Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill

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

Volume 1

Tax pooling

PAYE by intermediaries

GST & telecommunications services

Private and product rulings

Inland Revenue's information-gathering powers

Other policy issues

Remedial amendments

Miscellaneous amendments

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CONTENTS

Tax pooling 1

Overview 3
Use-of-money interest rates 5
Alternatives for determining provisional tax 7
Burden of risk 8
Compliance costs 10
Timing of introduction 11
Security of tax pooling funds 12
Confusion of persons 13
Establishment of tax pooling account 14
Size of pools 15
Contracting with an intermediary 16
Communication of entry and exit from the tax pooling rules 17
Individual tax account obligations 18
Income tax treatment of amounts paid into a tax pool 19
Early warning system 20
Details of contributing taxpayers 21
Availability of funds for transfers 22
Frequency of actioning of transfers 23
Effective date of transfers 24
Transfers between participants 25
Availability and timing of imputation credits 26
Sanctions for failing to maintain approval criteria 27
Winding up of a tax pooling account 28
Recovery of tax 29
Interaction with the penalty rules 30
Application of the use-of-money interest provisions 32
GST treatment of tax pooling intermediaries 33
Clarification of status of parties 34

PAYE by intermediaries 35

Overview 37
General submissions 38
Issue: Employers face high compliance costs 38
Issue: Application date 39
Accreditation requirements 41
Issue: Software certification 41
Issue: Misappropriation of funds 42
Issue: Revocation of accreditation 42
Intermediaries' trust accounts 45
Issue: Deposits to and withdrawals from trust accounts 45
Issue: Reference to trust account in new section NBA 5 47
Obligations of an intermediary 48
Issue: Use of an intermediary for all employees of an employer 48
Issue: Clarifying the role of an intermediary 48
Issue: Interaction between employees and PAYE intermediaries 50

Issue: Record keeping requirements 50
Issue: PAYE adjustments relating to prior periods 51
Issue: Access to information 52
Over- and underpayments of PAYE 54
Issue: Overpayments of PAYE 54
Issue: Underpayments of PAYE 55
Penalties 56
Issue: Application of late payment penalties 56
Issue: Penalty for breaching accreditation requirements 57
Consequential amendments 58
Drafting corrections 60
GST and telecommunications services 63
Overview 65
Definitions: "telecommunications services" and "content" 66
Definition: "telecommunications supplier" 67
The place of supply rules: supplies between registered persons 68
The place of supply rules: drafting error 70
The "initiator" test 71
The "billing address" test 72
Zero-rating 73
Registering non-resident suppliers: "roaming" services for non-resident corporates 75
Cross-referencing error 76
Relationship with the agency rules 77
Private and product rulings 79
Clause 72 – The inclusion of material facts in private and product rulings 81
The requirement that the facts be considered relevant or material by the commissioner only 82
The inclusion of material facts in private or product rulings should be legislated for separately from the definition of "arrangement" 83
The amendment should not proceed or, alternatively, background facts should be included 84
Inland Revenue's information-gathering powers 87
Overview 89
Authority to enter taxpayer premises 91
Issue: Specify officers authorised to enter 91
Issue: Specify who accompanies Inland Revenue 92
Issue: Warrants for assisting parties 92
Issue: Secrecy obligations 93
Assistance from third parties 94
Issue: Amendment not required 94
Issue: Amendment to apply only if the taxpayer does not cooperate 95
Issue: Access to occupier's staff 95
Issue: Payment of costs by Commissioner 96
Issue: Definition of "occupier" 96
Issue: Not required to provide facilities that do not already exist 97
Removing records for copying 98
Issue: Extension of power not required 98
Issue: Taxpayers able to access records 99
Issue: Compliance costs 100
Issue: Power should only be available if photocopying cannot be performed on premises 101
Issue: Taxpayer should have notification and the option to retain the records 102
Issue: Time limit on removal of documents 103
Issue: Taxpayer should be given a record of documents removed 103

Issue: Loss or destruction of records by Inland Revenue 104
Issue: Copying of privileged documents 105
Issue: Minimum timeframe given to the taxpayer to assemble records 105
Issue: Access to non-relevant information 106

Requisition of information held by offshore entities 107
Issue: Disagreement with the proposal 107
Issue: Amendment not required 108
Issue: Limitation to power 108
Issue: "Control" needs to be defined 109
Issue: Overreach of the aggregation rule 110
Issue: Ignoring foreign secrecy laws 110

Documents sent to a specified Inland Revenue office 112
Issue: Right to recover reasonable delivery costs 112
Issue: Timeframe for response to section 17 requisition 113

General 114
Issue: Taxpayers should be provided a copy of documents photocopied 114
Issue: Examples where existing powers were insufficient 114
Issue: Misuse of powers 115

Other issues 117
Issue: Removal of computers to copy information 117
Issue: Removal of the words necessary or relevant 117

Minor drafting issues 118
Issue: New section 16(2) 118
Issue: Section 16(4) 118
Issue: New section 17(1A) 119
Issue: New section 17(1B) 119

Other policy issues 121

Tax and charities 123
Issue: Increase in the individual rebate threshold should be indexed 123
Issue: Simplification of the thresholds for deductibility of donations by companies 124
Issue: Charitable purpose to be maintained 124
Issue: Deductions for charitable donations by close companies 126

Requirement to disclose changes in imputation ratios 127

Confirmation of annual income tax rates 129
Issue: Reduction in the company and personal income tax rates 129
Issue: The margin between the top personal tax rate and the company tax rate should be reduced or eliminated. 129

Remedial amendments 131

Depreciation rules on amalgamation 133
Issue: Whether the anti-avoidance rule should apply to companies that are not associated before amalgamation. 133
Issue: How the rules apply to non-qualifying amalgamations 135
Issue: Application to qualifying amalgamations 135
Issue: More initiatives on depreciation 136

Interest component of reimbursement for film production expenditure 137

International tax remedials 139
Issue: Limiting branch equivalent tax account credits when foreign tax credits are claimed 139
Issue: Interaction between conduit tax relief rules and branch equivalent tax account rules for consolidated groups 139
Issue: Quantification of branch equivalent tax account relief 140
Issue: Limiting branch equivalent tax credits for Maori authorities 141

Rationalisation of terminal tax payment date provisions 142

Remedial fringe benefit tax issue 144
Issue: Incorrect section reference in the FBT rules 144

Self-assessment remedial amendments 145
Issue: New date for payment of tax 145
Issue: Definition of "assessment" 146
Issue: Recovery of excess tax credits allowed 146
Issue: Minor drafting changes 147

Miscellaneous amendments 149

Regulatory impact and business compliance cost statement 150

Miscellaneous drafting issues 151

Issue: Commencement and application dates 151

Issue: Numbering 151

Remedial trustee income issue 152

Issue: Incorrect section reference in trustee income rules 152

Remedial application of tax codes 153

Issue: Incorrect reference in section NC 8(1)(da) of the Income Tax Act 1994. 153

Amendments to correct drafting errors in the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 154

Issue: Incorrect section cross references in section 59(1) of Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002. 154

Issue: An amendment to the definition of "taxable supply" in section OB 1 of the Income Tax Act 1994 was omitted from the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002. 154

Issue: Incorrect section references in sections 14(3) and 66(30) of the Taxation (Relief, Refunds and Miscellaneous provisions) Act 2002. These have the effect of rendering amendment to the definition of "consideration" potentially inoperative. 155

Tax pooling

OVERVIEW

Clauses 37, 81, 95, 97 and 124

The bill introduces a set of rules allowing taxpayers to pool their provisional tax payments with those of other taxpayers, with the result that underpayments may be offset by overpayments within the same pool. This proposal follows release of the discussion document *More time for business*, issued in May 2001.

Taxpayers have to pay their income tax by their terminal tax date. Often the amount actually due is uncertain, with the amount paid during the year as provisional tax reflecting the taxpayer's best judgement of the law on a large number of technical issues. If the taxpayer's judgement of their liability is incorrect, and they have actually overpaid or underpaid tax, they will be exposed to the imposition of use-of-money interest.

At present, there is no way taxpayers can avoid use-of-money interest without substantially overpaying their tax. The problem is exacerbated by the fact that many taxpayers consider that the rate of interest the government pays on tax overpayments to be too low and the rate it charges on underpayments too high.

Tax pooling, as proposed in this bill, will allow businesses to pool provisional tax payments, offsetting underpayments by overpayments within the same pool, thereby reducing use-of-money interest exposure. The pooling arrangement will be made through a commercial intermediary, who will arrange for participating taxpayers to be charged or compensated for the offset – participating taxpayers will pay or receive interest on their tax underpayments or overpayments.

Intermediaries will be able to pay a higher rate of interest to taxpayers who have overpaid their tax into the pool, and charge a lower rate of interest to those who have underestimated their tax, and have therefore borrowed from the pool, than the rates of use-of-money interest. The commercial intermediaries make their money by arbitraging the interest rate differential between the department's rates and their own (lower) financing costs.

A number of submissions have been received on the proposal, covering a range of issues, substantive and technical. Almost all the submissions support the proposal, at least in principle. Several do so with the qualification that their first preference is that the government address what they see as the inequity of the current use-of-money interest rates. The view is also expressed that the government should concentrate on the development of administrative mechanisms that would more directly address difficulties in determining provisional tax.

Many of the submissions either directly or indirectly focus on the issue of risk – for example, where the burden of risk should lie with respect to the security of taxpayers' payments to a tax pooling intermediary, and what administrative steps might be taken to mitigate the risks associated with tax pooling. The question of compliance costs has also been raised – questioning whether the proposal actually increases, rather than reduces these.

In addition, there are a number of technical submissions intended to improve the workability of the proposal. Our recommended responses to these, and the other submissions, would necessarily result in a number of amendments being made to the proposed legislation, some reasonably substantive, and some of a more minor and consequential nature.

USE-OF-MONEY INTEREST RATES

Clauses 37, 95 and 97

Submission

(12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand, 21W – KPMG, 31W – MinterEllisonRuddWatts)

Tax pooling does not address the inequity of the current use-of-money interest rates. The rate on underpayments should be reduced, and the gap between the underpayment and overpayment interest rates should be closed. Alternatively, the rates should be set according to a formula that better reflects the commercial borrowing cost of the taxpayer.

Comment

The objective of use-of-money interest is to compensate the relevant party (either the government or the taxpayer) for not having the use of its money.

The formula for calculating the use-of-money interest rate on tax underpayments is based on the Reserve Bank business base lending rate series. This series tracks the base rates that major banks charge their corporate customers. For other borrowers, banks generally add a margin of between two and five percentage points. The margin represents a premium for the risk of default associated with a particular borrower. The underpayment use-of-money interest rate is inclusive of a margin of two percentage points, which is added to the Reserve Bank business base lending rate. This ensures that smaller businesses have an incentive to pay the correct amount of tax on time.

The formula for calculating the use-of-money interest rate on tax overpayments is based on the Reserve Bank 90-day bank bill rate. The overpayment use-of-money interest rate reduces the 90-day bank bill rate by one percentage point, to discourage taxpayers from using Inland Revenue as an investment opportunity. The one percentage point margin also reduces the likelihood that the use-of-money interest overpayment rate will exceed the often-volatile 90-day bank bill rate.

The key features of the use-of-money interest rules are that:

- They apply regardless of the reason for overpaying or underpaying tax.
- They underpin the provisional tax rules.
- They recognise that Inland Revenue is an involuntary lender.
- The same underpayment rate applies to taxpayers regardless of their creditworthiness.

The use-of-money interest rate on tax underpayments is set at an appropriate rate reflecting the fact that Inland Revenue is an involuntary lender if taxpayers underpay. It is also an unsecured creditor in those circumstances. But unlike other trade creditors, Inland Revenue cannot stop taxpayers incurring further debt.

If the use-of-money interest rate on tax underpayments was reduced it would lead to a reduction in the efficiency of the provisional tax rules. The use-of-money interest rules have been very effective in ensuring that provisional taxpayers meet their tax liability on time during the income year. Use-of-money interest was extended to apply from the first provisional tax instalment date from the 1994-95 income year. Previously it had applied from the third provisional tax instalment date. The effect of this change has been that, in and after the 1994-95 year, the provisional tax payments at the first, second and third provisional tax dates have evened out.

Lower interest costs on unpaid provisional tax could lead to significant deferrals, because those taxpayers whose cost of borrowing exceeds the use-of-money interest rate on tax underpayments might choose not to pay provisional tax. This in turn would raise the possibility that the unpopular and now repealed underestimation penalty might have to be reinstated to limit this type of behaviour, or that the "lack of reasonable care" shortfall penalty would be imposed on provisional tax estimates that were deemed to be too low.

Using the same use-of-money interest rate on underpayments for all taxpayers means that the rate will always be too high for some taxpayers and too low for others. For example, the use-of-money interest rate on tax underpayments is still less than that applied by lenders who provide unsecured credit by way of credit card, and less than a bank's unsecured small business and personal borrowing rate.

The use-of-money interest rate on tax overpayments reflects the fact that Inland Revenue is not a financial intermediary and should not be treated as such by taxpayers. As with tax underpayments, Inland Revenue is an involuntary participant (this time, a borrower) if taxpayers overpay. When considering the use-of-money interest rate on tax overpayments, it should be recognised that taxpayers should not be in a position where they have an incentive to overpay tax, which is why the rate is less than those offered in the market. Also, it should reflect the fact that the overpayment of tax is not the government's preferred method of borrowing.

If the use-of-money interest rate on tax overpayments was increased it is quite likely that Inland Revenue would, in effect, become a target for taxpayers depositing funds, given the combination of a high interest rate and government guarantee. The levels of deposit that might occur may be significant, impacting on both financial markets and government debt management programmes.

As noted, use-of-money interest rates are based on the relevant Reserve Bank series, which in turn are used by the market as underlying rates. As a result, the differential between use-of-money interest rates on tax underpayments and overpayments is, by and large, mirrored in the market. Reducing this differential would create an incentive for taxpayers to defer their tax obligations (if the underpayment rate was decreased) or to "bank" with the government (if the overpayment rate was increased).

Recommendation

That the submission be declined.

ALTERNATIVES FOR DETERMINING PROVISIONAL TAX

Clause 37

Submission
(13 – Business New Zealand, 31W – MinterEllisonRuddWatts)

Although pooling provisional tax may allow taxpayers to reduce exposure to use-of-money interest, the same result could be achieved more directly through the development of administrative mechanisms that address the difficulties in determining the correct amount of provisional tax.

Comment

The government is continuing to work on developing proposals to reduce the difficulties associated with determination of provisional tax. Several were raised in the discussion document *More time for business*, released in May last year. They included ways to match provisional tax payments with cash-flow – for example, by basing provisional tax on the value of GST sales, and aligning the payment dates with those for GST.

Furthermore, tax pooling is designed not only to reduce taxpayer exposure to use-of-money interest, but also to provide taxpayers with flexibility in how they manage their tax payments.

Recommendation

That the submission be accepted – in addition to progressing the tax pooling proposal, we are working on ways to address the difficulties in determining the correct amount of provisional tax.

Clause 37

Submission
(16 – PricewaterhouseCoopers, 21W – KPMG)

Inland Revenue should shoulder some responsibility for the actions of an intermediary if there is a failure to pay tax on behalf of the taxpayer. The department should also put in place systems that will mitigate loss to taxpayers when default on the part of an intermediary has resulted in provisional tax payment obligations either not being met on time or not being met at all.

For example, when necessary, tax pooling participants should be entitled to have the due date for payment of tax extended, with a corresponding delay in the date of imposition of any late payment penalties. Additionally, no refund from a tax pooling account should be made to an intermediary without sufficient explanation having been provided to Inland Revenue concerning the taxpayers the refund relates to and their provisional tax payment obligations.

Furthermore, given that Inland Revenue will be approving the intermediaries, it should have an obligation to ensure the quality of those they approve, and better information on their attributes should be made available to participating taxpayers.

Comment

The onus for ensuring that tax payments have been made to Inland Revenue needs to remain on taxpayers, with the resolution of such issues as the transfer of taxpayers' payments to Inland Revenue being made on time and the issuing of refunds to an intermediary, when necessary, remaining on a commercial footing between the intermediary and taxpayers.

This will maintain intermediary accountability and the administrative benefits and savings that will flow to the government through introducing the proposal. It will also ensure that there will be no questions concerning the integrity of the tax system should an intermediary default occur.

It is important to recognise that participation in a tax pool will be voluntary, and that many taxpayers will make the choice whether or not to enter a tax pool on the advice of their accountants. Also, many taxpayers already subject themselves to similar risks concerning their tax payments, in that they use their accountants to on-pay their tax to Inland Revenue.

Participating taxpayers will be aware that payments that they have made to the intermediary do not satisfy their obligations to Inland Revenue. Where default on the part of an intermediary has resulted in a taxpayer's provisional tax payment obligations not being met, the taxpayer will have recourse to the usual legal avenues for obtaining compensation from the intermediary.

The legislation does establish certain minimum criteria for intermediaries, for the purpose of promoting general confidence in tax pooling. Beyond this, however, matters pertaining to the commercial security of an intermediary's tax pooling arrangements, such as certainty of treatment, ease of participation and privacy of taxpayer information, need to be dealt with at a commercial level, by way of contract between the intermediary and participating taxpayers.

Recommendation

That the submission be declined.

COMPLIANCE COSTS

Clause 37

Submission
(21W – KPMG)

The proposal will not reduce compliance costs, but will, in fact, raise them, as they introduce a new set of rules and associated expenses.

Comment

Participation in a tax pool will be voluntary – taxpayers will be free to choose whether or not the benefits flowing from participation outweigh the associated expenses. These benefits consist of the ability to better manage their provisional tax payments and to reduce their use-of-money interest costs.

Currently, taxpayers have to pay their income tax liability by their terminal tax date. Often the amount actually due is uncertain, with the amount paid during the year as provisional tax reflecting the taxpayer's best judgement of the law on a large number of technical issues. If taxpayers' judgement of their liability is incorrect, and they have actually overpaid or underpaid tax, they will be exposed to use-of-money interest. At present, taxpayers cannot avoid use-of-money interest without substantially overpaying their tax.

Recommendation

That the submission be declined.

TIMING OF INTRODUCTION

Clause 37

Submission
(30 – Ian Kuperus)

The proposed legislation currently provides that the tax pooling provisions apply for the 2003-04 and subsequent income years. For early balance date taxpayers this will be from February 2003. The proposed legislation should be amended to state that the provisions apply for all taxpayers from February 2003.

Comment

The proposed application, from the 2003-04 and subsequent income years, is required for administrative simplicity. This issue has been discussed with the submitter, who agrees with this position. It has also been agreed that persons wishing to act as pooling intermediaries should be allowed to apply to the Commissioner for approval to do so from the date of assent of the bill – the proposed legislation already provides for this.

Recommendation

That the submission be declined.

SECURITY OF TAX POOLING FUNDS

Clause 37

Submission
(21W – KPMG)

The nature of a tax pooling account should be that of a trust holding funds on behalf of the Crown.

Comment

The current wording of the proposed legislation already states that payments made to a tax pooling account must be legally secure, that is, held on trust on behalf of the contributing taxpayers. Beyond this, matters pertaining to the commercial security of intermediaries' tax pooling arrangements are most appropriately left as a matter of contract between the intermediary and participating taxpayers.

Recommendation

That the submission be declined.

CONFUSION OF PERSONS

Clause 37

Submission
(16 – PricewaterhouseCoopers)

The wording of the proposed section MBA 3(1)(e) needs to be amended, to clarify its intent.

Comment

The proposed section MBA 3(1)(e) is intended to provide that it must be made clear to participating taxpayers that payments made to an intermediary will not satisfy the taxpayer's obligations to Inland Revenue. We agree that this intention needs to be made clearer, to avoid confusion over this point.

Recommendation

That the submission be accepted.

ESTABLISHMENT OF TAX POOLING ACCOUNT

Clause 37

Submission
(21W – KPMG)

The wording of the proposed section MBA 4(1) needs to be amended, to clarify its intent.

Comment

Section MBA 4(1) currently merely provides that a tax pooling account must be established with Inland Revenue. The wording needs to be changed to make it clear that the provision applies only to a person who has received approval to do so under section MBA 3.

Recommendation

That the submission be accepted.

SIZE OF POOLS

Clause 37

Submission
(12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers, 21W – KPMG)

The restriction to pools of 100 or more participating taxpayers is unnecessary, inappropriate and difficult to apply in practice. Commercial factors should determine pool size. Alternatively, if the restriction is still to apply, then the rules should provide for temporary breaches.

Comment

It is necessary to require a minimum size for pools in order to prevent burgeoning administrative costs associated with intermediaries establishing multiple pools, with only a few participants in each. A minimum pool size of at least 100 taxpayers will allow individual accountants to establish pools for their clients, while reducing the risk of multiplicity of pools.

Larger taxpayers, who otherwise might want to have a separate pool for themselves, may have the ability to participate in a pool though their tax accountant. Moreover, in the longer term the restriction may not be relevant anyway, as larger pools will tend to have lower administrative costs and less risk for participants.

The provision is already worded in a way which allows the Commissioner administrative flexibility in applying the restriction. However, to further ease application of the rule, we recommend that the legislation include the requirement for the Commissioner to give 30 days' notice to an intermediary before winding up a pool owing to insufficient numbers.

Recommendation

That the submission to remove the restriction be declined. However, the proposed legislation should be amended to include a requirement for the Commissioner to give 30 days' notice to an intermediary before winding up a pool owing to insufficient numbers of pool participants.

CONTRACTING WITH AN INTERMEDIARY

Clause 37

Submission
(16 – PricewaterhouseCoopers)

The ability to enter into a tax pooling arrangement should not be restricted to only those transactions where the participant pays money to an intermediary. Additionally, the provision providing for this contracting should be redrafted to assist clarity.

Comment

We agree that ability to enter into a tax pooling arrangement should not be restricted to only those transactions where the participant pays money to an intermediary. Payment between the participant and the intermediary is a commercial matter, the form of which should be left as the concern of the two contracting parties.

We also agree that the relevant subsection should be redrafted to assist clarity.

Recommendation

That the submission be accepted.

COMMUNICATION OF ENTRY AND EXIT FROM THE TAX POOLING RULES

Clause 37

Submission
(21W – KPMG)

A provision should be inserted requiring that a taxpayer advise Inland Revenue when entering and exiting the tax pooling rules.

Comment

The proposed legislation already requires that, when a deposit is made to a tax pooling account, the intermediary must provide the Commissioner with written details concerning the names and tax file numbers of contributing taxpayers, along with the amount of their payments.

This provides the department with sufficient notice that the taxpayer will be participating in a tax pooling arrangement. It also provides taxpayers with the ability to check with the department, if they so desire, whether the intermediary has deposited the payment into the tax pooling account, as instructed by the taxpayer.

The department has no administrative need for information advising that a taxpayer has ceased to participate in a tax pool.

It is also worth noting that one of the intended advantages arising from tax pooling is that taxpayers who chose to participate will actually reduce their need to communicate with Inland Revenue regarding their income tax.

Recommendation

That the submission be declined.

INDIVIDUAL TAX ACCOUNT OBLIGATIONS

Clause 37

Submission
(21W – KPMG)

The proposed legislation needs to be prescriptive in relation to individual tax account obligations.

Comment

We agree that the proposed legislation should be clarified in relation to its intended application to individual tax account obligations. For example, it needs to clearly set out the rules governing transfers from a tax pooling account to an individual taxpayer's tax account. However, once a transfer is made from a tax pooling account to an individual taxpayer's account, it becomes "tax paid" for that taxpayer, and the usual tax rules will then apply.

Recommendation

That the submission be accepted, to the extent that it calls for a clarification of the application of the proposed legislation to individual tax account obligations.

INCOME TAX TREATMENT OF AMOUNTS PAID INTO A TAX POOL

Clause 37

Submission
(30 – Ian Kuperus)

The bill does not address the issue of how amounts paid to a tax pooling intermediary that are in the nature of tax will be treated for income tax purposes. The income tax legislation should be amended to provide that such amounts are not deductible, and also to provide that amounts paid that are in the nature of interest are deductible.

Comment

The income tax legislation already contains rules that will provide for the proper treatment of payments to an intermediary, in terms of ensuring that amounts paid that are in the nature of tax are not deductible. This has been discussed with the submitter, who agrees with this position.

We agree that, in order to remove any uncertainty, the proposed legislation should be amended to provide explicitly that payments to an intermediary that are in the nature of interest are deductible.

Following further consideration, we also recommend that the proposed legislation be amended to ensure that the resident withholding tax treatment of interest paid to and by an intermediary mirrors that applied to use-of-money interest generally – that is, intermediaries will be required to withhold the tax from interest payments made to taxpayers, but taxpayers will not be required to withhold the tax when making interest payments to intermediaries.

Recommendation

That the submission be accepted, to the extent that it recommends that the proposed legislation be amended to provide that payments to an intermediary that are in the nature of interest are deductible, and to ensure that the resident withholding tax rules apply appropriately.

Clause 37

Submission
(16 – PricewaterhouseCoopers)

The Commissioner should be required to issue a statement to the taxpayer when deposits are made to the tax pooling account, to confirm the amount and date of receipt.

Comment

We agree that the proposed legislation should provide participating taxpayers with the ability to obtain confirmation that their payments have been correctly deposited into a tax pooling account.

The proposed legislation already requires that when a deposit is made to a tax pooling account, the intermediary must provide the Commissioner with written details concerning the names and tax file numbers of contributing taxpayers, along with the amount of their payments. This will enable taxpayers to check with the department whether their payments have been deposited correctly by the intermediary. To remove any potential uncertainty concerning application of the secrecy provisions, we recommend that the proposed legislation be amended so that the Commissioner can provide this information to taxpayers when requested.

We recommend that, in addition, the proposed legislation be amended to state that the Commissioner must provide the intermediary with confirmation of the deposit details. This will enable taxpayers to check also with their tax pooling intermediary whether their payments have been deposited correctly.

Recommendation

That the submission be accepted, to the extent that it calls for participating taxpayers to have the ability to obtain confirmation whether their payments have been correctly deposited into a tax pooling account. To remove any uncertainty concerning application of the secrecy provisions, we also recommend that the proposed legislation be amended to allow the Commissioner to provide this information to taxpayers when requested.

DETAILS OF CONTRIBUTING TAXPAYERS

Clauses 37 and 81

Submission
(21W – KPMG)

Intermediaries should not be required to provide the Commissioner with details concerning contributing taxpayers, but instead should merely be obliged to retain this information for inspection, if required. Even more preferable, intermediaries should not be obliged to retain this information at all.

Comment

The requirement that the intermediary provide details concerning contributing taxpayers ensures that tax pooling participants have the ability to check with the department, if they so desire, whether their payment has been deposited into the tax pooling account, as instructed.

This information is also required by the government, for revenue forecasting purposes. It is important that the government knows the total income tax taxpayers consider they may have to pay each year. Under tax pooling this would be a combination of the total of any tax payments made by participants to Inland Revenue and any made to tax pooling intermediaries. If it were not possible for Inland Revenue to monitor contributions to a tax pool, trends in government revenue would be more difficult to determine.

We note that the proposed legislation currently states that the details concerning contributing taxpayers need to be provided to the Commissioner in writing. This is, in fact, inconsistent with the requirement in the proposed legislation that transfer requests, and the provision of associated information, be made by electronic means, in a format prescribed by the Commissioner. This inconsistency needs to be addressed, by ensuring that the same requirements apply to both.

Recommendation

That the submission be declined, but that the proposed legislation be amended to state that details provided by intermediaries to the Commissioner concerning contributing taxpayers be made by electronic means, in a format prescribed by the Commissioner.

AVAILABILITY OF FUNDS FOR TRANSFERS

Clause 37

Submission
(16 – PricewaterhouseCoopers)

The wording of the proposed section MBA 6(1) needs to be amended to clarify its intent, with respect to the availability of funds for transfer.

Comment

The proposed section currently states that, for a transfer to be made from a tax pooling account, the amount to be transferred must exist, or have existed, on the effective date of the transfer – that is, the date it is to be credited to the taxpayer's account. This is too general. The wording needs to be changed to make it clear that the funds have to be in the tax pooling account on that date.

Recommendation

That the submission be accepted.

FREQUENCY OF ACTIONING OF TRANSFERS

Clause 37

Submission
(21W – KPMG)

An intermediary should be able to request the actioning of a transfer at any time.

Comment

The proposed legislation is intended to limit the making of requests for the actioning of transfers to once a month. This restriction was considered necessary to avoid the administrative cost that might be associated with multiple requests being made each month.

The drafting in the bill reflects our original view that intermediaries will generally only need to make requests monthly in any case, given that provisional tax obligations fall only once a month, on the seventh of each month. Also, we considered that as transfer requests would usually be retrospective in nature, intermediaries and taxpayers would generally not be negatively affected by this restriction anyway.

Following further consideration, however, we agree that the limitation is strict, does not leave any room for flexibility and should, therefore, be waived.

Recommendation

That the submission be accepted.

EFFECTIVE DATE OF TRANSFERS

Clause 37

Submission
(30 – Ian Kuperus)

The wording of the proposed legislation needs to be amended to clarify its intent with respect to the effective date of transfers.

Comment

We agree that the proposed legislation should be clarified, to make clear the intention that transfers from a tax pool will generally be credited to a taxpayer's account as at the effective date of transfer.

The only exception to this will be where a taxpayer's terminal tax date has passed, and the taxpayer is exposed to penalties for failing to meet minimum provisional tax obligations. In this case, any request for a transfer from a tax pool will be treated as being made at the date of the request, not the effective payment date. This is necessary to ensure that the taxpayer is not able to gain an unfair advantage by utilising the tax pooling rules to offset resulting penalties and use-of-money interest. (This aspect of the rules is dealt with under a separate submission.)

Recommendation

That the submission be accepted.

TRANSFERS BETWEEN PARTICIPANTS

Clause 37

Submission
(10 – The New Zealand Retailers Association, 12 – Institute of Chartered Accountants of New Zealand)

Consideration should be given to moving towards allowing tax credits to be traded without first requiring that all parties be members of the same or any pool. A first move in this direction would be to liberalise the definition of "associated person" for the purpose of allowing transfers between associates.

Comment

Comprehensive new rules governing the transfer of overpaid tax were enacted in October. The new rules resolve many of the uncertainties previously surrounding such transfers. With respect to transfers from one taxpayer to another, the effective date of transfer will differ depending on the degree of association between the transferor and the transferee.

The submission seeks an amendment to those rules to extend the list of taxpayers who may make backdated transfers. Officials have previously recommended against this and continue to do so primarily because of the administrative impact.

The tax pooling provisions are targeted at taxpayers who cannot make backdated transfers under the new transfer rules. Allowing tax credits to be traded without first requiring that all parties be members of the same pool would significantly undermine the legislative intent of these new rules.

We do note, however, that although the proposed legislation is intended to place this restriction on the making of transfers, it does not currently do so. We recommend, therefore, that it be amended to rectify this point.

Recommendation

That the submission be declined, and that the proposed legislation be amended to codify the intent that tax credits may only be traded between members of the same tax pool.

AVAILABILITY AND TIMING OF IMPUTATION CREDITS

Clause 37

Submission
(21W – KPMG, 30 – Ian Kuperus)

The proposed legislation needs to make it clear that transfers to individual tax accounts qualify for imputation credits under the consolidation rules. Additionally, the imputation credits should arise to a taxpayer's imputation credit account at the time the request for a transfer is received by the Commissioner.

Comment

We agree that the wording of the proposed legislation should be amended to make these matters clear. It was always the policy intention that transfers to individual tax accounts qualify for imputation credits, where appropriate. Setting the timing of the imputation credit at the time when a transfer is requested avoids uncertainty for taxpayers.

Recommendation

That the submission be accepted.

SANCTIONS FOR FAILING TO MAINTAIN APPROVAL CRITERIA

Clause 37

Submission
(16 – PricewaterhouseCoopers, 21W – KPMG)

There needs to be some form of sanction against people who operate a tax pooling arrangement that fails to maintain the approval criteria. The Commissioner should be able to apply a penalty if the requirements are breached.

Comment

The proposed legislation already allows the Commissioner to wind up an intermediary's tax pooling operations if there is a breach of its obligations to the Commissioner or the taxpayer. Additionally, if appropriate, the Commissioner will be able to apply the usual criminal penalties provided for in the income tax legislation.

We do recommend, however, that the proposed legislation be amended to provide that, in addition to being able to wind up a tax pooling account if an intermediary breaches its obligations, the Commissioner should also be able to remove the intermediary's approved intermediary status.

We also recommend that the proposed legislation be amended to clarify that the Commissioner can exercise these powers if an intermediary fails to maintain the requirements that it must meet for initial approval as a tax pooling intermediary – for example, the holding of taxpayers' payments on trust, safeguarding of the privacy of taxpayer information and the maintaining of adequate record-keeping systems relating to taxpayers' payments. The proposed legislation does not currently make this clear.

Recommendation

That the submission be declined. However, the proposed legislation should be amended to provide the Commissioner with the power to remove an intermediary's approved status, when appropriate, and to clarify when the Commissioner can exercise his powers of sanction.

WINDING UP OF A TAX POOLING ACCOUNT

Clause 37

Submission
(16 – PricewaterhouseCoopers, 21W – KPMG)

Formal rules should be put in place governing the winding up of a tax pooling account. Additionally, a taxpayer's deposit to a tax pooling account should be automatically transferred to the taxpayer's individual tax account if the pool is wound up before the intermediary makes the requested transfer itself.

Comment

The proposed legislation already requires that an intermediary maintain adequate records to ensure that the correct amount will be paid back to a taxpayer if a tax pooling account is wound up.

Nevertheless, we do agree that the proposed legislation should be amended to provide that, where a tax pooling account has been wound up and Inland Revenue has reason to believe that the pooling account funds may not be distributed back to the contributing taxpayers in the correct amounts, it should have the discretion to apply to the court for directions as to the redistribution of the funds.

Beyond this, however, matters pertaining to the commercial security of intermediaries' tax pooling arrangements, including the procedures to be followed upon the winding up of a tax pool, are most appropriately left as a matter of contract between the intermediary and participating taxpayers.

Recommendation

That the submission be declined, but that the proposed legislation be amended to provide the Commissioner with the discretion to apply to the Court for directions as to the redistribution of pool funds upon winding up, when appropriate.

RECOVERY OF TAX

Clauses 37 and 124

Submission
(21W – KPMG)

Inland Revenue already has recourse under section 157 of the Tax Administration Act 1994 when it is seeking to recover amounts of tax owing. It is not necessary, therefore, to include amounts paid to an intermediary as "income tax" for the purposes of this section.

Comment

Under the proposed legislation, a payment made by a taxpayer to a tax pooling account does not constitute income tax – it only becomes "tax paid" once it is transferred to the taxpayer's individual tax account. Consequently, a payment to a tax pooling account would not be "income tax" for the purposes of section 157 unless specifically provided for in the legislation.

Recommendation

That the submission be declined.

INTERACTION WITH THE PENALTY RULES

Clause 37

Submission
(16 – PricewaterhouseCoopers, 30 – Ian Kuperus)

The proposed legislation provides that, for the purpose of the penalty rules, a transfer from a tax pooling account is to be treated as being paid to Inland Revenue on the date of the transfer, not the effective payment date. This seems to conflict with the general intention of the proposed legislation, which is to treat transfers as being made on the effective payment date elected by the intermediary. The section should either be amended, or removed.

Comment

The underlying rationale of the pooling proposal is to provide taxpayers with the ability to better manage their provisional tax payments and to reduce their use-of-money interest costs. This rationale must, however, be balanced with the need to ensure that taxpayers maintain reasonable compliance with the provisional tax rules.

In actuality, these considerations are not in conflict. Within reasonable parameters taxpayers should still be able to enjoy considerably more flexibility in terms of managing their provisional tax payments than they do at present, along with the ability to reduce their use-of-money interest costs.

The proposed legislation is intended to reflect this position. However, we recognise that it needs to be clarified to make it clear that when taxpayers fail to meet their minimum provisional tax obligations on a continuing basis, they should not be able to gain an unfair advantage from the proposal. For these taxpayers, at a certain point in time, the ability to offset resulting use-of-money interest and penalties should cease. We recommend that this point be reached within a reasonable period beyond a taxpayer's terminal tax date – by this stage the taxpayer should have met provisional tax payment obligations for the income year.

In practice, what this will mean is that, once a period of 60 days beyond the terminal tax date has passed, if a taxpayer is exposed to penalties for failing to meet minimum provisional tax payment obligations, any request for a transfer will be treated as being made at the date of the request, not the effective payment date, for both use-of-money interest and penalty purposes.

However, where taxpayers have complied with their minimum obligations, but beyond 60 days following terminal tax date still find themselves owing tax (that is, after a reassessment) they will be able to utilise the tax pooling rules to offset any potential penalties and use-of-money interest.

We recommend that the proposed legislation be amended to reflect this position.

Recommendation

That the submission be declined, but that the proposed legislation be amended to make it clear that when taxpayers fail to meet their minimum provisional tax obligations on a continuing basis, they are not able to gain an unfair advantage by utilising the tax pooling rules to offset resulting penalties and use-of-money interest.

APPLICATION OF THE USE-OF-MONEY INTEREST PROVISIONS

Clauses 37, 95 and 97

Submission
(30 – Ian Kuperus)

The proposed legislation needs to be clarified, in terms of the way the use-of-money interest provisions will apply to intermediaries and participating taxpayers generally, and in particular to deposits to tax pooling accounts, and refunds and transfers.

Comment

We agree that the proposed legislation should be clarified, in terms of the way the use-of-money interest provisions are intended to apply. For example, it needs to clearly provide that use-of-money interest will be calculated, on a daily basis, on the credit balance of a tax pooling account. It also needs to clearly provide for the allocation of interest between an intermediary and participating taxpayers, with respect to transfers.

Recommendation

That the submission be accepted, to the extent that it calls for a clarification of the application of the use-of-money interest rules to tax pooling.

GST TREATMENT OF TAX POOLING INTERMEDIARIES

Clauses 37

Submission
(30 – Ian Kuperus)

The bill does not address the issue of GST in relation to tax pooling. Tax pooling services should be zero-rated for GST purposes.

Comment

Tax pooling services should be subject to the same GST rules as other services. If they are financial services, they will be exempt from GST.

In October this year the government released a discussion document on the GST treatment of financial services. This document proposes that the provision of certain financial services to businesses be zero-rated. Resulting legislation is expected to take effect sometime in late 2004 / early 2005.

Recommendation

That the submission be declined.

CLARIFICATION OF STATUS OF PARTIES

Clauses 37

Submission
(Matter raised by officials)

The proposed section MBA 2 should be amended to more clearly convey the absence of a Crown guarantee with respect to the security of taxpayers' payments to a tax pooling intermediary.

Comment

The proposed section MBA 2 is intended to convey the absence of a Crown guarantee with respect to the security of taxpayers' payments to a tax pooling intermediary. It does so, but only to a limited extent.

The onus for ensuring that tax payments have been made to Inland Revenue will remain on taxpayers, with the resolution of such issues as the security of taxpayers' payments to a tax pooling intermediary remaining on a commercial footing between the intermediary and taxpayers.

This will maintain intermediary accountability, and the administrative benefits and savings that will flow to the government through introducing the proposal. It will also ensure that there will be no questions concerning the integrity of the tax system should intermediary default occur.

It is important that the legislation adequately reflect this intent, sufficiently safeguards the Crown's position, and clarifies the status of intermediaries. A new provision should be inserted, replacing the existing section, that properly codifies this position.

Recommendation

That the submission be accepted.

PAYE by intermediaries

OVERVIEW

The bill introduces an initiative that will allow employers to engage accredited intermediaries to largely assume an employer's obligations under the PAYE rules – the "PAYE by intermediaries" initiative. The intermediary would be responsible for calculating PAYE, paying it and filing returns. The initiative was raised in a discussion document, *More time for business*, released in May 2001 in response to two compliance issues raised by employers: the time spent keeping up to date with PAYE requirements and the risk that PAYE deductions are not available to be paid to Inland Revenue when due.

A number of submissions were received on the proposal, covering both general and technical issues. In addition, officials have consulted with other interested groups. Submissions welcomed the proposal, and some commented that the initiative was indicative of the high compliance costs currently placed on employers. A number of the submissions were also concerned with the risk to employers of engaging disreputable PAYE intermediaries, and suggestions were made to exclude such persons from the scope of the new rules. Technical submissions were also received in relation to how the rules should allow PAYE intermediaries to operate – for instance, the requirement for PAYE intermediaries to hold funds paid over by employers on trust and how these funds could be applied, the various obligations of PAYE intermediaries under the new rules, and sanctions for failure to comply with these rules. Submissions also suggested a number of drafting changes to the legislation in the bill.

Officials have also recommended a number of changes designed to improve the workability of the initiative. The main changes we have recommended are extending the application date for the new rules and removing software certification from the accreditation criteria for PAYE intermediaries. The first change is necessary for Inland Revenue to provide an electronic administrative system to support the work of PAYE intermediaries, and in consultation with potential intermediaries, they supported extending the application date on this basis. Officials have also requested permission to make a number of amendments to improve the technical clarity of the legislation.

Issue: Employers face high compliance costs

Clause 45

Submission
(5 – Datacom, 10 – NZ Retailers Association, 12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand, 16 – PricewaterhouseCoopers, 21W – KPMG)

All submissions supported the proposal, but some expressed specific concerns that:

- employers' PAYE responsibilities are too difficult and the government should urgently review the tax obligations imposed on employers and amend the law to ensure that the compliance obligations imposed on employers is reasonable *(KPMG)*;
- the government should contribute to employers' time and cost in meeting these obligations *(KPMG)*;
- Inland Revenue should be more forthcoming in providing advice and assistance to employers *(Business New Zealand)*; and
- there are likely to be costs for businesses from using intermediaries *(Business New Zealand)*.

Comment

A review of the tax withholding obligations on employers is outside the scope of this tax simplification initiative. Although it is recognised that the PAYE system imposes compliance costs on employers, the source deduction mechanism is the best currently available for ensuring tax is deducted accurately from wage and salary income and paid to Inland Revenue on time.

Inland Revenue research indicates that employers find the current system easier to comply with than previous models. The present system also supports important compliance cost reduction initiatives – most recently, the removal of requirements to file end-of-year tax returns for approximately 1.5 million wage and salary earners. The PAYE by intermediaries' initiative is designed to offer more options for employers to mitigate the compliance costs imposed by, and risks associated with, the PAYE system.

In relation to the submission that employers' costs from applying the PAYE rules should be reimbursed, it should be noted that businesses are already indirectly remunerated for their tax withholding function through the cash-flow advantage of retaining tax deductions before they are required to be paid to Inland Revenue. The proposed initiative will simply allow this benefit to be traded for lower compliance costs and less risk. Remunerating employers would also raise the issue of remunerating individual taxpayers and other intermediaries in the tax system, such as banks.

In relation to the submission that Inland Revenue should provide more support to employers, the department already provides a number of employer and small business support services, including tax advisory services, business kits and technical support for businesses that use Inland Revenue's electronic returns filing system. While these services are designed to reduce the risk of employers failing to comply with their tax obligations, the PAYE by intermediaries' initiative is different in that it will allow businesses to be largely removed from the PAYE rules and the associated risks.

Officials accept that the new service may come at a cost to employers: either the loss of the use of PAYE deductions before they are paid to Inland Revenue or a fixed fee charged by intermediaries. However, as correctly pointed out by Business New Zealand, businesses that are likely to engage a PAYE intermediary will do so because they consider the compliance cost savings to be significantly greater than the costs involved.

Recommendation

That the submissions be declined.

Issue: Application date

Clauses 35, 45-53, 56-58, 65(23), 67(7), 76, 80, 85, 96, 106, 119, 123, 124(4), 125-127, 131, 146-150, 152-154, 156-159, 162-163, 164(12)

Submission
(Matter raised by officials)

The application date of the proposed "PAYE by intermediaries" initiative should be extended from 1 April 2003 to 1 April 2004.

Comment

The application date in the bill presupposes using the current PAYE administration systems to support the tax simplification initiative. Although the bill envisages payments and returns will be made electronically, the current PAYE systems have several components that are paper based and rely on manual intervention. Given the number of employers that an intermediary could act on behalf of, using the current system to administer the initiative has the potential to overwhelm PAYE

intermediaries with multiple notifications in paper form and create unnecessary delays for them.

Extending the application date by one year will allow a new end-to-end electronic system to be built to support the initiative. The administrative process including registration, filing returns, making payments, acknowledging payments and returns, incorporating amended assessments and issuing refunds could be done electronically and with fewer delays. We consider that such an electronic system would reduce compliance costs for PAYE intermediaries and be more administratively efficient.

In discussions with Inland Revenue, potential PAYE intermediaries have expressed a strong preference for a delay in the application date so that the initiative can be supported electronically.

Recommendation

That the submission be accepted.

ACCREDITATION REQUIREMENTS

Issue: Software certification

Clause 45

Submission
(Matter raised by officials)

The requirement for Inland Revenue to certify the payroll software used by a PAYE intermediary, under proposed new section NBA 2(2) should be removed.

Comment

Under the proposed new section NBA 2(2), Inland Revenue will be required to certify that a person's payroll software used to calculate PAYE complies with the PAYE rules, before the intermediary is accredited as a PAYE intermediary.

After discussion with a number of payroll software developers, we consider that this aspect of accreditation will not offer sufficient security to either employers or the revenue in a way that outweighs the potentially significant administrative costs to Inland Revenue. In particular, we are concerned that software accreditation will be subject to widespread misuse, with many software developers seeking software certification not because they want to operate as PAYE intermediaries, but rather to have their software "ticked off" by Inland Revenue to improve its marketability. If the proposed legislation is enacted in its current form it is expected that almost all providers of these products will seek to have their software certified so as not to lose out to competitors. Inland Revenue does not have the resources to meet this level of demand. In particular, there is a significant danger that Inland Revenue's limited computer tax audit resources would be tied up indefinitely in this area, instead of carrying out more high-value investigations.

Instead of software certification, we recommend using Inland Revenue's normal audit processes to check PAYE intermediaries' compliance with the PAYE rules. This would be similar to the way Inland Revenue currently audits large employers and payroll firms. We consider that while this will ensure that taxpayers operating as PAYE intermediaries are subject to the desired level of scrutiny, it will not unnecessarily divert Inland Revenue's resources.

Recommendation

That the submission be accepted

Issue: Misappropriation of funds

Clause 45

Submission
(21W – KPMG)

People who are discharged or undischarged bankrupts, who are not eligible to be company directors or who have been convicted of fraudulent offences should not be PAYE intermediaries or a member of a PAYE intermediary.

Comment

The submission argues that the rules in proposed new section NBA 2 provide very little comfort or protection from someone establishing themselves as an intermediary and then misappropriating funds.

Officials agree that the categories of persons listed in the submission should not be allowed to be a PAYE intermediary. Officials have raised this issue with potential PAYE intermediaries, and they have agreed that such exclusion criteria would be a good idea. However, to be workable, the exclusion should be limited to principals and directors of PAYE intermediaries. Otherwise it would create significant compliance costs if the criteria had to be applied to all their staff, regardless of their position within their organisation. Officials consider that persons applying for accreditation as a PAYE intermediary should be responsible for evaluating whether they do not meet the exclusion criteria and give appropriate notice to Inland Revenue.

Recommendation

An amendment should be made to prevent people who are discharged or undischarged bankrupts, those who are not eligible to be company directors or who have been convicted of fraudulent offences from being a PAYE intermediary, or a director or principal of a PAYE intermediary.

Issue: Revocation of accreditation

Clause 45

Submission
(21W – KPMG)

Liquidation, receivership, transfer of incorporation, bankruptcy and conviction for fraud should all trigger revocation of accreditation.

Rules are required to ensure that funds held by a PAYE intermediary are returned to the appropriate employer if the intermediary has its accreditation revoked. Alternatively, the intermediary should be continued under statutory management (while issues arising from the revocation of accreditation are resolved) and also if the Commissioner is not satisfied with the performance of the intermediary.

Comment

Officials agree that liquidation, receivership, transfer of incorporation, bankruptcy and conviction for fraud of a PAYE intermediary should result in revocation of accreditation. We also consider that Inland Revenue should have the power to revoke accreditation if a person's disclosure when applying to be accredited as a PAYE intermediary is subsequently found to be false.

The second submission relates to money held by the PAYE intermediary at the time when accreditation is revoked. The bill deals with a similar situation – when a PAYE intermediary and employer cease their arrangement. In that case the PAYE intermediary is required to distribute any funds still held by it, and apply the PAYE rules in relation to those funds, as though it was still acting as an intermediary for that employer. We consider that this is the most appropriate way to deal with the funds held by an intermediary when its accreditation is revoked.

Inland Revenue will also have to make employers aware that their PAYE intermediary has lost its accreditation and the effect of this on arrangements with the intermediary. Officials consider that any arrangements should come to an end by fourteen days after Inland Revenue provides the notice to employers.

In relation to the issue of statutory management of failed PAYE intermediaries, under the Corporations (Investigation and Management) Act 1989 and the Reserve Bank of New Zealand Act 1989, only the Securities Commission and the Reserve Bank of New Zealand, respectively, are allowed to recommend that persons be placed under statutory management. A change to allow Inland Revenue to recommend that PAYE intermediaries be put under statutory management would not be feasible because Inland Revenue does not have the expertise to determine when statutory management is appropriate, as opposed to other courses of action. Inland Revenue's new role would also overlap (and potentially impinge on) those of the Securities Commission and Reserve Bank – for example, if Inland Revenue sees statutory management as a viable option and the Securities Commission does not.

Further, officials consider that the powers available to Inland Revenue under the Tax Administration Act 1994 to deal with defaulting taxpayers are sufficient to deal with defaulting or non-performing intermediaries.

Recommendation

That an amendment be made to:

- give Inland Revenue the power to revoke accreditation on the basis of liquidation, receivership, transfer of incorporation, bankruptcy and conviction for fraud of a PAYE intermediary, and also if a person has made a false declaration when applying to be accredited as a PAYE intermediary;

- distribute any funds paid over by an employer and held by a person that has lost accreditation as a PAYE intermediary and apply the PAYE rules in relation to those funds as though the person were still a PAYE intermediary;
- require Inland Revenue to give notice to employers that a PAYE intermediary acting on their behalf has lost its accreditation; and
- deem arrangements between employers and their PAYE intermediary to have ceased by fourteen days after that notice is issued.

That the submission that Inland Revenue should be able to recommend statutory management to run the affairs of a non-performing PAYE intermediary or one who has had their accreditation revoked be declined.

Issue: Deposits to and withdrawals from trust accounts

Clause 45

Submission
(5 – Datacom, 16 – PricewaterhouseCoopers, 21W – KPMG)

The requirement that gross wages should be deposited into the trust account should be changed so that only PAYE deductions are required to be deposited into the account. Also, PAYE intermediaries should be able to use money from the trust account to pay third parties on behalf of employees. *(Datacom)*

An amendment is required to proposed new section NBA 6 to allow withdrawals from the trust account:

- with the approval of the employer and the Commissioner; and *(KPMG)*
- if calculation errors occur. *(PricewaterhouseCoopers)*

The option to make payments directly from the employer to Inland Revenue, once the liability is notified by the intermediary, should also be available. *(KPMG)*

Comment

Datacom has commented that in virtually all instances employees' net salary and wages is debited from the employer's bank account and credited into employees' bank accounts in the same transaction. The funds, therefore, do not spend any time in any other account and would not be able to go through a trust account. Similarly, if an employer elected to pay an employee in cash, those funds would not be deposited in the trust account.

Officials recognise that commercial considerations may make it efficient for a PAYE intermediary to facilitate a direct transfer of net wages from employers' bank account to the accounts of their employees. Nevertheless, the requirement for employers to pay over gross wages (that is, net wages and PAYE) and for intermediaries to hold these amounts on trust exists to mitigate the risk that employers will pay net wages to their employees but not the PAYE deduction to Inland Revenue.

Under this proposed initiative, some of the risk that PAYE deductions are not paid moves from employers to the government. This risk is partially offset by the requirement that PAYE deductions be made from any salary or wages paid over by employers. If the requirement for gross salary or wages to be paid into the trust account is removed, this offsetting effect will also be removed.

If an employer pays an employee in cash, the PAYE intermediary will not have responsibility for applying the PAYE rules for that employee in respect of that payment.

Datacom points out that it is essential that an intermediary be able to receive and pay out funds in addition to tax deductions. Examples of such payments are healthcare premiums, union fees and payments to contributory superannuation schemes. It also says that many employers will wish to make only one payment to the intermediary for net wages, PAYE deductions, payments on behalf of employees to third parties and intermediaries' fees.

It would be difficult, in practice, to legislate for all of the types of payees that PAYE intermediaries could make payments to on behalf of employees without creating significant opportunities for the misappropriation of funds. Similarly, seeking Inland Revenue's approval for payment to these payees individually would also be impractical. Officials therefore consider that the best option would be to introduce a provision that clarifies that funds paid by employers into the trust account are held by the PAYE intermediary as trustee for the benefit of employees and Inland Revenue. This formulation will allow intermediaries to apply the funds to third parties on behalf of employees.

The PAYE by intermediaries initiative relies on the interest being available to be used by intermediaries to offset the cost of providing their services to employers. Therefore, the new provision would also have to stipulate that any interest earned on the trust account will be paid to intermediaries.

Officials have discussed this matter with Datacom, who now agrees with the proposed provision.

With respect to the ability to make withdrawals from the trust account for overpayments, fees and other unforeseen expenses, officials consider that such permutations would overly complicate the administration of the account and make it difficult to monitor and manage. Therefore we consider that intermediaries and employers should make alternative arrangements on a commercial basis. For example, overpayments could be applied towards future payments or paid to Inland Revenue, who could then refund the payment to the employer.

Officials consider the option of paying PAYE deductions directly from employers' accounts to Inland Revenue would be legislating for current practice. While this option would also move the PAYE risk to the government, it would do so without any of the benefits to government of intermediaries receiving the PAYE deductions at the time that net salary or wages are paid to employees. It is, therefore, not supported by officials.

Recommendation

That an amendment be made to clarify that gross salary or wages paid by employers to PAYE intermediaries are to be held on trust by intermediaries for the benefit of employees and Inland Revenue. The amendment should also specify that interest earned on the trust account should accrue to the trustee.

That submissions suggesting amendments be made to:

- allow withdrawals from the trust account with either the approval of the employer and the Commissioner or if calculations errors occur; and
- allow the option of making payments directly from employers to Inland Revenue

be declined.

Issue: Reference to trust account in new section NBA 5

Clause 45

Submission
(21W – KPMG)

The requirement to establish and maintain a trust account should be added to new section NBA 5 of the Income Tax Act 1994.

Comment

Officials agree that the bill should be amended to include the requirement for persons applying to become accredited as PAYE intermediaries to establish and maintain a trust account with a bank registered under the Reserve Bank Act 1989.

Recommendation

That the bill be amended to include a requirement in new part NBA for a person applying to be accredited as a PAYE intermediary to establish and maintain a trust account with a bank registered under the Reserve Bank Act 1989.

OBLIGATIONS OF AN INTERMEDIARY

Issue: Use of an intermediary for all employees of an employer

Clause 45

Submission
(5 – Datacom)

The requirement for all employees of an employer to be handled by a PAYE intermediary should be removed.

Comment

The submission points out that employers may use more than one payroll service provider or have different payroll systems for processing different employees – for example, an "in-house" system for the majority of staff and a payroll firm for its executive payroll.

The requirement in the bill reflects limitations in the administration system that existed at the time the legislation was drafted. Those limitations have now been removed and therefore officials agree that the requirement can be removed.

Recommendation

That the submission be accepted.

Issue: Clarifying the role of an intermediary

Clause 45

Submission
(5 – Datacom)

If an employer engages a PAYE intermediary but does the PAYE calculation themselves, using calculation tools provided by the intermediary, the intermediary's responsibility should only be that of ensuring that the PAYE calculated by the employer is paid to Inland Revenue on time and that returns relating to the payment have been made.

Comment

Officials consider that if an employer uses a PAYE intermediary's calculation tools then the intermediary should be responsible for the calculation. That is, responsibility for the calculation must rest with those responsible for the calculation mechanism. The employer should be responsible only if the raw data exported into the tool is incorrect.

Recommendation

That the submission be declined.

Submission
(Matter raised by officials)

The legislation should be clarified so it is clear that a person is a PAYE intermediary only if accredited as a PAYE intermediary by the Commissioner and the person assumes employer's responsibilities under the PAYE rules.

Comment

The intention of the PAYE by intermediaries' initiative is to transfer the entirety of employers' PAYE obligations to willing third parties, thereby limiting employers' risk exposure to the incorrect provision of employee information and payment of employee compensation to PAYE intermediaries. It was never the intention that the initiative would support the partial transfer of employers' PAYE obligations to third parties – for example, employers retaining the PAYE calculation function (and the responsibility for that function) while passing on the payment and returns filing obligations (as well as the respective responsibilities) to third parties. Such a system would be very complex, especially in relation to assigning responsibility for complying with the different aspects of the PAYE rules, as employers' responsibilities would then exceed that of simply providing employee information and gross salary and wages to an intermediary.

As drafted, the proposed legislation is not clear, however, in preventing the outcomes discussed above. That is, there is no legislative exclusion from the proposed rules in part NBA for persons accredited as PAYE intermediaries, but who do not assume all of the obligations placed on an employer under the PAYE rules. Officials recommend clarifying the legislation in the bill so that it is clear that a person is a PAYE intermediary only if accredited as a PAYE intermediary and the person assumes all of an employer's responsibilities under the PAYE rules.

Recommendation

That the submission be accepted

Issue: Interaction between employees and PAYE intermediaries

Submission
(5 – Datacom)

PAYE intermediaries should not be legislatively required to deal directly with employers' employees.

Comment

Datacom has submitted that the need for confidentiality and security over confidential information precludes payroll service providers from dealing directly with employees. It has indicated, for example, that it is very difficult to verify the identity of employees.

Officials originally considered that PAYE intermediaries would prefer to have the opportunity to have direct access to employees to, for example, verify information provided by employers (such as tax codes). However, after consultation with potential intermediaries this appears not to be the case.

Recommendation

That the submission be accepted.

Issue: Record keeping requirements

Clauses 45 and 76

Submission
(5 – Datacom and matter raised by officials)

Data retention requirements for PAYE intermediaries under the Tax Administration Act 1994 must reflect the functions the intermediary carries out. *(Datacom)*

Employers should be required to keep copies of any information provided to a PAYE intermediary. *(Matter raised by officials)*

Comment

Datacom has submitted that some employers may wish to continue to calculate their payroll internally using a PAYE intermediary's calculation tool, and delegate responsibility only for payment and reporting of PAYE to a PAYE intermediary. It suggests that requiring the employer to pass on all data relating to those calculations to the intermediary, when the employer should retain it, is both impractical and unworkable.

As noted earlier, if an employer calculates the PAYE using the PAYE intermediary's calculation tool the intermediary should have responsibility for the calculation. Sufficient records need to be maintained by the intermediary so that those calculations can be verified by Inland Revenue. Such records would necessarily include information such as the amount of source deductions payments made to individual employees for given periods.

With respect to officials' submission, we consider that employers should retain any employee information provided to PAYE intermediaries. This information is necessary to audit both employers and intermediaries. Officials consider that employers would want to retain this information in any case to monitor their dealings with intermediaries.

Recommendation

That no amendment be made to the record-keeping requirements of PAYE intermediaries. An amendment should be made, however, to require employers to keep records of the employee information that they provide to PAYE intermediaries.

Issue: PAYE adjustments relating to prior periods

Clause 45

Submission
(5 – Datacom)

There should be a legislative provision outlining the responsibilities (if any) of a PAYE intermediary in respect of periods prior to commencing as the PAYE intermediary for a given employer and periods after ceasing to be the PAYE intermediary for that employer.

Comment

Officials consider that situations will arise where PAYE intermediaries will want to make adjustments to assessments that relate to periods before they assumed employers' PAYE responsibilities or after the arrangement has ended. Rules governing what should happen in relation to funds held by the intermediary if the arrangement between the employer and the intermediary cease are already in the bill. The bill does not, however, contain rules governing changes to assessments that relate to periods prior to the arrangement.

We consider that intermediaries who wish to make amendments to prior periods should be responsible only for the changes they make and not for the underlying prior assessment. Given that the intermediary was not responsible for making tax deductions in those prior periods, the tax liability or refund of tax that results from such adjustments would need to be the responsibility of the employer.

Recommendation

That an amendment be made to allow intermediaries to amend assessments for periods prior to the arrangement, with the condition that the employer be liable for any resulting tax to pay or tax refund, whichever is the case.

Issue: Access to information

Clause 45

Submission
(16 – PricewaterhouseCoopers, 21W – KPMG)

PAYE intermediaries should have access to the information required to comply with employers' PAYE obligations not less than, say, five working days before the due date. *(KPMG)*

Clarification is required about how Inland Revenue intends to administer access rights to PAYE information for intermediaries – intermediaries should be given the equivalent of a tax agent's "linking rights" for the PAYE accounts they manage. *(PricewaterhouseCoopers)*

Comment

KPMG has submitted that it would help if there is a minimum time frame within which the employer must provide information to the intermediary. Failure to provide information by this time should result in any penalties being imposed on the employer rather than the intermediary.

Officials consider that the time frame for providing information to intermediaries should be subject to agreement between employers and PAYE intermediaries, and that it is inappropriate to legislate for a specified period. This reflects our expectation that different parties will come to different arrangements based on individual commercial considerations, and that legislating for a specific time period will create unnecessary barriers to participation.

PricewaterhouseCoopers has commented that as a PAYE intermediary effectively becomes "manager" of the employer's PAYE account under the proposed initiative (and is liable for interest and penalties under the legislation), it makes sense for the intermediary to have access to information about movements in the PAYE account. It has submitted that intermediaries should be able to be "linked" to a PAYE account, much the same as a tax agent is.

The submission notes that this is an administrative issue and should be dealt with as such. Officials agree that PAYE intermediaries should be able to have access to the PAYE accounts of the employers for whom they act. The initiative will be supported by administrative processes that will give intermediaries access to employers' PAYE accounts.

Recommendation

That no amendment be made to the bill in relation to the submissions.

Issue: Overpayments of PAYE

Clause 45

Submission
(5 – Datacom)

There needs to be recognition in the bill that if a PAYE intermediary inadvertently makes an overpayment of PAYE to Inland Revenue, the overpaid amount should be promptly reimbursed once the intermediary has notified the department of the error.

Equally, there should be a provision in the legislation to allow an intermediary to recover any PAYE paid to Inland Revenue if an employer's payment of gross wages to the intermediary is subsequently dishonoured.

Comment

In relation to the first point, the submission points out that in view of the potentially very large amounts involved, substantial delays in reimbursing overpaid tax could have a crippling effect on a PAYE intermediary's business.

Given that the electronic administration of the initiative will allow refunds of overpayments to be paid within one to two days of an amended return being filed, we consider that this matter will be adequately addressed administratively. Legislating for this administrative practice would make the legislation more complex, with very little benefit for PAYE intermediaries.

In relation to the second point, the submission has said that in some instances, where the due date for payment of PAYE occurs within a few days of payment by the employer, the employer's payment may be dishonoured by their bank, resulting in considerable difficulties for intermediaries who have paid the PAYE to Inland Revenue and must now obtain reimbursement.

Officials recognise that the quantum of PAYE deduction held by most PAYE intermediaries will exceed, many times over, their business assets, making delays in refunding overpayments quite critical for these businesses. We support clarifying in legislation that if a PAYE intermediary has paid PAYE but the underlying payment to the intermediary has been dishonoured by the employer, the PAYE will be refunded to the intermediary's trust account.

Recommendation

That the legislation be clarified to ensure that refunds of PAYE can be made to a PAYE intermediary's trust account if an underlying payment from an employer is subsequently dishonoured.

Issue: Underpayments of PAYE

Clause 45

Submission
(5 – Datacom)

There should be a provision in the legislation to enable an intermediary to seek redress from employees who have been undercharged PAYE, and third parties who have been overpaid deductions.

Comment

Officials do not consider that PAYE intermediaries should have powers of recovery from employees greater than that employers currently have.

In further consultation, the writer of the submission indicated that its main concern was an employee being undercharged PAYE as a result of employers providing incorrect information – for example, an incorrect tax code. The bill provides that in this situation the employer, not the intermediary, will be responsible for the shortfall.

Recommendation

That the submission be declined.

PENALTIES

Issue: Application of late payment penalties

Clause 45

Submission
(5 – Datacom)

There should be a cap on the maximum late payment penalty chargeable, at a level not likely to put a PAYE intermediary out of business or reduce the incentive for potential intermediaries to offer this service.

Comment

The submission has commented that because a PAYE intermediary's business may involve the payment of very large amounts of PAYE the 5% penalty for late payment could be large enough to potentially bankrupt the intermediary. These occurrences could be the result of an error or system failure by the intermediary, through a banking system failure, or force majeure. The submission has suggested that the deterrent effect of the penalty would be equally as effective if the overall amount of the penalty were to be capped at $10,000 for any one late payment, irrespective of the overall number of PAYE deductions involved.

The late payment penalty is necessary to encourage compliance with tax payment dates, a point acknowledged by the submission. The penalty is imposed in two stages: a penalty of 1% of the unpaid tax if payment is late by one day, and a further penalty of 4% if the tax remains unpaid a week after the due date. To the extent an intermediary misses payment by a period not exceeding six days from the due date, the maximum late payment penalty chargeable would be 1% of the unpaid tax.

While officials recognise that PAYE intermediaries, by making substantial tax payments on behalf of employers, will potentially be exposing themselves to large penalties if they err, we consider that intermediaries are in the best position to mitigate these risks. Intermediaries as specialists in the payroll function should have the processes to ensure the correct and timely payment of PAYE. That is, one would not expect PAYE intermediaries to fail to make payment for the reasons an employer would typically default (the unavailability of funds from use of PAYE deduction to meet business expenses). Intermediaries would also be eligible for remission of penalties on the basis of "reasonable cause", such as if the failure was due to an event or circumstance beyond their control.

Recommendation

That the submission be declined.

Issue: Penalty for breaching accreditation requirements

Clause 45

Submission
(16 – PricewaterhouseCoopers)

Part IX of the Tax Administration Act 1994 should be amended to enable the Commissioner to apply a penalty if a PAYE intermediary knowingly or negligently allows breaches of the accreditation requirements in proposed new section NBA 2.

Comment

The submission has commented that the most severe action that can be taken against a PAYE intermediary that breaches the accreditation criteria is for its accreditation to be revoked. It considers that there should be penalties on intermediaries who knowingly or negligently breach accreditation requirements.

PAYE intermediaries who breach the terms of their accreditation will be prevented from acting as an intermediary. The penalties and interest rules in the Tax Administration Act will apply if the breach results in late or short payment of PAYE. Officials consider that the existing penalties are sufficient to encourage compliance with the PAYE rules, and by extension, the requirements of accreditation.

Recommendation

That the submission be declined.

CONSEQUENTIAL AMENDMENTS

Clause 51

Submission
(16 – PricewaterhouseCoopers)

References in section NC 14(2) and NC 14(4) to "employer" should also include references to PAYE intermediaries.

Comment

Some references to "employer" in the PAYE rules relate to the relationship of employment. We consider that it is not appropriate to extend those references to include PAYE intermediaries because no such relationship exists. It is, however, appropriate to extend references to "employer" to include PAYE intermediaries if what is being described relates to the physical function of payment of salary or wages.

We consider that the three references to "employer" identified in the submission relate to the relationship of employment, so it is not appropriate to extend them to include PAYE intermediaries.

Recommendation

That the submission be declined.

Clause 80

Submission
(16 – PricewaterhouseCoopers)

An amendment should be made to section 36A(2) of the Tax Administration Act 1994 to include a reference to "PAYE intermediary" where there is a reference to "employer".

Comment

The submission has commented that while clause 80 of the bill amends subsections (1) and (3) of section 36A to include references to "PAYE intermediary", an adjustment to subsection (2) has been omitted. Officials agree that subsection (2) of section 36A should be amended so that it is consistent with subsections (1) and (3).

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

A change is required to the definition of "employer" in the Injury Prevention, Rehabilitation, and Compensation Act 2001 to specifically exclude PAYE intermediaries, in their capacity as intermediaries, from this definition.

Comment

A clarification of the ACC legislation is needed to ensure that PAYE intermediaries are not deemed to be the employer. One such example is for the purposes of determining the rate at which employer levies are calculated. This clarification can best be achieved by specifically excluding PAYE intermediaries from the definition of "employer" in the Injury Prevention, Rehabilitation and Compensation Act 2001. The exclusion will apply only to PAYE intermediaries in their capacity as an intermediary and not as an employer in their own right.

Recommendation

That the submission be accepted.

DRAFTING CORRECTIONS

Clause 65(9)

Submission
(16 – PricewaterhouseCoopers)

References to sections ND 3 and ND 4 of the Income Tax Act 1994 in the definition of "gross tax deductions" should be to sections ND 13 and ND 14 of that Act.

That definition can be further simplified by removing the phrases "in relation to an employer or a PAYE intermediary" and "in relation to an employer"

Comment

Officials agree that the references to sections ND 3 and ND 4 should be to sections ND 13 and ND 14.

Officials also agree in principle that removing the two phrases identified in the submission could make the provision simpler. However, the language used in the bill mirrors existing provisions that are being replaced. Given the reasonably complex interrelationship of various provisions in the PAYE rules, we consider that reviewing the language used in the current legislation is outside the scope of this initiative and should be considered within the context of the rewrite of the Income Tax Act.

Recommendation

That the references to sections ND 3 and ND 4 be changed to ND 13 and ND 14 in the definition of "gross tax deductions". The phrases in that definition to "in relation to an employer or a PAYE intermediary" and "in relation to an employer" should be retained.

Clause 127

Submission
(16 – PricewaterhouseCoopers)

The wording used in clauses 125, 126 and 127 of the bill should be consistent.

Comment

The new subsections being inserted set up a condition for the application of the main provision. Officials agree that, given that the condition is the same in all three sections, the new subsections should be worded similarly.

Recommendation

That clause 127 be redrafted to be consistent with clauses 125 and 126.

Clauses 35, 45-53, 56-58, 65, 76, 80, 85, 96, 106, 119, 123, 125, 126, 127, 131, 146, 147, 148, 149, 150, 152, 153, 154, 156, 157, 158, 159, 162, 163 and 164

Submission
(Matter raised by officials)

A number of technical amendments are required to improve the clarity and technical accuracy of the legislation enacting the initiative.

Comment

Officials recommend a number of changes to the present drafting of the legislation in the bill to improve its clarity and technical accuracy without affecting the operation of the "PAYE by intermediaries" initiative – for example, clarifying in new part NBA that any sanction imposed under the Tax Administration Act 1994 for non-compliance will be imposed on a PAYE intermediary and not the employer if the intermediary does not comply with the obligations placed on it by the PAYE rules (proposed new section NBA 5) and the employer has met all their requirements under proposed new section NBA 4.

Recommendation

That the submission be accepted

GST and telecommunications services

OVERVIEW

Clauses 132-142

The proposed changes clarify the GST treatment of cross-border supplies of telecommunications services by inserting a new place of supply rule and new zero-rating provisions and definitions. Although it is clear that supplies of telecommunications services should be subject to GST in New Zealand when they are consumed in New Zealand, the general place of supply rule and zero-rating provisions in the Goods and Services Tax Act 1985 are not easily applied to cross-border supplies of telecommunications services.

The nature of telecommunications services means that it can be difficult to state with certainty where the services are performed. Determining where the services are performed is of particular importance as, in many instances, the rules in the GST Act look to where a service is physically performed to determine its treatment. The concept of physical performance does not fit well with the nature of telecommunications services. Overseas case law suggests that physical performance takes place where the telecommunications equipment (satellite dishes and exchanges) is located.

The physical performance test can, therefore, be particularly difficult to apply in cases where cross-border telecommunications services are supplied, as in many instances the supplier of the services will have equipment located in both countries to complete the "circuit" needed for a telephone call.

New, specific, place of supply rules for telecommunications services proposed in the bill are intended to remove this uncertainty by removing the physical performance test for supplies of telecommunications services. The new provisions will, in effect, be a code for determining the place of supply (including zero-rating) for cross-border telecommunications services.

Seven submissioners commented on the provisions of the bill that are intended to clarify the GST treatment of cross-border supplies of telecommunications services. Submissions strongly supported the clarification of the place of supply rules for supplies of telecommunications services.

All submissions made various recommendations of a technical nature about the scope of the proposed changes.

DEFINITIONS: "TELECOMMUNICATIONS SERVICES" AND "CONTENT"

Submission
(12 – Institute of Chartered Accountants of New Zealand)

For purposes of consistency, the definition of "content" should be aligned with the definition of "telecommunication" in the Telecommunications Act 2001. This will exclude the supply of "broadcasting" services from the new place of supply rules.

Comment

The proposed definitions of "content" and "telecommunications services" in this bill are based on those used in the GST or VAT Acts of other jurisdictions. They are also based on the definition adopted by the International Telecommunications Union (of which the New Zealand government, represented by Telecom, is a member) in the Final Acts of the World Administrative Telegraph and Telephone Conference[1] and the Telecommunications Act 1987.

These definitions were settled on after extensive consultation with the telecommunications industry. Officials note that Vodafone New Zealand Limited (submission TXAR MOB/3) supports the definitions in clause 133, especially the clear distinction which is drawn between the supply of telecommunications services and the content "carried" by the telecommunications services.

Officials prefer the definitions in the 1987 Act as they are more closely aligned with those used in foreign GST/VAT jurisdictions. It is these definitions, rather than those in the Telecommunications Act 2001, with which the definitions in the GST Act should be consistent as this is more likely to prevent unintentional double or non-taxation of services between different GST/VAT jurisdictions.

Supplies of broadcasting should be (and currently are) within the GST base. If supplies of broadcasting services were to remain covered by the general place of supply rules in the Act the same issues and uncertainties that arise with respect to telecommunications services will continue to arise for these services.

Recommendation

That the submission be declined.

[1] Final Acts of the World Administrative Telegraph and Telephone Conference (WATTC – 88), Melbourne, 1988; known as the Melbourne Accord.

DEFINITION: "TELECOMMUNICATIONS SUPPLIER"

Submission
(16 – PricewaterhouseCoopers, 29 – New Zealand Law Society, 32 – Telecom New Zealand Limited)

A definition of "telecommunications supplier" should be inserted.

Comment

Officials agree that to clarify the scope and application of the amendments a definition of "telecommunications supplier" should be inserted in the Act.

Recommendation

That the submission be accepted.

THE PLACE OF SUPPLY RULES: SUPPLIES BETWEEN REGISTERED PERSONS

Submission
(16 – PricewaterhouseCoopers, 31 – MinterEllisonRuddWatts)

The current section 8(2)(b) should apply to supplies of telecommunications services so that, unless agreed otherwise, a supply from a non-resident to a registered person in New Zealand for the purposes of carrying on the registered person's taxable activity is treated as not being supplied in New Zealand and, therefore, not subject to GST.

Submission
(12 – Institute of Chartered Accountants of New Zealand)

A new provision should be inserted so that, if the supplier and the recipient agree, supplies of telecommunications services from a non-resident to a registered person in New Zealand for the purposes of carrying on the registered person's taxable activity are treated as not being supplied in New Zealand.

Comment

The provisos to the general place of supply rule in current section 8(2) mean that, when a non-resident supplier makes supplies of services to New Zealand:

- The supply is deemed to be made in New Zealand (and subject to GST) if the services are physically performed in New Zealand by a person in New Zealand at the time they are performed (section 8(2)(a)).
- When the services are supplied to a registered person for the purposes of carrying on that person's taxable activity they are deemed to have been supplied outside New Zealand (and not subject to GST) unless the non-resident supplier and the New Zealand recipient agree otherwise (section 8(2)(b)).

Officials consider that it would be inappropriate to apply section 8(2)(b) to supplies of telecommunications services, as that section applies in the context of services physically performed. The proposed amendments to the place of supply rules for telecommunications services are being changed to remove references to physical performance because a test based on physical performance is unworkable when applied to telecommunications and other "electronic" services.

The circumstances in which a telecommunications service would be supplied by a non-resident to a New Zealand resident would appear to be limited to those where the New Zealand resident initiated an offshore call using a foreign telecommunications company. If GST were chargeable by a non-resident telecommunications company to a New Zealand resident company initiating a call, the GST would generally be able to be recovered by the New Zealand resident company as an input tax credit. However, officials understand that this would give rise to compliance cost concerns.

Officials therefore agree that a new provision should be inserted to bring about the same effect as section 8(2)(b) – that is, unless the supplier and the recipient agree otherwise, supplies of telecommunications services from a non-resident to a registered person in New Zealand for the purposes of carrying on the registered person's taxable activity are to be treated as not being supplied in New Zealand and therefore not subject to GST.

Recommendation

That the submissions be accepted.

THE PLACE OF SUPPLY RULES: DRAFTING ERROR

Submission
(29 – New Zealand Law Society)

As currently drafted, there is a conflict between new section 8(2) and new section 8(6) as it is not stated, as with other sections, that section 8(6) applies despite section 8(2).

Comment

Section 8(6) is meant to apply instead of section 8(2) to determine the place of supply for telecommunications services supplied by non-resident suppliers. Clause 135(6) should, therefore, be amended to apply "despite subsection (2)".

Recommendation

That the submission be accepted.

THE "INITIATOR" TEST

Submission
(12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers, 32 – Telecom New Zealand Limited)

The definition of "initiator" in clause 135 should be replaced by a list of factors that should be taken into account when determining where a telecommunications supply is initiated.

Submission
(12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers, 29 – New Zealand Law Society, 32 – Telecom New Zealand Limited)

The proposed discretion for the Commissioner to prescribe circumstances in which a person is treated as initiating a supply should be removed.

Comment

Whether or not a person in New Zealand initiates a telecommunications supply generally determines whether or not the supply of the service is liable to GST. The definition of "initiator" in the bill is intended to clarify who is the initiator in relation to collect and multi-party calls.

Officials agree with the submission that the current definition of "initiator" does not provide sufficient guidance as to when a person is considered to have initiated a supply of telecommunications services. Officials therefore agree that the definition should be replaced with a provision listing factors to be taken into account when determining which party to a supply of telecommunications services has initiated the supply. These factors would include which party makes payment for the services and which party exerts control over the supply of services. Also, as suggested by submissions, a "tie-breaker" factor of which party has contracted for the supply would be included.

The proposed discretion for the Commissioner to prescribe circumstances, in addition to those in the current definition, in which a person is treated as initiating a supply was intended to give the Commissioner a flexible way of providing certainty for telecommunications suppliers in the treatment of telecommunications services. After further consultation with telecommunications suppliers, officials consider that guidance in the form of an article in Inland Revenue's *Tax Information Bulletin*, while not binding on the parties in the same way as a prescribed treatment by the Commissioner under a discretion, will provide an appropriate level of certainty, and the proposed discretion should therefore be removed.

Recommendation

That the submissions be accepted.

THE “BILLING ADDRESS” TEST

Submission
(29 – New Zealand Law Society)

As a telecommunications supplier may not always know the physical address (as opposed to a P. O. Box number) of a customer, the requirement that the telecommunications supplier apply the billing address test (and therefore know the physical address of customers) for all supplies made for the type of service or class of customer should be removed.

Comment

The “billing address” test in clause 136 is only intended to apply when the “physical location” test in clause 135 cannot be applied. In discussions with telecommunications suppliers it has generally been agreed that there will not be many situations when the billing address test will be used.

The requirement that the telecommunications supplier must apply the billing address test (and therefore must know the physical address of customers) for all supplies made for the type of service or class of customer is important to prevent New Zealand residents from using billing addresses offshore when they are physically present, and consuming services, in New Zealand. This could lead to a revenue loss. Officials therefore do not recommend removing this requirement.

Recommendation

That the submission be declined.

ZERO-RATING

Submission
(2 – Vodafone Group Services Limited (UK), 3 – Vodafone New Zealand Limited, 12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers, 29 – New Zealand Law Society, 32 – Telecom New Zealand Limited)

The zero-rating provided for by clause 138 should be extended to include supplies by New Zealand resident telecommunications suppliers to non-resident telecommunications suppliers, regardless of where the telecommunications service the supply relates to is initiated.

Comment

An example of services that submissions consider should be zero-rated occurs when a non-resident present in New Zealand uses a cellular phone while in New Zealand ("roaming") to make either an international or a local call through a non-resident telecommunications supplier with whom he or she has a contract for a supply of telecommunications services. This would be accomplished by a New Zealand resident telecommunications supplier providing a "link" between the roamer and the non-resident telecommunications supplier. (See attached diagram.) Under the current proposed rules as the non-resident roamer initiating the supply is physically in New Zealand the supply of the "link" services to the non-resident telecommunications supplier would be subject to GST.

Telecom's concern is more generally with the application of GST to supplies by resident telecommunications suppliers to non-resident telecommunications suppliers where there is an initiator in New Zealand.

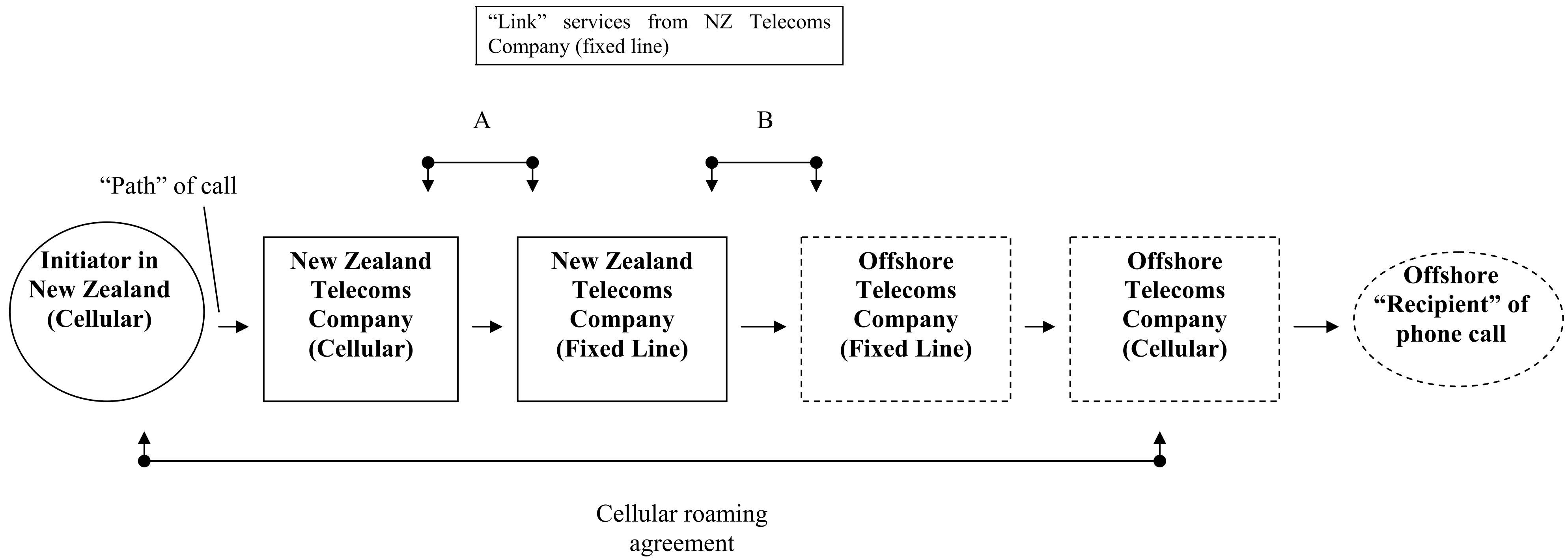
Officials consider that services in these circumstances are properly zero-rated given there is no physical interaction between the New Zealand telecommunications supplier and the initiator. The initiator in New Zealand does not directly receive the performance of the interconnection services – the offshore telecommunications supplier receives both the contractual and "actual" performance of the services and they should therefore be zero-rated as exported services.

Officials note that the Minister of Finance and Revenue has asked that the Committee consider an amendment to extend zero-rating to cover the situations referred to in submissions.

Recommendation

That the submissions be accepted.

EXAMPLE: Cellular Roaming Services



Link "A": properly subject to GST.

Link "B": should be zero-rated as an exported service.

REGISTERING NON-RESIDENT SUPPLIERS: "ROAMING" SERVICES FOR NON-RESIDENT CORPORATES

Submission
(29 – New Zealand Law Society)

Clause 141 (which excludes supplies by non-residents physically in New Zealand from supplies to be taken into account in determining the requirement to register for GST) should apply when an employee of a non-resident company initiates the supply of services in New Zealand on behalf of the company under a cellular roaming agreement. Clause 141 may not apply currently as the company will not be physically present in New Zealand.

Comment

Officials note that the proposed amendments to the definition of "initiator" will ensure that the services described in the submission are not subject to GST, and the non-resident telecommunications supplier is not forced to register for GST. When an initiator of telecommunication services is physically outside New Zealand the services are treated as being supplied outside New Zealand and GST does not apply.

Officials consider that the new rules would treat the non-resident company as the initiator of the supply. Although it is arguable that the employee roaming in New Zealand exerts control over the supply (as the roamer makes the telephone calls) the fact that the non-resident company would be paying for the supply and is the party which has the contractual relationship with the telecommunications supplier means that the company will be treated as the initiator.

Officials also note that Vodafone Group Services Limited (UK) (TXAR MOB/2) and Vodafone New Zealand Limited (TXAR MOB/3), telecommunications suppliers which are involved in providing cellular roaming services, agree with the drafting of clause 141.

Recommendation

That the submission be declined.

CROSS-REFERENCING ERROR

Submission

(3 – Vodafone New Zealand Limited, 12 – Institute of Chartered Accountants of New Zealand, 29 – New Zealand Law Society)

The reference in clause 141 to "section 8(5)" should be replaced by a reference to "section 8(6)".

Comment

The reference in clause 141 to section 8(5) is a cross-referencing error and it should be replaced by a reference to section 8(6).

Recommendation

That the submissions be accepted.

RELATIONSHIP WITH THE AGENCY RULES

Submission
(29 – New Zealand Law Society)

Clause 135(6) is inconsistent with the agency rules in section 60 of the GST Act.

Comment

The submission does not outline the practical impact of any inconsistency with the agency rules and officials are not aware of any issues. In any event, the place of supply rules for telecommunications services, which determine the liability to GST, are specific provisions which would be likely to be interpreted as taking precedence over the more general agency rules.

Recommendation

That the submission be declined.

Private and product rulings

CLAUSE 72 – THE INCLUSION OF MATERIAL FACTS IN PRIVATE AND PRODUCT RULINGS

Overview of submissions

The bill contains a proposal to amend the definition of "arrangement", within the Tax Administration Act 1994, for the purposes of the binding rulings legislation. The amendment will allow the Commissioner of Inland Revenue to include in private and product rulings facts that the Commissioner considers material or relevant, as background or context, to any of the matters on which the private or product ruling is sought. These facts will form part of the "arrangement" specified in a ruling. The amendment prevents private and product rulings having a wider application than intended.

Three organisations made submissions on the proposed legislation: The Institute of Chartered Accountants of New Zealand, The New Zealand Law Society, and the law firm Russell McVeagh.

One submission suggested an alternative drafting of the legislation, and two submissions related to a requirement that material facts be specified in the ruling. One submission also proposed that the facts covered by the amendment should be considered material by both the Commissioner and the taxpayer.

Russell McVeagh objected to the amendment on the basis that broadening the meaning of "arrangement" is unwarranted and unnecessary.

THE REQUIREMENT THAT THE FACTS BE CONSIDERED RELEVANT OR MATERIAL BY THE COMMISSIONER ONLY

Submission
(12 – Institute of Chartered Accountants of New Zealand)

The proposed definition of "arrangement" should be changed to include background or contextual facts included in a ruling that are considered material by both the Commissioner and by the taxpayer. The definition currently requires that the background facts be considered material by the Commissioner only.

Comment

The rulings legislation permits the Commissioner to bind him/herself to a view of the law. In the absence of this legislation, the Commissioner is not legally bound by his/her view. A ruling under the rulings legislation, being the Commissioner's view, not the taxpayer's, ought to allow the Commissioner to take into consideration all facts and to include any restrictions that the Commissioner considers relevant or important to determining his/her view.

Furthermore, if the taxpayer and the Commissioner were required to agree on which facts are relevant as background or context, an incentive would be established for taxpayers to disagree with proposed inclusions under the section so as to give rulings the broadest possible application. This scenario would be most likely to occur in the cases where the information covered by the amendment would decide the balance of, or be crucial to, the decision made by the Commissioner. This could frustrate the binding rulings process.

Recommendation

That the submission be declined.

THE INCLUSION OF MATERIAL FACTS IN PRIVATE OR PRODUCT RULINGS SHOULD BE LEGISLATED FOR SEPARATELY FROM THE DEFINITION OF "ARRANGEMENT"

Submission
(12 – Institute of Chartered Accountants of New Zealand)

To avoid confusion, legislating for the inclusion of background facts within a ruling would be better provided for in a separate "background facts" section, rather than as part of the "arrangement" of a ruling. Sections 91EB(2)(a) and 91FB(2)(a) could also be amended to provide non-application tests.

Comment

The submission suggests that "background facts" should be defined separately from "arrangement" and that the drafted section should then be linked to sections 91EB(2)(a) and 91FB(2)(a), the sections relating to the non-application of a ruling because of a breach of the "arrangement", by way of further amendments.

The submission's proposed drafting would not alter the effect of the legislation but, in officials' view, it would unnecessarily complicate the legislation.

The current drafting of the legislation aligns the treatment of "background facts" with the treatment of facts already covered by the definition of "arrangement" in a way that makes the effect of the amendment transparent and obvious, minimises the number of amendments required and avoids duplication.

Recommendation

That the submission be declined.

THE AMENDMENT SHOULD NOT PROCEED OR, ALTERNATIVELY, BACKGROUND FACTS SHOULD BE INCLUDED

Submissions

(9W – Russell McVeagh, 29 – New Zealand Law Society)

Russell McVeagh submits that the inclusion in the definition of "arrangement" of facts the Commissioner considers material or relevant as background or context introduces a subjective element to the definition.

The amendment also gives the Commissioner the ability to apply the tax laws on the basis of considerations external to the "arrangement". This is inconsistent with the manner in which New Zealand's tax laws are applied.

The amendment should, therefore, not proceed.

In the alternative, it is submitted by both Russell McVeagh and the New Zealand Law Society that the amendment does not make it clear that the material background or contextual facts must be included in the ruling if it is part of the "arrangement". Therefore the amendment requires clarification to ensure that taxpayers are aware, at the time a ruling is issued, of the basis on which the ruling is issued.

Comment

The rulings legislation permits the Commissioner to bind him/herself to a view of the law. In the absence of this legislation, the Commissioner is not legally bound by his/her view. A ruling under the rulings legislation, being the Commissioner's view, not the taxpayer's, ought to allow the Commissioner to take into consideration all facts and to include any restrictions that the Commissioner considers relevant to determining his/her view.

The amendment gives the Commissioner the flexibility needed to come to a well considered view that takes into consideration relevant background or contextual facts, without imposing unwarranted restrictions on the ruling.

Officials agree that any facts included within the "arrangement" of a ruling by virtue of the amendment should be stated in a ruling. However, officials consider that the amendment as drafted already requires such facts to be stated within a ruling.

Section 91EH(1)(b) of the Tax Administration Act provides that a private ruling must state the "arrangement" to which the ruling applies. Similarly, section 91FH(1)(c) requires the same in respect of product rulings.

The amendment provides that any facts that the Commissioner considers material or relevant as background or context to a private or product ruling fall within the meaning of "arrangement". Consequently, any facts that the Commissioner considers material or relevant as background or context to a private or product ruling must be stated in the ruling under sections 91EH(1)(b) and 91FH(1)(c).

Recommendation

That the submissions be declined.

Inland Revenue's information-gathering powers

OVERVIEW

Clauses 73, 74 and 75

The bill contains a number of proposed amendments that will extend and clarify Inland Revenue's information-gathering powers. These amendments are in line with the recommendations of the Committee of Experts on Tax Compliance, which reported in 1998. The amendments have also been subject to previous public consultation as part of the discussion document *Taxpayer, Compliance, Standards and Penalties: A Review*, which was released in August 2001.

The particular amendments in clauses 73 to 75 of the bill that extend and clarify Inland Revenue's main information-gathering powers in sections 16 and 17 of the Tax Administration Act 1994 are:

- clarifying that third parties can be required to give reasonable assistance and facilities when Inland Revenue is exercising its powers to access premises;
- clarifying who may be given authority to enter a taxpayer's premises;
- allowing warrants to enter private dwellings to be exercised by Inland Revenue officers in general;
- allowing Inland Revenue to remove documents from premises to copy;
- allowing Inland Revenue to requisition from New Zealand residents information held by offshore entities controlled by the New Zealand residents; and
- giving Inland Revenue the discretion to require documents to be sent to a particular Inland Revenue office.

Submissions were generally opposed to the amendments proposing to extend and clarify Inland Revenue's information-gathering powers. Submissions were most strongly opposed to the amendment in clause 74, which will allow Inland Revenue to remove documents from premises for copying. (Any documents removed must be returned as soon as practicable after copies have been made.) A number of submissions also requested that the government reimburse taxpayers for their costs in complying with information requisitions from Inland Revenue.

Officials consider that the proposed amendments are necessary to clarify Inland Revenue's information-gathering powers and address particular deficiencies in those powers. The department's information-gathering powers are critical to it carrying out its statutory function of collecting the correct amount of tax. In particular, the proposed power to remove documents for copying is necessary to address the risk in certain cases of documents being destroyed, removed or tampered with if an ordinary section 17 requisition is made for them. Although the government and the Commissioner endeavour to minimise compliance costs, the government does not generally reimburse taxpayers for these costs.

The main recommendations by officials to the Committee following submissions are that amendments should be made to the bill to:

- allow taxpayers to inspect and copy any removed documents;
- clarify the statutory secrecy obligations to ensure that they apply to persons accompanying Inland Revenue officers onto taxpayers' premises; and
- limit the aggregation rule in proposed section 17(1B), which applies for the purpose of determining whether an offshore entity is controlled by a New Zealand resident, to interests held by other New Zealand residents or controlled foreign companies.

A taxpayer will be able to exercise the right to inspect and copy removed documents at all reasonable times, including specifically at the time the documents are removed. This right should ensure that the removal of documents for copying does not unduly disrupt a taxpayer's business.

In addition, Inland Revenue's own administrative guidelines will impose the following controls on the use of the Commissioner's information-gathering powers:

- Documents will only be removed if the Inland Revenue officer considers that it is not practicable to make copies on the premises.
- When documents are removed from a taxpayer's premises for copying, the taxpayer will be given a receipt briefly outlining what items have been removed.
- Inland Revenue will provide taxpayers with a copy of any removed documents that are copied, unless all the documents removed have been copied, in which case the taxpayer will be told that all of the documents have been copied.

AUTHORITY TO ENTER TAXPAYER PREMISES

Clause 73

Issue: Specify officers authorised to enter

Submission
(13 – Business New Zealand, 21W – KPMG)

Increasing the power of Inland Revenue to enter premises without requiring separate warrants for each staff member raises concerns. *(Business New Zealand)*

The current law is not unreasonable in that the Commissioner should be required to formally turn his mind to which of his staff will exercise his powers of access under section 16. *(KPMG)*

Comment

As noted in the discussion document *Taxpayer compliance, standards and penalties: a review*:

> Practical difficulties can arise if the investigation requires the involvement of other investigators or other parties, such as computer programmers or police. For example, a new investigator may be needed if the original investigator becomes ill.[2]

While the current system of separate warrants clearly imposes costs, officials are uncertain about the benefits arising from specifying in a warrant which particular staff member will be entering the taxpayer's private dwelling. Taxpayers can always request the name and verification of identity of Inland Revenue staff members entering their premises.

Although a warrant is valid for one month, if multiple staff members are named and one is not available for whatever reason, it may be difficult to get all the staff members together again in that month.

Recommendation

That the submission be declined.

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[2] *Taxpayer compliance, standards and penalties: a review*, August 2001, paragraph 6.16.

Issue: Specify who accompanies Inland Revenue

Submission
(31W – MinterEllisonRuddWatts)

The legislation should specify who, and for what purpose, a person may accompany an authorised officer onto a taxpayer's premises.

Comment

The bill provides that a person whom the Commissioner considers necessary for the effective exercise of the Commissioner's inspection powers may accompany an Inland Revenue officer onto any premises. These powers are necessary to help the Commissioner carry out his statutory duty of collecting the correct amount of tax.

Specifying the particular circumstances when third parties can accompany the Commissioner raises the risk of possible circumstances going unspecified or uncertainty as to whether a particular circumstance is identified. In other words, the proposed requirement would seem to be too inflexible to cater for all potential circumstances where third parties may need to accompany Inland Revenue officers on to premises. Officials consider that it is reasonable to rely on the Commissioner's general obligation to use resources wisely and the overriding requirement under administrative law that all public powers must be exercised in good faith.

Recommendation

That the submission be declined.

Issue: Warrants for assisting parties

Submission
(9W – Russell McVeagh)

Where Inland Revenue is to engage an accompanying person to enter and search premises pursuant to section 16(2A), this should first be approved by way of a warrant, except where the accompanying persons are police officers.

Comment

Those accompanying Inland Revenue officers would be present only to assist the department and would be subject to the secrecy provisions.

The requirement to obtain a warrant in these circumstances (where premises are not private dwellings) would be an unnecessary impediment to the Commissioner carrying out his duty of collecting tax, as set out in section 6A(3) of the Tax Administration Act 1994. A warrant is not currently required to enter any premises other than private dwellings.

The proposed amendment is consistent with the Customs and Excise Act 1996, which entitles an officer to use such assistance as is reasonable in the circumstances and confers a power to search craft on any customs officer and any authorised person assisting the officer.

Recommendation

That the submission be declined.

Issue: Secrecy obligations

Submission
(9W – Russell McVeagh)

The proposed section 16(2A) of the Tax Administration Act would permit a person (not being an Inland Revenue employee) to accompany Inland Revenue employees. It is not clear whether the statutory secrecy obligations apply to such persons.

Comment

Officials agree that the secrecy provisions of the Tax Administration Act 1994 should apply to those persons accompanying Inland Revenue staff. Although section 87 may impose secrecy obligations, the definition of "person with access to restricted information" in section 87(5) is not clear, and clarification is appropriate. We therefore agree that the confidentiality obligations should be amended to apply expressly to persons accompanying Inland Revenue officers onto taxpayers' premises.

Recommendation

That the submission be accepted.

ASSISTANCE FROM THIRD PARTIES

Clause 73

Issue: Amendment not required

Submission
(12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers)

The Commissioner's powers do not need to be extended in this way. *(Institute of Chartered Accountants of New Zealand)*

The amendment requiring reasonable assistance from third parties provides Inland Revenue with unnecessary and unreasonable powers. The Australian Tax Office recently raided several accounting and legal firms providing tax advice. These raids were unannounced, involved sealing rooms with tape designed to reveal tampering and compelling staff to stand away from their desks to prevent document destruction. Adoption of the Australian provision would allow Inland Revenue to adopt a similar approach. We view this approach with concern. *(PricewaterhouseCoopers)*

Comment

This amendment provides Inland Revenue with powers that are both necessary and reasonable. The amendment was recommended by the Committee of Experts on Tax Compliance who recognised that uncertainty exists as to the application of current section 16(2) with respect to exactly who may be required to give reasonable assistance. For example, it is reasonable that a bank manager be required to identify the safety deposit box of a taxpayer.

As noted in the discussion document *Taxpayer compliance, standards and penalties: a review*, this measure is aimed at removing uncertainty over whether third parties are required to give reasonable assistance or answer questions. This uncertainty could potentially expose third parties to actions for breaches of confidence or infringement of the Privacy Act. Officials therefore consider that the amendment is necessary.

Recommendation

That the submissions be declined.

Issue: Amendment to apply only if the taxpayer does not cooperate

Submission
(12 – Institute of Chartered Accountants of New Zealand)

At a minimum, these laws should apply only where there is demonstrable failure to cooperate by the taxpayer.

Comment

Officials consider that the submission's proposal that the amendments apply only where there is demonstrable failure to cooperate by the taxpayer would be setting the threshold on the use of the power too high and significantly reduce its effectiveness.

As noted above this amendment simply clarifies the current legislation and provides third parties with protection. There are a number of cases where approaching the taxpayer involved is not feasible. For example, inspecting bank account records can only practicably be done through the relevant bank, regardless of whether or not the taxpayer is cooperating.

Recommendation

That the submission be declined.

Issue: Access to occupier's staff

Submission
(12 – Institute of Chartered Accountants of New Zealand)

Access or rights to detain an occupier's staff should be only available during normal business hours of the occupier's business and then only following a period of notice.

Comment

The normal practice will be for Inland Revenue to obtain the information during normal office hours. However, there are times when this will not be appropriate – for example, a taxpayer has records in storage and Inland Revenue has concerns that the taxpayer will destroy those records before normal working hours begin the next day. In this case Inland Revenue would require access outside of normal business hours. A requirement to give notice could also defeat the purpose of the amendments because it may mean that records could be destroyed, removed or tampered with during the period of the notice.

Recommendation

That the submission be declined.

Issue: Payment of costs by Commissioner

Submission

(13 – Business New Zealand, 16 – PricewaterhouseCoopers, 21W – KPMG)

The powers of Inland Revenue to require assistance from third parties should not be increased without reimbursement. *(Business New Zealand)*

Third parties required to attend in accordance with the proposals should be able entitled to compensation for their time and reasonable costs, as occurs in Australia. In borrowing from the Australian experience, the drafters have been disappointingly selective. The Australian provision[3] allows persons required to attend under the equivalent section to claim expenses to a level set by regulation. *(PricewaterhouseCoopers)*

Third parties should be allowed to claim reasonable costs. *(KPMG)*

Comment

Third parties will incur some compliance costs from information requests but it is unclear if these costs will increase because of this amendment. In fact, given that the proposal is simply to clarify current treatment, it is less likely that compliance costs will be incurred in arguing the current state of the law.

Compliance costs incurred by taxpayers are an inherent feature of the tax system. Complying with information requests is but one example of such costs. Although the government and the Commissioner will always endeavour to minimise compliance costs, it is not government policy to generally reimburse taxpayers for these costs.

Recommendation

That the submissions be declined.

Issue: Definition of "occupier"

Submission

(12 – Institute of Chartered Accountants of New Zealand)

The word "occupier" in proposed new section 16(2) – which ensures that third parties are required to assist Inland Revenue when it is exercising its power to access premises – should be defined.

[3] Section 264 of the Income Tax Assessment Act 1936.

Comment

Using the word “occupier” means that an obligation is placed on those persons in a position to help the Commissioner to exercise his statutory right to inspect books and documents to do so. Officials consider that defining the term is unnecessary. This amendment to section 16 is based on the equivalent Australian legislation, in which the word “occupier” is not defined, and this has not been a problem in practice.

Recommendation

That the submission be declined.

Issue: Not required to provide facilities that do not already exist

Submission
(31W – MinterEllisonRuddWatts)

The taxpayer should not be required to provide Inland Revenue with facilities not already existing and available.

Comment

This amendment is based on the equivalent Australian legislation,[4] under which this issue not been a problem in practice. If the legislation were amended in line with the submission’s proposal there might be uncertainty as taxpayers and Inland Revenue officers disputed what facilities were existing and available.

A taxpayer is not expected to provide facilities other than those existing. It is reasonable that basic facilities such as power, lighting and toilets should be available.

Recommendation

That the submission be declined.

[4] Section 263(3) of the Income Tax Assessment Act 1936.

REMOVING RECORDS FOR COPYING

Clause 74

Issue: Extension of power not required

Submission
(16 – PricewaterhouseCoopers, 29 – New Zealand Law Society)

The arguments for allowing Inland Revenue to remove documents for copying are overstated. Other provisions in the Act already cover Inland Revenue's concerns. For example, section 17 gives Inland Revenue the power to require a taxpayer to produce documents. *(PricewaterhouseCoopers)*

Inland Revenue should not have an unrestricted right to remove records. *(New Zealand Law Society)*

Comment

The importance of information to the discharge of the Commissioner's duty to collect taxes is well established. The Privy Council has stated that:

> The whole rationale of taxation would break down and the whole burden of taxation would fall only on diligent and honest taxpayers if the Commissioner had no power to obtain confidential information about taxpayers that may be negligent or dishonest.[5]

PricewaterhouseCoopers submitted that the ability to requisition documents relieves Inland Revenue of concerns about how the documents are produced. Officials recognise that section 17 gives Inland Revenue the power to require a taxpayer to produce documents; however, there are instances where this would be inappropriate. For example, requiring a taxpayer to produce a document is not a feasible measure if there is a risk that the documents might be altered or destroyed.

Although penalty provisions could apply if documents are destroyed, the application of a penalty does not result in the relevant information being obtained by the department. Therefore the proposed amendment allowing Inland Revenue to remove documents from premises for copying is directed at obtaining the information.

It is expected that the power to remove documents will not be exercised frequently. The exercise of the power will be limited to those situations where it is necessary to prevent the Commissioner's legitimate investigations being hindered. In many cases the department will continue to requisition documents under section 17.

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[5] *New Zealand Stock Exchange and National Bank of New Zealand* v *CIR* (1991) 13 NZTC 8,147, 8,149.

The Committee of Experts on Tax Compliance considered this amendment necessary because the absence of a power in current section 16 to remove documents for copying could be problematical in certain situations – for example, where it is not possible or practicable to make copies of documents on the taxpayer's premises and a risk exists that documents may be altered or destroyed if a section 17 requisition was made for them.

Several of the deficiencies in Inland Revenue's information-gathering powers were highlighted in the evidence given on specific investigations by the department to the Davison Commission. In its evidence the department also outlined the barriers frequently encountered in investigations and provided examples of the way in which Inland Revenue investigators were hindered in obtaining information.

Recommendation

That the submissions be declined.

Issue: Taxpayers able to access records

Submission
(12 – Institute of Chartered Accountants of New Zealand, 21W – KPMG)

Taxpayers should have reasonable access to their records if they are required.

Comment

Officials consider the proposed power to remove documents for copying is appropriate because there may be a risk that documents will be altered or destroyed. However, removal of documents could have a potentially significant impact on a business's ability to function. We see a need to balance these issues in a way which does not prevent Inland Revenue having the right to remove the documents but still allowing the taxpayer some protection.

Officials propose that the legislation be amended to allow a taxpayer to inspect and copy the documents removed. This right will be able to be exercised at all reasonable times, including specifically at the time the documents are removed. This amendment should ensure that the exercise of the power to remove documents does not unduly disrupt a taxpayer's business or activity and will enable a taxpayer to prepare a defence if necessary. Officials propose that a provision similar to current section 17(4) be inserted into section 16 to facilitate this. The wording would be along the lines of:

> The owner of any books or documents that are removed under this section is entitled at all reasonable times (including at the time the documents are removed) to inspect the books or documents and to obtain copies of them at the premises to which the books or documents have been removed.

Recommendation

That the submission be accepted by allowing a person to inspect and copy the documents removed.

Issue: Compliance costs

Submission
(13 – Business New Zealand)

The amendment allowing the removal of documents for copying (particularly those subject to legal privilege), should be reviewed in light of the need (not just desire), the compliance costs they would impose on businesses, and existing Inland Revenue powers.

Comment

The proposed amendments to the Commissioner's information-gathering powers have taken into account the compliance cost implications, the need for these amendments and Inland Revenue's existing powers.

Compliance costs are an inherent feature of the tax system, although the government tries to keep them as low as is feasible. In collecting taxes the Commissioner must have regard to the resources available, the importance of promoting compliance, and the compliance costs incurred by taxpayers.[6]

Inland Revenue collects information from both taxpayers who are under audit and from third parties who have information about the taxpayer or the taxpayer's business. Both taxpayers and third parties will necessarily incur some compliance costs as part of that information-gathering process. The measures aim to minimise costs arising from uncertainty and delay, by ensuring that the legislation clearly specifies Inland Revenue's powers to gather information.

It is unclear if compliance costs will increase because of this amendment. Because the amendment will improve Inland Revenue's access to information it may allow quicker investigations with resulting lower compliance costs.

Recommendation

That the submission be noted.

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[6] Tax Administration Act 1994, section 6A(3).

Issue: Power should only be available if photocopying cannot be performed on premises

Submission

(9W – Russell McVeagh, 31W – MinterEllisonRuddWatts)

Documents or books should not be removed from a taxpayer's premises or dwelling where it is practicable to make copies of the documents on the taxpayer's premises. Accordingly, it is submitted that after the proposed section 16A(1) of the Tax Administration Act, the words "if it is not practicable to make copies at the building or place where those books or documents are located" should be added. *(Russell McVeagh)*

Documents should only be removed where there are no facilities to enable the copying of the documents and records. *(MinterEllisonRuddWatts)*

Comment

At present, Inland Revenue has authority to make copies from any books or documents but not to remove documents for copying elsewhere. The concern being addressed by the proposed amendment is that if copying facilities are not available or are not made available, records may be destroyed before they can be requisitioned by the Commissioner under section 17.

A precedent for the proposed amendment is contained in section 165 of the Customs and Excise Act 1996, which authorises a Customs officer to remove from any place any documents for the purpose of making copies. Similarly, section 206 of the Fisheries Act 1996 enables a fishery officer, in the exercise of the officer's other powers under that Act, to remove for a reasonable time any documents for the purpose of making copies.

The Committee of Experts on Tax Compliance considered the amendment necessary because the absence of a power to remove documents for copying could be problematical in certain situations – for example, where it is not possible or practicable to make copies of documents on the taxpayer's premises, and a risk exists that documents may be altered or destroyed if a section 17 requisition was made for them. The Committee considered that the risk of altering or destroying documents exists despite the availability of inspection. If the documents are crucial to an investigation it is difficult to see what remedies could be effective other than those proposed.

It is expected that the power to remove documents will only be exercised occasionally, to prevent the Commissioner's legitimate investigations being hindered.

Officials consider that copies should be made on the taxpayer's premises, where this is reasonably practicable. However, this matter should be included in administrative guidelines rather than legislated for, in order to avoid disputes as to whether photocopying facilities were practically available. For example, a taxpayer has a functioning but clearly insufficient photocopier; the practical ability to make records would therefore be deficient.

Recommendation

That the submissions be declined.

Issue: Taxpayer should have notification and the option to retain the records

Submission

(9W – Russell McVeagh, 12 – Institute of Chartered Accountants of New Zealand, 29 – New Zealand Law Society)

The bill should require Inland Revenue to notify taxpayers which of their books or documents are to be removed for photocopying, so as to give them reasonable opportunity to make copies in the interim. *(Russell McVeagh)*

Taxpayers should continue to have the option to retain records but give Inland Revenue access. *(Institute of Chartered Accountants of New Zealand)*

If a book or document is needed for the taxpayer's business, the taxpayer must be able to retain it, subject to providing copies of the relevant parts to Inland Revenue. *(New Zealand Law Society)*

Comment

The proposals to provide the taxpayer with notification and the right to copy the documents before removal would defeat the very purpose of the amendments as they would involve the risk of documents being destroyed, removed or tampered with.

Documents removed for copying will be required to be returned as soon as practicable. As discussed above, taxpayers will also be able to inspect and copy any removed documents.

Officials consider that these measures are adequate to deal with the concerns expressed in the submissions.

Recommendation

That the submissions be declined.

Issue: Time limit on removal of documents

Submission
(9 – Russell McVeagh, 10 – New Zealand Retailers Association, 12 – Institute of Chartered Accountants of New Zealand, 21W – KPMG)

There should be a time limit imposed for when the documents being copied must be returned. One month is suggested as a more than sufficient period to enable copying of records. *(Russell McVeagh)*

In all but the most exceptional of cases, it should be possible for the Inland Revenue Department to copy records overnight, and that turn-around period should be adopted as the standard. *(New Zealand Retailers Association)*

There should be a requirement that the removed records are required to be assessed and returned within a predetermined time frame. *(Institute of Chartered Accountants of New Zealand)*

This proposal needs to be balanced by a requirement that the removed records are required to be accessed and returned within a predetermined time frame. *(KPMG)*

Comment

There will be a statutory obligation on the Commissioner to return any documents removed as soon as practicable after copies have been made. To set a time limit such as overnight or one month, as the submissions suggest, would be too inflexible because it could not take into account the individual circumstances of each case. In most cases documents will be returned to the taxpayer well within the proposed one-month period.

Recommendation

That the submissions be declined.

Issue: Taxpayer should be given a record of documents removed

Submission
(9W – Russell McVeagh, 29 – New Zealand Law Society)

The bill should require Inland Revenue to notify a taxpayer which, if any, of their books or documents have been photocopied. *(Russell McVeagh)*

The taxpayer must be given a written record of what has been taken for copying. *(New Zealand Law Society)*

Comment

Administrative guidelines will provide that when books or documents are removed the taxpayer will be given a receipt briefly outlining what items have been removed. The taxpayer will also receive a copy of the documents copied (unless all of the documents removed are copied, in which case the taxpayer will be told that all of the documents have been copied). Officials consider that these measures will address adequately concerns expressed in submissions.

We consider that the recommendation that the legislation be amended to allow a taxpayer to inspect and copy any documents removed also deals with concerns that taxpayers may require a copy of the documents removed.

Recommendation

That the submissions be declined, but note that administrative guidelines will provide for the taxpayer to be given a receipt briefly outlining what items have been removed and a copy of the documents copied (unless all of the documents removed are copied, in which case the taxpayer will be told that all of the documents have been copied).

Issue: Loss or destruction of records by Inland Revenue

Submission
(21W – KPMG, 31W – MinterEllisonRuddWatts)

If Inland Revenue is unable to return documents provided by a taxpayer, the onus of proof in any dispute should be with Inland Revenue and not the taxpayer. *(KPMG)*

In the event the Commissioner loses or damages documents obtained from the taxpayer's premises, then the onus of proof that would otherwise rest with the taxpayer (section 149A of the Tax Administration Act 1994) should shift to rest upon the Commissioner. *(MinterEllisonRuddWatts)*

Comment

Officials do not consider that the proposal is feasible. It would be inappropriate to shift the burden of proof if the lost document was not significant. This raises the question of how the significance of a document could be determined.

Other potential issues raised include the extent to which the burden of proof should be shifted and how this could be determined in a particular case. Also, if Inland Revenue has mislaid a document, it may not be able to meet the necessary evidential threshold for raising a valid assessment. This may provide a measure of protection to taxpayers in this circumstance.

Recommendation

That the submissions be declined.

Issue: Copying of privileged documents

Submission

(12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand, 21W – KPMG)

Inland Revenue must not copy any document that is subject to a claim of privilege. *(Institute of Chartered Accountants of New Zealand)*

We are concerned about the increase in the power of Inland Revenue to remove documents for copying, particularly those subject to legal privilege. *(Business New Zealand)*

Inland Revenue must not copy any document that is subject to privilege. If this is done the rule should specify that the information contained in the document not be admissible as evidence in any dispute. *(KPMG)*

Comment

The proposed amendment does not prevent a taxpayer from claiming privilege. If Inland Revenue removed and copied any information later identified as being subject to privilege, the information would not be admissible as evidence in court.

Recommendation

That the submissions be declined.

Issue: Minimum timeframe given to the taxpayer to assemble records

Submission

(12 – Institute of Chartered Accountants of New Zealand, 21W – KPMG)

A minimum statutory timeframe should be given to the taxpayer to assemble the records and check for any privileged documents, unless Inland Revenue has reason to believe the records are at risk of being removed or destroyed. *(Institute of Chartered Accountants of New Zealand)*

A minimum statutory timeframe should be given to the taxpayer to assemble the records and check for any privileged documents. *(KPMG)*

Comment

Officials consider that a minimum statutory timeframe would be too inflexible in practice as it would not cater for the different circumstances of each case. It could also defeat the purpose of the amendment as it could allow documents to be destroyed, removed or tampered with.

As noted above, any copied information later identified as being subject to privilege will not be admissible as evidence in court.

Recommendation

That the submissions be declined.

Issue: Access to non-relevant information

Submission
(29 – New Zealand Law Society)

If a book or a folder contains material that has no relevance to the investigation, but that book or folder cannot easily be taken apart, Inland Revenue must mark the pages of the book or folder it requires and the taxpayer must be allowed to organise the copying of those pages.

Comment

Again, officials consider that the submission's proposal places an unjustified restriction on the Commissioner's powers. The proposal could defeat the purpose of the amendment as it means that documents may be destroyed, removed or tampered with.

Recommendation

That the submission be declined.

REQUISITION OF INFORMATION HELD BY OFFSHORE ENTITIES

Clause 75

Issue: Disagreement with the proposal

Submission
(9W – Russell McVeagh, 12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand)

The proposed amendment would result in a New Zealand resident taxpayer being required to produce for Inland Revenue information held by non-resident entities related to the taxpayer, even if the taxpayer has no practical control over those entities, and in circumstances where the entities have no bearing on the taxpayer's New Zealand tax obligations. The proposed amendment goes far beyond what is justifiable. *(Russell McVeagh)*

The proposal will create a law with which New Zealand persons will, in some instances, simply be unable to comply. In that sense, it is bad law. *(Institute of Chartered Accountants of New Zealand)*

We are concerned about the increase in the power of Inland Revenue to require information held offshore to be provided, which raises complex issues of international jurisdiction. *(Business New Zealand)*

Comment

While section 17 enables the Commissioner to require a person to produce for inspection any records in the possession or under the control of that person, Inland Revenue investigators are sometimes hindered or delayed in obtaining access to information on offshore subsidiaries. For example, some companies respond to section 17 requisitions for the records of their offshore subsidiaries by saying that the information was the property of the subsidiary company, and it was the decision of the directors of the offshore subsidiary to release or withhold the information.

The amendment, which will allow the Commissioner to requisition from New Zealand residents records held by offshore entities that are controlled by the New Zealand residents, was recommended by the Committee of Experts on Tax Compliance. The Committee noted that the corporate veil can be used too readily to frustrate legitimate investigation of entities, which are, in substance, under the control of New Zealand taxpayers.[7]

Recommendation

That the submission be declined.

[7] *Tax Compliance*, report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance, December 1998 paragraph 9.17.

Issue: Amendment not required

Submission
(16 – PricewaterhouseCoopers)

The proposals to amend section 17 of the Tax Administration Act 1994 overlook the existence of section 21(1) of the same Act which currently addresses information requisitions in relation to offshore payments.

Comment

Section 21 of the Tax Administration Act is not an adequate substitute for the proposed amendment requiring records of offshore entities controlled by New Zealand residents to be produced for inspection in New Zealand. The difficulties in obtaining information from offshore entities have occurred despite the existence of section 21. Importantly, the operation of section 21 does not result in the production of such records, without which Inland Revenue's legitimate investigations may be frustrated.

Recommendation

That the submission be declined.

Issue: Limitation to power

Submission
(12 – Institute of Chartered Accountants of New Zealand, 21W – KPMG)

The power should not apply when the amount involved is immaterial, or when the request is not necessary or relevant. *(Institute of Chartered Accountants of New Zealand)*

A proviso to the introduction of such a power should be given when the amount involved is immaterial or when the request is not necessary or relevant. *(KPMG)*

Comment

In relation to an obligation being imposed on the Commissioner to prove that the tax involved is material before requisitioning information, officials are concerned that such a test may not be able to be satisfied without the requisitioned information itself. Also, even if the tax directly associated with specific information is not significant, the information itself may still be important – for example, in identifying flows of payments and chains of ownership. Therefore it is very difficult to determine what information is ultimately significant or not significant.

It is an existing requirement in section 17(1) that the Commissioner considers requisitioned documents to be necessary or relevant for any purpose relating to the administration or enforcement of any of the Inland Revenue Acts. It is therefore unnecessary to reproduce this requirement.

Recommendation

That the submissions be declined.

Issue: "Control" needs to be defined

Submission
(12 – Institute of Chartered Accountants of New Zealand, 16 – PricewaterhouseCoopers)

If the amendment proceeds, the term "control" needs to be defined. We submit this be defined to be the rules for determining group companies, that is, a minimum of 66 percent common ownership. *(Institute of Chartered Accountants of New Zealand)*

Extending Inland Revenue access to documents of non-residents controlled by New Zealand residents needs further attention. As drafted, the legislation does not define control. Control for the purposes of this section should not be the same as control interest in the controlled foreign company rules, which can be as low as a 40 percent interest. This is because, as a practical matter, a New Zealand resident with a 40 percent interest may be incapable of requiring the delivery of information to Inland Revenue. *(PricewaterhouseCoopers)*

Comment

In response to the concern that the controlled foreign company aggregation test would create an obligation on a New Zealand residents holding 40 percent of the controlled foreign company, officials note that this test is not used in the bill.

In response to the submission that the term "control" be defined, officials do not consider this to be necessary as case law has interpreted "control" to be greater than 50 percent of the shareholder decision-making rights.

Recommendation

That the submission be declined.

Issue: Overreach of the aggregation rule

Submission
(9 – Russell McVeagh)

There is an important "over-reach" problem which arises under the proposed section 17(1B)(a) of the Tax Administration Act which, for the purposes of proposed section 17(1A), deems any interests held by persons associated with the New Zealand resident to be held by the New Zealand resident. The associated person definition in section OD 7 of the Income Tax Act is so wide that it would include, in the case of a multinational group, every entity within that group. The proposed new section 17(1B) should be removed.

Comment

The Committee of Experts on Tax Compliance recommended that an aggregation rule be used to determine whether an offshore entity is under the control of a New Zealand resident. The voting interests in the offshore entities held by persons associated with the New Zealand resident should be aggregated with the voting interests held by the New Zealand resident, to prevent taxpayers circumventing the provision by fragmenting their interests among associated parties.

Officials acknowledge the amendment, as currently drafted, would extend beyond the intended reach of non-residents controlled by residents to the interests of non-residents that control New Zealand residents.

Officials consider that restricting the aggregation rule to interests held by New Zealand residents and controlled foreign companies would correct this situation.

Recommendation

That the submission be accepted in part and the aggregation rule be restricted to interests held by New Zealand residents and controlled foreign companies.

Issue: Ignoring foreign secrecy laws

Submission
(16 – PricewaterhouseCoopers, 21W – KPMG)

The proposal to ignore foreign secrecy laws should not proceed because it is inappropriate for the New Zealand government to require New Zealand residents to break the law of another jurisdiction. *(PricewaterhouseCoopers)*

A rule should not be introduced that effectively requires New Zealand residents to disregard laws that an entity which it controls is required to have regard to. Alternatively, the introduction of such a rule should not proceed in haste and some more thought be given to other legislative remedies. *(KPMG)*

Comment

The Committee of Experts on Tax Compliance noted that companies established subsidiaries in certain countries in the first place to take advantage of their secrecy laws and thereby frustrate legitimate investigations of tax authorities in their home countries.

Other countries, such as Australia and the United States already have provisions similar to that proposed in the bill for ignoring foreign secrecy laws.

The proposed amendment is consistent with the Organisation for Economic Co-operation and Development's project on harmful tax practices, in particular, in preventing domestic taxpayers hiding behind the secrecy laws of tax havens.

If information that is requisitioned is not provided, the taxpayer can be prosecuted for such failure. Taxpayers in this situation have the option of changing the location of the company to a jurisdiction which does not have secrecy laws that hinder the legitimate investigations of the tax authority in the parent company's country of residence.

Recommendation

That the submission be declined.

DOCUMENTS SENT TO A SPECIFIED INLAND REVENUE OFFICE

Clause 75

Issue: Right to recover reasonable delivery costs

Submission
(12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand, 21W – KPMG)

Taxpayers have the right to recover reasonable delivery costs from Inland Revenue. *(Institute of Chartered Accountants of New Zealand and KPMG)*

Business New Zealand is concerned about the increase in the power of Inland Revenue to require documents to be sent to a specified Inland Revenue office without any reimbursement. *(Business New Zealand)*

Comment

Compliance costs incurred by taxpayers are an inherent feature of the tax system. Although the government and the Commissioner endeavour to minimise compliance costs, the government does not generally reimburse taxpayers for these costs.

To reduce the compliance costs of this amendment, the department's administrative guidelines will provide that if a significant amount of documentation is required Inland Revenue will agree to a taxpayer's request to send the documents to the nearest Inland Revenue office, which will arrange the on-shipping of the documents to the Inland Revenue office conducting the investigation.

The amendment may also, in fact, reduce compliance costs as it may allow speeder resolution of disputes. Currently, delays may occur if taxpayers send records to an Inland Revenue office other than that conducting the investigation.

Recommendation

That the submissions be declined, but note that administrative guidelines will provide that if a significant amount of documentation is required Inland Revenue will agree to a taxpayer's request to send the documents to the nearest Inland Revenue office, which will arrange the on-shipping of the documents to the Inland Revenue office conducting the investigation.

Issue: Timeframe for response to section 17 requisition

Submission

(12 – Institute of Chartered Accountants of New Zealand, 21W – KPMG)

Taxpayers should have a statutory minimum time frame within which to respond.

Comment

The obligation to provide information to the Commissioner is not being amended – only the power for the Commissioner to specify the office to which the information is sent.

Officials consider that introducing a minimum timeframe would be too inflexible and would not take into account the particular circumstances of each case. The current approach of allowing the timeframe to be set by the investigator after discussion with the taxpayer works well in practice and should continue.

Recommendation

That the submission be declined.

Issue: Taxpayers should be provided a copy of documents photocopied

Submission
(10 – New Zealand Retailers Association)

In relation to documents that are removed from the taxpayer's premises, the Commentary on the Bill states that "*Administrative guidelines will require taxpayers to be provided with a copy of the specific documents photocopied, unless all the documents were photocopied.*" This measure should also apply in respect of on-premises copies made by the Inland Revenue Department, and that it should be a legislative requirement rather than merely administrative.

Comment

As taxpayers will bear the cost of photocopying on premises, it would be inappropriate to legislate for this requirement. The originals will remain with the taxpayer, and therefore a copy of documents photocopied may not be of any use to the taxpayer and could potentially be very costly. Instead, it would be possible to provide taxpayers with the opportunity to have a copy made, if they request one.

Recommendation

That the submission be declined.

Issue: Examples where existing powers were insufficient

Submission
(13 – Business New Zealand)

Inland Revenue should justify broadening its powers by providing the Committee with actual examples of where their existing information-gathering powers have not been sufficient.

Comment

There are numerous instances where the proposed amendments would have been of assistance. Specific examples of this include:

- A taxpayer who was under investigation allegedly had three suspicious fires and a lightening strike destroy the buildings where his business records were kept.

- A taxpayer, under investigation over a GST refund, claimed he was unable to supply his business records as his briefcase had been stolen. The taxpayer claimed to have reported the theft to the Police but the police had no record of the report. The investigator attempted to obtain copies of the records but these were allegedly stolen also. The purchaser claimed to have reported the theft to Police, although the Police had no record of this either.
- A taxpayer was required to send a particular invoice to Inland Revenue. The original was posted to the department and, when the invoice was examined, it was revealed that the taxpayer had stuck a piece of paper over parts of the invoice and altered it.
- A taxpayer was under investigation and the Inland Revenue Department officer responsible for the investigation had obtained a search warrant. The search warrant was in the name of this officer, as stipulated by section 16 of the Tax Administration Act 1994. The named investigator believed the taxpayer to be violent (based on interviews with informants) and a Police officer accompanied the investigator to the taxpayer's residence, for safety reasons. The Police officer did not take part in the search. The taxpayer sought to sue the Commissioner and the Police for $50,000, a cause of action in the statement of claim being that the warrant was invalid as it was exercised by persons who were not named officers of the department. Proceedings were withdrawn after a settlement was negotiated and an *ex gratia* payment was made.

Recommendation

That the submission be declined.

Issue: Misuse of powers

Submission
(12 – Institute of Chartered Accountants of New Zealand)

The submission expresses concern that the bill proposes wide ranging powers, which are actually needed for a very small number of instances, but could be misused by Inland Revenue in other situations. It is important that controls are placed on Inland Revenue's ability to use these extended powers if they are legislated. The submission suggests that Inland Revenue be required to report (as with the penalty regime) to Parliament annually its use of these powers and their existence, or otherwise, of complaints as to the use of the powers.

It is also noted that these changes are being made while further changes are being considered in the context of the discussion document on taxpayer privilege. It seems that Inland Revenue's information-gathering powers should be considered in the context of taxpayers' privilege and the current legislation should be deferred until that process is complete.

Comment

The majority of proposed amendments were recommended by the Committee of Experts on Tax Compliance. The proposed amendments both clarify the current powers of Inland Revenue and address deficiencies in those powers.

Our response to concerns over excessive use of the powers is that in exercising his duties, the Commissioner must have regard to the resources available.[8] For example, there would be no incentive to obtain non-relevant material because that would be an inefficient use of the Commissioner's resources. Therefore the Commissioner would commit only those resources which were necessary to effectively carry out a particular audit.

Officials agree that controls need to be in place around these powers. These powers are not unrestricted. Both the legislation and administrative guidelines will state procedures in relation to these. In the event that powers are used inappropriately, disciplinary procedures are in place and will apply. Also there is the overriding requirement under administrative law for all public powers to be exercised in good faith.

In response to the suggestion that Inland Revenue be required to report annually to Parliament on its use of its information-gathering powers, officials are of the view that this would impose significant and unnecessary costs for no real benefit. The Commissioner's powers are delegated on a wide level and there is no central registry which records each use of the department's information-gathering powers.

Officials do not agree that the current legislation should be deferred. Real deficiencies have been identified in the department's information-gathering powers. These can be readily dealt with aside from issues of privilege. Deferring these measures would cause an undesirable delay in correcting these deficiencies. These amendments result from an extensive consultation process, including recommendations from the Committee of Experts on Tax Compliance and a public discussion document.[9]

Recommendation

That the submission be declined.

[8] Tax Administration Act 1994, section 6A (3).
[9] *Taxpayer compliance, standards and penalties: a review,* August 2001, Chapter 6.

OTHER ISSUES

Issue: Removal of computers to copy information

Submission
(12 – Institute of Chartered Accountants of New Zealand)

It is agreed that, at a minimum, officials should carry out further work on whether the legislation should be amended to clearly provide for the removal of computers. However, we repeat our very strong objection to the proposal to remove computers – even more so than we disagree to removal of documents.

Comment

The government discussion document *Taxpayer compliance, standards and penalties: a review* included the proposal to amend section 3 of the Tax Administration Act 1994 to make it clear that the word "document" includes computers. This proposal is not included in the bill. There is no New Zealand case law on this point, and the meaning of the current law in this area would seem to be unclear. Officials agree with the submission and have been instructed by Ministers to carry out further research on this proposal.

Recommendation

That the submission to carry out further research on this proposal be accepted.

Issue: Removal of the words necessary or relevant

Submission
(12 – Institute of Chartered Accountants of New Zealand)

We agree with deferral of the proposal to remove the words "necessary or relevant", and again note our strong disagreement with the proposal.

Comment

This issue will be considered following the review of tax and privilege.

Recommendation

That the submission be noted.

MINOR DRAFTING ISSUES

Issue: New section 16(2)

Submission
(Matter raised by officials)

In the first line of proposed new section 16(2), a reference to "land" should be inserted before the word "building".

Comment

The proposed amendment is necessary to make the provision consistent with current section 16(1). The amendment will correct an unintended omission in the drafting of new section 16(2).

Recommendation

That the submission be accepted.

Issue: Section 16(4)

Submission
(Matter raised by officials)

In current section 16(4), "authorised officer named in the application" should be replaced by "an authorised officer".

Comment

As currently drafted, the bill provides that the section is amended to read "the authorised officer". Officials are concerned that there may be more than one authorised officer and therefore the amendment should refer to "an authorised officer" rather than "the authorised officer".

Recommendation

That the submission be accepted.

Issue: New section 17(1A)

Submission
(Matter raised by officials)

In the first line of proposed new section 17(1A), a reference to "information" should be added.

Comment

The proposed amendment is necessary to make new section 17(1A) consistent with the Commissioner's primary requisitioning power in section 17(1), which refers to "information" as well as to "books and documents". The amendment will correct an unintended omission in the drafting of new section 17(1A).

Recommendation

That the submission be accepted.

Issue: New section 17(1B)

Submission
(Matter raised by officials)

Proposed new section 17(1B), which treats the interests held by associated persons as being held by the New Zealand resident, should provide that whether a person is associated with the New Zealand resident is determined under sections OD 7 or OD 8(3) of the Income Tax Act.

Comment

As currently drafted, the provision relies only on the section OD 7 associated persons definition. This definition is inadequate in relation to trust relationships. This deficiency would be addressed by utilising the associated person definition in section OD 8(3) in addition to the section OD 7 definition. There are several precedents for this proposed approach, for example, sections EO 4A(6) and CG 11(8) of the Income Tax Act.

Recommendation

That the submission be accepted.

Other policy issues

Issue: Increase in the individual rebate threshold should be indexed

Clause 31

Submission
(12 – Institute of Chartered Accountants of New Zealand, 10 – New Zealand Retailers Association)

While supporting the increase in the maximum rebate that individuals can claim on their donations from $500 to $630, the Institute of Chartered Accountants recommends that the limit be indexed as a percentage of the individual's gross or net income, being the system in place in Canada and the United States. (*Institute of Chartered Accountants of New Zealand)*

The New Zealand Retailers Association also expresses concern that the monetary limit can get out of date. *(New Zealand Retailers Association)*

Comment

Under a threshold that is a percentage of income, the revenue cost to the government is determined by the donor's tax rate and income growth, so the government has less control over the aggregate amount of revenue it forgoes through the rebate. Furthermore, "support" may be biased towards the charitable purposes chosen by higher income earners.

The government has signalled that it intends to review the threshold more frequently than has been the case in the past decade, and that it would like to have more information about the fiscal implications of increasing the rebate further. Having a registration, reporting and monitoring system (as proposed by the Working Party on Registration Reporting and Monitoring of Charities, and agreed to by the government) will give the government a better understanding of the size and scope of the charitable sector. This will assist the government in deciding any changes to the quantum and type of threshold.

Recommendation

That the submissions be declined.

Issue: Simplification of the thresholds for deductibility of donations by companies

Clause 8

Submission
(12 – Institute of Chartered Accountants of New Zealand)

The proposed change to the limits on company donations should include a cross reference to "net income" under section BC 6.

Comment

The term "net income" is used in clause 8, the limit being set at 5 percent of net income. Section BC 6 indicates how "net income" and "net loss" are to be calculated for tax purposes.

Clause 8 does not need to refer to section BC 6 as "net income" is a defined term in the Income Tax Act 1994 and that definition already includes a cross-reference to section BC 6.

Recommendation

That the submission be declined.

Issue: Charitable purpose to be maintained

Clause 6

Submission
(8 – Inter Church Working Party on Taxation)

While supporting the proposal to ensure that a charitable purpose needs to be maintained for a society or institution to continue to be eligible for the tax exemption, the submission would not want this to be extended to apply to trusts. The submission's concern arises out of the comment on page 7 of the explanatory notes to the bill that "to qualify for the income tax exemption, an entity's charitable purposes have to be carried out in each year the exemption is claimed".

Comment

The submission's concern is that requiring trusts to be "maintained" for a charitable purpose may cause problems for trusts that do not apply their funds immediately for the charitable purpose for which they were established. The funds, for example, may be invested pending some major item of expense.

Section CB 4(1)(c) states that the income tax exemption applies to "any amount derived by trustees in trust for charitable purposes or derived by any society or institution established exclusively for charitable purposes...". As noted in the oral presentation by the writer of the submission, the *Latimer v CIR* case involving the Crown Forestry Rental Trust has thrown some doubt on whether the words "established exclusively for charitable purposes" apply also to trusts. Even though the Court of Appeal held that they did not, the case is to be heard by the Privy Council. If the words are held to apply to trusts, the proposed amendment in clause 6 would also apply as it adds "and maintained" after "established". The same issue also arises in section CB 4(1)(e).

It is the government's intention that charitable purposes need to be maintained by trusts as well as societies and institutions. While this is the intention behind the legislative amendment before the committee, arguably the wording of the current Act already achieves this in the case of trusts. This is because the tax exemption applies to income derived for charitable purposes – in other words, at the time the income is derived the trust must have charitable purposes. In that sense the words "and maintained" do not need to apply specifically to trusts. Those words do, however, need to apply to other societies and institutions. This is because the current legislation arguably confers a tax exemption on a society or institution "established for charitable purposes", whether or not it still maintains those purposes at the time the relevant income is earned. This situation has been clarified in the recently introduced Income Tax Bill, which contains the rewritten Parts A to E of the Income Tax Act and re-enacts the remainder of the Act.

We would also emphasise that it is not intended that a charity must distribute all of its income in each year. The government has announced the establishment of a charities commission to register and monitor charities. It is expected that if a charity is accumulating funds, the commission would have the power to enquire as to the purpose of that accumulation, but that a reasonable accumulation for (ultimately) charitable purposes would be acceptable.

Recommendation

That it be noted that:

- the uncertainties surrounding the words "established exclusively for charitable purposes" in sections CE 4(1)(c) and (e) are being addressed as part of the rewrite of the Income Tax Act;
- the government's intention is that charitable purposes need to be maintained by trusts as well as by societies and institutions;
- it is not intended that charities would have to distribute all of their income in each year.

Issue: Deductions for charitable donations by close companies

Clause 8

Submission
(6W – Anchor Wire Limited)

Small private companies should also be able to claim a tax deduction for their donations to charities.

Comment

The bill extends the range of companies that can claim a deduction for donations to charity, to include close companies listed on the stock exchange. Currently, all close companies are excluded from claiming such as deduction.

The submission argues that the change is too narrow as the relaxation would still require a company to have a sizable number of shareholders to gain stock exchange listing, thereby excluding most small private companies.

The reason the legislation precludes close companies in general from claiming the deduction is a concern that such companies might be used by their owners to extend their individual donations rebates. This is a real concern, given that the fiscal implications could be sizable as New Zealand is dominated by small businesses with few shareholders. This is less of an issue for companies that are widely held or are at least listed on a recognised exchange, given presumptions about greater scrutiny and transparency.

Recommendation

That the submission be declined.

REQUIREMENT TO DISCLOSE CHANGES IN IMPUTATION RATIOS

Submission
(Matter raised by officials)

The requirement to disclose changes to imputation ratios under section 69(2) of the Tax Administration Act 1994, if the ratios have increased or decreased more than 20 percent from the previous year, and to furnish an explanation for the change should be removed.

Comment

The submission was originally raised by PricewaterhouseCoopers in relation to the Taxation (Relief, Refunds and Miscellaneous Provisions) Bill. Officials considered that the amendment being requested was beyond the scope of that bill and recommended its consideration as part of the Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill.

Section 69(2) requires that a company disclose in its annual imputation account if the ratio of imputation and dividend withholding payment credits to total dividends paid, and the ratio of credits to debits in the imputation credit account have changed by more than 20 percent over the preceding year. It is also required to furnish an explanation for the change. The reason for requiring companies to disclose significant variation in these ratios is to identify cases where an arrangement may have been entered into to obtain a tax advantage. An example of when disclosure may reveal a practice that the Commissioner may wish to investigate further would be when a company decides not to attach any imputation credits (or a very small amount of imputation credits) in one imputation year, and then attach a substantial amount (say, at the maximum ratio of 33/67) in the subsequent year to enable shareholders to make more effective use of those credits.

PricewaterhouseCoopers commented that very few taxpayers comply with section 69(2) of the Tax Administration Act 1994 as most are unlikely to be aware of this requirement. As a result, while removing the disclosure requirement would not reduce compliance costs for taxpayers currently unaware of their obligations, it would nevertheless reduce the risks associated with not making a disclosure.

The information required to calculate the relevant ratios is already provided to Inland Revenue in the company income tax and imputation return. Consequently, officials consider that it would be possible for the Commissioner to calculate the ratios and to determine whether there has been a change of more than 20 percent between years. If the Commissioner determines that there has been a variation that warrants further investigation, the company can then be required to provide an explanation for the change. The amendment should apply from the 2002-03 income year

Recommendation

That the submission be accepted.

CONFIRMATION OF ANNUAL INCOME TAX RATES

Clause 3

Issue: Reduction in the company and personal income tax rates

Submission
(12 – Institute of Chartered Accountants of New Zealand, 13 – Business New Zealand)

The company tax rate and the personal tax rate should be reduced. A reduction in the company tax rate and the personal tax rate would contribute to economic growth and create a positive profile internationally.

Comment

The Income Tax Act 1994 provides for the rates of income tax specified in Schedule 1 of the Act to be confirmed each year. It has been a long standing practice of Parliament to confirm the tax rates annually. The bill confirms that the annual income tax rates for the 2002-03 income year will be the same as the rates that applied for the 2001-02 income year.

The rates being confirmed reflects the government's current policy as to the rates of income tax it wishes to levy on businesses and taxpayers. The increase in the top personal tax rate from 1 April 2000 was to generate additional revenue to meet the government's social policy commitments.

Recommendation

That the submissions be declined.

Issue: The margin between the top personal tax rate and the company tax rate should be reduced or eliminated.

Submission
(10 – New Zealand Retailers Association, 12 – Institute of Chartered Accountants of New Zealand)

The margin between the top personal tax and the company tax rate should be reduced or eliminated. Because a number of measures have been introduced to buttress the top personal tax rate of 39 percent, such as the multi-rate FBT rules and personal services attribution rule, these measures have added complexity to the legislation and have burdened taxpayers with additional compliance costs.

Comment

The Income Tax Act 1994 provides for the rates of income tax specified in Schedule 1 of the Act to be confirmed each year. It has been a long standing practice of Parliament to confirm the tax rates annually. The bill confirms that the annual income tax rates for the 2002-03 income year will be the same as the rates that applied for the 2001 -02 income year.

The rates being confirmed reflects the government's current policy as to the rates of income tax it wishes to levy on businesses and taxpayers. Its current policy in relation to personal income tax rates is to have a more progressive model than applied when the company rate was aligned with the top personal tax rate. The increase in the top personal tax rate from 1 April 2000 was to generate additional revenue to meet the government's social policy commitments.

Recommendation

That the submissions be declined.

Remedial amendments

DEPRECIATION RULES ON AMALGAMATION

(Clauses 9, 14, 15 and 144)

Issue: Whether the anti-avoidance rule should apply to companies that are not associated before amalgamation.

Submission
(16A – PricewaterhouseCoopers)

The proposed section FE 5(2) is flawed because it can apply when two previously non-associated companies amalgamate. This would mean that the associated persons rule applies all-pervasively and retrospectively. It would be wrong for companies that were not associated before amalgamation and that had no ability to influence tax outcomes before amalgamation to be prevented from achieving a step-up in the cost base. In terms of the scheme of the *Income Tax Act 1994*, the test for determining whether the subsection applies should be limited to those taxpayers who were associated parties before the amalgamation.

Comment

It is true that section FE 5(2), as drafted, could apply when two previously non-associated companies amalgamate, but we disagree that this is a flaw. On the contrary, it is necessary to achieve the policy intention of preventing an uplift in the cost base of depreciable property without a real change in the property's ownership.

The draft section FE 5(2) would apply the test of association by comparing the ownership of the continuing, amalgamated company as it exists immediately after amalgamation, with the ownership of the discontinued, amalgamated companies as if they continued to exist.

For example:

(i) Company A is wholly owned by Alice and has a net value of $100,000. It amalgamates with Company B, wholly owned by Bernard, with a net value of $50,000. The continuing company, Company A, is owned two-thirds by Alice and one-third by Bernard. The assets of Company B have been disposed of and acquired by Company A. (The assets of Company A have not been disposed of). In this case, the two companies are not treated as associated, because Bernard, the 100 percent owner of Company B, owns only 33 percent of the post-amalgamation Company A. Therefore the anti-avoidance rule does not apply to the transfer of assets from Company B to Company A. Any increase in the value of those assets can be taken into account in the depreciation cost base.

(ii) On the other hand, if Company B is the continuing company, then it is the assets of Company A which are disposed of. This time the test of association is deemed to be met. Alice, who owned 100 percent of Company A, now owns 67 percent of continuing Company B. That means that the anti-avoidance rule does apply to the transfer of assets from Company A to Company B.

The submission objects to this conclusion on the grounds that two companies which were, in fact, not associated are treated as if they were associated. A company which had no ability to influence tax outcomes before amalgamation is prevented from achieving a step-up in the cost base.

It is true that in example (ii), Company B had no ability to influence Company A before amalgamation. But the majority owners of Company B, as it continues after amalgamation, did have that ability, because they owned 100 percent of Company A. The assets formerly owned by Company A (and therefore owned by Alice) are still owned mostly by Alice, through her 67 percent shareholding in company B.

The formulation of section FE 5(2), as drafted, will ensure that where the ultimate ownership of assets changes more than 50 percent, the anti-avoidance rule will not apply. But where the original majority owners continue to own at least half of the assets transferred, then the anti-avoidance rule will apply to prevent an uplift in base cost.

If the submission were accepted, so that all previously unassociated companies were excluded, it would be easy for base cost to be uplifted without any change in ownership at all.

For example, Charles owns 100 percent of Company C, which is worth $10m. Company C owns a depreciable asset which was bought for $1m but which is now worth $2m. The company amalgamates with Company D, owned by Denise, which is worth $100,000. Company D is the continuing company, but Denise now has a 1 percent shareholding and Charles owns the remaining 99 percent. The companies were not associated before amalgamation. Company D has acquired an asset from a company over which it could have had no influence before the transfer. Nevertheless, it is right that this should be treated as a transfer between associated parties, because the underlying ownership of the asset has effectively not changed at all.

It has been suggested that existing anti-avoidance provisions could be used instead, in the case of companies unassociated before amalgamation. But the only relevant provisions are the general anti-avoidance rules at BG1 and GB1. It would be very difficult to apply these where there was a genuine commercial purpose associated with the amalgamation. The existence of a commercial purpose would not alter the fact that there has been no substantial change of ownership of the asset, and there should therefore be no uplift.

Recommendation

That the submission be declined.

Issue: How the rules apply to non-qualifying amalgamations

Submission
(13 – Business New Zealand)

The provisions would mean that assets transferred in a non-qualifying amalgamation would be valued at historic cost rather than market value. This is inconsistent with the approach that non-qualifying amalgamations are akin to arm's-length disposals.

Comment

The provisions would not apply to every non-qualifying amalgamation. They will apply only when the company transferring the asset and the continuing amalgamated company are "associated", that is, when at least 50 percent of their control is common. So where an asset is transferred in a non-qualifying amalgamation, and there is a significant change in its underlying ownership (that is, where at least half of the ownership changes) market value will continue to apply.

Anti-avoidance rules are needed to prevent the owners of assets which increase in value from increasing their depreciation deductions by making a disposal between companies which does not change the underlying ownership. Such disposals can include amalgamations. In a qualifying amalgamation, the transfer takes place at book value, so the avoidance would not work. But any amalgamation can be made non-qualifying through an election. These provisions will ensure that arm's-length treatment is not given to transactions which are not, in fact, at arm's length at all.

Recommendation

That the submission be declined.

Issue: Application to qualifying amalgamations

Submission
(16 – PricewaterhouseCoopers)

The proposed subsection FE 5(2) should not apply to qualifying amalgamations.

Comment

The rules for qualifying amalgamations already preclude the sort of avoidance which the provisions in the bill are intended to stop. It is therefore certainly intended that the proposed subsection FE5 (2) should not apply to qualifying amalgamations.

The current section FE 5, which will become subsection FE 5(1), already refers to "an amalgamation other than a qualifying amalgamation", and is therefore confined to non-qualifying amalgamations. The proposed subsection FE 5(2), as drafted, is similarly restricted. It refers back to FE 5(1) by speaking of "the" amalgamating company, where FE 5(1) speaks of "an" amalgamating company. To repeat the phrase "on an amalgamation other than a qualifying amalgamation" would make FE 5(2) unnecessarily long. However, to make absolutely certain the point can be covered in Inland Revenue's *Tax Information Bulletin* that details the new legislation once it is enacted.

Recommendation

That the submission be declined.

Issue: More initiatives on depreciation

Submission
(13 – Business New Zealand)

The Inland Revenue should be more proactive and better inform businesses of the opportunity to depreciate their equipment more rapidly when multiple shifts are being worked at their plant. They should also consider a less bureaucratic application process for rapid depreciation for firms operating over 35 hours per week.

Recommendation

These proposals are beyond the scope of the current bill, which deals only with depreciation on amalgamation.

INTEREST COMPONENT OF REIMBURSEMENT FOR FILM PRODUCTION EXPENDITURE

Clause 13

Submission
(12 – Institute of Chartered Accountants of New Zealand)

While supporting the change, the Institute of Chartered Accountants suggests that consideration should be given to the application date of this provision and asks whether some protection should be given for returns already filed and positions already taken.

Comment

Under section EO 4(1) of the Income Tax Act, when a person reimburses another party for film production expenditure, that person can deduct that reimbursement as if it were film production expenditure they had incurred themselves. Conceivably, the amount reimbursed could cover interest as well as other, more direct film production expenses.

An unintended consequence of clarifying last year the rules regarding the timing of interest deductions was that the reimbursement of interest expenses could no longer be deductible as film production expenditure. Clause 13 rectifies this problem.

Because the amendment clarifying the timing of interest deductions applied from the 1997-98 income year, we have also proposed that clause 13 apply from the 1997-98 income year. The submission suggests that this date should be reconsidered and some protection given to those that have already filed returns based on certain presumptions. This is unnecessary because rather than being restrictive, the new provision is permissive (referring to "may treat"), removing the anomaly and thereby clarifying what most taxpayers will have already been doing since 1997-98. Taxpayers that have not treated reimbursed interest expenses as film production expenditure will not be required to make any change as a result of the amendment.

Recommendation

That the submission be declined.

Submission
(Matter raised by officials)

We are proposing a minor drafting change to clause 13 to clarify that the policy intent is that the provision covers only the reimbursement of interest incurred in relation to producing the film. The change involves adding the words "in producing the film" after "other person" on line 17.

Recommendation

That the submission be accepted.

Issue: Limiting branch equivalent tax account credits when foreign tax credits are claimed

Clauses 42 and 43

Submission
(Submission – 16 PricewaterhouseCoopers)

The proposed amendments to limit branch equivalent tax account credits when losses are used and income tax is paid do not correctly limit the branch equivalent tax account credit when foreign tax credits are claimed. To achieve a correct result the provisions should be extended to include foreign tax credits and any amounts set off against a company's income tax liability for the income year.

Comment

Officials agree that the proposed amendment should be extended in the manner suggested by the submission.

Recommendation

That the submission be accepted.

Issue: Interaction between conduit tax relief rules and branch equivalent tax account rules for consolidated groups

Submission
(Submission – 9W Russell McVeagh)

Remedial amendments should be made to the rules for quantifying branch equivalent tax account debits and credits for a consolidated group that is entitled to conduit relief. The consolidated branch equivalent tax account rules should be clarified to ensure that branch equivalent tax account debits and credits are calculated before any conduit relief is given. This would bring the consolidated group provisions for branch equivalent tax accounts in line with the provisions for individual companies. The amendments should apply to the 1998-1999 and subsequent imputation years, which is the date the consolidated conduit provisions came into effect.

Comment

Officials agree that the current legislation is deficient in the manner set out in the submission.

Recommendation

That the submission be accepted.

Issue: Quantification of branch equivalent tax account relief

Submission
(Submission – 9W Russell McVeagh)

The current branch equivalent tax account rules prevent taxation of both the dividend and the attributed foreign income when a taxpayer either pays income tax or uses past losses to offset a tax liability on attributed foreign income. Double taxation, however, still arises when the tax liability on attributed foreign income is offset by current year tax deductions. As this is an anomaly, an amendment should be made to the branch equivalent tax account rules to remove this situation of double taxation.

Comment

Officials agree that a branch equivalent tax account credit is not created when the tax liability on attributed foreign income is offset by current year tax deductions, although that was the intention of the original branch equivalent tax account rules which allowed a branch equivalent tax account credit to be created only in proportion to the income tax paid. Subsequently, however, the branch equivalent tax account rules were expanded to also allow a branch equivalent tax account credit to be created when a past loss was used to offset a tax liability on attributed foreign income.

Officials agree that it appears anomalous that past losses used as offsets should be able to create a branch equivalent tax account credit, while current year losses cannot. However, officials would prefer that more work is done to ensure that the original policy intent is not subverted and recommend that this submission be considered as a remedial issue on a future tax policy work programme.

Recommendation

That the submission be declined but be considered for inclusion on a future tax policy work programme.

Issue: Limiting branch equivalent tax credits for Maori authorities

Clauses 42 and 43

Submission
(Matter raised by officials)

For companies taxed as Maori authorities, the proposed amendments to limit branch equivalent tax account credits when losses are used and income tax are paid should be based on the Maori authority tax rate rather than the company tax rate.

Comment

A previous officials' submission has recommended that when a Maori authority has offset New Zealand losses against attributed foreign income, the branch equivalent tax account credit created should be based on the Maori authority tax rate rather than the company tax rate, as the legislation currently allows.

Officials also recommend that, for Maori authority companies (who elected to be taxed under the Maori authority rules) the amendment which limits the branch equivalent tax account credit when income tax has been paid and New Zealand losses used should also be based on the Maori authority tax rate rather than the company tax rate, as currently set out in the amendment.

Recommendation

That the submission be accepted.

RATIONALISATION OF TERMINAL TAX PAYMENT DATE PROVISIONS

Clauses 20, 38, 54, 55, 65, 69, 90, 91, 92, 93, 99, 102, 122, 150, 151, 161 and 164

Submission
(12 – Institute of Chartered Accountants of New Zealand)

The payment date for taxpayers without an agent or without an extension of time for filing a return should be abandoned, and instead be aligned with the date for those with an agent and an extension of time. The reason for this is that very little tax is paid on the "standard" terminal tax date as compared with terminal tax with the two-month deferral.

Comment

Officials do not support the submission because it is outside the scope of the proposed amendments. The submission's proposal to align the terminal tax dates of taxpayers who have an agent and an extension of time with those who do not would involve deferring the payment of a significant amount of terminal tax and therefore have a fiscal cost, which was not the intention of the proposed amendments. The intention of the amendments was simply to rationalise the legislative provisions relating to terminal tax payment dates, mainly by reducing the three such provisions to a single provision.

Officials consider that the submission's proposal to align terminal tax dates (with some deferral of current terminal tax payments) should instead be considered as part of continuing tax system simplification.

Recommendation

That the submission be declined.

Submission
(Matter raised by officials)

A minor amendment should be made to improve the wording of proposed new section MC 1(2)(a).

Comment

The relevant wording of proposed new section MC 1(2)(a) refers to a person's return of income "giving rise to the terminal tax liability". This wording does not accurately reflect the law because a person's terminal tax liability properly arises under the Income Tax Act itself. The wording should be replaced with wording along the lines of "for the income year relating to the terminal tax liability".

Recommendation

That the submission be accepted.

REMEDIAL FRINGE BENEFIT TAX ISSUE

Issue: Incorrect section reference in the FBT rules

Submission
(Matter raised by officials)

Legislation enacted in the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 allowing employers to change the basis of calculating their fringe benefit tax (FBT) liability under the multi-rate FBT rules contains incorrect section references.

Officials recommend that:

- The incorrect section references in sections ND 1(4) and (5) of the Income Tax Act 1994 as introduced by section 59 of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 be corrected to refer to subsection (2) rather than subsection (1).
- The application date of this proposed amendment apply with effect from the date that the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 received its Royal assent, 17 October.

Recommendation

That the submission be accepted.

Issue: New date for payment of tax

Submission

(Matter raised by officials)

An amendment should be made to section 142A of the Tax Administration Act 1994 to re-enact the effect of former section 142A(1)(b) to require the Commissioner to set a new due date where the liability to pay tax is increased from that calculated by taxpayers in their returns.

Comment

Section 142A of the Tax Administration Act 1994 requires the Commissioner to set a new due date for payment of tax that is not a penalty. Section 142A(1) was recently amended by the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001, with the intention of making the section consistent with self-assessment.

Part of the 2001 amendment included repealing former section 142A(1)(b), which required the Commissioner to set a new due date where the liability to pay tax was increased from that calculated by taxpayers in their returns. This provision applied mainly to withholding taxes such as NRWT, where the Commissioner makes an assessment in limited cases only, such as following an audit.

The part of the 2001 amendment that repealed former section 142A(1)(b) of the Tax Administration Act went further than intended. Currently, section 142A applies only if an assessment is already in existence, whereas this may not be the case with withholding tax.

Officials therefore consider that it is necessary to re-enact the effect of former section 142A(1)(b) to ensure that section 142A can apply in withholding tax cases and require the Commissioner to set a new due date where the liability to pay tax is increased from that calculated by the taxpayer in their return. Because section 142A(1) applies only to situations where tax is increased, the current reference to "payment of the tax or increased tax" should also be replaced with "payment of the increased tax".

The proposed amendment does not result in a policy change and should apply from the 2002-2003 income year, which is the same application date as the main self-assessment amendments.

Recommendation

That the submission be accepted.

Issue: Definition of "assessment"

Submission

(Matter raised by officials)

The definition of "assessment" in the Income Tax Act 1994 should be relocated to the Tax Administration Act 1994. The Income Tax Act should also cross-refer to the new assessment definition in the Tax Administration Act.

Comment

The Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 enacted a definition of "assessment" in section OB 1 of the Income Tax Act 1994.

There are several problems with this definition of "assessment" that arise because of its location in the Income Tax Act instead of the Tax Administration Act. First, the opening reference to "tax" in the definition is meant to refer to all tax types and not just income tax. However, "tax" is defined in section OB 1 of the Income Tax Act 1994 as meaning only income tax, whereas "tax" is defined in the Tax Administration Act to mean all tax types. Secondly, the reference in the definition to "tax law" was meant to refer to the Tax Administration Act definition of that term, as that term is not defined in the Income Tax Act.

These problems would be resolved by repealing the definition of "assessment" in section OB 1 of the Income Tax Act and re-enacting it in section 3 of the Tax Administration Act (with any appropriate consequential drafting changes). A new Income Tax Act definition of "assessment" stating that the term has the same meaning as the Tax Administration Act definition should be enacted.

These amendments do not result in a policy change and should apply from the 2002-2003 income year, which is the same application date as the main self-assessment amendments.

Recommendation

That the submission be accepted.

Issue: Recovery of excess tax credits allowed

Submission

(Matter raised by officials)

Former section 165A of the Tax Administration Act 1994 should be re-enacted with the section heading of "Recovery of excess tax credits allowed". The re-enacted section should also be made subject to other specific excess credit recovery provisions.

Comment

The Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001 repealed section 165A of the Tax Administration Act 1994, which allowed the Commissioner to recover an excess tax credit previously allowed as if it were income tax payable under the Income Tax Act 1994. This amendment was consequential to the main self-assessment amendments.

Section 165A of the Tax Administration Act was repealed because the only explicit reference to that section in the tax credit provisions (section LC 3) had been repealed by an earlier amendment and, therefore, it was assumed that section 165A was redundant. However, this assumption was not correct. Although not explicitly referred to in other tax credit provisions in Part L, former section 165A allowed the recovery of certain excess tax credits previously allowed, such as resident withholding tax credits and imputation credits. These provisions previously contained their own excess tax credit recovery provisions which were repealed in 1996 when section 165A was originally enacted.

It is therefore desirable that section 165A be re-enacted to allow the recovery of excess tax credits. The section heading should be changed from the previous "Recovery of refund due to excess tax credits allowed" to "Recovery of excess tax credits allowed". This is because the provision allows the recovery of all excess tax credits and not just those which result in an actual refund being paid to a taxpayer.

The re-enacted section 165A should also be made subject to the specific excess credit recovery provisions in sections LC 3, LC 4(11) and LD 1(6).

The amendment should apply from the 2002-2003 income year, which is the same application date as the main self-assessment amendments.

Recommendation

That the submission be accepted.

Issue: Minor drafting changes

Submission
(Matters raised by officials)

In section ED 7(4) of the Income Tax Act 1994, "a amended assessment" should be replaced with "an amended assessment". In section LC 4(11)(e), "date of the assessment" should be replaced with "date of the notice of assessment".

Comment

The changes should be made to correct minor drafting errors in the self-assessment amendments enacted by the Taxation (Taxpayer Assessment and Miscellaneous Provisions) Act 2001. These minor corrections should apply from the 2002-2003 income year, which is the same application date as the main self-assessment amendments.

Recommendation

That the submission be accepted.

Miscellaneous amendments

REGULATORY IMPACT AND BUSINESS COMPLIANCE COST STATEMENT

Submission
(13 – Business New Zealand)

Officials should be asked to provide the best quantitative estimates on the financial and economic impacts of the changes contained in the bill, in the short and longer term.

Comment

Officials are already aware of the need to conduct a robust compliance cost analysis when developing tax policy proposals, and also adhere to the regulatory impact and business compliance cost statement requirements mandated by Cabinet. Consequently, tax policy proposals submitted to Cabinet which have compliance cost implications for business include a business compliance cost statement. Furthermore, resulting tax bills in which such proposals are introduced incorporate these statements. This procedure has been followed in relation to the legislative changes proposed in this bill.

In addition to meeting these existing requirements, tax policy officials are considering options for research into the tax-related compliance costs incurred by New Zealand businesses, with a view to establishing a robust benchmark for further analysis. The objective of the research would be to provide a continuing framework for monitoring the tax-related compliance costs of businesses, and to measure the impact on compliance costs of recent and proposed changes to the tax system.

Recommendation

That the submission be declined.

MISCELLANEOUS DRAFTING ISSUES

Issue: Commencement and application dates

Nature of proposed changes

The wording of clause 2 should be changed to reflect the existence of many application provisions relating to individual clauses. Those application provisions should be changed to improve the accuracy of the wording without changing its effect.

Clauses affected

2, 5 to 8, 10, 11, 15 to 36, 38, 39 to 43, 44 to 58, 59 to 70, 72 to 93, 94 to 97, 99, 105 to108, 111, 113, 119, 122, 123, 125 to 127, 128, 129, 131, 133 to 135, 137 to 142, 144, 146, 148 to 154, 156 to 159, 161 to 164.

Issue: Numbering

Nature of proposed changes

The numbering of inserted provisions needs to allow for the possibility of later insertions. A particular problem is the numbering of provisions that are inserted before an existing sequence. The practice of numbering inserted provisions has previously been inconsistent. It is proposed to standardise practice so that “B” (rather than “A”) is used in the number of the first provision inserted after an existing provision; “A” will be reserved for a provision inserted before the existing provision. Thus, “1B” will be inserted between “1” and “2”, while “1A” would be inserted before “1”. Similarly, “1BA” will be inserted between “1” and “1B”, and “1BB” will be inserted between “1B” and “1C”. Clauses 118 and 119 are examples of such insertions.

Clauses affected

5B, 9, 13, 15, 18, 24, 33, 34, 36, 37, 38B, 39 to 45, 58B, 60, 64 to 68, 72, 74 to 78, 80 to 82, 85, 88, 89, 93B to 97, 105, 107 to 111, 113 to 115, 117, 120, 121, 122B, 124, 125, 127 to 129, 131, 137, 160B, 164.

REMEDIAL TRUSTEE INCOME ISSUE

Issue: Incorrect section reference in trustee income rules

Submission

(Matter raised by officials)

Section HH 7 (b) of the Income Tax Act 1994 contains a reference to section 37 of the Tax Administration Act 1994. The reference should be to section 17 of the latter Act.

Officials recommend that:

- the incorrect reference to section 37 of the Tax Administration Act 1994 be corrected to refer to section 17 of that Act; and
- this proposed amendment come into force on 1 April 1995, and apply with respect to the tax on income derived in the 1995-96 and subsequent income years.

Recommendation

That the submission be accepted.

REMEDIAL APPLICATION OF TAX CODES

Issue: Incorrect reference in section NC 8(1)(da) of the Income Tax Act 1994.

Submission
(Matter raised by officials)

Section NC 8(1) provides the various tax codes for employees subject to the PAYE Rules. Sections NC 8 (1)(da) and (db) contain incorrect references to "Schedule 19, clause 6". The references should be to "Schedule 19(5A) and (5B), respectively, in each section.

Officials recommend that:

- The incorrect references to "Schedule 19, clause 6" in sections NC 8(1)(da) and (db) be corrected to refer to "Schedule 19, clauses (5A) and (5B)", respectively, in each section.
- These proposed amendments apply to tax deductions from source deduction payments for pay periods ending on or after 1 July 1998.

Recommendation

That the submission be accepted.

AMENDMENTS TO CORRECT DRAFTING ERRORS IN THE TAXATION (RELIEF, REFUNDS AND MISCELLANEOUS PROVISIONS) ACT 2002

Issue: Incorrect section cross references in section 59(1) of Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002.

Submission
(Matter raised by officials)

Section 59(1) of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 amends section ND 1(3) of the Income Tax Act 1994 to enable an employer who has previously elected to pay FBT on another basis to request the Commissioner to amend the earlier FBT liability.

The internal cross references in the new sections ND 1(4) to (6) incorrectly refer to subsections (1)(b)(ii), (1)(c)(ii) and (1)(c)(i). The correct references should be, respectively, to subsections (2)(b)(ii), (2)(c)(ii) and (2)(c)(i).

Officials recommend that:

- the incorrect cross references be corrected by amending sections ND 1(4) and (5) of the Income Tax Act 1994; and
- the proposed amendments come into force on 17 October 2002, that being the commencement date of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002.

Recommendation

That the submission be accepted.

Issue: An amendment to the definition of "taxable supply" in section OB 1 of the Income Tax Act 1994 was omitted from the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002.

Submission
(Matter raised by officials)

Section 23(2) of the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002 amends section ED 4(7)(a) of the Income Tax Act 1994 by replacing "services, and taxable supply" with "and services". To operate as intended, the amendment to section ED 4(7) also requires an amendment to the section OB 1 definition of "taxable supply". This amendment was omitted from the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002

Officials recommend that:

- the section OB 1 definition of “taxable supply” be amended by replacing “assigned by section ED 4(7) with “given to it by section 2 of the Goods and Services Tax Act 1985”; and
- this proposed amendment should apply to the 2002-03 and subsequent income years, that being the commencement date provided for the amendment to section ED 4(7) by the Taxation (Relief, Refunds and Miscellaneous Provisions) Act 2002.

Recommendation

That the submission be accepted.

Issue: Incorrect section references in sections 14(3) and 66(30) of the Taxation (Relief, Refunds and Miscellaneous provisions) Act 2002. These have the effect of rendering amendment to the definition of “consideration” potentially inoperative.

Submission
(Matter raised by officials)

Section 14 replaces section CJ 7 of the Income Tax Act 1994. Section 14(3) provides the basis on which the amendment commences and contains an incorrect reference to section 10(3). The reference should be to section 13(3).

Section 66(5) amends the associated definition of “consideration” in section OB 1. The amendment in section 66(5) is given application by sections 66(29) and (30). The reference in section 66(30) to “section 10(3)” should be to section 13(3).

As a result, section 14 and the amendment in section 66(5) have incorrect applications. In these circumstances, the appropriate method of correction of these errors is the amendment of sections 14(3) and 66(30).

Officials therefore recommend that:

- section 14(3) of the Taxation (Relief, Refunds and Miscellaneous provisions) Act 2002 be amended by replacing ‘section 10(3)” with “section 14(3).
- sections 66(30) of the Taxation (Relief, Refunds and Miscellaneous provisions) Act 2002 be repealed and re-enacted with the correct section reference in the replacement section 66(30).
- the proposed amendment and repeal and re-enactment should apply from 17 October 2002, that being the date of commencement of the Taxation (Relief, Refunds and Miscellaneous provisions) Act 2002.