation** of trust income undermines the fairness and integrity of the tax system.

13 While addressing the current under-taxation of trust income, it is also important as far as possible to mitigate any **over-taxation**. This arises when trustee income is taxed at a rate higher than the personal tax rates of the beneficiaries and settlors of the trust. Over-taxation is an existing issue with the 33% trustee rate that will be exacerbated by increasing the rate to 39%.



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14 The main way that trustees can mitigate the over-taxation of trust income is by allocating income to beneficiaries as beneficiary income – this is taxed at the personal tax rate of the beneficiary. However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to. It is very difficult to address under-taxation while mitigating over-taxation.

15 Due to Budget sensitivity, officials were unable to undertake public consultation during the development of the proposals in the Bill. However, since Budget 2023, officials have undertaken consultation with a large number of stakeholders. Feedback from most stakeholders and submitters on the Bill have focused on the risk of over-taxation of trust income.

## Proposed changes

### Trustee income de minimis

16 Stakeholders recommended introducing a de minimis to further mitigate risks of over-taxation under the proposed 39% trustee tax rate.

17 A de minimis for trustee income would mean that trusts with trustee income up to the threshold would be subject to the current 33% trustee tax rate. Trusts with trustee income greater than the de minimis would be subject to the 39% tax rate on all trustee income.

18 The likelihood that trustee income is over- or under-taxed is not necessarily correlated to the amount of trustee income earned. A trust with a small amount of income can still have 39% beneficiaries and settlors. For example, in the 2022 tax year, 9% of trusts with $10,000 or less trustee income had a beneficiary that earned over $180,000 (i.e., a 39% beneficiary).[1]

19 However, given the concentration of trustee income in a relatively small number of trusts, a trustee income de minimis could help reduce over-taxation for many trusts while still addressing most of the under-taxation of trust income.

20 For trusts with taxable income in the 2021 tax year:

20.1 **Trustee income is concentrated in a small number of trusts**; the top 5% of trusts in terms of trustee income (9,000 of 177,000) accounted for 78% of trustee income ($13.3 billion of $17.1 billion). These trusts will be most affected by the 39% trustee tax rate.

20.2 **Most trusts have relatively small amounts of trustee income**; the bottom 75% of trusts in terms of trustee income (133,000 of 177,000) accounted for only 2.5% of trustee income ($0.4 billion of $17.1 billion). This includes the lower 24% of trusts with assessable income (43,000 of 177,000) that reported only beneficiary income (i.e., they had no trustee income), so would not be impacted by a change in the trustee rate.

[1] This figure may be under-stated. Inland Revenue only holds information on beneficiaries that have received a trust distribution. Therefore, this figure does not include beneficiaries that have not received a trust distribution disclosed to Inland Revenue.



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21 We recommend setting the de minimis threshold at $10,000. Stakeholders recommended a range of different de minimis thresholds from $10,000 to $100,000.

22 A de minimis threshold of $10,000 provides a maximum benefit of $600 per trust (compared with the 33% trustee tax rate). Given the compliance costs of running a trust, the risk that taxpayers will set up multiple trusts to benefit from the de minimis is low. However, a higher threshold would create a greater incentive for taxpayers to set up multiple trusts.

23 Based on the 2022 tax year, 76,000 trusts had positive trustee income after expenses and losses. A $10,000 trustee income de minimis would mean that 27,000 trusts (36%) would no longer be impacted by the proposed 39% trustee tax rate.

24 Since most trustee income is concentrated in a small number of trusts, a higher de minimis threshold would help more trusts but at a diminishing rate. A higher threshold would also have a larger fiscal cost.

25 The fiscal cost of introducing a $10,000 de minimis for trust income is $14 million over the forecast period.

*Treasury comment*

26 The Treasury does not support a trustee income de minimis. The level of benefit provided to affected trusts is low (i.e., a maximum of $600 per annum), with the average level of benefit expected to be substantially lower. Additionally, the benefit that is provided is not well targeted at low net income beneficiaries, and is therefore not well targeted at over-taxed individuals. Therefore, while the fiscal cost of the proposal is low, the Treasury does not believe that the relative benefit justifies that cost.

## Estates

27 Deceased estates are taxed as trusts. It is likely that some estates are already over-taxed at the current 33% trustee tax rate – this would be exacerbated by the proposed 39% trustee tax rate. Unlike trusts, the beneficiaries of an estate may not be known in the income year the estate derives income, so the trustees of the estate may not be able to use beneficiary income allocations to mitigate over-taxation.

28 To help mitigate over-taxation, the Bill currently proposes a modification for estates. The modification provides that trustee income derived by an estate within 12 months of a person's death would be taxed at the deceased's personal tax rate instead of the proposed 39% trustee tax rate. The proposal is optional for taxpayers.

29 Officials received feedback that calculating and applying personal tax rates to trustee income of estates would be too complex and that the proposed 12-month application period would be insufficient. Stakeholders also recommended applying the modification automatically to all estates.

30 We recommend applying the current 33% flat tax rate to trustee income of estates. A flat tax rate would be easier to implement, administer, and comply with than personal tax rates. We also recommend applying the modification automatically to all qualifying estates to further simplify the proposals.



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31 We recommend extending the modification to apply for the income year of the deceased's date of death, plus three subsequent income years. We expect 85% of estates would be wound up within this timeframe.

32 Applying a 33% tax rate to trustee income of estates and extending the period for which this rate applies would increase revenue by $7 million over the forecast period. This proposal is revenue positive because some deceased people would have been on lower personal tax rates than the simpler flat 33% rate we are recommending.

## Disabled beneficiary trusts

33 The Bill includes a modification to help mitigate over-taxation for trusts settled for the care of disabled people ("disabled beneficiary trusts"). To qualify, a trust can only have one beneficiary and that beneficiary must be a "disabled beneficiary."[2] A disabled beneficiary is someone who receives either the child disability allowance or the supported living payment on the ground of restricted work capacity. Trustee income of a disabled beneficiary trust would be taxed at the disabled beneficiary's personal tax rate.

34 Officials received feedback that the modification's requirements are restrictive. Stakeholders also raised concerns that applying the personal tax rate of a disabled beneficiary to trustee income would have privacy issues and high compliance costs.

35 We recommend extending the definition of "disabled beneficiary" to include two other Government support payments – the Disability Allowance and the JobSeeker Support Health and Disability (if this has been paid for at least 6 months[3]). We also recommend extending the definition to include people aged 65 or over who would have met the disabled beneficiary criteria in the income year they turned 65 or the previous income year. This would help ensure that older New Zealanders with disabilities can continue to qualify as a disabled beneficiary despite no longer receiving disability-specific Government support once they transition onto New Zealand Superannuation.

36 We recommend applying the current 33% flat tax rate to trustee income of disabled beneficiary trusts. This would provide for consistency across the recommended modifications.

37 If our recommendation that disabled beneficiary trusts be taxed at a flat 33% rate is accepted, we also recommend allowing them to have multiple disabled beneficiaries. Allowing multiple beneficiaries while taxing these trusts at the personal tax rates of the beneficiaries would be very complex. If multiple disabled beneficiaries are permitted, we recommend that disabled beneficiaries can be added or removed, as long as there is at least one disabled beneficiary remaining.

38 The recommended changes to the disabled beneficiary trust modification are estimated to have no material fiscal impact.

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[2] Unless the disabled beneficiary has died, in which case there would be no restrictions on who can receive distributions from a disabled beneficiary trust when it is dissolved.

[3] We recommend requiring recipients of the JobSeeker payment to have received it for at least six months to be eligible, as this payment may also be made to people who are not disabled. A six-month period provides some consistency with the eligibility criteria for the disability allowance.



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## Energy consumer trusts

39 Most electricity distribution companies in New Zealand are owned by trusts or local councils. There are 20 “energy consumer trusts” that are subject to tax. The beneficiaries of these trusts are the persons whose premises are connected to the energy company’s distribution network.

40 Stakeholders have recommended that energy consumer trusts should be excluded from the 39% trustee tax rate due to concerns that neither the ability to make beneficiary income allocations nor the proposed de minimis will help mitigate over-taxation. Stakeholders note that most beneficiaries of energy consumer trusts are not 39% taxpayers, and that it is not always possible or desirable to distribute all taxable income as beneficiary income.

41 On balance, we recommend taxing energy consumer trusts at 33% instead of the 39% trustee tax rate. Although we expect these trusts would be able to distribute income as beneficiary income in most cases, some of these trusts may face administrative issues or have restrictions in their trust deed that prevent this. We have no concerns that such trusts could be used to circumvent the 39% top personal tax rate, as they are a well-defined group.

42 This exclusion would have an estimated fiscal cost of $5 million over the forecast period.

## Legacy superannuation funds

43 A “widely-held superannuation fund” is a retirement scheme that has 20 or more members (counting associated persons as one person). These funds are taxed at a flat 28% tax rate instead of the trustee tax rate to ensure they have similar tax treatment to portfolio investment entities (PIEs). Furthermore, many retirement schemes have entered into the PIE rules and would not be affected by the proposals.

44 Superannuation funds that have fewer than 20 members are subject to ordinary trust rules and would be subject to the proposed 39% trustee tax rate. Many widely-held superannuation funds are registered as “restricted” schemes that are closed to new members. Over time, these funds will fall out of the widely-held definition and be subject to the 39% trustee tax rate due to declining membership.

45 Superannuation funds have an increased risk of over-taxation as, under tax law, all their income is trustee income. They cannot make beneficiary income allocations to mitigate over-taxation.

46 We recommend that restricted superannuation funds that satisfied the widely-held test at some point in time are subject to the same tax treatment as widely-held superannuation funds. It is not the policy intent of these rules that such legacy schemes should be subject to a higher tax rate simply due to declining membership.

47 The recommended change is expected to have no material fiscal impact.



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## Corporate beneficiary rule

48 To buttress the 39% trustee tax rate, the Bill includes a proposal to tax certain beneficiary income allocations to companies at the 39% trustee tax rate. Affected allocations would be those where a settlor of a trust has natural love and affection[4] for a (direct or indirect) shareholder of a close company[5]. This is to ensure the proposed rule is targeted towards family trusts and would not affect the commercial use of trusts in large corporate groups.

49 Submitters have identified situations where this rule would not work as intended. If the settlor of the trust and the shareholder of the company is the same person, the rule may not apply as it is unclear whether a person can have natural love and affection for themself. Additionally, if the shareholder of the company is a trustee, the rule will not apply as a person cannot have natural love and affection for a trustee.

50 Submitters also identified situations where a securitisation trust would be impacted by the proposed corporate beneficiary rule. It is not intended for this rule to impact the use of trusts in corporate groups.

51 To ensure that corporate beneficiaries are properly targeted by the proposals, we recommend that the proposed rule also applies if a trust is making a beneficiary income allocation to a company and:

51.1 a (direct or indirect) shareholder of the company is a settlor of the trust making the distribution; or

51.2 the shareholder of the company is a trustee, and a settlor of the trust making the distribution has natural love and affection for a beneficiary of the trust that owns the company.

52 We also recommend that the proposed rule is amended to ensure that it does not apply to securitisation trusts.

53 The recommended changes are expected to have no material fiscal impact.

## Cost-of-living implications

54 The proposed changes would have no direct cost-of-living implications. However, they aim to help mitigate the over-taxation of lower-rate beneficiaries under a 39% trustee tax rate.

## Financial implications

55 The net fiscal impact of the proposed amendments to the 39% trustee tax rate is a revenue loss of $12 million, as shown below:

[4] "Natural love and affection" is an existing concept in tax law. It relates to an action by a person where the motive is induced not by a promise or something in return, but by the natural love and affection the person has for another. Natural love and affection is generally considered to subsist between relatives, whether by blood, marriage, a non-spousal domestic relationship, or adoption. It can be present between close friends as well, although not ordinary acquaintances or colleagues.

[5] A "close company" is a company where five or fewer natural persons or trustees hold more than 50% of the voting interests (treating associated persons as one person).



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| | $m – increase/(decrease) | | | | | |
|---|---|---|---|---|---|---|
| **Vote Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 and outyears | Total over forecast period |
| Crown Revenue and Receipts:<br>Tax Revenue | | | | | | |
| *Trustee income de minimis* | - | (1.0) | (7.0) | (3.0) | (3.0) | (14.0) |
| *Deceased estates* | - | - | 3.0 | 2.0 | 2.0 | 7.0 |
| *Energy consumer trusts* | - | - | (3.0) | (1.0) | (1.0) | (5.0) |
| **Total change in Revenue** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** | **(12.0)** |

56 This fiscal impact will be charged against the Tax Policy Scorecard.

57 The proposed amendments to the disabled beneficiary trust modification, legacy superannuation funds, and the corporate beneficiary rule are estimated to have no material fiscal impact.

## Administrative implications

58 The administrative and implementation costs of the recommended changes in this report are covered by the estimated costs already approved as part of Budget 2023. The departmental capital and operating costs of this work are self-funded by Inland Revenue (CAB-23-MIN-0142 refers).

## Legislative implications

59 Subject to Cabinet agreement, these proposals will be included in the departmental report on the Bill to be sent to the Finance and Expenditure Committee on 9 February 2024 and enacted as part of the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill by 31 March 2024.

## Impact Analysis

### Regulatory Impact Statement

60 The Quality Assurance panel from the Treasury and Inland Revenue has reviewed the *39% trustee rate – changes to the Multinational Tax Bill* regulatory impact statement (RIS) prepared by the Treasury and Inland Revenue and considers that the information and analysis summarised in the RIS partially meets the quality assurance criteria. This is because the scope of the options analysis has been constrained by the lack of time to fully consider other options given the impending legislative process, and the need for proposals to be consistent with the scope of the existing Bill. In addition, the panel



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considered that the problem definition could be clearer and the distributional effects of the de minimis could have been explored further if more time was available. The RIS would have also further benefited from a discussion of the feedback from consultation, including the views of the stakeholders on the options considered in the RIS.

### Climate Implications of Policy Assessment

61 The proposals included in this paper do not have any climate implications.

## Population implications

62 The following population groups have been identified as being potentially impacted by the proposed changes to the 39% trustee tax rate.

| Population group | How the proposal may affect this group |
|---|---|
| Māori | Inland Revenue does not hold ethnicity data for taxpayers, therefore it is very difficult to determine how the proposals will impact Māori.<br><br>The tax system provides targeted rules for Māori organisations that manage and own communal assets for the benefit of iwi, hapū and whānau. Organisations that are eligible to apply these rules are called "Māori authorities" and are taxed at 17.5%. Trusts that are Māori authorities would not be affected by the proposals.<br><br>Officials understand that some trusts that should be eligible for the Māori authority regime are not, and many that are eligible do not opt into the rules, often due to compliance cost reasons. Māori trusts can have large numbers of beneficiaries, and it can be very challenging for the trustees to obtain agreement from all the beneficiaries to opt into the Māori authority rules. Changes to the eligibility for the Māori authority regime would require a comprehensive review beyond the scope of the proposals. Further work on this issue could be considered for inclusion on the Government's Tax and Social Policy Work Programme.<br><br>During consultation, officials received feedback that it is likely Māori are over-taxed under the current 33% trustee rate, and that this will be exacerbated under the proposed 39% trustee rate. Stakeholders suggested that using beneficiary income allocations to mitigate over-taxation is not always be feasible.<br><br>Officials also received anecdotal evidence that Māori trusts tend to have small amounts of income. If Māori trusts have less than $10,000 of trustee income, they will be eligible for the proposed de minimis. |
| Disabled people | The Bill currently contains a modification to mitigate over-taxation of disabled beneficiary trusts. The changes recommended in this Cabinet paper would reduce the modification's complexity and expand eligibility.<br><br>Some trusts will remain ineligible, such as those with disabled beneficiaries that are not eligible for, or choose not to receive, the relevant support payments. We have limited information on the size of the problem, but Australian data indicates it is not likely to be large.[6] The recommended trustee income de minimis would also help mitigate over-taxation for trusts settled for disabled people that have up to $10,000 of trustee income. |



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| Population group | How the proposal may affect this group |
|---|---|
| Orphans | Officials received a small amount of feedback that trusts settled for the care of orphans may be unable or reluctant to make beneficiary income allocations. There were concerns that income intended to support vulnerable beneficiaries could be over-taxed at the proposed 39% trustee rate.<br><br>The size of this problem is unclear. However, where beneficiary income allocations are not feasible, the proposed $10,000 trustee income de minimis would help to mitigate over-taxation of trusts settled for orphans that have up to $10,000 of trustee income. |

## Human rights

63 The proposals comply with the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## Use of external resources

64 No external resources have been engaged in the preparation of this proposal.

## Consultation

65 The Department of the Prime Minister and Cabinet was consulted on this Cabinet paper.

66 As part of the policy development process in relation to these proposals, Inland Revenue has consulted with the Treasury, Ministry of Health, Ministry of Social Development and Whaikaha – Ministry of Disabled People.

67 Officials also consulted with members of the private sector on the proposals through a "Trusts External Reference Group", along with experts on the impacts of the proposals on Māori, the disabled community, and estates.

68 A list of stakeholders Inland Revenue consulted with as part of the policy development process is provided in Appendix 1.

## Communications

69 If agreed to, these changes will be included in the departmental report on the Bill to be sent to the Finance and Expenditure Committee on 9 February 2024. Once the Committee reports the Bill back to Parliament, these changes will be made public. Following enactment in March 2024, Inland Revenue will publish a Tax Information Bulletin to assist taxpayers in understanding the new rules.

## Proactive release

70 We propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

[6] There are fewer than 1,000 trusts eligible for the equivalent of a disabled beneficiary trust modification in Australia.



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## Recommendations

The Minister of Finance and Minister of Revenue recommend that the Committee:

1 **agree** that trusts and estates with up to $10,000 in trustee income in an income year should be subject to a 33% tax rate;

2 **note** the following changes as a result of the decision in recommendation 1 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | (1.0) | (7.0) | (3.0) | (3.0) |
| **Total Revenue** | **-** | **(1.0)** | **(7.0)** | **(3.0)** | **(3.0)** |
| **Total Operating** | **-** | **1.0** | **7.0** | **3.0** | **3.0** |

3 **agree** to apply a 33% tax rate to trustee income derived by trustees of all estates in the income year of death, plus the following three full income years;

4 **note** the following changes as a result of the decision in recommendation 3 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | - | 3.0 | 2.0 | 2.0 |
| **Total Revenue** | **-** | **-** | **3.0** | **2.0** | **2.0** |
| **Total Operating** | **-** | **-** | **(3.0)** | **(2.0)** | **(2.0)** |

5 **agree** to make the following changes to the disabled beneficiary trusts modification:

5.1 define "disabled beneficiary" for an income year to mean a person for whom one or more of the following support payments is paid for at least part of the income year (or the income year in, or before, the person turned 65 years of age);

- the disability allowance,
- the child disability allowance,
- the supported living payment on the ground of restricted work capacity, or
- the JobSeeker Support Health and Disability (if this has been paid for at least 6 months).

5.2 apply a 33% tax rate to trustee income of disabled beneficiary trusts;

5.3 allow disabled beneficiary trusts to have multiple disabled beneficiaries;

5.4 allow disabled beneficiaries to be added to, or removed from, a disabled beneficiary trust, as long as there is at least one disabled beneficiary remaining after a beneficiary is removed;

6 **agree** that energy consumer trusts should be excluded from the 39% trustee tax rate and taxed at 33% on trustee income;

7 **note** the following changes as a result of the decision in recommendation 6 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | - | (3.0) | (1.0) | (1.0) |
| **Total Revenue** | **-** | **-** | **(3.0)** | **(1.0)** | **(1.0)** |
| **Total Operating** | **-** | **-** | **3.0** | **1.0** | **1.0** |

8 **agree** that legacy superannuation funds should have the same tax treatment as widely-held superannuation funds (28% tax rate);

9 **agree** to make the following changes to the corporate beneficiary rule:

9.1 the proposed corporate beneficiary rule should apply if a settlor of the trust making the beneficiary income allocation is a (direct or indirect) shareholder of the company;

9.2 the proposed corporate beneficiary rule should apply if a trust makes a beneficiary income allocation to a company that has a trustee shareholder, and



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a settlor of the trust making the allocation has natural love and affection for a beneficiary of the trust that is the shareholder of the company;

9.3 the proposed corporate beneficiary rule should not apply to securitisation trusts;

10 **agree** that the approved amendments outlined in this paper should apply for the 2024–25 and later income years (1 April 2024 for most trusts);

11 **note** that if recommendations 1-10 are agreed to, then the corresponding amendments will be included in the departmental report on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill to be provided to the Finance and Expenditure Committee by 9 February 2024;

12 **note** the overall changes as a result of the decisions in recommendations 1, 3, and 6 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | (1.0) | (7.0) | (2.0) | (2.0) |
| **Total Revenue** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** |
| **Total Operating** | **-** | **1.0** | **7.0** | **2.0** | **2.0** |

13 **note** that we have agreed to manage the cost of the proposed changes against the Tax Policy Scorecard.

Authorised for lodgement

Hon Nicola Willis
Minister of Finance

Hon Simon Watts
Minister of Revenue



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## Appendix 1: List of stakeholders Inland Revenue consulted in the development of the proposals

- ACC
- Australian Tax Office
- Complex Care Group
- Deloitte
- Enabling Good Lives
- Financial Markets Authority
- Financial Services Council Taxation Committee
- Institute of Certified NZ Bookkeepers
- Ministry of Health
- Ministry of Social Development
- Māori Land Court
- Tax and Social Policy Māori Reference Group
- MCI & Associates
- OliverShaw
- Parininihi ki Waitotara
- Perpetual Guardian
- Private individuals (parents of disabled people)
- Public Trust
- Spooner, Hood & Redpath Ltd
- TaxLab
- Te Tumu Paeroa – Office of the Māori Trustee
- Trustees Executors Limited
- Trusts External Reference Group
- Veterans' Affairs
- Whaikaha – Ministry of Disabled People

Members of the Trusts External Reference Group:

- ATAINZ
- Baker Tilly Staples Rodway
- BDO
- Cantin Consulting
- Chapman Tripp
- Chartered Accountants Australia and New Zealand Tax Advisory Group
- Corporate Taxpayers Group
- CPA Australia
- Craigs Investment Partners
- Deloitte
- Ernst & Young
- Financial Services Council Taxation Committee
- Findex
- KPMG
- Mayne Wetherell
- MinterEllisonRuddWatts
- New Zealand Law Society
- OliverShaw



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- PwC
- Securities Industry Association
- Tomlinson Law



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# Regulatory Impact Statement: 39% trustee rate – changes to the Multinational Tax Bill

## Coversheet

| Purpose of Document | |
|---|---|
| Decision sought: | *Agreement to introduce amendments to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill, with respect to the 39% trustee rate.* |
| Advising agencies: | *Inland Revenue*<br>*The Treasury* |
| Proposing Ministers: | *The Minister of Finance*<br>*The Minister of Revenue* |
| Date finalised: | *17 January 2024* |

**Problem Definition**

The Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill ("the Bill") contains proposed rules to increase the trustee tax rate to 39% from 1 April 2024. The trustee rate increase addresses some under-taxation of income for individuals earning over $180,000 arising from misalignment between the top personal income tax rate and the trustee tax rate. During consultation, stakeholders expressed concern that the proposed approach would result in over-taxation of certain beneficiaries who have effective marginal tax rates below 39%. This RIS considers the options available for mitigating some of this over-taxation.

**Executive Summary**

***Background – rate misalignment, under- and over-taxation***

From 1 April 2021, the top personal income tax rate increased from 33% to 39%. However, the trustee tax rate remained unchanged at 33% - leading to a 6% rate misalignment between trust and personal income tax rates.

The trustee tax rate is a final tax, meaning that distributions of tax-paid trustee income to beneficiaries are not subject to any further tax. The current 33% trustee tax rate means that individuals are not subject to the 39% personal tax rate on the distributed tax-paid trustee income, even if they earn over $180,000 in (combined) personal income and distributed tax-paid trustee income. This **under-taxation** of trust income undermines the fairness and integrity of the tax system.

Misalignment therefore undermines the broader objectives of the progressive income tax system, and constrains the government's ability to raise revenue from personal income

taxation. The Bill contains proposals that would increase the trustee rate to 39% to mitigate this issue.

While addressing the current under-taxation of trust income, it is also important as far as possible to mitigate any **over-taxation**. This arises when trustee income is taxed at a rate higher than the personal tax rates of the beneficiaries and settlors of the trust. Over-taxation is an existing issue with the 33% trustee rate that will be exacerbated by increasing the rate to 39%.

The main way that trustees can mitigate the over-taxation of trust income is by allocating income to beneficiaries as beneficiary income – this is taxed at the personal tax rate of the beneficiary. However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to.

***Proposals***

Following the introduction of the Bill, feedback was sought on over-taxation resulting from the 39% trustee tax rate from stakeholders. In response to that feedback, officials recommend including the following changes to the Bill via the departmental report:

- Introduce a $10,000 trustee income de minimis, with a 33% rate applying below the de minimis; and
- Simplify and expand the existing proposals for deceased estates and disabled beneficiary trusts; and
- Exclude energy consumer trusts and legacy superannuation funds from the 39% rate; and
- Technical amendments relating to corporate beneficiaries.

Collectively, these changes would reduce further over-taxation for some beneficiaries as a result of the proposed 39% trustee tax rate. This would support the objectives of the progressive personal income tax regime. However, beneficiaries who are over-taxed under the status quo (i.e., under the 33% trustee tax rate) will receive minimal to nil relief from the current proposals.

There is also some risk that the relief provided (specifically, the $10,000 de minimis) will be used as a means of circumventing the base-maintenance intentions of the 39% trustee tax rate, though officials consider this risk low.

Over the forecast period (2023/24 to 2027/28), the net fiscal impact of all the recommended changes is estimated to be a revenue loss of $12 million, as shown below:

| | $m – increase/(decrease) | | | | | |
|---|---|---|---|---|---|---|
| | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears | **Total over forecast period** |
| Trustee income de minimis | - | (1.0) | (7.0) | (3.0) | (3.0) | **(14.0)** |
| Deceased estates | - | - | 3.0 | 2.0 | 2.0 | **7.0** |
| Energy consumer trusts | - | - | (3.0) | (1.0) | (1.0) | **(5.0)** |
| **Total** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** | **(12.0)** |

### *View of officials*

Inland Revenue supports all the proposed changes to the increase in the trustee tax rate (Option 2). The changes will reduce the instance of over-taxation of lower tax rate beneficiaries, simplify the rules and reduce compliance costs. Specifically, in relation to the proposal for a de minimis of $10,000 per trust for trust income, Inland Revenue considers this strikes a balance between mitigating over-taxation and the fiscal cost of the proposal.

The Treasury does not believe that the $10,000 trustee income de minimis is a cost effective means of achieving the stated objective (i.e., reducing the cost burden on a limited subset of over-taxed beneficiaries), and prefers the status quo relative to this change. The Treasury supports all other proposals.

### *View of stakeholders*

Stakeholders were generally opposed to the 39% trustee tax rate, and did not support the increase from the current 33% rate. Many stakeholders saw this increase as a departure from the principles of the broad-base low-rate system, and had specific concerns with the rate being too high. To that end, the proposals to reduce over-taxation will likely be received as not going far enough.

Additionally, many stakeholders have recommended that the 39% trustee tax rate be deferred to allow more consultation on the issue of over-taxation. Consultation focused on the proposal to increase the trustee rate, as opposed to alternative approaches to the issue. In that context, the de minimis was supported in principle, and support was stronger for a higher de minimis.

Following the introduction of legislation to increase the trustee tax rate officials undertook extensive consultation. All of the changes considered here relate to concerns raised by stakeholders.

## Limitations and Constraints on Analysis

### *Time constraints*

The proposed 39% trustee rate was originally considered as a Budget 2023 measure under the previous Government. Owing to Budget secrecy, officials were constrained from consulting with stakeholders on the impacts of the rate until after Budget 2023 was released.

Following the release of Budget 2023, consultation was undertaken, and additional risks of over-taxation were identified. However, with the pre-election period in force by the time consultation was completed, officials were unable to seek further decisions on the 39% trustee rate (and the Bill more generally) until after a new government had been sworn in following the 2023 general election.

### *Scope constraints*

Both the previous and current coalition Government have committed to implementing the Bill’s proposed 39% trustee tax rate given the current fiscal environment. In this way, officials were limited in their ability to canvas significant alternatives; which would have required more fundamental reviews of the trust tax landscape. Officials noted these

alternatives during the preceding regulatory impact assessment relating to the trust proposals for the Bill[1].

Ultimately, the policy question at issue in this regulatory impact assessment is the comparison of policy alternatives to the current policy proposals in the Bill, not hypothetical alternatives that may be preferable. This scope has constrained the ability of officials to examine significantly different alternatives to those proposed in this paper.

***Additional consultation constraints***

The Finance and Expenditure Committee are yet to hear public oral submissions on the Bill, scheduled for 31 January 2024. Oral submissions on the Bill were delayed as a result of the 2023 general election, and as a result officials have considered the proposals without this conventional step in the policy process. These submissions may raise additional concerns that have not been considered within this report and related proposals.

| **Responsible Manager(s) (completed by relevant manager)** | |
|---|---|
| *Chris Gillion*<br>*Policy Lead*<br>*Policy & Regulatory Stewardship – Inland Revenue*<br>s 9(2)(a) | *Jean Le Roux*<br>*Manager*<br>*Tax Strategy – The Treasury*<br>s 9(2)(a) |

| **Quality Assurance (completed by QA panel)** | |
|---|---|
| Reviewing Agency: | The Treasury, Inland Revenue |
| Panel Assessment & Comment: | *The Quality Assurance panel from the Treasury and Inland Revenue has reviewed the 39% trustee rate – changes to the Multinational Tax Bill regulatory impact statement (RIS) prepared by the Treasury and Inland Revenue and considers that the information and analysis summarised in the RIS partially meets the quality assurance criteria. This is because the scope of the options analysis has been constrained by the lack of time to fully consider other options given the impending legislative process, and the need for proposals to be consistent with the scope of the existing Bill. In addition, the panel considered that the problem definition could be clearer and the distributional effects of the de minimis could have been explored further if more time was available. The RIS would have also further benefited from a discussion of the feedback from consultation, including the views of the stakeholders on the options considered in the RIS.* |

[1] Regulatory Impact Statement: The Taxation of Trustee Income

# Section 1: Diagnosing the policy problem

## Context and expected developments

1. Under New Zealand law, an amount of income is taxed at different rates depending on the entity that derived that income. For example, income derived and retained by a trust is taxed at a flat 33%, while the same income derived by an individual would be taxed at that person's marginal income tax rate (up to 39%), or at a flat 28% if derived and retained by a company or derived by a portfolio investment entity. This is referred to as rate misalignment, and is a result of long-standing policy preferences by successive governments.

2. Historically however, misalignment between the personal income tax rate and the trustee tax rate has been avoided. The current trustee tax rate (33%) has remained unchanged since 1989 when the current tax regime for trusts was introduced. This rate was selected to align with the then top personal income rate of 33%.

3. This historical approach has been because individuals who earn at or above the 39% rate threshold (i.e., with personal income at or above $180,000 p.a.) are incentivised to divert that income into a trust to make use of the different treatment of income, depending on its treatment once it is derived by the trust:

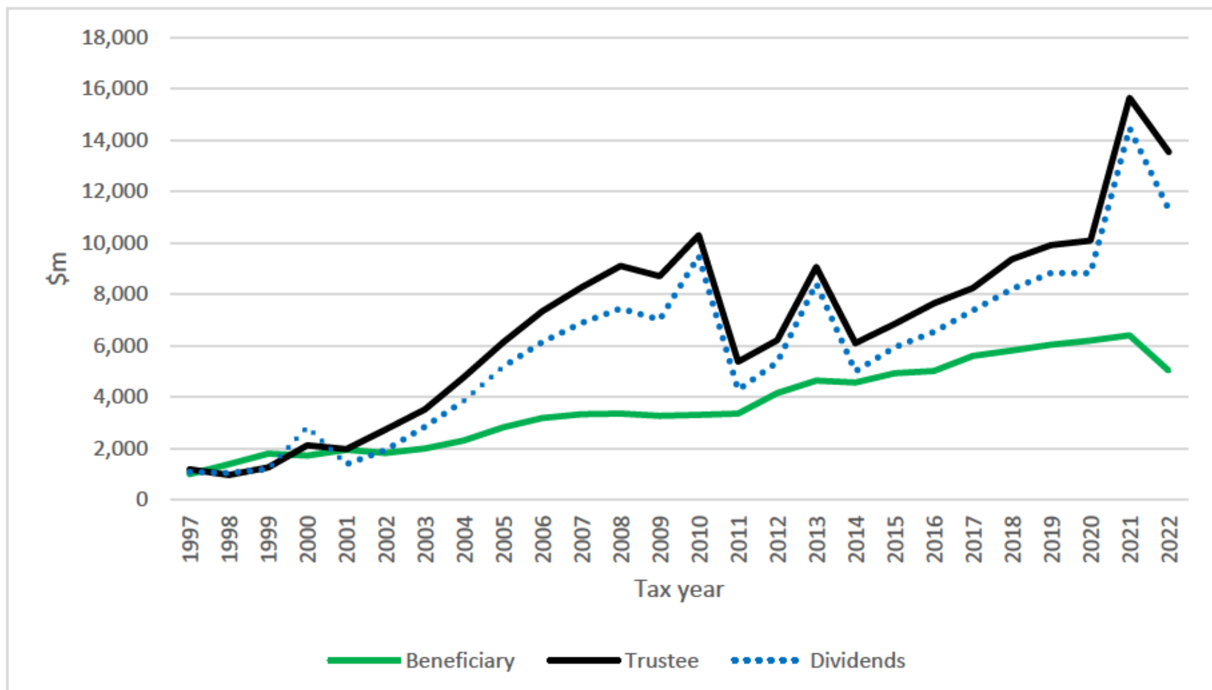
   - **Beneficiary income (taxed at the beneficiary's personal tax rate)** is an amount of income derived by a trustee of a trust and allocated to a beneficiary during any income year that either**:**
     - vests absolutely in the beneficiary during that income year, or
     - is paid or applied for the benefit of the beneficiary within six months after the end of that income year.

   - **Trustee income (taxed at a flat rate of 33%)** is all taxable income derived by a trust in an income year that is not beneficiary income. Subsequent distributions of this income to beneficiaries are tax-free.

4. Individuals on the top personal tax rate can therefore earn income through a trust where it will be subject to a lower 33% tax rate. This has flow on consequences for the progressivity of the income tax system, and the government's ability to raise revenue efficiently through that system.

5. Misalignment between the top personal tax rate and the trustee tax rate has only occurred in two periods – between 2000 and 2010, and 2021 and present; both being periods where the top personal income tax rate was either 38% or 39% respectively:

*Figure 1: Income reported on trust tax returns 1997 – 2022*




6. Figure 1 demonstrates the behavioural response to misalignment between the two rates. Information collected between 2000 and 2010 demonstrated that trusts were increasingly being used to shelter income, with a significant decrease the year after the top personal income tax rate was reduced back to 33% (i.e., the two rates were re-aligned).

7. Following the re-introduction of the 39% top personal income tax rate from 1 April 2021, trust disclosure rules were also introduced to monitor the behavioural response of trusts to the current misalignment. That data shows that trustees are retaining significantly more income as trustee income again.

8. For trusts that allocated beneficiary income in 2020 (prior to the 39% personal tax rate) to an individual with over $180,000 personal income, there has been a significant shift to retain more trust income as trustee income (which is currently subject to a 33% tax rate). The amount of income being treated as trustee income by these trusts has increased by 25 percentage points (from 35% in 2020 to 60% in 2022).

9. The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill ("the Bill") proposes to increase the trustee rate to 39% from 1 April 2024. This would re-align the two rates again, and is expected to mitigate the ability of individuals to circumvent the top personal rate through trusts.

## Policy issue – over-taxation of certain beneficiaries

10. The current 33% trustee tax rate means that individuals that earn tax-paid trustee income from a trust are not subject to the 39% personal tax rate on such distributions, even if they earn over the 39% personal tax rate threshold of $180,000 in personal income and distributed tax-paid trustee income.

11. While the proposals to increase the trustee rate to 39% aim to address the under-taxation of individuals on higher incomes, they also may result in the over-taxation of beneficiaries on lower income tax rates.

12. While trusts can be used by individuals to circumvent the top personal income tax rate, they are also used for a number of non-tax motivated reasons. A 2012 Law Commission review found that trusts are primarily established to protect family assets against various events (i.e., separations, creditors, succession), and to facilitate philanthropic and charitable purposes, or to support vulnerable family members.

13. The risk of over-taxation can currently be mitigated in many situations by the ability of trustees to allocate income to beneficiaries (taxed at the personal tax rate of the beneficiary). However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to. It is very difficult to address under-taxation while mitigating over-taxation.

14. In these cases, beneficiaries will often be over-taxed as a result of misalignment. As the trust rate increases, the materiality of that over-taxation also increases, relative to the individuals marginal tax rate.

15. Without intervention, the proposed increase of the trustee rate to 39% will increase current over-taxation issues further. Special rules are also proposed to buttress the 39% rate and help mitigate over-taxation that could arise for disabled beneficiary trusts and deceased estates. However, consultation has revealed that these special rules are likely to be insufficient to prevent the majority of the expected over-taxation, and that additional amendments are required.

### Objectives of the policy solution

16. The policy solution needs to balance three objectives for the trust tax regime:

    - Amendments should improve the after-tax position of beneficiaries that would otherwise be over-taxed by the current proposals;

    - Amendments should not provide high-income individuals additional means of subverting the base-maintenance intentions of the 39% trustee rate; and

    - Amendments should not be so difficult to comply with or to administer as to make them unattractive to the beneficiaries that are intended to receive relief.

17. Trade-offs are required to meet the balance between addressing under-taxation and mitigating over-taxation. This is because as additional carve outs are added or widened to reduce over-taxation, the ability and incentive for high-income individuals to utilise those carve outs increases.

18. In theory it would be possible to target the relief more specifically without undermining rate alignment, but doing so would require additional complexity in the rules (beyond that already present in the current trust tax regime). This is because the most feasible immediate option would be in tailoring the rules to more specifically identifiable beneficiaries. However, this would require that the beneficiaries either provide

information, or that Inland Revenue invest in new systems to identify a limited subset of beneficiaries more accurately. This would come with diminishing returns for utility.

19. Alternatively, rules could be designed that meet these objectives with a more favourable balance towards relief for over-taxed beneficiaries. However, doing so would require more fundamental adjustments to the trust tax regime. As noted in the coversheet of this report, officials have considered alternative approaches to trust taxation to be out of scope.

## Section 2: Deciding upon an option to address the policy problem

### Criteria for comparing to status quo

20. Options to address the over-taxation of certain beneficiaries have been assessed against the following criteria:

    - **Efficiency** – the options should minimise the excess burden or economic efficiency cost of the tax system (i.e., the cost of raising tax from New Zealanders which is over and above the tax revenue actually raised). This ensures that tax is doing as little as possible to distort labour supply, savings and investment, and entity decisions.

    - **Equity** - the options should ensure that taxpayers with similar levels of income pay similar levels of tax (horizontal equity) and that taxpayers on higher incomes pay higher levels of income tax in a way which reflects the Government's views on how progressive the tax system should be (vertical equity).

    - **Complexity** – the options should minimise the introduction of complexity as much as possible. Generally, complexity should be minimised so that tax laws are easy to comply with and difficult not to. This encourages voluntary compliance over time, which benefits both the tax take as well as paying tax at rates intended by the Government.

    - **Integrity** – the options should maintain protection against taxpayers using other vehicles taxed at lower rates to avoid the proposed top personal income tax rate. Integrity in the tax system ensures that taxpayers cannot access methods or vehicles to avoid paying tax at rates applicable to them given their economic circumstances.

    - **Revenue impact** - The options should be effective at raising the intended amount of revenue for the government.

### Scope that options have been considered within

21. The proposals that are contained in this RIS are a response to consultation sought following the introduction of the Bill, and where that Bill has short window for report back because of the general election (i.e., before the end of March 2024). As a result, the scope of this policy project has been unusual, in that it is constrained to amendments to an existing Bill which is already materially progressed.

22. Under normal policy processes, consultation would have been sought prior to the introduction of the Bill, which would have informed policy suggestions under the wider scope of the original policy project (i.e., during Budget 2023). However, owing to the combination of the Budget 2023 secrecy of the original proposal, and the interceding 2023 general election, officials have not been able to provide Ministers with alternatives to the proposed rules for the 39% trustee rate until very recently.

23. As a result, the proposals provided in this and accompanying reports have been defined within a narrow scope, owing to the delay required for the policy process.

## Options under consideration

24. Officials have considered the following options:

- **Option one** – maintain the status quo, and pass the Bill with no further amendments.

- **Option two** – amend the Bill to make various changes:

  - Introduce a $10,000 trustee income de minimis, with a 33% rate below the de minimis;
  - Simplify and expand the existing proposals for deceased estates and disabled beneficiary trusts;
  - Exclude energy consumer trusts and legacy superannuation funds from the 39% rate; and
  - Make other technical amendments related to corporate beneficiaries and securitisation trusts.

- **Option three** – amend the Bill to make various changes:

  - Simplify and expand the existing proposals for deceased estates and disabled beneficiary trusts;
  - Exclude energy consumer trusts and legacy superannuation funds from the 39% rate; and
  - Make other technical amendments related to corporate beneficiaries and securitisation trusts.

25. Options two and three share many of the same sub-components. Individually, these sub-components have marginal impacts on the assessment criteria, with the most material impact coming from the inclusion (or exclusion) of the trustee income de minimis. For simplicity and readability, these sub-components have been summarised below, and the assessment that follows will directly reference the material below.

***Trustee income de minimis***

26. A de minimis for trustee income would mean that trusts with trustee income up to the threshold (i.e., $10,000) would be subject to the current 33% trustee tax rate. Trusts with trustee income greater than the de minimis would be subject to the 39% tax rate on all trustee income.

27. This proposal recognises that whether a beneficiary is over or under-taxed is not necessarily correlated to the amount of trustee income that is earned by the trust. For example, in the 2022 tax year, 9% of trusts with $10,000 or less trustee income had a beneficiary that earned over $180,000 (i.e., a 39% beneficiary).

28. However, given the concentration of trustee income in a relatively small number of trusts, a trustee income de minimis could help reduce over-taxation for many trusts while still addressing most of the under-taxation of trust income.

29. Based on data from the 2022 tax year, 76,000 trusts had positive trustee income after expenses and losses. Therefore, a $10,000 trustee income de minimis would mean

that 27,000 trusts (36%) would no longer be impacted by the proposed 39% trustee tax rate.

30. A de minimis threshold of $10,000 also provides a maximum benefit of $600 per trust (compared with the 39% trustee tax rate). Given the compliance costs of running a simple trust, the risk that taxpayers will set up multiple trusts to benefit from the de minimis is low. However, a higher threshold would create a greater incentive for taxpayers to set up multiple trusts.

31. The proposed de minimis would come with a fiscal cost of $14m over the forecast period.

***Simplified / expanded rules for deceased estates and disabled beneficiaries***

32. The Bill includes proposals that would provide relief from the 39% trustee rate for two subsets of trusts:

    - **Disabled beneficiary trusts** – are trusts that have one beneficiary, and where that one beneficiary is a disabled person (as determined by their eligibility for specific government payments). These trusts would be taxable on trustee income at the beneficiary's marginal tax rate.

    - **Estates** – the estates of deceased persons are taxed as trusts. An estate would treat income received from the deceased as taxable at the deceased person's marginal tax rate if it was received within 12 months of the person's death.

33. These specific carve outs were included in the Bill to meet specific policy objectives (i.e., to mitigate the over-taxation of the disabled, and to ensure the rules were not punitive for estates). Following feedback received, officials have recommended adjustments to these two proposed carve outs:

    - The types of government payments that would qualify a person as disabled for the purposes of the exemption should be expanded to increase the modification's coverage. Disability trusts would be allowed to retain the 33% trustee rate concession if they have one or more disabled beneficiaries. If multiple beneficiaries are permitted, officials also recommend allowing disabled beneficiaries to be added or removed, as long as there is at least one disabled beneficiary remaining.

    - The period of time that estates would receive relief would be extended by three years to ensure that complex estates are not treated punitively. Estates would be taxed at 33% instead of the deceased's marginal tax rate to simplify the administration of the carve out, and the modification would apply automatically to qualifying estates.

34. Officials expect that these changes would ensure the proposals in the Bill cover the originally intended beneficiaries. The amendments for disabled beneficiaries are not expected to come with a fiscal cost, while the amendments for estates are expected to raise an additional $7m over the forecast period. The additional revenue reflects the change to applying a flat 33% tax rate instead of the deceased person's marginal tax rate (because some deceased people would have been on lower personal tax rates than 33%).

*Exclude energy consumer trusts and legacy superannuation funds*

35. Submissions from stakeholders have identified two additional subsets of trusts that would be treated punitively by the current drafting of the rules:

    - **Energy consumer trusts** – Most electricity distribution companies in New Zealand are owned by trusts or local councils. There are 20 "energy consumer trusts" that are subject to tax. The beneficiaries of these trusts are the persons whose premises are connected to the energy company's distribution network. Under the current rules, some of these trusts may not be able to use beneficiary income allocations to mitigate over-taxation effectively.

    - **Legacy superannuation funds** – Superannuation funds that have less than 20 members are subject to ordinary trust rules and would be subject to the proposed 39% trustee tax rate. Many widely-held superannuation funds are registered as "restricted" schemes that are closed to new members. Over time, these funds will fall out of the widely-held definition (subject to tax at 28%) and be subject to the 39% trustee tax rate due to declining membership.

36. Proposals would subject both subsets of trusts to a trustee tax rate of 33%. Both subsets are easily identifiable, and are unlikely to be difficult to administer relief for. Both subsets of trusts could be considered to be over-taxed in their respective scenarios.

37. The amendments for energy consumer trusts are expected to cost $5m over the forecast period. The amendments for legacy superannuation funds are not expected to come with a fiscal impact within the forecast period.

*Additional technical amendments*

38. Additional amendments are proposed to ensure that rules relating to corporate beneficiaries function as intended. These amendments do not impact a material number of taxpayers, nor do they come with an expected fiscal impact. Officials consider these amendments help ensure the increase in the proposals work as intended.

## Options analysis

### Option one – status quo – no additional relief for over-taxation for certain beneficiaries

39. This option represents no changes to the current proposals in the Bill, and therefore, maximises integrity while sacrificing relative equity (both horizontal equity and vertical equity).

*Efficiency*

40. The status quo would result in the lowest distortions *towards* trusts (i.e., the lowest number of incentives to use a trust to reduce tax payable) while also resulting in the most distortions *away from* trusts (i.e., the highest tax-related costs for trusts created for non-tax purposes). It is difficult to quantify this effect as the 39% rate has not yet been implemented as drafted.

*Equity*

41. The status quo would ensure the largest number of high-income beneficiaries are not able to use trusts to shelter income from the 39% rate. This would support the underlying progressive structure of the income tax system.

42. Conversely, the status quo would also subject the largest number of low-income beneficiaries to over-taxation. This would detract from both the horizontal and vertical equity of the current trust tax settings.

*Complexity*

43. The status quo would maintain the same level of complexity as is currently present in the Bill.

*Integrity*

44. The status quo would come with the greatest level of integrity for the tax system, as the fewest avenues to abuse the current trust tax rules would be available.

*Revenue impact*

45. The status quo represents the current expected fiscal impact of the 39% trustee rate proposal.

**Option two – introduce all proposed amendments to the current Bill**

46. This option is Inland Revenue's preferred option.

47. This option would implement all of the proposals to mitigate the over-taxation of certain beneficiaries, and result in the least over-taxation of all options. Conversely, this option would also create the potential for some abuse by high-income beneficiaries (specifically, through the $10,000 de minimis threshold), though the risk of this is low and is limited to the tax benefit of the threshold. A de minimis threshold of $10,000 provides a maximum benefit of $600 per trust (compared with a 33% tax rate).

48. This option also represents the largest fiscal cost. Complexity is marginally increased by the de minimis but is reduced by the other measures.

*Efficiency*

49. Option two would represent the most elimination of distortions away from the use of trusts of all the options for those trusts created for non-tax reasons.

50. Option two also retains the 39% trustee rate and therefore the disincentive to use trusts for primarily tax reasons. However, the de minimis threshold of $10,000 does still provide some limited tax planning opportunities in setting up multiple trusts to make use of the threshold multiple times. Officials consider that, given the compliance costs of running a trust, the risk that taxpayers will set up multiple trusts to benefit from the de minimis is low.

51. For the purposes of comparing this option to option three, the following subsets of the option are considered to exclusively improve the efficiency of the tax system:

- Simplifying and expanding the existing proposals for deceased estates and disabled beneficiary trusts;
- Excluding energy consumer trusts and legacy superannuation funds from the 39% rate; and
- Making other technical amendments.

***Equity***

52. Option two would ensure that the largest number of low-income beneficiaries are not impacted by a 39% trustee tax rate. Conversely, this option would also ensure that the majority of high-income beneficiaries would not be able to earn income from a trust that has been taxed at a lower rate.

53. As noted above, there is a low risk that a limited subset of high-income beneficiaries may attempt to use the de minimis to circumvent the 39% trustee tax rate, though this issue is primarily considered from the perspective of integrity, rather than equity for the purposes of this assessment.

54. For the purposes of comparing this option to option three, the following subsets of the option are considered to exclusively improve the horizontal equity of the tax system:

- Simplifying and expanding the existing proposals for deceased estates and disabled beneficiary trusts; and
- Excluding energy consumer trusts and legacy superannuation funds from the 39% rate; and
- Making technical amendments to the corporate beneficiary rules.

55. Of the options assessed, option two represents the greatest weighting towards horizontal equity, and for ensuring that low-income beneficiaries are over-taxed the least.

***Complexity***

56. Option two marginally increases complexity in relation to the de minimis, but reduces complexity for all other measures:

- **$10,000 de minimis threshold** – this amendment will introduce minimal complexity into the trust tax regime. Trustees with beneficiaries that are at or above a marginal tax rate of 33% are incentivised to retain trust income up to the de minimis threshold. This additional complexity is marginal and considered by officials to be of low impact.

- **Disability trusts** – Allowing multiple disabled beneficiaries reduces complexity because one disability trust can be settled for multiple disabled beneficiaries (rather than one trust being settled per beneficiary to access the modification). Some complexity is also removed relative to the status quo owing to a larger number of government support payments being used to determine eligibility.

- **Estates** – this amendment will reduce complexity for estates relative to the status quo. Estates will no longer be required to track the deceased marginal tax rate, and will be able to rely on a flat rate concession for a period of 4 years. The modification being automatically applied also reduces complexity.

57. Other amendments reduce complexity as they remove subsets of trusts from the regime relative to status quo (i.e., they continue pre-existing treatment), or are amendments exclusively to improve the functionality of rules at status quo.

***Integrity***

58. Option two reduces integrity relative to the status quo (i.e., the introduction of the 39% trustee rate without other amendments).

59. The de minimis provides limited scope for high-income beneficiaries to benefit from a 33% trustee tax rate, despite their marginal income tax rate being above 33%. As noted above, the expected structuring response is likely to be low, owing largely to the costs of administering multiple trusts, relative to the maximum tax savings per trust (which are $600 per year). However, officials expect there will be some occasions where taxpayers will be able to generate a favourable offset between administration costs and tax savings, such that the de minimis will be a favourable concession to exploit.

60. The number of taxpayers expected to abuse the de minimis by setting up multiple trusts is expected to be very low, but the amendment does represent a net decrease in integrity relative to status quo.

61. All other amendments are not expected to have any impact on integrity, as they do not provide new opportunities for trust structuring, nor do they eliminate existing opportunities for trust structuring.

***Revenue impact***

62. Option two represents the largest fiscal cost relative to status quo, and combined all the changes will cost $12m over the forecast period.

**Option three – introduce all amendments other than the de minimis threshold**

63. This option is the Treasury's preferred option.

64. Option three is materially very similar to option two, but would not progress the amendment for a $10,000 de minimis threshold. This would preserve the full integrity benefits of the status quo, while resulting in more over-taxation of low-income beneficiaries relative to option two. The assessment below will largely reflect a comparison directly to option two and the assessment provided above.

65. This option is less complex than option two and is the only option with a fiscally positive impact.

***Efficiency***

66. Option three would reduce over-taxation for some trusts created for non-tax reasons, and therefore reduces distortions relative to the status quo. However, option three

would still impose the same increase in the trustee rate on trusts that would otherwise have been subject to the de minimis, and therefore eliminates slightly fewer distortions than option two as trusts with trustee income under $10,000 may still be over-taxed.

***Equity***

67. Option three would reduce the over-taxation of low-income beneficiaries relative to the status quo, but would not reduce over-taxation as much as option two (as a result of not having a de minimis threshold). Additionally, fewer high-income beneficiaries would be able to earn income from a trust that has been taxed at a lower rate than in option two.

68. Of the options, option three represents the greatest weighting towards targeted relief for specific vulnerable beneficiaries, but does not provide as wide horizontal equity benefits as option two.

***Complexity***

69. Option three is more complex than the status quo, but less complex than option two. As noted above, the de minimis threshold minimally increases the complexity of the tax system. Without that component, option three retains the slight increase in complexity resulting from all other components.

***Integrity***

70. Option three represents an equal impact on integrity as the status quo, as no material means of circumventing the 39% rate for high-income beneficiaries are provided.

***Revenue impact***

71. Option three represents the most positive fiscal impact, and would have a lower revenue cost of $2m over the forecast period. This is a result of eliminating the $14m cost of the de minimis threshold over the forecast period.

## Option comparison relative to the status quo

| | Option One – Status Quo | Option Two – all amendments | Option Three – no de minimis, all other amendments |
|---|---|---|---|
| **Efficiency** | 0 | ++<br>*Eliminates the largest number of distortions for the use of trusts relative to the status quo.* | +<br>*Materially eliminates distortions for the use of trusts relative to the status quo.* |
| **Equity** | 0 | ++<br>*Provides low-income beneficiaries with the largest relief from over-taxation relative to the status quo.* | +<br>*Provides vulnerable beneficiaries with more relief from over-taxation relative to the status quo.* |
| **Complexity** | 0 | +<br>*Marginal increase in complexity from the de minimis but most other measures decrease complexity.* | ++<br>*The majority of measures under this option decrease complexity.* |
| **Integrity** | 0 | -<br>*Slightly lowers the impact of the 39% trustee rate in improving the integrity of the tax system relative to the status quo.* | 0<br>*Retains the integrity improvement of the 39% trustee rate, and is therefore equal to the status quo.* |
| **Revenue Impact** | 0 | -<br>*Higher fiscal cost relative to status quo.* | +<br>*Revenue positive relative to status quo.* |
| **Overall** | 0 | This option best meets the objective of lowering the over-taxation of low-income beneficiaries. | This option best balances all objectives, is less complex but does not deliver as much relief to low-income beneficiaries. |

## Option to best meet policy objectives

**Inland Revenue's view**

72. Inland Revenue supports all the proposed changes to the increase in the trustee tax rate (Option 2). The changes will reduce the instance of over-taxation of lower tax rate beneficiaries, simplify the rules and reduce compliance costs. Specifically, in relation to the proposal for a $10,000 trustee income de minimis of $10,000, Inland Revenue considers this strikes a balance between mitigating over-taxation and the fiscal cost of the proposal.

73. A de minimis would not add much complexity for taxpayers and it would relieve 27,000 trusts of the impact of the increased trustee tax rate, some of which are likely to have low-income beneficiaries. A de minimis of $10,000 also caps the tax benefit at $600 per

trust (compared to a 33% trustee rate). Inland Revenue considers that all other proposed changes mitigate over-taxation, reduce the complexity of the proposals or help ensure the proposals work as intended.

**The Treasury's view**

74. The Treasury supports option three as the best option for meeting the stated objectives.

75. The Treasury views the de minimis threshold as a low value-for-money method of delivering relief to low-income beneficiaries, could be poorly targeted, and believes that the cost of the de minimis would be better utilised by other initiatives across the Government:

    - The level of benefit provided by the de minimis to affected trusts is low (i.e., a maximum of $600 per annum), with the average level of benefit expected to be substantially lower. The benefit of this de minimis is likely to be disproportionately flowed-through to individuals with high effective marginal tax rates.

    - Additionally, complexity introduced to the tax system (i.e., introducing functionally progressive rates for trusts) is also large relative to the benefit provided; reducing the functional benefit of the cash benefit.

76. All other proposed amendments are considered good-value-for-money means of delivering the intended relief for over-taxed individuals.

## Section 3: Delivering an option

### How will the new arrangements be implemented?

77. Amendments to the Income Tax Act 2007 would be required to implement the proposals. These changes are proposed to be included in the Bill via the departmental report at the select committee stage. The proposals are recommended to apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts), with a commencement date of 1 April 2024.

78. Inland Revenue will work with stakeholders and tax intermediaries on communicating the proposals to affected taxpayers. The specifics of any education campaigns and communications strategies will be considered once policy proposals have been agreed to by Cabinet. The usual guidance will be published on the proposed changes on Inland Revenue's website and in a Tax Information Bulletin shortly after the proposals are enacted.

### How will the new arrangements be monitored, evaluated, and reviewed?

79. Increased trust disclosure rules were introduced for the 2021-22 and later income years. It is expected that these disclosure rules will be part of the monitoring of the effectiveness of the proposed changes, particularly in relation to the de minimis threshold. This is in addition to the requirement for trusts to file returns in relation to their income on an annual basis. A review of the trust disclosure rules is proposed in 2024.

# Cabinet Business Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

## Proposed Changes to the 39 Percent Trustee Tax Rate

**Portfolio** **Finance / Revenue**

On 25 January 2024, the Cabinet Business Committee:

1 **agreed** that trusts and estates with up to $10,000 in trustee income in an income year should be subject to a 33 percent tax rate;

2 **noted** the following changes as a result of the decision in paragraph 1 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | (1.0) | (7.0) | (3.0) | (3.0) |
| **Total Revenue** | **-** | **(1.0)** | **(7.0)** | **(3.0)** | **(3.0)** |
| **Total Operating** | **-** | **1.0** | **7.0** | **3.0** | **3.0** |

3 **agreed** to apply a 33 percent tax rate to trustee income derived by trustees of all estates in the income year of death, plus the following three full income years;

4 **noted** the following changes as a result of the decision in paragraph 3 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | - | 3.0 | 2.0 | 2.0 |
| **Total Revenue** | **-** | **-** | **3.0** | **2.0** | **2.0** |
| **Total Operating** | **-** | **-** | **(3.0)** | **(2.0)** | **(2.0)** |



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5 **agreed** to make the following changes to the disabled beneficiary trusts modification:

5.1 define "disabled beneficiary" for an income year to mean a person for whom one or more of the following support payments is paid for at least part of the income year (or the income year in, or before, the person turned 65 years of age);

5.1.1 the disability allowance;

5.1.2 the child disability allowance;

5.1.3 the supported living payment on the ground of restricted work capacity; or

5.1.4 the JobSeeker Support Health and Disability (if this has been paid for at least 6 months);

5.2 apply a 33 percent tax rate to trustee income of disabled beneficiary trusts;

5.3 allow disabled beneficiary trusts to have multiple disabled beneficiaries;

5.4 allow disabled beneficiaries to be added to, or removed from, a disabled beneficiary trust, as long as there is at least one disabled beneficiary remaining after a beneficiary is removed;

6 **agreed** that energy consumer trusts should be excluded from the 39 percent trustee tax rate and taxed at 33 percent on trustee income;

7 **noted** the following changes as a result of the decision in paragraph 6 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts: Tax Revenue | - | - | (3.0) | (1.0) | (1.0) |
| **Total Revenue** | **-** | **-** | **(3.0)** | **(1.0)** | **(1.0)** |
| **Total Operating** | **-** | **-** | **3.0** | **1.0** | **1.0** |

8 **agreed** that legacy superannuation funds should have the same tax treatment as widely-held superannuation funds (28 percent tax rate);

9 **agreed** to make the following changes to the corporate beneficiary rule:

9.1 the proposed corporate beneficiary rule should apply if a settlor of the trust making the beneficiary income allocation is a (direct or indirect) shareholder of the company;

9.2 the proposed corporate beneficiary rule should apply if a trust makes a beneficiary income allocation to a company that has a trustee shareholder, and a settlor of the trust making the allocation has natural love and affection for a beneficiary of the trust that is the shareholder of the company;

9.3 the proposed corporate beneficiary rule should not apply to securitisation trusts;



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10 **agreed** that the amendments approved above should apply for the 2024– 25 and later income years (1 April 2024 for most trusts);

11 **noted** that the amendments agreed above will be included in the departmental report on the Taxation (Annual Rates for 2023– 24, Multinational Tax, and Remedial Matters) Bill to be provided to the Finance and Expenditure Committee by 9 February 2024;

12 **noted** the overall changes as a result of the decisions in paragraphs 1, 3, and 6 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Tax Revenue | - | (1.0) | (7.0) | (2.0) | (2.0) |
| **Total Revenue** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** |
| **Total Operating** | **-** | **1.0** | **7.0** | **2.0** | **2.0** |

13 **noted** that the responsible Ministers have agreed to manage the cost of the changes against the Tax Policy Scorecard.

Rachel Clarke
Committee Secretary

**Present:**
Rt Hon Christopher Luxon (Chair)
Rt Hon Winston Peters
Hon David Seymour
Hon Nicola Willis
Hon Chris Bishop
Hon Brooke van Velden
Hon Simeon Brown
Hon Paul Goldsmith
Hon Dr Shane Reti
Hon Shane Jones
Hon Erica Stanford
Hon Judith Collins
Hon Simon Watts
Hon Andrew Bayly
Hon Andrew Hoggard

**Officials present from:**
Office of the Prime Minister
Department of the Prime Minister and Cabinet



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# POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:** **39% trustee tax rate – recommended changes to the Multinational Tax Bill**

| **Date:** | 20 December 2023 | **Priority:** | High |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2023/291 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Agree** to recommendations | 19 January 2024 |
| Minister of Revenue | **Agree** to recommendations | 19 January 2024 |

## Contact for telephone discussion (if required)

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Chris Gillion | Policy Lead<br>Inland Revenue | s 9(2)(a) |
| Carl Harris | Senior Policy Advisor<br>Inland Revenue | s 9(2)(a) |

20 December 2023

Minister of Finance
Minister of Revenue

# 39% trustee tax rate – recommended changes to the Multinational Tax Bill

## Executive summary

1. The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill includes proposals to increase the trustee tax rate to 39% from 1 April 2024. The Bill is currently before the Finance and Expenditure Committee. We are seeking your agreement to include amendments in the Departmental Report to the Bill to mitigate the risk of over-taxation of trust income and simplify the proposals.

## Background

2. The previous Government introduced proposals to increase the trustee tax rate to address concerns regarding the under-taxation of trust income and raise revenue for Budget 2023. The current 33% trustee tax rate means that individuals that earn tax-paid trustee income from a trust are not subject to the 39% personal tax rate on such distributions, even if they earn over $180,000 in personal income and distributed tax-paid trustee income. This undermines the fairness of the tax system.

3. While addressing the current under-taxation of trust income, it is also important as far as possible to mitigate any over-taxation. This arises when trustee income is taxed at a rate higher than the personal tax rates of the beneficiaries and settlors of the trust. Over-taxation is an existing issue with the 33% trustee rate that will be exacerbated by increasing the rate to 39%.

4. The risk of over-taxation can currently be mitigated in many situations by the ability of trustees to allocate income to beneficiaries (taxed at the personal tax rate of the beneficiary). However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to. It is very difficult to address under-taxation while mitigating over-taxation.

5. The Bill currently contains proposals to further help mitigate the risk of over-taxation of deceased estates and disabled beneficiary trusts. Any further changes to the 39% trustee tax rate will likely have a fiscal cost.

6. Due to Budget sensitivity, we were unable to undertake public consultation during the development of the proposals. However, since Budget we have undertaken consultation with a large number of stakeholders. Feedback from most stakeholders and submitters on the Bill have focused on the risk of over-taxation of trust income.

## Proposed changes

7. In response to feedback from submitters, we recommend introducing the following changes to the proposals in the Bill via the Departmental Report:

- **Introducing a $10,000 trustee income de minimis** would ensure that 36% of trusts (27,000 trusts) with some trustee income would not be affected by the proposed 39% trustee tax rate. These trusts would continue to be subject to a 33% trustee tax rate. Given the concentration of trustee income in a relatively

small number of trusts, this would reduce the over-taxation of many trusts while still addressing most of the under-taxation of trust income.

- **Simplifying and expanding the proposals relating to deceased estates and disabled beneficiary trusts** would reduce the risk of over-taxation and the costs of complying with the proposals.
- **Excluding energy consumer trusts and legacy superannuation funds from the 39% trustee tax rate** would reduce the risk of over-taxation. These trusts have limited ability to mitigate over-taxation.
- **Making other technical amendments** to ensure a proposed integrity rule targeted at the use of companies to shelter trust income from the 39% tax rate works as intended.

8. Attached to this report is an extract of the draft Departmental Report relating to the trustee tax rate proposals. The draft responses to submissions have been prepared in line with the recommendations in this report. Recommendations relating to other proposals in the Bill are included in the separate report IR2023/221.

9. The Finance and Expenditure Committee are yet to hear public oral submissions on the Bill, scheduled for 31 January 2024. Following this we will report back to you seeking approval to include any new recommendations into the Departmental Report if they arise from submissions.

### Financial and administrative implications

10. Over the forecast period (2023/24 to 2027/28), the net fiscal impact of the recommended changes is estimated to be a revenue loss of $12 million.

11. We recommend that this impact be charged against the Tax Policy Scorecard. For more information on how the direct fiscal impacts of tax changes can be managed through the Scorecard, refer to the briefing note BN2023/290: *The purpose and uses of the Tax Policy Scorecard*.

| | $m – increase/(decrease) | | | | | |
|---|---|---|---|---|---|---|
| **Vote Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 and outyears | Total over forecast period |
| Crown Revenue and Receipts: Tax Revenue | | | | | | |
| *Trustee income de minimis* | - | (1.0) | (7.0) | (3.0) | (3.0) | (14.0) |
| *Deceased estates* | - | - | 3.0 | 2.0 | 2.0 | 7.0 |
| *Energy consumer trusts* | - | - | (3.0) | (1.0) | (1.0) | (5.0) |
| **Total change in Revenue** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** | **(12.0)** |

12. The administrative and implementation costs of the recommended changes in this report are covered by the estimated costs already approved as part of Budget 2023.

### Next steps

13. Subject to your approval, the recommendations outlined in this report will be included in the Departmental Report that will be provided to the Finance and Expenditure Committee by 9 February 2024 for their consideration.

## Recommendations

We recommend that you:

a **indicate** in the body of the report where you agree or do not agree with a recommendation.

Indicated | Indicated

b **agree** that the approved amendments outlined in this report should apply for the 2024–25 and later income years (1 April 2024 for most trusts).

Agreed/Not agreed | Agree/Not agreed

**Chris Gillion**
Policy Lead
Inland Revenue

**Hon Nicola Willis**
Minister of Finance
/ /2024

**Hon Simon Watts**
Minister of Revenue
/ /2024

## Background

14. Trustee income is all taxable income earned by a trust in an income year that is not beneficiary income. The trustee tax rate is a final tax, meaning that distributions of tax-paid trustee income to beneficiaries are not subject to any further tax.

15. The current 33% trustee tax rate means that individuals are not subject to the 39% personal tax rate on the distributed tax-paid trustee income, even if they earn over $180,000 in (combined) personal income and distributed tax-paid trustee income. This is **under-taxation** of trust income, which undermines the fairness of the tax system.

16. While addressing the current under-taxation of trust income, it is also important as far as possible to mitigate any **over-taxation**. This arises when trustee income is taxed at a rate higher than the personal tax rates of the beneficiaries and settlors of the trust. Over-taxation is an existing issue with the 33% trustee rate that will be exacerbated by increasing the rate to 39%.

17. The main way that trustees can mitigate the over-taxation of trust income is by allocating income to beneficiaries as beneficiary income – this is taxed at the personal tax rate of the beneficiary. The definition of beneficiary income is broad and includes cash distributed to a beneficiary, income allocated to the beneficiary's current account (available to be called upon by the beneficiary), and income allocated to a beneficiary for them to possess at a future date.

18. However, there are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to. Addressing under-taxation while mitigating over-taxation is very difficult to solve.

19. Australia, Canada, the UK, and the US all have broadly similar tax regimes and trust laws to New Zealand. However, in those countries, most trustee income is subject to tax at the top personal rate. New Zealand's current non-aligned tax treatment of trustee income is therefore an outlier in comparison.

### Tax planning using a trust

20. Trusts are often used to split income within a family unit so that tax is paid at low rates under a progressive tax scale. Trustees can allocate beneficiary income as they choose to beneficiaries on lower personal tax rates. To ensure trusts cannot be used to split income with minors (under 16 years of age), the minor beneficiary rule applies to tax beneficiary income derived by minors at the trustee tax rate (rather than the beneficiary's marginal rate).

21. Trusts can also be used to shelter income from high personal tax rates. If a trust has a 39% rate beneficiary (who could also be a settlor of the trust), income may be accumulated in the trust and taxed at the 33% trustee rate; there is no further tax when the income is later distributed to the beneficiary.

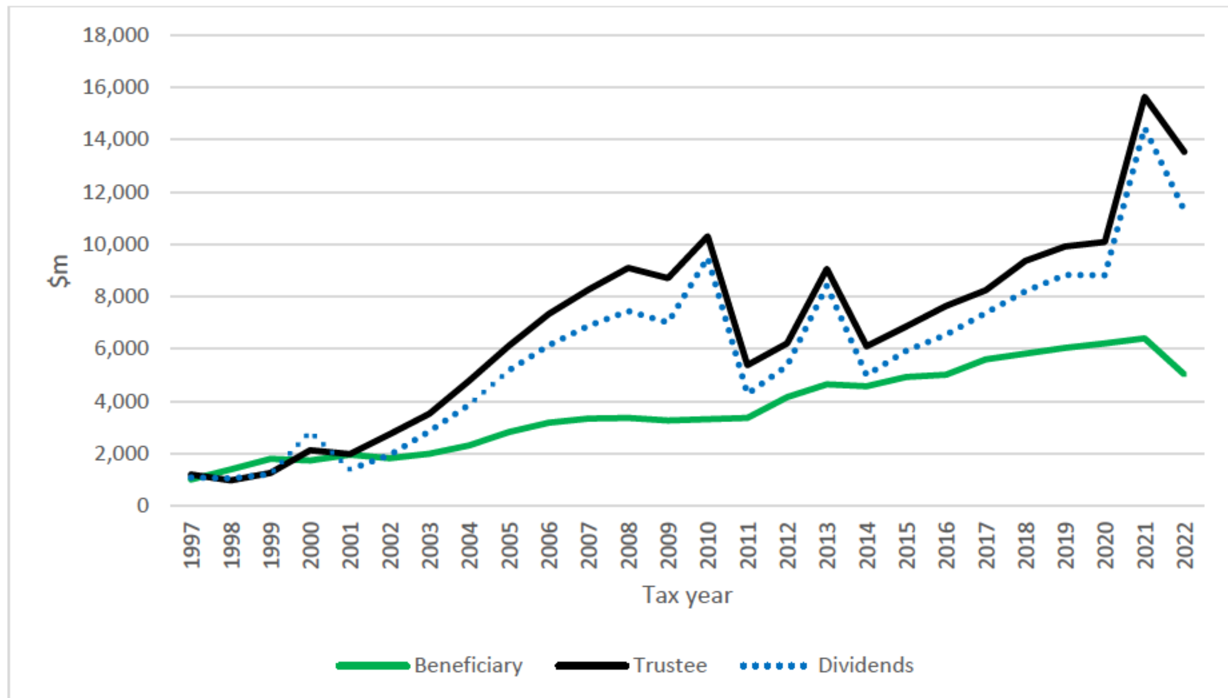
22. Trusts can offer non-tax advantages for those who use them. Settlors can use trusts for family succession planning, to protect assets from creditors and relationship property claims, and to circumvent rules that aim to target government assistance to lower-income people.

23. A settlor can retain enjoyment of trust property by being a beneficiary or having close family members who are beneficiaries. Trusts, therefore, may allow settlors to retain the benefits associated with owning property that has been transferred to a trust while avoiding the burdens and risks of ownership.

## Misalignment in the 2000s

24. Since the introduction of the current tax regime for trusts in 1988, the trustee tax rate has been 33%. This rate was chosen intentionally to achieve alignment with the top personal rate, and it has only fallen out of alignment during the two periods since 2000 when the top personal rate was 39%.

***Figure 1: Income reported by trusts (1997 – 2022)***




25. Figure 1 shows how significant amounts of income were diverted into trusts and taxed as trustee income when the personal tax rate was raised to 39% in 2000 but the trustee rate remained at 33%. Much of the growth of trustee income was in the form of dividends from companies to trustee shareholders. From 2022, the top personal tax rate has again been higher than the trustee rate. In advance of the 39% rate taking effect, companies paid out higher than usual dividends in the 2021 tax year so that trusts or individual shareholders would earn the dividends before the 39% personal tax rate took effect.

## Behavioural response to the 39% personal tax rate

26. Increased trust disclosure rules were introduced for the 2021–22 and later income years. Disclosure and tax return data shows that trustees are retaining significantly more income as trustee income following the introduction of the 39% personal tax rate from 1 April 2021.

27. For trusts that allocated beneficiary income in 2020 (prior to the 39% personal tax rate) to an individual with over $180,000 personal income, there has been a significant shift to retain more trust income as trustee income (which is currently subject to a 33% tax rate). The amount of income being treated as trustee income by these trusts has increased by 25 percentage points (from 35% in 2020 to 60% in 2022).

## Current proposals in the Multinational Tax Bill

28. The Bill proposes aligning the trustee tax rate with the 39% personal tax rate for the 2024–25 and later income years (beginning on 1 April 2024 for most trusts). Special rules are also proposed to buttress the 39% rate and help mitigate over-taxation that could arise for disabled beneficiary trusts and deceased estates.

29. Due to Budget sensitivity, we were unable to undertake public consultation during the development of the proposals. However, since Budget we have undertaken consultation with a large number of stakeholders. Feedback from most stakeholders and submitters on the Bill have focused on the risk of over-taxation of trust income.

## Trustee income de minimis

### Alternative approaches

30. Many submitters have recommended that the proposals should be deferred or not progressed to allow for more consultation and further consideration of the problem. Deferring the 1 April 2024 application date would have a significant fiscal impact. The proposals are estimated to raise approximately $350 million per annum.

31. Submitters also recommended that alternative solutions to the under-taxation of trust income be considered, including introducing an imputation system for trusts or departing from the current trust tax regime to introduce settlor-based rules for the taxation of trustee income. Consideration of alternative approaches that would result in fundamental changes to the trust regime is not feasible in the time available. Some of the proposed alternatives have complex policy issues and would require additional time to implement.

32. Submitters also recommended adopting changes within the existing trust tax regime, including a de minimis for trustee income, tiered tax rates, the use of anti-avoidance provisions, and other technical changes.

### Trustee income de minimis

33. A de minimis for trustee income would mean that trusts with trustee income up to the threshold would be subject to the current 33% trustee tax rate. Trusts with trustee income greater than the de minimis would be subject to the 39% tax rate on all trustee income.

34. The likelihood that trustee income is over- or under-taxed is not necessarily correlated to the amount of trustee income earned. A trust with a small amount of income can still have 39% beneficiaries and settlors. For example, in the 2022 tax year, 9% of trusts with $10,000 or less trustee income had a beneficiary that earned over $180,000 (i.e., a 39% beneficiary).[1]

35. However, given the concentration of trustee income in a relatively small number of trusts, a trustee income de minimis could help reduce over-taxation for many trusts while still addressing most of the under-taxation of trust income. For trusts with taxable income in the 2021 tax year:

- *Trustee income is concentrated in a small number of trusts*: The top 5% of trusts in terms of trustee income (9,000 out of 177,000) accounted for 78% of trustee income ($13.3 billion out of $17.1 billion). These trusts will be most affected by the 39% trustee tax rate.
- *Most trusts have relatively small amounts of trustee income*: The lower 75% of trusts in terms of trustee income (133,000 out of 177,000) accounted for only 2.5% of trustee income ($0.4 billion out of $17.1 billion). This includes the lower 24% of trusts with assessable income (43,000 out of 177,000) that reported only beneficiary income (i.e., they had no trustee income), so would not be impacted by a change in the trustee rate.

[1] This figure may be under-stated. Inland Revenue only holds information on beneficiaries that have received a trust distribution. Therefore, this figure does not include beneficiaries that have not received a trust distribution disclosed to Inland Revenue.

36. Submitters recommended a range of different de minimis thresholds from $10,000 to $100,000. We have considered the options against the potential incentive to settle multiple trusts, the compliance costs of running a trust, the coherence of the tax system, and the fiscal cost. On balance, we recommend setting the de minimis threshold at $10,000.

37. Based on the 2022 tax year, 76,000 trusts had positive trustee income after expenses and losses. A $10,000 trustee income de minimis would mean that 27,000 trusts (36%) would no longer be impacted by the proposed 39% trustee tax rate.

38. Since most trustee income is concentrated in a small number of trusts, a higher de minimis threshold would help more trusts but at a diminishing rate. A higher threshold would also have a larger fiscal cost.

39. A de minimis threshold of $10,000 provides a maximum benefit of $600 per trust (compared with the 33% trustee tax rate). Given the compliance costs of running a trust, the risk that taxpayers will set up multiple trusts to benefit from the de minimis is low. However, a higher threshold would create a greater incentive for taxpayers to set up multiple trusts.

40. Submitters have raised concerns about a range of specific types of trusts that may necessitate specific carve outs if the proposals proceed. Introducing a trustee income de minimis would help a large number of trusts in a consistent way across the tax system and reduce the need for many specific exemptions. Introducing many modifications would increase the complexity of the trust tax regime and reduce its coherence and fairness.

### Financial implications

41. Introducing a $10,000 trustee income de minimis would have a fiscal cost of approximately $14 million over the forecast period (2023/24 to 2027/28).

### Treasury comment

42. The Treasury does not support a trustee income de minimis. The level of benefit provided to affected trusts is low (i.e., a maximum of $600 per annum), with the average level of benefit expected to be substantially lower. The benefit of this de minimis is likely to be disproportionately flowed-through to individuals with high effective marginal tax rates. Additionally, complexity introduced to the tax system (i.e., introducing functionally progressive rates for trusts) is also large relative to the benefit provided. Therefore, while the fiscal cost of the proposal is low, the Treasury does not believe that the relative benefit justifies that cost.

| **Recommendations**<br>We recommend that you: | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|
| c **agree** that trusts and estates with up to $10,000 in trustee income in an income year should be subject to a 33% tax rate. ***(Inland Revenue's recommendation)*** | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Estates

43. Deceased estates are taxed as trusts. It is likely that some estates are already over-taxed at the current 33% trustee tax rate – this would be exacerbated by the proposed 39% trustee tax rate. Unlike trusts, the beneficiaries of an estate may not be known in the income year the estate derives income, so the trustees of the estate may not be able to use beneficiary income allocations to mitigate over-taxation.

44. To help mitigate over-taxation, the Bill currently proposes a modification for estates. The modification provides that trustee income derived by an estate within 12

months of a person's death would be taxed at the deceased's personal tax rate instead of the proposed 39% trustee tax rate. Feedback on the proposed modification largely focused on ensuring the modification applies for enough time and reducing its complexity.

**Extending the length of the modification**

45. Most feedback on the 12-month application period proposed in the Bill was that it would be insufficient since straightforward estates can take at least 18 months to wind up and more complicated estates (such as where assets or beneficiaries are overseas; there are disputes; property needs to be sold; or Māori land is involved) can take up to five years to wind up.

46. We recommend extending the modification to apply for the income year of the deceased's date of death, plus three subsequent income years. We expect 85% of estates would be wound up within this timeframe and a three-year period is consistent with similar rules in Australia and Canada. Furthermore, since 84% of estates have trustee income of $10,000 or less, the de-minimis we are recommending would help to mitigate over-taxation for estates that have not wound up by the time the modification ceases to apply.

**Simplifying the tax treatment**

47. Submitters suggested that applying personal tax rates to the trustee income of estates may be too complex to be worthwhile, particularly for estates that only have small amounts of income. They suggested that instead of applying personal tax rates, a flat tax rate could apply.

48. Applying a flat tax rate would be easier to implement, administer and comply with than personal tax rates, although personal tax rates would provide a more accurate tax outcome. Determining the applicable tax rate would likely have disproportionate compliance costs that could outweigh the benefit of the modification.

49. We recommend applying a 33% flat rate instead of personal tax rates because:

- it is the status-quo, estates will be no worse off under the proposals than they are currently; and
- it is consistent with our recommendations for a trustee income de minimis, disabled beneficiary trusts, and energy consumer trusts. Consistency with other modifications would help keep compliance costs low, and simplify the implementation and administration of the proposals.

**Applying the modification automatically**

50. The proposal in the Bill is optional for taxpayers. We recommend that it applies automatically to all estates that qualify since the recommended changes would result in better tax outcomes for estates and reduce the complexity of the proposal.

**Financial implications**

51. Relative to the proposal in the Bill, applying a 33% tax rate to trustee income earned by trustees of estates in the income year of death plus the following three full income years would raise approximately $7 million in revenue over the forecast period (2023/24 to 2027/28).

52. This change raises revenue because some deceased people would have been on lower personal tax rates than the simpler flat 33% rate we are recommending.

| **Recommendations**<br>We recommend that you: | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|
| d **agree** to apply a 33% tax rate to trustee income derived by trustees of all estates in the income year of death, plus the following three full income years. | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Disabled beneficiary trusts

53. The Bill includes a modification to help mitigate over-taxation for trusts settled for the care of disabled people ("disabled beneficiary trusts"). To qualify, a trust can only have one beneficiary and that beneficiary must be a "disabled beneficiary"[2]. A disabled beneficiary is someone who receives either the child disability allowance or the supported living payment on the ground of restricted work capacity. Trustee income of a disabled beneficiary trust would be taxed at the disabled beneficiary's personal tax rate. Feedback on the modification focused on reducing the complexity of the modification and ensuring it has sufficient coverage.

### Extending the definition of disabled beneficiary

54. Submitters raised concerns that the disabled beneficiary definition is too narrow – disabled people would not qualify if they did not receive the specific Government payments. Submitters had various suggestions for how the definition could be broadened, such as including other Government support payments or adopting a more general definition of disability.

55. To ensure that the rules are simple to comply with and can be administered by Inland Revenue, the eligibility criteria should be objectively verifiable (such as the receipt of Government support payments). We recommend extending the definition to include two other Government support payments – the disability allowance and the JobSeeker Support Health and Disability (if this has been paid for at least 6 months[3]).

56. We acknowledge that some trusts will remain ineligible, such as those with disabled beneficiaries that are not eligible for, or choose not to receive, the relevant support payments. We have limited information on the size of the problem, however Australian data indicates it is not likely to be large[4]. The recommended trustee income de minimis would also help mitigate over-taxation for trusts settled for disabled people that have up to $10,000 of trustee income.

57. We recommend extending the definition to also include people aged 65 or over who would have met the criteria in the income year they turned 65 or the previous income year. This would help ensure that older New Zealanders with disabilities can continue to qualify as a disabled beneficiary despite no longer receiving disability-specific Government support once they transition onto New Zealand Superannuation.

### Simplifying the tax treatment

58. We received feedback that applying the personal tax rate of a disabled beneficiary to trustee income was problematic for two key reasons:

[2] Unless the disabled beneficiary has died, in which case there would be no restrictions on who can receive distributions from a disabled beneficiary trust when it is dissolved.
[3] We would recommend requiring recipients of the JobSeeker payment to have received it for at least six months to be eligible, as this payment may also be made to people who are not disabled. A six-month period provides some consistency with the eligibility criteria for the disability allowance.
[4] There are fewer than 1,000 trusts eligible for the equivalent of a disabled beneficiary trust modification in Australia.

- Determining the applicable tax rate would have disproportionate compliance costs that could outweigh the benefit of the modification.
- There may be privacy issues with applying personal tax rates, as a disabled beneficiary might not want to share their income information with trustees.

59. Additionally, if you agree to allow disabled beneficiary trusts to have multiple disabled beneficiaries, applying personal tax rates to trustee income becomes challenging. This is because when the trustee income is earned, it would be unclear which beneficiary will eventually receive the trustee income.

60. To simplify the proposal and overcome privacy concerns, we recommend applying a flat tax rate to trustee income of disabled beneficiary trusts. We consider a 33% flat rate the most appropriate rate to apply. This would provide for consistency across the recommended modifications and preserve the status quo. Beneficiaries of these trusts would be no worse off than they are under the current 33% trustee tax rate.

**Restrictions on the number of beneficiaries**

61. We received strong feedback that limiting the modification to a single beneficiary was too restrictive. For families with multiple disabled members, allowing disabled beneficiary trusts to have more than one disabled beneficiary would reduce compliance costs because a single trust could be settled for multiple disabled family members.

62. Allowing multiple disabled beneficiaries while taxing these trusts at the personal tax rates of the beneficiaries would be very complex to comply with, administer, and implement. If you agree that disabled beneficiary trusts should be taxed at a flat 33% tax rate, then we also recommend allowing disabled beneficiary trusts to have multiple disabled beneficiaries. This would reduce compliance costs and expand the eligibility criteria for such trusts.

**Power to add or remove beneficiaries**

63. We received feedback from one submitter that most trust deeds include a power to add or remove beneficiaries. Under current proposals, a disabled beneficiary cannot be replaced once the modification has applied to a disabled beneficiary trust. This is an integrity measure to ensure a trust cannot be settled for a disabled beneficiary, have income taxed at rates below 39%, and then have the disabled beneficiary replaced with a person who has a higher personal tax rate at later date.

64. Given our recommendation that multiple disabled beneficiaries be allowed, we recommend modifying this rule so that disabled beneficiaries can be added or removed, as long as there is at least one disabled beneficiary remaining. However, we do not recommend extending this rule to allow non-disabled beneficiaries to be added to a disabled beneficiary trust (unless they are residual beneficiaries who can only receive amounts from a trust upon the death of the disabled beneficiaries).

**Financial implications**

65. The recommended changes to the disabled beneficiary trust modification are estimated to have no material fiscal impact.

| **Recommendations**<br>We recommend that you: | | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|---|
| e | **agree** to define "disabled beneficiary" for an income year to mean a person for whom one or more of the following support payments is paid for at least part of the income year (or the income year in, or before, the person turned 65 years of age):<br>• the disability allowance,<br>• the child disability allowance,<br>• the supported living payment on the ground of restricted work capacity, or<br>• the JobSeeker Support Health and Disability (if this has been paid for at least 6 months). | Agreed<br>Not agreed | Agreed<br>Not agreed |
| f | **agree** to apply a 33% tax rate to trustee income of disabled beneficiary trusts. | Agreed<br>Not agreed | Agreed<br>Not agreed |
| g | **agree** to allow disabled beneficiary trusts to have multiple disabled beneficiaries. | Agreed<br>Not agreed | Agreed<br>Not agreed |
| h | **agree** to allow disabled beneficiaries to be added to, or removed from, a disabled beneficiary trust, as long as there is at least one disabled beneficiary remaining after a beneficiary is removed. | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Energy consumer trusts

66. Most electricity distribution companies in New Zealand are owned by trusts or local councils. There are 20 "energy consumer trusts" that are subject to tax. The beneficiaries of these trusts are the persons whose premises are connected to the energy company's distribution network.

67. Submitters have recommended that energy consumer trusts should be excluded from the 39% trustee tax rate due to concerns that the ability to make beneficiary income allocations or the proposed de minimis will not help mitigate over-taxation. Submitters note that most beneficiaries of energy consumer trusts are not 39% taxpayers, and that it is not always possible or desirable to distribute all taxable income as beneficiary income.

68. On balance, we recommend taxing energy consumer trusts at 33% instead of the 39% trustee tax rate. Although we expect these trusts would be able to distribute income as beneficiary income in most cases, some of these trusts may face administrative issues or have restrictions in their trust deed that prevent this. We have no integrity concerns with providing an exclusion for these trusts, as they are a well-defined group.

## Financial implications

69. This exclusion would have an estimated fiscal cost of $5 million over the forecast period (2023/24 to 2027/28).

| **Recommendations**<br>We recommend that you: | | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|---|
| i | **agree** that energy consumer trusts should be excluded from the 39% trustee tax rate and taxed at 33% on trustee income. | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Legacy superannuation funds

70. A "widely-held superannuation fund" is a retirement scheme that has 20 or more members (counting associated persons as one person). These funds are taxed at a flat 28% tax rate instead of the trustee tax rate to ensure they have similar tax treatment to portfolio investment entities (PIEs). Furthermore, many retirement schemes have entered into the PIE rules and would not be affected by the proposals.

71. Superannuation funds that have less than 20 members are subject to ordinary trust rules and would be subject to the proposed 39% trustee tax rate. Many widely-held superannuation funds are registered as "restricted" schemes that are closed to new members. Over time, these funds will fall out of the widely-held definition and be subject to the 39% trustee tax rate due to declining membership.

72. Superannuation funds have an increased risk of over-taxation as, under tax law, all their income is trustee income. They cannot make beneficiary income allocations to mitigate over-taxation. We recommend that restricted superannuation funds that satisfied the widely-held test at some point in time are subject to the same tax treatment as widely-held superannuation funds. It is not the policy intent of these rules that such legacy schemes should be subject to a higher tax rate simply due to declining membership.

73. We do not recommend providing special rules for superannuation funds that are not widely-held or legacy schemes. There are no arm's length investment requirements for single-person superannuation funds or private trusts operated as retirement savings vehicles. Generally, concessionary tax treatment for retirement savings vehicles is only provided for widely-held entities such as PIEs. This helps ensure that such entities operate on arm's length terms and do not result in taxpayers receiving tax concessions for investing in related-party transactions.

### Financial implications

74. The proposals to increase the trustee tax rate to 39% did not estimate a fiscal gain due to superannuation funds falling out of the widely-held definition. The proposed change is expected to have a negligible fiscal impact.

| **Recommendations**<br>We recommend that you: | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|
| j **agree** that legacy superannuation funds should have the same tax treatment as widely-held superannuation funds (28% tax rate). | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Corporate beneficiary rule

75. To buttress the 39% trustee tax rate, the Bill includes a proposal to tax certain beneficiary income allocations to companies at the 39% trustee tax rate. Affected allocations would be those where a settlor of a trust has natural love and affection[5] for a (direct or indirect) shareholder of a close company[6]. This is to ensure the proposed rule is targeted towards family trusts and would not affect the commercial use of trusts in large corporate groups.

[5] "Natural love and affection" is an existing concept in tax law. It relates to an action by a person where the motive is induced not by a promise or something in return, but by the natural love and affection the person has for another. Natural love and affection is generally considered to subsist between relatives, whether by blood, marriage, a non-spousal domestic relationship, or adoption. It can be present between close friends as well, although not ordinary acquaintances or colleagues.

[6] A "close company" is a company where five or fewer natural persons or trustees hold more than 50% of the voting interests (treating associated persons as one person).

### Ensuring the rule works as intended

76. Submitters have identified situations where this rule would not work as intended. If the settlor of the trust and the shareholder of the company is the same person, the rule may not apply as it is unclear whether a person can have natural love and affection for themselves. Additionally, if the shareholder of the company is a trustee, then the rule will not apply as a person cannot have natural love and affection for a trustee.

77. To ensure that it is properly targeted, we recommend that the proposed rule also applies if a trust is making a beneficiary income allocation to a company and:

    - a (direct or indirect) shareholder of the company is a settlor of the trust making the distribution; or

    - the shareholder of the company is a trustee and a settlor of the trust making the distribution has natural love and affection for a beneficiary of the trust that owns the company.

### Excluding securitisation trusts from the rule

78. A securitisation is a transaction in which receivables (such as loans to businesses) from a sponsor (typically a finance company) are transferred to a special purpose vehicle trust. The trust issues debt securities to funders/investors and the payments on those securities are supported by the cash-flows from the receivables that have been securitised. Any residual profit in the trust after financing costs, service charges and other expenses is paid to the sponsor, typically in the form of a trust distribution.

79. Submitters have identified that there are situations where a securitisation trust would be impacted by the proposed corporate beneficiary rule. It is not intended for this rule to impact the use of trusts in corporate groups. We recommend that the proposed rule is amended to ensure that it does not apply to securitisation trusts.

### Financial implications

80. The recommended changes to the corporate beneficiary rule would have no fiscal impact.

| **Recommendations**<br>We recommend that you: | | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|---|
| k | **agree** that the proposed corporate beneficiary rule should apply if a settlor of the trust making the beneficiary income allocation is a (direct or indirect) shareholder of the company. | Agreed<br>Not agreed | Agreed<br>Not agreed |
| l | **agree** that the proposed corporate beneficiary rule should apply if a trust makes a beneficiary income allocation to a company that has a trustee shareholder, and a settlor of the trust making the allocation has natural love and affection for a beneficiary of the trust that is the shareholder of the company. | Agreed<br>Not agreed | Agreed<br>Not agreed |
| m | **agree** that the proposed corporate beneficiary rule should not apply to securitisation trusts. | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Financial implications of all the proposed changes

81. The net fiscal impact of recommendations c, d, and i, relating to the trustee income de minimis, deceased estates modification, and energy consumer trusts, is estimated to be a $12 million revenue loss over the forecast period (2023/24 to 2027/28).

| | $m – increase/(decrease) | | | | | |
|---|---|---|---|---|---|---|
| **Vote Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 and outyears | Total over forecast period |
| Crown Revenue and Receipts: Tax Revenue | | | | | | |
| *Trustee income de minimis* | - | (1.0) | (7.0) | (3.0) | (3.0) | (14.0) |
| *Deceased estates* | - | - | 3.0 | 2.0 | 2.0 | 7.0 |
| *Energy consumer trusts* | - | - | (3.0) | (1.0) | (1.0) | (5.0) |
| **Total change in Revenue** | **-** | **(1.0)** | **(7.0)** | **(2.0)** | **(2.0)** | **(12.0)** |

82. We recommend that this impact be charged against the Tax Policy Scorecard. For more information on how the direct fiscal impacts of tax changes can be managed through the Scorecard, refer to the briefing note BN2023/290: *The purpose and uses of the Tax Policy Scorecard*.

| **Recommendations**<br>We recommend that you: | **Minister of Finance** | **Minister of Revenue** |
|---|---|---|
| n **agree** that the net fiscal cost of $12 million over the forecast period (2023/24 to 2027/28) be charged against the Tax Policy Scorecard. | Agreed<br>Not agreed | Agreed<br>Not agreed |

## Administrative implications

83. The administrative and implementation costs of the recommended changes in this report are covered by the estimated costs already approved as part of Budget 2023. The departmental capital and operating costs of this work are self-funded by Inland Revenue (CAB-23-MIN-0142 refers).

## Consultation

84. The Treasury were consulted during the development of this report.

**POLICY AND REGULATORY STEWARDSHIP**

# Tax policy report: Departmental Report on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill

| | | | |
|---|---|---|---|
| **Date:** | 20 December 2023 | **Priority:** | Medium |
| **Security level:** | In Confidence | **Report number:** | IR2023/221 |

## Action sought

| | Action sought | Deadline |
|---|---|---|
| Minister of Revenue | **Agree** to recommendations | 19 January 2024 |

## Contact for telephone discussion (if required)

| Name | Position | Telephone |
|---|---|---|
| Stewart Donaldson | Principal Advisor | s 9(2)(a) |
| Andraya Heyes | Policy Advisor | s 9(2)(a) |

20 December 2023

Minister of Revenue

# Departmental Report on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill

## Executive summary

1. The attached Departmental Report on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill (the Bill) outlines the views of submitters on the Bill and officials' responses to those views. In this report, we seek your approval to accept a number of these submissions that would result in a material change to a current item in the Bill or result in the addition of a new item to the Bill.

2. The Departmental Report also contains a number of matters raised by officials that do not relate to a submission on the Bill. We also seek your approval to recommend the FEC include these changes in the Bill. The recommended changes in the report are remedial in nature and do not have any fiscal impact.

3. Officials are still to hear public oral submissions, scheduled for 31 January 2024. Following this we will report back to you seeking approval to include any new recommendations into the Departmental Report if they arise from the oral submissions.

## Recommended action

We recommend that you:

4. **indicate** in the body of this report where you agree or do not agree with the recommended amendments

   Indicated

5. **note** the agreed amendments will be included in the attached Departmental Report to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill

   Noted

6. **note** a separate report [IR2023/261] recommends setting effective dates for the OECD Pillar Two Global Anti-Base Erosion tax rules, which we also recommend including in the Departmental Report

   Noted

7. **note** a separate report [IR2023/291] outlines changes to the trustee tax rate proposal in the Bill that we also recommend including in the Departmental Report

   Noted

**Stewart Donaldson**
Principal Advisor
Policy and Regulatory Stewardship

**Hon Simon Watts**
Minister of Revenue
/ /2024

## Background

8. The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill (the Bill) is currently being considered by the Finance and Expenditure Committee (the FEC).

9. This report recommends several amendments to the Bill in response to matters raised by submitters and officials.

10. The recommended changes in the report are remedial in nature and do not require Cabinet approval. The changes do not have any fiscal impact. We seek your approval to recommend the FEC include these changes in the Bill.

11. There are adjacent reports [IR2023/261 and IR2023/291] that do recommend amendments to the Bill that have a fiscal impact. The reports outline a recommendation to set effective dates for the OECD Pillar Two Global Anti-Base Erosion tax rules and changes to the trustee tax rate proposal, both of which we also recommend including in the Departmental Report.

12. However, the FEC is yet to hear public oral submissions. Following these oral submissions on 31 January 2024, officials will be seeking your urgent approval to include any recommendations that may arise out of the submissions into the finalised Departmental Report to be sent to the FEC on 9 February 2024

## Matters raised by submitters

13. We recommend the following amendments to the Bill in response to matters raised by submitters.

### Debt/equity swaps

14. A recent amendment to the Income Tax Act 2007 introduced a rule to value shares at their market value if those shares were issued when the company was insolvent and the proceeds were, directly or indirectly, used to pay outstanding debt.

15. This rule was not intended to apply when shares were issued by an insolvent company if they were converted from debt issued when the company was solvent. However, the wording of the legislation does include such arrangements within its scope. We recommend the scope of the provision be narrowed to align with the original policy intent.

16. This amendment should apply retrospectively from 1 April 2023, the date the original provision was enacted.

17. The amendment will have no fiscal impact. The original amendment was estimated to raise $0.2 million tax per year over the forecast period and these convertible notes were not within the intended scope of the amendment and represent a small subset of the overall scope of the amendment, so a nil cost is appropriate.

**Recommendations**

**Agree** that the rule that overrides the value of shares issued by insolvent companies should not apply to shares issued by converting debt issued when the company was solvent.

Agreed/Not Agreed

**Agree** that this should apply from 1 April 2023.

Agreed/Not Agreed

### Related-party debt remission and deemed acquisition

18. When a group remits debt within a wholly-owned group, or in proportion to ownership, a rule in the ITA treats this debt as repaid in full so that no taxable income arises, which reflects that the group is in the same economic position before and after the remission.

19. However, if the debt was provided by a non-resident lender who migrated to New Zealand after the debt was impaired but before the debt was remitted, this same rule results in the lender having taxable income equal to the amount of the impairment, even though it occurred before they were a New Zealand resident.

20. We recommend amending this deemed repayment rule so that in this specific circumstance the amount of deemed repayment is reduced by the amount of the impairment that occurred before the lender became a New Zealand tax resident. The amendment should apply to debts remitted on or after the day following the enactment of the Bill.

21. The amendment will not have a fiscal impact. A lender in this situation can indefinitely defer the derivation of income by not remitting the loan. Therefore, this amendment merely reduces compliance costs rather than tax payable.

**Recommendations**

**Agree** that the deemed repayment of a related-party loan that is remitted by a lender that impaired the loan before migrating to New Zealand should be reduced by the amount of that impairment.

Agreed/Not Agreed

**Agree** that this should apply to debts remitted from the day after the Bill is enacted.

Agreed/Not Agreed

### Transfers from a trust following death of settlor

22. Recent amendments expanded the rollover relief previously available under the bright-line test to several common legal ownership change scenarios where economic ownership of residential land is unchanged or materially unchanged. This includes where land is transferred to a family trust by a settlor (or a group of settlors) or vice versa.

23. The rule that applies when land that was previously transferred to the trust by the settlors is subsequently transferred back to them by the trustee requires that the land each settlor receives from the trustee is in proportion to what they had originally transferred to the trust. A submitter on the Bill pointed out that this proportionality requirement does not allow rollover relief to apply in the scenario where one of the settlors dies and, following their death, all the land (including the deceased’s share) is transferred out of the trust to the surviving settlors. This outcome is contrary to what was intended and is inconsistent with what generally happens in an inheritance context when land is transferred from an estate to a beneficiary of that estate.

24. We recommend relaxing the proportionality requirement of this rule so that rollover relief can apply in the specific scenario where land is transferred to the surviving settlor(s) following the death of one or more settlors.

**Recommendations**

**Agree** to a relaxation of the proportionality requirement that applies when land that was previously transferred from the settlors of a family trust to the trustee is transferred back to the settlors, but only in the specific situation where land is transferred to the surviving settlor(s) following the death of one or more settlors.

Agreed/Not Agreed

**Agree** that this should apply from the date of enactment.

Agreed/Not Agreed

### Correcting extra pay inaccuracy on termination

25. The taxation of extra pay is currently based on the amount of extra pay and the annualised value of all PAYE income payments made to the employee in the four weeks preceding the date the extra pay is paid to the employee. However, the current approach can result in under- or over-taxation in the case of an employee termination where the final payment is not representative of a typical PAYE cycle.

26. To address this, the Bill proposes an amendment that would instead annualise the amount of PAYE income payments received by an employee over the last two paid PAYE periods preceding the employee's final PAYE income payment.

27. Submitters have asked that:

    a. the proposed application date be pushed back to 1 April 2025 to allow payroll providers additional time to update their systems, and

    b. the application of the proposed rule be confined to the situation in which extra pay arises on termination of employment (rather than all situations in which extra pay arises).

28. We agree with these submissions and recommend they be adopted.

**Recommendations**

**Agree** the proposed amendment would be confined to extra pay arising on the termination of employment only.

Agree

**Agree** to defer the application of the proposed remedial until 1 April 2025.

Agreed/Not Agreed

### Taxation of backdated lump sum payments – attendant care payments

29. The Bill contains amendments to the taxation of certain ACC and MSD backdated lump-sum payments. The amendments were intended to capture backdated attendant care payments administered by ACC, but the current drafting does not achieve this, and a number of submitters have pointed this out, requesting their inclusion.

30. Currently, backdated attendant care payments that are made to family members or caregivers are taxed in the year of receipt. This can result in more tax to pay for recipients of these payments who are pushed into a higher income tax bracket in the year of receipt of the payment, compared to if they had received the payment correctly spread over the prior years.

31. We agree that changes should be made to the drafting to capture backdated attendant care payments in line with the policy intent.

| **Recommendations** |
|---|
| **Agree** to amend the drafting of the Bill to include backdated attendant care payments.<br>Agreed/Not Agreed |
| **Agree** that this should apply from 1 April 2024.<br>Agreed/Not Agreed |

### Addition to schedule 32 – overseas donee status

32. In response to a submission from Emergency Alliance, we recommend granting it overseas donee status by adding it to schedule 32 of the ITA.

33. Emergency Alliance is a registered charity providing a single fundraising platform for its eight members, which are all charities currently listed in schedule 32. Emergency Alliance's purpose is to raise funds quickly and respond efficiently to humanitarian crises overseas.

34. We have analysed the charity and consider that Emergency Alliance meets Cabinet's approval criteria for overseas donee status.[1] The charity replaces existing fundraising activities undertaken by its members. As such, adding Emergency Alliance to schedule 32 does not impact fiscal and revenue baselines, and is a remedial change that does not require Cabinet approval.

35. On 26 October 2023, Emergency Alliance initiated an urgent appeal to raise funds for people affected by the escalating humanitarian crisis in Gaza. To align with this humanitarian aid appeal, we recommend that Emergency Alliance receive overseas donee status with effect from 26 October 2023. This application date does not have any systems or administration implications for Inland Revenue.

36. The Treasury and Ministry of Foreign Affairs and Trade have been consulted on this addition to schedule 32.

| **Recommendations** |
|---|
| **Agree** that Emergency Alliance be added to the list of organisations (schedule 32) with overseas donee status in the Income Tax Act 2007.<br>Agreed/Not Agreed |
| **Agree** that the amendment should apply from 26 October 2023.<br>Agreed/Not Agreed |

### Charities: deregistration tax

37. Where an entity is deregistered under the Charities Act 2005 and not reregistered within one year, certain net assets of the entity will be subject to income tax if they are not disposed of or transferred to another person for charitable purposes. This "deregistration tax" is designed as a disincentive to transfer net assets out of the charitable base once they are settled there. A proposal in the Bill would tighten

[1] CM 78/14/1 refers. Cabinet's approval criteria are broadly directed towards charities that carry out international humanitarian aid, such as providing relief from the ravages of war or natural disaster, and economic development in developing countries.

deregistration tax, so that it applies in any case where the charity's net assets are not disposed of or transferred to another registered charity.

38. We consider the retrospective application date for this proposal would unfairly tax charities that are currently in the process of deregistering. We therefore recommend pushing forward the application date of the proposal so that it only applies to charities that deregister on or after 1 April 2024.

**Recommendations**

**Agree** that the deregistration tax proposal should apply only to charities that deregister on or after 1 April 2024.

Agreed/Not Agreed

### Charities: Definition of "gift-exempt body"

39. A proposal in the Bill would extend the definition of a "gift-exempt body" in the Tax Administration Act 1994 to include all charities registered under the Charities Act 2005 and all persons eligible to apply for RWT-exempt status.

40. This change was intended to ensure that integrity provisions relating to the use of donated funds applied to the appropriate entities, however submitters have alerted us to potential unintended consequences resulting from this change. To give time to work through these, we recommend this proposal be withdrawn from the Bill.

**Recommendations**

**Agree** that the "gift-exempt body" definition proposal be withdrawn from the Bill.

Agreed/Not Agreed

## Matters raised by officials

41. We recommend the following amendments be included in the Bill via the Departmental Report.

### Information sharing with Te Whatu Ora for COVID-19 response purposes

42. Information collected by Inland Revenue is held strictly confidential. However, there are limited circumstances in which disclosure is permitted to facilitate the delivery of government services.

43. In 2020, an amendment was made to the Tax Administration Act 1994 allowing information to be shared between Inland Revenue and other "government agencies" for COVID-19 response purposes. This facilitated information sharing between Inland Revenue and the Ministry of Health for contact tracing purposes.

44. However, contact tracing has now been assumed by Health New Zealand – Te Whatu Ora (TWO). TWO is not a "government agency" as defined in the relevant section and so Inland Revenue is unable to disclose information to TWO despite its role in the COVID-19 response.

45. We therefore recommend adding TWO to the definition of "government agency" for the purposes of information sharing so that taxpayer information can be disclosed to TWO for contact tracing purposes.

**Recommendations**

**Agree** to amend the definition of "government agency" in the COVID-19 information sharing provision to include Health New Zealand.

Agreed/Not Agreed

**Agree** that this amendment should apply from 31 March 2024 onwards.

Agreed/Not Agreed

### Setting the early payment discount rate

46. The early payment discount (EPD) incentivises voluntary payment of taxes by businesses in their first year of paying tax. The applicable EPD rate is calculated using the Commissioner's paying rate (the credit use of money interest rate (UOMI rate)) plus 200 basis points, unless otherwise set by the Governor-General.

47. In the recent economic environment, the UOMI rate has changed more often than was envisaged. This has created uncertainty for taxpayers as to which EPD rate will apply to their total tax payable and could result in the under or over payment of tax. This outcome undermines the ability of the EPD to incentivise the voluntary payment of taxes by businesses in their first year of paying tax.

48. To maintain this incentive, we recommend tying the EPD rate to the UOMI rate at 31 March of the preceding income year for the 2024–25 and later income years.

49. For income years that are currently underway and will be finalised prior to the enactment of the Bill (the 2022–23 and 2023–24 income years), we recommend that the EPD be set using the highest UOMI rate applicable during those years plus 200 basis points.

**Recommendations**

**Agree** to base the EPD rate on the credit use of money interest rate at 31 March of the previous income year for the 2024–25 and later income years.

Agreed/Not Agreed

**Agree** to base the EPD on the highest credit UOMI rate during the income year for income years that are currently underway and will be finalised prior to the enactment of the Bill.

Agreed/Not Agreed

### Requirement to file annual Māori authority credit account (MACA) return

50. To reduce compliance costs for taxpayers, a 2022 amendment removed the requirement for a member of a consolidated tax group or consolidated imputation group to file a return for their imputation credit account (ICA) where it has a nil balance at all times during the relevant tax year.

51. We recommend extending this filing treatment to MACA returns where the MACA has a nil balance at all times during the relevant tax year.

52. This change should apply for the 2021–22 and later income years to align with the ICA remedial item.

| **Recommendations** |
| --- |
| **Agree** that a Māori authority that is a member of a consolidated tax or imputation group is not required to file an annual Māori authority credit account (MACA) return where the MACA has a nil balance at all times during the relevant tax year. |
| Agreed/Not Agreed |
| **Agree** that this amendment should apply from the 2021–22 and later income years. |
| Agreed/Not Agreed |

**Time to make a look-through company election**

53. A new company can elect to become a look-through company for tax purposes if this election is made before the last day it has to file its first tax return.

54. There is no policy rationale for requiring the election to be made before the last day for filing and this is inconsistent with other election provisions. In practice, Inland Revenue has allowed elections to be filed on the last day for filing.

55. We recommend aligning the law with Inland Revenue's current practice.

56. This change should apply for income years beginning on or after 1 April 2011 to provide certainty to taxpayers who have relied on Inland Revenue's previous practice.

| **Recommendations** |
| --- |
| **Agree** to amend the last election date for a new company to become a look-through company to be the last day to file the company's tax return. |
| Agreed/Not Agreed |
| **Agree** that this amendment apply to income years beginning on or after 1 April 2011. |
| Agreed/Not Agreed |

**Deductions for expenditure related to mitigating environmental hazards**

57. A rule in the ITA is intended to allow deductions for expenditure that involves avoiding, remedying, or mitigating environmental hazards. However, the rule's provisions contain several technical drafting errors that mean that this policy intent is difficult to achieve in practice. These errors came to our attention through a recent ruling application involving deductions for expenditure to remove asbestos from non-residential buildings.

58. Expenditure on mitigating environmental hazards is likely to become an increasingly important business expense. We therefore recommend technical amendments to ensure the legislation is consistent with the policy intent.

59. The amendments should apply retrospectively from the date the errors were originally enacted (in one case this is 1 October 2005 and in other cases this is 1 April 2008). This would mean amendments to both the Income Tax Act 2004 and the Income Tax Act 2007. It would not only protect past taxpayer positions aligned with the policy intent but also ensure, for taxpayer compliance cost reasons, that other positions taken could not be re-opened.

**Recommendations**

**Agree** to amendments to enable deductions for expenditure which involves avoiding, remedying, or mitigating environmental hazards in line with the policy intent.

Agreed/Not Agreed

**Agree** that this should apply retrospectively on and from 1 October 2005, or 1 April 2008, as relevant.

Agreed/Not Agreed

### Revoking redundant regulation

60. Regulations enacted in 2022 enable Inland Revenue to collect datasets from payment service providers (PSPs) on a regular basis.

61. When the regulations were drafted, PSPs were concerned with Inland Revenue's ability to criminally prosecute a PSP for late information filing, even if it was due to extenuating circumstances. A clause was therefore introduced to provide PSPs with a criminal defence if they took reasonable steps to provide the information by the due date.

62. The Regulations Review Committee (the Committee) subsequently raised concerns that the clause could provide a defence against the offences and criminal penalties outlined in the Tax Administration Act 1994, in which case the clause is ultra vires because it amends the application of primary legislation, when it has not been expressly empowered to do so by the legislation under which it is made.

63. On reviewing the clause, we agree with the Committee and consider the clause should be revoked.

**Recommendations**

**Agree** to revoke the ultra vires clause in the Tax Administration (Regular Collection of Bulk Data) Regulations 2022.

Agreed/Not Agreed

**Agree** that this amendment apply from the day after the date of Royal assent of the Bill.

Agreed/Not Agreed

### Partitioning of land among co-owners

64. In 2023 a rule was enacted to ensure that disposals of land between co-owners on a subdivision of land were not taxed where there is no substantive change in ownership following the subdivision.

65. If there is an effective change in ownership proportions, this should only be subject to tax under the rule if the change is greater than 5%. This 5% rule is intended to ensure that minor differences are ignored (these could arise due to topography for example).

66. The rule as currently drafted is ineffective in achieving the policy intent because:

- it does not apply on a "to the extent" basis, which means if there is no proportionality, the exemption does not apply
- the 5% test only applies to the co-owner who owns the smallest proportion of the land, not all co-owners
- it does not apply if any part of the land is disposed of to a third party. For example, if two siblings purchase land and subdivide it to create two separate houses, and one sibling purchases one of the houses with their partner, the rule would not apply and both siblings would be taxed on a disposal when only the disposal to the partner should be taxed.

67. To align the law with the policy intent, the rule should be amended to ensure that only disposals that constitute an effective change in ownership are taxed.

68. This change should apply from 27 March 2021, the date the rule originally applied from.

**Recommendations**

**Agree** to align the rule concerning disposals of land between co-owners of land on a partition or subdivision with its policy intent to ensure co-owners are only taxed to the extent there is an effective change in their ownership.

Agreed/Not Agreed

**Agree** that the amendment apply from 27 March 2021.

Agreed/Not Agreed

**Unintended land tainting on a partition of land**

69. The land tainting rules impose tax on the disposal of land owned by a person who is associated with a land developer, if the land is acquired at the time the developer is in business and disposed of within 10 years of acquisition.

70. We recommend the land tainting rules are amended so they do not apply to a disposal of land on a subdivision or partition of land between co-owners. This would ensure that disposals of land are only taxed where there is an effective change in ownership.

71. This change should apply from 27 March 2021, the relevant rule originally applied from.

**Recommendations**

**Agree** that the land tainting rules should not apply on a subdivision or partition of land between co-owners.

Agreed/Not Agreed

**Agree** that the amendment apply from 27 March 2021.

Agreed/Not Agreed

**Rollover relief and the main home exclusion**

72. Rollover relief ensures that the bright-line test is not triggered in certain common situations where there is a legal transfer of residential land, but no change in

economic ownership (or at least not a material one) – for example, where land held in a family trust is resettled in a new family trust.

73. The rollover provisions are ineffective in ensuring the bright-line test does not apply in certain circumstances where the main home exclusion also applies. For example, consider a situation where a house was used as a family home for three years while under the ownership of Trust A, before being resettled on Trust B and rented for a year before being sold. The time the property was used as a main home under Trust A should be attributed to Trust B, otherwise the true economic owners of the property will not be taxed appropriately.

**Recommendations**

**Agree** to amend the main home exclusion from the bright-line test to attribute the actions of the transferor trust to the transferee trust where rollover relief applies.

Agreed/Not Agreed

**Agree** that the amendment apply from 27 March 2021.

Agreed/Not Agreed

### Platform economy information sharing penalties

74. In 2023 New Zealand gave legislative effect to an information reporting and exchange framework developed by the Organisation for Economic Co-operation and Development (OECD).

75. From 1 January 2024, this framework will require digital platform operators to provide tax authorities with information about sellers and the income they earn on their platforms. This will provide Inland Revenue with increased visibility over incomes earned on these platforms that can be used to support tax compliance.

76. A penalty will apply to sellers that do not provide platform operators with the required information under the rules. However, the rules do not explicitly require sellers to provide information to platform operators, they merely require the operator to provide seller information to the tax authority. A remedial amendment is required to make it explicit that a seller will be liable for a penalty if they do not provide information to a platform operator that the operator requires to fulfil their reporting obligations.

77. The amendment should apply from 1 January 2024 to align with the application date for the reporting rules in New Zealand.

**Recommendations**

**Agree** that a seller should be liable for a penalty if they do not provide information to a platform operator that is required to fulfil the operator’s obligations under the model reporting standard for digital platforms.

Agreed/Not Agreed

**Agree** that this should apply from 1 January 2024.

Agreed/Not Agreed

### Land used by transitional housing providers

78. The interest limitation rules do not apply to interest incurred by a person for land, to the extent the land is used by either a registered community housing provider, a

government department or Kainga Ora and its wholly-owned subsidiaries for social housing, temporary accommodation or other accommodation for people in need.

79. It was intended that the interest limitation rules would additionally not apply to interest incurred by a person for land used by a transitional housing provider to provide transitional housing, however, the legislation does not achieve this. We recommend amending the law to align with the original policy intent.

80. This change should apply retrospectively from the date the interest limitation rules were introduced.

**Recommendations**

**Agree** that interest incurred by a person for land used by a transitional housing provider to provide transitional housing should not be subject to the interest limitation rules.

Agreed/Not Agreed

**Agree** that this should apply from 27 March 2021.

Agreed/Not Agreed

### Cross-border workers: amendment of the nominated taxpayer rule

81. To reduce compliance costs for cross-border workers, the "nominated taxpayer" rule in the ITA provides that a non-resident contractor can enter into an arrangement with a person resident in New Zealand in relation to their tax affairs or social policy entitlements, or both. The rule has not yet come into force.

82. Concerns have been raised internally regarding the implementation of the rule. In particular, the joint and several liability condition may overreach and cause unintended consequences. In addition, existing provisions already enable non-resident contractors to enter into an arrangement with a nominated person, agent or intermediary making the provision somewhat redundant.

83. However, the rule does confirm operational practice with regards to the reporting and payment of employment-related taxes (pay-as-you-earn, fringe benefit tax and employer's superannuation contribution tax) in some circumstances. These circumstances arise where a New Zealand resident undertakes employment-related tax compliance activities on behalf of a non-resident contractor.

84. Given this, officials recommend that the nominated taxpayer provision should be amended to narrow its application to employment-related taxes only and should not be subject to a joint and several liability requirement. However, a joint and several liability condition should apply where an application for an exemption from withholding of non-resident contractor's tax has been made in reliance on the New Zealand tax compliance history of another person. This mitigates risk to the tax base.

85. The proposed amendment should apply from 1 April 2024, the date the original provision comes into effect.

**Recommendations**

**Agree** that the nominated taxpayer rule should be amended so that it applies to employment related taxes only.

Agreed/Not Agreed

**Agree** that the joint and several liability condition should apply to applications for exemption on the basis of another person's New Zealand tax compliance history.

Agreed/Not Agreed

**Agree** that this amendment should apply from 1 April 2024.

Agreed/Not Agreed

### Clarifying that individuals earning income not taxed at source may change balance dates

86. With the Commissioner's approval, a taxpayer can change their balance date from the standard 31 March and file income tax returns to an earlier or later date aligning with their annual accounting period.

87. In 2019, amendments were made to simplify individuals' end-of-year income tax obligations. These changes unintentionally prevented individuals earning income that is not taxed at source to request a balance date change or return income to a late balance date where a late balance date has previously been approved.

88. We recommend an amendment to reverse this unintended effect and align the law with current practice.

89. The amendments should apply from 1 April 2019 (the date the legislative changes with the unintended effect apply from). This would provide certainty to any individuals that have had a balance date change approved and/or been returning income to a late balance date since this date.

**Recommendations**

**Agree** to clarify that individuals earning income that is not taxed at source can request a change of balance date and return income to a late balance date.

Agreed/Not Agreed

**Agree** that this amendment should apply from 1 April 2019.

Agreed/Not Agreed

### Remove time limit on emergency event payments for Working for Families purposes

90. As part of the Government's response to the January 2023 extreme weather events, a scheme was implemented to provide grants to affected Māori and Marae to enable them to relocate without giving up ownership of land. Under current law, receipt of a payment under the scheme will result in a decrease in the recipient's Working for Families (WFF) entitlements.

91. Under the ITA, payments aimed at relieving the adverse effects of an event (such as those made under the grant scheme) are exempt from family scheme income and thus do not affect a person's WFF entitlement, provided the event is declared

an emergency event by the Commissioner and the payment is made within 12 months since the first day of the event. This time limit creates inflexibility and impacts the Government's ability to distribute payments aimed at emergency event relief without impacting WFF entitlements. In the case of the grant scheme, many of the payments will not have been paid out by late January 2024 (12 months after the declaration of the emergency event).

92. We recommend removing the 12-month limit on emergency event determinations in relation to family scheme income. This would allow the Commissioner to set, extend, or change a declaration of an emergency event so any longer-term payments aimed at relieving adverse impacts of an event can be exempt for WFF entitlement purposes.

93. We recommend that this change apply retrospectively from 1 September 2023.

**Recommendations**

**Agree** to remove the 12-month limit on emergency event determinations in relation to family scheme income.

Agreed/Not Agreed

**Agree** that this should apply retrospectively on and from 1 September 2023.

Agreed/Not Agreed

### Buy-out of Nelson flood affected properties and the bright-line tests

94. The previous Government agreed a joint support package with the Nelson Council to help towards recovery from the Nelson floods of August 2022. This is likely to include the Council making buy-out offers for 14 properties. Potentially, the bright-line or other timing tests in the ITA could be triggered by such a buy-out, resulting in the proceeds being taxable. To avoid this possibility, officials are recommending that the tests be turned off for the Nelson buy-outs. This would align with the treatment already proposed in the Bill for properties that were seriously damaged by the Auckland floods and Cyclone Gabrielle.

**Recommendations**

**Note** this officials' recommendation.

### Platform economy GST remedials

95. We draw your attention to the items described on pages 232 to 235 of the Departmental Report. These are technical changes identified by stakeholders, including private sector GST advisors and affected platform operators, following the enactment of the GST rules for digital platform operators. The changes were agreed to by the former Minister of Revenue in August 2023. Inland Revenue informed platform operators and GST advisors of this immediately after to ensure as much time as practicable was available for them to work through the changes and how they could be implemented ahead of the rules taking effect on 1 April 2024.

**Recommendations**

**Note** the technical changes identified by stakeholders outlined on pages 232 to 235 of the Departmental Report.

## Consultation

96. The Treasury have been informed on the contents of this report.

## Next steps

97. The table below provides a provisional outline of key milestones for the Bill in the parliamentary process.

98. Following oral submissions on 31 January 2024, we will be seeking your urgent approval to include any recommendations that may arise into the finalised Departmental Report to be sent to the FEC on 9 February 2024.

| Milestone | Provisional timeframe |
|---|---|
| Officials brief the FEC | 31 January 2024 |
| Oral submissions | 31 January 2024 |
| Finalised Departmental Report to the FEC | 9 February 2024 |
| FEC considers the Departmental Report | 14 February 2024 |
| FEC considers the Revision Tracked Bill | 28 February 2024 |
| Final date for the FEC to report back to the House | 14 March 2024 |
| Remaining House stages | Mid to late March 2024 |
| Enactment | No later than 31 March 2024 |

Item 06

# POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:** **Setting Effective Dates for Global Anti-Base Erosion Tax ("GloBE Rules")**

| **Date:** | 20 December 2023 | **Priority:** | Medium |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2023/261 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Agree** to set 1 January 2025 as the effective date of the GloBE income inclusion rule and under-taxed profits rule, and 1 January 2026 as the effective date of the domestic income inclusion rule | 24 January 2024 |
| Minister of Revenue | **Agree** to recommendation described above | 24 January 2024 |

## Contact for telephone discussion (if required)

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Casey Plunket | Special Policy Advisor, Policy and Regulatory Stewardship, Inland Revenue | s 9(2)(a)<br>s 9(2)(a) |

20 December 2023

Minister of Finance
Minister of Revenue

# Setting Effective Dates for Global Anti-Base Erosion Tax ("GloBE Rules")

## Purpose

1. This report seeks your decision on when to implement the three elements of a new tax. The tax is imposed under the global anti-base erosion rules ("GloBE rules"), and will be paid primarily by New Zealand headquartered multinational groups with revenue over €750M pa. It is expected to raise around $7M pa. As discussed below, the New Zealand tax is part of a globally co-ordinated effort.

## Context and background

2. The Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill ("Multinational Tax Bill") was introduced in April 2023. It is currently with the Finance and Expenditure Committee and is expected to be enacted by 31 March 2024. It provides amongst other things for the imposition of tax under the OECD/G20-led GloBE rules. The GloBE rules are intended to reduce the scope for international tax planning by multinational groups. This is achieved by having a critical mass of countries enact identical domestic rules ensuring that multinational groups which operate in those countries pay at least 15% tax on their "mobile" income[1] in every country where that income is earned.

3. The GloBE rules proposed for New Zealand have three elements, all of which apply only to companies which are members of multinational groups which met the revenue threshold referred to above:

   3.1 the income inclusion rule (IIR). The IIR is a top-up tax on the undertaxed *foreign* source mobile income of a New Zealand company and its worldwide subsidiaries.

   3.2 the domestic IIR (DIIR) The DIIR is a top-up tax on the undertaxed *domestic* source mobile income of a New Zealand company and its New Zealandc subsidiaries.

   3.3 the undertaxed profits rule (UTPR). The UTPR is a top-up tax on the undertaxed mobile income of a New Zealand company and all other companies in its worldwide group.

   There is a "rule order" which ensures that income is only subject to one of these taxes.

   A fuller overview of the GloBE rules is provided in the annex at the end of this report.

4. The adoption of GloBE rules *by a critical mass of other countries* supporta the imposition of income tax by New Zealand on multinational groups. It does this by reducing the tax incentive for them to shift income out of New Zealand. The incentive is reduced because the minimum rate of tax on the mobile income of affected multinationals will be 15%, rather than the current 0%. This effect is

[1] Mobile income is income in a country in excess of a percentage mark up on the cost of employees and tangible assets in that country.

estimated to increase revenue from our existing income tax by approximately $16M pa. Additionally, the adoption of GloBE rules *by New Zealand* will increase New Zealand tax revenue directly, estimated now at $6M to $7M pa. This has decreased from the previously estimated $25M pa due to an expected tax increase in other countries where income is earned.

5. The Bill did not specify an effective date for New Zealand imposing tax under the GloBE rules, leaving this to be determined by an Order-in-Council. This was to allow the effective date to be set only once there was a high degree of confidence that the rules will also be enacted by a critical mass of other countries. Enactment by a critical mass is now virtually certain, with effect from:

   5.1 1 January 2024 for the IIR and DIIR.

   5.2 1 January 2025 for the UTPR.

6. An effective date for the IIR in New Zealand of 1 January 2024 would align New Zealand with most of the EU, Australia, Japan, Canada, the UK and others. However, it would also be feasible to set the IIR effective date at any time up to and including 1 January 2025. Some countries are making this choice, including 5 small EU countries. Setting the effective date beyond 1 January 2025 would be pointless, since if New Zealand does not impose the IIR on any undertaxed mobile foreign income earned by a New Zealand based multinational group, GloBE tax will be imposed on that income by other countries instead under their UTPRs. However, UTPRs will not apply to New Zealand source mobile income of New Zealand groups until years beginning on or after 1 January 2026 (this deferral was decided on in July 2023, and is referred to as the Transitional UTPR Safe Harbour).

## Options analysis

7. The most important issue is whether to make the IIR element of the GloBE rules effective in New Zealand on 1 January 2024 (so it will apply to taxpayers from their first tax year beginning on or after that date), or 1 January 2025. An intermediate date is also possible, but would be out of step with other countries and has not been seriously considered.

8. A 1 January 2024 effective date:

   8.1 is estimated to raise an additional $6m-$7m revenue in the 2026/27 year;

   8.2 will require all New Zealand headquartered in-scope multinational groups to comply with the record keeping and calculational obligations imposed by the GloBE rules from the start of their first tax year ending on or after that date, for all countries where they operate;

   8.3 will require Inland Revenue to have in place no later than June 2026 the system necessary to:

   - receive GloBE returns in electronic format from New Zealand and some foreign multinational groups
   - send the New Zealand returns, or parts of them, electronically to other countries with which we have appropriate exchange of information agreements
   - receive returns from other countries in relation to foreign MNEs operating in New Zealand.

9. An effective date for the IIR of 1 January 2025 will mean no additional revenue is collected in the 2026/27 year, but will defer the imposition of the obligations

referred to in 8.2 and 8.3. We now turn to discuss the benefits of setting a later date.

*Deferring obligations of NZ MNEs*

10. The GloBE rules are heavily based on accounting concepts of income and taxes. This is relatively novel. The rules also have many other novel features. The OECD is still working on guidance which is needed to explain how the rules apply in the wide and complex range of situations faced (or created) by multinational groups. Setting a later effective date for the IIR will allow some of these uncertainties to be resolved before New Zealand multinational groups are required by New Zealand law to apply them. This will defer, and may reduce in absolute terms, their compliance costs. For listed companies it will also defer the time at which they need to determine whether to accrue a liability for IIR tax in their interim (quarterly or semi-annual) financial statements, the first of which would be due in April 2024 (for December 31 balance date companies which report quarterly).

11. On the other hand, a number of countries have announced they are introducing the GloBE rules for income earned in their country by foreign multinational groups from 1 January 2024 (this is referred to as adoption of a "Qualifying Domestic Minimum Top up Tax" or "QDMTT"). This includes the UK, Australia, Japan, South Korea and much of the EU. New Zealand's deferring the effective date will therefore not prevent the imposition of GloBE calculation obligations on New Zealand multinational groups with operations in those countries. A multinational facing such an obligation in one or more countries may decide to put in place the necessary compliance systems for all countries where it operates at the same time, rather than proceeding in stages. In this case, New Zealand's deferral may have no significant benefit for affected businesses.

12. A review of effective dates in other countries follows:

    12.1 The UK and most of Europe are adopting the IIR in 2024, though there are 5 smaller EU countries intending to adopt later.

    12.2 Canada is adopting the IIR in 2024, including a QDMTT, but the US has no plans to adopt GloBE rules.

    12.3 Japan, South Korea, Vietnam and possibly Indonesia are adopting the IIR in 2024, with most other significant Asian economies expected to adopt in 2025. China has not made an announcement.

    12.4 Australia is adopting in 2024, including a QDMTT.

    12.5 Countries adopting IIRs in 2024 have also announced their intention to adopt UTPRs in 2025.

    The result is that of 22 New Zealand multinational groups in scope of the rules, 19 operate in at least one country that is adopting a QDMTT in 2024, and of these, 10 operate in two or more such countries.

13. There is also a benefit to New Zealand multinational groups from New Zealand implementing the IIR in 2024. In most cases, this will allow them to file a single Globe information return in New Zealand, which Inland Revenue can then provide to the other countries where the MNE operates. The alternative is filing the information return separately in such countries. For the 12 multinational groups which operate in less than two countries which are adopting QDMTTs, this is unlikely to be at all significant. For the other 10, being able to file once in New Zealand will reduce their tax compliance costs to some extent.

14. We understand that on balance, New Zealand headquartered multinational groups would prefer a 1 January 2025 start date for the IIR. Given that it is

almost 1 January 2024 now, multinational groups would also have very little notice if that date were chosen.

*Deferring obligations of Inland Revenue*

15. Development of the system necessary to receive (from multinational groups and other countries) and exchange (with other countries) GloBE returns will cost around $8.7m. Administration of the tax is expected to cost a further $3.1m annually. Inland Revenue's costs are being met from within current baselines, but deferral by one year will increase the department's capacity to implement other priority initiatives for the new Government.

16. On balance, we recommend an implementation date of 1 January 2025 for the IIR element of the GloBE rules because it will defer or reduce compliance costs for some MNEs, and administrative costs for Inland Revenue.

## Further issues

17. As set out above, it is now apparent that a critical mass of countries will implement the IIR element of the GloBE rules with effect from 1 January 2024. If you agree with our recommendation to set the New Zealand effective date as 1 January **2025**, we also recommend:

    17.1 That the effective date be specified in the legislation.

    17.2 That the legislation also set a 1 January **2025** date for the UTPR. This was always the intended effective date once it was established that the GloBE rules would be adopted by a critical mass of countries. The choice of date for the UTPR has no fiscal implications.

    17.3 That the legislation set a 1 January **2026** date for the DIIR. This is the latest date that will ensure that other countries do not impose their UTPR on any undertaxed mobile New Zealand source income of a New Zealand based multinational group. It will therefore minimise compliance and administrative costs on New Zealand multinational groups and the Government, without giving up revenue to foreign Governments. The choice of date for the DIIR also has no fiscal implications.

18. Setting these dates in the legislation will be more efficient than leaving them to be set by Order-in-Council since it will remove the need to draft and promulgate such Orders-in-Council.

## Conclusion

19. We recommend that the Government makes the IIR and the UTPR effective from 1 January **2025**. Given that it is now clear that there will be a critical mass of implementing countries by that date, this effective date should be set in the Bill, rather than achieved by an Order-in-Council.

20. We also recommend that the Government makes the DIIR effective from 1 January **2026**.

## Financial implications

21. If Ministers agree to an implementation date for the IIR of 1 January 2025, this will push out the $7 million (currently forecast to be received in the 2026/27 year) by one year to 2027/28.

22. When the fiscal implications of adopting the GloBE rules were originally included in forecasts, the implementation date was uncertain and Ministers agreed that it would be set later by Order in Council. This is the first time Ministers have been asked to agree a particular implementation date. The $7 million reduction in revenue in 2026/27 would therefore be reflected as a forecasting change, not a policy change. This means that it will have a negative impact on the OBEGAL balance in 2026/27.

23. Implementing the IIR in 2025 would also:

    23.1 reduce operating costs (funded from within existing baselines) over the forecast period by $3.1m.

    23.2 defer the capital expenditure costs (funded from within existing baselines) of $8.7m from 2024/2025 to 2025/2026.

24. Because both operating and capital expenditure costs are self-funded, their reduction or deferral will have no effect on the Government's fiscal position.

## Consultation

25. The Treasury was consulted on the contents of this report.

## Next steps

26. Now that the GloBE rules are certain to be adopted by a critical mass of other countries, the Order-in-Council mechanism is no longer appropriate. The Government needs to determine whether to impose tax under the IIR element of the GloBE rules from 1 January 2024 or 1 January 2025 (or an intermediate date). A decision can also be made about the effective date for the UTPR and the DIIR. We recommend that the Bill be amended to specify a 1 January 2025 effective date for both the IIR and the UTPR, and 1 January 2026 for the DIIR.

## Recommended action

We recommend that you:

1. **agree** to amend the Bill to set 1 January 2025 as the effective date of the IIR and UTPR.

   Agreed/Not agreed Agreed/Not agreed

2. **agree** to amend the Bill to set 1 January 2026 as the effective date of the DIIR.

   Agreed/Not agreed Agreed/Not agreed

**Casey Plunket**
Special Policy Advisor
Policy and Regulatory Stewardship

**Hon Nicola Willis**
Minister of Finance
/ /2023

**Hon Simon Watts**
Minister of Revenue
/ /2023

## Annex – Overview of Pillar Two GloBE rules

### Overview

The Global Anti-Base Erosion Rules (GloBE Rules) are the main component of Pillar Two – the second part of the OECD's *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*. As the world has globalised and digitalised, multinational enterprises (MNEs) have been able to drive down their tax liability by shifting profits from market countries to low-tax countries – particularly profits related to capital and intangible assets such as intellectual property ('mobile income'). The GloBE rules ensure large MNEs pay a minimum 15% effective rate of tax (ETR) on the mobile income arising in each of the jurisdictions where they operate.

### Determining tax liability

To determine its tax liability under the GloBE rules, an MNE must follow these steps:

1. Identify whether it is in scope (annual revenue of €750 million or more, and not an 'Excluded Entity' such as a Governmental Entity or Pension Fund).

2. Determine GloBE income of each group member (referred to as constituent entities). Broadly this is financial accounting net income, with some adjustments.

3. Determine the amount of 'Covered Taxes' attributable to each entity's income. Broadly this is current and deferred taxes, with some adjustments for timing differences.

4. On a jurisdictional basis, calculate:

   - ETR of all constituent entities (Covered Taxes ÷ GloBE income)
   - Top-Up Tax percentage (15% - ETR)
   - Excess Profit (GloBE Income – Substance Based Income Exclusion[2])
   - Top-Up Tax (Top-Up Tax % x Excess Profit – Qualified Domestic Minimum Top-Up Tax (QDMTT[3]))

5. Identify entities liable to pay Top-Up Tax under Income Inclusion Rule (IIR) or Undertaxed Profits Rule (UTPR) (explained in following section). Allocate Top-Up Tax to entities in proportion to their share of the undertaxed profits.

### Overview of charging rules

The OECD GloBE rules use two charging mechanisms (referred to in step 5 of the previous section) to impose tax: the IIR and the UTPR.

[2] The Substance Based Income Exclusion is an exclusion for a routine return on tangible assets and payroll. The rationale for the exclusion is that such income clearly arises from genuine economic activity tethered to the jurisdiction, and therefore is not in the realm of artificial profit shifting, which is the primary concern of the GloBE rules.

[3] See 'Overview of charging rules' section for explanation of the QDMTT.

Countries may also choose to enact a QDMTT – which applies in priority to both the IIR and UTPR – but this is not strictly one of the OECD GloBE rules. Alternatively, or additionally, they may choose to enact a *domestic* IIR (DIIR), which can be regarded as an optional component of the IIR.

***IIR***

The IIR is a top-up tax on the undertaxed *foreign* source mobile income of a domestic parent company's foreign subsidiaries. It is payable by the parent company on behalf of the undertaxed subsidiaries in the group. For example, Fonterra would pay top-up tax under the IIR to New Zealand on undertaxed income of its foreign subsidiaries.

***UTPR***

The UTPR is a backstop to the IIR. It is a top-up tax on the undertaxed *foreign or domestic* source mobile income of a domestic parent company and all other companies in its worldwide group. It applies where there is no IIR in the parent company's jurisdiction, and a QDMTT does not apply. It is payable by group members who have substance in countries that have enacted the GloBE rules. For example, if New Zealand does not adopt GloBE rules and Australia does, a Fonterra subsidiary in Australia would pay top-up tax under the UTPR to Australia on undertaxed income of other Fonterra group companies.

***QDMTT***

A QDMTT is a top-up tax on the undertaxed *domestic* source mobile income of a group company. It could be payable by the parent and/or its subsidiaries. The QDMTT is not strictly one of the OECD GloBE rules, but is contemplated by the OECD as a rule that a country can implement so that top-up tax on income sourced in that country is collected there, rather than in other countries where MNE entities are located, under those other countries' IIRs or UTPRs. A QDMTT applies in priority to the IIR or UTPR, so countries have a strong incentive to adopt one to assert their source taxing rights. For example, if Fonterra has a low tax subsidiary in a country which also adopts a QDMTT, that subsidiary will pay additional tax to the country where it is located, under the QDMTT. A QDMTT can also operate to tax the undertaxed income of a parent company itself, which is not taxed under the IIR (but is taxed under the UTPR or a DIIR).

***DIIR***

Finally, New Zealand is proposing to implement a DIIR, which is similar but not identical to a QDMTT. The DIIR is a top-up tax on the undertaxed *domestic* source mobile income of a domestic parent company and its domestic subsidiaries. It differs from a QDMTT only in that it applies solely to domestic headquartered MNEs, whereas a QDMTT also applies to foreign headquartered MNEs. DIIR top-up tax is payable by the domestic parent company.

***Overall interaction of charging rules***

The charging rules apply in the following priority order:

1. QDMTT
2. IIR and DIIR
3. UTPR

The overall scheme of the rules means that as long as a critical mass of countries adopts the rules, MNEs are not able to avoid the top-up tax. This reduces the incentive for MNEs to shift profits to low-tax jurisdictions.

# POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:** **Platform Economy: Remedial measures for inclusion in the current tax bill**

| **Date:** | 23 June 2023 | **Priority:** | Medium |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2023/178 |

## Action sought

| | Action sought | Deadline |
|---|---|---|
| Minister of Revenue | **Agree** to recommendations | 7 July 2023 |

## Contact for telephone discussion (if required)

| Name | Position | Telephone |
|---|---|---|
| Graeme Morrison | Policy Lead | s 9(2)(a) |
| Ben Smith | Senior Policy Advisor | s 9(2)(a) |

23 June 2023

Minister of Revenue

# Platform Economy: Remedial measures for inclusion in the current tax bill

## Purpose

1. This report seeks your agreement to include amendments which would resolve technical issues with the new platform economy rules that have been identified since enactment of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Act 2023.

2. We also seek your agreement to discuss the proposed changes with affected platform operators and their advisors prior to the rules taking effect next year.

## Background

3. Starting next year, new rules come into effect for platform operators:

   3.1 From 1 January 2024, New Zealand based platform operators will be required to report information to Inland Revenue about income that sellers earn from certain activities carried out on digital platforms. This information would be used for tax administration purposes or exchanged, to the extent it relates to non-resident sellers, with foreign tax authorities pursuant to exchange protocols developed by the Organisation for Economic Co-operation and Development.

   3.2 From 1 April 2024, platform operators will be required to collect and return GST on ride-sharing, taxable accommodation, and delivery services for food and/or beverages. These rules apply to foreign and domestic platform operators.

4. Inland Revenue is preparing detailed guidance on the new rules and is supporting platform operators during the implementation process. Platform operators and their tax advisors are, in turn, considering the implications of the new rules on their systems, processes, and contracts.

5. In preparing this guidance, and following conversations with platform operators, several minor technical issues have been identified as producing unintended outcomes or are inconsistent with the policy intent. It is highly desirable for legislative amendments resolving these issues to be made at the earliest possible opportunity. This would ensure that, as part of their implementation of the new rules, platform operators can make the necessary changes to their systems, processes, and contracts in a manner consistent with what was intended.

6. We therefore recommend that amendments be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill which is currently being considered by the Finance and Expenditure Committee. If you agree, we will recommend to the Committee, as part of the Departmental Report on the Bill, that these amendments be included in the Bill.

7. The proposed solutions outlined in this report are consistent with the policy intent underpinning both sets of rules. The proposed solutions also reduce compliance and administration costs as they provide affected platform operators with certainty and clarity about how the new rules should apply. The proposed solutions do not give rise to any fiscal implications.

## Issues identified and recommended solutions

8. The following table summarises the remedial matters that have been identified and the proposed amendments to resolve the issues.

| Issue | Further explanation and recommended solution |
|---|---|
| Record-keeping requirements for platform operators are based on a tax year or income year instead of calendar year | The general record-keeping requirements in the Tax Administration Act 1994 require records to be kept for a period of seven years following the end of the relevant tax year or income year. For platform operators, information is collected and reported on a calendar year basis.<br><br>An amendment should be made to align this general record-keeping requirement for platform operators to seven years following the end of the relevant calendar year. |
| Ability to opt-out of the GST rules should be limited to non-natural persons exceeding $500,000 of sales in a 12-month period | The GST rules require platform operators to account for GST on certain supplies (accommodation, ride-sharing, and delivery services for food and/or beverages) made by another person (referred to as an "underlying supplier").<br><br>An underlying supplier is therefore an accommodation host, such as a hotel or motel, driver, or deliverer. To reduce compliance costs associated with changing accounting systems and practices, the GST rules allow underlying suppliers with turnover of greater than $500,000 in a 12-month period to choose to remain responsible for their own GST obligations (instead of the platform operator).<br><br>We recommend only those underlying suppliers that are *not* natural persons be able to opt-out of the GST rules for this reason. Natural persons could purport to exceed the $500,000 threshold and this poses a potential integrity risk which could result in their supplies not being subject to GST under the rules. |
| Flat-rate credit: amend GST adjustment rules to apply to the flat-rate credit, and clarify the payment of the flat-rate credit is not consideration for GST purposes | The GST rules require platform operators to return a proportion of the GST collected on services they are treated as supplying to the underlying supplier. The proportion of the GST collected is to recognise the GST that would be deductible if the underlying supplier was registered for GST and filing GST returns.<br><br>We recommend clarifying that when a platform operator pays an underlying supplier the flat-rate credit that this does not give rise to consideration for GST purposes.<br><br>We also recommend enabling platform operators to make use of adjustment rules in circumstances where the amount of the flat-rate credit calculated is wrong. This could occur in circumstances where the value of the supply changes, or the supply to which the flat-rate credit relates is ultimately cancelled. |
| When multiple platform operators are involved | The current GST rules can be unworkable in circumstances when there is more than one platform operator involved in a supply of services. This is because the current rules treat the platform operator that authorises the charge or receives payment for the services as the supplier of the services (and therefore they have the obligation to account for GST and the flat-rate credit). Often this platform operator will not have a relationship with the underlying supplier. This means the flat-rate credit scheme cannot be applied.<br><br>To resolve this, we recommend a new hierarchy rule that would allow platform operators that have the relationship with the underlying supplier to be treated as the supplier. This would ensure the rules work as intended. |

### Communicating the changes

9. If you agree to the recommended solutions in this report, we will include these items as recommended amendments in the Departmental Report to the Finance and Expenditure Committee on the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill. This is the earliest practicable legislative vehicle for resolving the issues.

10. The Finance and Expenditure Committee is not due to report back to the House on the Bill until February 2024. This means the amendments will not be known to platform operators or their advisors until this time at the earliest. This would not leave them with sufficient time to design their systems to comply with the changes.

11. We therefore seek your approval to communicate the proposed changes to affected platform operators and their advisors ahead of the changes being included in the revision-tracked version of the Bill. This would be subject to caveats that the amendments are still subject to the parliamentary process and consideration by the Finance and Expenditure Committee.

### Consultation

12. The Treasury was consulted on the contents of this report. The Treasury agrees with the recommendations.

### Next steps

13. If you agree to the recommendations in this report, we will recommend amendments resolving the remedial issues identified be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill at the select committee stage. We will also communicate the intended amendments to affected platform operators and their advisors.

### Recommended action

We recommend that you:

(a) **agree** that platform operators with reporting obligations about sellers should be required to keep records for seven years following the end of the relevant calendar year (as opposed to tax year or income year)

Agreed/Not agreed

(b) **agree** that only underlying suppliers (for example, accommodation hosts such as hotels and motels) who are *not* natural persons with more than $500,000 of sales in a 12-month period should be able to choose to remain responsible for their own GST obligations (instead of the platform operator)

Agreed/Not agreed

(c) **agree** that when a platform operator pays the flat-rate credit to an underlying supplier that this should not give rise to consideration for GST purposes

Agreed/Not agreed

(d) **agree** to new rules allowing platform operators to make adjustments to flat-rate credit deductions in their GST returns when it is discovered the amount of the flat-rate credit is incorrect (for example, because the supply of services to which the credit relates is cancelled, or the value of the supply changes)

Agreed/Not agreed

(e) **agree** to introduce a new hierarchy rule that could apply when there is more than one platform operator involved in a supply of accommodation, enabling the platform operator that has the relationship with the underlying supplier to be treated as the supplier (ensuring they are liable for the GST on the supply, and administration of the flat-rate credit scheme)

Agreed/Not agreed

(f) where you have agreed to recommendations (a) to (e), **agree** that officials recommend amendments giving effect to these decisions be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill at the select committee stage (as part of the Departmental Report)

Agreed/Not agreed

(g) **agree** that officials can also recommend other changes of a minor technical or drafting nature (such as incorrect cross-references) that are consistent with the original policy intent and approvals

Agreed/Not agreed

(h) **agree** to allow officials to communicate the proposed changes referred to above with affected platform operators and their advisors ahead of the Finance and Expenditure Committee's report back to the House of Representatives which is due in February 2024.

Agreed/Not agreed

s 9(2)(a)

**Graeme Morrison**
Policy Lead
Policy and Regulatory Stewardship

**Hon David Parker**
Minister of Revenue
/ /2023

Item 08

# POLICY AND REGULATORY STEWARDSHIP

## Tax policy report: Disposals of trading stock at below market value

| **Date:** | 20 December 2023 | **Priority:** | Medium |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2023/259 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Agree** to the fiscal recommendations | 19 January 2024 |
| Minister of Revenue | **Agree** to all recommendations | 19 January 2024 |

## Contact for telephone discussion

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Stewart Donaldson | Principal Policy Advisor | s 9(2)(a) |
| Samantha Putt | Policy Advisor | s 9(2)(a) |

20 December 2023

Minister of Finance
Minister of Revenue

# Disposals of trading stock at below market value

## Executive summary

1. We are seeking your agreement to permanently change the operation and effect of an anti-avoidance valuation rule (the "valuation rule") as it applies to disposals of trading stock at below market value.

2. We recommend that a permanent change, which is supported by the business community, be legislated in an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill. The application date for the change would be for all disposals made on or after 1 April 2024, the day after temporary relief introduced in response to COVID-19 expires.

3. We recommend that related legislation that was introduced in response to COVID-19, which can be applied to certain future emergency events, be repealed.

## Background

4. Businesses have sought a permanent change to a trading stock valuation rule for many years, in order to deal with an over-reach in the provision. It was most recently raised in 2020, brought to our attention as part of the generic tax policy process.

5. Trading stock disposed of at below market value is deemed to have been sold by the disposer (and subsequently purchased by the recipient) at market value. As a result, the disposer is taxed on a deemed profit margin. It applies in a range of situations including to goods taken by a business owner for their own use or consumption, goods that are donated, and goods disposed of to both associated and non-associated persons in the ordinary course of business. The rule applies irrespective of whether there is a tax avoidance purpose or motive.

## Problem definition

6. There are two types of disposals which we have focused on in this report - trading stock disposals made in the ordinary course of business, and trading stock disposals not made in the ordinary course of business but which are donated to charitable or other public benefit causes. In both situations the valuation rule is interfering with business practice.

7. The valuation rule is considered by both officials and the business community to over-reach. This is particularly the case when it applies to transactions between non-associated parties in the ordinary course of business, because the value of these disposals should raise no avoidance concerns. It is also the case when trading stock is donated for charitable purposes, because the valuation rule acts as a significant disincentive to donate, distorts donation behaviour and is widely perceived to be unfair.

8. The valuation rule has been subject to two temporary amendments in the past to provide relief from the over-reach when trading stock is donated. Once in response to the Canterbury earthquakes in 2010-2012 and more recently in response to

COVID-19 from March 2020 to 31 March 2024. When the COVID-19 temporary relief expires, the valuation rule will be reactivated if there is no legislative amendment and if no other national emergency occurs.

9. Officials undertook public consultation on a permanent solution and an officials' issues paper was released in July 2023. Fifteen submissions were received and they were all supportive of legislative change.

**Options to address the problem**

*Disposals made in the ordinary course of business*

10. There are situations where the valuation rule will remain necessary to address tax avoidance concerns, for example, where there is a disposal between associated persons or when trading stock is taken by a business owner for their own use or consumption. In these situations, trading stock deductions in the tax base are not matched against commercial arm's-length income on disposal. The valuation rule should continue to apply in these types of situations.

11. However, we believe it is not necessary to apply the valuation rule to disposals made to non-associated persons in the ordinary course of business. It is reasonable to assume these transactions are commercial and arm's-length. Our preferred option is to exclude these transactions from the valuation rule.

*Disposals in the nature of a donation where there is no nexus with income*

12. For disposals that are in the nature of a donation and where there is no nexus with income, our preferred option is to address most of the over-reach by removing the valuation rule for donations of trading stock, provided the donations are made to approved donee organisations. This would be consistent with the donations framework, which generally restricts donor tax concessions to charitable or other public benefit donations made to organisations which benefit New Zealanders.

13. This option would allow businesses to donate trading stock to donee organisations and effectively claim a net tax deduction for the cost of that trading stock. The disincentive to donate and related behaviour distortions and perceptions of unfairness would be removed. It would be a simple approach for the majority of businesses, with minimal compliance or administrative costs. Because trading stock is already in the tax base, we do not anticipate that this change will result in valuation integrity and tax avoidance issues that would otherwise arise if non-trading stock assets were eligible for a tax deduction.

14. Donations with no nexus to income that are made to entities that are not donee organisations, for example, donations made to individuals, public authorities and to charities which mainly benefit people or purposes outside New Zealand, would continue to be subject to the valuation rule and the donor would not be able to claim a net tax deduction for the cost of that trading stock. This is appropriate, as it would ensure the tax concessions for donated trading stock and donations of money are consistently targeted. It would also mean the valuation rule for donations made to entities that are not donee organisations would apply in the same way to goods taken by business owners for private consumption (that is, the disposals would both be deemed to be at an amount equal to market value).

*Stakeholder views*

15. Submitters supported the removal of the valuation rule for disposals to non-associated persons.

16. Some submitters preferred an additional concession where a disposal to an associated person is also subject to FBT or deemed dividend rules, because they were concerned a "double tax" can arise. We have not recommended an additional

concession in this report because we believe the complex interaction with these rules could raise integrity issues or be addressed by affected businesses through the use of the imputation rules. However, it is an issue we will continue to monitor and will consider if there are future reviews of the FBT and deemed dividend rules.

17. Several submitters, many of whom represent large businesses, questioned whether a legislative provision which references "gifts" was necessary. They took the view all disposals of their trading stock were business transactions, with some being both altruistic as well as good for business. Several recommended that the valuation rule should be re-focused on disposals to associates and on disposals where there is no business purpose and the donation is not made to a donee organisation. We agree that the tax status of some disposals will be subject to the facts of each case and the interpretation is not always clear. Our proposed approach will focus on whether the disposal has a nexus with business income, rather than whether there is a gift, which will address their concerns.

18. Submitters who represented small businesses, such as farmers who donate livestock to charities such as foodbanks, were primarily focused on the removal of the valuation rule for donations of trading stock. Their main concern was with compliance costs if a legislation change still required them to calculate and report the market value of the donated trading stock. The option we prefer does not include that requirement and will address their concerns.

19. Several submitters requested that any concession be extended to donations made to public authorities such as hospitals. While the temporary COVID-19 measure did allow a deduction for donations made to public authorities, this was targeted at the specific needs at the time, such as the donation of sanitizers to hospitals. We do not support a permanent concession for donations of trading stock made to public authorities as it would be inconsistent with the donations framework, which targets donations made to donee organisations.

## Fiscal implications

20. The fiscal impact of the preferred options is a revenue loss of approximately $4 million a year, being $13 million spread over a five-year forecast period. This assumes an application of 1 April 2024 so that the amendment aligns with the end-date of the COVID-19 relief.

21. We recommend that this impact be charged against the Tax Policy Scorecard. For more information on how the direct fiscal impacts of tax changes can be managed through the Scorecard, refer to the briefing note BN2023/290: *The purpose and uses of the Tax Policy Scorecard*.

## Next steps

22. Legislative change is required to implement these recommended changes. If you agree, we recommend you **approve** and **lodge** the attached paper seeking Cabinet's agreement to the change. A legislative change can be progressed as an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill, at the Committee of the whole House stage scheduled for March 2024. The application date for these changes would be for all disposals made on or after 1 April 2024.

## Recommended action

### Minister of Finance and Minister of Revenue

We recommend that you:

1. **note** that the fiscal cost of the proposed amendments is $13 million spread over a five-year forecast period.

| | $ million increase / (decrease) | | | | |
|---|---|---|---|---|---|
| Vote Revenue<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Tax Revenue:<br>Company tax | 0 | (1.0) | (4.0) | (4.0) | (4.0) |
| **Total operating** | **0** | **1.0** | **4.0** | **4.0** | **4.0** |

Noted Noted

2. **agree** that this cost will be charged against the Tax Policy Scorecard.

Agreed/Not agreed Agreed/Not agreed

### Minister of Revenue

We recommend that you:

3. **agree** that for trading stock disposals made in the ordinary course of business, the valuation rule should not apply to disposals made to non-associated persons.

Agreed/Not agreed

4. **agree** that for trading stock disposals that are not made in the ordinary course of business, the valuation rule should not apply to donations made to donee organisations.

Agreed/Not agreed

5. **agree** that legislation introduced in response to COVID-19 to provide relief from the valuation rule, which can be applied to certain future emergency events, be repealed.

Agreed/Not agreed

6. **agree** that related consequential amendments be made at the same time, to correct the interface between the trading stock valuation rule, the general property disposal rules, and the purchase price allocation rules.

Agreed/Not agreed

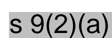
7. **note** that there are no significant administrative implications.

Noted

***Legislative implications***

8. **agree** to include the changes in an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill, with application from 1 April 2024.

Agreed/Not agreed




**Stewart Donaldson**
Principal Policy Advisor
Policy and Regulatory Stewardship

**Hon Nicola Willis**
Minister of Finance
/ /2024

**Hon Simon Watts**
Minister of Revenue
/ /2024

## Background

### Context

23. This report addresses an over-reach in an anti-avoidance provision which has been of concern to businesses for over 20 years.

24. There have been temporary fixes to the problem in times of national emergency. The most recent temporary relief was in response to COVID-19 and it ends on 31 March 2024.

25. Businesses and officials support a permanent change to the anti-avoidance valuation rule which will substantially address the over-reach and perception of unfairness, provide more certainty for businesses, and remove the need for temporary relief to be legislated when national emergencies occur in the future.

### Policy intent

26. When a business disposes of trading stock at below market value, for tax purposes it is deemed to have been sold (and subsequently purchased by the recipient) at market value. The policy intent of the rule is to stop a business transferring trading stock and revenue account property from the tax base for insufficient consideration and therefore reducing its taxable income.

27. For the purpose of the trading stock valuation rule, "trading stock" is widely defined. It includes anything produced or manufactured and anything acquired for the purposes of manufacture or disposal. It also includes timber, livestock and disposals of land that would result in income, commonly referred to as revenue account property.

28. This rule was introduced in the late 1940s as an anti-avoidance measure. It was intended to counter situations such as where a retiring farmer donates livestock to a relative who is also a farmer for no or minimal consideration. Without this rule in place, income tax on the donation would be avoided by the retiring farmer.

29. The rule is broad enough to ensure trading stock cannot be taken for private consumption by a business owner or their associates without a tax impost.

30. The rule also prevents businesses from claiming net deductions for donations of trading stock. Donations are generally not deductible for businesses as there is no nexus with income. The only exception is a business donation rule, introduced in the early 1970s, which allows companies to claim deductions for donations of money made to donee organisations, subject to a net income cap. This donation rule was subsequently extended to Māori authorities in the early 2000s.

31. Donee organisations are generally registered charities that apply their funds wholly or mainly to charitable purposes in New Zealand, or charities that carry out their charitable purposes overseas and have been specifically approved to be donee organisations by Parliament. Their donors can currently claim donation tax credits or income tax deductions by making donations of money. Non-cash donations (donations-in-kind) are not recognised for tax purposes in order to minimise fiscal and administrative costs and risks to the tax base.

## Problem definition

32. Despite being an anti-avoidance measure, this valuation rule applies automatically and does not require a tax avoidance purpose or motive. The early policy files note that it was not intended to apply to genuine transactions by parties at arm's length

even where there appears to be inadequate consideration. However, the provision was drafted broadly, so that it also applies to arm's length transactions.

33. The valuation rule is considered by both officials and the business community to over-reach. This is particularly the case when it applies to transactions between non-associated parties in the ordinary course of business, because the value of these disposals should raise no avoidance concerns. It is also the case when trading stock is donated for charitable purposes, because the valuation rule acts as a significant disincentive to donate, distorts donation behaviour and is widely perceived to be unfair.

34. In practice, the rule has had limited application in respect of disposals in the ordinary course of business to non-associated parties, because many businesses take the view they receive a benefit (such as marketing) equivalent to the market value of the trading stock. However, this is subject to the facts of each case and the interpretation is not always clear, which is why legislative clarification is necessary.

35. In respect of donations of trading stock, in practice the rule affects business behaviour. They may delay donating their trading stock until it has a low or nil market value. In the case of perishable goods such as food, this means the donations are typically not accepted by charities and ultimately add to food wastage. Alternatively, businesses may incur costs by entering sponsorship agreements with recipients so they effectively receive a market value in advertising, which is not something all charities are prepared to do. In many other cases, the valuation rule is simply not complied with when goods are donated.

36. Over the last 20 years, several piecemeal changes have been put in place to address the over-reach in times of adverse event or emergency. In 2004, in response to significant flooding in the Manawatū, a permanent override was put in place for donations to farming, agricultural or fishing businesses during an adverse event. From 2010 to 2012, a temporary override was put in place in response to the Canterbury earthquakes. From March 2020 to 31 March 2024, a temporary override was put in place in response to COVID-19. The ability to provide relief through an Order in Council for any future national emergencies was also introduced at this time.

## Consultation

37. Targeted consultation took place in 2020 to design temporary emergency relief in response to COVID-19. At the time, submitters asked the government to legislate a temporary solution for both donations and for disposals in the ordinary course of business, which was done in March 2021.

38. Officials undertook public consultation on a permanent solution and an officials' issues paper was released in July 2023 - "Disposals of trading stock at below market value". Fifteen submissions were received and they were all supportive of legislative change. We have been engaging with submitters through to mid-December 2023. The views of submitters are addressed below.

## Options Analysis

### Trading stock disposals that are in the ordinary course of business

#### *Restrict the trading stock valuation rule to associated persons (Officials' preferred option)*

39. In response to the 2023 consultation, submitters were all of the view that when trading stock is disposed of to a non-associated person, a deemed income adjustment should not arise. We agree with this view. It is reasonable to assume these transactions are commercial and arm's-length, so they can be excluded from the valuation rule.

40. There are situations where the valuation rule will remain necessary to address tax avoidance concerns, for example, where there is a disposal between associated persons or when trading stock is taken by a business owner for their own use or consumption. In these situations, trading stock deductions in the tax base are not matched against commercial arm's-length income on disposal. The valuation rule should therefore continue to apply in these types of situations.

41. Some submitters recommended that the rule's application to associated person transactions should be relaxed in circumstances where Fringe Benefit Tax (FBT) or deemed dividend rules also apply to trading stock disposals. However, we believe that any relaxation would weaken the effectiveness of the anti-avoidance rule because of the different design of the FBT and deemed dividend rules, so do not recommend any exclusions at this time. However, it is an issue we will continue to monitor and will consider if there are future reviews of the FBT and deemed dividend rules.

#### *Status quo - requirement to treat disposals as made at market value*

42. The status quo - continuing to require businesses to report deemed income when trading stock is disposed of at below market value to both associated and non-associated parties – will not address the over-reach of the law and will not reduce compliance costs for businesses. It was not an option supported by any submitters or officials.

43. However, the 2021 amendment does provide for relief in emergency times by allowing the valuation rule to be turned off through an Order in Council. This relief will apply to disposals in the ordinary course of business. So, while it is not a preferred option of officials or submitters and will return the tax treatment of disposals made outside of emergency times to its historical position from 1 April 2024, accepting the status quo is an option to consider.

### Trading stock disposals that are not in the ordinary course of business (donations)

#### *Remove the income rule for donations made to donee organisations (Officials' preferred option)*

44. Submitters in 2023 held different views regarding disposals that are donations. Several submitters, many of whom represent large businesses, questioned whether a legislative provision which references "gifts" was necessary. They took the view all disposals of their trading stock were business transactions, with some being both altruistic as well as good for business. Some noted this is subject to the facts of each case and the interpretation is not always clear. Several recommended that

the valuation rule should be re-focused on disposals to associates and on disposals where there is no business purpose and the donation is not made to a donee organisation.

45. In contrast, submitters who represented small businesses, such as farmers who donate livestock to charities, were primarily focused on the removal of the valuation rule for donations of trading stock. Their main concern was with compliance costs if a legislation change still required them to calculate and report the market value of the donated trading stock.

46. We considered several alternatives within a donation deduction option:

    46.1 *Should trading stock donation deductions be available to disposals made to public authorities?* We do not favour this option because it would create an inconsistency with the existing donation framework and was only introduced as a temporary measure due to COVID-19 and the donations being made to hospitals.

    46.2 *Should trading stock donation deductions be available to all donations and not restricted to donations made to donee organisations?* We do not favour this option because it would significantly undermine the donation deduction framework. For example, it would allow businesses to claim a deduction for trading stock donations to an overseas charity, whereas donations of money are restricted to overseas charities approved by the New Zealand Parliament.

    46.3 *Should trading stock donation deductions be subject to exactly the same rules as donations of money, including a donation cap?* We considered whether trading stock donations should continue to be subject to the valuation rule and the deduction for donations of money be extended to include donations of trading stock. While this would improve integrity of the trading stock donation deduction rules and would allow Inland Revenue to monitor all donation deductions, on balance we believe the taxpayer compliance costs and Inland Revenue administration costs would outweigh the integrity benefits. We believe integrity concerns would be sufficiently addressed if the valuation rule was switched off for donations made to donee organisations.

    46.4 *Should trading stock donation deductions be limited to certain types of trading stock?* The temporary COVID-19 relief specifically excluded certain types of trading stock (land and forestry) from the relief, because these types of donations were not considered directly relevant to helping victims of the pandemic. On balance, we do not have a compelling case to exclude certain types of trading stock from a permanent rule. We note that the concession we propose is going to be limited to non-associated person disposals and disposals to donee organisations which are regulated and publicly accountable, which should minimise integrity risks.

***Status quo - temporary relief in emergency times.***

47. The status quo - continuing to require businesses to report deemed income when trading stock is donated – will not address the over-reach of the law and will continue to deter businesses from donating trading stock (or deter them from complying with the valuation rule because of the over-reach). It was not an option supported by any submitters.

48. While businesses can support charities and people in need by gifting money, some businesses choose to donate trading stock, such as farmers donating livestock to charities and foodbanks. The current settings significantly discourage this behaviour outside of limited emergency times.

49. While the status quo is not our preferred option, we acknowledge that creating a concession for donated trading stock does have a cost and is outside the scope of the existing donation framework, which is limited to donations of money. So while it will return the tax treatment of disposals made outside of emergency times to its historical position from 1 April 2024, it is an option to consider.

## Conclusion

50. For disposals that are made in the ordinary course of business, we recommend removing the valuation rule where disposals are made to non-associated persons.

51. For disposals that are not made in the ordinary course of business, on balance, considering integrity, compliance, and administrative costs, we recommend removing the valuation rule where the disposal is a donation made to a donee organisation.

## Related Provisions

52. If changes are made to the trading stock rules it would also be timely to make minor consequential amendments to correct the interface between these rules and the general property disposal rules, the purchase price allocation rules, and apportionment of disposal of business assets that include trading stock.

## Financial implications

53. The fiscal impact of the changes is a revenue loss of approximately $4 million a year, with a corresponding impact on the operating balance:

| | $ million increase / (decrease) | | | | |
|---|---|---|---|---|---|
| Vote Revenue<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Tax Revenue:<br>Company tax | 0 | (1.0) | (4.0) | (4.0) | (4.0) |
| **Total operating** | **0** | **1.0** | **4.0** | **4.0** | **4.0** |

54. We have recommended that the revenue implications of these changes be counted on the Tax Policy Scorecard and will not impact the between-Budget spending contingency directly.

## Administrative implications and compliance costs

55. Implementation and on-going administration costs will be met through baseline funding. They will be minimal for the options recommended in this report.

56. The preferred option reflects stakeholder comments and concerns while balancing tax base integrity. It will significantly lower compliance costs for businesses who dispose of trading stock at below market value, particularly if the disposals are to non-associated persons in the ordinary course of business or to donee organisations, as no deemed income adjustments will be required.

## Consultation

57. The Treasury has been consulted in the preparation of this report.

## Next steps

58. Legislative change is required to implement these recommended changes. If you agree, we recommend you **approve** and **lodge** the attached paper seeking Cabinet's agreement to the change. A legislative change can be progressed as an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill, at the Committee of the whole House stage scheduled for March 2024. The application date for these changes would be for all disposals made on or after 1 April 2024.

Office of the Minister of Revenue

Chair, Cabinet Economic Policy Committee

# DISPOSALS OF TRADING STOCK AT BELOW MARKET VALUE

## Proposal

1 I am seeking the Committee's agreement to permanently change an anti-avoidance valuation rule (the "valuation rule") as it applies to disposals of trading stock at below market value. The change will address a long-standing over-reach within the trading stock rules. It will also provide certainty for businesses once a temporary change made in response to COVID-19 expires on 31 March 2024.

## Background

2 Trading stock disposed of at below market value is deemed to have been sold by the disposer (and subsequently purchased by the recipient) at market value. As a result, the disposer is taxed on a deemed profit margin. This is a longstanding anti-avoidance rule. It applies in a range of situations where avoidance is a concern, such as to goods taken by a business owner for their own use or consumption, and goods disposed of to associates.

3 However, the valuation rule also applies in situations where avoidance is not a concern, such as to goods disposed of to non-associated persons in the ordinary course of business and to goods that are donated to certain charities.

4 The valuation rule has been subject to temporary amendments in the past, to remove the over-reach when trading stock is donated in response to emergencies such as the 2010-2011 Canterbury earthquakes and COVID-19. The latter temporary relief expires on 31 March 2024.

## Analysis

### Problem definition

5 The valuation rule is considered by both officials and the business community to over-reach, distorting behaviour and causing unnecessary compliance costs and uncertainty.

6 This is particularly the case when it applies to transactions between non-associated parties in the ordinary course of business. The value of these disposals raise no avoidance concerns, however over-reach occurs because the rule applies irrespective of whether there is a tax avoidance purpose or motive.

7 In the case when trading stock is disposed of outside the ordinary course of business by way of a donation, the valuation rule also has an over-reach. The rule acts as a significant disincentive to donate, distorts donation behaviour and is widely perceived to be unfair. For example, farmers who donate food to foodbanks would not receive a deduction and instead would incur a tax liability on a deemed profit margin. The rule may deter them from donating, cause them to delay donating until the food has no value (which may not be accepted by foodbanks and thus add to food wastage), cause them to incur costs by entering sponsorship agreements with foodbanks so they effectively receive a market value in advertising (which not all foodbanks are prepared to do), or they may not comply with the rule and fail to report deemed income to Inland Revenue in their tax return.

#### Proposed Solution

8 For disposals made in the ordinary course of business, I propose removing the valuation rule where disposals are made to non-associated persons. This change means that commercial and arm's-length transactions will be excluded from the valuation rule.

9 For disposals that are not made in the ordinary course of business, I propose removing the valuation rule for donations made to donee organisations. Donee organisations are defined in the tax legislation. They are generally charities that apply their funds wholly or mainly to charitable purposes in New Zealand, or charities that carry out their charitable purposes overseas and have been specifically approved to be donee organisations by Parliament. Their donors can currently claim donation tax credits or income tax deductions by making donations of money. This solution would allow businesses to donate trading stock to donee organisations and effectively claim a net tax deduction for the cost of that trading stock.

10 As a consequence of the above changes, I propose that the measures enacted in response to COVID-19, which could be applied to certain future emergency events, be repealed.

11 Officials have publicly consulted on permanent amendments to the valuation rule. The proposed changes are strongly supported by the business community as well as by charities that receive donated trading stock.

### Financial Implications

12 The estimated financial implications of changing the anti-avoidance valuation rule are shown in the table below. Over the forecast period 2023-24 to 2027-28 the estimated fiscal cost is $13 million. This cost will be charged against the Tax Policy Scorecard.

| | $ million increase / (decrease) | | | | |
|---|---|---|---|---|---|
| Vote Revenue<br>Minister of Revenue | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Tax Revenue:<br>Company tax | 0 | (1.0) | (4.0) | (4.0) | (4.0) |
| **Total operating** | **0** | **1.0** | **4.0** | **4.0** | **4.0** |

## Legislative Implications

13 Implementing these proposals requires changes to the Income Tax Act 2007.

14 If approved, I propose including the required legislative changes in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill, by way of Amendment Paper, at the Committee of the whole House stage scheduled for mid-March 2024.

15 The Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill holds a category [1] priority on the 2024 Legislative Programme.

## Impact Analysis

#### Regulatory Impact Assessment

16 A Regulatory Impact Statement (RIS) has been completed by Inland Revenue and is attached in the Appendix.

17 The Quality Assurance reviewer at Inland Revenue has reviewed the RIS and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.

#### Climate Implications of Policy Assessment

18 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

## Consultation

19 Inland Revenue officials have consulted with the Treasury. The public was also consulted. The Department of the Prime Minister and Cabinet have been informed of the proposal.

## Communications

20 I will make an announcement on the contents of the Bill, including this proposal, when the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

## Proactive Release

21 I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

## Recommendations

The Minister of Revenue recommends that the Committee:

1 **note** that, absent a legislative change, a market value rule will apply to all disposals of trading stock by businesses at below market value, including donations, from 1 April 2024.

2 **agree** that for trading stock disposals that are made in the ordinary course of business, the valuation rule should not apply to disposals made to non-associated persons.

3 **agree** that for trading stock disposals that are not made in the ordinary course of business, the valuation rule should not apply to donations made to donee organisations.

4 **agree** that the reform in recommendation 2 and 3 apply to trading stock disposals made from 1 April 2024.

5 **note** that the fiscal cost of the proposed amendments is $13 million spread over a five-year forecast period and that cost will be charged against the Tax Policy Scorecard.

6 **note** that there are no significant administrative implications.

7 **authorise** the Minister of Revenue, after consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill that includes the reform in recommendations 2 and 3.

Authorised for lodgement

Hon Simon Watts

Minister of Revenue

ECO-24-MIN-0004

# Cabinet Economic Policy Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

## Disposals of Trading Stock at Below Market Value

**Portfolio** **Revenue**

On 21 February 2024, the Cabinet Economic Policy Committee:

1 **noted** that, without a legislative change, a market value rule will apply to all disposals of trading stock by businesses at below market value, including donations, from 1 April 2024;

2 **agreed** that for trading stock disposals that are made in the ordinary course of business, the valuation rule should not apply to disposals made to non-associated persons;

3 **agreed** that for trading stock disposals that are not made in the ordinary course of business, the valuation rule should not apply to donations made to donee organisations;

4 **agreed** that the decisions in paragraphs 2 and 3 above apply to trading stock disposals made from 1 April 2024;

5 **noted** that the fiscal cost of the above amendments is $13.0 million spread over a five-year forecast period and that costs will be charged against the Tax Policy Scorecard;

6 **noted** that there are no significant administrative implications;

7 **authorised** the Minister of Revenue, after consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill that includes the above decisions.

Rachel Clarke
Committee Secretary

**Attendance (see over)**

**Present:**
Rt Hon Christopher Luxon
Rt Hon Winston Peters
Hon Nicola Willis (Chair)
Hon Brooke van Velden
Hon Simeon Brown
Hon Judith Collins
Hon Tama Potaka
Hon Melissa Lee
Hon Simon Watts
Hon Penny Simmonds
Hon Chris Penk
Hon Andrew Hoggard
Hon Mark Patterson
Simon Court MP
Jenny Marcroft MP

**Officials present from:**
Office of the Prime Minister
Officials Committee for ECO



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Item 11

**POLICY AND REGULATORY STEWARDSHIP**

## Tax policy report: Interest deductibility phasing options

| **Date:** | 30 November 2023 | **Priority:** | High |
|---|---|---|---|
| **Security level:** | Sensitive | **Report number:** | IR2023/273 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Note** the contents of this report | 4 December 2023 |
| Associate Minister of Finance | **Note** the contents of this report | 4 December 2023 |
| Minister of Revenue | **Note** the contents of this report | 4 December 2023 |

## Contact for telephone discussion (if required)

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Chris Gillion | Policy Lead | s 9(2)(a) |
| Catherine Milner | Senior Policy Advisor | s 9(2)(a) |

30 November 2023

Minister of Finance
Associate Minister of Finance
Minister of Revenue

## Interest deductibility phasing options

### Purpose

1. This report provides advice on three proposed options for phasing the ability to claim interest deductions for residential investment properties back in. The advice covers the fiscal costs of reintroducing interest deductions, and any key delivery issues and impacts on taxpayers including issues that may arise from the retrospectivity involved with the first proposed option.

### Context and background

2. The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property.

3. For property acquired on or after 27 March 2021, interest deductions have been denied in full since 1 October 2021.

4. For property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021, the ability to claim interest deductions has been phased out as follows:

| Period that interest is incurred | Percentage of interest deductions allowed |
|---|---|
| 1 April 2021 to 30 September 2021 | 100% |
| 1 October 2021 to 31 March 2022 | 75% |
| 1 April 2022 to 31 Mach 2023 | 75% |
| 1 April 2023 to 31 March 2024 | 50% |
| 1 April 2024 to 31 March 2025 | 25% |
| On and after 1 April 2025 | 0% |

### Proposed options

5. The following options for phasing the ability to claim interest deductions for residential properties back in are:

| | Percentage of interest deductions allowed | | |
|---|---|---|---|
| | **Option 1** | **Option 2** | **Option 3** |
| 1 April 2023 to 31 March 2024 | 60% | 50% (current law) | 50% (current law) |
| 1 April 2024 – 31 March 2025 | 80% | 60% | 62.5% |
| 1 April 2025 – 31 March 2026 | 100% | 80% | 87.5% |
| Beginning 1 April 2026 | | 100% | 100% |

6. We note that we are working on the basis that the proposal is that all taxpayers will be allowed a deduction as set out in the table above, and there will no longer be any distinction between taxpayers who acquired property (and drew down loans) before 27 March 2021 versus those that acquired property on or after 27 March 2021.

## Costing of each option

7. The fiscal impact of reintroducing interest deductibility under each of the proposed options are as follows:

| | $m increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Fiscal year** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| **Option 1** | (60) | (360) | (785) | (855) | (915) |
| **Option 2** | 0 | (285) | (740) | (855) | (915) |
| **Option 3** | 0 | (295) | (760) | (855) | (915) |

## Delivery and administrative impacts

8. To implement Option 1, there will be some minor systems changes required to accommodate a retrospective change in deductibility, including the need to amend taxpayer guidance and communicating with taxpayers before they file their tax returns. Those changes can be accommodated, but need to be considered alongside any other changes the Government may require as a result of other 100-day policies.

9. Taxpayers will have made decisions based on the current law at the beginning of the year. Therefore, a retrospective change of this nature will have an impact on them. While returns for the 2023/24 income year do not need to be filed until 7 July 2024 (or 31 March 2025 if the taxpayer has a tax agent), taxpayers will have made provisional tax payments throughout the year based on the current level of deductibility. Increasing interest deductions will mean they may have overpaid their tax. Any overpaid tax will ultimately be refunded. Some taxpayers with early balance dates (i.e., balance dates between 1 October 2023 and 31 March 2024) may also file their tax returns before the changes are finalised, meaning their returns will need to be reassessed.

10. We also note that from a taxpayer perspective, changes that apply from 1 April, rather than, for example, 1 July, are easier to apply. Changes from 1 April avoid the need for complex calculations caused by having two different rates of deductibility.

### Legislative vehicle

11. We recommend that the preferred option be included in the current Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill by way of a Supplementary Order Paper (SOP), which could be introduced in March 2024.

12. This Bill needs to be enacted before 31 March 2024 as it contains the annual income tax rates. If your intention is to allow interest deductions for the current tax year under Option 1, including these changes in this SOP would ensure taxpayers would be able to deduct their interest costs in tax returns for the current tax year and avoids the need for bespoke legislation.

### Next steps

13. We will provide you with further detailed policy, fiscal, and implementation advice in relation to the interest deductibility proposals next week.

### Recommended action

We recommend that you:

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

Noted Noted Noted

s 9(2)(a)

**Chris Gillion**
Policy Lead
Inland Revenue

**Hon Nicola Willis**
Minister of Finance
/ /2023

**Hon David Seymour**
Associate Minister of Finance
/ /2023

**Hon Simon Watts**
Minister of Revenue
/ /2023

Inland Revenue
Te Tari Taake

**Policy and Regulatory Stewardship**
***Kaupapa me te Tiaki i ngā Ture***
55 Featherston Street
PO Box 2198
Wellington 6140
New Zealand

T. 04 890 1500

# Briefing note

| | |
|---|---|
| Reference: | BN2023/284 |
| Date: | 6 December 2023 |
| To: | Revenue Advisor, Minister of Finance – Melissa Siegel<br>Revenue Advisor, Minister of Revenue – Lonnie Liu<br>Private Secretary, Minister of Revenue – Helen Kuy |
| From: | Phil Whittington, Chief Economist |
| Subject: | **Confirmation of fiscal estimate for interest limitation changes** |

## Purpose

1. This briefing note provides you with the fiscal estimate of changes to the interest limitation rules following the discussion between the Ministers of Finance and Revenue on 5 December 2023.

## Interest limitation changes

2. The Ministers of Finance and Revenue have indicated their preference that interest deductions for residential properties be phased in as follows:

   a. 50% deductible for the 2023-24 tax year

   b. 80% deductible for the 2024-25 tax year, and

   c. 100% deductible for the 2025-26 and later tax years.

3. It is understood that the above deductions are to be available to all taxpayers who have incurred an interest expense in relation to a residential property regardless of when the property was purchased. This would mean that a person who purchased property after 27 March 2021 would be treated in the same way as taxpayers who purchased property before 27 March 2021.

4. The fiscal estimates for the various options for the reinstatement of interest deductions use a model that treats those who have full interest denial the same as those who had phased-in interest denial. These estimates were included in IR2023/273 which was provided to Ministers on 30 November. This was a pragmatic approach based on the relatively small number of affected parties, and the necessity to base any distinction on data that is not subject to validation on tax returns.

5. With attention turning to the treatment of those currently subject to full denial, we have done further work to estimate the impact of moving these taxpayers to 50% deductibility in the 2023-24 tax year.

6. The revised fiscal impact of the changes referred to in paragraph 2 is:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue Minister of Revenue** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| Tax Revenue | (5) | (360) | (785) | (855) | (915) |
| **Total Operating** | **5** | **360** | **785** | **855** | **915** |

**Consultation with the Treasury**

7. The Treasury was informed about this briefing note.

Phil Whittington
**Chief Economist**
s 9(2)(a)

Item 13

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

# **Tax Policy Report:** Tax policy options for Mini Budget

| **Date:** | 5 December 2023 | **Report No:** | T2023/2053<br>IR2023/279 |
|---|---|---|---|
| | | **File Number:** | MS-9-1 |

## Action Sought

| | Action Sought | Deadline |
|---|---|---|
| Hon Nicola Willis<br>**Minister of Finance** | **Note** the contents of this report | None |
| Hon Simon Watts<br>**Minister of Revenue** | **Note** the contents of this report | None |

## Contact for Telephone Discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|---|---|---|---|---|
| Robert O'Hara | Analyst, Tax Strategy, The Treasury | s 9(2)(a) (wk) | N/A (mob) | ✓ |
| Jean Le Roux | Manager, Tax Strategy, The Treasury | s 9(2)(a) (wk) | N/A (mob) | |
| Phil Whittington | Chief Economist, Inland Revenue | N/A (wk) | s 9(2)(a) (mob) | |

## Actions for the Minister's Office Staff (if required)

**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure**: No

# Tax Policy Report: Tax policy options for Mini Budget

## Executive Summary

### Purpose

1. This report provides a high-level summary of officials' views on tax policy options that may be in scope for the Mini Budget. These options are restoring interest deductibility, reducing the bright-line test to two years and denying depreciation deductions for commercial and industrial buildings. This report follows on from the joint advice you received on 30 November on the timing of delivery for your immediate tax policy priorities (T2023/2006, IR2023/271 refers). This report has been prepared under urgency.

2. If you decide to progress these options for the Mini Budget, Inland Revenue will prepare a Regulatory Impact Statement (RIS) on each policy, which will be published if and when the legislation that gives effect to the changes is introduced in the House. A RIS needs to include policy analysis of the proposal, so we are taking the opportunity to inform you of our views now.

3. The Treasury and Inland Revenue aim to provide joint advice on tax related matters as per the Memorandum of Understanding between these agencies. Should agencies have a differing view on key policies, officials will include split recommendations.

### Officials' high-level policy views

Restoring interest deductibility:

4. Officials recommend restoring interest deductibility. The Treasury recommends phasing the restoration and consideration of a cap on deductions (either as a maximum dollar amount or a fraction of interest expenses) to manage the fiscal cost. Inland Revenue has consistently recommended against denying interest deductions for residential rental properties. It does not recommend capping or lengthier phasing of deductions.

Reducing the bright-line test to two years:

5. Inland Revenue recommends reducing the bright-line test to 2 years to mitigate the efficiency impacts (as people hold property longer to avoid the tax) and fairness concerns (owing to the arbitrary time boundary) of the 10-year test. This would also return the test to its original role of being a proxy for taxing property gains where there was an intention to resell it when originally purchased.

6. The Treasury recommends a 20-year bright-line test or longer. This would capture more capital gains, thereby improving the fairness of the tax system and supporting more sustainable house prices. Gains could also be taxed at a lower rate from 2-20 years to address the concerns about efficiency and fairness noted above.

Denying depreciation deductions for commercial and industrial buildings:

7. Officials recommend continuing to permit depreciation deductions for commercial and industrial buildings to support productive investment into New Zealand. Officials acknowledge that denying deductions has a positive fiscal impact but recommend that, if the Government decides to proceed with denial, you consider restoring deductions as soon as fiscal pressures permit.

House price impacts:

8. The changes will put upward pressure on house prices; however, the size of impact is uncertain. The Treasury will analyse these impacts further and may adjust our house price forecasts to reflect them as part of the Budget Economic and Fiscal Update.

## Next steps

9. Should you wish to include these measures in the Mini Budget, you will need to have confirmed the commencement date of each policy in order for the fiscals to be included in the Mini Budget Cabinet paper. This will need to happen prior to Thursday 7 December when the Mini Budget Cabinet paper will be lodged.

10. Alternatively, you could include options in the Cabinet paper and make final decisions on the parameters through the Cabinet process. For each of the policies we are seeking your confirmation of the commencement date. We will seek this confirmation through T2023/2030 Mini Budget Scope and Decisions.

## Recommended Action

We recommend that you:

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

s 9(2)(a)

**Jean Le Roux**
Manager, Tax Strategy
The Treasury

s 9(2)(a)

**Phil Whittington**
Policy and Regulatory Stewardship
Inland Revenue

**Hon Nicola Willis**
Minister of Finance

/ /2023

**Hon Simon Watts**
Minister of Revenue

/ /2023

## Analysis

### *Interest deductibility for residential property investment*

*Purpose of rules*

1. These rules were introduced in April 2021. This was part of a package aimed at the previous Government's goals of reducing investor demand for existing property and incentivising investment in the new build market to increase housing supply.

2. There is some evidence to suggest investor activity in the housing market has decreased relative to first home buyers since the policy was introduced, though the effect cannot be separated from concurrent housing policy changes such as Loan-to-Value Ratio restrictions being reinstated and CCCFA reforms.

*Tax policy considerations*

3. Officials agree that allowing deductions for costs incurred in deriving income ensures that income tax reflects ability to pay. If a landlord earns $30,000 of rental revenue but interest and other costs amount to $25,000 then (all other things equal), the landlord's ability to pay has increased by $5,000, not by $30,000. Failing to allow deductions for the costs of earning income can create obstacles to sensible commercial decisions.

4. Denying deductions for interest expenses moved away from taxing income based on ability to pay, and maintaining incentives for people to make sensible commercial decisions. Restoring interest deductions is an important step to make the income tax system more consistent and coherent. Interest expenses are allowed as a deduction in other areas where an investment that is partly financed with borrowed funds generates taxable income.

*Housing market impacts*

5. In the short run, the bulk of the impact from restoring interest deductibility is likely to be reflected in house prices. House price impacts are highly uncertain and will depend on the final policy design and timing of the reintroduction of interest deductibility. The Treasury will analyse these potential impacts further and may adjust our house price forecasts to reflect them as part of the *Budget Economic and Fiscal Update.*

6. In the long run, tax changes could also impact the supply of housing by incentivising new construction, and could therefore have more significant impacts on rents. The long-run incidence on house prices and rents will depend on the flexibility of urban land supply and the availability of opportunities to intensify existing urban land:

   a. low flexibility of urban land supply and limited opportunities to intensify mean the policy will primarily raise house prices in the long run;

   b. high flexibility of urban land supply and significant opportunities to intensify mean the policy will primarily reduce rents in the long run.

7. We have consulted the Ministry of Housing and Urban Development (HUD), who agrees with this assessment of the impact on supply, house prices and rents and does not consider the impact will be material. In the near term, HUD expects that rising prices may mitigate the downturn in residential construction. Any impact on supply in the long term will depend on addressing underlying constraints to supply.

*Inland Revenue view*

8. Inland Revenue notes that the denial of interest deductibility involves a large tax increase on one type of investor (levered landlords) without changes in tax on other house purchasers. This is an unprecedented change which may have had a very large impact on incentives to own rental property with effects that are difficult to predict. Inland Revenue doubts whether there is a strong basis for concluding that there would have been insignificant short-run effects on rents as interest deductions were fully phased out if interest deductions had not been restored.

9. Inland Revenue has been concerned that any measures which make investment in rental property an unattractive proposition for many investors is likely, over time, to reduce the supply of housing. Inland Revenue's concern was that denial of interest deductions may have gradually made owning rental property less commercially viable. A healthy housing market needs a good supply of housing for both tenants and owner-occupiers.

10. The report from The Treasury and Inland Revenue in 2021 (T2021/103, IR2021/045 refers) summarised the impacts on the housing market in the following way:

> "Limiting interest deductions is expected to reduce investor demand for housing. This will put downward pressure on house prices, and as a result support first home buyers and home ownership. But in doing so, it may also decrease rental supply exerting upwards pressure on rents. For many renters housing costs are a significant burden, and nearly half of [all] children live in rental accommodation meaning increases in rents could impact on child poverty. This may also have flow on impacts for other Government policies, such as the Accommodation Supplement. The measure is also expected to have high efficiency costs relative to other ways to raise revenue. The size of these impacts is uncertain."

*Treasury view*

11. Research by the Housing Technical Working Group, a cross-agency group of housing experts, suggests that rents are primarily driven by household incomes and the relative supply and demand for rental housing. The Treasury therefore expects that changes in taxation would not significantly impact rents in the short run, as the stock of housing supply is fixed.

12. The Treasury's assessment of the evidence is that urban land supply has been highly restrictive over the last two decades, as demonstrated by the gradual fall in interest rates pushing up house prices rather than pushing down rents.

13. Recent policy changes (such as the Auckland Unitary Plan) appear to have improved the responsiveness of supply for higher-density housing, but further changes are needed to ensure housing supply continues to respond to demand in the long term.

14. Supporting the flexibility of urban land supply will make it more likely that restoring interest deductibility increases the supply of housing in the long run rather than primarily raising house prices. There are opportunities to do this through your policies including Going for Housing Growth and Resource Management Act reform.

*Fiscal impact*

15. Inland Revenue has provided fiscal costings for three proposed options for phasing interest deductibility back in. These options reduce revenue by between $2.825 and $2.975 billion over the forecast period, relative to the status quo of allowing deductibility to be phased out by 1 April 2025. These forecasts are higher than the expected revenue raised from denying deductions when originally forecast for three main reasons:

    i. The forecast period has been extended (from 2025/26 in the original costing to 2027/28 now). The extension of the period and growth in the size of interest deductions denied increases the cost of allowing them.

    ii. Interest rates are higher than those forecast in 2021. The expected revenue from denying interest deductibility increases if interest rates are higher, and this increases the costs of allowing them.

    iii. The model used to forecast the cost of the policy now uses more reliable data on residential interest expenses (which we did not collect when the original costing was done).

## ***Bright-line test***

*Purpose of rules*

16. The bright-line test was introduced in October 2015 as a proxy for taxing property gains where there was an intention to resell the property when originally purchased. The test initially captured property sold within 2 years, but was subsequently extended to 5 years (in March 2018) and then 10 years with a partial exemption for new builds (in March 2021).

*Tax policy considerations*

17. The taxation of capital gains from investment in housing is consistent with the principles of taxing economic income, and officials agree that a comprehensive capital gains tax or other options like a deemed rate of return tax would be desirable (although there are outstanding design questions around any of these options, including the applicable rate).

18. However, officials consider that the current 10-year bright-line test is an inefficient proxy for achieving this. It is expected that a relatively small proportion of housing capital gains are subject to tax under the current bright-line test, and the rule has the potential to significantly impact behaviour through lock-in effects, where people hold property beyond 10 years to avoid the tax. The arbitrary time boundary also raises issues of fairness.

19. Officials differ on how they weight the various costs and benefits of a longer bright-line test, however:

    - Inland Revenue believes the efficiency and fairness costs of a longer bright-line test are large relative to the benefits of increased taxation of capital gains.

    - The Treasury places greater weight on the positive impacts of a longer bright-line test such as greater taxation of capital gains and more sustainable house prices.

*Housing market impacts*

20. Reducing the bright-line test to 2 years may put some upward pressure on house prices in the short term, but this is expected to be small relative to the impact of restoring interest deductibility.

*Fiscal impact*

21. Reducing the bright-line test to 2 years is expected to reduce revenue by $0.2 billion over the forecast period.

### *Depreciation deductions for commercial and industrial buildings*

*Purpose of rules*

22. Depreciation deductions were restored for commercial and industrial buildings in 2020, with these buildings qualifying for depreciation at a rate of 2% on a diminishing-value (DV) basis.

23. A paper prepared by Inland Revenue's Policy and Strategy officials and presented in September 2018 to the Tax Working Group noted that international studies consistently show that buildings do depreciate, and that New Zealand was an outlier in the OECD in not allowing any depreciation deductions for commercial and industrial property. For that reason, both Inland Revenue and the Treasury recommended the 2020 restoration of depreciation deductions for these buildings[1].

*Economic impact of denying depreciation deductions*

24. Denying depreciation deductions will likely reduce investment in buildings in New Zealand and will distort investment decisions into lower quality investments. These impacts are likely to dampen productivity growth.

25. In Inland Revenue's last Long-Term Insights Briefing, officials noted that, under assumptions made by the OECD (including that non-residents demand a 3% real return on their capital), New Zealand was likely to have had the highest hurdle rate of return for investment in commercial and industrial buildings for the 38 countries in the OECD. This was when New Zealand allowed 2% depreciation on these buildings. Denying depreciation deductions would increase these hurdle rates of return more and make New Zealand a less attractive location for investment.

*Fiscal impact*

26. Denying depreciation deductions for industrial and commercial buildings is expected to raise $2.311 billion over the forecast period. Reducing building depreciation from 2 percent DV to 1 percent DV would be expected to generate half of this amount, $1.14 billion.

27. There are some transitional issues to incorporate such as accommodating taxpayers who have elected to depreciate the building and the building fit-out together. However, these transitional issues have been worked out when building depreciation was removed in 2010 and are relatively straightforward. The costing includes the effect of the transitional measures.

28. If depreciation deductions were retained there would be other ways to raise the revenue otherwise generated by this measure. To provide a sense of scale for the most closely connected tax rate, raising the company tax rate from 28 percent to 29 percent would generate approximately $2.47 billion revenue over the forecast period after removing taxes paid by Crown-owned companies and taking into account higher imputation credits on dividends. That would raise the cost of capital in a more uniform, less distorting way.

29. For the avoidance of doubt, we are not advising that you do that instead, as that would also raise the cost of capital for investment into New Zealand when it is already high from an international perspective.

[1] In 2010 the Treasury recommended removing building depreciation as there was some evidence that buildings did not depreciate in New Zealand. However, the Treasury subsequently changed its view following further analysis and review which provided strong evidence that buildings do depreciate.

# POLICY AND REGULATORY STEWARDSHIP

**Tax policy report:** **New bright-line test and removing building depreciation**

| **Date:** | 13 February 2024 | **Priority:** | High |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2024/015 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Agree** to recommendations | 21 February 2024 |
| Minister of Revenue | **Agree** to recommendations | 21 February 2024 |

## Contact for telephone discussion (if required)

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Peter Frawley | Policy Lead<br>Inland Revenue | s 9(2)(a) |
| Adam Carter | Senior Policy Advisor<br>Inland Revenue | s 9(2)(a) |

13 February 2024

Minister of Finance
Minister of Revenue

# New bright-line test and removing building depreciation

## Executive summary


1. This paper seeks Ministers' agreement to the design of the new bright-line test, resulting from reducing the bright-line period from 10- to two-years, and consequential policy settings. It also seeks agreement to technical aspects of removing commercial building depreciation.

2. Cabinet has agreed to replace the current bright-line tests with a two year bright-line test from 1 July 2024 and remove commercial building depreciation with effect from the 2024–25 and later income years (CAB-23-MIN-0490 refers). The proposals will go into the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper.

3. Cabinet also delegated the Minister of Revenue authority to release the Amendment Paper after consultation with the Minister of Finance and Leader of the House.

4. We recommend essentially returning to the policy settings that existed when the original two-year bright-line test was introduced in 2015. This will substantially reduce the complexity of the rules. This change would include removing time apportionment and land area apportionment for determining the extent to which the main home is exempt from the bright-line test. We also recommend retaining the rule that allows construction periods to be ignored when determining whether the main home exclusion applies. Finally, given the change in policy focus, we recommend simplifying and extending the current rollover relief rules to apply to all associated person transactions.

5. We have assumed that the policy objective of the proposal to remove commercial building depreciation is to return to pre-2020 settings, when the depreciation rate for buildings was last set at 0%. The 0% rate would apply to all buildings with an estimated useful life of 50-years or more regardless of when the building was acquired. Where transitional issues arise for some taxpayers, we recommend reintroducing similar provisions to those introduced when building depreciation was first removed in 2010. There may be fiscal implications with a different approach.

6. If you agree to the technical design of these two initiatives, we will provide you with an Amendment Paper in time to be released on 21 March 2024.

## Recommended action

We recommend that you:

a) **note** Cabinet has agreed to replace the current bright-line tests with a two-year bright-line test from 1 July 2024 and remove commercial building depreciation with effect from the 2024-25 and later income years;

Noted Noted

b) **note** the proposals will go into the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper;

Noted Noted

*Bright-line test*

c) **agree** to return to a test where the main home exclusion applies if the land is used for more than 50% of the period as the person's main home;

Agreed/Not agreed Agreed/Not agreed

d) **agree** to return to a test where the main home exclusion applies if more than 50% of the land area is used for the person's main home;

Agreed/Not agreed Agreed/Not agreed

e) **agree** to retain the exemption allowing construction periods to be ignored when determining whether the main home exclusion applies;

Agreed/Not agreed Agreed/Not agreed

f) **agree** to simplifying and extending the current rollover relief rules to apply to all associated person transactions;

Agreed/Not agreed Agreed/Not agreed

*Building depreciation*

g) **note** the building depreciation costings assumed a return to pre-2020 settings and varying from these settings may have fiscal implications;

Noted Noted

h) **agree** to return to pre-2020 settings for building depreciation including:

i. applying a depreciation rate of 0% to buildings with an estimated useful life of 50 years or more; and

ii. applying the 0% rate regardless of when the building was acquired;

iii. not allowing taxpayers to apply for special rates for their building; and

iv. continue not allowing a deduction for loss on disposal.

Agreed/Not agreed Agree/Not agreed

i) agree to reintroduce the exception for "grandparented structures" (specific types of buildings acquired on or before 30 July 2009 that qualify to be depreciated as structures rather than buildings);

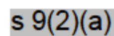
Agreed/Not agreed Agree/Not agreed

j) **agree** to reintroduce a transitional rule for taxpayers who own buildings acquired in or before the 2010-11 income year, allowing them to deem 15% of the adjusted tax value of the building as the value of commercial fit-out that can continue to be depreciated at the current straight-line rate for buildings (1.5% per year);

Agreed/Not agreed Agree/Not agreed

k) **agree** to a technical change to the previous transitional rule (recommendation j above) which would require future and historic deductions taken under that provision to be considered when calculating depreciation recovery income for buildings sold from the 2024-25 income year.

Agreed/Not agreed Agree/Not agreed




**Peter Frawley**
Policy Lead
Inland Revenue

**Hon Nicola Willis**
Minister of Finance
/ /2024

**Hon Simon Watts**
Minister of Revenue
/ /2024

## Background

7. Cabinet has agreed to repeal the current 10-year bright-line test, five-year new-build bright-line test, and five-year bright-line test, and replace them with a new two-year bright-line test from 1 July 2024. Cabinet has also agreed to remove commercial building depreciation with effect from the 2024–25 and later income years. The proposals will go into the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper.

## New bright-line test

8. On 20 December 2023, the Government announced its intention to bring the bright-line test for residential property back to two years, effective from 1 July 2024. Given the decision and announcement, changes to consequential policy settings within the bright-line test need to be decided on.

### Current settings

9. Under the 10-year bright-line test (and the five-year new-build bright-line test), the main home exclusion was amended to require apportionment. Apportionment was considered a more appropriate setting given the longer bright-line period to ensure residential rental properties were taxed appropriately on sale while main homes were not taxed. There are currently two bases of apportionment:

   9.1 **time apportionment:** the main home exclusion only applies for periods when a property is physically used as the owner's main home (subject to a "12-month buffer", where the use can be changed without consequence). Where there are changes of use (outside the 12-month buffer), gains on sale must be apportioned between main home use, and non-main home use, with gains attributed to non-main home periods being subject to tax. For example, under the current rules, if a person uses a property as their home for five years, and then rents the property out for three years before selling it, the person would be subject to tax on any gains during the three-year period the property was used as a rental property.

   9.2 **land area apportionment:** apportionment is also required where the land area is used for dual purposes and is not predominantly used as a person's main home. For example, if a property sold within the bright-line period contained three dwellings, where two were used as rental properties and one was used as the person's main home, under the current law, the person would be subject to tax on sale for gains relating to the two-thirds of the property that was used for the rental properties.

10. An amendment was also made in 2022 to extend the "12-month buffer" to cover a reasonable period during which a person constructs a dwelling they use as their main home.

### Proposed settings

11. The proposed reduction in the bright-line period will allow a return to the original policy objective of taxing property speculation by providing a simple, easy-to-apply bright-line rule. Given this objective, we recommend returning to the policy settings that existed when the original two-year bright-line test was introduced. In particular, we recommend:

    11.1 removing the time apportionment and returning to the original main home exclusion, which applies if the land is used for most (ie, more than 50%) of the period as the person's main home;

11.2 removing the land area apportionment and returning to the original main home exclusion, which applies where the land is used predominantly (i.e., more than 50% of the land area) for a dwelling that was the main home of the person.

12. The proposed main home exclusion applies on an all-or-nothing basis. This approach is consistent with the original policy of the bright-line test which was to have a simple, easy-to -apply rule. In doing so, this will result in some people being taxed when they sell their main home if, for example, the land area was not used predominantly for the main home, or the land was used as a rental property for a longer period than it was used for a main home. However, in the case of a two-year bright-line test, where fewer people who use land as a main home are likely to be subject to the test, a simpler approach that will reduce compliance costs is preferable.

13. We recommend that an exemption for construction periods is retained, so that these periods are ignored when determining whether the main home exclusion applies.

**Rollover relief**

14. Complex rollover relief provisions were introduced in 2022 following the extension of the bright-line period to 10-years. These rules allow transfers where the ultimate economic ownership does not change to effectively be ignored for the purpose of the bright-line test in some limited situations. The current rules cover transfers between:

14.1 settlors and trust, and between trusts, in some very limited situations;

14.2 partners and partnerships and look-through companies and their owners;

14.3 trusts that are Māori authorities and their settlors in limited situations; and

14.4 transfers made as part of the settlement under the Treaty of Waitangi.

15. The current roll-over rules are very complex, impose compliance costs, and not well understood meaning taxpayers may not know whether they apply to them. In addition, with the bright-line period being reduced to two years, the bright-line test now has reverted to its original policy purpose. In that context, we recommend simplifying and extending rollover relief to apply to all associated person transactions. This is appropriate given that transfers between persons who are associated would not be expected to be property speculation transactions.

16. Extending the rollover rules to associated person transactions would cover transfers between:

16.1 associated companies, or a person and an associated company;

16.2 relatives (within two degrees of relationship);

16.3 trusts and settlors, beneficiaries, and related trusts;.

16.4 a partner and a partnership; and

16.5 a look-through company and an owner of that company.

17. We recommend retaining the current rollover rules for trusts that are Māori authorities and settlements under the Treaty of Waitangi.

18. To protect against these broader rules being manipulated to achieve a result that is not intended, we also recommend including some anti-avoidance rules. In particular, we recommend that the use of the rollover relief rules be limited to

situations where the transferor and the transferee were associated for two years prior to the transfer, and only allow rollover relief to be claimed once in any two-year period.

## Financial implications

19. Reducing the bright-line test to two years is expected to reduce revenue by $0.2 billion over the forecast period from 2023/24 to 2027/28. This was agreed to in the mini-Budget.

20. The consequential changes recommended above, if agreed to, would not impact on the overall costings.

21. Extending the rollover rules to cover transactions between associated persons would not have a fiscal impact. No extra tax would be paid under the bright-line test with rollover relief (transactions between associated persons would not be taxable) but under a counterfactual of no rollover relief, the costing assumption is that affected transactions would instead be deferred until the (now shorter) bright-line period has elapsed.

## Consultation

22. We engaged with Chartered Accountants Australia & New Zealand (CA ANZ), the New Zealand Law Society (NZLS), and the Corporate Taxpayers Group (CTG) during targeted consultation on the proposal.

23. There was support for the bright-line test to return to the original policy settings by removing both the time and land area apportionment rules on the basis that it will reduce complexity and compliance costs.

24. However, it was suggested that a broader review of the rules, and in particular the coverage of the main home exclusion and the rollover relief rules, be considered given the new policy settings.

25. We have consulted the Treasury and the Ministry of Housing and Urban Development (HUD). The Department of Prime Minister and Cabinet (DPMC) has been informed.

## Removing commercial building depreciation

26. Cabinet has agreed to remove commercial building depreciation with effect from the 2024-25 and later income years.

27. Historically, buildings were depreciable property for tax purposes in the same way as other assets used for carrying on a business. However, in 2010, the ability to claim depreciation deductions for all buildings was removed, with effect from the 2011-12 income year. Building depreciation was re-introduced in 2020 for commercial buildings, with effect from the 2020-21 income year. Depreciation deductions continue to be denied for residential buildings.

28. Returning to pre-2020 settings is the simplest way to make the change in the current timeframes. This was also the assumption made when costing the policy for Cabinet. For transitional issues, we recommend similar provisions to those introduced when building depreciation was first removed in 2010. In particular, we recommend the following policy design.

### 0% rate for long-lived buildings

29. In 2010, a depreciation rate of 0% was applied to all existing and newly acquired buildings with an estimated useful life of 50 years or more. The 0% rate allows previous depreciation deductions on buildings to remain recoverable if the building is sold for more than its tax book value.

30. To ensure the policy is applied consistently, applications to the Commissioner for special depreciation rates for buildings were not allowed. However, depreciation rates remained available for buildings with an estimated life less than 50 years e.g., barns, chemical works, dairy sheds, fertiliser works, fowl houses, hothouses, pighouses, and tanneries.

31. There was one exception to the general policy introduced in 2010. This was for "grandparented structures". Grand-parented structures are specific types of buildings that, prior to an Interpretation Statement issued by Inland Revenue in 2010, were considered to be structures not buildings. Special rules were enacted to allow grand-parented structures acquired on or before 30 July 2009 to continue to be depreciated as structures rather than buildings. These rules were inadvertently repealed as part of the reintroduction of building depreciation in 2020. There has not been an intentional change in policy, and we do not recommend one. Therefore, the rules should be reinstated with retrospective effect.

32. Current law does not define what is a building, and it is not intended that this should change. However, the Commissioner published IS 22/04 *Claiming depreciation on buildings* in July 2022. This statement explained:

    32.1 which structures qualified as grand-parented structures; [15.2.2]

    32.2 how depreciation recovery income is determined on sale of a building; [15.4]

    32.3 when depreciation could be claimed on commercial fit-out; [15.6] and

    32.4 the mechanism for claiming depreciation on embedded fit-out [15.6]

33. This statement is based on the existing law but could be updated to reflect the new law once it is enacted if that was considered desirable.

**No deduction for loss on disposal**

34. An alternative way of allowing taxpayers to recover the lost value of their building through depreciation is to allow them to claim a deduction if a building is sold for less than its tax book value. While this treatment applies for most depreciable assets, it does not apply for buildings and was not allowed from 2010 even after the removal of building depreciation. One reason for this is that land and buildings are usually sold together, and it is difficult to establish how much of a total loss or gain is attributable to loss on the building itself.[1] Allowing such a deduction would also have a significant fiscal cost.

**Transitional provision for fit-out**

35. While the depreciation rate for these buildings is 0%, the depreciation rate for items used in, but not part of, these buildings remains unchanged, and they can continue to be depreciated separately from the building itself. This includes commercial fit-out.

36. A provision was introduced in 2010 to allow a building owner who has not previously recorded fit-out separately, to treat as fit-out up to 15 percent of the building's tax book value at the end of the 2010 income year. Taxpayers who opted to use this provision could then depreciate their fit-out at the straight-line building rate. We

[1] There are exceptions for buildings that are damaged due to a natural event not under control of the person and have been demolished or abandoned.

recommend taxpayers who used this provision from 2010 be allowed to use the provision again as though it had not been removed in 2020.

37. We do not recommend making this provision available for buildings acquired since 2010. Since 2010, taxpayers have had a strong incentive to record fit-out separately from the building. Taxpayers who acquired a building between 2010 and 2020 should have already separated fit-out from the building if they wished to claim any depreciation deductions during this period. We understand the common practice since 2010 (after the first removal of depreciation) is to separately value fit-out in a newly acquired building. This practice has been further reinforced by the purchase-price allocation rules from 1 July 2021 which requires vendors and purchasers to agree to separate values for bundles of assets that are being sold.

38. If you agree to reintroduce the transitional provision for building owners who used the provision in 2010, we recommend a technical change to how the provision previously operated. Deductions taken under the former transitional provision were not included in the calculation of depreciation recovery income (i.e., depreciation deductions which have been recovered by the asset selling for more than its adjusted tax value). To ensure consistency with the depreciation recovery regime, we recommend future and historic deductions taken under the transitional provision be included when calculating depreciation recovery income for buildings sold from the 2024-25 income year.

### Financial implications

39. Costings have been based on the policy settings outlined above. Changing these policy settings will impact the costing. The fiscal impact of the building depreciation changes is a revenue gain of approximately $2.31 billion over the forecast period, with a corresponding impact on the operating balance:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue** | **2024/25** | **2025/26** | **2026/27** | **2027/28** | **2029/30 and outyears** |
| Crown Revenue and Receipts:<br>Tax Revenue | **$57** | **$1120** | **$567** | **$567** | **$567** |
| **Total change in Revenue** | **$57** | **$1120** | **$567** | **$567** | **$567** |

40. The results for the 2024/25 and the 2025/26 years are a normal consequence from the lagged return filing then generating provisional tax assessments for the second year.

41. Any administrative costs associated with these policies will be managed within existing baselines.

### Consultation

42. We engaged CA ANZ, NZLS, and CTG during targeted consultation on the proposal. We also received feedback from EY and KPMG. There was general agreement amongst those consulted that buildings do depreciate and as such should be allowed a depreciation deduction. There was also general support for a transitional provision for fit-out.

43. The following suggestions were made during consultation:

 43.1 excluding certain buildings whose function is related to plant (e.g., a building whose purpose is to cover a crane);

43.2 allowing deductions for leasehold improvements (e.g., where an improvement is only intended to last the length of a temporary lease);

43.3 allowing deductions for seismic strengthening;

43.4 allowing for owners to claim a loss on disposal.

44. Making any of these changes would have fiscal implications and/or be risky to design under the current timeframes. We can provide you with further information on these suggestions if you would like to consider placing any of them on the policy work programme.

45. We have consulted the Treasury and HUD. DPMC has been informed.

## Next steps

46. If Ministers agree to the policy settings above, officials will begin drafting an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill in time to be released on 21 March 2024. The Bill is expected to be enacted by the end of March 2024.

# POLICY AND REGULATORY STEWARDSHIP

## Tax policy report: Restoring interest deductibility for residential property

| **Date:** | 1 February 2024 | **Priority:** | High |
|---|---|---|---|
| **Security level:** | In Confidence | **Report number:** | IR2024/027 |

## Action sought

| | **Action sought** | **Deadline** |
|---|---|---|
| Minister of Finance | **Agree** to recommendations<br>**Authorise** the lodgement of the attached Cabinet paper | 22 February 2024 |
| Associate Minister of Finance | **Agree** to recommendations<br>**Authorise** the lodgement of the attached Cabinet paper | 22 February 2024 |
| Minister of Revenue | **Agree** to recommendations<br>**Authorise** the lodgement of the attached Cabinet paper | 22 February 2024 |

## Contact for telephone discussion (if required)

| **Name** | **Position** | **Telephone** |
|---|---|---|
| Chris Gillion | Policy Lead<br>Inland Revenue | s 9(2)(a) |
| Catherine Milner | Senior Policy Advisor<br>Inland Revenue | s 9(2)(a) |

1 February 2024

Minister of Finance
Associate Minister of Finance
Minister of Revenue

## Restoring interest deductibility for residential property

### Purpose

1. This report seeks joint Ministers' agreement to restoring interest deductibility for residential properties. It also asks Ministers to authorise the lodgement of the attached Cabinet paper, once finalised, with the Cabinet Office by 10am, Thursday 22 February 2024 so that it may be considered by the Cabinet Business Committee at its meeting on Wednesday 28 February 2024.

### Background

1. The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property.

2. For property acquired on or after 27 March 2021, interest deductions have been denied in full since 1 October 2021.

3. For property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021, the ability to claim interest deductions has been phased out as follows:

| Period that interest is incurred | Percentage of interest deductions allowed |
|---|---|
| 1 April 2021 to 30 September 2021 | 100% |
| 1 October 2021 to 31 March 2022 | 75% |
| 1 April 2022 to 31 Mach 2023 | 75% |
| 1 April 2023 to 31 March 2024 | 50% |
| 1 April 2024 to 31 March 2025 | 25% |
| 1 April 2025 onwards | 0% |

### Restoring interest deductibility

4. As part of the coalition agreements, the Government has agreed to restore interest deductibility for residential property. The Government confirmed its commitment to fully restoring interest deductibility for rental properties in its Mini-Budget announcements in December 2023, with details of the phasing of this commitment to be the subject of an announcement in early 2024.

5. Advice was provided by Inland Revenue and the Treasury regarding the policy options for interest deductibility on 5 December 2023 (T2023/2053, IR2023/279 refers).

6. Ministers have indicated that the Government wants interest deductibility to be phased back in on the following basis:

| | **Percentage of interest deductions allowed** |
|---|---|
| 1 April 2023 to 31 March 2024 | 50% |
| 1 April 2024 to 31 March 2025 | 80% |
| 1 April 2025 onwards | 100% |

7. All taxpayers will be able to claim 50% of their interest expense in the first year (2023–24). This includes taxpayers who are currently denied a deduction in full because they acquired their property on or after 27 March 2021. This means there will be a retrospective restoration of the ability to claim interest deductions for those taxpayers who acquired their property on or after 27 March 2021.

8. The interest limitation rules currently contain a number of complex rules determining which types of land and taxpayers are subject to the rules, describing which loans are subject to the current phasing, and providing for specific anti-avoidance. While some of these rules will not be necessary if all taxpayers will be subject to the same deductibility restrictions going forward, it will be necessary to retain most of the rules while deductibility is being re-introduced. Therefore, we recommend that the only changes made to the rules with effect from 1 April 2023 are those necessary to allow interest deductibility to be phased back in as indicated above.

9. After 1 April 2025, when all taxpayers are allowed full deductions, the interest limitation rules will no longer be required. We recommend that the rules be repealed from that date.

10. However, there are currently rules that allow taxpayers whose disposals of residential land are subject to tax (under the bright-line test or one of the other land sales tax rules) to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of. These rules recognise that if the sale is subject to tax, the interest expense is a cost of acquiring the property that should be recognised in determining the net profit. We recommend that this rule be retained so that it continues to apply for future sales of properties that were subject to the interest limitation rules.

11. Given the intention for these rules to apply retrospectively to the 2023–24 income year (which for most taxpayers began on 1 April 2023), these changes will need to be enacted as soon as possible. Therefore, it is recommended that these changes be included in the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill, which is currently before the Finance and Expenditure Committee, via an Amendment Paper.

## Fiscal implications

12. The fiscal impact of reintroducing interest deductibility is $2.92 billion over the forecast period as per previous advice to your offices (BN2023/284 refers), as follows:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br><br>**Minister of Revenue** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| Tax Revenue | (5.000) | (360.000) | (785.000) | (855.000) | (915.000) |
| **Total operating** | **5.000** | **360.000** | **785.000** | **855.000** | **915.000** |

13. The Treasury notes that this decision is occurring out-of-cycle, with the fiscal impact of $2.92 billion (over the forecast period) a pre-commitment against the Budget 2024 operating allowance. This significant pre-commitment will reduce decision-making room for Ministers during the Budget 2024 process, but Treasury accepts that this decision needs to occur as soon as possible to allow for implementation on Ministers' desired timeframes.

## Consultation

14. The Treasury and the Ministry of Housing and Urban Development were consulted on this report and the attached Cabinet paper. The Department of the Prime Minister and Cabinet was informed.

## Next steps

15. If Ministers agree to the policy specifications above, Inland Revenue will begin drafting an Amendment Paper in time to be released on 21 March 2024.

## Recommended action

We recommend that you:

1. **agree** that interest deductibility should be phased back in over three years: with 50% deductibility in the 2023–24 (tax) year, 80% in the 2024–25 year, and 100% in 2025–26 and later years, for all affected taxpayers;

   Agreed/Not agreed　　Agreed/Not agreed　　Agreed/Not agreed

2. **note** the following changes as a result of the decision above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br><br>**Minister of Revenue** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| Tax Revenue | (5.000) | (360.000) | (785.000) | (855.000) | (915.000) |
| **Total operating** | **5.000** | **360.000** | **785.000** | **855.000** | **915.000** |

Noted　　Noted　　Noted

3. **note** that this decision is occurring out-of-cycle as a pre-commitment against the Budget 2024 operating allowance, and will reduce decision-making room for Ministers during the Budget 2024 process;

   Noted Noted Noted

4. **note** that the detailed interest limitation rules would be kept in place until 1 April 2025 when the ability to claim interest deductions is fully restored;

   Noted Noted Noted

5. **agree** to retain the rules that allow taxpayers whose disposals of residential land are subject to tax to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of;

   Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

6. **agree** to include this proposal in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper;

   Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

7. **authorise** the lodgement of the attached Cabinet paper, once finalised, with the Cabinet Office by 10am, Thursday 22 February 2024 for the Cabinet Business Committee to consider at its meeting on Wednesday 28 February 2024.

   Authorised/Not authorised Authorised/Not authorised Authorised/Not authorised

s 9(2)(a)

**Chris Gillion**
Policy Lead
Policy and Regulatory Stewardship

| **Hon Nicola Willis** | **Hon David Seymour** | **Hon Simon Watts** |
|---|---|---|
| Minister of Finance | Associate Minister of Finance | Minister of Revenue |
| / /2024 | / /2024 | / /2024 |

**In Confidence**

Office of the Minister of Finance

Office of the Associate Minister of Finance

Office of the Minister of Revenue

Cabinet Economic Policy Committee

# Restoring interest deductibility for residential property

## Proposal

1 This paper seeks the Cabinet Economic Policy Committee's agreement to restore interest deductibility for residential property. The ability to claim interest deductions for residential property was removed in 2021. We propose that the ability to claim interest deductions be phased back in over two years, with deductions allowed in full by the 2025–26 income year.

2 The proposal should be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper. The Bill is currently before the Finance and Expenditure Committee.

## Relation to government priorities

3 As part of the coalition agreements, the Government has agreed to restore interest deductibility for residential property. The Government confirmed its commitment to fully restoring interest deductibility for rental properties in its Mini-Budget announcements in December 2023, with details of the phasing of this commitment to be the subject of an announcement in early 2024.

## Executive Summary

4 We propose that interest deductibility be phased back in over three years: with 50% deductibility in the 2023–24 (income) year, 80% in the 2024–25 year, and 100% in 2025–26 and later years. It is proposed that this treatment be applied to all taxpayers (including those who are currently denied interest deductions in full).

5 We proposed that only minor amendments be made to the current rules with effect from the 2023–24 income year to allow for interest deductibility to be phased back in as proposed. However, the interest limitation rules would be substantially repealed with effect from the 2025–26 income year (once the ability to claim interest deductions is fully reinstated).

6 The proposals should be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill via an Amendment Paper.

## Background

7 The interest limitation rules were introduced in 2021 and deny a deduction for interest incurred for residential investment property.

8 For property acquired on or after 27 March 2021, interest deductions have been denied in full since 1 October 2021.

9 For property acquired before 27 March 2021, and borrowings drawn down before 27 March 2021, the ability to claim interest deductions has been phased out as follows:

| Period that interest is incurred | Percentage of interest deductions allowed |
|---|---|
| 1 April 2021 to 30 September 2021 | 100% |
| 1 October 2021 to 31 March 2022 | 75% |
| 1 April 2022 to 31 Mach 2023 | 75% |
| 1 April 2023 to 31 March 2024 | 50% |
| 1 April 2024 to 31 March 2025 | 25% |
| 1 April 2025 onwards | 0% |

10 The phasing in the currently enacted interest limitation rules applies to tax years (i.e., 1 April to 31 March). For taxpayers who have a non-standard balance date (e.g., 1 July to 30 June), this means that they will have two different percentages of interest denial applying to them in the same income year.

## Analysis

11 As part of the coalition agreements, the Government has agreed to restore interest deductibility for residential property. The Government confirmed its commitment to fully restoring interest deductibility for rental properties in its Mini-Budget announcements in December 2023, with details of the phasing of this commitment to be the subject of an announcement in early 2024.

12 We propose that interest deductibility should be phased back in on the following basis:

| | Percentage of interest deductions allowed |
|---|---|
| 2023–24 income year | 50% |
| 2024–25 income year | 80% |
| 2025–26 income year | 100% |

13 All taxpayers will be able to claim 50% of their interest expense in the first income year (2023–24) (which includes non-standard balance dates). This includes taxpayers who are currently denied a deduction in full because they acquired their property on

or after 27 March 2021. This means there will be a retrospective restoration of the ability to claim interest deductions for those taxpayers who acquired their property on or after 27 March 2021.

14 The interest limitation rules currently contain a number of complex rules determining which types of land and taxpayers are subject to the rules, describing which loans are subject to the current phasing, and providing for specific anti-avoidance. While some of these rules will not be necessary if all taxpayers will be subject to the same deductibility restrictions going forward, it will be necessary to retain most of the rules while deductibility is being re-introduced. Therefore, the only changes that should be made to the rules with effect from the 2023–24 income year are those necessary to allow interest deductibility to be phased back in as indicated above.

15 From the 2025–26 income year, when all taxpayers are allowed full deductions, the interest limitation rules will no longer be required. Therefore, the rules should be repealed from that year.

16 However, there are currently rules that allow taxpayers whose disposals of residential land are subject to tax (under the bright-line test or one of the other land sales tax rules) to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of. These rules recognise that if the sale is subject to tax, the interest expense is a cost of acquiring the property that should be recognised in determining the net profit. We recommend that this rule be retained so that it continues to apply for future sales of properties that were subject to the interest limitation rules.

## Cost-of-living Implications

17 Denial of interest deductions is likely to make investing in rental housing an unattractive proposition for many investors. Over time, this is likely to reduce the supply of housing and rental housing (relative to what would be the case if interest was deductible), which could put upward pressure on rents and gradually make rental properties less affordable for tenants. A healthy housing market requires a good supply of housing for both tenants and owner-occupiers.

18 In the short-run, the impacts of restoring interest deductibility are likely to be reflected in house prices. In the longer term, re-introducing the ability to claim interest deductions is likely to encourage some construction and supply of dwellings over time, decreasing pressure on rents and improving the cost of living. However, the magnitude of this is uncertain and will depend on other policies impacting housing and the flexibility of urban land supply.

## Financial Implications

19 The fiscal impact of reintroducing interest deductibility with the proposed phasing is as follows:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br><br>**Minister of Revenue** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| Tax Revenue | (5.000) | (360.000) | (785.000) | (855.000) | (915.000) |
| **Total operating** | **5.000** | **360.000** | **785.000** | **855.000** | **915.000** |

## Legislative Implications

20 Given the intention for these rules to apply retrospectively to the 2023–24 income year (which for most taxpayers began on 1 April 2023), these changes will need to be enacted as soon as possible. Therefore, it is proposed that these changes be included in the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill, which is currently before the Finance and Expenditure Committee, via an Amendment Paper.

## Impact Analysis

### Regulatory Impact Statement

21 A Regulatory Impact Statement has been prepared and is attached to this paper.

22 The Quality Assurance panel at Inland Revenue has reviewed the regulatory impact statement (RIS) prepared by Inland Revenue. The panel considers that information and analysis summarised in the RIS: Reintroducing interest deductibility on residential investment property partially meets the quality assurance criteria. The proposal being considered by Cabinet supports a broader tax reform package developed in response to the coalition agreements of the government. As such, the options under consideration were limited to the status quo and reintroduction of interest deductibility. Time constraints also applied to the policy development of the proposal and has not permitted consultation on the various options, or refinement of the preferred option.

### Climate Implications of Policy Assessment

23 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that CIPA requirements do not apply to this proposal as it is not expected to result in any significant, direct emissions impacts.

## Population Implications

24 The proposal is intended to reduce upward pressure on rents. Population groups that have higher rates of renting property (or lower rates of home ownership) are therefore likely to be more impacted by this proposal than other population groups. These groups include Māori and Pacific people as well as younger people. However, any benefit for home ownership rates may be offset to some extent by the proposal putting some upward pressure on house prices. The magnitude of the impact of restoring

interest deductibility on prices and rents is uncertain, so the magnitude of the impacts on these populations groups is also uncertain.

### Human Rights

25 The proposals comply with the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

### Use of external resources

26 No external resources have been engaged in the preparation of this proposal.

### Consultation

27 Inland Revenue has consulted with the Treasury and the Ministry of Housing and Urban Development on the policy development for this proposal and on this Cabinet paper. The Department of the Prime Minister and Cabinet was informed.

### Communications

28 If agreed to, these changes will be included in an Amendment Paper to the Bill due to be released on 21 March 2024. Following enactment in March 2024, Inland Revenue will publish a Tax Information Bulletin to assist taxpayers in understanding the new rules.

### Proactive Release

29 We propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

### Recommendations

The Minister of Finance, Associate Minister of Finance, and Minister of Revenue recommend that the Committee:

1 **agree** that interest deductibility should be phased back in over three years: with 50% deductibility in the 2023–24 (income) year, 80% in the 2024–25 year, and 100% in 2025–26 and later years, for all affected taxpayers;

2 **note** the following changes as a result of the decision in recommendation 1 above, with a corresponding impact on the operating balance and/or net debt:

| | **$m – increase/(decrease)** | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br><br>**Minister of Revenue** | **2023/24** | **2024/25** | **2025/26** | **2026/27** | **2027/28 & Outyears** |
| Tax Revenue | (5.000) | (360.000) | (785.000) | (855.000) | (915.000) |
| **Total operating** | **5.000** | **360.000** | **785.000** | **855.000** | **915.000** |

3 **agree** that the reduction in Crown tax revenue in recommendation 2 above be charged against the Budget 2024 operating allowance as a pre-commitment;

4 **note** that the detailed interest limitation rules should be kept in place until the 2025–26 income year, when the ability to claim interest deductions is fully restored;

5 **agree** to retain the rules that allow taxpayers whose disposals of residential land are subject to tax to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of;

6 **authorise** the Minister of Revenue, after consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill that includes the measures in recommendations 1 to 3 above.

Authorised for lodgement

Hon Nicola Willis
Minister of Finance

Hon David Seymour
Associate Minister of Finance

Hon Simon Watts
Minister of Revenue

ECO-24-MIN-0011

# Cabinet Economic Policy Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

## Restoring Interest Deductibility for Residential Property

**Portfolio** **Associate Finance (Hon David Seymour) / Finance / Revenue**

On 28 February 2024, the Cabinet Economic Policy Committee **referred** the submission under ECO-24-SUB-0011 to Cabinet on 4 March 2024 for further discussion given its significance.

Rachel Clarke
Committee Secretary

**Present:**
Rt Hon Christopher Luxon
Rt Hon Winston Peters
Hon David Seymour
Hon Nicola Willis (Chair)
Hon Brooke van Velden
Hon Shane Jones
Hon Chris Bishop
Hon Simeon Brown
Hon Erica Stanford
Hon Judith Collins
Hon Tama Potaka
Hon Matt Doocey
Hon Melissa Lee
Hon Simon Watts
Hon Penny Simmonds
Hon Chris Penk
Hon Andrew Bayly
Hon Andrew Hoggard
Hon Mark Patterson
Simon Court MP
Jenny Marcroft MP

**Officials present from:**
Office of the Prime Minister
Office of Hon Simon Watts
Inland Revenue
Officials Committee for ECO



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# Cabinet

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

## Restoring Interest Deductibility for Residential Property

**Portfolios** **Associate Finance (Hon David Seymour) / Finance / Revenue**

On 4 March 2024, following reference from the Cabinet Economic Policy Committee, Cabinet:

1 **noted** that in December 2023, as part of the mini-Budget decisions, Cabinet agreed to announce, with indicative costings, its intention to restore interest deductibility for rental properties [CAB-23-MIN-0490];

2 **agreed** that interest deductibility be phased back in over two years:

2.1 80 percent in the 2024–25 year for all affected taxpayers;

2.2 100 percent in 2025–26 and later years, for all affected taxpayers;

3 **noted** the following changes as a result of the above decision, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Tax Revenue | 0 | (360.000) | (785.000) | (855.000) | (915.000) |
| Total operating | 0 | 360.000 | 785.000 | 855.000 | 915.000 |

4 **agreed** that the reduction in Crown tax revenue above be charged against the Budget 2024 operating allowance as a pre-commitment;

5 **noted** that the detailed interest limitation rules should be kept in place until the 2025–26 tax year, when the ability to claim interest deductions is fully restored;

6 **agreed** to retain the rules that allow taxpayers whose disposals of residential land are subject to tax to claim a deduction for interest that was denied under the interest limitation rules at the time the property is disposed of;

7 **authorised** the Minister of Revenue, in consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill that includes the above measures.

Rachel Hayward
Secretary of the Cabinet



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# **Tax Policy Report:** Options to regulate and tax online casino gambling

| **Date:** | 18 December 2023 | **Report No:** | T2023/1942<br>IR2023/296 |
|---|---|---|---|
| | | **File Number:** | SH-13-5-3-12-M99969 |

## Action Sought

| | **Action Sought** | **Deadline** |
|---|---|---|
| Minister for Racing (Rt Hon Winston Peters) | Note the contents of this report | None |
| Minister of Finance (Hon Nicola Willis) | Agree to the recommendations | None |
| Minister of Internal Affairs (Hon Brooke van Velden) | Agree to the recommendations | None |
| Minister of Revenue (Hon Simon Watts) | Agree to the recommendations | None |

## Contact for Telephone Discussion (if required)

| **Name** | **Position** | **Telephone** | | **1st Contact** |
|---|---|---|---|---|
| Paul Quirke | Senior Analyst | s 9(2)(a) (wk) | s 9(2)(a) (mob) | √ |
| Jean Le Roux | Tax Strategy Manager | s 9(2)(a) (wk) | s 9(2)(a) (mob) | |
| Clare Allison | Director Gambling, Racing and Media Content DIA | | s 9(2)(a) (mob) | |
| Gordon Witte | Principal Policy Advisor, Inland Revenue | s 9(2)(a) | | |

## Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

| Note any feedback on the quality of the report | |
|---|---|

**Enclosure**: No

# **Tax Policy Report:** Options to regulate and tax online casino gambling

## Executive Summary

The online gambling policy in the National Party Tax Plan, endorsed by the Coalition Agreements, commits to a regulatory regime for online casino gambling (regulatory objective), to ensure the industry pays its fair share of tax (revenue objective). The plan includes using geo-blocking as an enforcement tool.

New Zealand remains one of the few OECD jurisdictions where online gambling is unregulated. Gambling on overseas sites by New Zealand-based gamblers provides minimal tax or other financial return to New Zealand. There is also limited oversight of harm minimisation.

Gambling harm has wide-reaching financial and non-financial impacts for the gamblers, their whānau and the wider community.

This report seeks your direction on regulating the online casino gambling industry, either:

A. Licensing (recommended approach): would introduce a licensing system for all online casino operators which are accessible to New Zealand gamblers with possibly a capped number of licences available. Officials note the earliest a licensing system could apply from is 2025/26, so a register and report system would apply to 2024/25. This is because of the implementation issues and risks detailed in the risks and limitation and administration impacts sections of this report.

B. Register and report/open market: would only require all online operators accessible to New Zealand gamblers to report on their income and pay the appropriate tax.

This report also seeks your direction on how to tax all online casinos[1] from 1 July 2024:[2]

1 **Tax like an onshore casino (National Tax Plan):** GST[3], 4% casino duty on Gross Betting Revenue (GBR)[4], 28% income tax on profits (totalling around 26% tax on GBR) and the problem gambling levy.[5] Whilst it is technically possible to apply income tax to online casinos which are located offshore, we are not aware of any other country that does this.

2 **Tax like a gaming machine:** GST and a 20% gaming machine duty on GBR (totalling 33% tax on GBR) and the problem gambling levy. Stricter regulation and higher taxes can support your harm minimisation and revenue objectives. While this option would, on the face of it, generate the highest revenue, it has the highest uncertainty. This is because it has the greatest risk that New Zealand gamblers move to non-compliant offshore casino operators, which would undermine the possible increased revenue and harm minimisation. The size of these risks is

[1] Including online casinos associated with New Zealand casinos.

[2] As indicated in the National Tax Plan.

[3] Collected on a GST-inclusive basis meaning 13% on GBR. i.e. if a gambler bets and loses $115, GST of $15 is collected.

[4] GBR refers to the net losses for gamblers (bets received minus prizes paid out).

[5] The revenue from problem gambling levy is used exclusively to fund problem gambling services.

uncertain, however we consider them significant and could undermine your harm minimisation and revenue objectives.

3 **Align tax with international regimes (recommended approach):** GST, 12% gaming duty (totalling 25% tax on GBR) and the problem gambling levy. This would align the treatment with our international counterparts which we consider would minimise the risks of gamblers moving into unregulated markets. As a result, officials consider this option would best balance revenue certainty and harm minimisation.

Whilst the uncertainty around the revenue estimates is reasonably balanced for options 1 and 3, it is significantly to the downside for option 2. This reflects uncertainty about how many gamblers would move to unregulated operators if New Zealand's tax rates were significantly higher than international comparators. Although the modelling allows for some such behaviour, it is plausible that the behavioural response leads to revenue being similar (or potentially lower) than option 3. Additionally, whilst the revenue may be similar to option 3, harm minimisation would be lower due to more gambling occurring outside of the regulated market. Officials therefore recommend a licensing model with operators taxed in alignment with international regimes (option A3). This is because officials consider the best way to achieve the Government's objectives is to ensure most gambling takes place in the compliant market under a regulated approach. Option A3 would generate an estimated $193 million over the forecast period.

Consistent with the National Tax Plan, this report does not currently consider sports and race betting and lottery draws. Officials could provide further advice on these areas if desired.

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There will be broader economic and social impacts from tightening the regulation and increasing the taxation of online casino gambling. These impacts are difficult to quantify.

Officials do not consider that there are any substantive legal risks with taxing and regulating the market. Careful design, however, will be required to ensure the system is consistent with New Zealand's international obligations, particularly free trade agreements.

If you opt for a licensing approach, the implementation and ongoing enforcement costs of a licensing system could operate on a cost recovery basis and be fiscally neutral over time. However, DIA would seek a repayable capital injection for one-off establishment costs.

## Recommended Action

We recommend that you:

a **agree** to regulate the online casino market through:

A. **Licensing (recommended approach):** A licensing system for online gambling operators would allow each licenced operator to offer online

gambling products and advertise. The earliest a licensing system could apply from is 2025/26,[6] so a register and report system would apply in 2024/25.

**OR**

B. **Register and report/open market:** A register and report approach would only require all overseas operators to report on their income and pay the appropriate tax.

b **agree** to tax online casinos from 1 July 2024,[7] either:

1. **Tax like an onshore casino (National Tax Plan):** online casinos would be subject to GST, 4% casino duty on Gross Betting Revenue (GBR) and 28% income tax on profits.

**OR**

2 **Tax like a gaming machine:** online casinos would be subject to GST and a 20% gaming machine duty on GBR. Income subject to the 20% gaming machine duty would be exempt from income tax.

**OR**

3 **Align tax with international regimes (recommended approach):** online casinos would be subject to GST and a 12% gaming duty on GBR. Income subject to the 12% gaming duty would be exempt from income tax.

Indicate your overall preference by ticking the relevant box in the following table:

| Options | Minister of Finance | Minister of Internal Affairs | Minister of Revenue |
|---|---|---|---|
| A1 Licensing, tax like onshore | | | |
| A2 Licensing, tax like gaming machine | | | |
| A3 Licensing, align tax regime internationally (recommended) | | | |
| B1 Register tax like onshore | | | |
| B2 Register, tax like gaming machine | | | |
| B3 Register, align tax regime internationally | | | |

[6] The implementation date is due to the implementation issues and risks detailed later in the risks and limitations and administration impacts sections of this report.

[7] As indicated in the National Tax Plan.

c **note** the following estimated fiscal impacts ($ millions) would differ depending on the option which was implemented as displayed in the following table:

| Options | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 | Over Forecast |
|---|---|---|---|---|---|---|
| A1 | - | 44 | 46 | 48 | 51 | 189 |
| A2 | - | 63 | 66 | 69 | 73 | 271 |
| **A3 (recommended approach)** | - | 45 | 47 | 49 | 52 | 193 |
| B1 | - | 33 | 35 | 37 | 38 | 143 |
| B2 | - | 50 | 52 | 55 | 58 | 215 |
| B3 | - | 35 | 36 | 38 | 40 | 149 |

*Noted* *Noted* *Noted* *Noted*

d s 9(2)(f)(iv)

e s 9(2)(f)(iv)

f s 9(2)(f)(iv)

g **note** that the costs of a licensing system would operate on a cost recovery basis and be fiscally neutral over time, but a repayable capital injection would be sought for one-off establishment costs.

*Noted* *Noted* *Noted* *Noted*

h **note** that regulating and taxing online gambling would require amendments to the Gambling Act 2003, the Tax Administration Act 1994, the Income Tax Act 2007 the Gaming Duties Act 1971 and regulations made under the Gambling Act 2003.

*Noted* *Noted* *Noted* *Noted*

i **direct** officials to draft a Cabinet Paper reflecting the decisions made in this report.

*Directed/not directed.* *Directed/not directed* *Directed/not directed*

j **agree** for officials to carry out some targeted consultation meetings with industry stakeholders on an in-confidence basis, and to meet with gambling regulators and revenue authorities in other countries (e.g. the UK), to reduce the risks associated with the proposals.

*Agree/disagree* *Agree/disagree* *Agree/disagree*

k **refer** this report to the Minister for Health.

*Refer/not referred*

s 9(2)(a)

s 9(2)(a)

s 9(2)(a)

Jean Le Roux
**Tax Strategy Manager**
The Treasury

PP Marilyn Little
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Department of Internal Affairs

Graeme Morrison
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Inland Revenue

Hon Nicola Willis
**Minister of Finance**

_____/_____/_______

Hon Brooke van Velden
**Minister of Internal Affairs**

_____/_____/_______

Hon Simon Watts
**Minister of Revenue**

_____/_____/_______

# **Tax Policy Report:** Options to regulate and tax online casino gambling

## Purpose of Report

1. Both Coalition Agreements confirm the Government will progress the commitment in the National Party's Tax Plan to establish a regulatory regime for online casino gambling (**regulatory objective**) to ensure they pay their fair share of tax (**revenue objective**).

2. This report provides advice to support your decisions on regulating and taxing online casinos. Options to enable regulation and licensing are outlined in this report. Advice is also provided on geo-blocking and the reasons we do not recommend utilising this as an enforcement tool. It contains the relevant decisions you will need to make and the recommended approach from officials.

## Context

3. The online gambling market has grown in recent years; however, the market has remained unregulated. Offshore operators can freely provide online gambling to New Zealanders with virtually no limitations, except that they cannot legally advertise to New Zealanders.

***The online gambling market is large and increasing in size***

4. SkyCity estimated the size of the online casino market (as opposed to the total online gambling market) as being between $400-500 million of Gross Betting Revenue (GBR) in 2022/23. Gross betting revenue refers to the net losses for gamblers (bets received minus prizes paid out).

5. The only official figures indicating the size of the online gambling market (for all forms of online gambling) are GST figures.[8] Online gambling operators that were registered for GST reported $342.5 million of GBR and $42.8 million of GST was collected from these operators in the 12 months ending 30 June 2023.[9] There are, however, a considerable number of online gambling operators who are not registered and do not pay GST (but these are likely to be significantly smaller operators than those registered for GST).[10] As a result, we expect the size of the market to be more than the stated $342 million of GBR.

6. Given the uncertainty of the size of the total market, we have estimated the total online casino market size is $400 million in GBR in 2022/23. This estimate is larger than the market size indicated by GST but is at the lower end of the range suggested by the SkyCity report. Different policy options will result in online casino operators and New Zealand customers changing their practices so either more or less gambling activity is conducted through compliant operators (which are licenced (if a licence is required) and pay taxes), resulting in the estimated future size of the compliant market differing.

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[8] The GST rules require offshore providers of services to New Zealanders to register and pay GST (subject to some exemptions).

[9] About 11% of this total was from sports or race betting.

[10] Applying GST to gambling is unusual internationally so some providers may not be aware that they are required to pay GST.

***Different tax and duty regimes apply to different types of gambling***

7. The current mechanisms to collect tax from online operators are limited compared to land-based operators, as per the table below:

| Operator | Taxes and/or Levies | Community distributions |
|---|---|---|
| **Lotto NZ** | • lottery duty (5.5% nominal value of all tickets represented in a lottery draw)<br>• GST<br>• problem gambling levy (0.44% on GBR) | • grants funding (100% of profits less prizes and costs) |
| **TAB NZ** | • GST<br>• problem gambling levy (0.76% on GBR) | • TAB NZ pays National Sporting Organisations a fee for taking bets on the sports they represent<br>• distribution to the racing codes and sports organisations (100% of surpluses from racing and sports betting after allowing for reserves) |
| **Class 4 pokies (gaming machines outside of casinos)** | • gaming duty (20% of GBR)<br>• GST<br>• problem gambling levy of 1.08% of GBR and after society and venue expenses | • operators must apply at least 40% of proceeds to authorised purposes (commonly referred to as community funding) |
| **Casinos** | • casino duty (4% of GBR)<br>• GST<br>• problem gambling levy of 0.87% of GBR<br>• income tax on their profits [11] | • distributions to community trusts (Sky City paid $5.3m of community grants in 2022/23).[12] |

8. Online casinos have been required to register for and collect GST since 2016.

9. Because online casinos are located offshore, they do not currently have to pay income tax. This reflects the fact that international tax settings generally only collect income tax on non-resident business income when it is generated through a physical presence in New Zealand (such as a premises or office).

10. Similarly, the gaming duties and problem gambling levy currently only apply to New Zealand licenced gambling providers. Revenues from gaming duty go into the Consolidated Fund, while the problem gambling levy is used to fund problem gambling services. While officials recommend expanding the scope of the problem

[11] Income from Gaming Machines, Lotto NZ and TAB NZ are exempt from income tax due to specific exemptions in the Income Tax Act.

[12] Sky City Annual Report 2022/23 pg 85. https://www.skycityentertainmentgroup.com/media/3590/20230823-annual-report.pdf

gambling levy so it also applies to online gambling providers, there would be no net fiscal impact because the increased revenue would be hypothecated to fund more problem gambling services.

***Online gambling harm is increasing***

11. Most people who gamble do so without experiencing harm, however the proportion of people who listed online gambling as their primary mode of gambling when seeking help for gambling harm has almost doubled since 2018 (from 6% in 2018 to 11% in 2022) [13]. Gambling harm has wide-reaching impacts, beyond just financial impacts, for the players and those connected to them, including their whānau and the wider community. Impacts besides financial problems include (but are not limited to): problems at work or study (ranging from poor performance to theft and fraud), poor parenting and other relationship problems, family violence, alcohol abuse, cultural harm, criminal activity, mental health problems, emotional or psychological distress, and death by suicide.
12. Online gambling is likely to be at least as harmful as pokies. It has several hallmarks of harm such as the continuous nature of play, its 24/7 accessibility on mobile phones and other devices, and its appeal to young people and other vulnerable members of society.
13. Different parts of society have different levels of consumption of online gambling as outlined in the 2020 Health and Lifestyles Survey. For example, Māori are more likely to gamble on online casino websites than non-Māori. The rate of Māori gambling on online casino websites has been increasing significantly over the years, from 1.3 percent in 2012 to 4.7 percent in 2020. Other groups did not experience a significant change. 32 percent of people accessing clinical services who recorded online gambling as one of the types of gambling causing them harm identified as Māori. While data is limited, evidence suggests that young people (aged 16 to 24 years) and men may also be relatively more likely to have gambled on online casino websites. The 2020 Health and Lifestyles Survey suggests that Pacific women were significantly more likely to gamble online than non-Pacific women, but Pacific men were less likely to gamble online than non-Pacific men.

## Problem definition and analytical framework

14. New Zealand remains one of the few OECD jurisdictions where online gambling is unregulated. Gambling on offshore sites provides minimal financial return to the New Zealand government or the community. Online casino sites are not taxed to the same extent as onshore providers. There is limited oversight of harm minimisation.
15. This report considers options to support both your regulatory and revenue objectives, and evaluates them against the Treasury's tax, Living Standards, and He Ara Waiora frameworks.[14]

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[13] 2020 Health and Lifestyles Survey (Health Promotion, National Public Health Service, Wellington, 2023). https://minhealthnz.shinyapps.io/nz-health-survey-2022-23-annual-data-explorer/

[14] https://taxworkinggroup.govt.nz/resources/twg-bg-tax-working-group-assessment-framework.html https://www.treasury.govt.nz/information-and-services/nz-economy/higher-living-standards/he-ara-waiora ; and https://www.treasury.govt.nz/information-and-services/nz-economy/higher-living-standards/our-living-standards-framework

16. These options would apply equally to the online casinos currently operated by SkyCity and the Christchurch Casino, which are both based in Malta for regulatory reasons.

## Options to regulate and tax online casino gambling

### Regulatory options

17. There are two options to regulate the online casino market: (1) a licenced approach; or (2) register and report under an open market approach. These options are discussed below.

***Option A:* Licensing (recommended approach)**

18. The first option is to introduce a licensing system for online casino operators. Officials recommend a licensing system with a capped number of licences. It would be illegal to provide online casino services to New Zealanders without a licence. Officials consider a licensing model with a cap on the number of licences would be the best way to increase revenue and enable harm minimisation standards to help protect New Zealanders.

19. There are a number of potential features of the licensing system that would increase revenue and minimise harm and ensure compliance:

    - licenced operators would be required to comply with their New Zealand tax obligations as a condition of their licence;
    - strong enforcement levers would ensure compliance e.g. formal warnings, significant fines, loss of licence;
    - controlled advertising would maximise revenue and minimise the risk of harm by channelling customers to licenced gambling providers;
    - public education and awareness would encourage people to gamble only within the regulated market;
    - harm minimisation tools would protect vulnerable New Zealanders; and
    - a requirement to pay the Problem Gambling Levy which funds problem gambling services.

20. While it might appear counter-intuitive that a licensing model could raise more revenue than a more open market, we expect this to be the case because a regulated market would allow licenced operators to advertise, which would in turn channel gamblers to the regulated market. To the extent that the proposed licencing model provides some oligopoly benefits to the licencees, there may be further incentives for current operators to stay in the market. However, this could be to the detriment of the New Zealand gamblers as there would be less competition and consumer choice than an open market.

21. There is a risk that a licensing approach may reduce tax revenues if the licence fees and conditions make it difficult for licenced providers to compete with non-licenced providers. Non-licenced providers may be able to offer more attractive odds to gamblers if their costs would be lower than licenced providers.

22. Harm minimisation tools that decrease harm caused by online gambling would strengthen human capital and Te Ira Tāngata (the human domain), and especially support Māori due to their relative higher rate of participation.

23. There are potential trade implications from regulating online gambling. However, if the purpose of regulating gambling is for public health reasons (which is one of the purposes of a licensing regime), there is an exception under New Zealand's various trade agreements. Any implications for international trade will require careful consideration during the detailed design of the licensing system, should Ministers agree with this approach.

24. Officials advise that the earliest a licensing approach could be implemented is 2025/26, so this option would involve a register and report system in 2024/25. Internal Affairs' officials can report back to you with details of the licensing system (including implementation costs) if you decide to progress with this option.

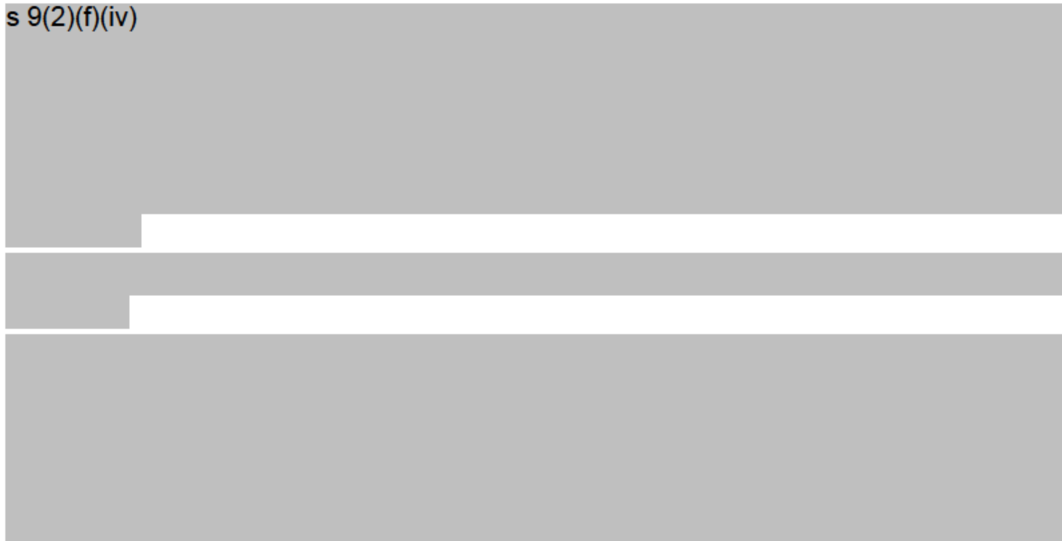
***Option B*: Register and report/open market**

25. A register and report approach would require all overseas operators to register with Inland Revenue, report on their income and pay the appropriate tax. This would allow any operators to provide online casino services to New Zealand gamblers (open market). It is likely that only reputable operators (who currently pay GST) would comply with the additional tax obligations. In other words, officials do not consider that it is likely that more operators will report for tax purposes under the proposed higher tax rates. In fact, some of the current compliant operators may opt to leave the market due to the increased tax and compliance costs. Taxing operators without allowing them any opportunity to increase their market share (as they would be able to with a licensing model as outlined above) will mean that there is likely to be a lower level of compliance. Having fewer compliant online casinos would reduce tax revenue and exacerbate current distortions, impacting efficiency and financial capital. Because online casinos have no legal presence in New Zealand, it would be difficult and costly to take enforcement action against operators that do not comply.

26. Taxing online operators without having any player protections in place could significantly increase gambling-related harm over time. Increased harm would negatively impact human capital and Te Ira Tāngata (the human domain) by undermining the mana of people and communities. Further, it is likely to impact the capability of people to pursue their aspirations (mana āheinga) and their power to grow sustainable, intergenerational wealth (mana whanake). The harm is likely to especially impact Māori due to their higher rate of participation. These impacts are difficult to quantify.

27. International examples illustrate the importance of ensuring harm minimisation standards. Most OECD countries that regulate online gambling include harm minimisation standards in their regulatory regime. The Netherlands is an example of gambling legislation that did not have sufficient harm minimisation standards with a resultant significant increase in gambling harm. The Dutch government is now working on proposals to tighten the rules around online gambling advertising and maximum gambling limits.

s 9(2)(f)(iv)


s 9(2)(f)(iv)

## Revenue options

31. Under New Zealand's current tax settings the only tax that online casinos are liable to pay is GST. This means they currently benefit from more favourable tax settings than their New Zealand competitors and lower gaming duties than they are liable to pay in the UK and most international jurisdictions.

32. Options for taxing online casinos are:

    - Option 1: Tax like an onshore casino (National Tax Plan)
    - Option 2: Tax like a gaming machine
    - Option 3: Align tax with international regimes (Recommended approach)

33. s 9(2)(f)(iv)

### *Option 1:* Tax like an onshore casino (National Tax Plan)

34. This option would aim to tax online casinos the same as land-based casinos that are physically located in New Zealand (supporting horizontal equity). These taxes are GST, a 4% casino duty on GBR and a 28% income tax on profits. Officials estimate this would equate to an effective tax rate of approximately 26% of GBR (based on estimated taxable income of online casinos of 33% of GBR).

35. Whilst it is technically possible to apply income tax to online casinos which are located offshore, we are not aware of any other country that does this. Instead, they apply gaming duties, which are consumption taxes on GBR. Current international tax settings generally only collect income tax on non-resident business income when it is generated through a physical presence. New Zealand's 40 double tax agreements prevent New Zealand from collecting income tax on non-

resident businesses from these treaty partners unless the income is attributable to a physical presence in New Zealand. Currently, most online casinos are in jurisdictions such as Malta and Gibraltar which New Zealand does not have double tax agreements with. However, there is a risk that an online casino could be relocated so it is a tax resident of one of the 40 jurisdictions New Zealand has a double tax agreement with. It may be possible to require an online casino to operate through a New Zealand company as a condition of being licenced to provide gambling to New Zealanders, although such a requirement could potentially be challenged under a relevant trade agreement.

36. Applying income tax would also impose high compliance costs on the affected casinos as they would need to calculate their New Zealand-sourced profits and comply with complex international tax rules. To avoid incurring these high compliance costs it is likely that some online casinos would choose to leave the New Zealand market by blocking New Zealand customers, rather than become liable for New Zealand income tax.

***Option 2:* Tax like a gaming machine**

37. This option would seek to tax online casinos like gaming/pokie machines. This approach would ensure that online casinos pay similar gaming duties to the class 4 sector reflecting the fact that online casinos are more like online gaming machines than physical casinos. Physical casinos have exclusive casino licences, are more regulated, employ many New Zealand staff and offer many other services besides gambling.

38. Class 4 gambling via gaming machines is subject to GST and a 20% gaming machine duty on GBR. Income subject to the 20% gaming machine duty is exempt from income tax. This income tax exemption reflects the fact that gaming machines pay a higher rate of gaming duty than physical casinos (20% of GBR compared to 4%) and the requirement for class 4 gambling to distribute at least 40% of their gaming machine proceeds (excluding GST) through community grants.

39. We do not consider it would be feasible to require online casinos to distribute 40% of their proceeds through community grants. Such a requirement would likely lead to many online casinos choosing to leave the New Zealand market by blocking New Zealand customers. These customers are then likely to switch to non-compliant online casinos which do not pay taxes or fund community grants.

40. Option 2 is simpler and more coherent with established policy settings for international taxation than option 1.

41. Under option 2, the total tax collected would be 33% of GBR (a combination of GST and gaming machine duty) which would be significantly higher than taxes imposed by larger online gambling markets such as the UK (21% of GBR) and Italy (20% of GBR).

42. Imposing a high overall tax burden significantly increases the risk that some online casino providers may choose to block New Zealand customers as the after-tax returns they could make from New Zealand customers would become too low. In response, New Zealand customers may shift their gambling activity to non-compliant online casino providers who do not pay any New Zealand taxes, which would result in a loss of tax revenues. It would also undermine harm minimisation as non-compliant operators may choose not to take steps to mitigate harm.

43. We note that SkyCity and the Christchurch Casino currently operate online casino websites. Under option 2, these websites would be required to pay 20% gaming

duty consistent with other online casino websites, as opposed to a 4% casino duty on their own websites.

### *Option 3:* Align tax with international regimes (recommended approach)

44. This option aims to tax online casinos at a rate that is in line with the tax that other jurisdictions apply to online casinos. Compared to option 1 and 2 which impose high taxes or compliance costs, option 3 would have a much lower risk of New Zealand gambling activity shifting to non-compliant online gambling operators which would undermine harm minimisation and revenue collection.

45. Under option 3, services provided by online casinos would remain subject to GST in New Zealand. It is proposed that an additional gaming duty of 12% would apply. This would result in online casinos paying the equivalent to a 25% tax on gross betting revenue.

46. A total tax of 25% on online casino GBR would put New Zealand at the midpoint of jurisdictions that impose gaming duties on online casinos (as opposed to banning them). Spain and Portugal apply a 25% tax on online casino GBR while Denmark (28%) and the Netherlands (29%) apply higher rates. Belgium, Italy, UK, Sweden and the Czech Republic apply lower tax rates, taxing online casinos on their GBRs at 11%, 20%, 21%, 22% and 23% respectively.

47. The main advantage of ensuring that the tax is internationally comparable is that it reduces the risk of online casinos blocking New Zealand customers.[15] In response to such blocks, there is a risk that some New Zealand customers may shift their gambling activity to non-compliant online casinos who do not pay taxes, and do not mitigate harm.

48. A key disadvantage of option 3 is that, because 12% would be less than the 20% gaming machine duty which applies to class 4 gaming machines, it could be opposed by class 4 operators or lead to lobbying to reduce the rate of gaming machine duty to align it with offshore websites. Also, as the 12% gaming duty would be more than the 4% casino duty, New Zealand casinos may seek to maintain a 4% duty on gaming conducted through their websites.

### The proposals may impact racing, sports and lottery betting

49. Online Lotto NZ and TAB NZ products could be impacted by increased competition and at risk of losing revenue, much of which goes to either community grants or funding the racing industry and sporting organisations. This would occur if existing TAB NZ and Lotto NZ customers abandoned their products or reduced their overall consumption of gambling content.

50. s 9(2)(f)(iv)

[15] In the sports and race betting context, online betting providers are subject to both GST and a 10% point of consumption charge in New Zealand. It is noted that this level of taxation (a 23% total tax rate) did not appear to cause any online sports and race betting providers to leave the New Zealand market. However, the nature of the sports and race betting market may be different than the online casino market.

51. s 9(2)(f)(iv)

52. s 9(2)(f)(iv)

## Broader economic and social considerations

53. There will be broader economic and social considerations from increasing the regulation and taxation of one sector of the gambling sector, online casino gambling. In the time available, it has not been possible to accurately estimate the relevant impacts.

### *Increased regulation and taxation will likely impact NZ gamblers*

54. Standard economic theory might suggest that due to the relevant restrictions and regulations that the costs of the increased taxation and regulation would be borne by the online casinos (through lower returns to labour, capital or shareholders).[16] However, to the extent that the market is more competitive, some of the economic incidence is likely to fall on local gamblers through operators passing through some of the increased costs.[17] The pass-through may occur via lower returns on bets or in a reduction in promotions. International literature suggests there is little direct empirical evidence on pass-through rates.[18] The lower returns from online casinos may lead gamblers to:

    a **Remain with unregulated online gambling operators:** to the extent that gambling remains with unregulated online operators that will reduce any increase in tax revenue and any harm minimisation that would have otherwise occurred.

    b **Switch to local casino operators or other forms of local gambling:** the increased taxation and regulation of online casinos may reduce the differential between them and local gambling, leading to a shift to local gambling.[19] This could increase domestic revenue for local operators leading to an increase in domestic employment and investment. Increased domestic gambling may also lead to more funding passing through to the industry

[16] "The UK betting and gaming market: estimating price elasticities of demand and understanding the use of promotions" (HM Revenue and Customs, 2014) 2.4.5

[17] Ibid

[18] Ibid

[19] Various studies have noted that casino gambling is a substitute for other types of gambling.

stakeholders, including the racing industry, and community funding. Increased domestic gambling may also impact other local businesses and neighbouring property values (both positively and negatively).

c **Reduce their gambling:** A reduction in online gambling expenditure might bolster jobs and tax revenues to the extent that households spend money on other domestic goods and services.

***Increased regulation and taxation will have broader social impacts***

55. Increasing the regulation and taxation of online casino gambling is likely to have broader social impacts. Previous analysis has suggested that to the extent that the increased taxation falls on the gamblers, it is likely to impact lower-income people more.[20]

56. Different parts of society are likely to be impacted differently from changes to the taxation and regulation of online casino gambling. For example, Māori, young people, men and Pacific women are more likely to gamble online. As a result, changes to the taxation and regulation of online gambling will impact those groups more than other parts of society.

## Risks and limitations

57. Most countries do not allow online casino gambling and the UK and EU member countries do not apply GST to online gambling (instead they apply gaming duties). This makes it difficult to use data from international comparators to estimate the impacts of our proposed tax changes, particularly when determining future market size and how much gambling activity will be channelled towards licenced and compliant gambling providers.

58. There is limited availability of data on the size of the total market for online gambling as well as the profitability of the industry. We have relied on reports commissioned by SkyCity, a key stakeholder in the market, as well as data from international markets in order to establish our assumptions.

59. There are a number of operational risks associated with the administration of both regulatory options. The gambling market has an active and engaged stakeholder group, including casinos, operators, societies and organisations who provide gambling harm services. These groups would likely want the opportunity to contribute to the design decisions for any licensing system. There are a number of implementation risks associated with a licensing approach. Although DIA has been working on regulatory options for some time there is a risk of rushed design if sufficient time is not given to consult with stakeholders and determine various design features such as extent of restrictions around advertising, offering of products, and the cost of licences. Further, there may be implications for DIA from the baseline savings process being carried out as part of Budget 2024.

[20] See for example, Daniel B. Suits "Gambling Taxes: Regressivity and Revenue Potential" (National Tax Journal, Volume 30, Number 1, March 1977); Mary O. Borg, Paul M. Mason and Stephen L. Shapiro "The Incidence of Taxes on Casino Gambling: Exploiting the Tired and Poor" The American Journal of Economics and Sociology Vol. 50, No. 3 (Jul., 1991); Sijbren Cnossen (ed.) Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving (Oxford Press, 2005).

60. Careful design will be required to ensure any system implemented is consistent with New Zealand's international obligations, particularly free trade agreements.

61. There is a risk that some online casino operators may not have sufficient time before 1 July 2024 to adjust their systems and commercial practices to comply with the new requirements and may block their New Zealand customers or become non-compliant. This risk can be reduced by aligning the design of new taxes closely with existing GST obligations (e.g. imposed on GBR and quarterly filing) and by announcing and legislating the changes shortly after Cabinet decisions have been made.

## Fiscal impacts

62. We have produced some estimates of the additional tax revenues which could be raised under six different policy reform scenarios, representing a combination of the two regulatory and three tax options. These initial estimates only forecast the increased tax revenues and ignore any possible administration costs.

63. While the estimates are based on historic data of GST reported by online gambling providers and the point of consumption charge to exclude sports and race betting, there is significant uncertainty about the future size of the compliant market. We consider that, in response to the significant increase in taxes and associated compliance costs, some online casino websites may block their New Zealand customers or focus on promoting gambling by customers in other markets which are more profitable. We expect these risks would be higher for income taxes, particularly where New Zealand has a higher tax rate on online casinos than other markets (as would be the case with option 2 – Tax like a gaming machine). Accordingly, the compliant online casino market may become smaller than it would otherwise have been under current policy settings (where the only tax imposed is GST).

64. A number of assumptions were required to produce the estimates. We note that the fiscal estimates are sensitive to these assumptions, but consider the assumptions used are reasonably conservative and robust. A wide range of fiscal impacts could be generated given different assumptions. Sensitivities vary across assumptions with loss of captured market being the most sensitive assumption. It is hard to calculate the sensitivities of the revenue estimates due to the novel approach to a complex market.

65. The different options would have different fiscal impacts, as follows ($ millions):

| Options | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 | Over Forecast |
|---|---|---|---|---|---|---|
| A1 Licensing, tax like onshore | - | 44 | 46 | 48 | 51 | 189 |
| A2 Licensing, tax like gaming machine | - | 63 | 66 | 69 | 73 | 271 |
| A3 Licensing, align tax regime internationally (recommended) | - | 45 | 47 | 49 | 52 | 193 |
| B1 Register, tax like onshore | - | 33 | 35 | 37 | 38 | 143 |

| | | | | | | |
|---|---|---|---|---|---|---|
| B2 Register, tax like gaming machine | - | 50 | 52 | 55 | 58 | 215 |
| B3 Register, align tax regime internationally | - | 35 | 36 | 38 | 40 | 149 |

66. It is important to note that while options A2 (licensing and tax like a gaming machine) and B2 (register and tax like a gaming machine) would on the face of it generate the highest revenue, they are the estimates with the highest uncertainty. This is because they are most likely to lead to online operators blocking New Zealand customers which would drive those gamblers to non-compliant overseas providers. This would lead to lower revenue and as well as lower harm minimisation.

67. Whilst the uncertainty around the revenue estimates is reasonably balanced for options 1 and 3, it is significantly to the downside for option 2. This reflects uncertainty about how many gamblers would move to unregulated operators if New Zealand's tax rates were significantly higher than international comparators. Although the modelling allows for some such behaviour, it is plausible that the behavioural response leads to revenue being similar (or potentially lower) than option 3. Additionally, whilst the revenue may be similar to option 3, harm minimisation would be lower due to more gambling occurring outside of the regulated market.

## Administrative impacts

68. Implementing the licensing system would require legislative changes to ensure online casino operators pay tax, making it illegal for unlicenced operators to offer online casino services to New Zealanders and ensuring a functioning licensing process is in place as well as the appropriate powers to monitor financial information. Empowering provisions would also be put in place to allow advertising restrictions and harm minimisation standards.

69. As noted previously, officials would report back on options for a licensing system if Ministers opt for that approach. The implementation costs and ongoing enforcement costs of a licensing system could operate on a cost recovery basis and be fiscally neutral over time. A repayable capital injection would be sought for one-off establishment costs. This could be repaid over time through the fees paid by the regulated operators. It may also be possible to raise additional revenue through licensing fees and potentially an auction of licences. Further work is required to establish what this cost will be. At this stage we expect set up costs to be $10 million to $25 million. These costs include regulatory system development, associated electronic monitoring infrastructure, regulatory resources and training.

70. The drafting of the required legislation could be done within baselines, however the development and implementation of the licensing system could not happen until funding is secured. It may therefore not be possible to have the whole regulatory regime in place by the next financial year. It would however be possible to put in place a register and report requirement for all online casinos ahead of having key elements of the licensing regime in place. This would ensure an increase in revenue in the interim period. If a repayable capital injection is sought

through a 2024 budget initiative or direct from cabinet in 2024, it is expected that the application process for licences could begin in July 2025 at the earliest.

71. Taxes would be collected by Inland Revenue and apply from 1 July 2024. Based on the current proposal Inland Revenue will look to self-fund any capital costs related to the initial system development and implementation of this policy. The administrative impacts of the policy on Inland Revenue are considered low, however a more detailed assessment of these will be conducted once the policy settings are confirmed. The timing and deliverability of this initiative will need to be considered alongside the wider tax and social policy programme as many of the policies agreed in the Coalition Agreements could be implemented from 1 July 2024.

72. We would also need to update Inland Revenue's existing Memorandum of Understanding with DIA to ensure both agencies can exchange information for the purposes of administering the new taxes and regulations.

## Consultation

73. Public consultation on whether the Government should regulate online gambling was undertaken in 2019. Eighty one percent of those who submitted on this issue were in support of government regulation.

74. We note that due to the lack of consultation on the details of how such regulation would work, there may be issues that have not been properly considered. Officials recommend that approval is given to carry out some targeted consultation meetings with industry stakeholders on an in-confidence basis, and to meet with gambling regulators and revenue authorities in other countries (e.g. the UK). This will reduce the risks associated with the proposals.

## Legislative impacts

75. Regulating and taxing online casino gambling would require amendments to the Gambling Act 2003, Gaming Duties Act 1971, the Tax Administration Act 1994, the Income Tax Act 2007 and regulations made under the Gambling Act 2003. Tax changes could either be included in an Amendment paper to the Taxation (Annual rates for 2023-24, Multinational Tax, and Remedial Matters) Bill or in a Budget 24 Tax Bill. Officials recommend using an Amendment Paper as that would be enacted earlier (in March instead of May) which would provide the online casinos with more certainty and time to prepare by making changes to their systems or processes. This would reduce the risk that the affected gambling providers will not be ready to comply with the new taxes from 1 July 2024.

76. Non-tax changes would require their own separate Bill.

## Next steps

77. We recommend that you direct officials to provide you with a draft Cabinet Paper reflecting your decisions.

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

# Tax Policy Report: Further information on online casino gambling

| Date: | 16 February 2024 | Report No: | T2024/362<br>IR2024/061 |
|---|---|---|---|
| | | File Number: | SH-13-5-3-12-M102157 |

## Action sought

| | Action sought | Deadline |
|---|---|---|
| Hon Nicola Willis<br>**Minister of Finance** | **Note** the contents of the report.<br>**Indicate** preferred option. | 20 February 2024 |
| Hon Simon Watts<br>**Minister of Revenue** | **Note** the contents of the report.<br>**Indicate** preferred option. | 20 February 2024 |

## Contact for telephone discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|---|---|---|---|---|
| Paul Quirke | Senior Analyst, Tax Strategy | s 9(2)(a) (wk) | N/A (mob) | ✓ |
| Jean Le Roux | Manager, Tax Strategy, Tax Strategy | s 9(2)(a) (wk) | s 9(2)(a) (mob) | |
| Gordon Witte | Principal Policy Advisor, Inland Revenue | s 9(2)(a) (wk) | N/A (mob) | |

## Minister's Office actions (if required)

| **Return** the signed report to Treasury. |
|---|

| Note any feedback on the quality of the report | |
|---|---|

**Enclosure**: Yes (attached)

# **Tax Policy Report:** Further information on online casino gambling

## Executive Summary

The National Party Tax Plan, endorsed by the Coalition Agreements, commits to a regulatory regime for online casino gambling to ensure the industry pays its fair share of tax.

New Zealand is one of the few OECD jurisdictions where online casino gambling is unregulated. Currently, New Zealand-based gamblers using offshore gambling platforms generates minimal tax (or other financial return) for New Zealand. There is also limited oversight of harm minimisation by these platforms.

Officials provided a Joint Report in December 2023[1] on options to regulate and tax online casino gambling. In that report, officials recommended making an in-principle decision to proceed with a licensing model for the 2025/26 year and to charge 12% gaming duties from 1 July 2024 in addition to the GST operators currently pay (Option A3). This would mean decisions on the features of the licensing regime (including whether to allow regulated advertising and whether to cap the number of licences) would be made by Ministers later.

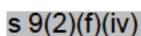
Another option is to progress with a "Register and Report" model (option B3), which would involve the same tax change as option A3 but would not entail any regulation of the online casino gambling market (unlike option A3).

You could also choose option B3 (Register and Report) and progress work on a regulatory regime without making an in-principle decision to proceed with a licensing model. However, there would be negative consequences and additional risks with this approach. Existing compliant operators would be faced with increased tax and compliance costs, while being unable to offset these costs through an increased market share (as a consequence of licencing). These operators may leave the New Zealand market, and reduce tax revenues.

New Zealand may also be perceived as profiting off of gambling harm by opting for an unregulated approach. Under this approach, the Government would receive additional tax revenue from gambling, without introducing harm minimisation standards.

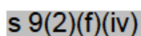
Officials will report back to Ministers with a draft Cabinet paper reflecting your decision by 21 February 2024.

s 9(2)(f)(iv)



While officials recommend an in-principle decision is made now to proceed with a licensing model, we also recommend that details of any regulatory regime (including market participants) be the subject of further analysis and consultation.

s 9(2)(f)(iv)



[1] *Options to regulate and tax online casino gambling* (T2023/1942, IR2023/296).

## Recommended Action

We recommend that you:

a **note** that officials consider that the regulated market option (Option A3) would result in higher revenue and better harm minimisation than an unregulated market (Option B3).

*Noted* *Noted*

b **note** that the option recommended by officials (option A3) does not commit the Government to any specific elements of the regulatory regime (including advertising and market participants), which would be developed later.

*Noted* *Noted*

c **note** that officials consider that the regulation of advertising to New Zealand gamblers will reduce the harm caused by online casino gambling.

*Noted* *Noted*

d **note** that officials consider that tax compliance by online casino gambling operators is likely to be higher under a regulated approach (Option A3).

*Noted* *Noted*

e **indicate** your preferred option in the table provided in the previous report (Refer: Options to regulate and tax online casino gambling, T2023/1942, IR2023/296, Dec 2023).

*Indicated / Not indicated* *Indicated / not indicated.*

f **note** officials will report back to Ministers with a draft Cabinet paper reflecting your preferred option by 21 February 2024.

*Noted* *Noted*

g s 9(2)(f)(iv)

h s 9(2)(f)(iv)

i s 9(2)(f)(iv)

j **refer** this report to the Minister of Internal Affairs.

*Refer*

s 9(2)(a)

s 9(2)(a)

Jean Le Roux
**Manager, Tax Strategy**
**The Treasury**

Gordon Witte
**Principal Policy Advisor,**
**Inland Revenue**

Hon Nicola Willis
**Minister of Finance**

_____/_____/_______

Hon Simon Watts
**Minister of Revenue**

_____/_____/_______

# **Tax Policy Report:** Further information on online casino gambling

## Purpose of Report

1. The purpose of this report is to provide further information to support decisions on the regulation and taxation of online casino gambling. This information is further to the analysis and recommendations contained in *Options to regulate and tax online casino gambling* (Refer: T2023/1942, IR2023/296).

2. The advice in this report has been prepared by Treasury and Inland Revenue officials, and is primarily intended to provide further clarification on the impacts of a tax option without regulation (option B3 in the December 2023 advice).

3. Treasury and Inland Revenue are jointly responsible for advising on any tax policy implications associated with the gambling market. The Department of Internal Affairs is responsible for advice on any gambling regulatory regime with the Treasury providing a second opinion role. The advice on regulation in this report draws on the Department of Internal Affairs' advice provided in December 2023, with which Inland Revenue and Treasury agree. Treasury officials recommend any further commissioning on online casino gambling involve Department of Internal Affairs' officials.

## Context

4. In both Coalition agreements, the Act and New Zealand First parties agreed to progress in this term the policies set out in National's Tax Plan. The National Tax Plan outlined the following[2]:

   *"National will close the online casino gambling tax loophole by:*

   - *Establishing a regulatory regime for online casino gambling to ensure offshore operators pay their fair share.*
   - *Requiring online casino gambling operators to register and report their earnings for tax purposes, with IP 'geo-blocking' of services that do not comply with the New Zealand licensing regime."*

5. The previous joint report (T2023/1942, IR2023/296) included options on regulating and taxing online casino gambling. In that report, officials recommended a licensing model with operators taxed in alignment with international regimes (option A3). Officials consider this the best way to achieve the Government's objectives, as it ensures most gambling takes place in a compliant market under a regulated approach.

## Overview of the current market

6. New Zealand is one of the few OECD jurisdictions where online casino gambling is unregulated. Gambling on overseas sites by New Zealand-based gamblers generates minimal tax (or other financial return) for New Zealand. There is also limited oversight of harm minimisation.

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[2] National's Back Pocket Boost. Pg 20. https://assets.nationbuilder.com/nationalparty/pages/17859/attachments/original/1693346887/Back_Pocket_Boost.pdf?1693346887

7. Currently, it is not legal to advertise paid online casino gambling in print media, radio, or billboards. However, online casino gambling operators are able to circumvent this by advertising 'free slot' sites which then link to paid sites. There are also many web-based advertisements for online casino sites.

8. Officials believe that unregulated advertisement of online casino gambling is occurring, and that the online casino gambling market has grown in recent years (as evidenced in the December 2023 report).

9. Gambling harm has wide-reaching financial and non-financial impacts for gamblers, their whānau and the wider community.

## Further information on officials' recommended approach

10. Officials recommend regulating the market via a licensing model with operators taxed in alignment with international regimes (option A3). There are a number of reasons for this recommendation:

    - Regulating the market alongside the tax increase will raise more revenue than leaving the market unregulated (option B3).
    - Implementing option A3 (licensing) raises $193 million over the forecast period compared to $149 million over the forecast period from option B3.
    - Regulation ensures higher rates of compliance with tax obligations and reduces gambling harm due to enforcing harm minimisation standards on licensed operators.
    - The $44 million difference in revenue over the forecast period is due primarily to the expectation that regulated advertising would channel gamblers to the regulated market, leading to more tax revenue.

11. Option A3 involves an in-principle decision to proceed with a licensing model. The option also involves the Government announcing its intention to regulate the market. Making this announcement at the same time as the changes to the taxation of online casino gambling would ensure the right signals are provided to the market and enable you to book the additional revenue that would be raised by option A3.

12. Option A3 does not commit the Government to features of a licensing system as design decisions would be made at a later date.

    A licensing system could have a number of features that would increase revenue collected, ensure compliance, and minimise harm. Various design decisions would have to be made at a later date and on the basis of further policy work and advice, including whether:

    - to implement a cap on the number of licences;
    - to require licensed operators to comply with their New Zealand tax obligations as a condition of their licence;
    - to implement strong enforcement levers that would ensure compliance (e.g. formal warnings, significant fines, loss of licence);
    - to allow for regulated advertising in order to maximise revenue and minimise the risk of harm by channelling customers to licensed gambling providers;

- to provide public education and awareness that would encourage people to gamble only within the regulated market;
- to enforce harm minimisation tools that would protect vulnerable New Zealanders; and
- to require operators to pay the Problem Gambling Levy which funds problem gambling services.

13. We understand that Ministers have raised concerns that officials' preferred option would allow online casinos to advertise, which may increase gambling harm. Officials note that regulated advertising currently occurs for existing New Zealand-based gambling, such as racing and Lotto betting. Officials recommend that any rules around advertising be determined under the licensing regime alongside other design decisions outlined above.

14. Officials believe the right to advertise will be an important benefit for firms entering the licensing regime, which will support the harm minimisation and maximise the revenue benefits of the compliant market. If compliant operators are not able to advertise, then more gambling activity will occur through non-compliant operators who do not pay tax or implement any harm minimisation measures.

15. Officials advise that the earliest a licensing approach could be implemented is 2025/26, so option A3 would involve a register and report system in 2024/25, with registered operators paying tax. There is the possibility to implement a licensing system at a later date, but this could increase the risk of operators leaving the market and decrease revenue collected. This is due to operators facing increased tax and compliance costs without the opportunity to increase their market share through a licensing approach.

16. We understand Ministers have raised concerns around compliance while the licensing regime is being developed. Officials consider that market operators are likely to ensure compliance in order to secure a subsequent licence, if an early announcement is made on the intention to introduce a licensing regime.

17. The previous report noted that compliance is likely to be higher under the recommended approach (option A3) than the status quo or an option that does not involve licensing (i.e., option B3). This is because officials consider there is a risk that compliant operators will leave the market due to the increased tax and compliance costs – if they do not have an opportunity to increase their market share through a licensing approach. This would result in less revenue and exacerbate current market distortions with New Zealand based gambling (i.e., New Zealand-based sports, racing, casino and lottery betting).

18. The Department of Internal Affairs has been approached by reputable operators who support regulation of online casinos in New Zealand as they recognise that this approach would enable them to advertise and grow their New Zealand customer base.

19. Department of Internal Affairs' officials would report back to you with advice on the features of a licensing system (including implementation costs expected to be largely in the form of a repayable capital injection) if you decide to progress with option A3.

## Further advice on officials' concerns with an unregulated approach

20. You also have the option to progress with a register and report model (option B3), which would not entail any regulation of the online casino gambling market. This option would increase the tax obligations for online casino gambling operators to align with international regimes in the same fashion as option A3 (12% gaming duty in addition to the 13% GST they already pay). This option would only require changes to the Gaming Duties Act 1971, which could be included in the current Tax Bill (due to be enacted by 31 March 2024) or in Budget night legislation. Officials would strongly recommend the former to give operators time to update their systems and commercial practices in order to enable compliance with the new tax rates from 1 July 2024.

21. Officials have concerns about proceeding with an approach that does not seek to regulate the online casino market, including:
    - Officials have previously reported to you on the risks to gamblers (and broader society) of not having harm minimisation protections in place. As noted above, unregulated advertising to New Zealand gamblers is already occurring. Without regulation, these practices are likely to continue resulting in further harm to New Zealand gamblers.
    - As noted above in paragraph 8, this option would also result in $44m less revenue over the forecast period compared to option A3.

## Regulating on a longer timeframe

22. If you choose option B3 (Register and Report) but would like to progress work on a regulatory regime without an in-principle decision to proceed with a licensing model, there would be some risks and downsides.

23. The longer a register and report system is in place prior to the introduction of a licensing system (or at least a Government announcement of the commitment to licensing in the near future), the more harm is likely to occur, the less tax revenue is collected, and the higher the risk of operators leaving the market in the meantime.

24. Choosing option B3 risks the perception that New Zealand could be seen as profiting from gambling harm due to increasing taxation without putting in place any harm minimisation standards to protect gamblers.

## Process timeframes

25. Officials recommend legislating for the proposed 12% gaming duty in March 2024. To provide for this, officials will report back to Ministers with a draft Cabinet paper by 21 February 2024. This would require meeting the following Cabinet timelines:
    - Lodge the Cabinet paper with Cabinet Office before 10am, 7 March
    - 13 March – Cabinet Business Committee (CBC)
    - 18 March – Cabinet
    - 21 March – Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill released
    - 28 March – Legislation enacted

26. Although it would be possible to legislate the proposed gaming duty as part of the May 2024 Budget night legislation, this is not recommended. If the above Cabinet dates are not met, it would become necessary to legislate the changes on Budget night.

27. Legislating later than March 2024 increases the risk that some of the affected offshore gambling operators will not be ready to comply with the new taxes from 1 July 2024 and will have to block New Zealand customers, which could reduce tax revenue and increase harm (as customers may switch to non-compliant operators).

## Next steps

28. Officials seek your direction on the preferred high-level approach noting that the design decision of a licensing system would be subject to further work and commissioning to Department of Internal Affairs' officials.

29. Officials will report back to Ministers with a draft Cabinet paper reflecting your decision by 21 February 2024.

## s 9(2)(f)(iv)

[3] The letter was copied to the Department of Internal Affairs.

s 9(2)(f)(iv)

Item 21

Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

TE TAI ŌHANGA
THE TREASURY

# Tax Policy Report: Online Casino Gaming Duty and Regulation Cabinet paper

| Date: | 23 February 2024 | Report No: | T2024/421<br>IR2024/029 |
|---|---|---|---|
| | | File Number: | 4922383v1 |

## Action Sought

| | Action Sought | Deadline |
|---|---|---|
| Minister of Finance (Hon Nicola Willis) | **Refer** a copy of this report and the draft Cabinet paper to the Minister of Internal Affairs<br>**Authorise** for lodgement a final version of the Cabinet Paper reflecting any changes requested by Ministers | Before 10am 29 February 2024 |
| Minister of Revenue (Hon Simon Watts) | **Authorise** for lodgement a final version of the Cabinet Paper reflecting any changes requested by Ministers | Before 10am 29 February 2024 |

## Contact for Telephone Discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|---|---|---|---|---|
| Paul Quirke | Senior Analyst | s 9(2)(a) | s 9(2)(a) | √ |
| Jean Le Roux | Tax Strategy Manager | s 9(2)(a) | s 9(2)(a) | |
| Gordon Witte | Principal Policy Advisor, Inland Revenue | s 9(2)(a) | s 9(2)(a) | |

## Minister's Office actions (if required)

| **Return** the signed report to Treasury and Inland Revenue |
|---|
| |

| Note any feedback on the quality of the report | |
|---|---|

**Enclosure**: Yes (attached)

# **Tax Policy Report:** Online Casino Gaming Duty and Regulation Cabinet paper

## Purpose of this report

1. This report provides you with a draft Cabinet paper (attached) seeking the Cabinet Economic Policy Committee's agreement to apply a 12% gaming duty to online casino operators. It also seeks an in-principle decision to regulate online casino gambling by developing a licensing system which would support tax collection, minimise harm and provide consumer protections to New Zealanders.

2. The draft Cabinet paper seeks approval for the tax and regulatory options you chose in our earlier report, *Options to regulate and tax online casino gambling* (T2023/1942, IR2023/296 refers).

## Proposal

3. Currently, the only tax that applies to online casino websites is GST. This means, online casino websites face significantly lower taxes compared to the New Zealand casinos and the gaming machines and to the taxes that apply to online casinos in the UK and some European countries.

4. The draft Cabinet paper proposes that from 1 July 2024 a gaming duty of 12% apply to online casino gambling.

5. The gaming duty would apply to online gambling provided by offshore operators to New Zealand residents, other than bets placed on sports or racing events. It would apply to offshore websites owned by New Zealand casinos but would exclude the existing online products currently offered by the Lotteries Commission (operating as Lotto NZ) and TAB NZ.[1]

6. The draft Cabinet paper also seeks Cabinet's agreement to make an in-principle decision to regulate online casino gambling by developing a licensing system to apply from 2025/26.

7. Note that Inland Revenue and Treasury drafted the attached Cabinet paper, but used earlier advice prepared by the Department of Internal Affairs to inform their advice.

## Financial implications

8. The combined impact of the proposals to apply a 12% gaming duty and to agree in-principle to regulate the online casino gambling by developing a licensing system is estimated to raise additional tax revenue of $193m over the forecast period.

9. Inland Revenue has estimated it will cost $3.2m of departmental operating costs over the forecast period and $1.5m of capital costs in 2023/24 to implement and administer the gaming duty proposal. The draft Cabinet paper seeks a Budget 2024 pre-commitment for the operating costs and notes Inland Revenue will manage the capital costs within existing baselines.

[1] The Gambling Act 2003 generally prohibits online gambling from being provided by operators located in New Zealand, with exceptions for the Lotteries Commission and TAB NZ.

10. The cost of a licensing system for online casinos would be fully recovered through licensing fees. If Cabinet makes an in-principle decision to develop a licensing system, Ministers would report back on design decisions in mid-2024. As part of this report back, the Department of Internal Affairs would produce revised estimates of the operating and capital costs associated with implementation and administration of a licensing system. Officials note that a licensing system could require a one-off repayable capital injection of up to $42m for establishment costs.

## Next Steps

11. Officials recommend legislating for the proposed 12% gaming duty in March 2024 as part of the Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill.

12. To be able to release the Amendment Paper in the week commencing 11 March, as requested by the Leader of the House's Office, it would be necessary to get Cabinet approval on 11 March. This would require the following timeline for the paper to be considered by a Cabinet Committee (ECO) first:

    - Lodge the Cabinet paper with the Cabinet Office before 10am, 29 February
    - 6 March – Cabinet Economic Policy Committee (ECO)
    - 11 March – Cabinet
    - Week commencing 11 March – Amendment Paper including Gaming Duties released
    - 28 March – Legislation enacted

13. If more time is required for Ministerial consultation, Ministers could potentially lodge the Cabinet paper with the Cabinet Office on 7 March and go straight to Cabinet on 11 March.

14. Although it would be possible to legislate the proposed gaming duty as part of 30 May 2024 Budget night legislation, this is not recommended. If we are unable to obtain Cabinet approval on 11 March, it would become necessary to legislate the changes on Budget night.

15. Legislating the gaming duty later than March 2024 increases the risk that some of the affected gambling providers will not be ready to comply with the new tax rules from 1 July 2024 and may choose to block New Zealand customers to remain compliant. This could reduce tax revenue and increase harm (as customers may switch to non-compliant operators).

## Recommended Action

We recommend that you:

a **Note** the attached draft Cabinet paper seeks Cabinet approval for the tax and regulatory options you chose in our earlier report, *Options to regulate and tax online casino gambling* (T2023/1942, IR2023/296 refers).

*Noted*
Minister of Finance

*Noted*
Minister of Revenue

b **Refer** a copy of this report and the attached draft Cabinet paper to the Minister of Internal Affairs.

*Referred / Not referred*
Minister of Finance

c **Authorise** for lodgement with the Cabinet Office a final version of the Cabinet Paper reflecting any changes requested by Ministers.

*Authorised / Not authorised*
Minister of Finance

*Authorised / Not authorised*
Minister of Revenue

Jean Le Roux
**Tax Strategy Manager**
The Treasury

Martin Neylan
**Policy Lead**
Inland Revenue

Hon Nicola Willis
**Minister of Finance**

_____/_____/_______

Hon Simon Watts
**Minister of Revenue**

_____/_____/_______

Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet Economic Policy Committee

# ONLINE CASINO GAMING DUTY AND REGULATION

## Proposal

1 This paper seeks the Cabinet Economic Policy Committee's agreement to apply a 12% gaming duty to online casino operators. It also seeks an in-principle agreement to regulate online casino gambling and develop a licensing system which would support tax collection, minimise harm and provide consumer protections to New Zealanders, subject to a report back by the Minister of Internal Affairs to Cabinet on the details of those features.

## Relation to Government priorities

2 The National Party Tax Plan, endorsed by the Coalition Agreements, commits to a regulatory regime for online casino gambling, to ensure online casino operators pay their fair share of tax.

## Executive summary

3 The offshore online gambling market has seen significant growth in recent years. Currently, the only tax that applies to offshore online casinos is GST. This means online casinos face significantly lower taxes than New Zealand land-based casinos, Class 4 operators (pokies in pubs and clubs), and online casinos in the UK and some European countries.

4 New Zealand is one of the last countries in the OECD with an unregulated online gambling market. New Zealanders have unrestricted access to online gambling websites and are targeted by offshore gambling operators. There is no oversight of harm minimisation and consumer protections currently, including ensuring that operators reliably return winnings. The proportion of people who sought help for gambling harm related to online gambling has almost doubled in the last five years.

5 We propose that from 1 July 2024 a gaming duty of 12% apply to online casino gambling. The gaming duty would apply to online gambling provided by offshore operators to New Zealand residents, other than bets placed on sports or racing events. It would apply to offshore websites owned by New Zealand casinos but would exclude the existing online products currently offered by the Lotteries Commission (operating as Lotto NZ) and TAB NZ.[1]

6 Gambling provided by online casinos would remain subject to GST in New Zealand. The proposal would result in online casino operators paying an overall tax rate of about 25% on gross betting revenue.[2] An overall tax rate of 25% would put New Zealand near the midpoint of jurisdictions that impose gaming duties on online casino operators.

7 The proposed gaming duty would apply from 1 July 2024 and will be legislated for using an Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill in March 2024. This legislative process is intended to provide certainty to the affected gambling operators and allow them time to prepare by making changes to their systems and commercial practices.

8 We are also seeking in-principle agreement to regulate online casino gambling and develop a licensing system which would support tax collection, minimise harm and provide consumer protections to New Zealanders, subject to a report back by the Minister of Internal Affairs to Cabinet on the details.

9 Under a licensing system, only licenced operators would be able to offer online casino gambling legally. Licenced operators would be allowed to advertise, with restrictions.[3] While this would mean that online gambling advertising would be more visible to New Zealanders, it would support the revenue and harm minimisation objectives. It would also benefit the licenced operators by increasing their market share and would benefit regulators because more gambling activity will occur through compliant and regulated providers.

10 The combined impact of the proposals to apply a 12% gaming duty and to make an in-principle decision to regulate the online casino gambling by developing a licensing system is estimated to raise additional tax revenue of $193m over the forecast period.

11 If Cabinet does not make an in-principle decision to regulate online casino gambling at this time, the proposal to apply a 12% gaming duty alone is estimated to raise additional tax revenue of $149m over the forecast period.

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[1] The Gambling Act 2003 generally prohibits online gambling from being provided by operators located in New Zealand, with exceptions for the Lotteries Commission and TAB NZ.

[2] Gross betting revenue is measured by bets received minus prizes paid out. Because GST on gambling is collected on a GST-inclusive basis, it is equivalent to a 13% tax on gross betting revenue. i.e. if a gambler bets and loses $115, GST of $15 (13% of the $115 of gross betting revenue) is collected.

[3] Advertising would include some restrictions similar to alcohol advertising such as the watershed period (not advertising at certain times and not targeting children).

12 Inland Revenue has estimated it will cost $3.2m of departmental operating costs over the forecast period and $1.5m of capital costs in 2023/24 to implement and administer the gaming duty proposal. We are seeking a pre-commitment against the Budget 2024 operating allowance for the operating costs. Inland Revenue will manage the capital costs within existing baselines.

13 The cost of a licensing system for online casinos would be fully recovered through licensing fees. If Cabinet makes an in-principle decision to develop a licensing system, officials would report back with design decisions later. Officials would also report on the costs of implementing the licensing system depending on the design decisions. Officials note that a licensing system could require a one-off repayable capital injection of up to $42m for establishment costs.

**Background**

14 The offshore online gambling market has seen significant growth in recent years. Online casino operators face significantly lower taxes than land-based New Zealand casinos, Class 4 operators (pokies in pubs and clubs), and online casinos in the UK and some European countries.

15 Currently, the only tax that applies to online casino operators is GST. GST has applied since 2016 as part of a wider reform that applied GST to remote (mainly digital) services. $42.8 million of GST was collected from offshore gambling operators in last fiscal year (the 12 months ending 30 June 2023) and about 11% of this amount relates to racing and sports betting (which is not included in this tax proposal). In addition to GST, racing and sports betting with offshore operators is also subject to 10% point of consumption charges.

16 In contrast, licenced New Zealand land- based casinos pay GST, a 4% casino duty, income tax and a problem gambling levy.[4] Class 4 operators pay GST, a 20% gaming duty, a problem gambling levy and are exempt from income tax (as they pay a high rate of gaming duty and are established to raise funds for the community).

17 Because online casinos are located offshore, they do not have to pay income tax in New Zealand. This reflects the fact that international tax settings generally only collect income tax on non-resident business income when it is generated through a physical presence in New Zealand (such as a premises or office).

18 New Zealand is one of the last countries in the OECD with an unregulated online gambling market, which makes it a target for offshore operators with aggressive online advertising and marketing to New Zealand-based customers. New Zealanders have unrestricted access to overseas gambling websites, many of which have little to no harm minimisation or consumer protection standards. There is no oversight of harm minimisation and consumer protections currently, including ensuring that operators reliably return winnings.

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[4] The problem gambling levy funds the Ministry of Health's strategy to prevent and minimise gambling harm, including gambling harm treatment services.

19 New Zealand gambling operators are required to comply with harm minimisation regulations and contribute to the problem gambling levy which funds problem gambling services. In contrast, non-resident online gambling operators are not licenced in New Zealand and are not subject to any of New Zealand's harm minimisation regulations.

20 Most people do not experience any negative effects from online gambling. However, gambling can be highly addictive and can lead to harm to individuals and the wider community. The proportion of people who sought help for gambling harm related to online gambling has almost doubled between 2018 and 2022.[5] Online casino gambling is likely to be at least as harmful as Class 4 gaming machines, with harmful features such as the continuous nature of play, 24/7 accessibility and its appeal to young people.

21 Offshore online gambling operators are prohibited from advertising in New Zealand but this is difficult to enforce due to limited jurisdictional reach. Currently, it is illegal to advertise paid online casino gambling in print media, radio, or billboards. However, some online casino operators circumvent this by advertising 'free slot' sites which then link to paid sites. There are also many web-based advertisements for online casino sites.

## Analysis

### Gaming duty on online casino gambling

22 We propose that from 1 July 2024 an additional gaming duty of 12% would apply to online casino gambling. The gaming duty would apply to online gambling provided by offshore operators to New Zealand residents, other than bets placed on sports or racing events. It would apply to offshore websites owned by New Zealand casinos but would exclude the existing online products currently offered by the Lotteries Commission (operating as Lotto NZ) and TAB NZ.

23 The exclusion for racing and sports betting reflects the fact that National's Tax Plan only proposed additional taxes for online casino gambling. Since 2021, the Department of Internal Affairs has collected 10% point of consumption charges from offshore operators who provide racing and sports bets to New Zealand customers which is used to fund distributions to the racing industry and sports organisations. The exclusion for Lotto NZ is because it is required to transfer all net profits to the community, providing valuable funds to the community.

24 Gambling provided by online casinos would remain subject to GST in New Zealand. The proposal would result in online casino operators paying an overall tax rate of about 25% on gross betting revenue.[6]

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[5] Intervention services data, Ministry of Health, 2022

[6] Gross betting revenue is measured by bets received minus prizes paid out. Because GST on gambling is collected on a GST-inclusive basis, it is equivalent to a 13% tax on gross betting revenue. i.e. if a gambler bets and loses $115, GST of $15 (13% of the $115 of gross betting revenue) is collected.

25 An overall tax rate of 25% would put New Zealand near the midpoint of jurisdictions that impose gaming duties on online casino operators. Spain and Portugal apply a 25% tax rate while Denmark (28%) and the Netherlands (29%) apply higher rates. Other countries apply lower tax rates, including Belgium (11%), Italy (20%), the UK (21%), Sweden (22%) and the Czech Republic (23%).

26 We considered alternative tax options including applying income taxes or applying a higher rate of gaming duty, such as the 20% rate which applies to Class 4 operators (pokies in pubs and clubs). However, officials advised that these options would involve a much higher risk of New Zealand gamblers moving to non-compliant operators.

27 Under the higher tax options, New Zealand would have some of the most onerous tax rules in the world and become a much less profitable market for online casino operators. Operators who are currently tax compliant would put less effort into attracting New Zealand customers and may choose to block New Zealand customers from accessing their websites rather than face the higher tax costs. This makes it likely that more New Zealand gamblers would gamble using non-compliant operators. This would erode the tax revenues which could be collected and could result in greater gambling harm.

28 Compared to these other reform options, a 12% rate of gaming duty is expected to lead to the most gambling activity being conducted with compliant operators, so it significantly improves tax collection without undermining harm minimisation.

**Regulatory system for the online casino gambling**

29 In conjunction with the decision to tax the online casino operators, we are also seeking a decision as to whether to regulate the market or not.

30 Specifically, we are seeking an in-principle decision to regulate online casino gambling by developing a licensing system which would support tax collection, minimise harm and provide consumer protections to New Zealanders.

31 An in-principle decision would not commit the Government to features of a licensing system as design decisions would be made at a later date. A licensing system could have a number of features that would increase revenue collected, ensure compliance, and minimise harm. Various design decisions would have to be made at a later date and on the basis of further policy work and advice, including whether:

31.1 to implement a cap on the number of licences;

31.2 to require licenced operators to comply with other laws (such as their New Zealand tax obligations) as a condition of their licence;

31.3 to implement strong enforcement levers that would ensure compliance (e.g. formal warnings, significant fines, loss of licence);

31.4 to allow for regulated advertising in order to maximise revenue and minimise the risk of harm by channelling customers to licensed gambling providers;

31.5 to provide public education and awareness that would encourage people to gamble only within the regulated market;

31.6 to enforce harm minimisation tools that would protect vulnerable New Zealanders; and

31.7 to require operators to pay the problem gambling levy which funds problem gambling services.

32 Allowing licenced operators to advertise (with certain conditions) would enable them to increase their market share and to provide public education and awareness to encourage New Zealanders to gamble only within the licenced market. While this would mean that online gambling advertising would be more visible to New Zealanders, it would support the revenue and harm minimisation objectives. If compliant operators are not able to advertise, then more gambling activity will occur through non-compliant operators who do not pay tax or implement any harm minimisation measures. The rules could reflect the regulated advertising that currently occurs for alcohol advertising. Decisions on advertising would be made later in conjunction with other design details.

33 The Minister of Internal Affairs would report back to Cabinet in mid-2024 seeking decisions on the design of the proposed licensing system and its associated regulations which would require changes to the Gambling Act 2003.

34 If Cabinet agrees to this in-principle decision, the Government would announce its intention to regulate. Making an announcement at the same time as the changes to the taxation of online casino gambling would ensure the right signals are provided to the market and enable the additional revenue ($44m over the forecast period) to be recognised in Budget 2024 tax forecasts and managed against Budget allowances. The increased revenue is due primarily to the expectation that regulated advertising would channel gamblers to compliant operators, leading to more tax revenue.

35 If the Government imposes a gaming duty on online casinos in July 2024, without announcing it has also made an in-principle decision to regulate online casinos, there is a risk that some responsible and compliant operators may exit the New Zealand market or focus on attracting more profitable customers from other countries instead. In response, New Zealand customers may shift their gambling activity to non-compliant operators who do not pay New Zealand taxes (including GST), which would result in a loss of tax revenues. This behaviour would also undermine harm minimisation as more gambling activity will occur through non-compliant operators who are more likely to engage in practices that contribute to gambling harm.

36 New Zealand-based gambling operators are currently subject to regulation, which places them at a competitive disadvantage to unregulated online casino operators. In addition, unregulated advertising to New Zealand gamblers is already occurring. Without regulation, these practices are likely to continue resulting in further harm to New Zealand gamblers. There are also risks to consumers from unregulated gambling as some operators make it difficult to obtain winnings.

37 Imposing gaming duty without regulating the market, risks generating the perception that New Zealand is seen to be profiting from gambling harm due to increasing taxation without putting in place any harm minimisation standards to protect gamblers.

**Implementation**

38 The new gaming duty will be collected by Inland Revenue and apply from 1 July 2024. Inland Revenue will need to update their systems and allocate compliance resources to assist the affected operators and their tax agents to comply with the changes. Inland Revenue has estimated it will cost $3.2m of departmental operating costs over the forecast period and $1.5m of capital costs in 2023/24 to implement and administer the gaming duty proposal. Inland Revenue will manage the capital cost within existing baselines. We are seeking a pre-commitment against the Budget 2024 operating allowance for the departmental operating costs.

39 There is an implementation risk that some online casino operators may not have sufficient time before 1 July 2024 to adjust their systems and commercial practices to comply with the new requirements and may block their New Zealand customers or become non-compliant. This risk is reduced by aligning the design of new taxes closely with existing GST obligations (e.g. imposed on gross betting revenue and quarterly filing) and by announcing and legislating the changes shortly after Cabinet decisions have been made. Accordingly, the overall impact of this risk is considered low.

40 Implementation details of a licensing system would depend on the design decisions and will be covered as part of the report back to Cabinet in mid-2024.

41 Because of the time required to conduct a full Bill process, develop new regulations and for the Department of Internal Affairs to invest in setting up the required systems, the proposed licensing system could be implemented in early 2026 if the standard processes were followed. It could be implemented in mid-2025 if the standard processes were shortened, including compressing the public consultation period. Due to the large amount of public interest in the gambling system officials do not recommend shortening the consultation period.

42 There is a risk that a licensing system may have unintended outcomes if the licence fees and conditions make it difficult for licenced operators to compete with non-compliant market operators. However, the UK and some European countries have been successful in introducing reforms that involve both licensing and applying gaming duties to offshore online gambling operators.

**Financial implications**

43 The combined impact of the proposals to apply a 12% gaming duty and to make an in-principle decision to regulate the online casino gambling by developing a licensing system is estimated to raise additional tax revenue of $193m over the forecast period, as shown in the following table:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 45 | 47 | 49 | 52 |
| **Total Revenue** | **-** | **45** | **47** | **49** | **52** |
| **Total Operating** | **-** | **(45)** | **(47)** | **(49)** | **(52)** |

44 If Cabinet, does not make an in-principle decision to regulate online casino gambling, the proposal to apply a 12% gaming duty is estimated to raise additional tax revenue of $149m over the forecast period, as shown in the following table:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 35 | 36 | 38 | 40 |
| **Total Revenue** | **-** | **35** | **36** | **38** | **40** |
| **Total Operating** | **-** | **(35)** | **(36)** | **(38)** | **(40)** |

45 Inland Revenue has estimated the implementation and administration costs of the gaming duty proposal to be $3.2m of departmental operating over the forecast period, as well as a one-off $1.5m capital cost in 2023/24. Inland Revenue will manage the capital costs within existing baselines. We are seeking a pre-commitment against the Budget 2024 operating allowance for the departmental operating costs:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Multi-Category Expenses and Capital Expenditure:<br>Services for Customers MCA | 0.500 | 0.800 | 0.800 | 0.800 | 0.300 |
| **Total Operating** | **0.500** | **0.800** | **0.800** | **0.800** | **0.300** |

46 The cost of a licensing system for online casinos would be fully recovered through licensing fees. If Cabinet makes an in-principle decision to develop a licensing system, Ministers would report back on design decisions in mid-2024. As part of this report back, the Department of Internal Affairs would produce revised estimates of the operating and capital costs associated with implementation and administration of a licensing system. Officials note that a licensing system could require a one-off repayable capital injection of up to $42m for establishment costs.

## Cost-of-living Implications

47 The proposed gaming duty will make New Zealand gamblers less profitable for online casino operators, who may choose to exit the New Zealand market. To the extent that this reduces gambling spending there could be improvements to some New Zealanders' ability to maintain their standard of living, including saving money that could be used for other expenses. However, there is also a risk that New Zealanders may transfer their gambling to less reputable and non-compliant operators.

48 If a licensing system is implemented, gambling harm is likely to be reduced which would further improve some New Zealander's ability to afford other expenses.

## Legislative Implications

49 The proposal to apply a gaming duty to online casino operators would require amendments to the Gaming Duties Act 1971. These changes could either be included in an Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill (Annual Rates Bill) or in a Budget night Bill.

50 We propose using an Amendment Paper to the Annual Rates Bill as that would be enacted earlier (in March instead of May) which would provide the online casino operators with more certainty and time to prepare by making changes to their systems and commercial practices. This would reduce the risk that the affected gambling providers will not be ready to comply with the new taxes from 1 July 2024.

51 Legislative implications related to the introduction of a licensing regime will be covered in detail in the system design report-back to Cabinet.

## Impact Analysis

### Regulatory impact assessment

52 The Quality Assurance reviewer at Inland Revenue has reviewed the Regulatory Impact Statement (RIS) prepared by Inland Revenue. The reviewer considers that information and analysis summarised in the RIS *Online Casino Taxes* partially meets the quality assurance criteria. Given earlier Ministerial decisions, the options under consideration were limited to options for improving the tax collection of online casino gambling. Time constraints also applied to the policy development of the proposal and have not permitted consultation on the various options.

53 To quantify the costs and benefits of the options it was necessary to make several assumptions. The estimated costs and benefits are sensitive to these assumptions, meaning that a wide range of impacts could be generated if different assumptions had been used.

54 Cabinet's impact analysis requirements apply to the proposal to regulate the online casino market, but the Regulatory Impact Statement has not been attached and the Treasury has not exempted the proposal from the impact analysis requirements. Therefore, it does not meet Cabinet's requirements for regulatory proposals. The Regulatory Impact Analysis team at the Treasury has advised that supplementary analysis will need to be provided at the time further policy decisions are sought.

#### Climate implications of Policy assessment

55 A Climate Implications of Policy Assessment is not required for this proposal.

### Population Implications

56 The status quo and proposed reform are expected to have a larger impact on Māori, young people (aged 16 to 24 years), men and Pacific women. Evidence suggests these groups may be more likely than average to have gambled on overseas websites.[7] It may also have a larger impact on Asian peoples and disabled people.[8] Due to data limitations officials have not attempted to quantify the impacts for segments of gambling consumers.

### Human Rights

57 There are no human rights implications of these proposals.

### Use of external resources

58 No external resources were used for this policy development process. The Department of Internal Affairs may need to procure an external legal resource as part of the development of a licensing system for online casinos. This is provided for in the costing estimates for the repayable capital injection.

### Consultation

59 The Department of Internal Affairs and the Ministry of Foreign Affairs and Trade were consulted.

[7] Health and Lifestyles Survey 2020
[8] Intervention services data, Ministry of Health, 2022

60 s 9(2)(h)

61 The Department of Internal Affairs has engaged with some online gambling operators, based domestically and internationally. They support regulation of online casinos in New Zealand as they recognise that this approach would enable them to advertise and grow their New Zealand customer base. They would welcome a more level playing field rather than competing with operators that can increase their profit margins by not investing in harm minimisation.

62 Officials would consult further with stakeholders, including casino operators, Class 4 operators, and organisations who provide gambling harm services, on design decisions for a licensing system.

## Communications

63 The Minister of Revenue will make an announcement on the application of a 12% gaming duty on offshore online casino gambling when the Amendment Paper to the Annual Rates Bill is introduced in March 2024.

64 Inland Revenue will publish the regulatory impact statement and guidance on the new legislation as part of a commentary on the Amendment Paper when the Amendment Paper is released in March 2024. They will also publish guidance as part of a *Tax Information Bulletin* after the Bill is enacted.

65 If Cabinet makes an in-principle decision, the Government would announce its intention to regulate the market. Making this announcement at the same time as the changes to the taxation of online casino gambling would support tax collection by encouraging operators to remain in the New Zealand market and to comply with their tax obligations so they can benefit from increasing their market share under the licensing proposal.

## Proactive release

66 We propose this Cabinet paper, associated minutes, and key advice papers be proactively released after the legislation containing the proposed gaming duty is introduced.

## Recommendations

We recommend that the Committee:

1 **note** that the National Party Tax Plan, endorsed by the Coalition Agreements, commits to a regulatory regime for online casino gambling, to ensure these operators pay their fair share of tax.

*Imposing gaming duties on online casino operators*

2 **note** that currently, the only tax that applies to offshore online casino operators is GST;

3 **agree** that a new gaming duty of 12% of gross betting revenue apply to online casino gambling from 1 July 2024;

4 **note** the gaming duty would apply to online gambling provided by offshore operators to New Zealand residents, other than bets placed on sports or racing events;

5 **note** that amendments to the Gaming Duties Act 1971 would be required to implement the new gaming duty in recommendation 3 above;

6 **authorise** the Minister of Revenue, after consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill that includes the new gaming duty in recommendation 3 above;

*In-principle decision to regulate the market*

7 **agree** in principle, to regulate online casino gambling and develop a licensing system which would support tax collection, minimise harm and provide consumer protections to New Zealanders, subject to the Cabinet report back referred to in recommendation 8;

8 **direct** the Minister of Internal Affairs to report back to Cabinet in mid-2024 seeking decisions on the details of a licensing system which would require changes to the Gambling Act 2003 and associated regulations;

9 **note** that the earliest that the proposed licensing system could be implemented (if the standard processes were followed) would be early 2026;

10 **note** that a potential Government announcement following Cabinet decisions on the proposals in this paper would support tax collection from 1 July 2024 by encouraging operators to remain in the New Zealand market and to comply with their tax obligations so they can benefit from increasing their market share under the licensing proposal;

*Financial recommendations*

11 **note** the following changes if Cabinet agrees to apply a 12% gaming duty and to make an in-principle decision to regulate the online casino gambling market, as a result of the decisions in recommendations 3 and 7 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 45 | 47 | 49 | 52 |
| **Total Revenue** | **-** | **45** | **47** | **49** | **52** |
| **Total Operating** | **-** | **(45)** | **(47)** | **(49)** | **(52)** |

12 **note** the following changes if Cabinet agrees to apply a 12% gaming duty but does not agree to regulate online casino gambling, as a result of the decision in recommendation 3 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 35 | 36 | 38 | 40 |
| **Total Revenue** | **-** | **35** | **36** | **38** | **40** |
| **Total Operating** | **-** | **(35)** | **(36)** | **(38)** | **(40)** |

13 **agree** that the increases in Crown revenue and receipts in either recommendation 11 or 12 above be charged as a pre-commitment against the Budget 2024 operating allowance;

14 **approve** the following changes to appropriations to give effect to the policy decision in recommendation 3 above, with a corresponding impact on the operating balance and/or net debt;

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Multi-Category Expenses and Capital Expenditure:<br>Services for Customers MCA | 0.500 | 0.800 | 0.800 | 0.800 | 0.300 |
| **Total Operating** | **0.500** | **0.800** | **0.800** | **0.800** | **0.300** |

15 **note** that the above changes to appropriations in recommendation 14 for 2023/24 will be reported and disclosed in the 2023/24 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply;

16 **agree** that the expenses incurred under recommendation 14 above be charged as a pre-commitment against the Budget 2024 operating allowance;

17 **note** that Inland Revenue will manage the one-off $1.5 million capital cost of implementing the gaming duty under recommendation 3 above within existing baselines;

18 **note** that there will be operating and capital costs for the Department of Internal Affairs associated with the implementation and administration of any licensing system dependent on design decisions;

19 **note** the initial estimate of $42 million as a one-off capital cost for the implementation of a licensing system based on assumptions about design decisions, which could be funded through a repayable capital injection;

20 **direct** the Department of Internal Affairs to produce revised estimates of the operating and capital costs associated with implementation and administration as part of the report back to Cabinet in mid-2024 seeking decisions on the details of a licensing system, in recommendation 8 above.

Authorised for lodgement.

Hon Nicola Willis

Minister of Finance

Hon Simon Watts

Minister of Revenue

ECO-24-MIN-0018

# Cabinet Economic Policy Committee

## Minute of Decision

*This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.*

## Online Casino Gaming Duty and Regulation

**Portfolios** **Finance / Revenue**

On 6 March 2024, the Cabinet Economic Policy Committee:

1 **noted** the submission under ECO-24-SUB-0018 on online casino gaming duty and regulation;

2 **referred** the submission to Cabinet on 11 March 2024 for further consideration.

Jenny Vickers
Committee Secretary

**Present:**
Hon David Seymour
Hon Nicola Willis (Chair)
Hon Brooke van Velden
Hon Shane Jones
Hon Chris Bishop
Hon Simeon Brown
Hon Erica Stanford
Hon Judith Collins
Hon Tama Potaka
Hon Matt Doocey
Hon Melissa Lee
Hon Simon Watts
Hon Chris Penk
Hon Andrew Bayly
Hon Andrew Hoggard
Hon Mark Patterson
Simon Court MP
Jenny Marcroft MP

**Officials present from:**
Office of the Prime Minister
Officials Committee for ECO
The Treasury
Office of Hon Chris Bishop
Office of Hon Judith Collins
Inland Revenue



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# Cabinet

## Minute of Decision

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## Online Casino Gaming Duty and Regulation

**Portfolios** **Finance / Revenue**

On 11 March 2024, following reference from the Cabinet Economic Policy Committee, Cabinet:

### Background

1 **noted** that the National Party Tax Plan, endorsed by the Coalition Agreements, commits to a regulatory regime for online casino gambling, to ensure these operators pay their fair share of tax;

### Imposing gaming duties on online casino operators

2 **noted** that currently the only tax that applies to offshore online casino operators is GST;

3 **agreed** that a new gaming duty of 12 percent of gross betting revenue apply to online casino gambling from 1 July 2024;

4 **noted** that the gaming duty would apply to online gambling provided by offshore operators to New Zealand residents, other than bets placed on sports or racing events;

5 **noted** that amendments to the Gaming Duties Act 1971 would be required to implement the new gaming duty in paragraph 3 above;

6 **authorised** the Minister of Revenue, after consultation with the Minister of Finance and the Leader of the House, to release an Amendment Paper to the Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill that includes the new gaming duty in paragraph 3 above;

### In-principle decision to regulate the market

7 **agreed in principle** to regulate online casino gambling to support tax collection, minimise harm, and provide consumer protections to New Zealanders, subject to the report back referred to in paragraph 8;



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8 **invited** the Minister of Internal Affairs to report back to the Cabinet Economic Policy Committee (ECO) in mid-2024 seeking decisions on the details of the regulatory system, which would require changes to the Gambling Act 2003 and associated regulations;

9 **noted** that depending on the nature of the regulatory system chosen, it could take until 2026 to have the system in full operation;

10 **noted** that a potential Government announcement following Cabinet decisions on the proposals in the paper under CAB-24-SUB-0072 would support tax collection from 1 July 2024, by encouraging operators to remain in the New Zealand market and to comply with their tax obligations in the expectation of benefitting from the regulated market proposal;

## Financial implications

11 **noted** that the application of a 12 percent gaming duty and the in-principle decision to regulate the online casino gambling market as a result of the decisions in paragraphs 3 and 7 above will have a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 45 | 47 | 49 | 52 |
| **Total Revenue** | **-** | **45** | **47** | **49** | **52** |
| **Total Operating** | **-** | **(45)** | **(47)** | **(49)** | **(52)** |

12 **noted** the following changes resulting from a 12 percent gaming duty, but if Cabinet does not agree to regulate online casino gambling, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Crown Revenue and Receipts:<br>Gaming Duties | - | 35 | 36 | 38 | 40 |
| **Total Revenue** | **-** | **35** | **36** | **38** | **40** |
| **Total Operating** | **-** | **(35)** | **(36)** | **(38)** | **(40)** |

13 **agreed** that the increases in Crown revenue and receipts in paragraph 11 above, or paragraph 12 if applicable, be charged as a pre-commitment against the Budget 2024 operating allowance;


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14 **approved** the following changes to appropriations to give effect to the policy decision in paragraph 3 above, with a corresponding impact on the operating balance and/or net debt:

| | $m – increase/(decrease) | | | | |
|---|---|---|---|---|---|
| **Vote Revenue**<br>**Minister of Revenue** | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 & Outyears |
| Multi-Category Expenses and Capital Expenditure: | | | | | |
| Services for Customers MCA | 0.500 | 0.800 | 0.800 | 0.800 | 0.300 |
| **Total Operating** | **0.500** | **0.800** | **0.800** | **0.800** | **0.300** |

15 **noted** that the above changes to appropriations in paragraph 14 for 2023/24 will be reported and disclosed in the 2023/24 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply;

16 **agreed** that the expenses incurred under paragraph 14 above be charged as a pre-commitment against the Budget 2024 operating allowance;

17 **noted** that Inland Revenue will manage the one-off $1.5 million capital cost of implementing the gaming duty under paragraph 3 above within existing baselines;

18 **noted** that there will be operating and capital costs for the Department of Internal Affairs associated with the implementation and administration of any regulatory system, dependent on design decisions;

19 **noted** the initial estimate of $42 million as a one-off capital cost for the implementation of a possible licensing system based on assumptions about design decisions, which could be funded through a repayable capital injection;

20 **invited** the Minister of Internal Affairs to seek revised estimates of the operating and capital costs associated with implementation and administration as part of the report back to ECO in mid-2024, referred to in paragraph 8 above.

Rachel Hayward
Secretary of the Cabinet

**POLICY AND REGULATORY STEWARDSHIP**

## Tax policy report: Platform Economy: Transitional GST rule

| | | | |
|---|---|---|---|
| **Date:** | 27 February 2024 | **Priority:** | High |
| **Security level:** | | **Report number:** | IR2024/071 |

## Action sought

| | Action sought | Deadline |
|---|---|---|
| Minister of Revenue | **Agree** to recommendations | 5 March 2024 |

## Contact for telephone discussion (if required)

| Name | Position | Telephone |
|---|---|---|
| Ben Smith | Principal Policy Advisor | s 9(2)(a) |
| Shanae Sherriff | Senior Policy Advisor | s 9(2)(a) |

27 February 2024

Minister of Revenue

# Platform Economy: Transitional GST rule

## Purpose

1. This report seeks your agreement to include a transitional rule in the upcoming Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill ("Multinational Tax Bill") at the Committee of the whole House stage.

2. The transitional rule would ensure platform operators did not have to account for GST on contracts for short-stay or visitor accommodation entered into before 1 April 2024, when the new GST rules for platform operators will take effect.

## Background

3. Starting 1 April 2024, operators of digital platforms will be required to account for GST on supplies of "listed services". These are taxable (that is, short-stay and visitor) accommodation, ride-sharing, and delivery services for food and beverages.

4. Platform operators will have GST liabilities if they issue an invoice or receive a payment in respect of these services on or after 1 April 2024. Having the GST liability arise at the earlier of an invoice being issued or a payment being made is a standard GST timing rule.

## Transitional issue for contracts entered into before 1 April 2024

5. We are working with affected platform operators to support them with implementation. Several platform operators have highlighted a practical issue arising from there being no special rules to deal with the transition. The issue is some contracts for taxable accommodation will have been entered into before 1 April 2024 (and before a payment is made or invoice is issued in respect of the services) that will not include a GST component. Without a transitional rule to deal with this, the effect is that platform operators will either need to bring the invoice or payment date forward or bear an unanticipated and unfunded GST cost themselves.

6. To resolve this issue, a transitional rule could be inserted into the Goods and Services Tax Act 1985 allowing platform operators to treat the new rules (that will create a GST liability for them) as not applying to contracts that were entered into before 1 April 2024.

7. No fiscal cost is anticipated from this change. This is because the transitional rule would apply only to accommodation booked before the rules take effect on 1 April 2024. Such bookings (including those which already exist) were not included in the fiscal estimates. The only potential for a fiscal cost would be from a behavioural change with bookings made earlier than they otherwise would be because of the transitional rule. Officials consider there will be very limited opportunity for such a behavioural response given the transitional rule would be enacted just a few days prior to the platform economy rules taking effect.

8. Platform operators would support such a change being introduced.

## Consultation

9. Treasury was consulted in the preparation of this report.

## Next steps

10. If you agree to our recommendation, we will prepare legislative amendments for the transitional rule to be included in the Amendment Paper to the Multinational Tax Bill at the Committee of the whole House stage.

## Recommended action

We recommend that you:

(a) **agree** to a transitional rule allowing platform operators to treat the GST platform economy rules as not applying to contracts for short-stay or visitor accommodation entered into prior to 1 April 2024;

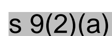
Agreed/Not agreed

(b) **note** that the transitional rule described above would have no fiscal impact;

Noted

(c) **agree** to include the transitional rule in the Amendment Paper to the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill.

Agreed/Not agreed




**Ben Smith**
Principal Policy Advisor
Policy and Regulatory Stewardship

**Hon Simon Watts**
Minister of Revenue
/ /2024