

# **Income Tax Bill**

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*Commentary on the Bill*

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## Chapter One

### INTRODUCTION AND BACKGROUND

The task of rewriting the Income Tax Act is being undertaken in stages. The first stage was the reorganisation of the Income Tax Act 1976, which resulted in the enactment of the Income Tax Act 1994. The second stage, the rewrite of the core provisions of the Act, was completed in 1996. This bill, which rewrites Parts A to E and Y of the Act, is the third stage of the project, leaving approximately half of the Act to be rewritten in future stages.

The key aim of the rewrite project is to produce tax legislation that is clear, uses plain language and is structurally consistent. Clear legislation makes an important contribution to increasing voluntary compliance with tax laws, because taxpayers can more easily identify and observe their income tax obligations.

The objective is to make the legislation clear without substantively changing the policy content, and associated compliance requirements, of the current Act. The policy clarifications made in the bill are of a minor nature and have been presented for public consultation in recent years. They are discussed in chapter four.

The bill rewrites Parts C, D, and E and aspects of Parts A and B. It re-enacts, but does not rewrite, the remainder of the Act. The new Act comes into force on 1 April 2004 and applies to income derived in the 2004-05 tax year and later tax years (or in the corresponding income years).

Care has been taken in the development of the bill to ensure that its provisions have the same outcomes as those of the current Act. Some minor policy clarifications have been made, but were subject to consultation before they were included. If in the initial years of the new Act's operation it is found to produce a different result from that which would have been produced under the 1994 Act, the Government will promote a remedial amendment to correct the position from the date of effect of the new legislation.

The bill re-enacts the entire Act for the benefit of users. The options for the bill were to:

- amend the current Act by replacing Parts A to E and Y with rewritten Parts; or
- produce a new Act containing rewritten Parts A to E and Y and reproduced Parts F to O and the schedules.

The second option was chosen because it minimises confusion over the numbering of sections. For example, in the current Part C, section CB 1 is about the exempt income status of interest. In the rewritten Part C, clause CB 1 is about the income status of amounts derived from business. If the current Act were amended, users referring to section CB 1 of the Income Tax Act 1994 would need to make it clear whether the reference is to section CB 1 of the Act before it was amended or section CB 1 as inserted by the amendment. If there is a new Act, the reference can be identified as section CB 1 of the Income Tax Act 1994 or section CB 1 of the Income Tax Act 2002.

## **History of the rewrite**

New Zealand's Income Tax Act is a very old piece of legislation, dating back to 1891. In the intervening period the Act has expanded significantly to become a more comprehensive measure of income and to reflect the changing nature of tax and business in New Zealand. The Act has been recast on several occasions but it was not until the 1990s that it was comprehensively reviewed from a fundamental structural and presentational perspective.

Various reports and papers in the early 1990s discussed the rewriting of the Income Tax Act. The first significant report was that of the Consultative Committee on the Taxation of Income from Capital (the Valabh Committee) in 1990. The committee highlighted various weaknesses in the numbering, formatting and reorganisation of the legislation, including:

- a lack of integration in the core provisions, and between the core provisions and the rest of the Act;
- difficulty in discerning the scheme and purpose;
- the absence of a logical structure in the Act and the ordering of its sections;
- a failure in the organisation of the material to reflect the Act's role, that role being to quantify taxable income, to impose the tax liability on that income, and to set out the process of assessment and collection; and
- inconsistent drafting styles, redundant wording, cumbersome sections, and repetitive provisions.

To resolve these problems the Valabh Committee proposed:

- the division of the existing legislation into separate Acts;
- the division of those Acts into parts and subparts;
- the reorganisation of the legislation into a more logical and coherent scheme;
- the consolidation of certain legislation;
- the use of purpose clauses and extra-statutory references; and
- a commitment to modern drafting techniques and to plain language.

Following on from the recommendations of the Valabh Committee, the Working Party on the Reorganisation of the Income Tax Act recommended in 1993 that the Act be reordered, reorganised and progressively rewritten. The report of the Organisational Review of the Inland Revenue Department in 1994 also supported the rewriting of the Act.

The substantive reordering of the Income Tax Act 1976 and the Inland Revenue Department Act 1974 was completed in 1994. This work produced the Income Tax Act 1994 and the Tax Administration Act 1994. New core provisions for the Income Tax Act 1994 were enacted in 1996, with effect from the 1997-98 year. As a result, the Income Tax Act is now organised by parts based around a set of core provisions under an alphanumeric numbering system. There has been some consolidation of material by topic, and the definitions have been brought together in one section.

Work over the last few years has focussed on refining the new structure and progressively redrafting Parts A to E of the Act using plain language drafting techniques. During that time, the following documents have been issued for purposes of consultation:

- a discussion document on the possible structure and content of Parts C, D, and E and their relationship to the new core provisions;<sup>1</sup>
- two issues papers identifying policy issues that had arisen in the course of rewriting;<sup>2</sup> and
- an exposure draft of the rewritten legislation.

Submissions made in response to these documents have had an important influence on the development of this bill.

New Zealand has not been alone in seeing the need for rewriting its tax legislation. Similar work is under way in Australia and the United Kingdom.

### **Advisory Panel**

The Advisory Panel on the Rewrite of the Income Tax Act has provided the Government with valuable assistance in the development of the bill. The panel, which was established in 1995, is chaired by Colin Blair and consists of one representative each from the Institute of Chartered Accountants of New Zealand, the New Zealand Law Society, the Inland Revenue Department and the Treasury.

The panel has two core functions:

- to ensure that there is a procedure in place to identify any policy issues that might arise from the rewrite drafting instructions or draft legislation and to refer such policy issues to the Government with relevant comments; and
- to act as a “steering committee” and report periodically to the Government on the achievement by the project team of pre-determined milestones and adherence to agreed processes, including adequate public consultation.

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<sup>1</sup> *Rewriting the Income Tax Act: Parts C, D and E. A discussion document.* September 1997.

<sup>2</sup> *Rewriting the Income Tax Act: Parts C, D and E. Issues Paper 1.* March 1998. *Rewriting the Income Tax Act: Parts C, D and E. Issues Paper 2.* June 1998.

It has performed those functions to a high standard and has made an important contribution to the development of this bill.

### **Why the Act needs rewriting**

Although the Income Tax Act itself dates back to 1891, the structure on which it is based has existed since 1916, when the Act comprised 43 pages and 169 sections. Since that time layers and layers of major changes and new groups of tax rules have been added to the legislation, with the result that it now comprises over 2000 pages.

The 1916 structure was not able to support the increased volume and sophistication of the legislation that was added later, with the result that by 1990 it had become difficult to discern a cohesive scheme and purpose within the Income Tax Act 1976. Moreover, the language that has been used by drafters over the years to deal with complex policy objectives was very difficult for most readers to understand.

The problem was discussed in detail in the report *Organisational Review of the Inland Revenue Department*,<sup>3</sup> presented to the Minister of Revenue in 1994. The report said:

**Currently the legislation attempts to deal with the complexity and to provide certainty and precision through the detailed expression of policies in the variety of complex circumstances in which they operate. As a result the intent is often blurred in a torrent of convoluted language in sentences of an average length, measured by a 1992 study, of 135 words. Tax practitioners, Treasury and IRD agree that the legislation is difficult to read and understand. That must have a direct bearing on the difficulties and the cost of administering the legislation and the difficulties and the cost for taxpayers of complying with the legislation. [page 79]**

### **Advantages of rewriting the Act**

The benefit of clear legislation will be felt in the longer term. The report *Organisational Review of the Inland Revenue Department* observed that:

**In a 1994 study by Tan and Tooley, 69 percent of tax practitioners surveyed considered tax legislation difficult to read. In commenting to the review committee on those findings, IRD agreed that tax legislation was very difficult to read and understand.**

**It is obvious that those comprehension problems must have a direct bearing on the difficulties and so the cost of administering the legislation and the cost of complying with the legislation. [Appendix H of the report]**

Making the law clearer will result in an overall reduction in business compliance costs. The reorganisation of material into a consistent structure, and rewriting it in plain language, will make it easier for readers to locate all the material they need to read and to understand what they read, thus saving time and cost.

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<sup>3</sup> *Organisational Review of the Inland Revenue Department: Report to the Minister of Revenue (and on tax policy, also to the Minister of Finance) from the Organisational Review Committee.* April 1994.

## **Examples of the benefit of plain language drafting**

The plain language style of drafting includes presenting ideas clearly and directly, avoiding archaic terms, repetition and verbosity, and using words as close to their ordinary meaning as possible. Set out here are three samples of rewritten legislation which demonstrate the advantage of using these principles.

## EXAMPLE 1

### Breaking a 14-line sentence into easily understood pieces

#### Current legislation

##### **DJ 2 Deduction from estate income of irrecoverable book debts**

Where the amount of any debt owing to any person at the date of the person's death has been included in gross income of the person or of the trustee of the person's estate for any income year, and the debt or any part of it is proved to the satisfaction of the Commissioner to be irrecoverable and to have been actually written off by the trustee as a bad debt, the amount so written off shall be deemed to be a loss incurred by the trustee in the income year in which the amount was written off, and shall be allowed as a deduction, first to the trustee to the extent of any gross income derived by the trustee as trustee income, and then, as to any balance, to any beneficiary to the extent of any gross income derived in that year by or in trust for the beneficiary if that beneficiary has a vested interest in the capital of the estate to the extent that the loss is chargeable against the capital of that beneficiary; and any balance not allowed as a deduction in that year shall be allowed as a deduction in that same manner to the extent of gross income of the trustee or beneficiary derived in the next income year and so on.

#### Rewritten legislation

##### **DB 24 Bad debts owed to estates**

###### *When this section applies*

- (1) This section applies when –
  - (a) a debt owing to a person at the date of their death is, for a tax year, –
    - (i) counted income of the person; or
    - (ii) counted income of the trustee of their estate; and
  - (b) some or all of the debt is written off as bad because it is not recoverable.

###### *Deduction*

- (2) The following persons, in the following order, are allowed a deduction for the amount of the debt written off:
  - (a) first, the trustee, to the extent of counted income derived as trustee income; and
  - (b) second, any beneficiary who has a vested interest in the capital of the estate, to the extent of counted income derived in the tax year by or in trust for the beneficiary, and to the extent to which the amount is chargeable against the capital of the beneficiary; and
  - (c) third, the trustee or a beneficiary denied a deduction for the balance in the tax year is allowed a deduction in the same manner in the next tax year, and so on.

###### *Link with subpart DA*

- (3) This section supplements the general permission. The general limitations still apply.

EXAMPLE 2

**Breaking up a long sentence covering three ideas into three separate sections**

**Current legislation**

**CD 4 Personal property**

The gross income of any person includes, any amount derived from the sale or other disposition of any personal property or any interest in personal property (not being property or any interest in property which consists of land), if the business of the person comprises dealing in such property or if the property was acquired for the purpose of selling or otherwise disposing of it, and any amount derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

**Rewritten legislation**

*Schemes for profit*

**CB 2 Carrying on or carrying out schemes for profit**

An amount that a person derives from carrying on or carrying out an undertaking or scheme entered into or devised for the purpose of making a profit is income of the person.

*Personal property*

**CB 3 Personal property acquired for purpose of disposal**

An amount that a person derives from the disposal of personal property is income of the person if they acquired the property for the purpose of disposing of it.

**CB 4 Business of dealing in personal property**

An amount that a person derives from the disposal of personal property is income of the person if their business is to deal in property of that type.

EXAMPLE 3

**Explaining what is allowed rather than what is not**

**Current legislation**

**DD 1 Certain deductions not allowed - rents, interest, and premises**

Except as expressly provided in this Act, no deduction is allowed to a taxpayer in respect of any of the following sums or matters:

- (a) .....
- (b) Interest (not being interest of any of the kinds referred to in section DB 1(1)(e) and not being interest to which section LF 7 applies to prohibit a deduction), except so far as the Commissioner is satisfied that -
  - (i) It is payable in deriving the taxpayer's gross income; or
  - (ii) It is necessarily payable in carrying on a business for the purpose of deriving the taxpayer's gross income; or
  - (iii) .....

**Rewritten legislation**

**DB 6 Interest: not capital expenditure**

***Deduction***

- (1) A person is allowed a deduction for interest incurred.

***Exclusion***

- (2) **Subsection (1)** does not apply to interest for which a person is denied a deduction under **section DB 1**.

***Link with subpart DA***

- (3) This section overrides the capital limitation. The general permission must still be satisfied and other general limitations still apply.

## Chapter Two

### STRUCTURE OF THE NEW ACT

The structure of the revised Act has been the subject of much discussion from the time of the Valabh Committee report, culminating in the discussion document on the rewrite of Parts C, D, and E of the Income Tax Act 1994 (September 1997). That document set out a detailed structure for the three parts. The importance of the three as a group is that, together, they define the elements that determine net income.

The discussion document recognised that creating a clearer scheme for the Act requires a logical organisation of the material that takes into account both the function of provisions and their subject matter. Accordingly, improving the structure has been a key aim of the rewrite.

The core provisions enacted in 1996 gave the Act a more consistent scheme, establishing the notion that each part of the Act has a specific function. The bill applies this notion across Parts C, D, and E and also clarifies the interaction of those parts with the core provisions. Therefore the core provisions have also been rewritten.

#### Structural principles

The general structural principles adopted in the rewritten legislation are:

- **Organising from the general to the specific.** Parts, subparts, and sections generally begin with more widely used rules and conclude with less widely used rules.
- **Using general rules to perform a pivotal role.** General rules have been used to overarch more specific rules, the general deductibility provision in draft Part D being a prime example. This approach helps to identify the inter-relationships between the provisions and any common policy intent.
- **Minimising overlap.** An aim has been to make the categories used to group items as self-contained as possible.
- **Grouping like with like.** Functions or subject matter that are the same have been grouped for the reader's convenience, and to put provisions within a context.
- **Reducing repetition.** An aim has been to minimise duplication. Applying common sets of rules is one technique that has been used to achieve this.
- **Using a consistent format.** This aids accessibility by improving the flow of the text.
- **Linking back to the core provisions.** When the Act was restructured in 1994, subparts CA, DA, and EA were reserved for provisions setting out the purpose of the relevant part. However, purpose provisions have not been included in the bill on the basis that it is difficult to draft a meaningful yet comprehensive purpose provision for parts which are either lists or disparate. Also, the title, structure, table of contents, and sub-indexes should adequately clarify the role

of each Part. Instead, for draft Parts C and D, subpart A sets out the general rules that link back to the core provisions. Draft Part E does not have a similar set of general rules because it contains a disparate set of regimes.

- **Placing terminating provisions into a separate subpart at the end of each part.** This is a continuation from the current Act but the contents of subparts CZ, DZ, and EZ have been significantly culled because many of the provisions are either spent or are unlikely to have future relevance. Omitting these provisions does not remove their application to relevant past situations, but it does reduce the size of the Act.

### **Core provisions of the bill**

Overall, the core provisions retain their role of stating the principal rules on what is income, what is a deduction, and how that income or deduction is timed. Draft Parts C, D, and E then provide the associated detail. However, a consequence of rewriting the legislation in phases is that the rewrite of later parts can necessitate changes to previously rewritten parts. This is true of the core provisions and has resulted in several key changes:

- The deduction rules in section BD 2 have been shifted to draft Part D. This change was signalled in the discussion document on Parts C, D, and E and is discussed further in the commentary on the structure of draft Part D (page 15).
- The proposal that the terms *derived* and *incurred* be defined in the legislation has not proceeded in light of the submissions on the exposure draft. Submitters expressed the view that the proposed definitions were not a clear reflection of the case law interpretation of the terms and were likely to result in confusion rather than enlightenment. The submissions have been accepted, but it is nevertheless desirable that readers of the legislation appreciate the importance of these terms. For this reason the bill draws readers' attention to the fact that their meaning in the tax context has been established by case law.
- The rules on allocating income and deductions acknowledge that there are sets of rules that are not general timing regimes but nevertheless allocate amounts to income years other than simply on a derived and incurred basis, as understood by the common law. The discussion document on Parts C, D, and E proposed that these timing regimes be included in non-exhaustive definitions of *derived* and *incurred*, on a deemed basis. The reason for not adopting the discussion document approach is that is easier for readers if the timing rule and the associated income/deduction provision are kept together, as many of the timing aspects are ancillary minor modifications and closely linked with their respective income and deduction provisions.

Similarly, certain key terminological changes have been made:

- *Gross income* has become *income*. *Gross income* was a useful term to emphasise the change from a net to a gross basis as part of the core provisions, but this change has now been sufficiently understood and embedded to allow the simpler term *income* to be used. Also, some items of *gross income* are, in fact, net concepts and the term is, therefore, inaccurate.

- A new concept of *counted income* distinguishes amounts of income that are taxable from amounts, such as exempt income, that are not. The term *counted income* is used both in the core provisions and in cases where the current term *gross income* needs to be read as excluding exempt income – for example, when deductions are authorised. This approach preserves current law, under which references to *gross income* must be read as excluding exempt income.
- *Annual allowable deduction* has become *annual total deduction*. Likewise, *allowable deduction* has become *deduction*. This does not imply any change to the apportionment rules.
- *Taxpayer* is replaced by *person*. The Act currently applies these terms without any uniformity – some subparts refer to taxpayers while others refer to persons. The bill applies *person* across the board in Parts A to E because the subtleties of the definition of *taxpayer* are not evident from the term.
- *Tax year* has been defined as the period from 1 April to 31 March. *Income year* has been retained in recognition that individual taxpayers may have assessment periods that end other than on 31 March.

Certain provisions have been omitted. Section AA 2, which attempts to identify whom the Act covers, has been omitted because of its inaccuracy. Even though the discussion document had noted the benefit of section AA 2 as an indication to readers as to whether they are covered by the Act, it is too inaccurate as a general statement and would become too detailed if made accurate. Section AA 3 (1) has also been omitted because it duplicates an equivalent provision in the Interpretation Act 1999.

## **Part C of the bill**

Draft Part C defines *income* and identifies the person to whom the income belongs. It also defines amounts that would be income but are, nevertheless, exempted or excluded from income. The structure of draft Part C largely follows that set out in the discussion document on Parts C, D, and E, taking into account the submissions on that document; for example, business income has been given greater prominence than proposed in the discussion document.

### ***Overall structure***

General rules as to what is income are set out in draft subpart CA. These introduce the specific rules in the rest of draft Part C and include a catch-all provision in clause CA 1 to pick up any other amounts that would be income under ordinary concepts, corresponding to section CD 5.

Following the structural principle of organising from the general to the specific, four general categories of income result:

- income from business or trade-like activities, in draft subpart CB;
- income from holding property (divided into non-equity, in draft subpart CC, and equity in draft subpart CD);

- income from employment in draft subpart CE; and
- pensions and government entitlements (such as benefits, compensation and government grants) in draft subpart CF.

Draft subpart CG then brings together the separate provisions throughout the Act relating to recoveries and adjustments for the purposes of either:

- negating the effect of a deduction previously allocated to an income year, such as in the case of a recovered bad debt; or
- limiting the effect of a deduction in the year to which it is allocated, such as trading stock adjustments or when a government grant or suspensory loan is provided under current subpart DC.

Moving to the more specific, income from controlled foreign companies and foreign investment funds, life insurance, superannuation funds, petroleum mining, and mineral mining are respectively contained in draft subparts CQ, CR, CS, CT, and CU. Provisions that quantify income and time when it is recognised have been moved to draft Part E.

Entity-specific rules for group companies and crown research institutes are contained in draft subpart CV.

Amounts that are exempt income or excluded income are, respectively, provided for in draft subparts CW and CX. Exempt income covers amounts that would normally be considered to be income but are exempted by virtue of the nature of the income or the person who receives the income. The exemption is made specifically. Excluded income covers those other amounts that the statute excludes from tax other than by specific exemption, such as output tax on goods and services supplied by a registered person, as well as those items, such as fringe benefits, that are equivalent to income or would be income were it not for the fact that someone else pays the tax.

Draft subpart CY notes that there are provisions in other parts of the Act that make items income. Likewise, draft Part D contains a comparable draft subpart DY for deductions elsewhere in the Act. The placement of the provisions outside Parts C and D will be revisited as the other Parts of the Act are progressively rewritten.

Draft subpart CZ has been retained for terminating provisions.

If an income provision has an ancillary timing element, the timing element is sometimes included as part of the income provision, rather than being relocated to draft Part E. This is allowed for in the core provisions (clause BD 3(2)). For example, clause CB 29(1) provides that an amount equal to the market value of stolen property is income. Subclause (2) then directs that the amount is income in the income year in which the property is stolen. Splitting off such a closely linked timing element and relocating it in draft Part E would make the information less accessible to readers and make it more difficult for them to find their way to a correct conclusion on the application of the legislation.

## Part D of the bill

The purpose of draft Part D is to define amounts that are deductions.

The discussion document on Parts C, D, and E proposed that the Act's general deductibility rule, currently in section BD 2(1), include section BD 2(2)(e), which precludes deductions for capital expenditure (unless specifically allowed in the Act). Remaining deduction rules would then be divided into the following categories:

- deductions for expenditure or loss that satisfy the requirement of the general deductibility rule for a link with deriving gross income;
- deductions for expenditure or loss that expand on the general deductibility rule; and
- supplementary deductions created by statute.

The principle behind the discussion document's approach was to make explicit whether a specific rule narrows or expands the general deductibility rule and to clarify the relationship between expansions and limitations; for example, expansions are usually subject to the general limitations.

The bill adopts aspects of this approach. The general deductibility rule, entitled *general permission*, is set out in clause DA 1. The exclusions in section BD 2(2) are then brought into clause DA 2 as *general limitations* to the *general permission*. The general limitations are limitations for expenditure or loss:

- of a capital nature (the capital limitation);
- of a private or domestic nature (the private limitation);
- incurred in deriving exempt income (the exempt income limitation);
- incurred in deriving income from employment (the employment limitation); and
- incurred in deriving schedular gross income subject to final withholding (the withholding tax limitation).

The provision denying a deduction for capital expenditure, currently in section BD 2(2)(e), has not been included as part of the general permission as was proposed in the discussion document on Parts C, D and E. Instead, it has been included in the general limitations as the *capital limitation*. Grouping it with the other general limitations is seen as a more appropriate location.

Clause DA 3 then sets out in detail the relationship between the remaining rules in draft Part D – those in draft subparts DB to DF and DN to DX – and the general permission and general limitations. The rules in draft subparts DB to DF and DN to DX cover limitations and expansions of the general permission. However, they are not grouped according to whether they limit or expand. Instead, the bill retains a subject-based approach. This approach gives readers of the legislation greater comfort that, once they have dealt with the provisions in a discrete block, there are unlikely to be other provisions elsewhere that also need to be taken into account. Nevertheless, there is still a need to identify which rules override which. Hence, each

clause that allows a deduction concludes with a provision identifying its relationship with the other deduction rules.

Included among the rules from draft subpart DB onwards are rules which specifically allow a deduction for certain amounts which arise from a calculation undertaken in draft Part E. For example, the trading stock adjustment required when opening value exceeds closing value is allowed as a deduction by clause DB 40, and clause DB 41 allows a deduction for the unexpired amounts of expenditure on prepayments.

Draft subpart DY notes that there are provisions in other parts of the Act that make items deductible.

Draft subpart DZ covers terminating provisions.

### **Part E of the bill**

Draft Part E contains sets of rules that have a predominant focus on matching or allocation of income or deductions. As a number of the existing sets of such rules deal with quantification, this has been signalled in the title of the Part.

Given that draft Part E contains a range of provisions and sets of rules with differing operative effects, it does not have any general opening provisions. To some extent, such rules are already contained in the core provisions.

Nor does draft Part E contain every element of a specific provision that has a timing aspect. This is because splitting every provision would provide difficulties from a reader's perspective, as many timing provisions are closely linked with their respective income and deduction provisions.

Instead, ancillary timing rules remain with the specific provision creating income or a deduction. Necessarily, there has had to be an exercise of judgment as to what is *ancillary*, bearing in mind that the ultimate aim is to enhance the ease with which readers can find their way to the correct conclusion on the application of the legislation.

In addition to the rules on depreciable assets, trading stock, and revenue account property, draft Part E also contains sets of rules within which the timing, income and deduction rules cannot easily be separated, that is, the financial arrangements rules, the international rules and the life insurance rules. However, these groups of rules have been drafted to preserve, for draft Parts C and D, the actual provisions that make the timed and quantified amount either income or a deduction.

### ***Specific timing rules***

Specific timing rules may defer all or part of an income or deduction amount to one or more subsequent income years or, conversely, permit the income or deduction amount to be allocated to an earlier income period. Some timing rules do not allocate income or deductions, as such, but merely have the effect of modifying the allocation that would otherwise occur. A good example is the trading stock valuation rules, which make adjustments separately from the actual deduction claimed for the cost of the trading stock.

The key specific timing rules are:

- accrual expenditure (section EF 1);
- revenue account property (section EF 2);
- depreciation (subpart EG);
- financial arrangement rules (subpart EH); and
- valuation of trading stock (subparts EE, EL, and EM).

### **Other structural changes**

A number of administrative rules have been moved to the Tax Administration Act 1994.

### **Numbering**

In draft Parts C, D and E, clauses applying potentially to all or a large number of taxpayers occupy the top of the alphabet, and sections applying to particular groups of taxpayers occupy the bottom of the alphabet, leaving a gap in the middle. The gap allows drafters some leeway in future to avoid the use of subparts with 3-letter identifiers – for example, to avoid inserting a subpart CEA between subparts CE and CF.



## Chapter Three

### ORGANISATION OF MATERIAL

This chapter sets out the approach that has been taken to the organisation of the legislation. The changes are not categorised on a clause-by-clause basis, but by subject matter. The reason is that the legislation in Parts C, D, and E provides the income, deduction, and timing rules for transactions that have tax implications, with many of the rules being allocated to more than one Part. Discussion of the approach taken to the organisation of material between the Parts is more easily achieved through discussion on a subject matter basis than on a clause by clause basis. This chapter explains the main changes that have been made. It also sets out the subparts or clauses in the bill where the subject matter has been located. However, the information in the boxes should not be regarded as being a definitive list of all the clauses in the bill that deal with the subject matter referred to.

#### Depreciation

<i>Bill references</i> subpart EE	<i>Subject matter</i> Depreciation
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To be consistent with the approach adopted for other sets of rules in draft Part E, the depreciation rules are drafted so as to preserve for draft Parts C and D the role of specifying what is income or a deduction. Hence, the focus of the depreciation rules is on the quantification of an amount of depreciation loss. The general rules in draft subpart DA must then be applied to identify whether or not a deduction is allowed for the loss (but with a specific override of the general limitation preventing deductions for capital amounts).

This approach also clarifies the relationship between the depreciation rules and the general rules relating to deductibility of expenditure and loss. It avoids duplication of wording designed to require a link with income production appearing in both the general rules and the depreciation rules.

The treatment of improvements has been made explicit. At present, the practice is for improvements to be treated separately from the main asset in the year that they are made, and to be eligible for a part-year depreciation deduction. After the end of the income year, the improvement can either be incorporated into the main asset, or continue to be treated as a separate depreciable item. This practice is not, however, explicitly provided for in the current legislation.

If the improvement is a separate item, the bill treats it as separately depreciable. Otherwise, the expenditure is incorporated into the cost of the asset. In either case depreciation of the improvement begins from the time the improvement is made.

In the bill, specific depreciation-related definitions have been brought into the body of the text. At present, the definitions are spread between subpart EG and section OB 1. The most important definition affected by this change is *adjusted tax value*.

The bill also brings together the provisions relating to ownership, and specifically allows for joint ownership. At present, the only express acknowledgement of the possibility of joint ownership is in section EG 19(8), which refers to disposals by partnerships.

For reasons of clarity, the bill divides disposals between actual disposals and other events that are currently deemed to be disposals.

## **Dividends**

<i>Bill references</i>	<i>Subject matter</i>
subpart CD	Income from equity
subpart CW	Exempt income – Income from equity

Because the bill uses a substantially different approach to presenting the dividend provisions from that in the current legislation, a more detailed explanation of the approach adopted in the bill is set out below.

### ***Background***

The dividend provisions in the Act are currently contained in subpart CF. Those provisions have a varied history. Before 1958, dividends were not taxed directly. From 1958 to 1988 both the company and the shareholder were taxed with, generally, no recognition of any tax paid by the company when an amount was distributed. In 1988 the imputation system was introduced. This system allows individual dividend recipients an offset for any New Zealand tax paid by the company on the distributed income.

Also in 1988, the definition of *dividend* in the Act was rewritten because it had become unwieldy, not only as a result of incorporating imputation but also through the introduction of various withholding tax rules, fringe benefit tax, and a range of policy amendments. Those policy amendments essentially widened the dividend definition to bring in non-cash items.<sup>4</sup>

In the early 1990s the Valabh Committee reviewed the definition of *dividend*, and several changes were made as a result. The key change was the introduction of an explicit shareholder capacity test. This test limited the definition's coverage to distributions arising from a shareholder's ownership interest in a company.<sup>5</sup> Since then, the main change to the definition has been to provide for the tax consequences of company law reform that facilitated the buy-back of shares.

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<sup>4</sup> For example, the remission of loans to shareholders, the acquisition of property at above market rates from shareholders, the making available of company property for the private use of shareholders and the provision of low interest loans to shareholders, and shares in lieu of dividends.

<sup>5</sup> A person may receive a payment from a company in many possible capacities – for example, as an employee (in the form of wages), or payment for the provision of other services (say as a contractor), or from the sale of an asset to the company. From the perspective of a dividend, what is important is that there is a link between the payment and a person's shareholding in the company.

## Case law

Key cases underlying the law on dividends are *Smout v CIR* (1982) 5 NZTC 61,158 and *CIR v Brierley* (1990) 12 NZTC 7,184. These cases found that the definition of *dividend* was a code and exhaustive of the primary taxability of transactions between a company and its shareholders. A code attempts to embody everything (including the common law and existing statutes) in a coherent piece of legislation. These two cases held that distributions from a company to a shareholder that were not dividends were capital in nature and were, therefore, not taxable elsewhere within the Act.

Changes to the law since these two cases limit their effect. Under section CF 2(15), for example, a share repurchase can give rise to gross income when the shares are held on revenue account, despite the fact that an amount is excluded from being a dividend. Other exceptions are section CF 3(1)(g) and (h) which, respectively, relate to fringe benefits and certain monetary remuneration received by shareholders. Although these two items are not dividends, they are not excluded (that is, tax-free) income in the Act.

### ***Approach underlying the rewritten provisions***

The central idea behind the definition of *dividend* is to encompass all corporate distributions to shareholders. Accordingly, the starting point for the rewritten definition is that a dividend is any (net) transfer of value that is obtained by virtue of a shareholder's ownership interest in a company. This underlies the concept of *transfer of value* in the bill. But there are certain limitations to this wide coverage because not all transfers of value are treated as dividends. Certain additions are also necessary. And some items are included in the legislation to remove doubt as to whether they are dividends. The adjustments are summarised in the following table.

<i>Type of adjustments</i>	<i>Reason adjustment necessary</i>
<b>Additions</b>	
Imputation and DWP credits	Not of value to company but are of value to shareholder
Certain foreign tax credits and refunds of foreign tax	Is a benefit to the recipient but not paid by the company
Attributed repatriation by controlled foreign company	Is a notional non-cash adjustment and so no transfer is made by the company
Taxable bonus issue	No transfer of value as there is no distribution of property
Certain non-cash benefits of shareholder-employees	Is a transfer of value but not necessarily received in shareholder capacity
<b>Subtractions</b>	
Returns of capital – share cancellations, treasury stock etc	Are transfers of value but no net gain to shareholder
Capital distributions on liquidation	Are transfers of value but are capital rather than income in nature
Taxed elsewhere: subject to FBT, monetary remuneration, cash distributions in relation to notional distributions, FIF interest calculated under certain methods	To ensure no double taxation
Property from amalgamating company that does not exist after the amalgamation	Is conceptually not a transfer of value as the amalgamating company remains in existence as part of the amalgamated company
Property made available by flat-owning company	No real transfer of value as is merely a form of ownership
Use of associated company's property	De minimis rule applies and also exclusion for "downwards" transfers only caught because of breadth of "associated person" rules
<b>Included in legislation to remove doubt</b>	
Non-taxable bonus issues	No transfer of value as no property distributed. Share splits reduce the value of existing shares. Included in legislation to confirm that they are excluded income

The approach is similar to that outlined in the discussion document on Parts C, D, and E. One major exception is that the bill follows the present legislation in making the shareholder capacity test explicit.<sup>6</sup> The bill also retains the indicative criterion for measuring shareholder capacity (that is, the payment is made on terms different from that applying to non-shareholder relationships) even though this is only one possible factor for assessing capacity.

### ***Benefits of this approach***

The main benefits of defining *dividend* generically followed by specific adjustments are that it:

- allows readers to tell at an early stage whether they need to delve further into the subpart;
- focuses on the essence of a dividend, which is a net transfer of value from the company to the shareholder in the capacity of shareholder;
- simplifies the presentation by removing the need to list all possible instances when a distribution is a dividend. *Transfer of value* covers section CF 2 (1)(a)-(k) (apart from *taxable bonus issues* in (f)); and
- facilitates future changes to the definition, since they can more readily be accommodated through changes to the adjustments.

### ***Specific drafting style***

The approach to dividends in the rewritten legislation differs from that of the current legislation in a number of main areas.

#### *Terminology – Use of ‘company’, ‘share’ and ‘shareholder’*

These defined terms have been rewritten and rationalised. The aim is to have a consistent set of words defining when non-standard entities, such as unit trusts, category A group investment funds and producer boards, are treated as companies. Although this stretches the natural meaning of the terms *company* and *share*, it is necessary to use a single defined term which is not so generic as to be meaningless to readers, and the relevant entities are generally bodies corporate in nature.

The various explanations and qualifications that relate to the individual adjustments to the general rule are now located with the adjustments, and detailed calculation rules are dealt with subsequently and separately.

The current legislation is divided between what is a dividend (section CF 2(1)) and what is not a dividend (section CF 3(1)). Following each of these subsections is a series of provisions found both in the rest of subpart CF and elsewhere within the Act. The reader needs to go through these provisions to establish whether there are any limitations to an item specified in either section CF 2(1) or section CF 3(1) or, alternatively, how to calculate the amount that is, or is not, a dividend. These

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<sup>6</sup> The reason for making the capacity test explicit rather than implicit is to put the application of the test beyond doubt. Making the test explicit also removes the need specifically to exclude payments by a company to its shareholders in relation to services provided to the company.

additional rules have generally either now been located alongside their relevant lead provision or else shifted (to avoid obscuring the basic rules) into a separate segment containing detailed calculation rules.

*Complex and directly relevant definitions incorporated back into the rules*

At present, key definitions are spread between subpart CF and section OB 1. The definition most affected by this is *available subscribed capital*. To assist readers, complex and inter-linked definitions have generally been converted into sections located in the relevant segment of draft subpart CD.

## Employment

<i>Bill references</i>	<i>Subject matter</i>
subpart CE	Employee or contractor income
subpart CW	Exempt income – Employee or contractor income
subpart CX	Excluded income – Fringe benefits
subpart DC	Employee or contractor expenditure
subpart DD	Entertainment expenditure

Provisions relating to employees’ remuneration and benefits have been reordered. The main changes are as follows:

- Amounts that employees are required to account for as income are brought together in draft subpart CE, including amounts currently provided for in the definition of *monetary remuneration* and benefits under share purchase agreements.
- Amounts that employees would ordinarily be required to account for as income, but that are specifically exempted, are brought together under the heading ‘Employee or contractor income’, in draft subpart CW (Exempt income).
- Fringe benefits are identified in a separate division of draft subpart CX (Excluded income).
- The specific deduction provisions for employers, at present in subpart DF, now appear in draft subpart DC (Employee or contractor expenditure). Their relationship to general deductibility rules has been made clearer.
- The rules limiting deductions for expenditure on entertainment, currently in subpart DG and schedule 6A, now appear in draft subpart DD (Entertainment expenditure).

## Farming and forestry

<i>Bill references</i>	<i>Subject matter</i>
clauses CB 23 and CB 24	Timber
clause CB 25	Refunds under income equalisation scheme
clauses CW 1 to CW 3	Forestry
clause CX 44	Income equalisation schemes
subpart DO	Farming and aquacultural business expenditure
subpart DP	Forestry expenditure
subpart DQ	Income equalisation schemes
subpart EH	Income equalisation schemes
clause EI 1	Spreading backward of income from timber
subpart EJ	Spreading of specific expenditure – Farming and forestry

The provisions on farming and forestry have been reordered. The main changes are:

- The provisions on income arising from farming or forestry have been set out together in clauses CB 23 to CB 25.
- The provisions on certificates about the nature of trees and the purpose of their planting, sections CJ 1(3) and DO 4(5), have been moved to the Tax Administration Act 1994.
- The provisions on income equalisation schemes have been teased out into a subpart that is longer but simpler than current subpart EI.

## Films

<i>Bill references</i>	<i>Subject matter</i>
clause CC 11	Films
subpart DS	Film industry expenditure
subpart EJ	Spreading of specific expenditure – Films

The main structural changes made by the bill are to separate the allowable deduction and timing elements of the current film expenditure provisions in sections EO 3 and EO 4 and move them to draft Parts D and E respectively. The rewritten film expenditure provisions reduce the current overlap between the film expenditure rules and arrange them in a more logical order.

The bill makes it clear that the film expenditure rules override the matching rules for the cost of revenue account property. Because all amounts received from the disposal of a film are income, films would come within the definition of *revenue account property*.

## Financial arrangements rules

<i>Bill references</i>	<i>Subject matter</i>
clause CC 3	Financial arrangements
clauses DB 9 to DB 12	Financial arrangements adjustments
subpart EW	Financial arrangements rules
subpart EZ	Terminating provisions – Old financial arrangements rules

The rules for calculating and allocating income and expenditure under financial arrangements were revised in 1999. The 1999 revisions were implemented by making the sections in subpart EH into division 1 and adding a division 2. Some minor amendments were made to division 1, but essentially it was left unchanged so as not to disturb the law under which existing financial arrangements had been made. There is no advantage in departing from that approach and rewriting it now. As a result, the bill contains a rewritten version only of subpart EH, division 2. Division 1 has been shifted to subpart EZ.

## International

<i>Bill references</i>	<i>Subject matter</i>
subpart CQ	Attributed income from foreign equity
subpart DN	Attributed losses from foreign equity
subpart EX	Controlled foreign company and foreign investment fund rules

The structure of these provisions has been altered in a number of ways:

- Provisions relating to both the controlled foreign company (CFC) rules and the foreign investment fund (FIF) rules have been re-ordered.
- Provisions that merely create the income amount or deduction amount have been included in, respectively, draft subparts CQ (Attributed income from foreign equity) and DN (Attributed losses from foreign equity). This is consistent with the structural approach in the bill. Each of these subparts is subdivided to deal separately with the CFC and FIF rules. Each subpart has a section listing the criteria that must be satisfied for amounts to be attributed under either the CFC or FIF rules. These provisions cross-refer to the relevant provisions in draft Part E that detail the specific rules in the CFC and FIF regimes.
- The remaining detailed rules within the CFC and FIF regimes have been shifted from draft Part C, where they are currently located, into draft Part E. Because the rules apply equally to the calculation of income amounts and loss amounts, it is inappropriate to put them in draft Part C. Also, because the rules deal in significant part with both timing and quantification aspects, draft Part E is a more appropriate location.

- Some very detailed definitions have been shifted from section OB 1 into the body of the operative provisions in draft subpart EX. For example, the definition of *interest in an employment-related foreign superannuation scheme* is so detailed that it best appears as a specific provision in draft subpart EX.
- Some spent provisions have been omitted, and in one case a terminating provision (relating to FIF interests held on 1 April 1993) has been shifted to draft subpart EZ.
- Provisions in the FIF rules that treat non-market transactions as having taken place at market value have been shifted into subpart GD, on the basis that the bill's structure requires subpart GD to be used for circumstances when transactions are deemed to take place at market value. However, a flag is left in draft subpart EX directing readers to the relevant provision in subpart GD.
- In draft subpart EX the detailed rules of the CFC and FIF regimes have been restructured and subdivided to make it easier to understand how the detail of those regimes functions to produce a result in terms of income or loss for a taxpayer.
- Some new terminology has been introduced. In particular, the term *attributing interest* has been used in the FIF rules to avoid having to use the existing term *interest in a foreign investment fund* to define both what constitutes a fund and what constitutes an interest that gives rise to FIF income or loss. Also, to reduce verbosity, the acronyms CFC and FIF are used widely.

### **Life insurance, general insurance and superannuation funds**

<i>Bill references</i>	<i>Subject matter</i>
subpart CR	Income from life insurance
subpart CS	Superannuation funds
clauses CX 34 to CX 36	Insurance
subpart DR	Life insurance business expenditure
clauses DV 1 to DV 4	Superannuation funds
subpart EY	Life insurance rules
clauses FC 13 to FC 17	Non-resident general insurers

These provisions deal with sections of the Act that specifically relate to the taxation of life insurers, general insurers, and superannuation funds.

There are two main structural changes. First, the bulk of the provisions on life insurance have been moved into draft Part E. An amount timed and quantified under the life insurance rules in draft Part E is made either income or a deduction by a provision in draft Part C or Part D. Second, the provisions on non-resident general insurers have been moved into Part F, which deals with apportionment and recharacterised transactions.

## Livestock

<i>Bill references</i>	<i>Subject matter</i>
clause CH 1	Trading stock, livestock, and excepted financial arrangements
clause DB 40	Trading stock, livestock, and excepted financial arrangements
subpart EC	Valuation of livestock

These provisions set out the options available to owners and bailees of livestock for valuing livestock on hand at the end of the year. Taxpayers are required to choose a particular valuation option. As with trading stock, the purpose of valuing the livestock on hand is to establish the extent to which an adjustment needs to be made to ensure that what is claimed as a deduction is only the cost of the stock that is sold. But, in the case of the herd scheme, the adjustment serves a different purpose – to ensure that any change in an animal’s average value does not have a tax impact.

At present, the livestock valuations fit into the general trading stock rules (through section EE 2) by subtracting the opening value from the closing value to produce a valuation adjustment. Livestock is specifically included within the definition of *trading stock*.

In the bill, *livestock* is separated from the definition of *trading stock*. The reason for not treating livestock as trading stock is that *livestock* is an amalgam of *plant* and goods produced for sale.<sup>7</sup> Despite this separation, livestock will continue to be on revenue account.

### *Partnership elections*

To prevent confusion about whether a valuation election applies to all activities of a taxpayer when that taxpayer has an interest in a partnership as well as other interests, the bill makes it clear that the partnership interest is to be treated separately.

The general rule is that an election applies to all of a taxpayer’s livestock. But the intention is that taxpayers can make separate elections for the partnership interest and their individual interests.

Therefore taxpayers who own their own farm and are also a partner in another farming venture do not have to apply the same valuation method chosen for the partnership to livestock on their own farm.

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<sup>7</sup> The herd scheme option for valuing livestock for tax purposes is provided in recognition that animals can be on hand to produce other goods (such as offspring, wool and milk) rather than merely as goods in their own right.

## Mining

<i>Bill references</i>	<i>Subject matter</i>
subpart CT	Income from petroleum mining
subpart CU	Income from mineral mining
clauses CX 37 and CX 38	Petroleum mining
clauses CX 39 to CX 41	Mineral mining
subpart DT	Petroleum mining expenditure
subpart DU	Mineral mining expenditure

Provisions relating to both petroleum and mineral mining have been reordered:

- Provisions identifying income from mining and related activity are brought together in draft subparts CT (Income from petroleum mining) and CU (Income from mineral mining). Much of this material is currently located in Part D.
- Provisions allowing deductions related to mining activity are brought together in draft subparts DT (Petroleum mining expenditure) and DU (Mineral mining expenditure).

The bill makes it clear that the specific petroleum mining deduction provisions override the revenue account property rules (section EF 2).

## Property

<i>Bill references</i>	<i>Subject matter</i>
subpart CB	Income from business or trade-like activities
subpart CC	Income from holding property (excluding equity)
clauses CW 4 to CW 8	Income from holding property (excluding equity)
clauses DB 13 to DB 16	Premises costs
clauses DB 17 to DB 22	Revenue account property
clauses DB 28 to DB 31	Patent rights
clauses DB 33 to DB 36	Theft and bribery
clauses EI 2 to EI 5	Land
clauses EJ 19 and EJ 20	Leases

Provisions relating to property have been reordered:

- Income provisions that are currently grouped within single sections have been split into separate sections. For example, the three limbs of section CD 4 (Personal property) now appear in three different clauses, with their subject matter clearly signalled. The different rules in section CD 1 (Land transactions) are similarly separated.
- Amounts that are royalties, but that are currently identified in the definition of *royalty* in section OB 1, are brought into the substantive royalty provision in draft Part C.

- Provisions that allow a deduction for expenditure incurred following non-compliance with a covenant to repair, currently in sections EN 1 and EO 5, now appear in a division, ‘Premises costs’, of draft subpart DB (Specific rules for expenditure types).
- Spreading options for income and expenditure appear under the division heading ‘Land’ in draft subpart EI (Spreading of specific income) and under ‘Leases’ in subpart EJ (Spreading of specific expenditure). However, ancillary timing rules such as section EN 5, which allocates income derived from stolen property, have been relocated with the income or deduction provision to which they relate.

## Trading stock

<i>Bill references</i>	<i>Subject matter</i>
clause CH 1	Trading stock, livestock, and excepted financial arrangements
clause DB 40	Trading stock, livestock, and excepted financial arrangements
subpart EB	Valuation of trading stock (including dealer’s livestock)

These provisions set out the valuation rules for trading stock that are used to value stock on hand at year-end. This value is then compared with last year’s closing value (equivalent to this year’s opening value) to derive an annual valuation adjustment. The approach adopted in the bill is consistent with the approach outlined in the discussion document on Parts C, D, and E in that the adjustment feeds into either draft Part C or Part D rather than, as at present, the closing value being income and the opening value a deduction.

The definition of *trading stock* has been incorporated into the bill. However, livestock has been excluded from the definition, as have bloodstock and excepted financial arrangements. This makes no practical difference as livestock and bloodstock already have their own subparts.

There are two reasons for excluding excepted financial arrangements from the definition. The excepted financial arrangement provisions do not fit well with the trading stock rules because they apply to all excepted financial arrangements that are revenue account property, not just those that are trading stock. Moreover, excepted financial arrangements can be valued only at cost, whereas trading stock in general can potentially be valued at either its cost, market value or replacement price.

Even though livestock, bloodstock and excepted financial arrangements have been separated from trading stock, they are all put through the same process to calculate a combined annual stock adjustment (see clause EA 1).



## Chapter Four

### POLICY CLARIFICATIONS

Making the law clearer has been achieved by using plain language within a consistent structure. The objective is to do this without substantively changing the policy content, and associated compliance requirements, of the current Act. Care has been taken to ensure that, apart from minor policy clarifications, the bill produces the same outcome as the existing law.

The proposed policy clarifications were presented in the exposure draft of the rewritten legislation that was released for public consultation in September 2001, in earlier policy documents, such as issues papers 1 and 2, and in two discussion documents. The bill takes into account the submissions received on those documents.

The policy clarifications that have been made in the bill are of a minor nature and have been presented for public consultation in recent years. Rather than repeat all those proposals, this chapter is confined to the main changes that have been made in the bill.

Consistent with the principles of self-assessment outlined in the discussion document *Legislating for self-assessment of tax liability*, especially Chapter 4, Commissioner's discretions have been removed where appropriate.

Two proposed changes that were identified in the exposure draft were opposed in submissions and have not been included in the bill. They relate to the provision of services to shareholders at less than market value, and taxation of dealers in personal property.

#### **Dividends – inclusion of services**

The central idea behind the definition of *dividend* is to encompass all corporate distributions to shareholders. Accordingly, the starting point for the rewritten definition is that a dividend is any (net) transfer of value that is obtained by virtue of a shareholder's ownership interest in a company.

The exposure draft of the rewritten legislation suggested that, conceptually, this approach would include not only benefits arising in relation to property but also benefits from services provided by the company to its shareholders for inadequate consideration. Consequently, it was proposed that the definition of dividend be extended to cover services provided by all organisations, not just closely-held companies.

Submissions on the exposure draft opposed this change as representing a significant change in the law which should be subject to further consultation. For this reason it has not been included in the bill, but will be subject to further consultation as part of the Government's tax policy work programme.

## **Dealers in personal property**

The rewrite exposure draft proposed a change to the provision that taxes the sale of personal property by a person who is in the business of dealing in that type of property (section CD 4). The provision currently does not clarify whether or not the property must have been acquired or held for the purposes of the business – section CD 4, third limb. The exposure draft proposed the express removal of a portfolio distinction for these dealers by deeming all property in which they dealt to be on dealing account.

The proposal was opposed in some submissions, which argued that it went beyond clarification and would represent a change in the law. As a result, it has not been included in the bill, and further consultation will be undertaken through the normal tax policy development process.

## **New issue: Recovery of amounts previously claimed as a deduction**

One policy issue that has not been the subject of public consultation relates to the recovery of an amount that has previously been allowed as a deduction.

Currently, the Act prohibits a deduction for expenditure or loss which, although otherwise deductible, is recoverable under insurance or a right of indemnity. This denial can create a problem if the amount recovered is itself treated as income. Denying the deduction means that the taxpayer ends up being taxed twice. General insurers who get reinsurance payments as part of their business are an example of taxpayers who are, theoretically at least, exposed in this way.

The bill deals with this problem by dispensing with the provision that prohibits the deduction of the amount recovered and replacing it with a provision that treats the amount recovered as income. The change is that the amount recovered is treated as income in the year it is recovered, whereas under current law it is effectively treated as income in the year the deduction was claimed.

## **Part C changes**

**Section CB 1 (Exempt income – interest).** Subsection (1)(a), which provides a limited exemption for interest from Post Office National Development Bonds or New Zealand Savings Certificates, has not been rewritten as it is obsolete.

**Section CB 2 (Non-residents' exempt income).** Subsection (1)(c), which exempts personal services income earned by visitors to New Zealand if the visit does not exceed a period of 92 days has been rewritten as clause CW 15. The clause now makes clear that the day of arrival and the day of departure each counts as a whole day for the purpose of calculating the 92-day period. The change makes the provision consistent with section OE 1(4), which directs part-days to be included when calculating the 183-day period for residence.

**Section CB 3 (Public and local authorities' exempt income).** Paragraph (b)(i), which exempts any amount derived by a local authority other than an amount received in trust, has been rewritten as clause CW 29 and now makes clear that the amounts intended to be excepted from the exemption are amounts that a local authority receives as a trustee.

**Section CB 3 (Public and local authorities' exempt income).** Paragraph (d), which exempts the income of Geothermal Development Limited, has not been rewritten as it is obsolete.

**Section CB 5 (Certain pensions, benefits, and other compensation exempt).** Subsection (1)(d), which exempts certain retiring allowances of former public servants of the Cook Islands and Western Samoa, has not been rewritten. The payments identified in the provision are now deemed not to be income by clause HH 3 (5), the provision that provides generally that distributions to beneficiaries from a qualifying trust are not income. The provision is, therefore, superfluous.

**Section CC 2 (Payments to employees or former employees while on naval, military, or air service).** This section has been omitted from the bill because it is redundant. The effect of the section is covered by clause CA 1(2).

**Section CC 3 (Forestry encouragement grants).** This section has not been rewritten because grants are no longer available.

**Section CD 1 (Land transactions).** The timing of the associated person tests in section CD 1(2)(b), (c), and (d) has been clarified. Clauses CB 6 to CB 9 make clear that the test of association applies when land is acquired or, in the case of builders, improved, rather than at the time of disposal.

**Section CE 2 (Amounts derived from use or occupation of land).** This section has not been rewritten. Its predecessor was introduced in 1939 at a time when farmers whose land had an unimproved value of £3,000 or less were not liable to pay income tax. The intention of the government of the day was to ensure that farmers would pay income tax on the same basis as other income earners. However, that policy objective is now achieved by the general business rule so section CE 2 is superfluous.

**Section CE 4 (Amounts remitted to be gross income).** Issues paper 2 proposed that when amounts of expenditure or loss for which a deduction has been allowed in one year are remitted in a subsequent year, the remitted amount be treated as income and allocated to the year in which the remission occurs. Currently, the remitted amount is treated as income but is backdated to the year the original deduction was taken, requiring an amendment to the tax return for that year. The proposal has been incorporated into the bill.

**Section CJ 1 (Income from minerals, timber, or flax).** The reference to flax in section CJ 1 has not been rewritten. Amounts derived from a disposition of flax will continue to be identified as income, when appropriate, by clauses CB 1 to CB 4 (sections CD 3 (Business) and CD 4 (Personal property) of the 1994 Act). Expenditure incurred in deriving such income will continue to be deductible under the normal deductibility and revenue account property rules.

**Section CK 2 (Energy trading operators).** This section, which provides that certain amounts are income of energy trading operators, has not been rewritten. No energy trading operators remain in existence and so the provision is obsolete.

**Section CL 2 (Trustee income).** This section provides that the trustees of investing superannuation funds are not taxed on the proceeds of life insurance policies that have been issued in New Zealand. The section has been rewritten as clause CX 35 and altered to extend coverage to life insurance policies offered or entered into in New Zealand. This makes the provision consistent with the other parts of the life insurance tax regime.

**Section CM 2 (Business of life insurance may include provision of annuity).** This section treats annuity business as though it were life insurance business. The section has been absorbed into the definition of *life insurance*.

**Section CM 18(1) (Transfer of life insurance business).** This subsection sets out the opening balance of the actuarial reserves that a transferee must use in performing the policyholder base income or loss calculation under section CM 15. It is the aggregate of the actuarial reserves of the life insurer in respect of all policies of life insurance for which the life insurer was the insurer immediately after the transfer. A change has been made to make it clear that the pre-existing life insurance business of the transferee is also included in the opening actuarial reserves figure.

**Section CM 18(2) (Transfer of life insurance business).** This subsection deals with the transfer of life insurance business between companies in a wholly owned group. The provision has been rewritten as clause EY 44, and a change has been made to make it clear that both companies in a wholly owned group must be in the same group at the time of that transfer rather than at any time during the year.

**Section CN 3(2) (Non resident life insurer issuing policies in New Zealand).** This subsection makes it clear that non-life insurance business of a life insurer is taxed under the normal provisions of the Act. This provision was used under the former schedular approach to the taxation of life insurance. It has not been rewritten because it is no longer needed.

**Section CZ 3 (Fringe benefit tax).** This section, which imposed fringe benefit tax in limited circumstances during the period April to October 1989, is obsolete and has not been rewritten.

**Section CZ 6 (Insurance companies other than life insurance companies).** The transitional provisions relating to non-life insurers contained in section CZ 6 have been omitted as they are no longer applicable.

## **Part D changes**

**Section DH 2 (Use of actual records to establish business use proportion of motor vehicle).** Clause DE 12 allows Inland Revenue Mileage Rates to be used to measure business use of a motor vehicle.

**Section DF 3(1) (Contributions to employees' superannuation schemes).** The first part of this section has not been rewritten. In allowing a deduction for employer superannuation contributions, it merely replicates the general deduction rule. The part of subsection (1) that allocates the deduction to the time when the contribution is made has been combined with section EO 1 in a new, comprehensive timing rule for employer superannuation contributions (clause EJ 21). Subsection (2), which denies a deduction for employer superannuation contributions to schemes that are not superannuation funds or companies has not been rewritten either. The denial pre-dates, and is now superseded by, the current foreign investment fund rules, and its removal was proposed in issues paper 1, page 46. Subsection (3), which directs a reversal of earlier deductions allowed for employer contributions to a superannuation scheme if the employer receives a benefit from the scheme, has been replaced by an income provision (clause CG 5). This change is consistent with proposals in the discussion document on Parts C, D, and E and was specifically proposed in issues paper 1. The current limitation to contributions made in the preceding 12 months has also been removed, as proposed in the issues paper.

**Section DF 6 (Payments to employees or former employees while on naval, military, or air service).** This section, which allows employers a deduction of up to \$8 a week for payments made to employees or former employees called up for service in the armed forces, has been omitted from the bill.

**Section DG 1 (Limitation on deduction for expenditure on specified types of entertainment).** Section DG 1 and Part A, clause 4(c)(ii) of Schedule 6A limit the deductibility of expenditure on food and beverage if provided or consumed in an area of the taxpayer's premises reserved for senior staff and their guests. The bill makes it clear that the legislation applies not only where the area is reserved for senior staff and their guests, but also where it is reserved exclusively for senior staff.

**Section DM 4 (Farm-out arrangements).** A cross-referencing error in this section has been corrected. The error occurred when the Income Tax Act 1976 and the Inland Revenue Department Act 1974 were reordered into the Income Tax Act 1994 and the Tax Administration Act 1994. Current section DM 4(2)(a)(i) provides that excess expenditure incurred before 16 December 1991 is allowed as a deduction in accordance with section DM 1(2). That reference, however, should have been to section DM 1(3).

**Section DM 11 (Further development expenditure in Maui field).** This section has been omitted from the bill as the Maui B project is now complete.

**Sections DO 3 (Certain expenditure on land used for farming or agricultural purposes) and DO 4 (Expenditure on land improvements used for farming or agricultural purposes).** These sections have been rewritten as clauses DO 1 and DO 4, and the current overlap between the two provisions has been removed. Currently, section DO 3, introduced in 1991, allows certain expenditure on assets to be deducted in the year of incurrence. At the same time, section DO 4, an older provision, continues to direct that some of the same expenditure is to be recognised over the life of the assets under a depreciation-type scheme. The draft now provides that the expenditure in question should be deducted in the year of incurrence.

**Section DO 6 (Deductions by lessors of land used for farming or agricultural purposes).** The section allows lessors of farm land a deduction for expenditure identified in section DO 3, which they are able to claim if they, rather than their tenants, are carrying on a farming business on the land. It has been rewritten as clause DO 5, and now extends to expenditure of the type identified in section DO 4.

**Section DZ 1 (Premium paid in respect of leased machinery).** This section is obsolete and has been omitted from the bill.

**Sections DZ 2 to DZ 4 (Certain expenditure on land used for forestry purposes, farming and agricultural purposes, or aquaculture).** These sections are obsolete and have been omitted from the bill.

**Section DZ 6 (Companies engaged in exploring for, searching for, or mining petroleum).** This section has been omitted from the bill as the Maui B project is now complete.

### **Part E changes**

**Section EG 19(4) (Disposition of depreciable property).** The reference in item ‘b’ has been changed from *cost* to *base value*.

**Section EJ 2 (Compensation in connection with outbreak of scrapie).** This section is obsolete and has been omitted from the bill.

**Section EL 5 (Herd scheme for specified livestock).** Subsection (4) has been rewritten in clause EC 10(3) in a way that makes it clear that it applies only to increases in numbers of a class of livestock, and does not apply to bailment deficiencies arising under section EL 7.

**Section EL 10 (Valuation of high-priced livestock).** Subsection (7) has been omitted from the bill on the basis that it is no longer relevant. The subsection set out the method of valuing livestock that were classified as high-priced livestock under the previous livestock valuation rules. It not expected that any of that livestock will still be on hand when the bill comes into force.

**Section EO 2 Deduction to lessee in non-specified lease).** The section has been rewritten as clause EJ 19, but the application dates in subsection (3) have not been included as they are obsolete.

**Sections EO 3 (Costs of acquiring any film or any right in any film) and EO 4 (Cost of producing films).** The overlap between sections EO 3 and EO 4 for expenditure incurred in producing a film has been removed (by removing the rules in section EO 3 relating to film production). This simplification of the legislation should not result in a substantive change in policy because section EO 3 is subject to section EO 4. Currently, a film owner who incurs expenditure in producing a film must use section EO 4 to deduct that expenditure. In addition:

- The provisions that replace section EO 4 provide that they are the only provisions under which *film production expenditure* can be deducted.
- Broadcasters have been excluded from the rewritten film production expenditure provisions.
- The bill makes it clear that broadcasters who incur production expenditure on a film are excluded from the film expenditure rules only if the film is produced mainly for the purpose of being broadcast in New Zealand.
- The anti-avoidance provision, section EO 4(12), relating to expenditure that is deemed to be incurred at the time of payment, has been relocated to Part G.
- The reference to *right* as an amount that is dependent on or calculated by reference to income from the sale, use, rental or other exploitation of a film (currently contained in section EO 4A(2)(a)(ii)) has been incorporated into the replacement provisions for sections EO 3 and EO 4. As a result, these sections constitute a code for all film-related expenditure incurred by persons who own a right in a film. This change simplifies the drafting of the replacement provisions to sections EO 4A and GD 12.
- As a result of removing the film production rules in section EO 3, the associated anti-avoidance provisions (in section GC 11(3) and (4)) have also been omitted. (The corresponding provisions for the film expenditure rules in section EO 4(1) to (12), GD 12(1) and (1A), have been retained.)

**Section EZ 1 (Spreading of income arising in 1992-93 income year from revaluation of specified livestock);**

**Section EZ 2 (Spreading of liquor revaluation income);**

**Section EZ 3 (Depreciation allowances, etc., on motorcars);**

**Section EZ 7 (Unreturned retail profit in relation to goods sold on hire purchase);**

**Section EZ 8 (No first year depreciation allowance for previously exempt taxpayers).**

These sections are obsolete and have been omitted from the bill.

### **Parts F to N changes**

**Section FB 6 (Films).** This section deals with the apportionment of expenditure in the acquisition of a film if the film is acquired together with other property. It has been omitted from the bill because it is considered to be unnecessary.

**Section IE 1 (Net losses may be offset against future net income).** Issues paper 2 proposed that section IE 1(4) should be repealed and the general rule in section CE 4 relied on instead; the effect of the ordering rule in section IE 1(4)(d) should be relocated to section CE 4; and the deduction for post-remission payments in section IE 1(4)(g) should be relocated to Part D. The proposal has been incorporated into clauses CG 2 and DB 38 of the bill.

## **Part O changes**

**Definition of ‘superannuation scheme’.** The definition has been changed to align it with that in the Superannuation Schemes Act 1989. This provides for consistency between the Acts.

**Definition of ‘trading stock’.** The issues pertaining to the inter-relationship between bloodstock and trading stock have been addressed through excluding livestock from trading stock.

## Chapter Five

### PLAIN LANGUAGE DRAFTING

Plain language law drafting seeks to convey the intended message of the legislation in the plainest possible way. It involves not only using plain language as far as possible, but also using shorter sentences and ‘ordinary’ grammar, formatting provisions consistently, and arranging information so that it can be easily found.

This chapter sets out the guidelines on various matters of style and language that have been used in rewriting the legislation in this bill. They are based on the guidelines proposed in the government discussion document *Rewriting the Income Tax Act – objectives, process, guidelines*<sup>8</sup> and on Parliamentary Counsel Office drafting guidelines.

#### Style

##### *Active or passive*

The active voice has been used in preference to the passive voice.

##### *Capitals*

Capitals have been used only as necessary.

Capitals have not been used:

- to begin each paragraph of a series of paragraphs within a sentence; or
- to begin each word defined in a series of definitions.

A word used in a general sense does not have a capital letter even though the same word used in a particular sense does – for example, *court* or *government*.

Capitals have been used for:

- titles of legislation;
- the Crown;
- names and titles of persons of considerable eminence (*Governor-General, Minister*).

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<sup>8</sup> *Rewriting the Income Tax Act: Objectives, process, guidelines. A discussion document.* December 1994.

### ***Drafting in the positive***

Affirmative statements are usually more direct and straightforward than negative statements. The use of multiple negatives, as in the example below, is confusing and has been avoided when possible:

**Notwithstanding anything in this Act, with respect to the income of an underwriter carrying on the business of insurance, the gross income of the underwriter shall not include gross income derived from insurance business carried on out of New Zealand to the extent that the gross income so derived consist of income other than income of the kinds referred to in any of paragraphs (e), (f), (g), (h), (l), (m), and (n) of section OE 4(1).**

### ***Numbers***

Figures have been used instead of words except at the beginning of a sentence.

Examples are:

**No later than 12 months after the end of the income year...**  
**Twelve months after the end of the income year and no later...**

### ***Paragraphing***

Sentences have been presented in a paragraphed form when doing so assists communication. Otherwise they have been broken up into separate subsections.

If a sentence has needed to be divided beyond subparagraphs, the structure of the sentence has been reviewed. In these cases, the sentence has been broken up into shorter sentences to make it more comprehensible.

### ***Parentheses***

Parentheses enclose explanations, illustrations and digressions that are connected with the message of the sentence. They have been used with caution because an interruption to the flow of the sentence may impede understanding.

### ***Present tense***

The present tense and the indicative mood have been used wherever possible.

### ***Provisos***

The traditional form of legal proviso beginning *provided that* is archaic and has been avoided. It may be uncertain whether the proviso is intended to be a true proviso derogating from a general provision or a co-ordinate supplementary provision. An example of the latter is found in the first proviso to the general interest deductibility section, section DD 1(b) of the Income Tax Act 1994, which states:

**Provided that for the purpose of this paragraph expenditure incurred under the accrual rules is treated as interest payable...**

The words *provided that* are superfluous.

### ***References to dates***

The format used for referring to dates is *1 April 1995*, not *the first day of April 1995* or *1<sup>st</sup> April 1995*.

### ***References to legislative provisions***

A reference in one section of the Act to another provision of the same Act does not include the words *of this Act* unless to omit them would create ambiguity, as when another Act is referred to in the same provision.

### ***Section length***

Sections and subsections have been kept to a manageable length. The length of sections depends on whether there is a relationship between subsections which is complementary and obvious. In some cases, subsections, and sections without subsections, contain more than one sentence.

### ***Sentence structure***

Generally, a short sentence has been used in preference to a long sentence, to ensure that the core structure of a sentence can be easily recognised by the reader. The intention has been to ensure that the core structure is not obscured by multiple or complex modifying elements, particularly those positioned before the subject.

### ***Singular or plural***

There may be a choice between constructing a sentence in singular or plural terms. The general rule that has been adopted is to use the singular.

### ***Symbols, abbreviations and acronyms***

A symbol, abbreviation or acronym has been used when it assists the flow of meaning. Common examples are \$ and %. Acronyms have also been used for often repeated technical terms such as *FIF* and *FBT*. In these cases, the acronyms have been defined.

### **Word choice**

The plain language drafting style used in the rewritten legislation minimises complexity, repetition and the use of redundant words. It also uses words according to their ordinary meaning as far as possible.

### ***Accurately expressing the intended meaning***

In a number of cases in the existing Act, words have been used in a way that does not accurately express their intended meaning. Every effort has been made to correct these in the rewritten legislation.

- **all, each, every**  
These words are often used unnecessarily in the existing Income Tax Act and have generally been omitted or replaced by *a*, *an* or *the*. The use of *all*, *each* and *every* has been restricted to contexts in which their core meaning is needed.
- **any**  
*A* or *an* has generally been used instead of *any* as they are usually simpler, free from ambiguity and often just as effective. *Any* can be ambiguous because it is capable in some contexts of carrying the same meaning as *every*.
- **deem**  
The purpose of deeming is to create a “legal fiction”. Deeming provisions have been used only if a thing is to be treated as something it is not or not treated as something it is. The word *treated* has, in most instances, been used instead.
- **less than, more than**  
Provision for *less than X* and *more than X* leaves X itself unprovided for. This has been avoided by providing for X. *Above/below* and *over/under* have been avoided. *Less* means *a smaller amount of* and has been applied only to things measured by amount.
- **may, must, shall**  
*May* has been used when a power, permission, benefit or privilege given to some person may, but need not, be exercised. *May* is discretionary. It has not been used when a duty must be performed.
- **Notwithstanding anything in this Act** (or an equivalent phrase referring to a group of provisions) does not indicate which provisions are to be overridden, especially if the phrase is used more than once in the Act. The specific provisions which are overridden should ideally be identified unless the intention is to override all provisions in the Act. Problems which can otherwise arise include incomplete communication of the legal effect of the provisions and the possibility of a broader application than intended.

When it has been necessary to clarify the relationship between provisions, the drafters have used plain language, affirmative statements and specific references. For example:

**CC 5 Annuities**

***Income***

- (1) An annuity derived by a person is income of the person.

***Apportionment***

- (2) Income under an annuity due but unpaid on the date on which a person disposes of the annuity is apportioned between the person disposing of the annuity and the person acquiring it.

***Relationship with sections CW 4 and CW 23***

- (3) This section is overridden by **sections CW 4** (Annuities under life insurance policies) **and CW 23** (Annuities from Crown Bank Accounts).

- **where**  
Although *where* has been traditionally used to introduce a conditional clause, in common usage it suggests place. It has been replaced with *when* or *if* in the rewritten legislation.

### ***Using words in a consistent manner***

Some terminological changes have been made to ensure that words are used in a consistent manner. Examples are:

- **Acquisition.** The rewritten provisions use *acquisition* and *acquire* in place of expressions such as *acquires or becomes possessed of*, *acquired or created*, and *purchase or creation*.
- **Disposal.** The rewritten provisions use *disposal* in place of *sale or other disposition*, *sale or other transfer*, *alienation or transfer*, and similar expressions. The verb used is *dispose*.
- **Mainly.** The rewritten provisions use *mainly* in place of *primarily and principally* and similar expressions. The expression *primarily and principally* was considered by Eichelbaum J in *Newman Tours Ltd v CIR* (1989) 11 NZTC 6,027 (High Court). The judge interpreted the expression as requiring that the purpose not only be the main one, in the sense of outweighing all the other purposes, singly or collectively, but also the primary one, that is, the first one. Sufficiently similar connotations can be conveyed in the single word *mainly*.
- **They.** The rewritten provisions use *they* as the singular pronoun in place of repetition of *the taxpayer* or *the person* or multiple gender pronouns, i.e. *His, her or it*. There is ample authority that this is an acceptable English usage.

### ***Avoiding archaic or unnecessary words***

The rewritten legislation avoids the use of the following wherever possible:

- *above* and *below* in references (for example, *subsection (1) above*)
- *abovementioned*, *aforementioned*, *beforementioned*, *foregoing*
- *an amount equal to an amount of*
- *as to*, especially before *whether*
- *hereby*, *hereafter*, *herein*, *hereinafter*, *hereinbefore*, *hereto*, *herewith*, *hitherto*
- *pursuant to*
- *said*, *aforesaid*
- *save that*, *forthwith*
- *thereto*, *thereof*, *thereafter*, *therefrom*
- *whatsoever*, *whomsoever*, *wheresoever*

### ***Terminology changes***

Other examples of differences in terminology between that used in the current Act and that adopted in the rewritten legislation are:

<b>Current legislation</b>	<b>Rewritten legislation</b>
aggregate	total
all or some of a part or all of all or a part of all or part of or similar phrases	some or all of
as the case may be	as applicable
by means of	by
by virtue of the fact that	because
commence	start
elect	choose (but, for the noun, <i>election</i> , not <i>choice</i> )
exceeds	is more than
expire	end
fair and reasonable	reasonable
furnish	file
immediately following	immediately after
in respect of with respect to	for about concerning
in the event that	if
just and reasonable	reasonable
less than zero	negative
may not	must not (if that is the right sense)
nil	zero

notwithstanding	despite although even if even though
partly or wholly wholly or substantially or similar phrases	wholly or partly wholly or mainly
preceding prior earlier (unless of 2)	previous
prior to	before
purchase	buy
referred to as	called
subject to	overridden by
subsequent	later
subsequent to	after
succeeding	following
terminate	end
until such time as	until



## Chapter Six

### TRANSITION TO THE NEW ACT

The new Act comes into force on 1 April 2004 and first applies to income derived in the 2004-05 tax year (or corresponding income year).

#### Transitional provisions

Clause YA 3 of the bill sets out the transitional provisions. These provisions simply ensure that a reference in any Act or document to the new Income Tax Act can be read as a reference to the 1994 or 1976 Acts, and a reference to one of those Acts can be read as a reference to the new Act. The clause provides that:

- A reference in an enactment or document to a provision in the new Act is to be read as a reference to the corresponding provision in the Income Tax Act 1994 (or the Income Tax Act 1976 if applicable) to the extent that it is necessary to reflect sensibly the intent of the enactment or document. Similarly, references to the new Act are to be read as references to the 1994 or 1976 Act.
- A reference in an enactment or document to a provision in the Income Tax Act 1994 or the Income Tax Act 1976 is to be read as a reference to the corresponding provision in the new Act to the extent that it is necessary to reflect sensibly the intent of the enactment or document. Similarly, references to the 1994 or 1976 Acts are to be read as references to the new Act.

#### Saving of binding rulings

Clause YA 4 is designed to ensure that binding rulings that were based on the provisions of the Income Tax Act 1994, and were intended to apply in one or more of the years following the date of effect of the new Act, will continue to apply. It applies to binding rulings applied for before 1 April 2004.

The clause provides that when a binding ruling has been issued about a provision in the Income Tax Act 1994, it will be treated as if it had been issued about the equivalent provision in the new Act at the time the new Act began to apply. An equivalent provision is one that corresponds to the provision in the 1994 Act on which the ruling was based. If that provision in the new Act is subsequently amended, the provisions of section 91G of the Tax Administration Act will apply in the same way as if the binding ruling had been made under the new Act.

Clause YA 4(1)(c) uses the words “*corresponds to the old law*” to link the provision in the 1994 Act on which the ruling was based with the provision in the new Act which has the same effect. These words are designed to reflect the Government’s intention that existing binding rulings should not be affected by the enactment of the new Act, but should continue to apply as if they had been made about provisions in that Act at the time it came into effect. Clause YA 4 also provides that a binding ruling cannot be issued concerning the application of the new Act to an arrangement already governed by a binding ruling subject to the savings provision.

Accordingly, it will be important that the words used in the savings provision are given an appropriately purposive interpretation so that taxpayers and Inland Revenue do not have to go to the time and effort of obtaining or issuing replacement binding rulings. In other words, the intention is that the requirement that the new law *corresponds to the old law* should not be given any narrow, obstructive interpretation to prevent binding rulings being saved.

### **Saving of accrual determinations**

Clause YA 5 is designed to ensure that accrual determinations which were based on the provisions of the Income Tax Act 1994 (or the Income Tax Act 1976), and were intended to apply in one or more of the years following the date the new Act came into force, will continue to apply. It applies to accrual determinations made before 1 April 2004.

The clause provides that when an accrual determination has been issued about a provision in the Income Tax Act 1994 or the Income Tax Act 1976, it will be treated as if it had been issued about the equivalent provision of the new Act at the time the new Act began to apply. An equivalent provision is one that corresponds to the provision in the earlier Act on which the determination was based.

Clause YA 5(1)(d) uses the words *corresponds to the old law* to link the provision in the earlier Act on which the determination was based with the provision in the new Act which has the same effect. These words are designed to reflect the Government's intention that existing accruals determinations should not be affected by the enactment of the new Act, but should be able to continue as if they had been made about a provision in that Act at the time it came into force. As with clause YA 4, it will be important that these words are not given any narrow interpretation that would prevent accrual determinations from being saved.