Taxation (FBT, SSCWT and Remedial Matters) Bill

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

4 July 2000

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SUPERANNUATION FUND WITHDRAWAL TAX

OVERVIEW OF SUBMISSIONS

Submissions received

The Seafarers Union (2)
The Seafarers Retirement Fund (3)
National Provident (4)
New Zealand Law Society (6W)
Works Superannuation Scheme (8W) – supports submission 14
Trustees of the Mobil Employee Retirement Plan (9)
Westpac Trust Financial Services (11W)
PricewaterhouseCoopers (12, 12A)
Investment Savings and Insurance Association of New Zealand (ISI) (13)
Association of Superannuation Funds of New Zealand (ASFONZ) (14)
New Zealand Employers' Federation (15)
Tower Investment Savings (16)
New Zealand Dairy Board (17W)
New Zealand Society of Actuaries (NZSA) (18)
Institute of Chartered Accountants of New Zealand (ICANZ) (19)
Phillips Fox (20)
Watson Wyatt (22)
Deloitte Touche Tohmatsu (29W)

General comment

The bulk of the submissions on this bill were devoted to the proposed superannuation fund withdrawal tax. Most expressed concern about the application of the withdrawal tax to people on incomes below $60,000. Specific concerns were that the SSCWT rate was not being reduced for people on incomes lower than $38,000, and that the proposed application date for the changes, 1 April 2000, was too early.

Other concerns expressed in submissions related to the lack of consultation in developing the policy, and the choice of an income tax mechanism over a withholding tax mechanism, with its resulting problems associated with the provisional tax and use of money interest rules.

Officials consulted with the authors of two of the most substantial submissions on the proposals, the Institute of Chartered Accountants of New Zealand (ICANZ) and the Investment Savings and Insurance Association of New Zealand (ISI), to discuss their concerns. Our aim was to identify ways to achieve the anti-avoidance objective of the measure at a lower compliance cost than that imposed by the bill as introduced. For example, compliance costs will be lowered by deferring payment of the withdrawal tax one year to address the provisional tax and use of money interest concerns.

We also held a number of discussions with the Committee's adviser, Therese Turner, on the key issues raised in submissions. These meetings were helpful and constructive, especially in relation to the major issues raised in submissions on the fund withdrawal tax.

As a result of these and similar discussions, and further consideration of the proposals, officials have recommended changes to the draft legislation as it relates to the fund withdrawal tax. They are outlined in this report. Our main recommendations are to remove:

- the liability for the tax in relation to withdrawals by those on incomes of less than $60,000;

- liability for the tax in relation to withdrawals made up to the date the bill is reported back to Parliament; and

- the problems associated with provisional tax and use of money interest by deferring the income arising from a withdrawal until the following year.

We believe that with these changes the proposed legislation will still achieve the Government's objectives while being more acceptable to taxpayers. Superannuation funds which do not allow in-service withdrawals and lock in those withdrawals for two years, when subject to the two-year rule, will bear minimal, if any, increase in compliance costs.

The fund withdrawal tax is a key measure in the Government's programme to ensure that those earning over $60,000 do not avoid the new 39% marginal tax rate. The measure is not intended to raise revenue but to prevent avoidance. As such, the measure will be monitored. If it proves that significant levels of the fund withdrawal tax are being paid the Government will analyse the reasons for this and will increase the rate if necessary.

PURPOSE OF LEGISLATION

Issue: Statement of purpose of legislation

Submission
(19 – ICANZ)

It should be clearly stated by the Minister at the second reading of the bill, and in the *Tax Information Bulletin* which explains the legislation, that one of the purposes of the legislation is to provide taxpayers who receive income of more than $60,000 a year with an incentive to invest in a superannuation fund. This will alleviate a concern that Inland Revenue may seek to apply the general anti-avoidance rule to people who take up the incentive.

Comment

The measures are not intended as an incentive for saving for retirement, but are anti-avoidance in nature. The Government considers that its avoidance concerns can be addressed without the need for the 33 percent SSCWT rate to be increased.

While these measures are not intended as an incentive, they represent an approach which does not increase the barriers to people saving for their retirement. Other approaches to preventing avoidance by those earning over $60,000 would have placed an increased tax liability in some form on employer contributions, reducing incentives for long-term saving. The withdrawal tax only taxes employer contributions in cases where they are not used for long-term retirement savings.

Recommendation

That the submission be declined.

POLICY PROCESS

Issue: Generic tax policy process should be followed

Clauses 6, 10-14, 19

Submission
(14 – ASFONZ)

The proposed amendments should be removed from the bill and should go through the generic tax policy process. The withdrawal tax concept introduces an unnecessary compliance burden on trustees of superannuation funds.

Comment

The Government decided on the fund withdrawal tax after consultation with the Investment Savings and Insurance Association, the New Zealand Employers' Federation and the Institute of Chartered Accountants.

While this consultation was undertaken in a short period of time, this restriction on consultation reflected the need for these measures to be in place from 1 April 2000. Without this measure, high-income earners could divert part of their salary through a superannuation fund, paying tax at 33% on income which should have been taxed at 39%.

Significant delay in enactment of these measures is likely to lead to significant use of superannuation funds in the interim to avoid the 39% tax rate.

Recommendation

That the submission be declined.

OPTIONS OTHER THAN WITHDRAWAL TAX

Issue: "Cap" instead of withdrawal tax

Submission
(15 – Employers Federation)

The Government should consider "capping" employer contributions to superannuation schemes at, say, 10 percent of an employee's salary, with SSCWT remaining at 33%. Any contributions above this rate could be subject to a higher SSCWT rate, thus reducing incentives for employees to encourage their employers to substitute large superannuation contributions for salary and wages.

Comment

There are a number of potential approaches to preventing high-income earners from diverting part of their salary through a superannuation fund – for example, use of the fringe benefit tax rules, reliance on the Superannuation Schemes Act 1989, and a "cap" on employer contributions. Each of these approaches has advantages and disadvantages.

As these options were theoretically feasible, they were discussed with the industry and employer representatives. The current option was chosen as it was effective and supported by the superannuation industry during consultation. Its principal advantage over the cap approach, from the point of view of the Investment Savings and Insurance Association, is that no percentage limit is placed on those wanting to save for their retirement.

Recommendation

That the submission be declined.

INCOME TAX vs WITHHOLDING TAX MODEL

Issue: Withdrawal tax as a withholding tax rather than an income tax

Submission 1
(4 – NPF, 6 – NZLS, 12A – PricewaterhouseCoopers; 13 – ISI, 19 – ICANZ)

The withdrawal tax should be imposed as a withholding tax rather than an income tax. An income tax model results in the fund coming under the provisional tax rules, use of money interest applying, greater delay in remittance of the withdrawal tax to Inland Revenue, and the possibility of non-resident fund members being subject to double taxation. A withholding tax is a more appropriate basis for the withdrawal tax as it would ensure liability fell with the fund members and not the trustees.

Submission 2
(12A – PricewaterhouseCoopers, 16 - Tower)

If the income tax model is adopted, there should be no provisional tax or use of money interest liability. Amounts recovered from members making withdrawals could be deemed to be provisional tax payments and be allocated proportionately across the year to remove use of money interest liability (*PricewaterhouseCoopers)*. Alternatively, the withdrawal tax could be removed from the definition of "residual income tax" *(Tower)*.

Submission 3
(19 – ICANZ)

Alternatively, superannuation funds should be allowed a deduction for the amount of the withdrawal tax recovered from the withdrawing member.

Comment

The measures in the bill are intended to prevent avoidance of the 39% marginal tax rate by routing remuneration through a superannuation fund with a resulting tax liability of 33% on that remuneration. Officials consider the most appropriate approach to addressing this concern is the one which imposes least cost overall.

A withholding tax approach, while feasible, would have higher aggregate compliance and administrative costs than the current proposal in the bill. For example, new due dates for payment of the tax would have to be established and returns required to ensure correct payment.

Alternatively, if the withholding tax was integrated into another existing withholding tax, such as PAYE, to minimise compliance costs on taxpayers, significant administrative costs would be imposed on Inland Revenue. There would also be a significant delay in the application of the withholding tax approach as Inland Revenue systems were amended. Given the anti-avoidance nature of the provision, this delay could have a significant revenue impact.

However, officials consider the concerns underlying the submissions for the introduction of a withholding tax are significant and need consideration. These concerns generally relate to liability for provisional tax and use of money interest on underpayments of provisional tax.

Provisional tax and use of money interest

Officials consider that the provisional tax and use of money interest concerns can be addressed by providing that a withdrawal is gross income in the income year following the year of withdrawal (except in the year the fund winds up). This measure addresses the concerns raised.

In the case of provisional tax payable, the concern that a shortfall penalty may apply to any estimate of provisional tax due in relation to a withdrawal is removed. The year delay allows quantification of the actual amount having to be paid by way of provisional tax in the subsequent year. Similarly, with use of money interest, any concern regarding an interest charge on a withdrawal late in an income year is removed as the withdrawal tax is not due until the subsequent year.

Double taxation of non-resident member

The submission from PricewaterhouseCoopers argues that a withholding tax would avoid the possibility of non-resident fund members being subject to double tax. The double tax will arise when a withdrawal from a superannuation fund by a non-resident member is income, and therefore subject to tax, in the foreign jurisdiction, and the member in effect pays the 5% tax on the withdrawal in New Zealand. The argument is that if the tax were a withholding tax, the member may be able to get a credit for it in the foreign jurisdiction.

It is not clear that, if the withdrawal tax were imposed as a withholding tax, it would be creditable overseas. Generally, only income tax paid in the home jurisdiction is creditable overseas, and in New Zealand it is clear that superannuation fund withdrawals are not income to the member. Therefore it seems unlikely that any tax paid in relation to the withdrawal would be classified as income tax.

As a withdrawal from a superannuation fund is exempt from tax in New Zealand, it is likely that, if a withholding tax model were imposed, it would be by way of a final withholding tax paid by the fund – similar to FBT and SSCWT. A credit for these taxes is not available in overseas jurisdictions.

Recommendation

That, except in the year a superannuation fund winds up, a withdrawal is gross income of a fund in the income year following the year of withdrawal.

That a withholding tax not be introduced as an alternative to the approach currently in the bill.

EFFECT ON LOW AND MIDDLE-INCOME EMPLOYEES

Issue: Taxing savings of low and middle income employees at correct rate

Submission 1
(2 – Seafarers Union, 14 – ASFONZ)

The proposed amendments relating to the fund withdrawal tax and SSCWT should be struck out of the bill, pending work on a proposal which taxes employees at their appropriate rate.

Submission 2
(15 – Employers Federation)

The Government should examine options targeted at overcoming the long-standing problem of the SSCWT rate of 33% applying in relation to people who earn less than $38,000.

Comment

The purpose of the proposed changes is to protect the revenue base by limiting the ability of high-income earners to plan around the new top personal tax rate of 39%. The proposal is, therefore, a high priority, with the new top personal tax rate having applied since 1 April 2000. Officials recommend that the measures in the bill proceed.

Further work is being carried out by officials on options for low and middle-income employees. The Minister of Finance has stated that he agrees with the concern that those earning under $38,000 are subject to a 33% SSCWT rate. Officials have been directed to consider solutions to this matter for inclusion in a bill early next year. As this is a long-standing issue which is being considered, the matter can be progressed in a way which allows significant time for consultation.

Recommendation

That:

- the submission proposing the removal of amendments relating to the fund withdrawal tax be declined;
- the submission proposing that the government examine options in relation to the treatment of those earning under $38,000 be accepted.

Issue: Application of withdrawal tax to low and middle-income employees

Submission 1
(3 – Seafarers Retirement Fund, 4 – NPF, 6 – NZLS, 11 – Westpac, 15 – Employers Federation, 13 – ISI, 14 – ASFONZ, 16 – Tower, 17 – Dairy Group, 19 – ICANZ, 20 – Phillips Fox, 22 – Watson Wyatt)

The withdrawal tax should only apply to employees subject to the 39% marginal tax rate (incomes over $60,000):

- at the time the employer's contribution is made *(ASFONZ);*
- in either of the two years immediately before withdrawal *(ISI, Employers Federation, Phillips Fox).*

Submission 2
(18 – NZSA)

Low and middle-income employees earning less than $60,000 can be liable for the withdrawal tax and consequently pay the same amount of tax as high-income employees. This is especially so for new members who join after the grandparenting cut off date.

This problem could be alleviated by an exemption for all members from the withdrawal tax for contributions up to a certain monetary or percentage ceiling each year ($10,000 or 10% net of tax). This exemption would result in most employer contributions for low and middle-income earners being "ring-fenced" from the withdrawal tax, while still making the withdrawal tax apply to contributions over and above this level to limit the ability of high-income employees to plan around the 39% personal tax rate.

Comment

Officials consider that it is feasible to address the concerns expressed in submissions about the withdrawal tax applying to those earning under $60,000 through a certification process. This could be done by allowing members making withdrawals to state whether the combination of their taxable income and any gross superannuation contributions made on their behalf exceed $60,000 for each of the last four years. For each year this total exceeds $60,000, 25% of the withdrawal would be subject to withdrawal tax. For example, if for two of the last four years an employee had taxable income over $60,000, 50% of the amount withdrawn would potentially be subject to withdrawal tax. If in any year a withdrawing member is non resident, the taxable income may be nil.

Considering the last four years of an employee's income to determine application of the withdrawal tax is proposed as this is the normal period for which information is stored before being archived by Inland Revenue. Thus the required information should be available at low compliance costs to a member making a withdrawal. An

advantage of a longer income measurement period, such as four years, over a shorter measurement period, is that the effects of one-off fluctuations are mitigated slightly.

Officials consider that it is necessary to exclude the year of withdrawal from the four-year test as this reduces the potential for considerable complexity associated with determining annual income part-way through an income year. It also removes issues such as the treatment of redundancy payments from the calculations. However, it does provide some room to manipulate the concession. Again, this benefit is reduced by the use of a four-year measurement period.

As outlined earlier, officials consider that, in relation to withdrawals from defined contribution funds, the under-$60,000 exemption should include any employer superannuation contributions. This reduces the risk of employers and employees structuring the employee's remuneration as just less than $60,000 of salary with the remainder by way of superannuation contribution. In relation to withdrawals from defined benefit funds, the $60,000 exemption will include only the taxable income of the member. The employer's superannuation contribution in relation to a particular employee will not be known.

The outlined approach minimises compliance costs, although these costs will still increase as those earning under $60,000 must collect the information required for the exemption to apply. To ensure a withdrawing member can get the required information, officials recommend an amendment requiring employers to provide on request by a person making a withdrawal a record of the employer's contributions to a superannuation fund on their behalf over the last four years.

The proposals will deal with the bulk of likely cases that may arise and is supported by the ISI. However, there will be exceptions not catered for, principally those with income which is generally below $60,000 but fluctuates regularly over $60,000. Nor do they cater for, without an increase in complexity, people earning over $60,000 for most of their working life but who reduce their work load before retirement and thus meet the proposed test for withdrawal free of the withdrawal tax.

Recommendation

That:

- the withdrawal tax be reduced by 25% for each year a person has a combined taxable income and employer contributions to a superannuation fund on their behalf of less than $60,000; and

- that measurement of the last four years' taxable income and employer contributions to a superannuation fund not include the income year in which the withdrawal is made; and

- employers be required to provide on request by a person making a withdrawal a record of the employer contributions to a superannuation fund on their behalf over the last four years.

APPLICATION DATE

Issue: Retrospective application date

Submission 1
(12A – PricewaterhouseCoopers, 13 – ISI, 16 – Tower, 19 – ICANZ, 22 – Watson Wyatt)

The application date of 1 April 2000 is retrospective and places new obligations on trustees. Under the bill, trustees will be obliged to recover the withdrawal tax from members. The difficulties involved in recovering from past members may result in remaining members being penalised by having to fund the tax liability. A 1 October 2000 application date would mean trustees could meet their obligations.

Submission 2
(14 – ASFONZ)

The withdrawal tax should be introduced in relation to increases in employer superannuation contributions from 1 April 2001.

Submission 3
(4 – NPF, 13 - ISI, 14 – ASFONZ, 20 – Phillips Fox)

The withdrawal tax should not apply to members who leave schemes between 1 April and the time of enactment.

Submission 4
(19 – ICANZ)

If the application date of the bill is not deferred, the tax liability should be relieved to the extent the trustee is unable to recover the money.

Submission 5
(16 – Tower)

There should be transitional provisions in addition to those covering the period from 1 April to 1 October. These need to protect trustees who act in good faith until the final form of the legislation is known. It is also necessary to provide for adequate timing for scheme administrators to set up systems for compliance.

Comment

The withdrawal tax measures currently apply from 1 April 2000. The concerns expressed in submissions are that this will result in trustees having to recover withdrawal tax liabilities, incurred in respect of members who have quit a superannuation fund, from the remaining members of the superannuation fund. The probability of recovering the tax from the departing member, while theoretically feasible, may be extremely difficult in practice.

However, this concern has to be balanced against the anti-avoidance nature of the provisions and the risk that any deferral in application date may allow higher income earners to avoid the 39% tax rate. The principal risk with any deferral is in relation to the grandparenting provisions. These provide that employer contributions at levels agreed on or before 1 April can be withdrawn without the withholding tax applying. A delayed date may result in some employees using the delay to negotiate large increases in their employer superannuation contribution to avoid the 39% top marginal tax rate on their salary income.

A potential solution is to continue with the 1 April 2000 application date, ensuring that there is no scope for re-negotiation of employment contracts, but to remove any liability in relation to withdrawals made before the date the bill is reported back to the House. Officials recommend removal of any liability up to the date of report-back of the bill as any later date may allow scope for one-off lump sum employer contributions to be routed through a superannuation fund and back to high-income employees, with the trustee being relieved of the withdrawal tax on that sum.

Officials do not support the proposal that the withdrawal tax should be introduced in relation to increases in employer superannuation contributions from 1 April 2001. The measure needs to apply before that time to prevent avoidance of the 39% tax rate.

Recommendation

That the submissions be declined but that a provision removing any liability to pay withdrawal tax from 1 April 2000 to the date of the report-back of the bill be introduced.

Issue: Transitional period to allow for changes to prospectuses and investment statements and to amend required systems

Submission
(13 – ISI, 14 - ASFONZ)

A transitional period to, say, 31 December 2000 should be included in the bill to allow superannuation funds to update their prospectuses and investment statements.

Comment

The concern raised is that enactment of the withdrawal tax provisions may make investment statements and prospectuses misleading as they will not refer to the withdrawal tax. If this is the case, any contract entered into by a member to participate in a superannuation fund would be voidable.

To remove this risk, on enactment of the legislation, superannuation funds would have to amend their prospectuses and their investment statements immediately to refer to the withdrawal tax. This will impose significant compliance costs on superannuation funds and administrative costs on the Companies Office.

Given the grandparenting provisions and the proposals to address the concerns expressed in relation to those earning under $60,000 in income, the number of fund members potentially affected by the tax who will benefit from this work will be small. Officials conclude that the compliance costs incurred by the funds in amending investments statements will be out of proportion to any resulting informational benefits provided to members.

We have discussed industry concerns with the Securities Commission, as well as options for minimising compliance costs. The Commission has indicated that it has the power, by Order-in-Council, to exempt temporarily superannuation funds from any requirement to refer to the withdrawal tax in an investment statement.

The exemption is likely to be subject to a requirement that members are notified of the effect of the withdrawal tax, and a statement of its effect is attached to investment statements. This is likely to be acceptable to the industry.

The Commission will charge for dealing with an exemption application in accordance with the Securities (Fees) Regulations 1998. The Commission is funded by the Government on the basis that it will and should charge for this service. The fee will be approximately $2,000. This should need to be incurred only once in relation to an application on behalf of the entire superannuation industry.

Recommendation

That the submission be declined. However, officials propose an alternative approach which is likely to be acceptable to the industry. The Securities Commission has indicated that it has the power, by Order-in-Council, to exempt temporarily superannuation funds from any requirement to refer to the withdrawal tax in an investment statement. The exemption is likely to be subject to a requirement that members are notified of the effect of the withdrawal tax, and a statement of its effect is attached to investment statements.

GRANDPARENTING

Issue: Grandparenting of current levels of employer contributions

Submission
(4 – NPF, 6 – NZLS, 13 – ISI, 14 – ASFONZ, 12A – PricewaterhouseCoopers, 16 – Tower, 17 – Dairy Group, 19 – ICANZ, 22 – Watson Wyatt)

The legislation should be amended to reflect the policy intent of exempting current levels of employer contributions from the withdrawal tax (including increases that were set under superannuation trust deeds or employment contracts before 1 April 2000).

Comment

The policy goal was to exempt from the withdrawal tax any employer contributions made on or after 1 April 2000 if the level of contributions was not increased or the increase was already agreed under a superannuation trust deed or employment contract in place before 1 April 2000. The submission that the bill does not reflect this position is correct.

Recommendation

That the submission be accepted.

Issue: Treatment of pre-1 April 2000 amounts

Submission 1
(13 – ISI)

Section CL 3(3) provides an exemption for an amount that existed in a superannuation fund before 1 April 2000. This allows picking a balance before a substantial withdrawal is made. Also, the amount in a market-linked fund will fluctuate with the market. The rule needs more precise definition.

Submission 2
(16 – Tower)

It is unclear from section CL 3 if the withdrawal tax applies to subsequent investment earnings of funds that existed before 1 April 2000.

Submission 3
(13 – ISI, 20 - Phillips Fox)

There should be no liability for fund withdrawal tax in respect of members of a scheme in existence before 1 April 2000 unless employer contributions on behalf of employees earning more than $60,000 per annum increase by more than 50% in either

of the two years prior to withdrawal, other than in accordance with a trust deed or employment contract that was in existence before 1 April 2000.

Comment

Officials agree with submission 1 from the ISI. Section CL 3(3) provides that the tax does not apply to a withdrawal of an amount *that existed in a superannuation fund before 1 April 2000*. Officials recommend that the section be amended to refer to an amount that existed in a superannuation fund as at 31 March 2000.

In relation to the submission from Tower, the intention of the bill is that reserves in existence before 1 April 2000 would not be subject to the withdrawal tax when withdrawn. This position holds also for any return on those reserves. Officials agree that section CL 3 could be clearer on this issue. We recommend a further amendment to this section to include reference to any earnings on or after 1 April 2000 on amounts that existed in a superannuation fund as at 31 March 2000.

For funds that have a balance date other than 31 March, we propose later in this report that the trustee have the option to adopt the immediately preceding balance date of the fund instead of 31 March.

Recommendation

That the submission be accepted.

Issue: Ordering rules for withdrawals

Submission 1
(12A – PricewaterhouseCoopers, 13 – ISI, 19 - ICANZ)

Members should be able to withdraw exempt contributions first.

Submission 2
(4 – NPF)

The legislation should specify ordering rules (FIFO or LIFO) in order to provide certainty to trustees in dealing with the components of a withdrawal that may be subject to the rule.

Comment

The withdrawal tax provisions in the bill are silent on the source of any withdrawal, leaving it to the discretion of the trustee. Trustees may choose to pay out exempt contributions first. It is not the policy intent to require taxable reserves to be paid out first.

While it would be possible to provide rules on the source of a withdrawal, this would act to reduce the flexibility available to trustees. It could result in the withdrawal tax

applying in cases where the trustee could have chosen an alternative which would not have resulted in the withdrawal tax applying.

Recommendation

That the submission to introduce ordering rules be declined.

Issue: Proposal should not apply to established schemes that have not changed their manner of operation

Submission
(18 - NZSA)

Most employer-based schemes do not currently allow members to make "in service withdrawals." Therefore, the bill should not apply to established schemes provided that they do not change their method of operation.

Comment

Officials do not support the proposal that withdrawals from established schemes be exempt. This provides established schemes with an advantage relative to new schemes and may distort the investment decision of prospective members.

The withdrawal tax will not have a significant impact on employer-based schemes that do not allow "in service" withdrawals. The withdrawal tax will only apply in relation to members earning over $60,000 who have a 50 percent increase in employer contributions in the two years prior to cessation of employment or who are employed for less than two years. In such circumstances, the tax will not apply if the member chooses to lock-in the withdrawal for two years. If the tax does apply, it is only in relation to contributions over those two years.

Recommendation

That the submission be declined.

Issue: Increased employer contributions

Submission
(12A – PricewaterhouseCoopers)

To the extent that employer contributions have increased and exceed current contribution levels, only withdrawals of the excess contributions should be liable to tax.

Comment

The objective of the withdrawal tax is anti-avoidance in nature. This proposal would increase the complexity of the legislation. At the time of a withdrawal, the trustee would require information on the amount contributed by the employer that represented an increase in employer contributions above the grandfathered level. The trustee would also need to determine to what extent the amount withdrawn came from such increases.

Given this, and the fact that savings in superannuation funds are principally for retirement and are not intended to meet day-to-day expenses, officials consider that a potential liability for withdrawal tax on the full sum withdrawn is appropriate.

Recommendation

That the submission be declined.

EXCLUSION OF CERTAIN PAYMENTS FROM THE TAX

Issue: Exclusion of certain payments from the withdrawal tax

Submission
(4 – NPF, 13 – ICI, 18 – NZSA, 19 – ICANZ, 22 – Watson Wyatt)

The following should not be subject to the tax:

- withdrawals in the nature of pensions (typically for retirement or disability);
- withdrawals such as a retirement benefit without the member ceasing employment;
- withdrawals that are payments as a result of insurance claims;
- withdrawals to meet fund expenses, trustee and management fees; and
- provisions of group benefits (such as life and health insurance benefits).

Comment

Officials understand that trustees may make withdrawals from a member's fund to meet costs associated with administering the fund. They also make withdrawals to meet certain benefits provided by the fund, such as life insurance. These withdrawals will, without amendment to the bill, trigger a withdrawal tax liability.

The intention of the withdrawal tax is to prevent avoidance, which does not arise in these instances. Further, if no amendment were made to address this matter, the tax would substantially impact on current industry practice. However, a blanket exemption for all expenses would provide scope for funds to increase the types of benefits they provide to members, who would otherwise buy these benefits out of income subject to tax at 39%.

Officials therefore recommend an exemption which covers benefits generally provided by superannuation funds currently, and fund administration costs. These are:

- any expenses associated with the maintenance of the superannuation fund;
- any administrative, consulting, statutory compliance, auditing, legal or investment management fees;
- any fees or charges imposed by the trustee; and
- any group or individual life health, sickness and accident insurance held by the superannuation fund.

In the case of pensions, most will be paid on retirement and therefore fall under the cessation of employment exemption. Pensions paid on partial retirement should also

be exempt as officials have proposed that cessation of employment include partial retirement. Pensions paid as an annuity of more than five years will also be exempt.

Recommendation

That the submission be accepted.

Issue: Indirect benefit test

Submission
(19 – ICANZ)

The withdrawal test applies where a benefit is provided, either directly or indirectly, to a member. The trustee of a fund will not provide all indirect benefits, as the provision seems to imply. The indirect benefit test should apply only if there is an arrangement between the superannuation fund trustees and a member.

Comment

ICANZ provides an example of two members of a fund, mother and daughter. The mother withdraws contributions on cessation of employment, so these are exempt. However, she uses the funds to provide a benefit to her daughter. These funds, therefore, have indirectly provided a benefit to the daughter member. The trustee cannot know this.

The policy intent is that whenever the employer's contribution in relation to a member is withdrawn by anyone (that member or another), the tax potentially applies. In the example above, there should be no liability in relation to the daughter.

The legislation should be reworded to achieve the policy intent and address the concern of the submission. This could be achieved by deleting the reference to provision of a direct or indirect benefit to a member.

Recommendation

That the legislation be redrafted to avoid reference to the provision of a direct or indirect benefit to a member.

MEMBERS BEGINNING EMPLOYMENT AFTER 1 APRIL 2000

Issue: Tax applying to new employees after 1 April 2000

Submission 1
(17 – Dairy Group)

Employers' contributions for employees employed after 1 April 2000 who have exactly the same employment contracts as those employed as at 31 March will have a different superannuation fund tax profile. This should be corrected.

Submission 2
(13 – ISI, 22 – Watson Wyatt)

The tax should not apply to members who join a fund on or after 1 April 2000 in respect of whom the employer contribution at commencement is less than 20 percent of salary.

Comment

Employees with same employment contracts

The Dairy Group's submission highlights the difference between the treatment of employer contributions for members beginning employment after 1 April 2000 and employer contributions for members who are employed on the same terms as at 31 March. Up to 31 March 2000, it can be assumed that employer contributions to superannuation savings were not driven by the tax advantage provided by the 33% SSCWT rate over a 39% top marginal tax rate. This assumption cannot be made in relation to employer contributions after 1 April.

Our concerns with the Dairy Group proposal are that:

- New employees earning over $60,000 will be moved to the most advantageous existing employee contract, with existing employees being moved to that contract when opportunities arise. Tax-driven behaviour will not be prevented but will occur within the range of contracts available to an employer.

- Employers who compete for staff will have that competition distorted by the level of superannuation contribution available under contracts in place as at 31 March 2000.

Officials also consider that the proposals to remove the withdrawal tax on those earning less than $60,000 substantially reduces the impact of the withdrawal tax on those starting employment after 1 April 2000.

Employer contribution under 20 percent of salary

In relation to the ISI submission that the tax should not apply to members who join a fund on or after 1 April 2000 in respect of whom the employer contribution at commencement is less than 20 percent of salary, the issue of a percentage cap was considered and not progressed as an alternative approach.

Recommendation

That the submissions be declined.

LIABILITY FOR WITHDRAWAL TAX

Issue: Amount subject to withdrawal tax

Submission 1
(4 – NPF, 18 - NZSA)

Only contributions made in the two years before the event giving rise to the tax liability should be subject to the tax.

Submission 2
(13 – ISI)

There should be an option for the member to choose to either:

- pay the tax at the time of withdrawal
- defer receipt of the employer contributions liable for the withdrawal tax for the balance of the two-year period
- take the withdrawal in the form of an annuity or any other income stream which provides a payment over not less than five years.

Submission 3
(17 – Dairy Group)

Ex-employees should be able to leave the employer's contribution in the fund for two years from leaving employment to gain exemption from the withdrawal tax.

Submission 4
(17 – Dairy Group)

If a trust deed has a minimum two year period before 100 percent of the employer's contribution vests to the employee, withdrawals from the fund should be exempt from the withdrawal tax.

Comment

Only last two years' contributions liable

A number of concerns are raised by the first submission that only contributions made in the two years before withdrawal should be subject to the withdrawal tax. It would be simple for a member to source withdrawals from employer contributions outside the two-year period. The superannuation fund could therefore be used as a cash-box, which is the mischief the withdrawal tax aims to prevent.

Officials therefore recommend that this submission be declined. However, such a restriction is recommended in the case of withdrawals on cessation of employment, which are subject to the withdrawal tax because the employer's contribution increased by more than 50 percent in either of the two years before cessation of employment.

Deferral of receipt of withdrawal

The proposal from the Dairy Group is that if a trust deed has a minimum two-year period before 100 percent of the employer's contribution vests to the employee, withdrawals from the fund should be exempt from the withdrawal tax. This does not represent a sufficient lock-in. Employer contributions would simply be withdrawn from amounts that are not locked in. The extent of this behaviour would be limited only by the total amount of employer contributions in the fund not subject to the lock-in period.

For example, in 2003 an employee with $50,000 employer contributions in the 2000-2001 income year could simply withdraw this sum as salary, with the employer making a compensating $50,000 contribution to the superannuation fund. Effectively, the employer is paying $50,000 a year to the employee, with tax being paid at only 33%. In two years' time the $50,000 in the 2002-2003 year would become available to the employee as salary. To address these avoidance opportunities results in significantly increased complexity. Officials recommend the submission be declined.

Receipt withdrawn as annuity

Officials consider that withdrawal in the form of an annuity which provides a payment over not less than five years, as proposed by the ISI, does not raise avoidance concerns and recommend that this submission be accepted.

Recommendation

That:

- submissions 1, 3 and 4 be declined.

- submission 2 be accepted in relation to the proposal that withdrawal in the form of an annuity which provides for a payment over not less than five years or life not be subject to the withdrawal tax.

Issue: Non-monetary amounts withdrawn

Submission 1
(14 - ASFONZ)

The legislation provides that an amount withdrawn means "money withdrawn, or, if money is not withdrawn, the market value of the withdrawal". It should be clear that the market value is determined at the time of withdrawal.

Submission 2
(19 – ICANZ)

Only non-monetary benefits that are capable of being converted into cash should be subject to the tax. What if a superannuation fund owns assets available for employees to use? For example, a superannuation fund may own the business premises in which employees work. These premises may provide car parking, a cafeteria, morning and afternoon tea and so on.

Comment

In relation to submission 1, the policy intent is that where a withdrawal is not in a monetary form, the market value of the withdrawal should be determined at the time of the withdrawal.

In relation to submission 2, there must a withdrawal from a fund in order to trigger a tax liability. This includes monetary and non-monetary withdrawals. In the example above, there appears to be no withdrawal.

Recommendation

That submission 1 be accepted and submission 2 be declined.

Issue: Employers can pay the withdrawal tax

Submission
(17 – Dairy Group)

Provision should be made for an employer to pay the withdrawal tax as an alternative to the superannuation fund.

Comment

Officials consider that the liability should not be placed on an employer because the employer will not know when a withdrawal occurs and will be unable to deduct the tax from the withdrawal. There is also the risk that the employer may have ceased business.

Recommendation

That the submission be declined.

TRACKING EMPLOYER CONTRIBUTIONS

Issue: Certification by employers

Submission
(4 – NPF, 11 – Westpac, 12A – PricewaterhouseCoopers, 13 – ISI, 14 – ASFONZ, 15 – Employers Federation, 18 – NZSA, 19 – ICANZ, 20 – Phillips Fox)

A mechanism is needed whereby employers are required to provide sufficient details to trustees so that the tax status of contributions can be determined. Trustees should be able to rely on this information. If the information is not correct, the liability should fall on the employer. There should be protection for trustees from incurring a liability when it cannot be recovered from the withdrawing member, provided the trustees have acted in good faith and in reliance upon information received from the employer, or the member in the case of a fund in which the primary relationship is not through an employer.

Comment

Officials agree with this submission. We recommend a certification approach under which a superannuation fund can request information from a member making a withdrawal and from any employer who has made a contribution to that member's superannuation savings. A superannuation fund would be able to rely on the information it received provided it did not have grounds for believing the information to be incorrect.

Where inaccurate information is supplied, we recommend that the withdrawal tax not be re-calculated but that the Commissioner consider applying criminal penalties in relation to the supply of false information. Potentially, a taxpayer knowingly providing false information could be liable for a fine of $25,000 for a first offence and $50,000 for a subsequent offence.

We consider a superannuation fund should be able to request the following information:

From employers

- the extent to which any employer contributions have been treated as salary and wages under section NE 2A;
- the extent to which any employer contributions are subject to SSCWT at 39%;
- the extent of any employer contribution to superannuation by an employer;
- whether an employer has increased their contributions in accordance with a contract in effect before 1 April 2000;
- whether an employer has increased their contributions by more than 50 percent in either of the two years before a member ceases employment with that employer;

- whether a member has ceased employment, and if so, whether this is within two years of starting.

From other superannuation funds and schemes

- the extent to which any transfer of funds represents employer contributions, employee contributions or any amount in a superannuation fund as at 31 March 2000 (or earlier balance date if elected by the transferor superannuation fund);

- any information previously provided by an employer or member to a superannuation fund from which a member is transferring.

From members

- information on the last four years' income of that member, and any employer superannuation contributions made on behalf of that member over the same period;

- whether the member has ceased employment, and if so, whether this is within two years of starting;

- any information a superannuation fund may require to determine whether a withdrawal is being made to alleviate significant hardship.

Officials also recommend including a catch-all provision to allow any person to request information required to ensure an accurate calculation of the withdrawal tax.

A person receiving a request for information should be required to provide the information within 20 working days of the request.

Recommendation

That the submission be accepted.

Issue: Inability to identify employer contributions

Submission
(13 – ISI)

If the amount of employer contributions cannot be separately identified, the trustee should be able to calculate a fair and reasonable amount of employer contributions, rather than making withdrawals of all contributions subject to the tax.

Comment

Officials do not support this submission. Government policy is that if the amount of employer contributions cannot be identified, the entire withdrawal is subject to the

tax. In addition, it is not clear what constitutes a "fair and reasonable" amount, and this would give rise to disputes.

Recommendation

That the submission be declined.

Issue: Measurement of amounts in funds at 1 April 2000

Submission 1
(14 - ASFONZ)

There should be clarification of how the amount that existed in a superannuation fund before 1 April 2000 should be calculated. Market values should be used to determine those amounts.

Submission 2
(13 – ISI, 14 – ASFONZ, 18 - NZSA)

Trustees should be allowed to determine the balance in member accounts at the balance date nearest to 1 April 2000, rather than having to do a one-off balance as at 1 April 2000.

Comment

Officials agree with the ASFONZ submission that market values should be used to determine amounts in funds at 1 April 2000.

In relation to the second submission, in order to reduce compliance costs, we propose that a superannuation fund may calculate grandparented reserves and the balance in member accounts as at its last balance date before 1 April 2000. We do not support allowing funds to use a balance date after that because it would allow an opportunity for members to avoid the 39% income tax rate applying from 1 April 2000.

Officials also received an oral submission on the treatment of late balance date funds. The concern was that if a fund has a late balance date, a withdrawal after 1 April but before their balance date would be income in the 1999-2000 year. This would be before the tax is intended to apply and after provisional tax payments for that year have been made.

Officials propose that withdrawals in the 1999-2000 income year give rise to a withdrawal tax liability in the 2001/02 income year. We do not propose that withdrawals give rise to a tax liability in the 2000/01 year because there may be insufficient time for a fund to put in place systems before the first provisional tax payment for that year falls due. Further, the 2000/01 income year is the same year that standard balance date funds will commence paying withdrawal tax if the proposal by officials to defer payment of the tax on any withdrawal to the next year is adopted. (This proposal addresses provisional tax and use of money interest problems).

Officials recommend that a withdrawal from a fund in the 1999-2000 income year give rise to a withdrawal tax liability in the 2001/2002 income year.

Recommendation

That:

- submission 1 be accepted and that submission 2 be accepted in part. Superannuation funds should be permitted to calculate reserves as at their latest balance date before 1 April 2000;

- a withdrawal from a fund in the 1999-2000 income year give rise to a withdrawal tax liability in the 2001/2002 income year.

WITHDRAWALS ON CESSATION OF EMPLOYMENT

Issue: What constitutes cessation of employment

Submission 1
(13 – ISI, 20 - Phillips Fox)

Cessation of employment should be defined to include a reduction of hours worked over all employment to a maximum of 30 hours per week, or a reduction by at least 25 percent of total hours worked over all employment.

Submission 2
(11 - Westpac, 13 – ISI, 18 – NZSA, 19 – ICANZ, 20 - Phillips Fox)

Cessation of employment should be defined to mean:

- a change in employers (including redundancy);
- the terms and conditions of employment have materially changed in such a way that the employee cannot be regarded as performing the same employment that they carried on prior to the changes; and
- death and total or permanent disablement.

Comment

Partial retirement

A concern expressed in submissions is that those who are nearing retirement may wish to partially retire, and make withdrawals to fund that partial retirement. Officials consider that the concern underlying the submissions should be addressed, but that the criteria for determining partial retirement be tighter than those proposed in submissions. Officials consider the criteria should be that:

- A member is employed for a maximum of 30 hours per week;
- The reduction in hours worked is a consequence of the member leading up to full retirement.
- The member has no intention of increasing hours in paid employment in the future. This is an intention test, so it does provide scope for members to increase their hours worked at a later date. It does not lock a member into a fixed reduced number of working hours a week but does provide some scope for avoidance behaviour.
- All employer and employee contributions to any superannuation fund cease. If a member is both contributing and withdrawing, there is a risk that the fund is being used for avoidance purposes.

General definition of cessation of employment

Officials recommend against defining the term "cessation of employment" to include the events proposed in submissions. The concern that changing employers may not be a cessation of employment is addressed in the submission immediately below. Officials consider that death is clearly a cessation of employment. However, this could be clarified in the *Tax Information Bulletin* released after enactment of the bill. A material change in the terms and conditions of employment, and a disablement, should not automatically constitute a cessation.

Recommendation

That the bill be amended to allow withdrawal without imposition of the withdrawal tax if:

- a member is employed for a maximum of 30 hours per week;
- the reduction in hours worked is a consequence of the member leading up to full retirement;
- the member has no intention of increasing hours in paid employment in the future; and
- all employer and employee contribution to any superannuation fund cease.

That the submission that cessation of employment be defined be declined.

Issue: Cessation of employment with a particular employer

Submission 1
(14 - ASFONZ)

An amendment is needed to make it clearer that the date the employee ceases employment is the date the employee ceases employment with the employer sponsoring the member's scheme. Otherwise the exclusion could be interpreted as only applying on the cessation from all employment.

Submission 2
(12A – PricewaterhouseCoopers)

A number of larger corporate groups operate through a variety of group company structures, generally to separate different aspects of their overall business. The proposed legislation does not include any employer-associated person provisions. Therefore employees who may be moved around a group of companies to provide services to those companies, hence being employed by each group company for a period of less than two years, will have their employer contributions 'tagged', and on ultimate retirement/cessation of employment will suffer withdrawal tax with respect

to the tagged employer contributions. Associated person employer provisions should be included.

Comment

Cessation of all employment

It is not intended that the exemption on cessation of employment apply only when there is a cessation of all employment. We therefore propose that the legislation be clarified to reflect the policy intent and address the concerns expressed in the ASFONZ submission.

Employees transferring between associated employers

Officials agree with the submission from PricewaterhouseCoopers in relation to employees transferring between associated corporate employers. Associated employers should be deemed to be one employer for the purposes of the cessation of employment rule generally. This addresses the concern raised in the submission. It also ensures that the transfer of employees between associates does not constitute a cessation of employment for the purpose of the exemption. Withdrawals on such a transfer will be subject to the tax.

Withdrawals before cessation of employment

Those with whom we have consulted on the bill have raised an additional issue related to withdrawals on cessation of employment. A withdrawal can be made shortly before, but in relation to, a cessation of employment. The current exemption in the bill only applies to withdrawals made on or after cessation of employment. We therefore propose that the legislation be amended to provide that a withdrawal made before, but in relation to, a cessation of employment does not attract the withdrawal tax.

Recommendation

That:

- the ASFONZ submission be accepted;

- associated employers should be deemed to be one employer for the purposes of the cessation of employment rules;

- a withdrawal made shortly before, but in relation to, a cessation of employment should not be subject to the withdrawal tax.

CESSATION OF EMPLOYMENT– TWO-YEAR RULE

Issue: Increase in employer contributions over previous two years

Submission 1
(16 – Tower, 17 – Dairy Group)

This provision should be deleted as it imposes significant compliance costs on scheme administrators and requires them to be vigilant about individual employment contracts.

Submission 2
(12A – PricewaterhouseCoopers, 13 – ISI, 14 – ASFONZ, 16 – Tower, 19 – ICANZ, 22 – Watson Wyatt)

The test for employer contributions made in the final two years of employment should be 150 percent, not 50 percent, of the previous year's superannuation contributions.

Submission 3
(19 – ICANZ)

The reference to the 50 percent increase in contributions should exclude any increase when the percentage of contributions has not changed as a percentage of salary.

Submission 4
(4 – NPF)

Where the increase in the two years before cessation of employment is 50 percent or more, the tax should apply only if employer contributions are in excess of an acceptable range when compared to salary (say 1 – 10 percent).

Submission 5
(19 – ICANZ, 20 – Phillips Fox)

Employees who are employed for less than two years should be allowed a safe harbour option. A deemed contribution level of 10 percent *(ICANZ)* or 20% *(Phillips Fox)* is appropriate.

Submission 6
(12 – PricewaterhouseCoopers, 19 - ICANZ)

Only that part of the contribution which is an increase greater than the threshold should be liable for the withdrawal tax, not the entire contribution. This would be consistent with the grandparenting provisions in the bill, which preserve the tax status of existing levels of contributions.

Submission 7
(19 – ICANZ)

If submission 5 is not accepted, the withdrawal tax should apply only to employer contributions made during the last two years.

Submission 8
(13 – ISI)

An additional amount of contributions made in the last two years before withdrawal to make up for a mistaken underpayment of employer contributions should not be included for the purposes of calculating the increase over the last two years.

Submission 9
(11W – Westpac Trust)

Employees who have been employed for less than two years should be allowed to agree to such benefits being locked in until they leave the employer's service, but with a minimum period of two years applied. This agreement could be made at the time when the contributions begin, subject to the terms of the trust deed.

Comment

Removal of provision

The submission from Tower and the Dairy Group argues for the removal of the provision which triggers the tax if there is an increase in contributions in the last two years of employment. If this were to be removed, there would be significant scope for employees close to retirement to avoid the top marginal tax rate by negotiating an increase in employer contributions to a superannuation fund, knowing that they will be accessible in a short period of time when the employee retires.

150 percent of employer contributions in previous years

Officials agree that the test for employer contributions made in the final two years of employment should be 150 percent, and not 50 percent, of the previous year's superannuation contributions. This is a drafting error which requires correction.

No liability where contributions as percentage of salary remains same

We agree with the ICANZ submission that the reference to the 50 percent increase in contributions should exclude any increase when the percentage of contributions has not changed as a percentage of salary. We recommend that the current provision to this effect in section CL 6 also apply in this case.

Application of tax only where employer contributions exceed percentage of salary

The submissions from the National Provident Fund, ICANZ and Phillips Fox propose that the withdrawal tax apply only where the increase in employer contributions in the

two years before cessation of employment exceeds an acceptable percentage of salary. They suggests a level of 10 percent or 20 percent of salary is appropriate.

This would reduce compliance costs on superannuation funds because they would not have to calculate a liability for most withdrawals. However, the proposal also has a number of costs. It would allow those on incomes greater than $60,000 to increase employer contributions before retirement, knowing that they will have access to those funds in a short time. Further, this proposal relies on new information being provided by employers, which increases their compliance costs. Officials recommend that this submission be declined.

Application of tax only to employer contributions in excess of threshold

Officials do not agree with the submission that the tax should only apply in relation to that part of the employer's contribution which is greater than the 150 percent threshold. The objective of the measure is to prevent avoidance by those close to retirement. If the submission were to be accepted, the effectiveness of the measure would decrease and the compliance costs on employers would increase.

Liability only for employer contributions in previous two years

Officials agree that where there is a liability for the tax on cessation of employment, the tax should only apply to employer contributions made during the two years prior to cessation. This reduces compliance costs and does not present a significant avoidance risk.

Additional employer contributions to correct previous underpayment

We agree with the submission from the ISI that additional employer contributions made in the two years before withdrawal, to make up for an earlier underpayment of employer contributions, should not be included for the purposes of calculating the increase in those years.

Lock-in of employer contributions

Officials agree with the thrust of the Westpac Trust submission that employees who have been employed for less than two years should be allowed to lock in contributions as an alternative to the withdrawal tax applying. However, officials consider that a withdrawal should have to be locked-in for two years from cessation of employment before the withdrawal tax not apply.

The avoidance risk which underlies the two-year rule is reduced substantially where there is a lock-in for two years. The increased employer contributions will not be able to be drawn down immediately after retirement.

On this basis officials consider the withdrawal tax should not apply to contributions that would have been liable under the two-year rule if they are locked in for two years following cessation of employment.

Recommendation

That:

- Submissions 1, 4, 5 and 6 be declined.

- Submissions 2, 3, 7 and 8 be accepted.

- Submission 9 be declined but that there be no tax payable in relation to a withdrawal made at least two years after cessation of employment as a result of an election to lock in those funds.

Issue: Employment for less than two years

Submission 1
(14 – ASFONZ, 22 – Watson Wyatt)

The tax should not apply to all withdrawals by employees who have been employed for less than two years.

Submission 2
(17 – Dairy Group)

Bona fide retirements within two years of employment should not be subject to the tax.

Submission 3
(19 – ICANZ)

If an employee ceases employment before two years, only those contributions made to the employee's superannuation fund by that employer should be subject to the withdrawal tax. The withdrawal tax should not apply to a previous employer's contributions that were entitled to be withdrawn free of tax – for example, employer contributions from a previous employer that could have been withdrawn when the employee ceased work for that employer, but instead were left in the fund.

Comment

No tax liability where person employed for less than two years

Section CL 4(3)(b) provides that the tax applies to a withdrawal by a person who is ceasing employment within two years of starting. That rule is a consequence of the rule in section CL 4(3)(a) which triggers the tax where there has been a 50 percent increase in employer contributions in the two years before cessation of employment. If the period of employment is under two years, employer contributions from that employer will always have increased by 50 percent or more in the two years before cessation of employment. Paragraph (b) is inserted to alert members, funds and employers to the consequence of the 50 percent increase rule. It should be retained.

Bona fide retirements

In relation to submission 2, officials point out that both the two-year rules are intended to catch bona fide retirements. In the absence of the two-year rules, it would be possible for employees to substitute high levels of employer superannuation contributions for salary, and to access those contributions on leaving the employment, shortly after.

Withdrawal of previous employer's contributions

ICANZ argues that, when an employee ceases employment, the tax should not apply to the withdrawal of contributions made by a previous employer that were eligible for tax-free withdrawal but left in the fund on cessation of the previous employment. This is the policy intent.

Section CL 4(3) provides that the tax does not apply to withdrawals made on **or after** cessation of employment (except where the two-year rules are triggered). A previous employer's contributions can therefore probably be withdrawn tax-free when a member subsequently ceases employment. However, we recommend that the legislation be clarified to reflect the policy intent.

Recommendation

That:

- Submissions 1 and 2 be declined.

- Submission 3 be accepted.

Issue: Redundancy within two years

Submission
(12A – PricewaterhouseCoopers, 17 – Dairy Group)

Pay-outs to employees who are made redundant from their employment should not be liable to withdrawal tax. The two-year employment rule could result in unduly harsh implications in such circumstances.

Comment

The concern expressed in submissions is that, in cases of redundancy within two years of employment, members may suffer financial hardship, and so no withdrawal tax liability should apply. However, if the redundancy has caused significant hardship, the member will already be able to withdraw funds tax-free on that basis.

Officials do not support the submission to exempt redundancies because, in some cases, redundancy may be within the control of the employee, raising an avoidance concern.

However, officials consider that the tax should not apply where a member has ceased employment owing to circumstances outside their control. We therefore propose that, in cases of cessation of employment on the grounds of injury, disablement or death, withdrawals should not be subject to the tax, even if the two-year rule would otherwise apply.

Recommendation

That the submission be declined but that withdrawals on cessation of employment, which would otherwise be subject to the two-year rule, be exempted if the reason for cessation of employment was injury, disablement or death.

Issue: Trigger for liability – within two years of joining fund

Submission

(13 – ISI)

Liability for withdrawal tax should be triggered by withdrawal within two years of joining the fund, rather than within two years of starting employment with that employer.

Comment

As noted earlier, the two-year rule in section CL 4(3)(b) is a consequence of the rule which targets increases in employer contributions in the two years before cessation of employment. The basis of the latter rule is employment, not membership of a fund.

Recommendation

That the submission be declined.

SIGNIFICANT HARDSHIP

Issue: Withdrawals to alleviate significant hardship

Submission 1
(4 – NPF, 11 – Westpac, 12A – PricewaterhouseCoopers, 13 – ISI, 14 – ASFONZ, 16 – Tower, 18 – NZSA, 20 – Phillips Fox, 22 - Watson Wyatt)

The definition should be extended from including permanent physical or mental incapacity affecting the member's ability to earn income to other circumstances of financial distress or hardship to members and their families. It should include a withdrawal to make a payment in respect of the division of assets under the Matrimonial Property Act 1976, temporary disablement benefits, children's education, and unemployment of spouse or family members. Guidelines should be issued.

Submission 2
(19- ICANZ)

"Hardship" should be better defined to include those things that give rise to financial difficulties, which in turn require access to superannuation savings, rather than the actual event that may or may not give rise to hardship.

Submission 3
(19 – ICANZ)

That an alternative way of defining "hardship" would be to define it in the negative.

Submission 4
(14 – ASFONZ, 16 – Tower, 19 - ICANZ)

The reference to "significant" should be removed.

Submission 5
(4 – NPF, 14 – ASFONZ)

The responsibility for determining whether hardship applies to each case should be given to the trustee but:

- this should be subject to challenge by the Commissioner *(ASFONZ)*
- this should not be subject to challenge by the Commissioner *(NPF).*

Submission 6
(16 – Tower)

Scheme administrators should be able to rely on an employer's certification or a statutory declaration by the employee that the withdrawal is due to genuine hardship as defined under legislation and guidelines.

Submission 7
(19 – ICANZ)

The bill should be changed to ensure the hardship provisions apply notwithstanding any other withdrawal tax rule.

Comment

Officials agree with the submission of ICANZ that hardship should be defined to include financial difficulties arising from certain events, rather than the events themselves that may or may not give rise to hardship.

We do not consider that the term "significant" should be removed. Doing so would raise the risk that requests for hardship will become a way to withdraw funds from a superannuation fund without the application of the withdrawal tax. Also, the lower the threshold the more pressure placed on trustees in determining whether withdrawals qualify for hardship.

On this basis officials recommend that the withdrawal tax not apply if the withdrawal is required to alleviate significant financial hardship arising from:

- the inability of a member to carry out his or her normal occupation as a result of illness or injury, either temporarily or permanently;
- the inability of a member to meet minimum living expenses or to meet payments on a loan which will lead to foreclosure of a mortgage on the member's principal place of residence;
- modification of the member's principal place of residence to accommodate special needs arising from the disability to the member or member's dependants;
- the member having medical treatment to treat illness, injury or rehabilitation of the member or the dependant of the member;
- the need to meet palliative care for the member and any dependants and funeral or burial expenses for the dependants.

Those making submissions argue that the responsibility for determining whether hardship applies to each case should be given to the trustee, but there is disagreement about whether this should be subject to challenge by the Commissioner. Officials consider the current approach of the bill is appropriate. It provides that the test is an objective one – whether the taxpayer has suffered significant hardship. This approach allows both the Commissioner and the member making the withdrawal to dispute whether significant financial hardship had occurred in a particular case. It would be inequitable to deny the member making a withdrawal this right. Further, without the Commissioner having such a right, a trustee may be inclined towards accepting a taxpayer's argument for significant financial hardship rather than risking a dispute knowing that the Commissioner could not challenge that decision.

Officials consider a provision, although not one relating to significant financial hardship, should be included to provide for funds required to settle an agreement for division of assets under the Matrimonial Property Act 1976.

It should include a withdrawal to make a payment in respect of the division of assets under the Matrimonial Property Act 1976 (but not a matrimonial property agreement). Officials note that this provision may require amendment to address issues raised by the Matrimonial Property Amendment Bill 2000.

Finally, officials agree with the ICANZ submission that the hardship provisions apply notwithstanding any other withdrawal tax rule.

Recommendation

That:

- submissions 2 and 7 be accepted;
- "hardship" be defined to include financial difficulties arising from the following events -
  - the inability of a member to carry out his or her normal occupation as a result of illness or injury, either temporarily or permanently;
  - the inability of a member to meet minimum living expenses or to meet payments on a loan to prevent foreclosure of a mortgage on the member's principal place of residence;
  - modification of the member's principal place of residence to accommodate special needs arising from the disability to the member or member's dependants;
  - the member having medical treatment to treat illness or injury to the member or the dependant of the member; and
  - the need to meet palliative care for the member and any dependants and funeral or burial expenses for the dependants.
- the test remain one of significant hardship;
- the hardship test remain an objective one;
- a provision, although not one relating to significant financial hardship, be included to provide for the tax-free withdrawal of funds required to settle an agreement for the division of assets (but not a matrimonial property agreement) under the Matrimonial Property Act 1976.

DEFINITION OF "MEMBER"

Issue: Narrowing the definition of "member"

Submission 1
(22 – Watson Wyatt)

The definition of "member" is the same as that used in the Superannuation Schemes Act 1989. In that Act, the definition includes as a member trustees of a scheme which invests in another scheme. For the purposes of this bill, this wider definition could accidentally trigger unintended tax liabilities when a scheme trustee requests money from the master trustee to pay legitimate benefits. A better definition of "member", for the purposes of the bill, is "an employee or former employee".

Submission 2
(18 – NZSA)

The bill should be amended in line with the Superannuation Schemes Act 1989 to limit the definition of "member" to natural persons.

Comment

Officials agree that the tax should not apply when a fund that has invested in another fund withdraws that investment. The withdrawal tax should potentially apply only in cases where a natural person is withdrawing a sum from a superannuation fund.

We have a concern, however, about the suggestion that the definition of a member be restricted to a natural person or an employee. The risk is that a withdrawal from a superannuation fund by another superannuation fund would lose its nature as employer or employee contributions, allowing a withdrawal from the second fund by a natural person to be free of withdrawal tax.

Officials recommend the following solution to the problem. A withdrawal by a superannuation fund from another superannuation fund is not subject to withdrawal tax, and the amount withdrawn retains its nature. That is, the amount which represents employer contributions remains as such or, if that amount is not known, the entire withdrawal will be employer contributions. This allows the superannuation fund making the withdrawal to determine whether the withdrawal tax should apply, and to what extent, if it subsequently pays that amount out as an in-service withdrawal.

Recommendation

That the submissions be declined but that:

- a withdrawal by a superannuation fund from another superannuation fund is not subject to withdrawal tax;

- that the amount withdrawn retain its nature as employer or employee contributions.

TRANSFERS BETWEEN FUNDS

Issue: Responsibility for establishing the extent to which transfers are composed of employer contributions

Submission 1
(12A – PricewaterhouseCoopers, 19 - ICANZ)

On the transfer of amounts from one fund to another, there should be some form of declaration by the transferor regarding the status of the amount transferred which the transferee fund can rely on.

Submission 2
(13 – ISI, 19 – ICANZ)

If the transferee fund is not able to obtain the relevant information from the transferor fund,

- it should be able to assume that all amounts transferred are employee contributions *(ICANZ)*
- there should be some form of apportionment between employer/employee contributions *(ISI)*.

Submission 3
(13 – ISI)

A retail fund may not know until after a member has withdrawn that an amount which had been transferred into the fund included employer contributions. The tax should not apply in this situation as the fund would not be able to recover the tax from the member.

Comment

Officials agree that on the transfer of amounts from one superannuation fund to another, there should be some form of declaration by the transferor regarding the status of the amount transferred which the transferee fund can rely on. Officials recommend an amendment to require a transferor fund to provide to the transferee such information as it has available for determining the application of withdrawal tax. This should be calculated as if the transferred sum been withdrawn rather than transferred.

If the transferee fund is not able to obtain the relevant information from the transferor, the amounts transferred should be classified as employer contributions, which are potentially liable to the tax on withdrawal by a member.

Officials do not support submission 3 from the ISI. A fund should determine at the time of withdrawal whether amounts transferred from other funds include employer contributions. If this information is not available, the withdrawal should be subject to the tax.

Recommendation

That submission 1 be accepted and submissions 2 and 3 be declined.

Issue: Withdrawal and re-investment in another superannuation fund

Submission
(14 - ASFONZ)

No tax should be payable when an employee makes a withdrawal and immediately invests that amount in another superannuation fund. This should be treated as a transfer between superannuation funds.

Comment

In principle this approach is correct in that a withdrawal followed by immediate investment in another superannuation fund by a member is, in substance, the same as a direct transfer. However, officials are concerned about the lack of guarantee that any amount withdrawn is in fact immediately reinvested. The exemption from withdrawal tax on a direct transfer is appropriate only because receipt of the savings by the transferee is guaranteed.

Officials understand that some trust deeds prevent payment being made to a person other than the member. In these cases, if the trustee acts as an agent of the member and transfers payment on the member's behalf to another superannuation fund, officials consider the withdrawal tax would not apply. This would be treated as a direct transfer. We propose that this be stated in the *Tax Information Bulletin* released after enactment of the bill.

Recommendation

That the submission be declined.

Issue: Transfers from defined benefit to defined contribution funds

Submission 1
(12A – PricewaterhouseCoopers, 13 - ISI)

A portion of the amount transferred from a defined benefit to a defined contribution fund should retain its exempt status to avoid difficulties when rationalising schemes. This could be agreed with the Government Actuary or be determined by an actuary.

Submission 2
(13 – ISI)

In a transfer from a defined benefit fund, where the amount of employer contributions is not readily identifiable, it may be determined by deducting employee contributions from the total transfer amount.

Comment

Officials are proposing changes in relation to the treatment of withdrawals from defined benefit funds. The bill proposes that withdrawals from a defined benefit fund be exempt from the withdrawal tax. However, in the light of submissions, officials now consider that a withdrawal from a defined benefit fund should be subject to the tax except where the withdrawal:

- is sourced from employee contributions, or the return on employee contributions; or
- is sourced from pre-1 April 2000 reserves; or
- is on cessation of employment; or
- is to alleviate significant hardship.

This means that when an amount that would be exempt on withdrawal from a defined benefit fund is transferred to a defined contribution fund, it should retain its exempt status in the transferee fund.

Recommendation

That the submissions be declined but that amounts that would be exempt if withdrawn from a defined benefit fund should retain that status if they are transferred to a defined contribution fund.

Issue: Continuity of exemption if a member transfers from one scheme to another

Submission 1
(12A – PricewaterhouseCoopers, 22 – Watson Wyatt)

Proposed section CL 5(4) treats the entire transfer as liable to tax where the transferring fund is unable to split the transfer between employer and employee contributions. To the extent that pre-1 April 2000 amounts can be identified in the transferor fund, their tax-free status should be preserved in the transferee fund.

Submission 2
(18 – NZSA)

When a member transfers from one scheme to another, any employer contributions that were exempt from the withdrawal tax should continue to be exempt in the receiving scheme. This is necessary to maintain employment conditions where a merger or acquisition takes place, and makes it easier to make revisions to schemes.

Comment

The policy intent is that amounts that are grandparented in a superannuation fund retain that status on transfer to another superannuation fund. Similarly, other amounts that would not be subject to the tax on withdrawal, such as employee contributions, should retain their status when transferred between funds. In both cases, this is subject to the transferor fund being able to identify, and notify the transferee of, those amounts.

Recommendation

That the submissions be accepted.

Issue: Employer contributions not transferred

Submission
(16 – Tower)

Section CL 5 exempts the application of withdrawal tax to employer contributions transferred to another superannuation scheme on ceasing employment. The same exemption should apply to employer contributions remaining in a retail scheme. Upon ceasing employment the member should be able to continue in the same retail superannuation scheme, and any employer contributions already made should not be subject to the withdrawal tax when they are accessed.

Comment

Section CL 4(3) already provide that the withdrawal tax does not apply to withdrawals made on **or after** cessation of employment.

Recommendation

That the submission be declined.

Issue: Exemption from withdrawal tax for funds investing in other funds

Submission
(4 – NPF, 12A – PricewaterhouseCoopers, 13 - ISI)

A specific exemption is needed to ensure that the practice of one superannuation fund investing in another superannuation fund does not result in the withdrawal tax applying. As any withdrawals made are in the nature of an investment and are not received by members, not having an exemption could see the withdrawal tax apply in circumstances that were not intended.

Comment

Officials have proposed that a withdrawal by a fund of an amount invested in another fund should not cause a withdrawal tax liability.

Recommendation

That the submission be accepted.

Issue: Transfers between superannuation schemes and superannuation funds

Submission 1
(13 – ISI, 19 – ICANZ)

Amounts transferred from a foreign superannuation scheme, and from a superannuation scheme to a superannuation fund, should be considered employee contributions because they will have been subject to fringe benefit tax. They should therefore be excluded from the withdrawal tax provisions.

Submission 2
(19 – ICANZ)

When a transfer is made from a superannuation fund to a superannuation scheme, such amounts should not be subject to withdrawal tax. This situation is likely to be limited to those cases when a superannuation fund is deregistered from the Superannuation Schemes Act 1989.

Comment

The bill is silent on transfers from a superannuation fund to a superannuation scheme or foreign superannuation scheme and vice versa. Officials recommend that:

- Any amount transferred from a resident or non-resident superannuation scheme to a superannuation fund be treated as an employee contribution as any New Zealand employer contribution will have been subject to FBT. Further, if the member had withdrawn the funds from a superannuation scheme and then

deposited them into a superannuation fund, the alternative to direct transfer, that amount would have been treated as an employee contribution.

- Any amount transferred from a superannuation fund to a superannuation scheme is a withdrawal from the superannuation fund subject to the normal exemptions.

The approach to transfers from a superannuation fund to a superannuation scheme differs from that proposed in submission 2, which argues that the amounts transferred should not be subject to withdrawal tax. The reason for treating transferred amounts as withdrawals is that the withdrawal tax does not apply to withdrawals from superannuation schemes because employer contributions to superannuation schemes are subject to fringe benefit tax rather than SSCWT. To extend the application of the tax to superannuation schemes would broaden substantially the coverage of the withdrawal tax and thus increase the compliance costs imposed.

Recommendation

We recommend that

- any amount transferred from a resident or non-resident superannuation scheme to a superannuation fund be treated as an employee contribution;

- any amount transferred from a superannuation fund to a superannuation scheme is a withdrawal from the superannuation fund and, if the usual exemptions do not apply, will be subject to the withdrawal tax.

Issue: Transfer to defined benefit scheme

Submission
(22 – Watson Wyatt)

Defined benefit schemes should be permitted to receive transfers without the tax applying provided that the component of the transfer which would have been subject to the tax on payment is identified throughout the subsequent membership of the member and is subject to tax notwithstanding that it would be a withdrawal from a defined benefit scheme.

Comment

Officials have proposed significant changes in relation to the treatment of withdrawals from defined benefit funds. The bill currently proposes that withdrawals from a defined benefit fund be exempt from the withdrawal tax. However, in the light of submissions, officials now consider that a withdrawal from a defined benefit fund should be subject to the tax except where the withdrawal:

- is sourced from employee contributions, or the return on employee contributions; or

- is sourced from pre-1 April 2000 reserves; or
- is on cessation of employment; or
- is to alleviate significant hardship.

Because it is now proposed that withdrawals from defined benefit funds be subject to the tax, on the transfer of an amount from a defined contribution to a defined benefit fund, amounts which would be tax-free if the member were to withdraw from the defined contribution fund at the time of transfer should be deemed to be employee contributions in the defined benefit fund. This means that they could be withdrawn tax free from the defined benefit fund.

Recommendation

That the submission be accepted.

Issue: Deducting and accounting for withdrawal tax at time of transfer

Submission
(19 – ICANZ)

A superannuation fund to which contributions are transferred should be able to elect to deduct and account for the withdrawal tax at the time of receipt of the funds. This would be beneficial to employers that have over-funded superannuation funds that do not require employer contributions. By deducting the tax on entry, the superannuation fund need not be concerned about keeping systems in place to monitor those employees affected and may thereafter disregard any obligations related to this tax.

Comment

Making provision for transferee funds to deduct the withdrawal tax on receipt of the transferred funds would penalise members who may ultimately be able to withdraw from the transferee fund without payment of tax (for example, significant hardship, cessation). Officials therefore oppose the submission.

Recommendation

That the submission be declined.

BORROWING AGAINST A FUND

Issue: Application of tax to borrowing against the superannuation fund

Submission 1
(13 – ISI, 19 – ICANZ)

Borrowing from, or against an interest in, a superannuation fund should not constitute a withdrawal. Such a loan would already be subject to tax under section GD 6 in respect of any concessional interest component. In the vast majority of cases superannuation fund trustees would not simply give the money away as this would be a breach of their obligations to act fairly in all members' interests. In any case, the accrual rules would apply to deem a base price adjustment to any amount of the loan that is not repaid.

Submission 2
(14-ASFONZ)

It is inequitable that an amount borrowed from a superannuation fund should be treated as a "withdrawal" when by its nature a loan will be repaid. The only "withdrawal" as such is the difference between the FBT rate of interest and the interest paid, if the interest paid is lower than the FBT rate. If the amount borrowed is not repaid but is forgiven by the trustees, the amount forgiven would become a "withdrawal" and subject to the provisions at the date of forgiveness. The amount of a withdrawal should be the prescribed FBT rate less the rate being charged, applied to the amount of employer contributions to superannuation savings.

Submission 3
(12A – PricewaterhouseCoopers, 19 - ICANZ)

The provision should be limited to situations where a member borrows directly from the fund. The legislation is too wide in that it covers instances where a member uses their interest in the fund to borrow money.

Comment

Under the bill the withdrawal tax applies when a member borrows against an interest in a superannuation fund and the interest rate on the loan is less than the market rate. The concern underlying this measure is that one way to avoid the withdrawal tax is simply to borrow from a fund rather than make a withdrawal. If the member is charged no interest and the loan is for a long period, there is little difference in monetary terms between the loan and a withdrawal. While the fund will pay income tax at 33% on the concessional interest element, no withdrawal tax is paid.

The submissions argue that the withdrawal tax may simply be triggered by a movement in interest rates which has the unintended affect of making a loan concessional at a point in time.

Officials consider there are three potential solutions to the problem of members making withdrawals via a loan rather than directly:

- The proposal in the bill that if at any time a loan becomes concessional the fund withdrawal tax applies. To prevent this rule applying superannuation funds would have to ensure that the loans they provide are never concessional. This would be a matter of ensuring that the interest rate charged by the fund remains above the rate applying under the FBT rules. This measure imposes significant compliance costs on funds on monitoring loans to ensure this does not happen. Also, it may not actually be possible for a trustee to prevent this rule applying given the trustee has to abide by the loan agreement which may not allow an interest rate review.

- That the withdrawal tax be incorporated into an existing provision which states that the difference between the amount of interest that would be charged on a loan at a market rate and the interest actually charged is gross income to the superannuation fund. While theoretically feasible this measure would have significant compliance costs and would also require a trustee to continually track the income of a borrower to determine if they earn over $60,000.

- That the fund withdrawal tax only apply if, at the date of the loan, the interest rate is set at a rate that is less than the market rate. The concern with this approach is that those who wished to provide a concessional loan would ensure that it was not concessional initially making the measure ineffective.

Given the significant concerns expressed in submissions with the current approach and the costs associated with the alternative measures identified, officials have re-considered the extent of the avoidance risk. The issue is whether the benefits of reducing this avoidance opportunity exceed the costs that would be imposed in preventing this type of avoidance.

On the basis that a superannuation fund is currently charged income tax at 33% on the concessional interest element of a loan to a member, that the avoidance concern is probably only an issue with closely held funds and that the compliance costs the solutions would impose on all funds are significant, officials recommend that the current provision be removed.

Recommendation

Officials recommend the removal of section CL 4(1) and (2) which provides that a low interest loan to a member is a withdrawal.

WITHDRAWALS ON WINDING-UP OF FUND

Issue: No withdrawal tax on winding up

Submission 1
(16 – Tower)

Applying a withdrawal tax to a member when the withdrawal is literally imposed by the scheme trustee would be against public policy and the spirit of the establishment and wind-up rules of any trust deed establishing a superannuation trust. On a wind-up, scheme assets should be equitably distributed to members and not subjected to the withdrawal tax. A winding up of a scheme is a process and it should not be treated as an event for tax purposes.

Submission 2
(14 - ASFONZ)

There should be no tax payable in relation to a withdrawal when a superannuation fund is wound up by reason of the employer going into receivership or liquidation or otherwise ceasing to operate.

Submission 3
(16 – Tower)

The deregistration of a scheme should be excluded from a "winding up" process and any distribution of funds should not be subject to the withdrawal tax.

Submission 4
(13 – ISI)

There should be no tax payable in relation to a withdrawal made by a member who is made redundant as a result of the circumstances that have lead to the wind-up of the fund.

Comment

Whether an employer contribution is received by a member choosing to make a withdrawal or on the wind-up of a fund, the consequence is identical in that an employer contribution is received. If employer contributions were free on the wind-up of a fund there would be an incentive for superannuation funds to wind up as a way of distributing money to members. While this would not be an issue with larger schemes, it is quite feasible for this to occur with smaller numbers of members, or funds where members are related.

In the case of deregistration of a scheme, officials recommend that the withdrawal tax continue to apply to any withdrawal of employer contributions made during the period the superannuation scheme was a superannuation fund. However, if the superannuation scheme becomes a foreign superannuation scheme, the withdrawal tax should apply immediately to all liable employer contributions.

Recommendation

That:

- the submissions be declined and that withdrawal tax continue to apply to withdrawals on the wind-up of a fund
- in the case of deregistration, the withdrawal tax continue to apply to any withdrawal of employer contributions made during the period the superannuation scheme was a superannuation fund. However, if either a superannuation fund or an ex-superannuation fund becomes a foreign superannuation scheme the withdrawal tax apply immediately on deregistration to all liable employer contributions.

Issue: Exemption from tax

Submission 1
(19 – ICANZ)

It should be clear that only contributions that exceed the threshold levels and are not grandparented should be subject to tax if a superannuation fund is wound up.

Submission 2
(19 – ICANZ)

Section CL 9 needs to be clarified to cater for the situations when a wind-up and a withdrawal that qualifies as an exclusion from section CL 3 occur at the same time – for example, what if the fund winds up at the same time as employment ceases?

Comment

The policy intent of the bill is that grandparented amounts are not subject to tax when withdrawn, whether on winding up of a fund or otherwise. Similarly, whenever an exclusion from section CL 3 applies – for example when a member withdraws an amount on ceasing employment – the exclusion should apply regardless of whether the withdrawal is from a fund that continues to exist or one that is winding up.

We agree that the legislation should be clarified to reflect the policy intent.

Recommendation

That the submission be accepted.

Issue: Withdrawals on wind-up of fund transferred to another fund

Submission
(13 – ISI)

There should be no tax payable in relation to a withdrawal from a fund that is wound up where the withdrawal is transferred to another fund.

Comment

There should be no liability for withdrawal tax when the amount withdrawn is transferred direct from the fund that is winding up to the transferee fund. In other circumstances the tax should apply.

Recommendation

That the submission be accepted where amounts are transferred direct from a superannuation fund that is winding up to another superannuation fund.

OPTION TO ELECT 39% SSCWT RATE

Issue: Election on a per employee basis

Submission 1
(4 – NPF, 12A – PricewaterhouseCoopers, 14 – ASFONZ, 19 - ICANZ)

The election by employers to pay SSCWT at 39% on the contributions they make should be made on a per employee basis and not for all employees.

Submission 2
(14 – ASFONZ)

The election to withhold SSCWT at the 39% rate should be by agreement between the employer and employee rather than a unilateral decision of the employer.

Comment

Section CL 6 provides that the withdrawal tax will not apply to any contributions subject to the 39% SSCWT rate. This election is currently made by an employer, and if made, it applies to all SSCWT contributions made by that employer. Given the proposals to prevent application of the withdrawal tax to those earning, in total, less than $60,000, the generic application of the measure is inappropriate. Officials therefore agree with the submission that the election by employers to pay SSCWT at 39% on the contributions they make should be made on a per employee basis and not for all employees. Officials also agree that an election should take place with the agreement of the affected employee.

Recommendation

That the submission be accepted

Issue: Return on employee contributions

Submission
(14 - ASFONZ)

The tax should not apply in relation to the return on contributions subject to the higher 39% rate of SSCWT.

Comment

Officials agree that this is the correct approach.

Recommendation

That the submission be accepted.

Issue: Person determining composition of withdrawals

Submission
(19 – ICANZ)

Section CL 7(2) refers to an **employer** establishing the extent to which employer contributions have been subject to the 39% rate. This should refer to the trustee (with information provided to the trustee by the employer).

Comment

Officials agree that the trustee of a superannuation fund, rather than an employer, calculates the tax liability on withdrawals, including the extent to which employer contributions have been subject to the 39% SSCWT rate. Section CL 7(2) should therefore refer to the trustee.

Recommendation

That the submission be accepted.

DEFINED BENEFIT FUNDS

Issue: Exemption for defined benefit funds

Submission 1
(13 – ISI)

There appears to be little scope under a defined benefit fund for the avoidance the bill is directed at stopping, unless the trust deed is amended to allocate employer contributions to members. The bill should be amended to introduce the concept of employer contributions allocated to members rather than simply referring to employer contributions. Consequently, the exemption for defined benefit funds can be removed as it becomes unnecessary.

Submission 2
(4 – NPF, 8 – Mobil, 11 – Westpac, 12A – PricewaterhouseCoopers, 14 – ASFONZ, 18 – NZSA, 19 – ICANZ, 22 – Watson Wyatt)

The definition of "defined benefit fund" is too limited in that it applies only to superannuation paid in the form of a pension. This requirement should be deleted. The definition could be changed to "A scheme registered under the Superannuation Schemes Act 1989 which operates on the principle of unallocated funding and requires a periodic actuarial valuation as required under section 15 of the Act" (*PricewaterhouseCoopers).* Alternatively, the definition could be omitted and reliance be placed on the common law meaning.

Submission 3
(4 – NPF)

If the requirement that superannuation be paid in the form of a pension is retained, the DBP Contributors Scheme and Aircrew Superannuation Scheme, governed by the National Provident Fund Restructuring Act 1990, should be specifically exempted from the tax. This is justified because the Contributors Scheme is comparable only with the Government Superannuation Fund, which is specifically exempted.

Submission 4
(4 – NPF, 14 – ASFONZ)

The term "defined benefit fund" should be redefined so that the fact that an employer may temporarily cease to make contributions will not affect the status of the fund.

Submission 5
(4 – NPF, 14 - ASFONZ)

The definition of defined benefit fund should refer, in paragraph (b), to the member's **benefit** (rather than "return") being based on a formula that relates the benefit to the length of time an employer has been a member of the fund, and not the length of time in employment.

Comment

Submissions point out that very few defined benefit schemes come within the definition in section CL 8(2) because members can generally withdraw part of their entitlement by way of a lump sum. It appears that they can do this on retirement or while in employment.

Because of this, officials are concerned that there may be opportunities to route remuneration through a defined benefit scheme – most likely one with few members. However, as employer contributions are not attributable to particular members, the general rule applying to defined contribution funds cannot apply to defined benefit funds.

We therefore recommend that the proposed exemption in section CL 8(1) for withdrawals from a defined benefit fund be deleted. Instead, withdrawals from a defined benefit fund would be subject to the withdrawal tax except to the extent that the withdrawal:

- is sourced from employee contributions, or the return on employee contributions; or
- is sourced from pre-1 April 2000 reserves; or
- is on cessation of employment (the two-year exceptions to this exemption will not apply); or
- is to alleviate significant hardship.

Officials understand that some trust deeds provide that employer contributions are deemed to be member contributions. Only contributions that are actually made by employees should be withdrawn tax free.

Definition of defined benefit fund

The definition of "defined benefit fund" in section CL 8(2) will still be required. We accept the point raised in submissions that most funds are excluded by the requirement in paragraph (c) that a member's benefit is payable only as a pension, and propose that the current definition be deleted and replaced with that suggested in submission 2.

The changes suggested in submissions 3, 4 and 5 are, therefore, no longer relevant.

Recommendation

That:

- a withdrawal from a defined benefit scheme be subject to the tax except where the withdrawal:

  - is sourced from employee contributions, or the return on employee contributions; or

  - is sourced from pre-1 April 2000 reserves; or

  - is on cessation of employment; or

- is to alleviate significant hardship.

- the definition of defined benefit fund proposed in submission 2 be accepted.

- submissions 3, 4 and 5 be declined as they no longer apply.

Issue: Withdrawal tax in relation to defined benefit schemes

Submission
(18 - NZSA)

For defined benefit schemes, the whole benefit arising from the past two years worth of membership, less the total of the accumulated member's own contributions in the last two years, should be subject to the withdrawal tax with the same exclusions as employer contributions to defined contribution funds. However, the same level of contributions before and after April 2000 would be replaced by the same level of benefits.

Comment

If the Committee agrees with officials' earlier recommendations in relation to the treatment of defined benefit schemes, this submission is no longer relevant.

Recommendation

That the submission be declined.

Issue: Conversion from defined benefit scheme to defined contribution scheme

Submission
(18 – NZSA)

When a fund converts from defined benefit to defined contribution, a level of employer contributions to which the general exemption will apply needs to be provided for. The bill should be amended to set this level through discussions with the Government Actuary.

Comment

The proposed new treatment of defined benefit funds is discussed earlier in this report. Where a scheme converts from defined benefit to defined contribution, employee contributions and the return on those (together with any pre-1 April 2000 reserves) should be tagged. Withdrawals up to that amount should not be subject to the withdrawal tax.

Recommendation

That the submission be declined but that on conversion of a scheme from defined benefit to defined contribution, employee contributions and the return on those should be tagged as they should not be subject to the withdrawal tax on a subsequent withdrawal.

DEFINITION OF "EMPLOYER CONTRIBUTIONS"

Issue: Definition of employer contributions to superannuation savings

Submission 1
(13 – ISI, 14 – ASFONZ, 17 – Dairy Group, 18 – NZSA)

Paragraph (b) of the definition of "employer contributions to superannuation savings", which refers to any return on employer superannuation contributions, should be removed or amended to include only amounts of gross income derived from the investment of certain employer contributions.

Submission 2
(19 – ICANZ)

The definition of "employer contributions" includes any return on employer contributions. The amount of the return should be set by reference to the actual fund earnings for the previous income year of the find. Also, a simple formula should be available to be used to determine the return.

Submission 3
(13 – ISI, 12 – NZSA, 14 – ASFONZ, 17 – Dairy Group, 20 – Phillips Fox, 22 - Watson Wyatt)

Paragraph (c) of the definition, which refers to reserves, also should be removed or amended to refer only to amounts of gross income derived from the investment of those reserves.

Submission 4
(17 – Dairy Group)

If funds are required to track returns on employer contributions and reserves, the Commissioner should be given discretion to accept alternative methods that approximate tracking or produce materially similar results. This would provide superannuation funds with an ability to reduce compliance costs should acceptable methods be developed and endorsed by the Commissioner.

Comment

Returns on employer contributions, and reserves

Submissions recommend that paragraphs (b) and (c) of the definition of "employer contributions to superannuation savings" be deleted or include only amounts of gross income derived from the investment of employer contributions. Those paragraphs respectively include in the definition any return on employer superannuation contributions, and reserves (defined as employer contributions which do not vest in a member, and any return on those contributions).

Officials do not support the deletion of paragraph (b). All returns to employer contributions are subject to the withdrawal tax in order to minimise avoidance

opportunities. Employers could make a large contribution to a superannuation fund, with the return on that contribution being taxed at 33% and subsequently withdrawn by employees earning over $60,000.

Officials also oppose the deletion of paragraph (c), which is designed to counter avoidance schemes based on the creation of reserves which can be allocated to members earning over $60,000.

Narrowing the definition of “return” or “reserves” to include only amounts of gross income derived from the investment of employer contributions would provide scope for funds to allocate non-taxable investment returns to employer contributions, and taxable returns to employee contributions. Officials recommend the submissions be declined.

Calculating return on employer contributions

ICANZ suggests that the amount of the return on employer contributions should be set by reference to the actual fund earnings for the previous income year, or on the basis of a simple formula. The Dairy Group suggests that the Commissioner accept alternative methods that approximate tracking.

Officials understand that returns to members have to be calculated for the purposes of the superannuation fund. Whatever method is chosen for this purpose should be adopted in calculating the return for withdrawal tax purposes.

Recommendation

That the submissions be declined.

RECOVERING TAX FROM MEMBERS

Issue: Deduction of tax from amount withdrawn

Submission
(12A – PricewaterhouseCoopers, 19 - ICANZ)

If the form of the tax remains as an income tax, the legislation should be amended to allow trustees to withhold the tax from the withdrawal rather than recover it from the member subsequently.

Comment

Officials agree with the submission. The intention is that trustees have the ability to withhold or recover any tax liability arising from a withdrawal from the member making that withdrawal.

Recommendation

That the submission be accepted.

Issue: Recovery of trustee expenses

Submission
(13 – ISI, 20 – Phillips Fox)

Proposed section 165AA should be amended to allow a trustee of a superannuation fund the option also to recover from the member any necessary expenses incurred in calculating the withdrawal and the amount of tax liability, and in notifying other trustees and the member in relation to transferred benefits.

Comment

Officials agree that trustees should be able to recover from a member making a withdrawal reasonable costs associated with processing a withdrawal request. If this were not the case, members remaining in the superannuation fund would be required to a bear that cost. This would be inequitable on those members.

Giving effect to this amendment will require an amendment to the Superannuation Schemes Act 1989.

Recommendation

That the submission be accepted.

MISCELLANEOUS DRAFTING ISSUES

Issue: Application dates

Submission
(19 – ICANZ)

A central application date provision should be inserted in the bill to clarify application. Currently the application dates are spread throughout the various withdrawal tax provisions.

Comment

To the extent that application dates can be amalgamated, officials consider that this is desirable. However, if an application date is specific to a particular section, it should be retained in that section.

Recommendation

That the submission be accepted in part.

Issue: Priority of provisions

Submission
(13 – ISI)

Section CL 3 needs to be redrafted to make it clear that the exemption for pre-1 April 2000 amounts takes precedence over all other clauses.

Comment

Officials agree that a section should be inserted at the beginning of the withdrawal tax provisions that makes it clear that the tax does not apply in relation to grandfathered amounts, such as pre-1 April reserves.

Recommendation

That the submission be accepted.

Issue: Separation of employer and employee contributions

Submission
(13 – ISI, 14 – ASFONZ, 19 - ICANZ)

Section CL 3(1)(a) should be amended to provide that the withdrawal tax applies only if a member withdraws from a superannuation fund to which an employer of the member has made contributions *on behalf of the member*.

Comment

Officials agree with the submission. The withdrawal tax should potentially apply only if the withdrawal by a member is from a superannuation fund to which an employer has contributed on behalf of that member.

Recommendation

That the submission be accepted.

Issue: Application of CL 5

Submission
(14 – ASFONZ, 16 - Tower)

Section CL 3(1)(b) is drafted in such a way that no amounts will ever fall within it. The section should be removed, or re-worded to give effect to the policy behind the section. It should be amended to read: "one that has received a transfer from another superannuation fund in respect of the member withdrawing, *not* being a transfer to which section CL 5 applies."

Comment

Section CL 5 exempts transfers between funds from the withdrawal tax, but this excludes transfers to a defined benefit fund. In the discussion on defined benefit funds officials have recommended that these be subject to the tax. As a result, the provisions to which the submissions refer have been redrafted and the point made in them is no longer relevant.

Recommendation

That the submissions be declined.

Issue: Section placement

Submission
(19 – ICANZ)

Section CL 4(3), (4) and (5) should be located in a more appropriate section, because section CL 4 deals with the extended meaning of "withdrawal". These subsections state when section CL 3 does not apply. They should be drafted either as an exception to section CL 3 or put into a separate section.

Section CL 7(1) is an exclusion to section CL 3 and should be put into that section.

Section CL 8(1) is an exclusion to section CL 3 and should be put into that section.

Section CL 9 should be incorporated in the principal charging provision section CL 3.

Comment

Officials agree that the exceptions to section CL 3 should be placed together, in a separate section. We also agree that section CL 9 should be incorporated into the principal charging provision.

Recommendation

That the submissions be accepted.

Issue: Withdrawal tax should not apply where only employee contributions withdrawn

Submission
(13 – ISI, 14 – ASFONZ, 29W – Deloitte Touche Tohmatsu)

Section CL 3 should not apply when the trustee can show that no part of the amount withdrawn was contributed by the employer. The effect of section CL 3(4) as drafted now is not to allow the exemption if only employee contributions are withdrawn.

Comment

Section CL 3 currently provides that amounts withdrawn will be subject to the withdrawal tax unless the trustee can establish the employer contribution component withdrawn, in which case the tax is limited to that component.

The submission is that the withdrawal tax not apply to the tax to the extent the trustee knows the amount withdrawn is from employee contributions. This approach gives a trustee the option of tracking the employee rather than employer contribution, which in some cases may be easier. If any withdrawal does not exceed the amount of any employee contributions, no withdrawal tax will apply.

Recommendation

That the submission be accepted.

Issue: Transfers between superannuation funds

Submission
(14 - ASFONZ)

Section CL 5(1) should state that section CL 3 does not apply to an "amount" that is transferred to another superannuation fund. It currently refers to a "withdrawal" that is transferred.

Comment

The submission is accepted. It would be clearer if the provision referred to an "amount".

Recommendation

That the submission be accepted.

Issue: Trustee of transferor fund

Submission 2
(14 - ASFONZ)

Section CL 5(4) should refer to the **trustee** of the transferor fund, rather than the fund itself, as having responsibility for determining the degree to which the transfer is composed of employer contributions.

Comment

Officials agree that the section should refer to the trustee of the fund.

Recommendation

That the submission be accepted.

Issue: Treatment of withdrawal if employer elects higher rate of SSCWT

Submission
(13 – ISI, 14 - ASFONZ)

As section CL 7(2) is currently drafted, it would not allow an exemption for "grandparented" amounts or member contributions. Section CL 7(2) should be amended to limit the application of section CL 3 to the amount that would otherwise be subject to the withdrawal tax.

Comment

The concerns expressed in this submission will be addressed by the proposed insertion of a section at the beginning of the provisions that makes it clear that the tax does not apply to grandparented amounts or member contributions.

Recommendation

That the submission be accepted.

Issue: Minor drafting error

Submission
(22 – Watson Wyatt)

The first paragraph under section CL 9 should be annotated (1).

Comment

This submission reflects confusion between the numbering of the proposed sections for the Income Tax Act 1994 and the clause numbering of the bill.

Recommendation

That the submission be declined.

Issue: Section numbering

Submission
(19 - ICANZ)

The amendment proposed in section NE 2AA should be included by way of amendment to section NE 2, which already contains an exemption to the standard SSCWT rate.

There is also an internal inconsistency. Section NE 3 requires the employer to deduct the amount of SSCWT specified in section NE 2(which is either 33% or nil if section NE 2A applies). Under the proposed section NE 2AA, the employer may elect to "pay" SSCWT at 39%. Which section is right?

Therefore, ICANZ recommends that the following amendments be made to section NE 2A:

(1) A specified superannuation contribution made to a superannuation fund is subject to specified superannuation contribution withholding tax at the rate specified in Schedule 1, Part A, clause 10, unless **either** section NE 2A(2) **or subsection (3) of this section** applies.

(2) For the purposes of the SSCWT rules, unless the context otherwise requires, the amount of a specified superannuation contribution shall be deemed to be the aggregate of-
   (a) the amount of the specified superannuation contribution received by the superannuation fund; and
   (b) the amount of any specified superannuation contribution withholding tax payable under the SSCWT rules in respect of the contribution.

(3) An employer may elect to deduct specified superannuation contribution withholding tax on specified superannuation contributions made to a superannuation fund on or after 1 October 2000 at the rate specified in Schedule 1, Part A, clause 10(a)

(4) An employer makes an election under subsection (3) by paying specified superannuation contribution withholding tax at the rate specified in Schedule 1, Part A, clause 10(a).

Comment

Officials agree with the intention of the suggested provisions, although there may be a better approach to the drafting than that proposed in the submission. Officials therefore recommend:

- an amendment to section NE 2 to refer to section NE 2AA; and

- an amendment to section NE 3 to refer to either a 33% or 39% deduction rate. This would be specified in either section NE 2 or NE 2AA accordingly.

Recommendation

That the submission be accepted but that the drafting recommendations to address the concerns raised not be accepted.

Issue: Tax recovered from member

Submission
(22 – Watson Wyatt)

Section 165AA(2) of the Tax Administration Act 1994 is to have a formula "tax rate x gross income" with the tax rate defined by reference to Schedule 1, Part A, clause 4 of the Income Tax Act 1994. For consistency, section CL 3(1) should be constructed in a similar fashion. That is, instead of stating 15.15%, it should be 5.0% divided by the tax rate stated in Schedule 1, Part A, clause 4 of the Income Tax Act 1994.

Comment

Officials consider the submission has merit and agree with the recommendation.

Recommendation

That the submission be accepted.

MULTI-RATE FRINGE BENEFIT TAX

OVERVIEW OF SUBMISSIONS

Submissions received

Retail Merchants Association of New Zealand (1)
Air New Zealand (5)
New Zealand Law Society (6W)
Health Funds Association of New Zealand (HFANZ) (10)
PricewaterhouseCoopers (12, 12A)
New Zealand Employers' Federation (15)
Institute of Chartered Accountants of New Zealand (ICANZ) (19)
Corporate Taxpayers Group (21W)

General comment

Submissions received on the FBT changes have been generally supportive of the proposal to create more equitable FBT rules. More specifically, submitters have noted that the proposal alleviates the long-standing problem of fringe benefits received by low-income employees being overtaxed, while limiting the opportunity for fringe benefits to be used to plan around the 39% top personal tax rate.

Although the benefits of the proposal are generally supported, most submissions point out that the multi-rate rules will result in some increase in compliance costs. Under the current rules, employers simply apply a flat rate to the value of fringe benefits they provide. The proposal will require employers to identify the fringe benefits individually received by employees and to calculate the FBT payable, while pooled benefits, in general, will be subject to a flat 49% rate. This issue can be seen solely as a trade-off between equity and compliance costs, and submissions generally recognise that the benefits of accuracy (equity) far outweigh the increased complexity of the calculation involved.

In general, officials have supported submissions which presented amendments to improve the clarity of the legislation or indicated changes that reduced compliance costs without a corresponding loss of equity or increase in administration costs.

The bill, as introduced, requires the FBT payable to be calculated by using FBT rates equivalent to the total cash remuneration received from the employer providing the fringe benefits. For example, if the employee's cash remuneration is $55,000, any attributable fringe benefits received by that employee are taxed at the flat rate of 49%, notwithstanding that the value of the fringe benefits may mean that the employee's marginal tax rate is 39% (an equivalent FBT rate of 64%).

Officials propose that the bill be amended so that the value of the attributed benefits is taken into account in calculating the FBT payable on those benefits. Such a change will require substantial drafting changes to the FBT provisions in the bill, and officials seek the Committee's approval to consult with interested parties such as ICANZ on these proposed changes.

INCLUSION OF VALUE OF ATTRIBUTED BENEFITS IN CALCULATION OF FBT PAYABLE

Submission
(Matter raised by officials)

Officials propose that the bill be amended so that the value of the attributed benefits is calculating FBT payable on those benefits.

Comment

Under the proposed legislation, the FBT liability for attributable benefits is calculated by determining the level of cash remuneration received by the employee concerned and applying the appropriate flat rate (as shown in the table below). Cash remuneration is defined in the bill as salary and wages, extra emoluments, withholding payments, and payments to a specified office holder. All pooled benefits are subject to the flat 49% rate.

Table 1 – Method under the proposed legislation

Cash remuneration	*FBT rate to apply*
Less than $38,000	27%
$38,000 to $60,000	49%
Over $60,000	64%

Officials have identified two problems with this approach:

- The major consequence identified is that because the FBT rate applied is a flat rate, a $1 increase in remuneration could result in employers having to pay an increased rate of FBT on all the fringe benefits they provided. This creates inefficiencies in remuneration decisions in that a $1 pay increase could cost an employer more than $1 in increased FBT liability.

- A secondary consequence of this approach is that it may result in some level of tax avoidance by employers and employees negotiating to cap cash remuneration below a tax threshold (such as $37,999 or $59,999). By structuring remuneration packages in this way, employers would be liable for payment of FBT at a lower rate.

Officials have identified an alternative approach called the “net remuneration” method whereby the value of attributed benefits is taken into account in calculating the FBT payable on those benefits.

The calculation proposed results in fringe benefits passing through progressive tax bands (akin to income subject to PAYE), and thus the problems of applying flat FBT rates are avoided. Put another way, the proposed calculation results in the same amount of tax being paid as if the entire remuneration package was cash, irrespective of the proportion of fringe benefits in the package. This method, therefore, has the advantage of not impacting on employment package decisions.

The steps involved in the net remuneration method are explained in table 2.

Table 2 – Net remuneration method

The following steps summarise the method:
1. Take the net cash remuneration of an employee (after the PAYE assessed is deducted).
2. Add the taxable value of all attributable fringe benefits to this amount.
3. Use the "tax exclusive" scale to calculate the total tax payable on this amount.
4. Subtract from the total tax payable amount the PAYE assessed – the difference being the FBT due for that employee.

Table 3 – Tax rates and tax payable under the method

"Net" income including fringe benefits (statutory tax bands in brackets)	**Grossed-up tax rate (statutory rate in brackets)**	**Tax payable (cumulative)**
0		0
	18% (15)	
8,075 (9,500)		1,425
	27% (21)	
30,590 (38,000)		7,410
	49% (33)	
45,330 (60,000)		14,670
	64% (39)	

The calculation would apply as follows:

Salary	$55,000
Less PAYE	13,020
Net salary	**41,980**
Plus value of attributed fringe benefits	7,000
Net value of salary	**48,980**
Tax payable	17,006
Less PAYE	13,020
FBT payable	**$3,986**

This proposal will increase compliance costs for employers as they will be required to undertake the calculation for each employee who receives attributed benefits rather than determine for each employee the flat FBT rate to apply to the value of attributed benefits based on their cash remuneration. Officials consider that the increase in compliance costs is offset by the increased accuracy and by eliminating the significant FBT liability that may arise where an employee's remuneration crosses a threshold owing to overtime or a salary adjustment. We have discussed this proposal with ICANZ, the Employers' Federation and the tax adviser to the Committee. They have indicated their support for this change.

Inland Revenue is looking at ways of providing employers with the necessary information (such as tax tables) to undertake this calculation and thereby reduce compliance costs.

Recommendation

That a fringe benefit inclusive definition of cash remuneration be used to calculate FBT liability as outlined in the net remuneration method above.

CHANGING FBT TO AN EMPLOYEE-BASED TAX

Submission
(15 – New Zealand Employers' Federation – issue not in bill)

The employees receiving the fringe benefits and not the employers providing them should be liable for FBT. It is "quite bizarre" that employers are liable for the tax impost on a form of remuneration to employees, and as such the FBT rules are inconsistent with the PAYE rules, where employees are taxed on their gross income. Therefore FBT should be taxed in the hands of employees so that the fringe benefits received are taxed at the appropriate rate.

Comment

There are difficult and substantial issues to consider when a tax liability is moved from the employer to the employee. Fringe benefits are a different form of remuneration from income subject to PAYE, in that many benefits are not readily substitutable for cash as the benefit that an employee receives may be at best, an indirect form of remuneration. For example, an employee may not want use of the company car over the weekend, but may under the terms of his or her employment be required to take the car home because of a lack of parking at work.

The taxable value of a fringe benefit may not represent the actual worth of the benefit to the employee. Furthermore, as fringe benefits necessarily have to be grossed up to be taxed (unlike cash, where tax can be withheld), subjecting employees to FBT would see their net cash incomes decrease to pay their FBT liability. This change would also have significant consequential effects on social policy entitlements.

The multi-rate proposal in this bill reflects Government policy of retaining FBT as an employer-based tax, but in doing so, taking account the remuneration derived by employees receiving the benefits. Under the proposal, the benefits that can be attributed to individual employees are taxed at a more appropriate rate than had been the case with the previous flat FBT rate.

Recommendation

That the submission be declined.

TRANSITIONAL PERIOD

Submission
(10 – HFANZ, 12A – PricewaterhouseCoopers)

Both submissions question the need for a compulsory 64% rate in the transitional first quarter of the 2000-2001 year.

HFANZ argues that this transitional quarter will add to the complexity of the changes and compliance costs for employers, who will have to apply the 64% rate in the first quarter and then have a choice of rates from the second quarter onwards.

PricewaterhouseCoopers submits that the compulsory application of the 64% in the transitional quarter (April to June 2000) is unfair and should not proceed. It argues that while some employers will overpay relative to the new rules in the bill, they will not receive use of money interest.

Comment

The Taxation (Tax Rate Increase) Act 1999 increased the FBT rate from 49% to 64% with application to fringe benefits provided or granted on or after 1 April 2000.

The bill proposes that there be a transitional period for the first quarter of the 2000-2001 year where the flat 64% rate would apply. This was necessary as employers are required to file a return for the first quarter before the bill is enacted. The transitional period allows Inland Revenue time to redesign returns, make system changes, and inform employers of their new FBT obligations, which contain significant changes from the current FBT rules. This implementation is contingent on the legislation being in place before a return is due.

The expected date of enactment of the legislation will be delayed to such an extent that the option of applying 49% or 64% for a quarterly return cannot be implemented for the second quarter. (Note that the expected enactment date is now late August – early September.) This is because any delay in enactment impacts on the ability to implement the changes in terms of completing the necessary technical checking, testing system changes, and the printing and distribution of information to employers.

Therefore officials recommend that the transitional period apply to both the first (April to June) and second quarter (July to September) returns for the 2000-2001 year. Any overpayments resulting from the transitional period can be adjusted in the end of year square-up.

Recommendation

That the submission be declined, and that the application of the compulsory 64% rate be extended to the second quarter of the 2000-2001 year.

ATTRIBUTABLE FRINGE BENEFITS

Submission

(12A – PricewaterhouseCoopers, 19 – ICANZ)

Further guidance is required to determine the principle recipient or user of fringe benefits.

Currently the bill requires employers to attribute certain benefits to the employee who "principally uses, enjoys or receives the benefit" or to whom the fringe benefit is "principally available."

Further clarification is needed in the legislation to guide employers in how to treat certain scenarios. For example, there is ambiguity in how to treat the situation of two employees having exclusive use of a motor vehicle for half a quarter each.

Comment

Officials agree that the bill should be clarified to provide guidance to employers. Therefore we recommend clarifying that the principal user is the employee to whom the fringe benefit is used, enjoyed, or available to (against any other employee or employees using, enjoying or having that same benefit available to them in that quarter). In other words, the employer will be required to determine the principle user on a quarterly basis. By requiring employers to attribute the benefit only to the one employee who benefited most from it during the quarter concerned, employers can avoid complicated apportionment calculations to different employees within a quarter.

The principal user rule outlined above works in all but one situation, in which some apportionment will be required – where two employees have exclusive use of the same fringe benefit for the same amount of time within the same quarter. In this specific situation, employers should be required to split the value of the fringe benefit equally between the two employees.

Recommendation

That the submission be accepted and the bill be amended as outlined above.

ATTRIBUTION CATEGORIES

Issue: Section CI 1(h) benefits

Submission
(12A – PricewaterhouseCoopers)

The "catch-all" category, section CI 1(h) should be able to be broken down into further categories to allow the $1,000 threshold to apply more sensibly.

Currently the bill as written will result in employers having to track low-value benefits they provide that fall into category (h) as over a year a number of these low-value fringe benefits could breach the threshold. This is a result of category (h) being a "catch-all" category which can include fringe benefits ranging from inexpensive flowers to more substantial benefits such as car-parks.

The alternative approach would therefore be to grant employers the option of breaking-down category (h) benefits into further sub-categories to which the $1,000 threshold would then apply.

Comment

Officials agree that the proposed threshold of $1,000 could be breached as a result of the accumulation effect of a number of low-value benefits and therefore has the potential to impose compliance costs on employers in tracking low-value benefits. However, breaking-down category (h) benefits into further sub-categories does cause definitional problems in ensuring that all benefits are covered. Furthermore, it would create an opportunity for employees to substitute a wider range of fringe benefits for salary, if the value of those fringe benefits is under the attribution threshold and taxed at the non-attribution rate of 49%.

Officials consider that the attribution threshold for category (h) benefits should be increased to $1,500. We have discussed this with the Committee's tax adviser, who supports an increase.

Recommendation

That the attribution threshold for category (h) benefits be increased to $1500.

Issue: $1,000 threshold for fringe benefit categories

Submission
(10 – HFANZ)

The use of a category threshold of $1,000 is supported but this level should be indexed to account for increases in insurance premiums over time.

Comment

The Income Tax Act 1994 and the Tax Administration Act 1994 contain numerous thresholds, and none of these thresholds are automatically adjusted each year by an index (such as the CPI). However, a number of thresholds in the Income Tax Act 1994 can be adjusted by Order in Council. This provides some flexibility in increasing such thresholds without the need to amend the legislation.

Recommendation

That the submission be declined, but the attribution threshold be able to be altered by Order in Council.

TAX RETURN FILING

Issue: Availability of the 27% filing rate for quarters 1-3

Submission
(10 – HFANZ)

Under the proposed legislation, employers can choose to apply either the 49% or 64% FBT rate to the taxable value of fringe benefits they provide in the first, second and third quarter returns they make during the year. The 27% rate for attributable fringe benefits can only be applied in the final quarter and yearly square-up.

Employers should have the option of using the 27% for their quarterly returns during the year. This option would avoid making employers overpay their FBT during the year and in doing so require them to claim a refund under the square-up at year's end.

Comment

Officials recognise that there will be a group of employers who will overpay their FBT liability in the first three quarters. This will occur if a significant number of low-income employees (earning under $38,000) have received attributable fringe benefits. However, allowing all employers to be able to elect a 27% rate will have significant cash-flow implications for the Government. As a result, the Government would need to consider whether it should implement use of money interest rules to minimise this effect. Such rules would increase both compliance costs on employers and administrative costs on Inland Revenue. Currently a significant majority of employers would have an average tax rate closer to 49%.

Recommendation

That the submission be declined.

Issue: Option in the final quarter to pay retrospectively the flat 64% rate for prior quarters

Submission
(6W – New Zealand Law Society)

The bill provides employers with three options. If they pay 49% in any quarter they must undertake the end of year square-up, or if they pay 64% in every quarter they can choose either to undertake the square-up or avoid the calculation and pay a flat 64% rate (that is, pay 64% in every return period).

At the very least in the first year of the new rules, employers should be able to have the option of paying a flat 64% in the final quarter irrespective of the FBT rate used in prior quarters. In other words, employers should be able to pay 49% in the first three quarters and be able to "top up" these payments to 64%, should they decide by the final quarter, to pay the flat 64% rate.

Comment

The intention of the bill is to give employers the choice of either opting into the square-up by paying 49% in earlier quarters, or avoiding the square-up altogether but paying 64%. Allowing employers to "top up" payments to 64% at the end of the year would cause significant revenue loss in terms of use of money. Any employer who would have otherwise opted out of the square-up and chosen to use the 64% rate in every quarter would simply use the 49% rate and retain the difference for payment in the final quarter.

Recommendation

That the submission be declined.

Issue: Widening the eligibility for annual filing

Submission

(10 – HFANZ – issue not in bill)

FBT is filed quarterly (the most common method), annually, or by income year. The eligibility for employers to move from being quarterly to annual filers should be widened.

Such a move would reduce compliance costs for many employers, who would no longer be required to file returns every quarter. Under the changes, annual filers will simply have to decide either to apply the flat 64% rate or undertake the square-up at year's end.

Comment

Approximately 18,000 employers are eligible to file annually as their gross PAYE and SSCWT deductions are less than $100,000 per annum. However, only about 2,000 of these employers choose to file annually. We understand that one of the main reasons for this is the imposition of use of money interest charged on FBT returned annually.

As part of the changes proposed in the discussion document *Less Taxing Tax*, this bill removes the imposition of use of money interest from 1 April 2001. Therefore the major barrier preventing more eligible employers moving to annual filing will be removed. Consequently, it is likely that there will be a significant movement by eligible employers from filing quarterly to annually.

Furthermore, an increase in the eligibility threshold from $100,000 to $125,000 would only result in a 5 percent increase in the number of employers eligible for annual filing, while an increase to $150,000 would result in a 9 percent increase. Officials consider, therefore, that the removal of the current use on money interest rules will enable a significant number of employers who pay FBT to adopt an annual return.

Recommendation

That the submission be declined.

FINAL QUARTER AS A FINAL TAX

Submission
(12A – PricewaterhouseCoopers)

The legislation lacks explicit guidance that the election either to pay 64% in all quarters or elect into the square-up is irrevocable, with the tax paid in the fourth quarter a "final tax".

An amendment should be made to state explicitly that the election is irrevocable. There are examples of this in other areas of the Income Tax Act 1994.

Comment

Officials accept that legislation should be clarified to ensure that an employer who elects to pay FBT at the 64% rate in relation to the final quarter could not at a later date seek to undertake a square-up for that year. An employer makes an election by filing and paying FBT at the elected rate. A similar provision is required for employers who file annually and elect the 64% rate.

Recommendation

That the legislation be clarified to ensure that elections are irrevocable.

MAJOR SHAREHOLDERS

Submission
(19 – ICANZ)

Under the proposed legislation, if a major shareholder-employee is a recipient of a pooled fringe benefit, a higher pooled flat rate of 64% will apply, rather than the flat 49% rate for other pooled benefits.

From a compliance point-of-view it is more appropriate to have just the 49% rate. Furthermore, the bill assumes that all major shareholder-employees are high-income earners so should be subject to the 64% rate.

Comment

Major shareholder-employees are different from other employees in that they either have or appear to have some control over remuneration decisions. Therefore major shareholder-employees not only have the incentive but can also have the ability to structure remuneration packages in the most tax-advantageous way.

Officials recommend an amendment be made to the bill to allow employers to use two separate pools. Employers could use one pool subject to the 64% rate for any pooled fringe benefits received by a major shareholder-employee, and an optional second pool at the 49% for pooled fringe benefits not received by a major shareholder-employee. Note that a particular pooled benefit could be placed in only one of these pools. For example, if a pooled vehicle was shared by several non-major shareholder-employees it could be placed in the 49% pool. However, that same car used by several employees including a major shareholder-employee would be subject to the 64% rate.

All employers under the bill have the option to attribute low-value benefits (that is, below the attribution threshold). Therefore a major shareholder employee with a low or middle income could attribute all the low-value benefits provided, leaving only shared benefits at the 64% rate.

Recommendation

That the submission be declined, but that the legislation be amended to allow for two pools for pooled benefits as outlined above.

SUBSIDISED TRANSPORT CATEGORY

Issue: Treatment of subsidised transport

Submission
(5 – Air New Zealand)

Employers are required to attribute subsidised transport provided to employees where the value of the transport is $1,000 or more. Under the fringe benefit tax rules, the value of subsidised transport is calculated as 25 percent of the market value of the travel. Therefore the market value would have to exceed $4,000 per employee per year before the employer would be required to attribute that travel to a particular employee.

Air New Zealand submits that fringe benefits in the subsidised transport category should be pooled and taxed at the 49% pooled rate. Furthermore, Air New Zealand submits that the proposed exclusion should apply only where all staff are entitled to the same or similar subsidised travel entitlement. (In their case travel is tied to length of service, not position in the organisation.) This is to prevent subsidised travel being substitutable for salary or wages.

The justification made for the submission is that by including subsidised transport as a category where benefits with a value of $1,000 or more have to be attributed, Air New Zealand will incur significant compliance costs in tracking travel provided to staff when in only a minority of situations would the threshold be breached. Furthermore, any employees receiving travel over the threshold could well be subject to the 49% rate (the same as the pooled rate anyway) or the 27% rate (employees earning $38,000 or less).

Air New Zealand has advised officials that the compliance costs of changing their systems to identified subsidised travel that should be attributed to employees is:

One-off system changes - $22,000
Ongoing staff costs - $17,000 per annum. (This cost is to ensure that the data entered into the system is accurate.)

Similar issues arise for Tranz Rail and other airlines.

Comment

Officials recognise Air New Zealand’s concern about the compliance costs associated with initial systems costs and the ongoing costs of tracking and correlating subsidised travel provided against employee remuneration information. Furthermore, officials note their evidence that owing to the universal nature of their travel entitlement and the employee data provided, there would be no significant difference in revenue from either requiring attribution or exempting this category from attribution and allowing the flat 49% pooled rate to be applied. The analysis provided by Air New Zealand indicates that the additional revenue could be somewhere between $3,172 (10 percent of subsidised travel attributed) and $15, 858 (50 percent of subsidised travel attributed).

Against these arguments is the concern that granting an exemption from attribution for the category of subsidised transport could set a precedent for other taxpayers to seek similar exclusions based on compliance cost concerns. Officials recognise that the subsidised transport category is unique in terms of the small number of taxpayers involved as it applies only to employers who are in the business of providing transport.

Recommendation

That, on balance, an option be granted for fringe benefits in the subsidised transport category to be pooled at 49%. However, this option will be conditional on the entitlement to the benefit being open to all employees on the same terms (including length of service), but cannot be based upon position or rank in the organisation. Any benefits restricted to certain positions, such as managers, will be required to be attributed where the value of the benefit is $1,000 or more.

DEDUCTIBILITY OF FRINGE BENEFIT TAX

Submission
(21W – Corporate Taxpayers Group – issue not in bill)

Employers are able to deduct 33 percent of the grossed-up value of the fringe benefits they provide from their income tax. This deduction will not be affected by any changes in the bill.

Employers should be able to elect to forgo the deductibility of FBT, however, and in exchange use a reduced FBT rate. The deduction is of little use to employers who are in a tax loss position, and the new 64% rate for benefits attributable to employees earning over $60,000 will simply result in their cashflow being reduced to pay their FBT liability. The deduction they receive will be of little use to them.

Comment

The issue of forgoing the deductibility of FBT in exchange for a reduced FBT rate is outside the scope of the bill. Furthermore, any move towards this suggestion would be inconsistent with general tax policy of not allowing taxpayers to cash up losses. The Income Tax Act 1994 allows the cashing-up of losses only to offset tax penalties that have been imposed.

Recommendation

That the submission be declined.

RESPONSIBILITY FOR THE CALCULATION

Submission
(19 – ICANZ)

Inland Revenue is better placed than employers to undertake the end of year square-up calculation.

This would reduce compliance costs on employers by allowing Inland Revenue to use information already provided by employers to determine each employer's FBT liability and to send out a notice of assessment.

Comment

Inland Revenue receives monthly schedules setting out the salary and wages employers have provided to their employees. Therefore Inland Revenue has some ability (dependent on each employer filing on time) to determine the level of remuneration each employee is receiving and, by implication, the FBT rate that an employer should apply for the attributable benefits received by each employee.

The crucial information that Inland Revenue lacks is which employees received which benefits, and the taxable value of those benefits. Inland Revenue receives from employers the total taxable value of four categories of fringe benefits. Under the proposed changes, employers will be required to file this information, along with their final adjusted assessment, only after the square-up.

For Inland Revenue to undertake the calculation on behalf of employers, it would require employers to undertake most of the calculation first, eliminating any compliance and administrative savings. This means employers would be the only body able to value and attribute fringe benefits to the employees concerned and to calculate the total value of pooled benefits. They would then have to file the calculation sheets along with the return to Inland Revenue for processing, which in turn would delay the issuing of assessment notices and the date by which the FBT would have to be paid.

Implementing the suggestion would simply result in employers and Inland Revenue doubling up on calculations and would not result in the compliance savings to employers envisaged under the proposal. Therefore officials recommend the submission be declined.

Recommendation

That the submission be declined

CALCULATION OF FBT ON MOTOR VEHICLES

Submission
(1 – Retail Merchants Association, 15 – New Zealand Employers' Federation – issue not in bill)

The calculation of FBT liability on motor vehicles should be based on depreciated book value, not on a formula based upon original cost price as at present.

Comment

Original cost price was selected as the basis for the formula to bring certainty, limit compliance costs and avoid the need for ongoing valuations. This decision was based on the 1982 report of the Task Force on Tax Reform and was subsequently endorsed by the 1998 report of the Committee of Experts on Tax Compliance.

Recommendation

That the submission be declined

MISCELLANEOUS DRAFTING ISSUES

Issue: Multi-rate calculation for attributed fringe benefits

Submission
(12A – PricewaterhouseCoopers, 19 – ICANZ)

Clarification is needed for section ND 1C(1). The section currently states, "*An employer who must attribute a fringe benefit must….*"

PricewaterhouseCoopers submits that this wording should be amended to clarify that employers who elect to attribute must follow the multi-rate rules.

Similarly, ICANZ submits that the wording be amended to read "*An employer who attributes fringe benefits (either by election or otherwise) must –.*"

Comment

Officials agree that an amendment is needed to clarify section ND 1C(1) to state that an employer who elects to attribute must follow the multi-rate rules.

Recommendation

That the submission be accepted.

Issue: Definition of "annual taxable value"

Submission
(12A – PricewaterhouseCoopers – 19 – ICANZ)

The term "annual taxable value" should be defined in the bill.

Comment

Officials believe that the term "annual taxable value" is such a basic concept for employers to work with that it is unnecessary to use an explicit definition in the bill.

Recommendation

That the submission be declined.

Issue: Pooling of fringe benefits

Submission
(19 – ICANZ)

Section ND 1B(4) should be amended to make it clear that only benefits in categories outlined in section CI 1(d)-(h) can be pooled.

Comment

Officials consider that the bill is already clear about which fringe benefit categories must be attributed and, by implication, which can either be attributed or pooled depending on the employer.

Recommendation

That the submission be declined.

Issue: Amendment to the requirement to calculate employee cash remuneration

Submission
(19 – ICANZ)

Section ND 1C(1)(a) currently reads that employers attributing fringe benefits must "calculate the cash remuneration the employer pays to the employee to whom the fringe benefit is provided."

The word "pays" should be substituted with "provided" to ensure the paragraph is consistent with the definition of "cash remuneration" in the bill.

Comment

Officials agree that this change should be made to ensure clarity and consistency in the bill.

Recommendation

That the submission be accepted.

Issue: Definition of "cash remuneration" for major shareholders

Submission
(19 – ICANZ)

The bill provides a specific definition for "cash remuneration" derived by major shareholder-employees. This definition is wider than for other employees as it includes dividends and interest.

An amendment is needed to change the paragraph from reading *"cash remuneration…. including dividends and interest"* to read cash remuneration *plus* dividends and interest. As currently drafted, the paragraph implies that dividends and rent are ordinarily seen as being within the term cash remuneration.

Comment

Officials agree that this amendment should be made.

Recommendation

That the submission be accepted.

Issue: Annualisation of part-year employees

Submission
(19 – ICANZ)

Employers should not be required to annualise an employee's remuneration as this calculation may well not equate to an employee's actual income for the year. If, however, annualisation is required, a minor amendment is needed to section ND 1E(5)(b), which currently reads:

> *…an employer must –*
> *(a) annualise the cash remuneration, excluding an extra emolument; and*
> *(b) add to the annualised cash remuneration an extra emolument paid to, credited to or applied on account of the employee in that part of the income year.*

The references to "an extra emolument" should be changed to "any" extra emolument in both paragraph (a) and (b).

Comment

Under the proposal, employers are required to annualise the remuneration they provide to employees to ensure that an appropriate FBT rate is applied. For example, if an employee earned $70,000 per annum but ceased employment in that tax year after six months, his or her benefits would be undertaxed, as the 49% FBT rate rather than the 64% rate would apply.

Officials recommend that if the fringe benefit inclusive definition of "cash remuneration" is adopted that there is no need to require employers to annualise remuneration as the proposed method in itself increases the accuracy of the calculation. Furthermore, this amendment will reduce compliance costs associated with the calculation. Note, however, that if the definition of cash remuneration remains as under the bill, officials recommend that annualisation is necessary.

Officials agree with the proposed drafting changes to section ND 1E(5)(b) that "an extra-emolument" should be replaced with "any extra emolument".

Recommendation

That, subject to the fringe benefit inclusive definition of cash remuneration being adopted, employers should not be required to annualise employee remuneration. Officials also recommend that the proposed amendment to section ND 1E(5)(b) be made as outlined above.

Issue: Clarification of the threshold

Submission
(6W – New Zealand Law Society)

Clarification is needed in the bill regarding the $1,000 threshold. Section ND 1B(1) requires employers to attribute fringe benefits with a taxable value of *more than* $1,000, while section ND 1B(4) is concerned with fringe benefits with a taxable value of *less than* $1,000. Therefore some clarification is needed to guide employers as to how they should deal with fringe benefits of exactly $1,000.

Comment

Officials agree that clarification is needed and recommend that this is best achieved by amending the bill to state that fringe benefits with a taxable value of $1,000 or more must be attributed.

Recommendation

That the amendment be made to require attribution if the category has a taxable value of $1,000 or more.

Issue: **Definition of "cash remuneration"**

Submission
(19 – ICANZ)

Currently the definition of "cash remuneration" is contained in section ND 1E(1), which states cash remuneration is *"….the cash remuneration paid to, credited to or applied on account of the employee by the employer (employer A) or a related employer….".*

This definition is also supplemented by section ND 1E(6), which explicitly lists forms of cash remuneration.

For simplicity, the two paragraphs should be incorporated into one definition of cash remuneration. Furthermore, they state that section ND 1E(1) is circular in its use of the phrase "is the cash remuneration…" to define cash remuneration.

Comment

Officials accept that as currently drafted, the proposed section ND 1E contains two definitions of cash remuneration and therefore should be redrafted.

Recommendation:

That section ND 1E be redrafted.

Issue: Definition of "cash remuneration" and use of the phrase "employer A"

Submission
(12A – PricewaterhouseCoopers)

A minor drafting change is needed to subsections ND 1E(2) and ND 1E(3) to reword the phrase "employer A" to avoid any confusion.

Comment

Officials accept that these provisions as currently drafted do create some confusion and recommend that they be redrafted for clarity.

Recommendation

That the relevant provisions be redrafted to provide clarity.

Issue: Payment of FBT every quarter

Submission
(19 – ICANZ)

A minor amendment is needed to section ND 2(2) to replace the conjunction "and" between paragraphs (a) and (b) with "or" so that only one of the paragraphs needs to be met before the section does not apply.

Comment

Officials agree that this amendment should be made.

Recommendation

That the submission be accepted.

Issue: Section numbering

Submission
(19 – ICANZ)

Sections ND 1 and ND 2 should be renumbered in line with *Rewriting the Income Tax Act: Objectives, Process, Guidelines* as set out by the Working Party on the Reorganisation of the Income Tax Act 1976.

The approach in the bill of using alphabet suffixes for new sections is contrary to these drafting guidelines. Therefore the entire subpart should be renumbered from ND 1 to ND 12.

Comment

Officials agree that in this instance, it is practical and user-friendly to renumber Subpart ND. However, sections in Subpart ND that were not amended by the bill cannot simply be renumbered here. These sections must be re-enacted, and the other sections in other Parts of the Act require amendment to refer to the new section numbers proposed.

We note that in cases where one or two sections are being inserted, alphabet suffixes are the only way to insert new sections, irrespective of whether this is contrary to drafting guidelines. This approach is used in all statutes. The only difference with the Income Tax Act 1994 is that the alpha prefix in the alpha-numeric numbering system compounds the problem.

Recommendation

That the submission be accepted and Subpart ND and its references be renumbered.

Issue: Use of money interest on FBT

Submission
(Raised by ICANZ with officials)

The bill provides special rules for determining the commencement date of any use of money interest payment on overpayments of FBT under the multi-rate proposal. As the provision is currently drafted, an employer is not entitled to any interest if an overpayment is made during the first three quarters.

Comment

Officials agree that if an employer overpays FBT for any of the first three quarters, interest will not be payable by the Commissioner on that overpaid tax. The policy intention was that use of money interest would not apply if employers overpaid their FBT in the first three quarters if they were entitled to a refund in the last quarter as a result of the square-up. Likewise, no interest is payable on any underpayment on the first three quarters because of the square-up. However, an employer should be entitled to use of money interest on any overpayment of tax for any of the first three quarters if the overpayment was due, for example, to a calculation error.

Recommendation

That the submission be accepted.

Issue: Amendment to section ND 2

Submission
(Raised by ICANZ with officials)

A drafting amendment is required for section ND 2. Subsection 2 states that the section as a whole does not apply to an employer who elects to undertake the square-up, but subsection 2(A) goes on to outline the requirements for forwarding a return to the Commissioner for those employers who do undertake the square-up.

Comment

Officials agree that an amendment is required to section ND 2(2) to state that only subsection (1), not the entire section, does not apply to employers who pay fringe benefits tax in accordance with sections ND 1C and ND 1D.

Recommendation

That the submission be accepted.

ISSUES IDENTIFIED BY OFFICIALS

Issue: Two due-dates

Submission
(Matter raised by officials)

The bill should be amended so that all returns for the final quarter are due on 31 May, irrespective of whether an employer opts to pay the flat 64% rate or undertakes the square-up.

Comment

As drafted, the bill provides two due dates for the final quarter. Employers who choose to apply the 64% flat rate are required to file, in line with the three earlier quarters, by the 20th day of the month following the end of the quarter (20 April). Employers who undertake the square-up have until 31 May to file their return.

The purpose of allowing employers an extension to 31 May is to recognise that some employers may require more time to complete the new calculation.

Administratively, it is unworkable to have two due dates for the end-of-year return, and as such officials recommend all employers have until 31 May to file their return (irrespective of whether they choose to undertake the square-up).

Recommendation

That all fourth quarter returns be due on 31 May.

Issue: Rate for fringe benefits received by associates of a major shareholder employee

Submission
(Matter raised by officials)

The FBT payable on any fringe benefits received by associates of major shareholder-employees who do not themselves have an employment relationship with the employer concerned should be calculated on the same basis used for the major shareholder-employee.

Comment

Under the proposed legislation, any attributable fringe benefits received by an associate of a major shareholder-employee, where the associate is not themselves an employee, are taxed at the same FBT rate (27%, 49% or 64%) as had the benefit been received by the major shareholder employee.

Officials recommend that if the fringe benefit inclusive definition of cash remuneration is adopted, employers add the fringe benefits received by the associate to the cash remuneration of the major shareholder-employee to calculate the FBT payable.

Example

Major shareholder-employee and their associate	
Net cash (such as salary, extra-emoluments, dividends)	$50,000
Taxable value of fringe benefits of major shareholder-employee	$20,000
Taxable value of fringe benefits of the associate	$ 5,000
Total remuneration to calculate FBT liability from	**$75,000**

A further issue is that pooled benefits received by non-employed associates are currently proposed to be taxed at the general pooled rate of 49% where the major shareholder-employee does not receive the pooled benefit. Officials recommend that pooled benefits received by an associate (without their own employment relationship) be subject to the same rules as if the pooled benefit had been received by the major shareholder-employee and therefore should be taxed at 64%.

Recommendation

That the FBT due on attributable fringe benefits received by non-employee associates of major shareholder employees added to the remuneration of the major shareholder-employee as outlined above. Furthermore, any pooled benefits received by non-employee associates of major shareholder employees should be included in the 64% pool.

Issue: Description of filing requirements

Submission
(Matter raised by officials)

Section ND 2(2A) should be amended to a less prescriptive provision to eliminate any confusion over filing obligations of employers.

Comment

Officials are concerned that section ND 2(2A) as drafted, is too prescriptive in form and may lead some employers to believe they must furnish their calculation sheets along with the return. Therefore officials recommend that section ND 2(2A) be redrafted to state simply that employers must calculate their FBT payable in the form prescribed by the Commissioner and return this by 31 May next following the end of the return period.

Recommendation

That section ND 2(2A) be amended to a more general provision.

REMEDIAL ISSUES

FOREIGN INVESTMENT FUNDS RULES AND COMPANY MIGRATION

Issue: Value of interest on entry to or exit from foreign investment fund rules

Submission
(7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers, 24W – M J Kokich, 25W – CJ Smith, 26W – H Lowry, 27W – G O M Gair, 28W- J W Drury)

The foreign investment fund rules should be amended so that New Zealand investors who become subject to the foreign investment fund rules because of a company migration are able to elect to value their investments at cost price rather than market value.

Comment

The submissions consider the case when the shares in a company decrease in value in the period before the company migrates from New Zealand, and then increase in value once the interest is subject to the foreign investment fund rules. They suggest it is inequitable that, even though a loss may be made over the entire period in which the shares are held, the pre-migration capital loss will be non-deductible if the shares were acquired as a long term investment, while any gain following migration will be subject to tax under the foreign investment fund rules.

From a policy perspective, officials do not agree that this result is inequitable. When taxpayers acquire shares under this scenario, it is in the knowledge that the anticipated capital growth from holding the shares would not be taxable, and that any losses would be non-deductible. That the company migrates following a fall in its share value should not provide a windfall gain to shareholders by allowing them to access pre-migration losses. It would be, however, inequitable that existing shareholders should receive a benefit that is not available to shareholders who sold their holding pre-migration. Such shareholders were not able to offset their capital losses against future foreign investment fund income, as is being proposed by the submission-makers.

Subjecting the investment to the foreign investment fund rules recognises that following migration, New Zealand is no longer able to tax the economic income of the New Zealand shareholders by taxing the company directly. Instead, the income must be taxed indirectly in the hands of the shareholders. The only way that the pre-migration and post-migration income can properly be identified is if market value at the time of migration is used when calculating post-migration income or losses.

It is also an established tax principle that when assets move from one set of tax rules to another, they do so at market value.

The submissions note that when the current foreign investment fund rules were introduced in 1992, transitional rules allowed investors to choose whether to enter the rules on the basis of cost or market value at the time the rules took effect. They suggest this provides a strong precedent for doing likewise with the current amendments.

Officials do not agree with this proposition. An important distinction with the 1992 transitional rules was that they introduced a fundamentally new way of taxing foreign income. It was considered appropriate in that context that transitional rules should be implemented. By contrast, the current amendments are being made to rules for taxing foreign income that have now been in place for almost eight years. It is established principle that the income accruing in foreign investment funds is taxed as it arises. Using market value for entry into the rules when a company migrates ensures that only the income or loss accruing once the company has migrated is brought to account under the foreign investment fund rules. This separate treatment of pre-migration and post-migration gains and losses ensures consistency with the separate established policies for taxing shares in resident and non-resident companies respectively.

Officials consider it appropriate, therefore, that the foreign investment income or losses should continue to be calculated based on the market value of an interest at the date a company migrates, as is established in the bill.

Recommendation

That the submission be declined.

Issue: Exemption for publicly listed entities on recognised exchanges

Submission
(7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers, 21W – Corporate Taxpayer Group)

An exemption from the foreign investment fund rules should be provided for interests held in publicly listed companies.

Comment

The submissions suggest that the foreign investment fund rules were enacted to prevent New Zealand residents deferring or avoiding New Zealand tax by accumulating income in offshore funds. They suggest that because publicly listed companies pay dividends regularly and the shareholders are not able to control the distributions from the company, there is no opportunity for deferral of income.

In officials' view, the submission fails to address the fundamental policy behind the foreign investment fund rules, namely that the rules aim to remove distortions in the investment decisions of our residents, by measuring and taxing the economic income of New Zealand shareholders from foreign companies as it accrues. Merely because a company is listed and its shareholders have no control over their dividend flows does not remove the incentive for investors to acquire shares in that company because its tax treatment may be concessionary compared to that of a New Zealand company. Thus such an exemption for publicly listed companies would be contrary to the policy rationale of the foreign investment fund rules.

To illustrate by way of example, companies resident in Singapore are taxed on their Singapore income at 26%. Significantly, however, there are a number of incentives available to companies investing in Singapore that will have the effect of reducing this rate. Singapore also does not tax companies on income earned from outside Singapore, except when it is received in Singapore. As one submission acknowledges, publicly listed companies typically do not distribute all of their income by way of dividends. This means that merely taxing the dividend flow will not be sufficient to capture the tax benefits implicitly accruing to the New Zealand shareholders. If the foreign investment fund rules did not apply to such interests, shareholders of that company could benefit significantly from the more relaxed tax treatment afforded that company than to a New Zealand resident company.

It is also relevant to note that not all listed entities pay dividends, and shareholders should be aware of an entity's distribution policy prior to investment.

Officials do not agree that an exemption from the foreign investment fund rules should be extended to all publicly listed company. Such an exemption would clearly be contrary to the policy intent of the rules.

Recommendation

That the submission be declined.

Issue: Removal of loss quarantining

Submission
(7 – Brierley Investments Limited)

The requirement that foreign investment fund losses cannot be offset against non-foreign investment fund income, but can only be carried forward and offset against future foreign investment fund income, should be removed.

Comment

The submission notes that foreign investment fund losses are currently quarantined; they can only be offset against ordinary income to the extent that foreign investment fund income has previously been returned.

The foreign investment fund rules have been the subject of detailed consideration in the past. They were initially reviewed by the Consultative Committee in 1988 before the original rules were implemented in 1988, and were the subject of significant review and refinement by the Government in 1991 to 1993. The current rules were enacted in 1992.

The quarantining of foreign investment fund losses is part of the basic design of the foreign investment fund rules, and was recommended by the Consultative Committee in July 1988. It may be appropriate to review whether the quarantining rules remain appropriate in the context of a broader review of the foreign investment fund rules. Such a review is, however, beyond the scope of the amendments currently under consideration.

Recommendation

That the submission be declined.

Issue: Accounting profits method – exclusion of grey list income

Submission
(7 – Brierley Investments Limited)

The accounting profits method should be amended to enable shareholders to exclude New Zealand and grey list country income derived by a foreign investment fund from the calculation of foreign investment fund income.

Comment

The submission suggests that the method of applying the accounting profits method should be changed to allow taxpayers the possibility of excluding income derived by that fund from New Zealand or a grey list country from the calculations. This would recognise that such income would not be taxed in New Zealand if earned directly by a fund resident in New Zealand or a grey list country.

The issue here is how accurately one might be able to measure income derived through a foreign entity. For controlled investments, a relatively accurate measurement is obtained, as the controlled foreign company rules require the income of a foreign entity to be re-cast as if the foreign entity were a branch. This approach is, however, impractical for uncontrolled investments, when shareholders are unlikely to have access to sufficient information to enable relevant income calculations to be made. Consequently, the foreign investment fund rules allow taxpayers to choose one of four proxy methods for measuring their foreign investment fund income or loss. It is inherent in the design of the rules that there is a trade-off between attempting to measure income accurately and the ability of taxpayers to comply with the rules.

The point raised in the submission addresses a fundamental aspect of the design of the foreign investment fund rules. It may be appropriate to review how income should be measured under the accounting profits and other methods in the context of a broader review of the foreign investment fund rules. Such a review is, however, beyond the scope of the amendments currently under consideration.

Recommendation

That the submission be declined.

Issue: Use of branch equivalent tax accounts (BETAs) by individuals

Submission
(7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers)

The application of the branch equivalent tax account (BETA) rules for individuals should be clarified.

Comment

The BETA mechanism is intended to prevent double taxation of controlled foreign companies and certain foreign investment fund income, which would otherwise arise from tax being imposed both on attribution of income and separately on dividend receipts.

The PricewaterhouseCoopers submission notes that when income is attributed to an individual under the foreign investment fund rules before dividends are received, the BETA mechanism operates to alleviate double taxation. However, the submission suggests that when the dividend is received before income is attributed, the application of the mechanism is unclear.

The submissions do not elaborate on why the application of the mechanism is unclear. However, from discussions with the submissioners, officials understand that they would like to see similar provisions to the BETA rules for companies, as amended in 1992, extended for use by individuals.

Officials note, however, that the current provisions applying to companies operating a BETA are complicated. Extending the model currently applying for companies to individuals would introduce a significant additional layer of complexity to already complex provisions.

Officials also note that the perceived problem should not be an issue in the long run, as listed companies typically do not distribute 100 percent of their income and it is reasonable to expect that dividends will be paid after the income is attributed to the shareholder. Even in the transitional year, when it may appear that dividends are being paid before income is attributed, it seems appropriate to argue that those dividends are paid from pre-migration sources, meaning there is no double taxation.

On balance, therefore, officials do not consider an amendment to extend the company treatment of BETAs to individuals would be appropriate.

Recommendation

That the submission be declined

Issue: Accounting Profits method – non-standard balance dates

Submission
(*7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers*)

The calculation of foreign investment fund income is based on the use of one measurement day, 31 March. The legislation should be amended to allow foreign investment fund interest holders using the accounting profits method to calculate their income interest as at the balance date of the foreign investment fund.

Comment

The submission notes that the calculation of foreign investment fund income is to be based on the use of a single measurement day, 31 March, and was intended as a simplification measure. The submission suggests that the application can pose a problem for foreign investment funds with non-standard balance dates.

The submission further notes that for foreign investment funds with non-standard balance dates, it would be necessary to make special information available to shareholders at 31 March to calculate their income interests. The submissions consider that it would be more practical if shareholders were able to calculate their income interest as at the foreign investment funds balance date, as this information could be taken straight from the shareholder information contained in the financial statements.

Officials note that the single measurement date is a concessionary rule to reduce the compliance costs associated with having to determine a person's income interest at the end of each quarter in the year. If a person holds an interest in a foreign entity on 31 March, they are treated as having held the interest for the entire year. Conversely, if a taxpayer does not hold an interest on 31 March, they are treated as not having held the interest for any part of the year. March 31 was selected as the single measurement date because it aligns with the end of the income year for taxpayers with standard balance dates.

If the submission were to be adopted, it would be necessary to use the balance date test for all foreign investment funds. If taxpayers were given the choice of 31 March or the foreign investment fund's balance date; they could select the date that gives the best tax result. This would be inappropriate.

The 31 March date has been used in practice since 1992 without any apparent difficulties. Officials do not consider the argument in the submission to be sufficiently compelling to justify a change in the measurement date.

Recommendation

That the submission be declined.

Issue: Operation of Branch Equivalent Tax Account – minor error

Submission
(*7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers*)

There is a minor cross-referencing error in the existing section MF 13(2). This section refers to item "d" of the formula in subsection (1). This should read item "b".

Comment

Officials agree that an amendment to correct the cross-reference would be desirable, and consider the amendment should be backdated to the 1997-98 income year, the time from which the current provision was effective.

Recommendation

That the submission be accepted, with application from the 1997-98 income year.

Issue: Increasing the $100,000 deemed rate of return threshold

Submission
(*7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers*)

The threshold for using the deemed rate of return method currently set at $100,000 should be increased to $250,000

Comment

The submissions note that the foreign investment fund rules as originally enacted in 1993 established a maximum threshold of $100,000 for use of the deemed rate of return method. This means that natural persons whose total foreign investment fund interests were below $100,000 can elect to use the deemed rate of return method when calculating foreign investment fund income. This amount has not been increased since that time, despite general increase in other monetary thresholds contained in the tax legislation. Consequently, it is proposed that the threshold should be updated.

Officials note that the deemed rate of return method is considered to be the least reliable method for measuring foreign investment fund income, which is why constraints were placed on its use. However, it is the least complicated method, and has the potential for significant compliance cost savings if it can be employed more readily.

Officials agree that an increase in the threshold would be appropriate, but because it provides the least reliable measure of income, consider it appropriate that its use should remain restricted to some extent. Exactly what level the threshold should be increased to is a somewhat arbitrary judgement. However, officials consider an increase to $250,000 would be consistent with the aim of reducing compliance costs while still addressing concerns as to the reliability of the method for measuring income.

Officials consider that application from the 1999-2000 income year, consistent with the application dates currently in the bill, would be most appropriate. This would enable taxpayers who are calculating foreign investment fund income for the first time in the 1999-2000 income year to use the new threshold for that income year.

For taxpayers with existing foreign investment fund income, however, the higher threshold will effectively apply only from the 2001-2002 income year. This reflects that these taxpayers have already made decisions on which method to use to calculate their foreign investment fund income or losses. If taxpayers were now to be able to elect to use the deemed rate of return method for the 1999-2000 and 2000-2001 income years, they would be able to choose the method that gave them the best tax result for those years. This would be inappropriate.

Recommendation

That the submission be accepted, with an application from the 1999-2000 income year.

Issue: Increasing the de minimis exemption from $20,000

Submission
(*7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers*)

The de minimis threshold used to exclude taxpayers with small interests in foreign entities should be increased from its current level of $20,000.

Comment

The submissions seek an increase in the de minimis exemption threshold below which taxpayers simply return income as it is received. An increase in the threshold is sought on the grounds that it will reduce the compliance costs of taxpayers, and that there has not been an increase since 1992.

While both submissions seek an increase in the de minimis threshold, Brierley Investments Limited seeks an increase to $100,000, while PricewaterhouseCoopers seeks an increase only to $50,000.

Officials agree that it is appropriate to review the de minimis threshold, in light of the length of time since it was set. Again, the level to which it is adjusted is largely a matter for judgement. Any decrease in compliance costs to taxpayers from an

increased threshold must be balanced both against potential revenue loss and the risk that investments up to the threshold are chosen primarily for their tax advantage.

Officials consider that if the de minimis threshold were increased to $100,000, the potential revenue loss and the risk of inefficient investment would outweigh any benefit to taxpayers in lower compliance costs. A $50,000 threshold would appear to better balance the competing considerations, although the judgement remains somewhat arbitrary

In view of the issues associated with corporate migration, officials recommend as a transitional measure that the de minimis should be increased to $50,000. Representatives of Brierley Investments Limited orally indicated to the Finance and Expenditure Committee that an increase in the de minimis to $50,000 would take out all but approximately 400 of their shareholders. However, the level of and jusitification for a threshold should be reviewed more fully if a future review addresses some of the more fundamental policy underpinning the foreign investment fund rules. It may be that such a review will determine the $50,000 threshold to be too high.

Officials consider it appropriate for the increase to apply from the 1999-2000 income year. In the ordinary course of events, however, such a change to the threshold would be made prospectively. In this case, though, if the de minimis threshold were increased prospectively, smaller shareholders affected by corporate migration in the 1999-2000 income year would still need to account for their interests for that year before the increase takes effect.

Recommendation

That the submission to raise the de minimis threshold to $50,000 be accepted, with application from the 1999-2000 income year.

Issue: $20,000 threshold – natural persons and trustees

Submission
(*7 – Brierley Investments Limited, 12A – PricewaterhouseCoopers*)

It is currently unclear whether the de minimis threshold applies to trustees. Clarity, whether by legislation or Inland Revenue guideline, is sought on this issue.

Comment

The submission details the situations when the Income Tax Act contemplates whether or not a trustee falls within the definition of a natural person. It suggests that legislative amendment is necessary to clarify whether trustees are to be treated as natural persons in determining whether the de minimis rule applies to trustees.

Officials note that the policy intent of the natural persons exemption is not to include trustees. Trusts have a structure more akin to that of a company and so should be

excluded from the de minimis exemption. If this were not the case, taxpayers with large interests could potentially take advantage of the de minimis rule by holding their interests through a number of trusts.

Officials agree, however, that that it would be desirable to clarify the application of the law. It is proposed, therefore, to make an amendment to put beyond doubt that trustees are not treated as natural persons for foreign investment fund purposes.

As the amendment is merely a clarification of existing law, any application date chosen would be somewhat arbitrary. Officials propose that the clarification apply from the 1999-2000 income year, consistent with the application date of the other foreign investment fund amendments in the bill.

Recommendation

That an amendment be made to clarify that natural persons do not include trustees for the purposes of the foreign investment fund rules, with application from the 1999-2000 income year.

Issue: Miscellaneous drafting issues

Submission

(19 - Institute of Chartered Accountants of New Zealand)

Further amendments should be made to:

- clarify that "funds" are included within the scope of the amendments, as well as 'entities';
- state explicitly that the cost or expenditure of a foreign investment fund when applying the de minimis threshold is based on market value for a migrating entity;
- ensure that a migrating company will not have to publish separate sets of pre-migration and post-migration accounts in the year of migration; and
- reflect the intent that a gain or loss be crystallised on migration and thereby become assessable or deductible for revenue account shareholders.

Comment

The submission suggests a number of technical drafting amendments. Officials do not consider, however, that the amendments need to be made and have discussed this with ICANZ.

On the first point, officials consider that "funds" are already included within the scope of the amendments. The term "fund" is defined in section OB 1 to be a foreign investment fund for the purposes of the foreign investment fund rules. There is no anomaly in section CG 14(4) referring to "fund or other foreign entity". If an interest

in a foreign entity is exempted from the foreign investment fund rules, it does not become a foreign investment fund. Consequently, it is necessary and appropriate to distinguish "fund" from "other foreign entity". Similar considerations apply in the other places where the submission suggests that amendment to include reference to "other foreign entity" is required.

On the second submission point, officials note that the de minimis rule in section CG 15(2)(d) applies on the basis of the "cost or expenditure incurred" in acquiring an interest. An amendment is being made in the bill to section CG 14(1) which treats the market value of the interest at the date of migration to be the expenditure incurred in acquiring the interest. Consequently, officials consider the amendments are already clear that the de minimis applies on the basis of the market value of interests at the date of migration.

On the third submission point, officials note that the amendment already has the effect of ensuring that a migrating company will not have to publish separate sets of pre-migration and post-migration accounts. The drafting of section CG 12 is wide enough that so its application is not limited to controlled foreign companies. Section CG 12 also covers foreign investment funds for which income is calculated under the accounting profits method. Section CG 12(3), however, makes it clear only that separate accounts are not required for the pre-migration and post-migration periods for controlled foreign companies, or for foreign investment funds when income or losses are calculated under the branch equivalent method. The amendments in the bill, therefore, ensure that similar treatment will apply when foreign investment fund income or losses are calculated under the accounting profits method.

On the final submission point, officials note that the deemed disposition and reacquisition applies “for the purposes of this Act”. This means that normal provisions in the Act that would apply if the interest was sold will apply automatically, without the need to set out again in section CG 23 what the normal treatment would be on the disposition of the shares.

Recommendation

That the submissions be declined.

Issue: Sundry issues raised

Submission
(23W- P L A du Chateau, 24W – M J Kokich, 25W – C J Smith, 26W – H Lowry, 27W – G O M Gair, 28W – J W Drury, 30W - JR Allison, 31W - W J Keith, 32W - G E Trotman)

- New Zealand should give an imputation credit for the underlying foreign tax paid on dividends (*23W- P L A du Chateau)*
- Investments in migrating companies should have the same tax treatment as investments in companies registered in New Zealand (*26W – H Lowry).*

- Shareholders who have held shares in a company for at least five years when the company migrates on the day of migration should be exempted from the foreign investment fund rules (*28W- J W Drury).*

Submissioners also commented that:

- A capital gains tax has no place in the New Zealand situation (*23W- P L A du Chateau).*

- A small minority should not be penalised by a regime that was designed to control large overseas investors (*23W- P L A du Chateau).*

- Family Trusts are unjustly penalised as the de minimis exemption only applies to natural persons (*28W- J W Drury).* Consideration should be given to also applying the exemption to trustees *(32W - G E Trotman).*

- It is inconsistent that New Zealand welcomes overseas investment but penalises outward investment by taxing unrealised capital gains under the FIF rules *(31W - W J Keith)*.

Comment

These issues have largely been dealt with elsewhere in the report. On specific points, however, officials note that:

- As imputation credits are only designed to prevent double New Zealand taxation of company profits, they do not extend to foreign taxes.

- An exemption from the foreign investment fund rules for shareholders who have held their shares for five years when a company migrates would be contrary to the intent of taxing economic income as it accrues. There is also no policy reason for such an exemption.

- The de minimis threshold exempts taxpayers from the foreign investment fund rules at a level where the costs of compliance and administration are considered to outweigh any potential revenue loss and the risk that investments up to the threshold are chosen primarily for their tax advantage. Extending this exemption to family trusts would enable the establishment of several trusts, all for the benefit of one individual in order to receive multiple exemptions. This would be contrary to the intent of the de minimis rule.

AMALGAMATION PROVISIONS

Submission
(PricewaterhouseCoopers)

There are no provisions in the bill regarding the amalgamation regime. However, there are several provisions in the Income Tax Act 1994 relating to the amalgamation of companies which require clarification. The provisions are:

- section IF 6, dealing with the entitlement of an amalgamated company to carry forward net losses, attributed foreign net losses and foreign investment fund net losses upon amalgamation;

- section FE 7(3), dealing with consideration to be included in an amalgamating company's base price adjustment calculation upon amalgamation, section FE 6(7) and section FD 10(4A).

Comment

The submission seeks changes to the provisions in the Income Tax Act which deal with the amalgamation of companies. There is no provision in the bill relating to the amalgamation regime. Even if the Government considers the submission has merit, the proposed changes should not be inserted at the select committee stage of a bill. Other tax practitioners and taxpayers should have the opportunity to consider, and make submissions on, proposed changes to the Income Tax Act.

The submission should be considered as part of the tax policy work programme, and go through the generic tax policy process.

Recommendation

That the submission be declined.

MINOR REMEDIAL AMENDMENTS TO INCOME TAX ACT 1994

Submission

(Matter raised by officials)

Section CC 1(1)(bb) should be amended to refer to section 188(1)(a) of the Accident Insurance Act 1998.

Comment

Section CC 1(1)(bb) was amended by the Accident Insurance Amendment Act 2000. The amendment was meant to insert the words "(as it read before its repeal by section 7 of the Accident Insurance Amendment Act 2000)" after the reference to section 188(1)(a) of the Accident Insurance Act 1998. However, the amendment substituted those words rather than inserted them.

Officials consider that the correcting amendment should apply from 1 July 2000, the date from which the original amendment is to come into force.

Recommendation

That section CC 1(1)(bb) be correctly amended.

MINOR REMEDIAL AMENDMENT TO TAX ADMINISTRATION ACT 1994

Submission
(Matter raised by officials)

Section 44A should be amended to correctly refer to "taxable income".

Comment

Section 44A of the Tax Administration Act 1994 incorrectly refers to a taxpayer's "net income". It should refer to a taxpayer's "taxable income". Officials consider that the reference should be corrected with the effect from 17 November 1998, the date from which the section took effect.

Recommendation

That section 44A be corrected from 17 November 1998.