
Rewriting the Income Tax Act
Exposure Draft

Part F

Income Tax **1994**
2004

Rewrite Project Team

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Rewriting the Income Tax Act: Exposure Draft – Part F
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Introduction

This exposure draft has been prepared by the project team responsible for rewriting New Zealand's income tax legislation. It contains draft legislation for the rewrite of Part F of the Income Tax Act 2004, which relates to special rules that modify the way other Parts of the Act operate for a variety of circumstances.

The key objective of rewriting the Act is to produce tax legislation that is clear, uses plain language and is structurally consistent. This should make it easier for taxpayers to identify and comply with their income tax obligations, and ultimately save them time and money.

We are rewriting the law as it currently stands. Changes to the law, other than minor ones in the interests of clarity or simplicity, will continue to be handled through the normal legislative programme. Cross references to sections outside Part F are to provisions within the Income Tax Act 2004. The presence or absence of provisions in the rewritten draft legislation does not necessarily indicate any future change in tax policy.

We invite submissions on any aspect of this work, including the points raised in this commentary. The closing date for submissions is 31 January 2006. Submissions should be made to:

The Rewrite Project
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON

Electronic submissions should be sent to: policy.webmaster@ird.govt.nz.

Please note submissions may be the subject of a request under the Official Information Act 1982. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with the Act. If you feel any part of your submission could be properly withheld under the Act (for example, for reasons of privacy), please indicate this clearly in your submission.

COMMENTARY ON REWRITTEN PART F OF THE INCOME TAX ACT 2004

Introduction

The current Part F contains a range of provisions, including:

- apportionment rules for cross-border transactions;
- modifications to the interest deductibility rules for certain types of debentures and, under thin capitalisation rules, some foreign-owned organisations and banks;
- rules for consolidated companies when calculating their income tax liability for a tax year;
- rules for determining how groups of companies use imputation credits; and
- modifications to the tax treatment of certain transfers of property and financial arrangements under a relationship agreement or upon death.

The rewritten Part F preserves the role of modifying the calculation of taxable income for a tax year for persons entering into certain arrangements or transactions from the outcome that would occur if Part F did not exist. However, as apportionment is one of the functions ascribed to Part F in the 2004 Act, a number of apportionment rules have been moved closer to their related provisions in Parts C, D, and E. Despite this move, the apportionment rules relating to interest deductibility in thin capitalisation situations have been retained in Part F.

This commentary outlines the main drafting changes made in rewriting Part F. These drafting changes relate mainly to structural relationships, are relatively minor, and are intended to improve the legislation. They fall into three main types:

- modernising the style and language;
- improving the clarity of the law; and
- removing redundant material and moving some provisions to other parts of the Act.

Some minor policy changes are being made for the rewrite of Part F, mainly to correct drafting errors or improve clarity. Provisions relating to consolidated companies have been moved into the rewritten Part F to make it easier to access this set of rules.

Benefits of the proposed structure

Although current readers may be familiar with the concepts contained in Part F, the rewriting of this Part must also take into account the needs of future readers.

Future readers will come to the legislation without knowledge of how the various rules in Part F interact with the core provisions and other Parts of the Act. In identifying these interrelationships, the draft legislation helps readers understand the relationship between provisions in other Parts of the Act and the transactions and situations dealt with in Part F.

The ordering of the subparts and provisions in the subparts reflects the drafting policy that more generally applicable provisions should appear earliest in each Part.

Cross-references in this exposure draft to Parts outside Part F relate to the 2004 Act, not to the recently released exposure drafts of other rewritten Parts. This is because further intensive specialist reviews of these exposure drafts are planned and may lead to changes to these draft provisions.

Specific feedback

Questions for specific consideration by readers of the exposure draft are set out in the commentary under the relevant draft sections. Comment on any of the drafting clarifications are also welcomed.

Minor policy changes and technical corrections

Commentary on technical corrections and clarifications in individual draft sections

Draft section FA 2: Recharacterisation of certain debentures

References to debentures issued before 23 October 1986 contained in section FC 1 of the 2004 Act have been relocated to draft section FZ 1.

References to debentures issued before 30 August 1940 contained in section FC 2 of the 2004 Act have been omitted as we have assumed that debentures issued earlier than this date are no longer in existence. However, if there are debentures from this period still on issue, this should be brought to our attention.

Draft section FA 3: Recharacterisation of certain dividends: recovery of cost of shares held on revenue account

In the 2004 Act, section FC 3 is intended to address the situation when a person enters into a dividend-stripping arrangement in relation to a purchase of shares on revenue account. This rule adjusts the sale price on disposal of those shares to take into account all dividends derived from pre-acquisition profits.

Draft section FA 3 has been rewritten more simply to quantify the amount of the dividend from pre-acquisition profits that is taken into account as income (sale proceeds) by reference to the cost of the shares. This approach has enabled the proviso to be omitted.

Draft section FA 5: Assets acquired and disposed of after deduction of payments under lease

In draft section FA 5(5), the time of association is clarified as being at the time of acquisition by the associated person, irrespective of whether there is an association at the time of sale.

Draft section FA 6: Recharacterisation of amounts derived under finance leases

The draft provision provides a clear link to the financial arrangement rules, the valuation provisions contained in those rules, and the depreciation provisions. This approach allows the drafting of the finance lease provisions to be significantly rationalised.

The relationship between lease payments under a finance lease and the non-resident withholding tax rules is to be addressed in the exposure draft of Part N.

Draft section FA 12: Recharacterisation of amounts derived under hire purchase agreements

The draft provision provides a clear link to the financial arrangement rules, the valuation provisions contained in those rules, and the depreciation provisions. This approach allows the drafting of the hire purchase provisions to be significantly rationalised.

Draft section FA 17: Treatment when agreement ends: when the buyer is a cash basis person

Draft section FA 17(3) clarifies the ambiguity in section FC 10(4) of the 2004 Act by making it clear that the expenditure incurred by the lessee from hire purchase payments refers to the interest component of those payments.

Draft section FB 13: Trading stock

In draft section FB 13, the period to which the provision relates has been changed from “tax year” (31 March) to “income year” (31 March or approved alternative balance date). This change is necessary to ensure the provision aligns correctly with the trading stock provisions in Part E, which are based on the income year rather than the tax year.

Draft section FB 16: Non-specified livestock: adjustments for enhanced production

Draft section FB 16 has been rationalised with section EC 31 of the 2004 Act. This has allowed significant portions of the text to be omitted in draft section FB 16.

Draft section FB 19, FB 20 and FB 21: Leased assets; Mining Assets; Depreciable property

The transfer values set out in these three draft sections have been rationalised with the depreciation provisions, where possible, by referring to the defined terms “adjusted tax value” and “base value”.

Draft section FB 21: Depreciable property

In draft section FB 21(6), the relationship between this provision and the depreciation provisions has been clarified to show that draft subsection (6) is only for the purpose of determining the correct depreciation rate.

Subpart FE: Interest apportionment on thin capitalisation

In this subpart, the drafting clarifies how the thin capitalisation provisions apply to natural persons and trustees.

Draft section FM 2: The consolidation rules

This definition has been relocated from section OB 1 to draft section FM 2. An index entry will be retained in section OB 1.

We invite comment on whether the retention of this definition in the Act is desirable.

Draft section FN 2: The imputation rules

This definition has been relocated from section OB 1 to draft section FN 2. An index entry will be retained in section OB 1.

We invite comment on whether the retention of this definition within the Act is desirable.

Draft section FN 9: Joining existing imputation group

Draft section FN 9(3) rewrites existing section FDA 4. However, this provision may be unnecessary, given this liability is a statutory imposition.

We invite comment on whether draft section FN 9(3) should be omitted.

Relationship of Part F to other Parts

The relationship between the provisions in Part F and those in other Parts of the Act are proposed to be signalled with new draft linkage provisions in Parts C, D, E, H, K, L, M, and N. While this exposure draft contains specific linkage provisions, consideration is being given to providing for a general linkage provision in Parts C, D, and E in particular which would list the relevant Part F provisions. An example of this approach is set out in the exposure draft of Part G issued mid-2005.

Comment is invited on the advantages and disadvantages of providing general linkage provisions in Parts C, D, and E that list the provisions in Part F that modify the operation of provisions in Parts C, D, and E.

Moving 2004 Act Part F provisions to other Parts

Section FB 2(1) has been moved to draft section OE 4B, as this rule attributes a source to a particular amount of income.

Section FB 2(1A) has been moved to draft subsections LC 1(5B) and (5C) to more appropriately locate the rule.

Section FB 3 has been moved to draft section CB 1B as this provision is an apportionment rule that is better aligned with the business income and trading stock rules.

Section FB 4A has been moved to section DB 21B as this provision is an apportionment rule related to the land sale rules.

Section FB 7 has been moved to draft section EE 42B as it is an apportionment rule that is better aligned with the depreciation rules.

Sections FC 13 to FC 16 and FC 18 to FC 21 (which relate to what is income or what is not a deduction) for non-resident insurers, shippers and film renters have been moved to Parts C, D, and O as draft sections CR 3, CV 3, CV 4, DW 3, OE 9 and OE 10. This move ensures that these income and deduction prohibitions and their attribution of a New Zealand source to that income are appropriately treated in the scheme of the 2004 Act.

Section FC 17 has been moved to draft sections HK 27 and HK 28 to reflect the policy of the agency relationship that arises on payment of certain insurance premiums to non-resident insurers.

Moving 2004 Act provisions from other Parts to Part F

Sections HB 1 and HB 2 have been moved to draft subpart FM for integration with the consolidated company rules.

Moving 2004 Act provisions from Part F to subpart FZ

Sections FC 6 to FC 8, which relate to the specified lease regime, have been relocated to draft sections FZ 2 to FZ 4.

Section FF 5, relating to commercial bills, has been moved to draft section FZ 6.

Section FF 18, relating to specified activities carried on before 11 October 1982, has been moved to draft section FZ 7.

Sections FI 9 and FI 10 of the 2004 Act have been moved to, and combined in, draft section FZ 7.