Taxation (Annual Rates and Remedial Matters) Bill

Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill

2 August 1999

CONTENTS

POLICY ISSUES ... 3
Dividends from shares held on revenue account ... 4
New Zealand Raspberry Marketing Council ... 9
Conduit taxation ... 11
Joint bank accounts between residents and non-residents ... 15
Available subscribed capital ... 17
Crown entities and the associated person test ... 19
GST - treatment of exported services ... 20
Other policy issues not in Bill ... 34
Thin capitalisation – inclusion of leases in asset base ... 35
Depreciable intangible property - casino premises licences ... 36

REMEDIAL ISSUES ... 37
Trading stock ... 38
Transfer pricing ... 39
Tax simplification ... 40
Use of money interest on foreign investor tax credits ... 46
Other remedial issues not in Bill ... 47
Taxation of financial arrangements ... 48
Tax exemption of portable New Zealand superannuation and veteran's pension ... 55
Use of money interest and short or late paid provisional tax ... 57
Effective dates for use of money interest rules ... 58
GST and benefits under accident insurance policies ... 60
Minor remedial amendments ... 61

POLICY ISSUES

DIVIDENDS FROM SHARES HELD ON REVENUE ACCOUNT

General comment

Two parties have made submissions in relation to section FC 3, although neither comments directly on the changes proposed in the bill. Instead they make other proposals in relation to the section's scope and methodology.

Instead of making piecemeal changes in response to these submissions, officials recommend that section FC 3 be totally reviewed to ensure that it works appropriately. This would address the submitters' concerns that the section should spell out more clearly what it covers. In the meantime, the proposed extension of the section's scope, as outlined in the bill, should proceed.

Background

Section FC 3 can apply when a company owns shares that it intends to sell. This section is designed to ensure that the exempt dividend provisions, such as the inter-corporate dividend exemption for wholly owned group members, cannot be used to avoid the tax that should be paid on disposal of the shares. This can be illustrated as follows:

Suppose Parent Co buys all the shares in Target Co for $100 with the intention of selling them. They are eventually sold for $110 – the $10 gain is taxable.

Now suppose that Parent Co causes Target Co to pay it a dividend of $30 and then Target Co is sold for $80. In the absence of section FC 3, Parent Co would have derived an exempt dividend of $30 and suffered, for tax purposes, a tax loss of $20 on the transaction, notwithstanding the net gain of $10.

Section FC 3 provides that the $30 dividend is income from the 'sale' of the shares – thus the net gain of $10 is taxable.

Other aspects of section FC 3 are:

- The section applies only to dividends that are paid out of pre-acquisition reserves because these represent a return *of* part of the purchase price. In contrast, dividends paid out of post-acquisition reserves are a return *on* the amount invested.
- The shares do not need to be sold for an adjustment to be made.
- To ensure that there is no double taxation, the intention is that the adjustment is reduced by any of the dividend amounts that are taxable.

Changes proposed in the bill

The two changes proposed in the bill widen the section's coverage to include:

- all revenue account shareholders, not merely those shareholders engaged in the business of dealing in shares or who have acquired the shares for the purpose of selling them; and

- associated companies of the shareholder.

These changes are being made for base maintenance reasons and are intended to apply from the date the bill was introduced into Parliament (20 May 1999).

Issue: Gross income and exempt income

Clause 5

Submission
(11W - PricewaterhouseCoopers)

The proviso to subsection 1 (in particular subparagraph (d)) of the current section should be rewritten to clarify whether the reference to 'dividends that have been treated as gross income under subsection (2)' includes dividends treated as exempt income under section CB 10(2).

Comment

We agree that the interaction of the proviso to section FC 3(1) with section FC 3(2) is confusing and might be open to various interpretations in terms of which dividends are taken into account to ensure that the gross income generated by section FC 3 does not result in double taxation. Double taxation would arise if the payment were taxed once under section FC 3 and again as a dividend.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Interaction of foreign dividend withholding payments

Clause 5

Submission
(11W - PricewaterhouseCoopers)

To avoid what effectively amounts to double taxation, section FC 3 should recognise any liability for foreign dividend withholding payment deductions (FDWP) when adjusting the amount that is brought to account as gross income.

Comment

We propose that this matter be left at this stage, but that it be explored as part of further work on section FC 3. Clearly, dividends from non-portfolio revenue account investments in grey list countries do not result in double taxation because they are not subject to FDWP. In contrast, in cases when FDWP is payable there could be effectively double taxation.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Dividends including imputation credits

Clause 5

Submission
(11W - PricewaterhouseCoopers)

Sections FC 3 and CF 2(15) should be standardised in terms of their inclusion of imputation credits in dividends when adjusting gross income to ensure that there is no double taxation.

Comment

The submission raises an issue that we propose to explore as part of further work on section FC 3.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Interaction with section CF 2(15)

Clause 5

Submission
(11W - PricewaterhouseCoopers)

The interaction of sections FC 3 and CF 2(15) should be clarified given that:

- CF 2(15) is explicitly 'subject to FC 3', and
- CF 2(15) applies only in situations when shares are cancelled, whereas FC 3 applies more widely.

Comment

The purpose of the reference in section CF 2(15) to FC 3 is to avoid double taxation. The wording in this area appears in need of clarification, as part of the wider review of section FC 3.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Cost basis adjustment for shares subject to FC 3

Clause 5

Submission
(11W - PricewaterhouseCoopers)

After the enactment of the Core Provisions amendments in 1996 it is clear that there is no matching deduction for either the whole or any part of the cost of the shares against the section FC 3 income deemed to arise from the sale of the shares. This should be fixed.

Comment

We agree that there should be an adjustment if section FC 3 is applied. However, a deduction for the cost of shares that have not been sold appears inappropriate given that the cost of shares held on revenue account is taken into consideration only when the shares are sold (under section EF 2). Similarly, the current requirement to bring the section FC 3 deemed income 'adjustment' to account in the current income year as gross income seems inappropriate.

Accordingly, officials will be exploring other options as part of the review of the section.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Application to pre and post-acquisition reserves

Clause 5

Submission
(4 – ICANZ, 11W - PricewaterhouseCoopers)

Section FC 3 should be redrafted:

- to clarify that dividends distributed from post-acquisition reserves do not fall within its scope, and
- so that dividends be deemed to be distributed from post-acquisition reserves first (ICANZ only).

Comment

Officials agree that section FC 3 should be redrafted to clarify the transactions to which it applies.

Recommendation

That the submission be declined at this stage, pending further work.

Issue: Limit coverage to dividend stripping arrangements

Clause 5

Submissions
(4 - ICANZ)

Section FC 3 should be limited to dividend stripping arrangements. It should not extend to normal commercial arrangements involving the distribution of dividends. The current section FC 3(1)(b)(i) should, therefore, be excluded.

Comment

This submission misses the point of section FC 3. Any return on an investment held on revenue account should constitute gross income. A return of pre-acquisition profits from shares held on revenue account should, therefore, be gross income. A distribution of pre-acquisition profits need not be confined to an arrangement to buy shares. It can also be achieved through having a controlling shareholding and, hence, the reason for subsection FC 3(1)(b)(i).

Recommendation

That the submission be declined.

Issue: Limit to wholly-owned companies

Clause 5

Submissions
(4 - ICANZ)

Section FC 3 should be limited to wholly-owned companies.

Comment

Officials recommend that the submission be considered as part of the wider review of section FC 3.

Recommendation

That the submission be declined at this stage, pending the wider review.

NEW ZEALAND RASPBERRY MARKETING COUNCIL

Issue: **Consistency of terminology with the Raspberry Marketing Authorities (Dissolution) Regulations 1999.**

Clause 10

Submission
(Matter raised by officials)

The terminology used in the proposed amendment should be consistent with that used in the Raspberry Marketing Authorities (Dissolution) Regulations 1999.

Comment

The Raspberry Marketing Authorities (Dissolution) Regulations 1999 have recently been enacted and were not finalised at the time the proposed amendment to the Income Tax Act 1994 was prepared. The suggested changes ensure that the terms used in the amendment to the Income Tax Act 1994 are consistent with the terms used in the regulations.

Recommendation

That the submission be accepted.

Issue: Available subscribed capital of Rubus Investments Nelson Limited

Clause 10

Submission
(Matter raised by officials)

The legislation should clarify that following the distribution of shares in Rubus Investments Nelson Limited (Rubus) to the current growers for the Nelson Raspberry Marketing Committee, there will be available subscribed capital in Rubus representing those shares issued to current growers.

Comment

As drafted, the legislation is unclear as to whether Rubus has any available subscribed capital (ASC) following the distribution of shares to current growers. ASC generally represents the contributions of capital made by shareholders to a company. ASC can be returned to shareholders in certain circumstances without a tax cost. As the legislation is currently drafted, it is not clear whether growers could be said to have paid capital into Rubus.

Nevertheless, the current growers have, in effect, at least for tax purposes, received a distribution of Cold Storage Nelson Limited shares and then contributed them to Rubus in return for shares in Rubus. Consequently, the market value of Cold Storage Nelson Limited shares should be equal to the ASC of Rubus. It is important to note that under the proposed

legislation, current growers would be taxed on the value of the shares in CSNL they effectively receive. That distribution is likely to be covered by imputation credits and capital gain amounts and consequently is unlikely to have a tax cost for the grower.

The result of this treatment is that the growers are effectively putting a tax-paid contribution into Rubus, so there should be ASC in Rubus representing that contribution.

Recommendation

That the submission be accepted.

CONDUIT TAXATION

Issue: Avoiding double debits

Clause 21

Submission
(4 – ICANZ)

An amendment should be made to ensure that a section FH 8(5) adjustment does not give rise to a debit in the conduit tax relief accounts of both the consolidated group and the individual company.

Comment

When a conduit tax relief account company has excessive interest expense in New Zealand and this is applied against its dividend withholding payment income, a conduit tax relief adjustment is calculated under section FH 8(5). If the relevant company is a member of a consolidated group, the bill, as introduced, would result in a debit arising to the conduit tax relief accounts of both the company and the consolidated group. This result is unintended, and an amendment is, therefore, appropriate.

Recommendation

That the submission be accepted.

Issue: Transfers between memorandum accounts

Clause 21

Submission
(4 – ICANZ)

The operation of new section MI 20 should be widened to allow credit balances to be transferred from an individual company's conduit tax relief account or dividend withholding payment account against debit balances in the consolidated group's dividend withholding payment account or conduit tax relief account.

Comment

The conduit tax relief account rules for consolidated groups are broadly patterned on the existing rules for consolidated group dividend withholding payment account rules. Those rules in turn are similar to those for consolidated group imputation credit accounts.

The general rule followed for a company that becomes a member of a consolidated group is that any transactions to which the company is party after becoming a member affect the relevant memorandum account of the consolidated group. Balances existing before the company becomes a member of the group remain in that company's individual account, but

may be drawn into the consolidated group's account to offset subsequent entries to the group's account.

The rule in section MI 20(1) to which the submission relates deals with a special case unique to the conduit rules. When under a wash-up adjustment a credit is transferred from a dividend withholding payment account to a conduit tax relief account, Inland Revenue is required to make a refund to the taxpayer to the extent of the transfer. In the absence of the special rule in section MI 20(1), it may be possible for a consolidated group, as a whole, to have received an appropriate amount of conduit relief (reflected in the aggregate balance of the conduit tax relief account of the group and its members being in credit), but still effectively obtain further relief from a refund for a transfer within the consolidated group's memorandum accounts (resulting because the conduit tax relief account of the consolidated group itself is in debit). Given the aggregate situation, issuing a refund for a wash-up adjustment would result in an inappropriate cost to the revenue.

Similar revenue concerns do not arise for other transfers involving the dividend withholding payment account, hence the absence of a special rule to cover them in the bill.

It should also be recognised that the taxpayer base to which the consolidated group conduit rules will apply is very narrow, and for the rules in question to apply, is also likely to require that a company has been a conduit tax relief account company before becoming a member of a consolidated group. The amendment sought by the submission will add complexity to the drafting, and does seem to seek a level of refinement that is not justified by the narrow ambit of the rules. Aside from the revenue consideration outlined above, there also does not appear to be a clear case for why the conduit rules for transfers between a consolidated group and its members should diverge from the precedent established in the rules for other memorandum accounts.

Officials recommend, therefore, that the submission be declined.

Recommendation

That the submission be declined.

Issue: Drafting clarification - Shareholder measurement dates

Clauses 14 and 25

Submission
(4 – ICANZ)

Additional words should be added to sections KH 2(2) and NH 7(3A) to clarify the effect of the subsections.

Comment

The submission seeks the insertion of additional words in the legislation, to clarify the interface between certain subsections. Officials agree that inserting additional words would make the legislation less confusing and is, therefore, desirable.

Recommendation

That the submission be accepted.

Issue: Effect of conduit election rules

Clause 19

Submission
(4 – ICANZ)

Consequential amendments should be made to sections MG 6 and MZ 4 so that when a company has revoked an election to be a conduit tax relief account company, but the revocation is not yet effective, the company may attach dividend withholding payment credits to dividends paid to non-residents without the limitation currently imposed by section MZ 4.

Comment

The submission argues that if a company has revoked an election to be a conduit tax relief account company, the requirement under section MG 6 that it still attach only conduit tax relief account credits to dividends paid to non-resident shareholders could result in it carrying the cost of paying additional dividends until it can obtain a refund after the end of the income year.

First and foremost, it must be recognised that the taxpayer base to which the conduit rules apply is very narrow. Consequently, the revocation of a conduit election will not be commonplace. The amendment sought by the submission does, therefore, seem to be seeking a level of refinement to the rules that is not justified by their narrow ambit.

There is, however, also a counter-argument to the amendment sought which is not contemplated in the submission. Even though a company may have revoked its election to be a conduit tax relief account company, conduit relief could still arise if an income tax return is filed for a relevant income year after a revocation is made but before it takes effect. If the amendment sought in the submission is made, an inappropriate cash-flow advantage would then arise to the company instead.

The cash flow issue here is essentially the same as that raised by the wash-up adjustment in section MI 6. It was an accepted fact in developing that rule that a perfect credit allocation rule does not exist. The wash-up adjustment was implemented as a compromise acceptable to both Government and affected taxpayers and can, depending on circumstances, result in a taxpayer's cash flow being advantaged or disadvantaged.

Recommendation

That the submission be declined.

JOINT BANK ACCOUNTS BETWEEN RESIDENTS AND NON-RESIDENTS

Clause 24

Submission
(4 – ICANZ)

The proposed amendment should be considered further before implementation.

Comment

When interest income is derived jointly by residents and non-residents, the payer is often not readily able to identify the respective beneficial entitlement of each recipient. This can create compliance difficulties for payers seeking to determine the correct amount of tax to withhold. It also creates administrative difficulties, as residents that have been subjected to the lower non-resident withholding rate have no incentive to advise Inland Revenue and account for the under-deducted tax.

The amendment was intended to remove doubt over the withholding rate that should apply. Its aim was to achieve the following:

- Non-resident withholding tax should be imposed on interest derived jointly by residents and non-residents at the rate of resident withholding tax. However, if the payer is not required to deduct resident withholding tax, he or she should not be relieved from the obligation to deduct non-resident withholding tax.

- Treaty relief should still be available, but only on application to Inland Revenue for a refund of over-deducted tax, as contrasted with relief arising at source under existing rules. Relief will not, however, be available other than under a treaty.

- Subject to treaty relief, NRWT deducted under the new rules should remain a final tax on the non-resident, even though the rate of tax will be higher than what it is at present.

In most cases, the amendment would lead to an over-deduction of tax on that portion of interest to which a non-resident is beneficially entitled. The submission questions whether this is the intended effect, particularly for residents of non-treaty countries, who would have no entitlement to seek a refund of the over-deduction. Officials confirm that this effect was intended – the purpose is to encourage non-residents to operate separate bank accounts if they want the correct withholding rates to apply. Further, by setting the non-resident withholding rate equal to the resident withholding rate, the amendment also ensures that residents cannot have withholding tax under-deducted on their interest income by being treated as non-residents.

The submission also questions whether it was intended that the amendment would allow non-residents to take a deduction for expenses incurred in deriving the relevant interest income. Officials acknowledge that this effect was unintended. It compromises the integrity of the non-resident tax base, and could have the perverse effect of encouraging non-residents to derive interest jointly with residents. It is desirable that this anomaly be addressed by

ensuring that interest income earned by non-residents is treated as non-resident withholding income, thereby preventing the deduction of expenses.

Recommendation

That an amendment be made to ensure that non-residents are not inadvertently permitted to access deductions against their interest income derived from New Zealand.

AVAILABLE SUBSCRIBED CAPITAL

Issue: Clarification of wording

Clause 26

Submission
(4-ICANZ)

The proposed amendment is appropriate, although the wording suggested in section OB1 is ambiguous and should be clarified.

Clarification suggestion 1:

> *Excluded from available subscribed capital [ASC] is consideration received by a company "if the consideration is the giving up of rights or interests of membership in the company". Presumably* ***the*** *company refers only to the company which has received the consideration. Accordingly, the giving up of rights in another company (which is not associated or in substance the same company) could still produce the unintended result.*
>
> *The definition goes on to state "The total available subscribed capital per share in calculated after deducting the "ineligible capital amount". Reference to the term "ineligible capital amount" suggests that the definition is intended to apply both to the giving up of rights in* ***the*** *company or another company. If this is the case, the definition should refer to* ***any*** *company instead of* ***the*** *company.*

Comment

In relation to the first part of this suggestion, to replace "the company" with "any company" would mean that the words "(which is associated or in substance the same company)" would become meaningless and the provision would become much broader in operation. To go wider could lead to unintended results, and the amendment could potentially apply to situations not intended to be covered.

As for the second part of the suggestion, the reference to "the company" rather than "any company" in relation to the "ineligible capital amount" is intended to track the current wording in the ASC definition of "ineligible capital amount". Consequently, to change this might also have consequences for that definition and could give rise to unintended consequences under both parts.

Clarification Suggestion 2:

> *It is unclear, or at the least confusing, to include within the definition of ASC reference to Available Subscribed Capital. We note that this already occurs within the definition, however where we are calculating the ASC in a particular company we are required to refer to the ASC in the same company.*

Comment

There may be an element of circularity in referring to the term "available subscribed capital per share" within the definition of "available subscribed capital" but this does not, in our view, require clarification. In fact, clarification by way of including the definition of "available subscribed capital per share" within this definition would give an unnecessarily long and complicated definition. It would, however, help to clarify the timing of the calculation of the available subscribed capital per share that is referred to in the amendment. In this regard the legislation should refer to the available subscribed capital *immediately before* the rights or interests are given up.

Officials also believe that it would make the legislation clearer if the reference to "total available subscribed capital" was instead to "aggregate available subscribed capital". This would mean there was consistency of terminology within the definition of "available subscribed capital".

Recommendation

That the submission be declined but the timing of available subscribed capital be clarified and the reference to "total available subscribed capital" be replaced by "aggregate available subscribed capital".

CROWN ENTITIES AND THE ASSOCIATED PERSON TEST

Clauses 27 and 28

Submission
(1W - KPMG on behalf of Meridian Energy Limited)

Further amendments are necessary to the special corporate entity (SCE) rules to:

1. clarify that the subsidiaries of SCEs cannot group loss offset with the subsidiaries of any other SCE; and

2. confirm that subsidiaries of a SCE can group losses with its parent SCE.

These are generic problems with the SCE rules.

Comment

Officials are still considering issues raised by this submission and will report further.

GST - TREATMENT OF EXPORTED SERVICES

General comment

The proposed amendment is intended to exclude from the GST zero rating provisions the supply of services that are consumed in New Zealand but contracted for by a non-resident who is outside New Zealand. The amendment aims to protect the integrity of the tax base by ensuring that services consumed in New Zealand are subject to GST, even though a non-resident may have purchased the service. An example of this would be where a non-resident parent contracts with a New Zealand school to educate the parent's non-resident child in New Zealand.

The boundary between which services should be zero rated and which should be standard rated for GST purposes is difficult to draw with exact precision. It is likely that other difficulties in this area will emerge, and they can be considered as part of the Government's current wider review of the GST Act.

Issue: Consumption in New Zealand

Clause 38

Submission
(4 – ICANZ)

The current drafting of the proposed section 11(2A) should be amended to take into account whether any consumption of those services occurs in New Zealand when the non-resident is present in New Zealand.

Comment

The submission considers that new section 11(2A) does not determine whether there has been any consumption of services while the non-resident has been in New Zealand, only whether the non-resident was present in New Zealand. However, officials consider that the current drafting does focus on consumption in New Zealand rather than merely presence in New Zealand. Paragraph (a) of the new provision refers to the performance of the services being received by a person. Such receipt of the performance of services is equivalent to the consumption of those services. Although officials recognise that there is an element of uncertainty with both terms, the receipt of performance terminology provides a more accurate description of the consumption of services than the use of consumption terminology, whose meaning can vary depending on the context in which it is used. Paragraph (c) then requires the person receiving the performance of the services to be in New Zealand at the time the services are performed.

Officials consider, therefore, that the current drafting of new section 11(2A) takes into account whether any consumption of services has occurred in New Zealand.

Recommendation

That the submission be declined.

Issue: Clarifying persons referred to

Clause 38

Submission
(4 – ICANZ)

The current drafting of proposed new section 11(2A) does not clearly address which "person" it is referring to. For instance, it is unclear as to whether "the person" in subparagraph (i) refers to the "another person" in paragraph (a) or, alternatively, "a person" in the body of the section. This uncertainty, in turn, means that the reference to "other person" in paragraphs (b) and (c) is unclear. Accordingly, the drafting should be clarified. A suggested redraft is provided.

Comment

Officials do not consider that the current drafting of proposed section 11(2A) is unclear as to which persons are being referred to. "The person" in subparagraph (i) clearly refers to "a person" in the opening words of the provision and not to the "another person" in paragraph (a). There are two main reasons for this. First, the subparagraph (i) wording of "the person who is not resident in New Zealand" is based on the wording used in the opening words of the provision: "a person who is not resident in New Zealand". Also, the use of the definite article "the" in subparagraph (i) relates back to the use of the indefinite article in "a person" in the opening words.
“”“”“”“”“”“”“”“”

Although officials consider that the current drafting of new section 11(2A) is clear, it is possible to provide more assistance to users of the legislation by using the term "person A" for the non-resident contracting for the services and the term "person B" for the person receiving the performance of the services.

Recommendation

That the submission be accepted, in part, by using the descriptors "person A" and "person B" for the person contracting for the services and the person receiving the performance of the services respectively.

Issue: Timing relationship

Clause 38

Submission
(4 – ICANZ)

The current drafting of proposed section 11(2A) should be amended to clarify the timing relationship between the receiving of the services under paragraph (a) and the presence in New Zealand under paragraph (c).

Comment

The clarification sought by ICANZ can be achieved by removing paragraph (c) and inserting into paragraph (a) a requirement that the receipt must be in New Zealand.

The submission also provides an example where a non-resident company contracts to receive services from a New Zealand supplier and in order to arrange for the provision of those services the Chief Financial Officer of the non-resident company visits New Zealand for a short period. The submission considers that under the current drafting of new section 11(2A), the provision of the services would not be zero rated because the performance of the services has been received by the Chief Financial Officer who is in New Zealand at the time the services are performed. The submission seeks clarification to the new section on this point.“”

Officials consider that the supply of the services in the example would continue to be zero rated under the amendment. The performance of the services under the contract is received by the non-resident company only. New section 11(2A) would therefore not be applicable. The remaining question is whether the company is “outside New Zealand” in terms of the zero rating provision in section 11(2)(e). Officials consider that the minor presence test in new section 11(2B) would apply to ensure that the supply of the services in the example would continue to be zero rated under section 11(2)(e).

Therefore no amendment is necessary to ensure that the services supplied in the example are zero rated. An appropriate example will be included in Inland Revenue’s *Tax Information Bulletin* item on the amendment to illustrate this point.

Recommendation

That the submission be accepted in part, by removing paragraph (c) of the new provision and inserting in paragraph (a) a requirement that the receipt must be in New Zealand.

Issue: Fees received by New Zealand travel agents from overseas suppliers for arranging overseas bookings

Clause 38

Submission

(3 – Travel Agents Association of New Zealand)

The proposed legislation should be amended so that fees received by New Zealand travel agents from overseas suppliers for arranging offshore travel and accommodation packages for those travelling out of New Zealand are zero rated.

Comment

Officials agree that proposed section 11(2A) may affect the current zero rating of arranging services provided by New Zealand travel agents to overseas suppliers. This is because the performance of the arranging service supplied by the New Zealand travel agents may be received by those travelling out of New Zealand as well as by the overseas suppliers. New section 11(2A) may apply if the arranging service is performed when the traveller is still in New Zealand. In policy terms, however, zero rating is the appropriate GST treatment of these arranging services because the services which are arranged, such as accommodation, are physically performed outside New Zealand.

An amendment should be made, therefore, to ensure the zero rating of services comprising the arranging of services physically performed outside New Zealand. This amendment would be consistent with the existing zero rating provision in section 11(2)(d) concerning services physically performed outside New Zealand.

Recommendation

That the submission be accepted by making an amendment to section 11(2)(d) to zero rate services comprising the arranging of services that are physically performed outside New Zealand.

Issue: Modifications to new section 11(2A)

Clause 38

Submission

(5W – Deloitte Touche Tohmatsu)

Proposed section 11(2A) should be modified to provide that:

- the subsection applies only *to the extent that* the criteria in paragraphs (a), (b) and (c) are satisfied; and
- paragraph (c) of the provision is also prefaced by the words "it is reasonably foreseeable".

Comment

Proposed section 11(2A) will provide a further restriction on existing section 11(2)(e), which zero rates services contractually supplied to a non-resident. Existing section 11(2)(e) does not contain any apportionment wording. A supply of services to a non-resident either qualifies for zero rating under section 11(2)(e) or it does not. It would not be appropriate at this time to introduce apportionment wording (such as “to the extent that” suggested by the submitter) in new section 11(2A) as it would result in an inconsistency between that provision and existing section 11(2)(e), which contains no apportionment wording. The issue of apportionment has wider implications and, therefore, requires further consideration as part of the current wider review of the GST Act.

Officials agree with the submitter that at the time of supply there may be no certainty as to whether the “other person” referred to in paragraph (c) (the person receiving the performance of the services) will be in or outside New Zealand when the services are performed. “”“”

In response to a submission from ICANZ, officials are recommending that paragraph (c) be removed. However, the new reference to future presence in New Zealand in paragraph (a) should be prefaced by a requirement that such presence be “reasonably foreseeable”.

Recommendation

That the submission be accepted, in part, by “”“”prefacing the reference to future presence in New Zealand in paragraph (a) with a requirement that that presence be “reasonably foreseeable”.

Issue: Services supplied to a non-resident company through a representative in New Zealand

Clause 38

Submission
(8W – Stuart Hutchinson)

Proposed section 11(2A), in its current form, would inappropriately exclude from zero rating the supply of services (such as professional advice) consumed offshore by a non-resident company, but received in New Zealand by a representative who relays the advice to the non-resident company. New section 11(2A) would properly focus on third party arrangements if it were redrafted to refer to the consumption of services in New Zealand rather than the performance of the services being received by a person in New Zealand. A suggested redraft is provided.

Comment

This submission is similar to that made by ICANZ. The submitter is concerned that proposed section 11(2A), as currently drafted, would impose GST on supplies of services (such as legal advice) to a non-resident company if a representative of the company (such as a director or employee of the company) received, on behalf of the company, the services in New Zealand. The submitter considers that the current drafting does not focus on either the intended recipient or on where the services are consumed, but instead incorrectly equates any receipt of the service in New Zealand with consumption of the service in New Zealand.

Officials note that the current drafting is intended to focus on consumption in New Zealand. Paragraph (a) of new section 11(2A) refers to the performance of the services supplied being received by another person. Officials consider that such receipt of the performance of services is equivalent to the consumption of those services but is considered to be the more appropriate terminology in this context. Paragraph (c) requires the person receiving the performance of the services to be in New Zealand at the time the services are performed.

Officials consider that the supply of the services in the example where the non-resident company receives legal advice from a New Zealand firm would continue to be zero rated under the amendment. Officials agree with the submitter that the director of the non-resident company that is visiting New Zealand merely receives the legal advice as a conduit and relays that advice to the company. As the submission itself points out, it is the non-resident company, not its directors or employees, that makes use of and relies upon the legal advice supplied. Thus the performance of the services under the contract – that is, the provision of legal advice – is received by the non-resident company only. New section 11(2A) would, therefore, not be applicable. The remaining question is whether the company is "outside New Zealand" in terms of the zero rating provision in section 11(2)(e). Officials consider that the minor presence test in new section 11(2B) would apply to ensure that the supply of the services in the example would continue to be zero rated under section 11(2)(e) even though a director of the non-resident company was in New Zealand.

The submission may have been prompted by the reference to an employee or director in paragraph (a). These references were included to distinguish between a company and its employees or directors in the situation where the employee or director does in fact receive the performance of a particular service, such as the provision of accommodation in New Zealand. In the case of an agreement to supply accommodation, the performance of the contract involves the provision of accommodation which is received by the individual employee or director. This should be distinguished from the submitter's example of the provision of legal advice. Officials' view is that such advice is clearly provided to the non-resident company only.

No amendment is necessary, therefore, to ensure that the services supplied in the submitter's example, or other similar cases involving professional services, are zero rated. An example will be included in the *Tax Information Bulletin* item on the amendment to illustrate this point.

Recommendation

That the submission be declined.

Issue: GST on education services supplied to foreign students

Clause 38

Submission
(6W – Association of Polytechnics in New Zealand and Education New Zealand Trust)

There should be a specific amendment to zero rate all education services provided to foreign students except students who are permanent residents under the Immigration Act 1987. ("Education services" should be defined as services, not including goods, supplied by education institutes registered with the Ministry of Education.)

Comment

The aim of GST is to tax all consumption taking place in New Zealand. Therefore all services consumed in New Zealand should be subject to GST even though a non-resident may have purchased the service.

The submitter wants to retain the current GST treatment of exported services as reflected in the Court of Appeal decision in *Wilson & Horton* v *CIR* (1995) 17 NZTC as "the Government should not be looking to change confirmed law to ensure that the IRD's interpretation is upheld".

Although the particular result in *Wilson & Horton* was correct in terms of policy, the wider implications of the decision were not desirable. The decision meant that services contracted for by a non-resident outside New Zealand qualify for zero rating even though they are not exported for offshore consumption by the non-resident, but instead are consumed in New Zealand by another person. An example of this would be the education of non-resident students at New Zealand education institutes.

The submitter refers to the direct financial benefits to education institutes from the payment of fees by foreign students and the indirect benefits to the economy from the consumption by the students of other goods and services in New Zealand during the period of their studies. The submitter is also concerned that charging GST on educational services supplied to non-residents in New Zealand could undermine the international competitiveness of New Zealand education providers.

The main aim of GST is to raise revenue in a way that imposes the lowest possible economic cost on New Zealand. To achieve this, GST is applied to the widest possible range of goods and services consumed in New Zealand, both by residents and non-residents. This reduces the extent to which GST distorts consumption and production decisions in New Zealand.

Officials consider that if education services consumed by non-residents in New Zealand were zero-rated any benefits in terms of the sector's international competitiveness would be considerably outweighed by the following factors:

- Significant GST revenue would be lost.
- There would be a risk to the GST base because non-residents could purchase education services on behalf of residents.
- Administrative costs would increase because of the opportunity for residents to avoid GST.
- Compliance costs would increase because there would be two rates of tax on domestic supplies of education services.
- Other sectors that provide services to non-residents that are consumed in New Zealand would seek similarly favourable treatment.
- Production decisions would be distorted.

International competitiveness is influenced by many factors, of which GST is only one. Any business can be made more "competitive" by a tax subsidy, such as not charging GST. However, given the Government's revenue requirements, such subsidies are at the cost of higher tax on other (unsubsidised and profitable) business and are thus to the detriment of New Zealand's overall economic welfare. The Government's tax strategy recognises this by promoting a broad-base, low-rate tax system. Providing a subsidy by zero-rating education services provided to non-residents in New Zealand would be inconsistent with this strategy.

There is also a horizontal equity argument for charging GST on all education services provided in New Zealand, whether paid for by residents or non-residents. New Zealand residents who are required to pay GST on education services they or their children receive could regard it as unfair that a non-resident attending the same education institute is not charged GST.

Finally, the key overriding factor is the policy principle of taxing all consumption that takes place in New Zealand. Exports are not subject to GST because the consumption is considered to be outside New Zealand. Therefore the fact that fees received from the education of non-resident students in New Zealand would be classified by Statistics New Zealand as export receipts is not determinative. Similarly, all receipts from non-resident tourists would be classified as export receipts, yet all goods and services consumed in New Zealand by non-resident tourists are generally subject to GST.

Recommendation

That the submission be declined.

Issue: Telecommunication services

Clause 38

Submission
(7 – Telecom New Zealand Ltd)

A further amendment, which is specific to telecommunication organisations, should be included in the bill to clarify that "inbound" international telecommunication services are zero rated.

Comment

The submitter is concerned that proposed section 11(2A) may, contrary to the policy intent, incorrectly exclude "inbound" telecommunication services from the GST zero rating provisions.

The main example of an "inbound" telecommunication service is an overseas caller making a telephone call to a person in New Zealand. This service is provided to the overseas caller by an overseas telecommunications provider who contracts with a New Zealand telecommunications provider (for example, Telecom) to connect the call in New Zealand. Telecom serves as a link between the overseas telecommunications provider and the New Zealand resident receiving the phone call.

Although there is always scope for a generic provision to give rise to differing interpretations, officials do not consider that new section 11(2A) affects the current zero rating of the connection services provided by New Zealand telecommunication providers to overseas telecommunications providers. This is because the performance of the connection service supplied by the New Zealand telecommunications provider is received by the overseas telecommunications provider only, not by the New Zealand resident receiving the call. New section 11(2A) is not applicable, therefore, because that provision would apply only if the performance of the connection services was received by a party other than the overseas telecommunications provider who contracted for those services. Accordingly, officials consider that section 11(2)(e) continues to apply to zero rate the connection service contractually supplied to the overseas telecommunications provider by the New Zealand telecommunications provider.

For the performance of the connection service supplied by a New Zealand telecommunications provider to have been treated as being received by the New Zealand recipient of the call would require an indirect benefit test. For example, the opening words of paragraph (a) in new section 11(2A) would need to read: "A benefit of the services is or will be received by another person". Such an indirect benefit test has not been employed in new section 11(2A). The receipt of performance test actually used in new section 11(2A) is inherently narrower than such an indirect benefit test.

Therefore officials do not consider that a specific amendment is necessary to ensure that inbound telecommunications services continue to be zero rated. This is because there is a sufficiently clear distinction between these services and the types of services to which the amendment is directed.

Recommendation

That the submission be declined.

Issue: Meaning of “minor presence”

Clause 38

Submission
(4 – ICANZ)

It should be made clear that a minor presence of a non-resident in New Zealand that is linked to the supply under consideration is still not sufficient to render the non-resident no longer “outside New Zealand” for the purposes of section 11(2)(e) or 11(2)(fa). It would clarify the provision if “minor presence” was defined as “a presence in New Zealand insufficient for the overseas entity to be considered to be resident for the purposes of the GST Act”.

Comment

Proposed section 11(2B) will ensure that a presence in New Zealand of a non-resident that is unrelated to a supply of services, or that is minor, would not mean that a non-resident was no longer “outside New Zealand” for the purposes of the zero rating provisions in section 11(2)(e) or 11(2)(fa). (These provisions require that the non-resident who contracts for the services is outside New Zealand at the time the services are performed.) There is currently significant uncertainty as to what constitutes “outside New Zealand” for the purposes of these provisions. The proposed amendment aims to reduce this uncertainty.

Officials consider that new section 11(2B) clearly provides that a minor presence in New Zealand by a non-resident that is related to the supply under consideration (for example, a visit to New Zealand by an employee of a non-resident company to liaise with the New Zealand supplier) still allows the non-resident to be treated as being “outside New Zealand”. An example will be included in the *Tax Information Bulletin* item on the amendment to illustrate this point.

However, officials do not consider that it is feasible to define precisely the meaning of “minor presence” because the meaning to be accorded to those words is dependent on the facts and circumstances of the particular case. In particular, officials do not agree with the suggested wording of the definition of “minor presence”. The suggested wording would equate a minor presence in New Zealand of a non-resident with anything falling short of the GST Act definition of a “resident”. The GST definition of a “resident” includes a person to the extent that the person carries on in New Zealand any activity while having any fixed or permanent place in New Zealand relating to that activity. Therefore a non-resident is required to have a significant presence in New Zealand before that person is treated as being resident in New Zealand for GST purposes. Officials consider that it would be going too far to define a “minor presence” as anything falling short of a fixed or permanent place in New Zealand. This would amount to equating a “minor presence” with what is in fact a quite significant presence. This would result in an inappropriate widening of the zero rating provisions and a tax effectively based on residence rather than consumption in New Zealand.

Recommendation

That the submission be declined.

Issue: Replacing proposed section 11(2B) with section 11(2)(e) amendment

Clause 38

Submission
(8W – Stuart Hutchinson)

Proposed section 11(2B), which attempts to clarify the meaning of "outside New Zealand" for the purposes of section 11(2)(e), should be replaced by an amendment to section 11(2)(e) which would provide that services are zero rated if supplied to non-resident individuals not present in New Zealand and companies and unincorporated bodies to the extent that they are not resident in New Zealand.

Comment

This submission is similar to that made by ICANZ. The imposition of GST on a particular supply requires a territorial connection with New Zealand (section 8 of the GST Act refers). This is because the aim of GST is to tax all consumption taking place in New Zealand. As a tax on consumption, GST is based on the presence in New Zealand of the recipient of a supply, not the residence of the recipient. For example, all goods and services consumed in New Zealand by non-resident tourists are generally subject to GST. Proposed section 11(2B) provides some guidance as to the level of territorial presence in New Zealand that a non-resident company or unincorporated body may have before that non-resident is treated as being no longer "outside New Zealand" for the purposes of section 11(2)(e) or 11(2)(fa). It would be contrary to the policy principles of GST to replace the territorial connection test with the resident test as proposed by the submitter.

Officials also consider that it would result in an inappropriate widening of the zero rating provisions if anything supplied to a company or unincorporated body that is not resident in New Zealand was zero rated. This is because the GST definition of a "resident" includes a company to the extent that the company carries on in New Zealand any activity while having any fixed or permanent place in New Zealand relating to that activity. A person who is an unincorporated body of persons is treated as being resident in New Zealand only if that body has its centre of administrative management in New Zealand. Therefore a non-resident company or unincorporated body is required to have a significant presence in New Zealand before that person is treated as being resident in New Zealand for GST purposes. Officials consider that it would be inappropriate to zero rate any supply made to a company or unincorporated body which is not resident in New Zealand because it does not meet these significant thresholds.

Recommendation

That the submission be declined.

Issue: Replacing "effectively connected with" test

Clause 38

Submission
(5WA – Deloitte Touche Tohmatsu)

Proposed section 11(2B) should be modified by replacing the words "effectively connected with" with the words "directly in connection with".

Comment

The submitter is in favour of replacing the words "effectively connected with" with the words "directly in connection with" because it would ensure consistency with existing "directly in connection with" terminology in the zero rating provisions. It would also have the benefit of allowing reference to the several New Zealand court cases which have considered the "directly in connection with" terminology.

Officials consider that the current "effectively connected with" language better achieves the purpose of new section 11(2B) than "directly in connection with" language. The existing language ensures that a presence in New Zealand of a non-resident that is unrelated to a supply of services would not mean that the non-resident was no longer "outside New Zealand" for the purposes of section 11(2)(e) or 11(2)(fa). The "effectively connected with" language better allows the substance of a connection to be taken into account than the word "directly". The "directly in connection with" terminology in the zero rating provisions is also used in a different context; in particular, it is not used in the context of "presence" which is the subject matter of new section 11(2B). There is also a risk that "directly in connection with" language could be circumvented by a step or transaction being interposed between the non-resident and the relevant supply.

Recommendation

That the submission be declined.

Issue: Time of supply for vouchers should be standardised

Clause 37

Submission
(Submission 4 - ICANZ)

The plethora of rules concerning the treatment of vouchers with a face value and those without a face value is causing confusion. These rules should be standardised to remove this uncertainty. This value of the supply arising from a voucher should be the time it is redeemed.

Comment

The issues raised by the ICANZ are considerably wider than legislation before the Committee and anticipate work currently being undertaken as a result of the post-implementation review of GST.

Clause 37 is an interim measure to ensure the legislation in clause 38 operates as intended while work continues on rationalising the current rules concerning vouchers, which at times require recognition for GST purposes on acquisition, and at other times on redemption. Clause 37 would make vouchers relating to services covered by new section 11(2A) subject to GST at the time of acquisition. The clause has been inserted in response to submissions on the exported services proposal contained in the GST discussion document. The submissions sought clarification of the timing rules when vouchers are used.

This clarification is necessary because vouchers involve two supplies. The first supply is when the voucher is issued, and the second is when the voucher is redeemed for goods or services. The supply that is subject to GST is determined by whether or not a voucher has a face value.

- Vouchers with a face value are subject to GST at the time of redemption since section 10(16) disregards the issue of the vouchers (unless the consideration paid for that voucher exceeds its face value).

- Vouchers without a face value are subject to GST on issue. Section 10(17) deems the supply of goods and services resulting from redemption to have a nil value.

The current voucher rules could give rise to difficulties in the application of the legislation in clause 38, which is intended to apply at the time the agreement to supply the services is entered into. Clause 38 would fail to apply if a travel voucher had a face value. This is because the issue of this type of voucher to a non-resident under section 10(16) is, in effect, deemed not to occur.

The Committee should note that the current voucher rules contemplated only domestic voucher transactions, hence the question of "does consumption occur in New Zealand?" never arose. Clause 37 provides guidance in respect of vouchers that are used internationally.

Aside from clause 38 failing to apply under a redemption test, officials have additional concerns with using redemption to determine the tax treatment of a voucher. If a voucher is taxed at redemption the issuer of the voucher may face additional compliance costs when the voucher is redeemed. This is because a voucher that leaves New Zealand will have its value altered by foreign exchange movements and by any fees or margins charged by offshore agencies. This may mean that the voucher will be more valuable when it is redeemed in New Zealand that it was when it was issued. If this higher value were taxed the supplier would have to return more GST than was anticipated.

Therefore the purpose behind clause 37 is to reduce compliance costs as far as practicable, as well as ensuring the correct application of clause 38.

Recommendation

That the submission be declined.

Issue: No conceptual basis for voucher policy proposal

Clause 37

Submission
(Submission 4 - ICANZ)

From a policy perspective there appears to be no conceptual basis for a distinction between a voucher for goods and voucher for services. In some respects a voucher will in itself be "goods".

Comment

As noted above, the issues raised by the ICANZ have a wider scope than the legislation before the Committee. The submission is similar to an earlier submission by the Institute on the GST discussion document and anticipates work currently being considered by officials as part of the post-implementation review of GST.

Recommendation

None.

OTHER POLICY ISSUES NOT IN BILL

THIN CAPITALISATION – INCLUSION OF LEASES IN ASSET BASE

Issue: Rules for measuring New Zealand assets

Submission
(2 – KPMG)

An amendment should be made, with retrospective effect to the commencement of the thin capitalisation rules, to include finance and specified leases within the definition of total assets when measuring the debt percentage of a New Zealand group.

Comment

The submission does not relate to any matter contained in the bill. Further, as outlined below, the appropriate solution is not clear-cut. It is recommended, therefore, that the issue not be addressed in this bill. Officials will, however, analyse and consult with the submission-maker further, with a view to developing an appropriate solution.

The thin capitalisation rules can deny companies a deduction for interest expense if their New Zealand assets are funded excessively by debt. The amount of debt is measured based on tax principles, but assets are measured instead using generally accepted accounting principles (GAAP). The latter aim to reduce compliance costs by allowing taxpayers to use information in existing financial statements, but the trade-off is a less accurate measurement of debt to asset levels.

Finance leases are an alternative to debt for financing the acquisition of an asset. Many finance leases have, therefore, been brought within the ambit of the thin capitalisation rules, as if they were tax debt. However, as the submission points out, the use of GAAP as the basis for measuring assets will not always result in the corresponding asset being included in the group debt percentage calculation.

Officials confirm that this was not an intended policy effect, but is an unforeseen consequence of the trade-off inherent in using GAAP. Officials agree, however, that leases deserve further attention. Unlike normal issues arising from using GAAP, which relate to straight asset valuations, the issue here is that assets and debt matched in a company's balance sheet are not similarly matched in its thin capitalisation calculations.

Officials note, however, that the solution will not be as clear-cut as the submission suggests. For one, the leases in question do not actually fall out of the thin capitalisation calculations. Rather, if GAAP does not treat the asset as "owned" by the lessee, it will still be included in the assets of the lessor. Retrospective application is also unclear. Before the recent amendment of the accrual rules, some lessees would have benefited from having leased assets treated as assets while not having the lease treated as debt. Consequently, correcting the treatment of leases retrospectively could disadvantage some taxpayers.

Recommendation

That the submission be declined, but will be considered further by officials.

DEPRECIABLE INTANGIBLE PROPERTY - CASINO PREMISES LICENCES

Issue: Including casino premises licences in the Income Tax Act's schedule of depreciable intangible property

Submission

(9W - Mr Declan Mordaunt, PricewaterhouseCoopers)

A casino premises licence granted under the Casino Control Act 1990 meets the definition of depreciable intangible property and is intangible property of a type listed in Schedule 17 of the Income Tax Act 1994.Therefore it is appropriate for such licences to be included in Schedule 17. Licences should be included with effect from the date the Casino Control Act 1990 was enacted (1 August 1990).

Comment

The submission does not relate to any amendment proposed in the bill.

It may be appropriate for casino premises licences to be included in the Income Tax Act's schedule of depreciable intangible property, but further work is required to confirm this. In the meantime, officials note that neither Schedule 17 nor its predecessor was in existence in August 1990.

Recommendation

That the submission be declined pending further work.

REMEDIAL ISSUES

TRADING STOCK

Issue: Restricting the rule on transfer of EFAs to transfers between residents

Clause 4

Submission
(4 - ICANZ)

The restriction is appropriate, but the application date should be the date of introduction of the trading stock rules rather than 20 May 1999.

Comment

Officials consider that 20 May 1999 is a more suitable application date because an earlier date might in this case penalise some taxpayers.

Recommendation

That the submission be declined.

Issue: Appropriateness of association test in definition of "small taxpayer"

Clause 26(5)

Submission
(4 - ICANZ)

Narrowing the associated persons test for small taxpayers is appropriate, but is there a need for an associated person test at all? A targeted anti-avoidance rule would fulfil the same purpose with a lower compliance cost.

Comment

Officials agree that the proposed associated person rule is arbitrary in nature and that it might be possible to devise a targeted anti-avoidance rule which expressed the policy underlying the rule more effectively. However, further work would be required to develop such a rule.

In the meantime, the proposed rule is effective in significantly limiting the definition of "association".

Recommendation

That the submission be declined pending further work.

TRANSFER PRICING

Issue: Application of transfer pricing rules to interest-free loans

Clause 9

Submission
(4 – ICANZ)

Section GD 13(5) should explicitly state that the transfer pricing rules do not apply to interest-free loans made to taxable New Zealand residents, otherwise the interface with other rules that exempt income could trigger the application of the transfer pricing rules.

Comment

Section GD 13(4) allows the transfer pricing rules to apply to transactions when a non-resident makes a supply to New Zealand for inadequate consideration. Commonly, this would result in additional non-resident withholding tax being imposed.

In many cases, however, the additional tax revenue would be more than offset by the tax benefit to the New Zealand recipient when it took a deduction on the increased transfer price. If the overall effect of applying the transfer pricing rules would be a loss of revenue, section GD 13(5) prevents the transfer pricing rules applying.

When interest expense on debt is non-deductible, there would be a revenue gain from applying the transfer pricing rules to an interest-free loan. The policy intent was that the transfer pricing rules would apply in such situations – this includes the situations outlined in the submission. The amendment sought by the submission is, therefore, inconsistent with the policy intent of the rules.

Recommendation

That the submission be declined.

TAX SIMPLIFICATION

Issue: Tax code specified by Inland Revenue

Submission
(ICANZ)

The proposed amendment to section NC 12A of the Income Tax Act 1994 should be clarified to specify at what point an employer is required to change an employee's tax code.

Comment

The proposed amendment ensures that an employer must apply a tax code specified by the Commissioner to an employee's wages or salary until the employee's circumstances change.

As indicated in the submission, an employer will be aware of a change in an employee's circumstances only if the employer receives notification, either by the employee or Inland Revenue. Officials support this submission and recommend that the amendment be clarified to incorporate this point.

Recommendation

That the submission be accepted.

Issue: Incorrect tax code references

Submission
(Matter raised by officials)

References to old tax codes should be corrected.

Comment

Tax codes were changed as part of recent tax simplification initiatives. Officials have subsequently identified that various consequential amendments are required to the Income Tax Act 1994 to correct incorrect tax code references.

Recommendation

That the submission be accepted.

Issue: Housekeeper and donations rebate

Submission
(Matter raised by officials)

- Section 41A of the Tax Administration Act 1994 (TAA) should be amended to allow eligibility for housekeeper and donation rebates to be calculated using the income a taxpayer receives in the year in which the payment or donation was made.

- Section 41A of the TAA should be amended so that housekeeper and donation rebates continue to be claimable only after the end of the income year in which they were made.

- Section 41A of the TAA should be amended to state that the period within which taxpayers with early balance dates can claim these rebates is from 1 April following their balance date.

- The housekeeper and donation rebates should be removed from the definition of "allowable rebates" in section OB 1 of the Income Tax Act for the purposes of section BC 8.

Comment

Section 41A of the Tax Administration Act 1994 states that income from the previous year is to be used when establishing eligibility for housekeeper and donation rebates. However, since this legislation was enacted Inland Revenue has developed systems that in many cases will allow a taxpayer's current year income to be used. Officials propose, therefore, that current year income be used to determine eligibility, when appropriate.

The current practice, and the policy that the Government consulted on in the discussion document *Simplifying taxpayer requirements,* is that housekeeper and donation rebates can be claimed only after the end of the income year. Officials have identified that the legislation unintentionally enables taxpayers to claim these rebates during an income year in which they make a payment or donation. Officials propose that this legislation be amended so that these rebates can be claimed only from the end of the income year.

For taxpayers with early balance dates, officials note that it is not, at present, administratively feasible to implement the housekeeper and donation rebate process before 1 April 2000. Therefore officials consider that a further amendment is required to ensure that the period within which these taxpayers can claim these rebates begins from 1 April 2000 following their balance date. Officials note that this will affect fewer than 200 taxpayers.

Section BC 8 of the Income Tax Act 1994 describes the process of calculating a taxpayer's income tax liability and states that allowable rebates must be subtracted from a taxpayer's unadjusted income tax liability to determine the adjusted tax liability. The new rebate claim process, however, involves separating these rebates from the calculation of a taxpayer's tax liability. To ensure that the legislation is consistent with the new process, officials recommend that the definition of allowable rebates be amended to remove references to the housekeeper and donation rebates.

Recommendation

That the submission be accepted.

Issue: Issuing income statements

Submission
(Matter raised by officials)

- Amendments should be made to section 33A of the TAA to clarify further the rules on who should be required to file tax returns, who is required to receive income statements, and who is not required to have contact with Inland Revenue.

- The words "or received" should be removed from section 80B (1) of the TAA to remove ambiguity.

Comment

As part of the simplification initiatives, taxpayers with relatively simple tax affairs are not required to square up their tax affairs. To prevent taxpayers from undergoing tax square-ups for minor amounts, a $200 threshold was introduced whereby taxpayers are not required to receive income statements if they receive less than $200 of income that has been taxed incorrectly. An amendment should be made to ensure that the $200 income threshold applies to taxpayers to whom the PAYE rules have been incorrectly applied, for example, because of the use of an incorrect tax code.

To prevent unnecessary contact between taxpayers and Inland Revenue, taxpayers who receive significant amounts of income about which the Commissioner has no knowledge should declare this income on a return of income rather than receive an income statement. This should include taxpayers who receive interest or dividend income from outside New Zealand, where that income has had no withholding tax deducted, should file returns of income. Similarly, taxpayers who receive over $200 interest or dividend income from outside New Zealand, where that income has had withholding tax deducted, should be required to file a return of income.

An amendment is required so that taxpayers who request a square-up of their tax affairs part-way through an income year must file a return of income rather than request an income statement. This is because the Commissioner may not possess all the relevant information at the time the taxpayer wishes to have his or her tax affairs squared up.

An amendment is required to state expressly that a taxpayer is not required to request an income statement if an incorrect deduction of resident withholding tax occurs solely because of an error on the part of the interest payer. This is because taxpayers may be unaware of incorrect tax deductions from interest income, so a requirement to request an income statement is unreasonable.

A consequential amendment is required to replace the term "absentee" with the term "non-resident" following a similar amendment to section KC 1(2) of the Income tax Act 1994 in the Taxation (Accrual Rules and other Remedial Matters) Act 1999.

Taxpayers who receive income statements only because of an error (for example because another taxpayer mistakenly uses an incorrect IRD number) should not automatically be issued another corrected income statement unless they specifically request one. This ensures that taxpayers, who in the absence of errors would not otherwise be issued with income statements, are not forced to undergo a square-up of their tax affairs.

Recommendation

That the submission be accepted.

Issue: Family assistance

Submission
(Matter raised by officials)

Amendments should be made to part KD of the Income Tax Act 1994 to reflect that the new income statement process will incorporate the family assistance square-up. Amendments are also required to allow for the new one-off registration process.

Comment

The existing family assistance legislation refers to filing returns of income. However, with the introduction of the income statement process the legislation requires amending to reflect the inclusion of family assistance square-ups.

Amendments are also required to ensure that the legislation is consistent with the new policy of a one-off family assistance registration which replaces the old system that required family assistance claimants to re-register every income year.

Recommendation

That the submission be accepted.

Issue: Particulars to be included on income statements

Submission
(Matter raised by officials)

Section 80E of the TAA should be amended to clarify the particulars that the Commissioner is required to include on an income statement.

Comment

An amendment is required to expressly allow Inland Revenue to include on an income statement only those details that it holds at the time an income statement is issued. This amendment is necessary because it is not possible for the department to determine whether it holds all the information required for an income statement at any point in time before a taxpayer is contacted.

Recommendation

That the submission be accepted.

Issue: Compulsory direct crediting of tax refunds

Submission
(Matter raised by officials)

Section 184A of the Tax Administration Act 1994 should be amended to ensure that Inland Revenue is not required to direct credit all tax refunds for all tax types from 1 April 2000.

Comment

Section 184A of the Tax Administration Act 1994 requires that all tax refunds must be made by direct credit to a taxpayer's bank account, unless doing so would result in undue hardship for a taxpayer. This provision takes effect from 1 April 2000 and applies to all tax types, including GST and FBT.

Inland Revenue is not currently in a position to implement compulsory direct crediting of refunds for all tax types by 1 April 2000. It does, however, consider that a phased implementation for different tax types would provide benefits both to taxpayers and to Inland Revenue.

Phased implementation of compulsory direct crediting would give taxpayers more time to provide Inland Revenue with up-to-date bank account details. It would also further allow the department to consult with taxpayers and develop practices that suit taxpayers' needs. This would allow taxpayers with complex business activities further time to make any necessary arrangements to deal with direct-credited refunds of different tax types. The phased implementation approach would also provide the department with more time to educate taxpayers about direct crediting.

ICANZ has been consulted and agrees with the proposed amendment. ICANZ is concerned that the existing timeframe for implementing compulsory direct crediting does not provide adequate time to ensure that Inland Revenue will be able to operate this system with sufficient accuracy.

The proposed amendment would allow the current practice of paying many refunds by cheque to continue and, therefore, would not increase compliance costs. Compliance cost reductions that would result from direct-crediting refunds to taxpayers who currently receive cheques, however, would not be realised until compulsory direct crediting is fully implemented.

Officials consider that the proposed amendment should apply from the date that the Taxation (Annual Rates and other Remedial Matters) Bill receives Royal Assent. To allow Inland Revenue the necessary flexibility to determine the dates when direct crediting of refunds can be implemented, section 184A should come into force by Order in Council to allow for different application dates for each tax types.

Recommendation

That the submission be accepted.

USE OF MONEY INTEREST ON FOREIGN INVESTOR TAX CREDITS

Issue: Use of money interest on credit applied to earlier income year

Clause 34

Submission
(4 – ICANZ)

- When a foreign investor tax credit is applied to an earlier income year, use of money interest should still be credited from the date an election is made to carry back the credit until it is refunded.

- A cross-reference error in section OB 1 should be corrected.

Comment

The amendment ensures that when taxpayers carry back and apply a foreign investor tax credit against an earlier income year, that credit does not give rise to use of money interest. This reflects that the carry-back rule is merely a mechanism for allowing a refund to be issued, and does not reflect that the Commissioner has had the use of any money in that earlier year.

The submission does not dispute the rationale for the amendment. It suggests, however, that the Commissioner should credit interest from the date on which the Commissioner is able, under the law, to issue a refund until it is actually issued.

Officials do not consider that such an amendment would be appropriate. The carry-back rule is a concessionary rule, so that taxpayers do not face a cash flow disadvantage when funding a supplementary dividend. In the absence of such concessionary treatment, taxpayers would instead merely be allowed to carry an unutilised credit forward, having no access to the cash benefit of the tax credit nor receiving use of money interest in the interim. Officials recommend, therefore, that this point in the submission be declined.

Officials agree with the submission that a cross-reference error in section OB 1 be corrected.

Recommendation

That the cross-reference error be corrected, but that the submission otherwise be declined.

OTHER REMEDIAL ISSUES NOT IN BILL

TAXATION OF FINANCIAL ARRANGEMENTS

General Comment

The rules that govern the taxation of financial arrangements were recently reformed by the enactment of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999. The amendments proposed here merely fine-tune the earlier changes.

Issue: Non-residents becoming resident

Submission
(Matter raised by officials)

It should be clarified how subpart EH applies to a person who is non-resident and becomes resident after 20 May 1999.

Comment

Under section EH 19, Division 2 applies to financial arrangements that a person enters into on or after 20 May 1999 (the date of enactment of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999).

Under Division 1, if a person who was non-resident becomes a resident of New Zealand the person is treated as acquiring the financial arrangement on the date the person become resident for an arm's length value on that date (section EH 16(2)(b)).

A provision similar to section EH 16(2)(b) was omitted in error from Division 2.

A section should be inserted in Division 2 providing that if a non-resident becomes resident after 20 May 1999 and the person is a party to financial arrangements the person is treated as having acquired those financial arrangements at the time the person becomes resident for arm's length consideration.

Recommendation

That the submission be accepted.

Issue: Section EH 18

Submission
(Matter raised with officials by ICANZ)

The relationship between Part EH Division 1 and the other provisions of the Act needs to be clarified.

Comment

Section EH 18 applies to financial arrangements to which Division 1 applies (those entered into before 20 May 1999 for which no transitional adjustment has been made).

Section EH 18 is intended to apply to a person who is holder or issuer of a financial arrangement to which Division 1 applies if other provisions of the Act would have applied to that financial arrangement, and those provisions had not been amended by the Taxation (Accrual Rules and Other Remedial Matters) Act 1999. In that case the provisions should apply as they were before the enactment of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999.

As section EH 18 is currently drafted, this is unclear. The section should be clarified.

Recommendation

That the submission be accepted.

Issue: Section EH 26(3)

Submission
(Matter raised by officials)

Section EH 26(3) should be amended so that the value of the property transferred is determined by applying section EH 48(3) in alphabetical order until a paragraph applies.

Comment

Section EH 26(3) determines the value for which property is treated as being transferred under other provisions of the Act by referring to the paragraphs of section EH 48(3). The paragraphs are applied in alphabetical order. It should be made clear that the paragraphs should be applied in alphabetical order until a paragraph applies.

Recommendation

That the submission be accepted.

Issue: Section EH 31

Submission
(Matter raised by officials)

Under section EH 31 a cash basis person can elect to apply a spreading method. There is no provision for the revocation of this election and there should be.

Comment

Under section EH 31 a cash basis person may elect to use a spreading method to calculate income or expenditure in respect of the financial arrangements to which they are a party. The election must be made for all financial arrangements the person is a party to at the time of the election and any financial arrangements entered into in subsequent years. The person must continue to use the spreading method for those financial arrangements until the financial arrangements mature.

There should be a provision allowing taxpayers to revoke the election and for the revocation to apply by giving notice to the Commissioner. Once notice had been given the revocation would apply to financial arrangements entered into in the year following the income year in which the notice is given.

Recommendation

That the submission be accepted.

Issue: Section EH 48(2)

Submission
(Matter raised by officials)

Section EH 48(2) should be clarified.

Comment

Section EH 48(2) states:

> *For an original party to an agreement for the sale and purchase of property or services or a specified option, not being an agreement or an option that has lapsed or does not proceed, a finance lease or a hire purchase agreement, the consideration for the property or services is determined by applying subsection (3)(a) to (d) in alphabetical order until a paragraph applies.*

The section can be read in two ways. The first is "For an original party to any agreement for the sale and purchase of property or services or a specified option, not being … a finance lease or a hire purchase agreement …". The second way is "For an original party to any agreement for the sale and purchase of property or services or a specified option, … a finance lease or a hire purchase agreement …". The second interpretation is correct, and the section should be clarified to reflect this.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

It should be clarified that if the consideration for a financial arrangement includes property or services regardless of whether the consideration is paid to the person or paid by the person, the value of the property or services is determined under section EH 48(2) and (3).

Comment

Consideration is defined in section EH 48. If consideration includes property or services the value of the property or services is determined under sections EH 48(2) and (3). It is unclear whether the definition of consideration applies to the consideration paid to the person or the consideration paid by the person, or to both.

It should be made clear that if the consideration includes property or services the regardless of whether the consideration is paid to the person or paid by the person, the value of the property or services is determined under section EH 48(2) and (3).

Recommendation

That the submission be accepted.

Issue: Section EH 48(3)(a)

Submission
(Matter raised by officials)

Section EH 48(3)(a) should be amended so that the amount determined under the "lowest price" paragraph is the amount the parties would have agreed if payment had been required in full at the time the first right in the property was transferred or the services provided.

Comment

"Consideration" is defined in section EH 48. As currently drafted, paragraph (a) refers to the lowest price "the parties would have agreed, on the date the agreement was entered into or the specified option was granted, if payment was required in full at the time the first right in the contracted property was transferred or the services provided".

This paragraph would never apply as payment "was not required in full at the time the first right" was transferred. The section should be amended to refer to the lowest price that would have been paid if payment had been made in full at that time.

Recommendation

That the submission be accepted.

Issue: Section EO 2A

Submission
(Matter raised by officials)

Section EO 2A should set out how a deduction under an operating lease is spread rather than the grounds for allowing a deduction.

Comment

Section EO 2A provides that a lessee "is allowed a deduction for expenditure incurred in making lease payments under an operating lease". Section EO 2A should set out how the deduction is calculated rather than providing the grounds for the deduction. The deduction should be subject to the normal deductibility tests.

Recommendation

That the submission be accepted.

Issue: Section FC 8A

Submission
(Matter raised by officials)

Section FC 8A should be clarified so that it is clear how the rules recharacterise a lease into financing transaction.

Comment

Under section FC 8A a lease is treated as a sale of the lease asset from the lessor to the lessee at the beginning of the lease. The lessor is also treated as advancing a loan to the lessee which the lessee uses to purchase the lease asset. As the legislation is currently drafted, the loan from the lessor is for the lessor's disposition value, and the lessee uses the loan to purchase the lease asset for the lessee's acquisition cost. The lessee's acquisition costs include installation fees incurred by the lessee, so the loan may only partially fund the acquisition of the lease asset.

The section should be amended so that the leasing of an asset is treated as a sale of the asset from the lessor to the lessee, the lessor is also treated as giving the lessee a loan, and the lessee is treated as using the loan to purchase the lease asset. The value of the loan for the lessor is the lessor's disposition value and for the lessee the lessee's acquisition cost.

Recommendation

That the recommendation be accepted.

Issue: Section FC 8C

Submission
(Matter raised by officials)

Section FC 8C(2) is not necessary because the amount the section treats as income is already income under the accrual rules.

Comment

Section FC 8C deals with early terminations of leases. If a lease terminates early, and the lease asset is returned to the lessor, the lease asset is treated as being sold to the lessor "for the amount by which the outstanding balance of the loan on the date of termination is more than the amount the lessee paid to be released from his or her obligations under the lease". Under section FC 8C(2) if the amount paid by the lessee to be released from the loan exceeds the outstanding balance, the excess is gross income of the lessor. This section is not necessary as the income would arise under the accrual rules.

Recommendation

That the submission be accepted.

Issue: Sections FC 8F and FC 10(6A)

Submission
(Matter raised by officials)

The words "for the purpose of this Act" at the beginning of sections FC 8F and FC 10(6A) are redundant.

Recommendation

That the submission be accepted.

Issue: Section FC 8H

Submission
(Matter raised by officials)

It should be clarified that an adjustment under section FC 8I is required only if an operating lease becomes a finance lease as a result of the lease term becoming longer than 75 percent of the estimated useful life of the lease asset.

Comment

Section FC 8H provides that a lessor and a lessee must make an adjustment under section FC 8I if

(a) their lease is a consecutive or successive lease and is deemed to be one lease under the definition of ‘lease’; and

(b) they did not contemplate, at the start of the lease term, that the lease would be for more than 75 percent of the lease asset’s estimated useful life.

It is not clear that the adjustment should only be made if, as a result of the extension of the lease, the total lease term becomes a period longer than 75 percent of the lease asset’s estimated useful life. This should be made clear in the legislation.

Recommendation

That the submission be accepted.

Issue: Definition of “lease term”

Submission
(Matter raised by officials)

The definition of “lease term” in section OB 1 refers to paragraph (d) of the definition of “lease”. The reference should be to paragraph (f).

Comment

The reference is incorrect and should be corrected.

Recommendation

That the submission be accepted.

TAX EXEMPTION OF PORTABLE NEW ZEALAND SUPERANNUATION AND VETERAN'S PENSION

Submission
(Matter raised by officials)

- The definitions of "portable New Zealand superannuation" and "portable veteran's pension" in section OB1 of the Income Tax Act 1994 and section 2 of the Income Tax Act 1976 should be amended to include payments made under section 17B of the Social Welfare (Transitional Provisions) Act 1990. These amendments should be backdated to 30 June 1993.

- These definitions in section OB1 of the Income Tax Act 1994 should also be amended to include payments made under the new section 17BA inserted by the Social Welfare (Transitional Provisions – Special Portability Arrangement) Amendment Act, which comes into force on 1 October 1999.

Comment

Section 17B of the Social Welfare (Transitional Provisions) Act 1990 provides for the payment of New Zealand superannuation and veteran's pension to entitled persons who are resident in the Cook Islands, Niue, or Tokelau. This provision came into force on 30 June 1993.

The Social Welfare (Transitional Provisions – Special Portability Arrangement) Amendment Act, enacted in July 1999, repeals the current section 17B and introduces a new section 17BA. This extends the special portability arrangement to a number of Pacific Island nations. This legislation comes into force on 1 October 1999.

The tax treatment of the payments under the special portability arrangement has always been that they are exempt from tax in New Zealand. However, the Income Tax Act 1994 does not contain a provision exempting payments of New Zealand superannuation or veteran's pension under the existing special portability arrangement to the Cook Islands, Niue or Tokelau.

The Income Tax Act exempts "any portable New Zealand superannuation or portable veteran's pension" from tax. However, the definitions of these terms in section OB 1 restricts them to payments made under sections 17 or 19 of the Social Welfare (Transitional Provisions) Act. There appears to have been an oversight when section 17B was enacted, in 1993, so that the definitions were not amended to include section 17B.

Officials recommend that the definitions of "portable New Zealand superannuation" and "portable veteran's pension" in section OB1 of the Income Tax Act 1994 and section 2 of the Income Tax Act 1976 be amended to include payments made under section 17B of the Social Welfare (Transitional Provisions) Act 1990, since 30 June 1993. These definitions in section OB1 of the Income Tax Act 1994 should also be amended to include payments to be made under the new section 17BA.

Recommendation

That the submission be accepted.

USE OF MONEY INTEREST AND SHORT OR LATE PAID PROVISIONAL TAX

Submission
(Matter raised by officials)

An amendment should be made to the use of money interest provisions that relate to short-paid or late-paid provisional tax, to correct an error that gives an unintended result.

Comment

Section 120K(4B) of the Tax Administration Act 1994 was inserted during the select committee stage of the Taxation (Remedial Provisions) Bill 1997 in response to a late concern from a taxpayer that use of money interest could be imposed on "safe-harboured" taxpayers to the extent that they have paid less tax than required by the provisional tax formula at a due date. The intention of section 120K(4B) was to prevent use of money interest being imposed on late-paid or short-paid provisional tax paid by a safe-harboured taxpayer. However, what the provision actually does is prevent interest being imposed on late-paid or short-paid provisional tax paid by all taxpayers, whether safe-harboured or not. Use of money interest begins at the terminal tax date. This result was clearly not intended.

Officials consider that this section should be amended to ensure that it is consistent with the original policy intent. At a practical level the Commissioner has been both paying and charging interest in accordance with the policy intent and this position needs to be confirmed.

Officials propose that the amendment apply from the 1997-1998 income year. We also propose a saving provision to protect taxpayers who have relied on the literal interpretation of this section, provided that such taxpayers have informed the Commissioner in writing or in a tax return by the report-back date to the select committee for the Taxation (Annual Rates and Remedial Matters) Bill.

Recommendation

That the submission be accepted.

EFFECTIVE DATES FOR USE OF MONEY INTEREST RULES

Submission
(Matter raised by officials)

- Sections 128(6) and 138I(5) of the Tax Administration Act 1994 should be amended to provide that if the competent objection or challenge relates to the 1996-97 income year, interest must be calculated on deferrable or non-deferrable tax from the later of the day on which the notice of assessment was issued or the day after the due date.

- The application date for sections 106 and 109 of the Taxation (Accrual Rules and Other Remedial Matters) Act, which inserted sections 128(5) and (6) and 138I(4) and (5), should be amended to 1 April 1997, rather than the date that Act received Royal assent (20 May 1999).

Comment

The proposed amendments are aimed at correcting a drafting error in the Taxation (Accrual Rules and Other Remedial Matters) Act 1999.

The compliance and penalties legislation of 1996 introduced new use of money interest rules, with application to tax liabilities and rights that arose in respect of the 1997-98 and subsequent income years.

When a taxpayer enters a dispute with the department, he or she is required to pay 50 percent of the amount of tax assessed by Inland Revenue as payable, on the due date. This is known as the non-deferrable tax. The remaining 50 percent of tax in dispute is not due until the 30th day after the day of determination of final liability, and is known as deferrable tax.

Sections 128(5) and 138I(4) of the Tax Administration Act, inserted by the Taxation (Accrual Rules and Other Remedial Matters) Act 1999, provide that the new use of money interest rules apply from 1 April 1997 to calculate the interest payable on deferrable and non-deferrable tax. This is irrespective of whether the dispute relates to an income year before the 1997-98 income year. However, the interest provisions were amended to ensure that taxpayers were not disadvantaged as a result of these amendments applying from 1 April 1997, by allowing the old rules to apply in certain circumstances for the 1996/97 income year and earlier income years.

Sections 128(6) and 138I(5) ensure that if a dispute relates to the 1995/96 or an earlier income year, the old rule as to when interest begins will apply. Thus interest will not begin until after the date that the period of deferral starts, which is the later of; (a) the date on which the notice of assessment was issued; and (b) the day after the due date. Under the new rules, interest begins on the day after the due date for the payment of tax.

The effect of sections 128(6) and 138I(5) is that for disputes relating to the 1996/97 income year, interest begins on the day after the due date, which is usually 7/2/98 for the 1996/97 return. This was never the intention. For all income years before the 1997-98 income year it was intended that although the new rules should apply, interest should not begin until the date under the old rules. Consequently, it is proposed that sections 128(6) and 138I(5) be amended to replace 1995/96 or an earlier income year with 1996/97 or an earlier income year.

Sections 128(5) and 138I(4) of the Tax Administration Act provide that the new use of money interest rules apply from 1 April 1997 to calculate the interest payable on deferrable and non-deferrable tax. However, because sections 106 and 109 of the Taxation (Accrual Rules and Other Remedial Matters) Act, which inserted these sections, do not come into effect until the date that Act received Royal assent (20 May 1999), this intention is not given effect.

Recommendations

- That an amendment be made to sections 128(6) and 138I(5) of the Tax Administration Act 1994 to provide that if the competent objection relates to the 1996-97 income year, interest must be calculated from the later of the date on which the notice of assessment was issued, or the day after the due date.

- That the application date for sections 106 and 109 of the Taxation (Accrual Rules and Other Remedial Matters) Act be amended to 1 April 1997.

GST AND BENEFITS UNDER ACCIDENT INSURANCE POLICIES

Issue: GST treatment of accident insurance policies

Clause 36A

Submission
(Matter raised by officials)

The supply of an accident insurance policy under the Accident Insurance Act 1998 should be treated as the supply of general insurance services only for GST purposes with effect from 1 April 1999 rather than 1 July 1999 as first proposed to the Committee.

Comment

Under the accident compensation reforms employers must provide accident insurance for their employees under contracts which, for GST purposes, comprise both a general insurance (taxable) and a minimal life insurance (exempt) component.

This means that insurers and employers would have to make apportionments for GST purposes, imposing high compliance costs upon both insurers and employers to ensure a technically correct GST treatment. Inland Revenue would incur higher administrative costs to monitor the compliance of insurers and employers with the requirement.

After consultation it is proposed that the provision of all benefits under accident insurance policies be treated as being in respect of supplies of general insurance for GST purposes and, therefore, taxable by excluding the provision of the minimal life benefits from the definition of a life insurance contract in section 3(2) of the Goods and Services Tax Act 1985.

Insurers have advised that the amendment should apply from 1 April 1999, not 1 July 1999 as first proposed, because 1 April is the earliest possible date that insurers could offer accident insurance policies to employers under the Accident Insurance Act.

Recommendation

That the submission be accepted.

MINOR REMEDIAL AMENDMENTS

Income Tax Act 1994

Submission
(10W - PriceWaterhouseCoopers)

Section DJ 1(b)(v) should be amended. The words "commencing on or after 1st day of April 1993 and" should be inserted into section DJ 1(b)(v) after the words "in any income year".

Comment

The submission does not relate to any amendment proposed in the bill.

Recommendation

That the submission be declined pending further work.

Submission
(Matter raised by officials)

Sections KD 4(3), KD 5AB and KD 5AC should be repealed.

Comment

Section KD 4(3) relates to the time when employers paid family support to employees and were reimbursed by Inland Revenue. Because employers no longer pay family support, the provision should be repealed.

Sections KD 5AB and KD 5AC are transitional provisions for interim instalments of the family credit that were required as a result of changes in the rates of family assistance. Section KD 5AB relates to the period 1 July 1997 to 31 December 1997, and section KD 5AC relates to the period 1 January 1998 to 30 June 1998. As these sections are now spent, they should be repealed.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

Section KD 4(2)(b) should be amended to remove redundant words.

Comment

Family assistance may be paid in interim instalments or claimed at the end of the income year as a credit of tax in a taxpayer's return of income. Section KD 4(2)(b) refers to the Commissioner establishing that a taxpayer received an interim instalment of family assistance during the income year "otherwise than by way of any such crediting in payment of provisional tax". These words are redundant and should be removed as the Commissioner no longer offsets the credits of tax against provisional tax payments due.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

Transposed section references in section NG 4 should be corrected.

Comment

The references to section NG 3(1)(b) and section NG 3(1)(c) in section NG 4 are transposed and the error should be corrected, with effect from the 1997/98 income year.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

References in the Income Tax Act 1994 and the Income Tax Act 1976 to "state-owned enterprise" should be changed to "state enterprise".

Comment

Various provisions of the Income Tax Act 1994 refer to a "state-owned enterprise". They should be amended to refer to the correct terminology, "state enterprise".

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

The definition of "airport operator" definition should be updated in the light of the Civil Aviation Act 1990.

Comment

The definition of "airport operator" refers to the Minister of Civil Aviation and Meteorological Services. The Civil Aviation Act 1990 provides that any reference to the Minister of Civil Aviation and Meteorological Services is to be read as a reference to the Minister of Transport. Since the Income Tax Act 1994 was enacted after the Civil Aviation Act 1990, officials consider that the "airport operator" definition should correctly refer to the Minister of Transport.

These amendment should apply from 1 April 1995, the date the Income Tax Act 1994 came into force.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

A section reference in the definition of "consideration" should be clarified.

Comment

Paragraph (c) of the definition of "consideration" refers to section FE 6(b)(i), whereas it should refer to section FE 6(6)(b)(i) and be amended accordingly.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

An incorrect cross reference in the definition of "member" in section OB 1 should be corrected.

Comment

The definition of "member" in section OB 1 incorrectly refers to section LC 1(5). The correct reference should be section LC 1(6).

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

One of the two paragraphs numbered (d) in the "property" definition should be renumbered as paragraph (e).

Comment

Section 55 of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 amended section OB 1 by adding a new paragraph (d) into the definition of "property". However, this amendment ignored an earlier amendment by the Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Act 1998 that had already inserted a paragraph (d) in that definition. Because it is not intended to repeal the existing paragraph (d), the newly added paragraph (d) should be renumbered as paragraph (e).

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

An incorrect cross reference in the definition of "residual income tax" in section OB 1 should be corrected.

Comment

The definition of "member" in section OB 1 incorrectly refers to section LE 2(6)(b). The correct reference should be section LE 2(4)(b), with effect from 12 December 1995.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

One of the two subparagraphs numbered (xi) in the definition of "tax" should be renumbered as subparagraph (xii).

Comment

Section 62 of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 amended section 3 of the Tax Administration Act 1994 by introducing a new subparagraph (xi) into the definition of "tax". However, this amendment ignored an earlier amendment by the Taxation (Simplification and Other Remedial Matters) Act 1998 that had already inserted a subparagraph (xi) in that definition. Because it is not intended to repeal the existing subparagraph (xi), the newly added subparagraph (xi) should be renumbered as subparagraph (xii).

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

The proviso to section OD 8(3) should be corrected.

Comment

Section 59 (1)(c) of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 sought to insert sections DM 1A, EH 7, EH 53, EL 7(3)(b) and EO 4A in the proviso to section OD 8(3). These sections were not inserted correctly, and an amendment to add them to the proviso should be made.

Recommendation

That the submission be accepted.

Tax Administration Act 1994

Submission
(Matter raised by officials)

An incorrect cross-reference in section 120K(4A)(c) should be corrected.

Comment

In section 120K(4A)(c), the reference to section MB 5(11) is incorrect as that section does not exist. The correct reference should be MB 5A. The correction should be made with effect from the date of enactment of this legislation.

Recommendation

That the submission be accepted.