Taxation (Annual Rates, Savings Investment, and Miscellaneous Provisions) Bill

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

Volume 1

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Changes to the tax treatment of geothermal wells

OVERVIEW

Clauses 13, 23, 24, 33, 37, 38, 39, 40, 42, 126(8) and (19), 157, 159, and 162(3)

The changes in the bill address concerns that certain expenditure on failed geothermal wells is not recognised for tax purposes.

The purpose of the change is to recognise and allow a deduction for the costs of unsuccessful geothermal wells from the 2003-04 income year. Consequential changes include clawing back this deduction if the unsuccessful well is subsequently used or sold and allowing all geothermal wells to be depreciated from the date of completion or acquisition.

Economic theory suggests that the tax system should allow deductions for the decline in value of capital assets. When this occurs, the tax rules have no impact on an asset's market value. In the case of failed geothermal wells, the tax system currently does not recognise this expenditure, unless the asset had been previously been in use or available for use. This result may lead to an under-investment in geothermal wells relative to other assets.

Six submissions were received on the proposed changes. All submissions supported the proposed change, although a couple of submissions raised concerns with some of the detail.

GEOTHERMAL WELLS DRILLED OR ACQUIRED BETWEEN 1 APRIL 2003 AND 16 MAY 2006

Issue: All the proposed rules for geothermal wells should apply retrospectively

Submission
(578 – New Zealand Institute of Chartered Accountants, 678 – Mighty River Power)

The prospective rules for geothermal wells should all apply retrospectively so that wells drilled or acquired between 1 April 2003 and 16 May 2006 are depreciable from the date of completion or acquisition.

Comment

The retrospective application date was to provide comfort on the legality of deductions claimed for expenditure incurred on unsuccessful geothermal wells when there was some ambiguity about whether the law allowed such deductions.

However, we can see merit in allowing wells drilled or acquired between 1 April 2003 and 16 May 2006 to be depreciable without having to satisfy the normal in-use or available-for-use requirement. Firstly, from a compliance perspective, it would be simpler to have consistent treatment for geothermal wells. Secondly, it is relatively simple for businesses to enter into arrangements that result in these wells being subject to the new rules.

Rather than going through the compliance and administrative costs of re-open prior year returns, however, we recommend that taxpayers be allowed to depreciate geothermal wells completed, or acquired, between 1 April 2003 and 16 May 2006 but not yet in service from the beginning of the 2006 income year.

Recommendation

That the submission be accepted and that taxpayers be allowed to depreciate geothermal wells drilled or acquired between 1 April 2003 and 16 May 2006 that are not yet in service from the beginning of the 2006 income year.

Issue: The changes do not apply to revenue account expenditure

Submission

(597 – PricewaterhouseCoopers, 601 – The Petroleum Exploration and Production Association of New Zealand)

The changes should be amended so that they clearly apply only to expenditure that is not deductible because of the capital limitation.

Comment

Our view is that there is no problem because of the way that the Income Tax Act 2004 is structured and because of the way section EE 7(j) operates.

The concern appears to be that any expenditure on geothermal wells will be treated as though it is capital expenditure if amendments are not made to the relevant clauses in the bill. We consider that such changes are unnecessary.

Whether expenditure is an item of capital or revenue is determined by the facts. For one taxpayer the facts might point toward the expense being capital. For another they may point to the expenditure being revenue. Where expenditure on geothermal wells is under ordinary concepts a revenue expense, the taxpayer is entitled to a deduction under section DA 1, unless a limitation applies, and unless Part E modifies the allocation of deductions. If the expenditure relates to an item that is of a capital nature, then the general limitation on expenditure that is of a capital nature applies. In this circumstance, taxpayers must look to sub-part EE to quantify an amount of depreciation loss that they can claim as a deduction.

The proposal is to insert the substantive provisions in Section EE of the Act. This suggests that the expenditure must apply to an item that is of a capital nature. Moreover, section EE 7 defines what is not depreciable property. Sub clause (j) basically says that an item is not depreciable property where the cost of the property is allowed as a deduction under another provision of the Act. So if the cost of a geothermal well is on revenue account, a deduction will be allowed under section DA 1, and no deduction will be allowed under sub part EE.

That said, should Parliament pass the proposed changes to the tax treatment of geothermal wells unamended, Inland Revenue's *Tax Information Bulletin* would make it clear that the changes in no way affect whether expenditure on a geothermal well is capital or revenue. Such a decision should remain based on the relevant facts.

Recommendation

That the submission be declined.

“BLACK HOLE” EXPENDITURE

Submission
(589 – KPMG, 597 – PricewaterhouseCoopers)

The change is a model worthy of wider application to address issues of the non-recognition of expenditure for income tax purposes.

Comment

The problem of not recognising expenditure for income tax is often called “black hole” expenditure. Officials will be working through submissions and providing advice to the government on black hole expenditure as part of the Business Tax Review.

We would have concerns about a broader application of this model to deal with other forms of black hole expenditure. This model was designed for a particular set of circumstances and in consultation with large geothermal users. In other circumstances, the model may confer significant timing advantages and associated costs that are not justified by the facts. For example, the model is quite concessionary in it allows deductions to be taken from the date of completion, rather than when the asset is in use or is available for use. It also allows expenditure to be written off and then be subsequently brought back into service.

Recommendation

That the submission be noted and that work on addressing black hole expenditure is being considered as part of the Business Tax Review.

DRY AND DEPLETED OIL AND GAS WELLS

Submission
(601 – Petroleum Exploration and Production Association of New Zealand)

The tax rules should be amended to allow a deduction for the costs of dry oil and gas production wells and a write-off for the remaining tax value of depleted oil and gas wells.

Comment

This submission is outside the scope of the bill. However, policy officials plan to release a technical issues paper later in the year that considers these issues.

Recommendation

That the submission be declined.

REMEDIAL AMENDMENTS

Submission
(Matters raised by officials)

Clause 157 of the bill introduces new section DZ 7 (which relates to Geothermal wells between 31 March 2003 and 16 May 2006) to the Income Tax Act 1994. Clause 159 of the bill introduces new section DZ 15 (which also relates to Geothermal wells between 31 March 2003 and 17 May 2006) to the Income Tax Act 1994. In both clauses, taxpayers are incorrectly referred to as "persons".

Clause 23 of the bill introduces new section DZ 15 (which relates to Geothermal wells between 31 march 2003 and 17 May 2006) to the Income Tax Act 2004. The defined term geothermal energy proving period is incorrectly referred to as 'geothermal proving period.

In addition, Ministers have agreed to extend the scope of the application of the depreciation rules relating to geothermal wells contained in clause 24.

Comment

Amendments are necessary to correct these matters.

Recommendation

That the committee accept the proposed amendments.

Australian superannuation fund exemption

OVERVIEW

Clause 52

Seven submissions were received on the new exemption. Most of them strongly supported the exemption relief and considered that it should help to resolve tax compliance problems arising under New Zealand's foreign investment fund (FIF) rules for certain taxpayers and remove barriers to attracting skilled migrants from Australia. However, they also considered that the exemption should be extended to other foreign superannuation schemes (and not limited to certain schemes constituted in Australia) and that it should be retrospective in its application.

EXTEND EXEMPTION RELIEF TO ALL FOREIGN SUPERANNUATION SCHEMES

Submission
(556 – AMP, 578 – New Zealand Institute of Chartered Accountants, 589 – KPMG, 597 – PricewaterhouseCoopers)

The exemption should be extended to all foreign superannuation schemes that are subject to similar rules of preservation and restrictions on early release of benefits that apply to Australian superannuation schemes.

This submission is supported because:

- It will improve neutrality and be fair to all who have preserved foreign superannuation interests. *(AMP)*
- It is inappropriate to discriminate against migrants who hold retirement savings in superannuation schemes not located in Australia. *(New Zealand Institute of Chartered Accountants)*
- It will simplify the tax rules. *(KPMG)*
- It will remove the disincentive to migrate to New Zealand for all migrants with foreign superannuation interests. To allow for minor variations in different countries, preservation criteria could be drafted in terms of key principles and those foreign schemes that meet the criteria would qualify for the exemption. *(PricewaterhouseCoopers)*

Comment

The New Zealand tax treatment of Australian superannuation interests was raised as a significant concern by both countries at the first New Zealand/Australia Business Leadership Forum in 2004 and again at the Forum in 2005. In particular, it was considered that the tax treatment of such interests is often regarded as a significant barrier to trans-Tasman labour migration, especially at the senior executive level. The New Zealand Forum representatives requested that the government resolve this specific matter.

The exemption is a specific response aimed solely at removing the potential tax disincentive for certain people with interests in particular Australian superannuation schemes to take up long-term or permanent employment in New Zealand.

While the same rules should apply to interests in foreign superannuation schemes in all countries to reduce distortions, the exemption is aimed solely at addressing the concern above. Officials do not consider that further work is warranted at present to consider extending the new exemption to other countries unless it can first be established that it is creating a significant tax barrier to persons from other countries taking-up long-term or permanent employment in New Zealand.

Recommendation

That the submission be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants, 597 – PricewaterhouseCoopers)

If the preceding submission is not accepted, the FIF exemptions in sections EX 36 and EX 37 of the Income Tax Act 2004 should be amended to clarify that they apply to both preserved and non-preserved entitlements in a single superannuation scheme.

Should achieving consistency between the existing exemptions and the new exemption from the FIF rules not be possible in this respect, sections EX 36(8) and EX 37(3) should be amended to specifically contemplate apportionment of the interests for the purposes of the FIF rules where those sections are only partially satisfied because of preserved and non-preserved interests in a foreign superannuation scheme existing concurrently.

Comment

This submission seeks to align the treatment of non-preserved entitlements under the existing exemptions (in sections EX 36 and EX 37) with the treatment of such entitlements under the new exemption.

The proposed exemption recognises that a person's interest in an Australian superannuation scheme could contain both preserved and non-preserved entitlements. This is largely a result of the gradual tightening of the rules relating to accessing Australian superannuation benefits and the "grand-parenting" of any interests that a person has at the time of each change. As noted in the Commentary to the bill, excluding unpreserved interests from the exemption relief would have led to both compliance costs for taxpayers and administrative costs for Inland Revenue, thereby negating any benefit to be gained from the proposed exemption.

Extending this same treatment in the new exemption to the existing exemptions in sections EX 36 and EX 37 is not supported. As noted in the comment in the preceding submission, the proposal to exempt Australian superannuation interests from the FIF rules was to deal with a specific concern. In addition, it also will minimise the compliance costs associated with the FIF rules for returning New Zealanders who have worked in Australia and as a result have interests in Australian superannuation schemes that may have unrestricted portions. Officials do not consider that the policy rationale for the new exemption warrants the changes sought in the submission to provide a different tax treatment based on whether access to the interest is restricted or not.

Officials also consider that the alternative submission to amend sections EX 36(8) and EX 37(3) should not be supported. One submission noted that an unpreserved amount in a foreign superannuation scheme may taint the preserved amount and cause the entire entitlement to fail the relevant exemption. Officials are aware that there is an alternative interpretation that section EX 36 already contemplates apportionment between preserved and non-preserved entitlements. It is the view of officials that the alternative submission should be clarified in the *Tax Information Bulletin* dealing with the new legislation.

Recommendation

That the submission be declined.

RETROSPECTIVE APPLICATION OF THE PROPOSED EXEMPTION

Submission
(556 – AMP, 568 – Corporate Taxpayers Group, 589 – KPMG)

The new exemption should apply retrospectively.

If the exemption is not retrospective there would be too many situations where individuals, especially those who had arrived in New Zealand in the last few years, would be inequitably affected depending on when they arrived. *(AMP)*

The exemption should apply retrospectively from the 2000 income year. This suggestion is based on the view that some taxpayers simply do not understand these rules, the numbers of taxpayers involved are extremely small, the fiscal implications are not significant and the compliance costs would otherwise be considerable. *(Corporate Taxpayer Group)*

The proposed application date of 1 April 2006 would mean that those people who are not complying now would continue not to comply. The on-going concern is how this non-compliance is to be approached and how the FIF rules are to be enforced in the future for those superannuation schemes remaining subject to tax. The exemption should apply equally to those interests in superannuation funds that exist as at 1 April 2006. To the extent that taxpayers have accounted for their interest as a FIF in prior income years, they would now be placed on an equal footing with taxpayers with interests in Australian superannuation funds acquired from 1 April 2006. This will also reduce the level of non-compliance in this area. *(KPMG)*

Comment

It is the view of officials that the suggested change should be accepted as that will simplify the application of the new exemption and improve the overall equity of the FIF rules as they apply to those individuals who acquire their Australian superannuation interests from 1 April 2006 and those that had acquired similar interests before that date.

Although the suggested change is likely to give rise to a fiscal cost, it is expected to be small because some existing FIF exemptions relating to superannuation scheme interests have been interpreted by taxpayers as applying to them, while others have already left New Zealand.

Officials also note that there are likely to be administrative costs associated with reassessments for those taxpayers who have previously been subject to the FIF rules. However, the number of reassessments should be low owing to the current level of non-compliance with the FIF rules and the application of the existing exemptions.

Recommendation

That the submission be accepted.

ROLL-OVER RELIEF FOR TRANSFERS BETWEEN PRESERVED SCHEMES

Submission
(578 – New Zealand Institute of Chartered Accountants, 597 – PricewaterhouseCoopers)

The FIF rules should contain provisions for rollover relief (being the continuation of an exemption from the FIF rules for the foreign superannuation scheme interest) for transfers between schemes that are subject to strict preservation rules and restrictions on early release of benefits.

Comment

In the absence of a roll-over provision, a transfer between schemes may be deemed a withdrawal, which could result in the new contribution falling outside the exemption provisions.

We agree with the general thrust of this submission but believe that any roll-over relief should be adopted only in relation to the proposed exemption. In other words, the roll-over relief should be limited to transfers between Australian superannuation schemes that are subject to strict preservation and restrictions on the early release of those benefits.

Recommendation

That roll-over relief be provided for transfers between those Australian superannuation schemes specified in the new exemption.

TAX TREATMENT OF WITHDRAWALS

Submission
(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG, 597 – PricewaterhouseCoopers, 1409W – Rex Ward)

The current rules relating to withdrawals of superannuation benefits where those benefits have been subject to an exemption from the FIF rules should be clarified.

The rules relating to lump sum withdrawals where the taxpayer's foreign superannuation interest is exempt under the FIF rules is unclear. Technically, any distribution from these superannuation schemes could be taxed under either the dividend or trust rules. Amounts taxed under the dividend rules could potentially include distributions of capital amounts relating to a person's contributions. These uncertainties should be clarified, particularly when the government's intention is to provide migrants with certainty of their tax obligations. *(New Zealand Institute of Chartered Accountants)*

There is a present risk that the exemption will disadvantage people with superannuation entitlements. If a person retires in New Zealand, the proposed exemption may actually mean the investor will pay more tax on withdrawal than would have been payable under the FIF rules. Accordingly, the integration of the rules should be considered, to ensure that exemption from the FIF rules is not counteracted by taxation on withdrawal under the trust rules. *(KPMG)*

A provision should be inserted to clarify the tax treatment for lump sum withdrawals from foreign superannuation schemes, regardless of whether the interest is exempt from or subject to the FIF rules. *(PricewaterhouseCoopers)*

Withdrawals from eligible Australian superannuation schemes should also be tax-free in New Zealand as this would be consistent with the proposed Australian tax treatment of withdrawals from those schemes. *(Rex Ward)*

Comment

We agree with the views expressed in the submissions. Officials acknowledge that the current FIF rules do not adequately deal with the tax implications that arise on an individual's withdrawal (especially lump sum withdrawals) of an interest from a foreign superannuation scheme where that interest meets an existing exemption from the FIF rules or the new exemption.

Officials recommend that further work be undertaken on the tax implications of withdrawals from foreign superannuation schemes that have previously been subject to the FIF rules. This further work should be included in the government's tax policy work programme.

Recommendation

That the submission be noted and that the matter be included in the government's tax policy work programme.

TECHNICAL AMENDMENT

Submission
(594 – New Zealand Law Society)

The definition of "retirement savings accounts" should refer to the Retirement Savings Accounts Act 1997 (Aus).

Comment

Officials agree. The correct reference to the Retirement Savings Accounts Act 1997 should be cited.

Recommendation

That the submission be accepted.

“Salary sacrifice”: ensuring that employer superannuation contributions are taxed fairly

OVERVIEW

The amendments in the bill will ensure that specified superannuation contribution withholding tax (SSCWT) rates under the progressive scale will be based on the total of an employee's salary or wages and employer superannuation contributions. The possibility of overtaxing some employees on superannuation contributions will be minimised by increasing the SSCWT thresholds in relation to the equivalent income tax thresholds.

This will minimise the opportunity for taxpayers to significantly decrease their tax liabilities through the practice of excessive salary sacrifice.

The bill also removes some methods of assessing tax on employer superannuation contributions that are not being used.

The amendments will apply from 1 April 2007.

Six submissions were received. Some supported the amendments and some opposed them. Most noted concerns with the paucity of evidence for the practice of salary sacrifice, and suggested that the amendments were contrary to the overall policy goal of increasing savings. Some submissions suggested technical amendments and amendments that would avoid potential problems.

LACK OF EVIDENCE FOR EXCESSIVE SALARY SACRIFICE

Submission
(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG, 615 – Business New Zealand)

There is not enough evidence of excessive salary sacrifice to justify changing the law. SSCWT rates should continue to be based on employees' marginal tax rates.

Comment

It is difficult to estimate the extent of salary sacrifice, but there is anecdotal evidence of some individuals making salary sacrifice arrangements. There is also some evidence of systematic approaches to developing and implementing salary sacrifice schemes. If salary sacrifice schemes become more common, the loss to government revenue could be significant. The proposed rules limit the possibility of extreme salary sacrifice becoming a significant threat to government revenue.

The existing SSCWT rates are based on employee's marginal tax rates, which has created the possibility of excessive salary sacrifice in the first place. When these rules were introduced it was noted that this risk existed.

Recommendation

That the submission be declined.

WIDER ISSUE OF INCENTIVES FOR SAVING

Submission
(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG)

The proposed new rules will be a relatively efficient way of countering extreme salary sacrifice, but the issue is part of the wider issue of savings in general. The policy behind the proposed amendment is a disincentive to genuine superannuation savings.

Comment

The wider issue of savings in general has been considered through the portfolio investment entity proposals and the new KiwiSaver legislation. People making genuine superannuation savings will be subject to SSCWT rates no higher than, and in some cases lower than, their existing marginal tax rates, so there is no disincentive to save. Positive incentives to save via the KiwiSaver scheme, such as the initial government contribution, the fee subsidy and the exemption from SSCWT for employer contributions to KiwiSaver accounts, were added to the KiwiSaver Bill in its final stages in Parliament.

Recommendation

That the submission be declined.

ALTERNATIVE METHODS OF MINIMISING SALARY SACRIFICE

Submission
(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG, 1176 – Baucher Consulting Limited)

Alternative methods of minimising extreme salary sacrifice could be investigated, including a monetary cap of, say, $30,000 on the amount that could be sacrificed; reviewing superannuation policy to strengthen the lock-in of savings; increasing fund withdrawal tax; strengthening the fund withdrawal rules; and using a flat rate of 21%.

Comment

Officials investigated other options for minimising excessive salary sacrifice, including monetary caps, caps based on a percentage of salary, subjecting all employer superannuation contributions to PAYE instead of SSCWT, allowing adjustments to the extent that employer superannuation contributions shift an employee over a threshold, using progressive bands for SSCWT, and allowing lower rates to be used for a certain proportion of employer superannuation contributions. A flat rate could result in some employees being overtaxed and, if the rate is set at a low level, would still allow excessive salary sacrifice for some higher paid employees. Officials concluded that, on balance, the better approach was that proposed in the new rule, which is less complex for employers than the other possible approaches and does not result in overtaxation.

Recommendation

That the submission be declined.

6% DIFFERENTIAL SHOULD BE EXTENDED TO ALL INCOME BRACKETS

Submission
(578 – New Zealand Institute of Chartered Accountants)

There is a 6% differential between the top rate of SSCWT (33%) and the top rate of income tax (39%). This differential exists only for the top rate of income tax, but it should be extended to all marginal tax rate classes. Alternatively, the 6% differential should be removed. If the differential is not removed, Inland Revenue should explicitly acknowledge that the differential can be used as a method of tax planning, to allow certainty.

Comment

Extending the 6% concession would have a high fiscal cost of $100 million per annum, although a substantial proportion of that cost (about $60 million) would arise from contributions to the state sector retirement scheme. The net fiscal cost would be about $40 million.

It is not clear that the 6% differential is inequitable. Those benefiting from the existing 6% concession only do so because they are paying tax at a higher rate in the first place. Many taxpayers on lower rates already obtain significant relief from their effective marginal tax rates in respect of employer superannuation contributions because these contributions are not taken into account in determining entitlements to family assistance and accommodation supplements.

There is no barrier to using the differential between the top rate of SSCWT and the top rate of income tax for tax planning.

Recommendation

That the submission be declined.

INCREASE THE THRESHOLD UPLIFT

Submission

(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG)

The difference between the SSCWT thresholds and the equivalent personal income tax thresholds should be higher, not 15%, because some schemes have employer contribution rates greater than 15 percent of salary and wages (although the only examples found were schemes for high-income earners), and to encourage superannuation savings.

Comment

Available data suggest that 90% of employer superannuation contributions are equal to or less than 15 percent of salary and wages. High-income earners would fall into the 33% SSCWT bracket anyway, although some larger schemes which officials do not consider involve excessive salary sacrifice have higher employer contribution rates. For example, the New Zealand Defence Force scheme, which is compulsory for enlisted personnel, has an employer contribution rate of 17.9 percent, and the New Zealand Police Force scheme has an employer contribution rate of 15.2 percent for sworn personnel. Many members of these schemes fall into lower income brackets. The SSCWT thresholds could be set, say, 20 percent higher than the equivalent income tax thresholds, which should be sufficient to ensure that lower income earners are not overtaxed on employer superannuation contributions.

Setting SSCWT thresholds 20 percent higher than the equivalent income tax thresholds generates the following thresholds.

Proposed salary and wages and employer superannuation contribution thresholds	Revised proposed salary and wages and employer superannuation contribution thresholds	SSCWT rate
0 – $10,925	0 – $11,400	15%
$10,926 – $43,700	$11,401 – $45,600	21%
$43,701 upwards	$45,601 upwards	33%

Recommendation

That the submission be accepted in part by setting the SSCWT rate thresholds at $11400 and $45,600.

REMOVING METHODS OF ASSESSING SSCWT THAT ARE NOT BEING USED

Submission
(578 – New Zealand Institute of Chartered Accountants, 589 – KPMG, 1176 – Baucher Consulting Limited)

Of the three submissions, one supported removing the methods of assessing SSCWT that are not being used. However, the other two argued that methods of assessing SSCWT that are not being used should be retained because they provide flexibility, and because the PAYE method is used by some overseas employers. Further, the PAYE method allows complete alignment of SSCWT and personal income tax rates.

Comment

If the methods are not being used, then they are not needed and so should be removed. Although having different options allows flexibility, it also increases the complexity of the system, especially if those options do not add any value by not being utilised. However, if the PAYE method is being used, as the New Zealand Institute of Chartered Accountants suggests, it should be retained.

Recommendation

That the submission be accepted in part by retaining the PAYE method of assessing tax on employer superannuation contributions.

SUPERANNUATION CONTRIBUTION CONTRIBUTIONS FOR NON-RESIDENTS

Submission
(578 – New Zealand Institute of Chartered Accountants)

SSCWT should not be levied on superannuation fund contributions made by New Zealand employers with staff working and resident outside New Zealand.

Comment

This issue has been noted previously and is on the tax policy work programme.

Recommendation

That the submission be noted.

IRD RESPONSIBILITY FOR ASSESSING AND DEDUCTING SSCWT

Submission
(567– Mercer Human Resource Consulting)

The assessment and deduction of SSCWT should be the responsibility of the IRD, in order to minimise the complexity of the new rules for employers.

Comment

Cabinet has directed officials to report on this suggestion, in the cases where both employer and employee contributions to KiwiSaver are being paid via Inland Revenue. Officials are still to report to Ministers on the matter. In addition, Inland Revenue does not have the capacity in the short term to implement such a proposal.

Complexity will be minimised for employers who choose to make matched employer contributions to KiwiSaver schemes, because they will be eligible for the KiwiSaver SSCWT exemption.

Recommendation

Note that officials will be reporting to Ministers on this proposal in the near future.

POSSIBLE OVER TAXATION OF SOME EMPLOYEES

Submission
(567 – Mercer Human Resource Consulting)

The proposed changes to the SSCWT rules could result in lower income employees being overtaxed if employers opt to use the easier 33% flat rate rather than the more progressive scale. The existing rules could be maintained if certain conditions are met, with the new rules applying otherwise, to prevent abuse. Suggested conditions are: total remuneration not exceeding $100,000 and/or annual employer contributions not exceeding 15 percent of an employee's taxable income, or annual employer contributions not exceeding, say, $50,000.

Comment

A two-tier system is more complex than the proposed new rules. Officials investigated various other options and concluded that the simplest approach was that proposed in the new rules. Forcing employers to use the more complex method forces an increase in compliance costs.

Recommendation

That the recommendation be declined.

ALIGNMENT OF SSCWT AND PIE THRESHOLDS

Submission
(567 – Mercer Human Resource Consulting)

The SSCWT thresholds should be the same as the thresholds for portfolio investment entities (PIE) income.

Comment

PIE thresholds are based on all of a taxpayer's income, whereas SSCWT thresholds are based on salary and wages and employer superannuation contributions alone. Employer superannuation contributions are part of an employee's remuneration, so it is more appropriate to use a threshold based on the equivalent income tax thresholds.

Recommendation

That the submission be declined.

CLARIFICATION OF WORDING

Submission
(977 – Bell Gully)

The use of the word "relates" in Clause 126 (33) of the bill, which defines the SSCWT rate threshold amount, and in Schedule 1 Part C of the Income Tax Act 2004 should be clarified. It is possible that payments made in one year "relate" to a previous income year. However, the policy intent is that the word "relates" is intended to be a reference to the time that the superannuation contribution is paid by the employer. The word "relates" could create confusion over which base should be used for assessing SSCWT. "… in the tax year to which the specified superannuation contributions relates" should be replaced by "… in the tax year in which the specified superannuation contribution is to be made on behalf of the employee."

Comment

Like the treatment of salary and wages, the tax liability on employer superannuation contributions should be assessed at the time that those contributions are actually paid. The use of the word "relates" could cause confusion. The suggested wording could still create confusion, but it could be eliminated by referring to the year in which contributions are paid. This is consistent with taxing employment remuneration in the year in which the employee is paid, not when the income is accrued.

Recommendation

That the submission be accepted in part by amending the bill and Schedule 1 Part C of the Income Tax Act 2004 so that they refer to the year in which employer superannuation contributions are paid.

Allowing documents to be removed for inspection

OVERVIEW

The amendment will give the Commissioner the power to remove documents for inspection. This power will assist Inland Revenue in its investigation of tax evasion and avoidance schemes (such as cases involving abusive GST refund claims) and in particular facilitate the forensic examination of documents.

Currently, sections 16, 16B and 17 of the Act, relating to access to premises and requisitions for information, constitute the Commissioner of Inland Revenue's main information gathering powers. These sections do not give the Commissioner any power to retain and inspect the documents without taxpayers' express permission. It may not, however, be feasible to ask a taxpayer for permission to retain and inspect documents as the person may refuse to provide the requested document or may even destroy it. Although it is an offence to fail to provide information to the Commissioner when required to do so by a tax law, a person may prefer to face a monetary penalty for not complying with such laws rather than be prosecuted for a more serious offence such as fraud or tax evasion based on the documents requested.

There are a number of other reasons for giving the Commissioner the power to remove, retain and inspect documents. Having original documents satisfies the "best evidence" rule by which Courts may view an original document more favourably than a copy. This provides the best evidential basis for prosecution. Additionally, it may be necessary to forensically examine an original document. This may happen, for example, when there is a dispute as to who has created the document or whether the information contained in the document has been altered.

The importance of information to the discharge of the Commissioner's duty to collect taxes is well established. The Committee of Experts on Tax Compliance (1998) stated that: "Information is the lifeblood of the Inland Revenue Department's taxpayer audit activity".

The Privy Council in New Zealand Stock Exchange and the National Bank of New Zealand v CIR (1991) 13, NZTC 8,147 discussed the public policy justification for Inland Revenue's information-gathering powers in the following terms:

> "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 who may be negligent or dishonest".

There were nine submissions on the proposal to allow documents to be removed for inspection. Most of the submissions express concern with the administration and operation of the proposal.

To improve the system of checks and balances on the use of the proposed power, officials have recommended that a new provision be added to the amendment to require the Commissioner to seek a warrant from a judicial officer before the exercise of the power.

GENERAL OPPOSITION

Submission
(1176W – Baucher Consulting Limited)

Existing sections 16 and 16B of the Tax Administration Act 1994 are extensive enough. Furthermore, the Commissioner has not offered any direct evidence of the abuses such as the deliberate destruction of documents. Stiffer penalties for the deliberate destruction of documents are recommended.

Comment

The amendment fills a clear gap in the Commissioner's information gathering powers, and does not represent a significant extension of these powers.

Secrecy obligations prevent officials from publicly disclosing specific cases, but difficulties faced by Inland Revenue in the field are the reason why the resources have been committed to promote this amendment.

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 Commissioner. Therefore, the proposed amendment allowing Inland Revenue to remove and retain documents is directed at obtaining the information.

Recommendation

That the submission be declined.

OBTAINING COPY OF AN ORIGINAL DOCUMENT AND THE COST OF THE COPY

Submission
(578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society, 589 – KPMG, 568 – Corporate Taxpayer Group, 615W – Business New Zealand, 668 – Saint, 970W – Crocker)

Submissions seek to ensure that the Commissioner considers the right of taxpayers to obtain copies of original documents.

The documents taken should be immediately copied, with the copied version handed to the business as soon as possible. *(Business New Zealand)*

There must be a duty on the part of the Commissioner to provide the taxpayer with a copy of the material that is removed. *(New Zealand Law Society)*

A new section should be introduced to require the Commissioner to provide a certified copy, at the Commissioner's expense, of the documentation that is removed. *(New Zealand Institute of Chartered Accountants)*

Who bears the cost of any copies required and the timely delivery or availability for collection of the copies. It also indicates that there is a cost to the taxpayer of having to re-sort and re-file the documents removed. *(KPMG)*

The taxpayer must first have an opportunity to copy the documents that are to be removed. *(Saint and Crocker)*

Comment

In relation to the issues of the availability of copies of removed documents for taxpayers and the cost of making copies, officials consider that the current procedures are satisfactory to both taxpayers and the Commissioner.

Under the current legislation, the owner of a document that is removed is entitled to inspect and obtain a copy of the document. When the taxpayer requests copies of documents, the Commissioner will make copies of the documents for the taxpayer at the Commissioner's expense. An objective of the rules is to disrupt taxpayers' affairs as little as possible.

Recommendation

That the submissions be declined.

SAFEGUARDS AGAINST ABUSE OF POWER

Submission
(589 – KPMG, 568 – Corporate Taxpayer Group, 1176W – Baucher Consulting Limited)

A comprehensive framework should be established to ensure that the Commissioner strictly adheres to the spirit of the legislation and does not seek to make the exercise of the power a day-to-day occurrence. The power should only be delegated to a sufficiently high level, such as the level equivalent of "Manager Investigations" or above. *(KPMG)*

There is concern about the administration of checks and balances that will apply in relation to the power and with the delegation of the power to the level of a "Team Leader" in investigations. *(Corporate Taxpayer Group)*

There is concern about the extension of the Commissioner's powers without detailing checks and balances to apply to Inland Revenue officers. *(Baucher Consulting Limited)*

Comment

Officials note that there are already many constraints on the exercise of Commissioner's information-gathering powers.

Inland Revenue officers are subject to the normal administrative law requirements. These require any public powers to be used for their proper purpose and to be exercised in good faith.

Additionally, the internal Inland Revenue rules will preclude official powers from being used for any improper purpose. Disciplinary procedures are in place and will apply in any such case.

The proposed new power will not be delegated to an individual investigator but would only be delegated down to a managerial level. Officials consider that setting the level of delegation too high would unduly reduce the efficiency of the powers. Officials believe that the level of a Team Leader, Investigations, is an appropriate level for delegation as it preserves a right balance between safeguarding against the unconstrained use of the power and administrative efficiency.

It is intended that the Commissioner's proposed power to remove documents for inspection will be applied to taxpayers mainly at the top of the Inland Revenue's "compliance model", typically in fraud/evasion and/or avoidance type cases. This would be similar to the way the Commissioner applies the current power to remove documents for copying. In addition, under the heading "Legislative controls", it is proposed that to amend the bill to ensure that documents cannot be removed for inspection unless a warrant has been issued. The warrant will be issued by a judicial officer, normally a District Court Judge, who will need to be satisfied that there are reasonable grounds for requiring documents to be removed for inspection.

Recommendation

That the submissions be declined but see the recommendation under the heading "Legislative controls".

DOCUMENTS UNDER LEGAL PRIVILEGE

Submission
(568 – Corporate Taxpayer Group, 594 – New Zealand Law Society)

It should be made clear that the Commissioner is not entitled remove and retain documents that are subject to legal professional privilege and advice privilege. *(New Zealand Law Society)*

Regard should be had to allowing the taxpayer to review documents for legal privilege rights and non-disclosure rights before the Commissioner may remove and retain documents. *(Corporate Taxpayer Group)*

Comment

The proposed amendment does not prevent a taxpayer from claiming legal professional privilege or the non-disclosure right, with respect to relevant books and documents, under sections 20 and 20B to 20G of the Tax Administration Act 1994.

With respect to legal professional privilege, where the Commissioner does not challenge such a claim the Commissioner cannot and will not remove and retain the relevant documents. When it is necessary to determine a legal professional privilege claim, an appropriate process will be followed pending the necessary proceedings. Section 20(5) of the Tax Administration Act 1994 authorises both the Commissioner, and the affected person to apply to a District Court Judge for an order to determine whether the legal professional privilege claim is valid.

With respect to the non-disclosure right, where the Commissioner does not challenge such a claim the Commissioner cannot and will not remove and retain the relevant documents, although the Commissioner may request that the taxpayer provide the relevant tax contextual information. When it is necessary to determine a non-disclosure right claim, an appropriate process will be followed pending the necessary proceedings. Section 20G(1) of the Tax Administration Act 1994 authorises both the Commissioner and the affected person to apply to a District Court Judge for an order to determine whether the non-disclosure right claim is valid.

Where the Commissioner removes and retains documents before a taxpayer has been able to review the relevant documents for legal professional privilege and the non-disclosure right. Examples of these situations are where a taxpayer is not at the relevant premises, where the taxpayer has given permission to the Commissioner to clone a hard drive at the Commissioner's premises, or the taxpayer has given permission to the Commissioner to remove and retain documents but wishes to maintain his or her legal privilege and/or non-disclosure rights – Inland Revenue intends that the taxpayer will still have those rights. We note that these issues will be able to be further considered as part of the normal post-implementation review of the non-disclosure rights.

Officials note that the proposed amendment is subject to sections 20 and 20B to 20G of the Tax Administration Act 1994.

Recommendation

That the submissions be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society)

If the amendments are to be enacted, a new section should be included to specify the controls on the Commissioner in operating these provisions in the Tax Administration Act 1994. *(New Zealand Institute of Chartered Accountants)*

The Commissioner's power to remove or retain any books or documents should, in the absence of exceptional circumstances, specifically be limited in section 16B to circumstances where a taxpayer has failed to produce those books and documents under a section 17 notice. It is submitted that section 16B should not take the place of section 17. *(New Zealand Law Society)*

The exceptional circumstances where section 16B can be used to remove or retain original documents in the absence of a section 17 notice need to be articulated in section 16B and adjudged by the warrant of a District Court Judge. The Society's submission is that these circumstances are:

- where the Judge is satisfied that the Commissioner has reasonable grounds to believe the taxpayer is going to leave New Zealand; and/or
- where the Judge is satisfied that the Commissioner has reasonable grounds to believe that the taxpayer has acted fraudulently, taking into account the criminal tests of fraud. *(New Zealand Law Society)*

Where a taxpayer has not complied with a section 17 notice and section 16B is used to remove books and documents, the Commissioner's ability to retain original books or documents for use as evidence in Court should be subject to a warrant from a District Court Judge. Furthermore, the taxpayer should be notified of the application to the Court, except that the application can be ex parte in the two exceptional circumstances as mentioned in the previous paragraph. *(New Zealand Law Society)*

Comment

To closely circumscribe the Commissioner's proposed power in the legislation could invite numerous challenges to the scope of the power by those at the top of the "compliance model" at whom the power is directed, and it could therefore render the power ineffective. A better system of checks and balances is provided by Inland Revenue's internal procedures, delegation of the power down to Team Leader level only, and normal administrative law requirements, which require any public powers to be used for their proper purpose and to be exercised in good faith. Inland Revenue has extensive training programmes in place to educate investigators about their powers and the safeguards on those powers. In the event that powers are used inappropriately, disciplinary procedures are in place and will apply.

Moreover, to impose detailed legislative restrictions on the Commissioner's power to remove and retain documents would be inconsistent with the other information-gathering powers of the Commissioner (for example, section 17) which are broadly drafted.

It is not desirable to have a requirement for a section 17 notice before the proposed removal power is exercised in cases at which the amendment is directed, that is, evasion and avoidance cases. In these circumstances, if a section 17 request has to been made first, the person may refuse to provide the requested document and destroy it. This would defeat the whole purpose of the Commissioner's power to remove documents, which is to assist the Commissioner to obtain information in evasion and avoidance cases. The exceptions to the requirement to apply section 17 first, suggested by the Law Society, are too narrow to allow the effective application of the proposed power.

However, to improve the system of checks and balances on the use of the proposed power, officials recommend that an amendment be made to the bill to ensure that documents cannot be removed for inspection unless a warrant has been issued. The warrant will be issued by a judicial officer, normally a District Court Judge, who will need to be satisfied that there are reasonable grounds for requiring documents to be removed for inspection.

Recommendation

That an amendment be made to ensure that documents cannot be removed for inspection unless a warrant has been issued.

TIME LIMIT ON RETAINING DOCUMENTS

Submission
(594 – New Zealand Law Society)

The Commissioner's ability to retain original books and documents should be limited in section 16B to a maximum four month period. This timeframe should be sufficient for the Commissioner to test those books and documents and is to ensure that the taxpayer also has the ability to obtain evidence from testing those books and documents.

Comment

Officials note there will be a statutory requirement to return documents when the inspection is completed. In many cases the inspection could be completed within the four month period suggested by the Law Society. However, the actual time required for testing depends on the facts and circumstances of the particular case. There may be exceptional cases where longer than four months is required for testing. A one-size-fits-all approach is not desirable.

Recommendation

That the submission be declined.

RETURNING THE DOCUMENTS TO DEFEND AN ACTION

Submission
(668 – Saint, 970W – Crocker)

Taxpayers have no means or certainty of return of a document should the taxpayer decide to defend a later action.

Comment

One of the reasons for the proposed amendment is to provide certainty that original documents will be available to the Court if necessary. A taxpayer will also be able to obtain a copy of any document removed and retained.

Recommendation

That the submissions be noted.

REMOVAL OF ELECTRONIC EQUIPMENT

Submission
(578 – New Zealand Institute of Chartered Accountants)

The items fundamental to the operation of the business such as personal computers and laptops, hard drives and printers, and fax machines should not be removed.

Comment

The new power will allow the Commissioner to remove and retain "books and documents". The term "book and document" is defined in section 3 of the Tax Administration Act 1994 to include "all books, accounts, rolls, records, registers, papers and other documents and all photographic plates, microfilms, photostatic negatives, prints, tapes, discs, computer reels, perforated rolls, or any other type of record whatsoever".

Although the definition is a broad one, it is not interpreted by the Department to include the electronic equipment of the type mentioned in the submission. The Commissioner's practice is to clone computer hard-drives on taxpayers' premises.

Recommendation

That the submission be noted.

LOSS OF DOCUMENTS BY THE COMMISSIONER

Submission
(594 – New Zealand Law Society)

If the Commissioner loses or is unable to locate the taxpayer's original books or documents and does not provide the taxpayer with a copy of those original books or documents, then the taxpayer's burden of proving matters that can only be proved by those books or documents should be deemed to be satisfied, and/or it should be specifically provided under section 138G(2) of the Tax Administration Act 1994 that the hearing authority will allow the taxpayer to admit other evidence, despite the evidence exclusion rule.

Comment

Officials do not consider that the proposal is feasible. It would be inappropriate to shift the burden of proof or disapply the evidence exclusion rule 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 submission be declined.

DRAFTING OF AMENDMENT

Submission
(597 – PricewaterhouseCoopers)

The Commissioner's powers should be worded more precisely to ensure that its meaning is clear and that the circumstances in which it may be used are defined more precisely. It should be made explicit that "full and complete inspection" includes forensic testing. The words allowing the Commissioner to use documents as evidence in court proceedings should be moved from the definition section to the substantive section.

Comment

Officials consider that it is unnecessary to make it explicit that the Commissioner's power to inspect includes forensic testing. The phrase "full and complete inspection" inevitably implies that the Commissioner may perform all necessary tests, including forensic tests.

Officials also consider it unnecessary to relocate the legislative power to use removed documents as evidence in Court from the definition section to section 16B. The term "full and complete inspection" is also used in section 17 of the Tax Administration Act and making such a drafting change would have implications for the meaning of the term in that section.

Recommendation

That the submission be declined.

Other policy matters

EXEMPTION FOR MILITARY SERVICE IN OPERATIONAL AREAS

Clause 10

Issue: Support for the exemption

Submission
(616W – National Council of Women of New Zealand (Inc.))

While this exemption may not apply to a significant proportion of the income of the men and women of the New Zealand Defence Force (NZDF) on designated operation duties, the intent is seen as worthy.

Comment

The submission should be noted.

Recommendation

That the submission be noted.

Issue: Remove the exemption

Submission
(578 – New Zealand Institute of Chartered Accountants, 615W – Business New Zealand)

The exemption should be removed on the basis that it undermines the principle of horizontal equity – that is, two people on the same level of income should pay the same amount of tax.

Operational allowances paid to military personnel in operational areas should be subject to tax but correspondingly increased to ensure the net (after tax) allowance is the same as it would have been had the allowance not been taxed. If the government wishes to increase the rewards to members of the NZDF who serve in operational areas, it should increase Vote: Defence Force for the purposes of allowing the Ministry of Defence to increase its taxable remuneration to military personnel in operational areas.

Comment

Officials do not agree with this submission because it would lead to higher compliance costs for the NZDF and higher administrative costs for Inland Revenue and the Ministry of Social Development (MSD). These costs would arise as a result of efforts to negate any flow-on effects for a person's entitlement to family assistance, student loan obligations, child support assessments (unless a custodian makes a successful application for administrative review on the basis that the liable parent has increased capacity to pay) or entitlements under the Social Security Act. Operational allowances are not intended to have any effect on a person's social policy entitlements or obligations.

If operational allowances were grossed up by the amount of the tax, and then subject to tax, these allowances would need to be included in a person's taxable income and PAYE deducted at source by the NZDF. The NZDF would also need to exclude these allowances from the calculation of a person's student loan repayment obligation. In addition, these allowances would need to be included in a person's personal tax summary but excluded from any end-of-the-year calculations undertaken by Inland Revenue in relation to that person's family assistance entitlements and or child support liabilities.

The exemption approach means that operational allowances to which the exemption applies would not be treated as income for the purpose of calculating student loan repayments, family assistance entitlements or child support assessments for liable parents (unless a custodian makes a successful application for administrative review on the basis that the liable parent has increased capacity to pay). The government intends to make Regulations under the Social Security Act to provide that allowances subject to the exemption are not counted as income when assessing a person's entitlement to social security benefits and allowances. This is consistent with the government's view that operational allowances should not affect eligibility to social assistance entitlements.

An exemption simplifies the overall payment process for NZDF staff, removes administrative difficulties with the current payment process that involves the MSD and the NZDF, and minimises the administrative implications for Inland Revenue.

Recommendation

That the submission be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants)

If the preceding submission is not accepted, sections CW 19(2)(b) and CW 19(3), which enable the Ministerial Committee to exempt from income tax an amount of income paid to NZDF staff in operational areas, should be removed from the bill. These provisions breach the established principle that the power to tax (or not to tax) vests in Parliament, and not in Ministers of the Crown.

Comment

Officials agree that the power to tax (or not to tax) indeed resides with Parliament in New Zealand. The relevant authority for this proposition is found in the Bill of Rights Act 1688. However, officials are concerned about the Institute's analysis of the legality of the Ministerial Committee being given the power to exempt from income tax an amount of income paid to NZDF staff in operational areas.

Officials believe that the Institute's submission is misplaced as it does not distinguish between delegating a decision-making right as to whether or not tax is imposed and the case where a decision-maker without Parliament's express authority decides whether or not tax is imposed. If the exemption remains in the bill as drafted and the bill passes, the Ministerial Committee deciding on the exemption would be "with consent of Parliament" and would be lawful. Therefore, there would be no problem with the Bill of Rights Act 1688 as an Act of Parliament would give the Ministerial Committee its power "not to tax".

It is the view of officials that the power of the Ministerial Committee to decide that certain amounts of income are exempt from income tax would be lawful if Parliament were explicit that such was its intention and the Ministerial Committee kept within its delegated authority. This would be achieved if clause 10 of the bill was enacted.

Recommendation

That the submission be declined.

Issue: Extend exemption to apply to New Zealand Police personnel

Submission
(562 – New Zealand Police Association)

The proposed exemption should apply to allowances paid to New Zealand Police personnel serving in "operational areas".

Comment

Officials agree with this submission. New Zealand Police personnel are involved in a number of overseas deployments and carry out a variety of operational and peacekeeping duties, often working alongside the New Zealand Defence Force. If New Zealand Police personnel are serving in operational areas any allowances paid to them directly and solely for serving in those areas should automatically be exempt from income tax.

Officials also consider that the Ministerial Committee should have the ability to exempt from income tax the pay and other allowances paid to New Zealand Police personnel who are serving in operational areas in the same way as pay and other allowances paid to NZDF personnel.

Recommendation

That the submission be accepted.

Issue: Include the Minister of Police in the definition of "Ministerial Committee"

Submission
(562 – New Zealand Police Association)

The Minister of Police should be included in the definition of "Ministerial Committee".

Comment

Under the exemption, a Ministerial Committee will continue to have the ability to exempt from income tax the pay and other allowances paid to members of the New Zealand Defence Force (and the New Zealand Police, if the above recommendation is accepted) who are serving in operational areas.

If the exemption is extended to apply to operational allowances paid to New Zealand Police personnel serving in operational areas, it is appropriate that the Minister of Police be included in the Ministerial Committee that has responsibility for determining whether the standard pay and other allowances paid to persons serving in operational areas are exempt from income tax.

Recommendation

That the submission be accepted.

SPREAD OF INCOME ON SALE OF PATENT RIGHTS

Clause 45

Issue: Spreading of taxable income on sale of patent rights

Submission
(568 – Corporate Taxpayers Group, 578 – New Zealand Institute of Chartered Accountants)

The proposed three-year spread on the sale of patent rights is supported.

Recommendation

That the submission be noted.

Issue: Consistency with the sale of other "technology rights"

Submission
(578 – New Zealand Institute of Chartered Accountants)

The taxation of the sale of patent rights should be consistent with the sale of other "technology rights".

Comment

Other technology rights are treated as assets, with gains on sale not considered taxable income unless the vendor is a trader in "technology rights". Patents can generate income either through licensing the patent and earning a stream of royalties, which is assessable income, or by selling the patent. Gains on the sale of patent rights are treated as assessable income to ensure consistency with the treatment with income earned by licensing patent rights. The consistency ensures that decisions about whether to license or sell patents are not driven by tax consequences.

Recommendation

That the submission be declined.

Issue: Depreciable property

Submission
(578 – New Zealand Institute of Chartered Accountants)

It should be clarified that patent rights are "depreciable property", given that there can also be a deduction for cost when gains on sale of a patent are calculated.

Comment

Patents and the rights to use patents are already included in Schedule 17: Depreciable intangible property. Section DB 31 allows both a depreciation deduction and a deduction for cost when calculating the gain on sale of a patent.

Recommendation

That the submission be declined.

Issue: Consistency of wording

Submission
(597 – PricewaterhouseCoopers)

Proposed section EI 3B(1) should be reworded so that it refers to the sale of patent applications and patent rights, which is consistent with the heading of section CB 26.

Recommendation

That the submission be accepted.

CHARITABLE DONEE STATUS

Clause 89

Submission
(578 – New Zealand Institute of Chartered Accountants)

The submission agrees with the proposed additions to the list of approved donee organisations in section KC 5(1) of the Income Tax Act 2004. Inclusion in this list allows individual taxpayers to claim a rebate of 33 1/3 percent of the amount donated, to a maximum of $630 a year for all donations made. The submission has suggested that the government consider increasing the maximum.

Comment

United Future’s Confidence and Supply Agreement with the government includes a review of the charitable donations rebate. The review, which is planned for later this year, will be considering this issue.

Recommendation

That the submission be declined.

Submission
(978W – PricewaterhouseCoopers)

The organisation The World Swim for Malaria Foundation should be added to the list of approved donee organisations in section KC 5(1) of the Income Tax Act 2004.

Comment

Organisations seeking listing in section KC 5(1) are subject to an approval process which includes consideration by Cabinet. Granting approval in the manner sought would circumvent this process and would therefore be unfair to all other organisations which have been subject to it.

Officials will report to Ministers on this application in due course.

Recommendation

That the submission be declined.

THE IMPUTATION SYSTEM AND COMPANIES TREATED AS NOT BEING RESIDENT UNDER A DOUBLE TAX AGREEMENT

Clause 113(1)

Issue: Drafting

Submission
(578 – New Zealand Institute of Chartered Accountants)

The definition of "foreign company" (in section OB 1) should be used in section ME 1(2)(b), instead of the new wording introduced by clause 113(1).

Comment

It would not be appropriate to use the definition of "foreign company" in section OB 1. That definition covers both non-resident companies and resident companies treated as not being resident under a double tax agreement. Section ME 1(2)(b) deals only with the latter category. It provides an exception to general rule that resident companies must establish and maintain an imputation credit account. The new wording introduced by clause 113(1) is similar to that used in equivalent provisions elsewhere in the Income Tax Act. (See, for example, sections IG 2(11)(b)(ii) and LF 1(2)(v).)

Recommendation

That the submission be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants)

The language used in provisions equivalent to section ME 1(2)(b) could be standardised, to aid interpretation and application of these rules.

Comment

There are a number of provisions in the Income Tax Act that refer to companies' resident status under a double tax agreement. The Rewrite Project is responsible for rewriting the Income Tax Act in plain language. Officials will consider the scope for standardising the relevant provisions as part of the Rewrite Project's work on Parts F to O of the Act.

Recommendation

That the submission be noted.

Issue: Accuracy of the commentary

Submission

(594 – New Zealand Law Society)

The Commentary to the bill says that the amendment to section ME 1(2)(b) made by Clause 113(1) "clarifies" the law and that the removed words are "descriptive" and "[set] out the general consequence of deemed non-residence under a double tax agreement". The Commentary does not accurately articulate the historical position because the equivalent section in the Income Tax Act 1976 originally had the same effect as Clause 113(1) is intended to achieve, but had to be amended to deliver the policy intent of the imputation regime. The Commentary should accurately reflect the historical position.

Comment

The Commentary is correct as it stands. The equivalent section in the Income Tax Act 1976 was section 394B. This was introduced by section 55 of the Income Tax Amendment Act (No. 5) 1988. Under section 394B as originally enacted, a company that was resident in New Zealand but treated as not resident under a double tax agreement was required to establish and maintain an imputation credit account. Section 394B was amended by 61(1) of the Income Tax Amendment Act 1989, which introduced new paragraph (aa). Paragraph (aa) was the equivalent to section ME 1(2)(b), which Clause 113(1) amends.

From the outset, the drafting of paragraph (aa) was similar to the current drafting of section ME 1(2)(b). The rule now at section ME 1(2)(b) has therefore been similarly cast since it was first introduced. Clause 113(1) does not remove that rule and revert to the position before the changes made by the Income Tax Amendment Act 1989. As stated in the Commentary, it simply clarifies the drafting of the rule.

Recommendation

That the submission be declined.

CONSOLIDATED GROUPS AND FOREIGN LOSSES

Clauses 126 and 162

Issue: Proposal contrary to the original policy intention of the consolidated group rules

Submission
(578 – New Zealand Institute of Chartered Accountants, 597, 597b – PricewaterhouseCoopers)

The proposal is contrary to the original policy intention of the consolidated group rules, as Parliament did not make the consolidation loss rules consistent with group loss rules at the time of enactment.

Comment

While it was not clear whether this issue was considered at the time of enactment of the consolidation rules, the loss rules for consolidation do appear to indicate that it was expected that all the rules governing losses, including those for dual resident companies, would be incorporated. However, the drafting appears not to have achieved this. No explicit concession was ever intentionally given to consolidated groups.

This amendment is, therefore, consistent with the rules applicable to consolidated groups. The consolidation rules were introduced to reduce compliance costs, not to provide tax advantages over groups of companies that do not consolidate, and so the amendment is appropriate.

Recommendation

That the submission be declined.

Issue: Consolidated rules analogous to branch treatment

Submission
(597, 597b – PricewaterhouseCoopers, 1279 – Deloitte)

The consolidated group rules are analogous to, and should be made consistent with, company-branch treatment. They should not be aligned with the standard grouping rules.

Comment

Officials accept that in some situations the loss treatment received by dual resident companies within a consolidated group is analogous to the treatment received by a foreign branch of a New Zealand company. However, this amendment is simply to align the tax treatment of consolidated and non-consolidated groups.

Recommendation

That the submission be declined.

Issue: Amendments should focus on specific areas of concern

Submission
(1279 – Deloitte)

The amendments are unnecessarily broad. They should be focussed on the specific areas of concern rather than making all dual resident companies ineligible to be a member of a consolidated group. The effect of the amendments is to make dual resident companies ineligible to become or remain members of a consolidated group, which is broader than denying loss offsets to dual resident companies.

Comment

Officials agree that amending the definition of "eligible company" has the effect of making the amendment wider than strictly necessary. However, in order to specifically deny loss offsets to dual resident companies within a consolidated group, all dual resident companies would need to effectively de-consolidate and prepare separate tax accounts, but group only if in profit. The rules required to carve out the dual resident companies within a consolidated group would be extremely complex. This effectively defeats the purpose of the consolidation rules. Therefore, from a compliance perspective, it is more practical to make a dual resident company ineligible to be a member of a consolidated group.

Recommendation

That the submission be declined.

Issue: Tax residence not easily manipulated

Submission
(1279 – Deloitte)

The proposal is unnecessary as a company's tax residence cannot be easily manipulated.

Comment

While officials accept that some aspects of tax residence cannot be easily manipulated, other aspects can be. For example, the residence test based on a company's directors can be manipulated through the movement of the directors outside New Zealand. Furthermore, in the case of New Zealand, incorporation can also be moved to other jurisdictions.

Recommendation

That the submission be declined.

Issue: Full consultation needed

Submission
(594 – New Zealand Law Society, 568 – Corporate Taxpayer Group, 1279, 1279a – Deloitte)

The proposals should be removed until the full Generic Tax Policy Process, including full consultation, is undertaken.

Comment

As this is a base maintenance issue, it was not appropriate to apply the Generic Tax Policy Process. Full consultation was not undertaken in order to prevent further opportunities for taking advantage of the misalignment of the rules.

Recommendation

That the submission be declined.

Issue: Unit trusts may be excluded from consolidation

Submission

(578 – New Zealand Institute of Chartered Accountants, 1279 – Deloitte, 597 – PricewaterhouseCoopers)

Unit trusts cannot meet the requirement that that the entity must be incorporated in New Zealand, as a unit trust cannot be incorporated.

Comment

The grandparenting provision proposed below ensures that the current law (which does not require incorporation) applies to companies, including unit trusts, who have met certain criteria. Therefore the amendment will generally not disadvantage unit trusts that rely on the existing definition.

This is an existing issue that is also relevant to the loss rules, as a loss company must be incorporated in New Zealand before its losses can be offset against the income of profit companies. The issue is also relevant to other provisions which refer to incorporation. If there is an issue in practice, it should be dealt with on a comprehensive basis rather than only in the context of a single provision.

Recommendation

That the submission be declined.

Issue: Grandfathering provisions

Submissions generally supported the intent of the Supplementary Order Paper 44, which protects the position of existing consolidated groups where the consolidated group has made provisional tax payments before 17 May 2006. However, submissions considered that the grandfathering provision should be extended.

Submission

(568 – Corporate Taxpayer Group, 578 – New Zealand Institute of Chartered Accountants, 589a – KPMG, 594 – New Zealand Law Society, 597, 597b – PricewaterhouseCoopers, 1279, 1279a – Deloitte)

The amendment should be made on a prospective basis with effect from the 2007-08 income year. *(New Zealand Institute of Chartered Accountants, Corporate Taxpayer Group, Deloitte, PricewaterhouseCoopers, New Zealand Law Society)*

Alternatively, the amendments should enable consolidated groups existing at 17 May 2006 to apply the existing tax rules to the end of their current income year. *(New Zealand Institute of Chartered Accountants)*

The amendment should grandfather existing non-financing, dual resident companies which had applied to join a consolidated group prior to the 17 May 2006. *(Deloitte)*

The position for the 2005-2006 year should be protected for all taxpayers. The position for the 2006-2007 year should be protected for taxpayers who have relied on the previous legislation, or at least the position should be protected for taxpayers who have had their first provisional tax instalment date prior to the date of the amending SOP, being 20 June 2006. *(KPMG)*

Comment

As this is a base maintenance issue, the amendment, as it currently stands, applies from the 1997-1998 income year. This reduces the likelihood that taxpayers will retrospectively take advantage of the discrepancy in the current law by seeking to have their assessments for previous years amended. The amendment does not apply to taxpayers who are part of existing consolidated groups where the consolidated group has made provisional tax payments before 17 May 2006.

However, officials agree that the position for all companies should be protected for their 2006-2007 and earlier years if they have elected to join the consolidated group before 17 May 2007, regardless of their provisional tax instalment date.

To minimise any possible compliance costs, officials agree that it would be appropriate to grandfather certain existing dual resident companies. These companies must be in business other than a financing business, and must have applied to be a member of a consolidated group before 17 May 2006. This proposal would generally resolve the concerns raised by submissions by grandfathering dual resident entities that are genuine trading companies.

A financing business will be determined by comparing the company's interest expense to its total allowable deductions. A dual resident will not be an "eligible company" if its interest deductions (or deductions under the accrual rules ignoring foreign exchange fluctuations in the debt) for each year are more than 50 percent of total allowable deductions.

Recommendation

That the submission be accepted.

Issue: SOP – requirement that the taxpayer be a member of a consolidated group

Submission
(597, 597b – PricewaterhouseCoopers)

The requirement that the consolidated group has had its first provisional tax instalment date prior to 17 May 2006 should be removed and replaced with the requirement that the application to become a member had been made before 17 May 2006.

Comment

Officials agree that the grandfathering provision should be changed to require that the member had applied to be part of a consolidated group by 17 May 2006.

Under the SOP as it currently stands, the taxpayer is required to be a member of a consolidated group as at 17 May 2006.

However, a taxpayer can backdate the application to the start of the group's income year in some circumstances. If an application is made within 63 working days of the start of the group's income year, the taxpayer will be deemed to be a member of a consolidated group from the beginning of the income year. Further, a newly created company can apply to be part of a consolidated group at any time during the income year, and that company will be deemed to be a member of the consolidated group from the start of the income year (as long as the application is made within 63 working days of the incorporation of the new company).

To prevent such companies from backdating their application, it is therefore appropriate to require that the member had applied to be part of a consolidated group by 17 May 2006.

As noted above, officials agree that the requirement that the consolidated group has made its first provisional tax payment before 17 May 2006 should be removed.

Recommendation

That the submission be accepted.

Issue: Drafting issues

Submission
(1279 – Deloitte)

Paragraph (e), requiring that a company be incorporated in New Zealand or carry on a business in New Zealand through a fixed establishment, appears to allow some dual resident companies to join consolidated groups. However, the requirement in paragraph (f) that a company must not be liable to income tax under the law of another jurisdiction by reason of domicile, residence or place of incorporation is unlikely to ever be met. Paragraph (e)(ii) is therefore rendered practically ineffective.

Comment

The bill's addition of paragraphs (e) and (f) in the "eligible company" definition simply aligns the loss rules for consolidated groups with those for non-consolidated groups.

There are some fact situations covered by paragraph (e) that would not also be covered by paragraph (f).

Recommendation

That the submission be noted.

Submission
(1279 – Deloitte)

Paragraph (e)(ii) seems to allows New Zealand tax losses of a dual resident company to be included in the New Zealand tax consolidated group. However, the consolidation rules do not allow for only part of a company to be included in a consolidated group. This needs to be clarified.

Comment

The intention of the amendment is to align the loss rules for consolidated groups with those for non-consolidated groups. Inclusion of paragraph (e)(ii) is therefore not intended to change the basis on which consolidated groups are taxed.

Recommendation

That the submission be declined.

Submission
(1279 – Deloitte)

Paragraph (f) should be removed as it is unclear what purpose it serves. The reference to the law of a foreign jurisdiction is problematic.

Comment

The requirement in paragraph (f) is a current rule for companies joining groups that are not consolidated, and has applied for a number of years.

Recommendation

That the submission be declined.

Submission
(1279 – Deloitte)

Guidance should be provided as to what happens where there is only one other New Zealand company within a consolidated group.

Comment

As a consolidated group can continue if it has only one member, officials do not consider that guidance is necessary.

Recommendation

That the submission be declined.

Submission
(1279 – Deloitte)

The consequences of exiting a group (such as depreciation recoveries) should be provided for.

Comment

The rules normally applicable to companies exiting a consolidated group under section FD 8 will apply. Consequences such as depreciation recovery will be dealt with under existing rules. It is therefore unnecessary to enact new rules.

Recommendation

That the submission be declined.

ANNUAL CONFIRMATION OF INCOME TAX RATES

Clause 3

Issue: Support for a broad base, low-rate tax policy

Submission
(578 – New Zealand Institute of Chartered Accountants)

The government should restrict the conditions that make tax avoidance attractive by adopting a broad base, low tax rate policy. The existing differential income tax split between corporate and trustee and personal marginal tax rates is causing significant compliance costs domestically as individuals seek to find the most tax efficient business structure.

Comment

The submission should be noted.

Recommendation

That the submission be noted.

COMMISSIONER MAY ISSUE AN ASSESSMENT WITHOUT FIRST ISSUING A NOPA

Clause 149

Issue: Amendment unnecessary and should not be proceeded with

Submission
(578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society, 1176 – Terry Baucher, Baucher Consulting Limited)

The proposed amendment is unnecessary and should not be proceeded with. It derogates from the disputes resolution procedures. *(New Zealand Law Society, New Zealand Institute of Chartered Accountants)*

The Commissioner should not be able to effectively waive the two-month response period for his own administrative convenience. *(Terry Baucher, Baucher Consulting Limited)*

There are already sufficient procedures available to the Commissioner to issue assessments without following the disputes procedures. *(New Zealand Institute of Chartered Accountants)*

Even if fraudulent activity exists, this does not necessarily mean that the Commissioner's ability to collect tax is affected. If the proposed amendment proceeds it needs an additional requirement that the Commissioner's ability to collect tax is directly affected. *(New Zealand Law Society)*

Comment

The purpose of the notice of proposed adjustment (NOPA) and notice of response (NOR) phases of the disputes resolution process is to encourage an "all cards on the table" approach to tax disputes to ensure that all relevant evidence, facts and legal arguments are canvassed. In the normal course of a dispute initiated by Inland Revenue, the Department would issue a NOPA and the taxpayer has two months to respond by issuing a NOR. If the taxpayer does not respond, then Inland Revenue can issue an assessment.

This process is appropriate in the majority of tax disputes. However, section 89C of the Tax Administration Act 1994 lists a limited range of circumstances in which the Commissioner may issue an assessment without first issuing a NOPA. These exceptions recognise that there are situations in which it is appropriate that the NOPA and NOR process not be followed – for example, to reduce compliance or administrative costs and for revenue protection purposes.

Fraudulent behaviour by taxpayers is at the extreme end of non-compliant behaviour. Processes that are appropriate and designed to facilitate compliance among the majority of taxpayers who aim to comply with the law are not necessarily appropriate for situations involving deliberate non-compliance.

In situations involving fraudulent behaviour it is necessary for Inland Revenue to be able to issue an assessment and begin debt recovery activity quickly. The NOPA and NOR process can be time consuming and resource-intensive, particularly in situations where a fraudulent scheme has involved a number of taxpayers. The consequent delay in issuing an assessment to allow time for the NOPA and NOR process delays the beginning of the debt recovery process, and the funds available for collection may be reduced.

Some situations in which the proposed amendment will apply will also be covered by an existing exception – for example, section 89C(e). This exception covers the situation where the Commissioner has reasonable grounds to believe that a notice may cause the taxpayer to take steps in relation to the existence or location of the taxpayer's assets that make it harder for the Commissioner to collect the tax from the taxpayer. However, this potential overlap will only occur in some situations involving taxpayer fraud.

It is important to note that taxpayers will still have dispute rights in respect of any resulting assessments made by Inland Revenue, as a taxpayer may issue a NOPA in response to the Commissioner's assessment. The proposed amendment will enable the Commissioner to begin tax debt recovery sooner when taxpayers choose not to exercise their dispute rights. Consequently, this amendment will help ensure that the revenue base is protected and the Commissioner's resources are used in the most appropriate way without limiting the taxpayer's dispute rights.

Recommendation

That the submission be declined

Issue: Circumstances in which the exception will apply need to be more tightly defined

Submission

(578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society)

If this amendment proceeds the following changes are required:

- Its application should be tightly defined by reference in the legislation to the criminal tests of fraud. *(New Zealand Law Society)*

- Guidance and safeguards should be provided as to what is considered to be "fraudulent" and what level of evidence the Commissioner should have before this power can or should be exercised. The threshold that the Commissioner only has to "believe" the taxpayer "may" have been involved in fraudulent activity is too low. *(New Zealand Institute of Chartered Accountants)*

Comment

Officials agree that it is desirable for taxpayers to have certainty as to when this provision will be applied. The terms "fraud" and "reasonable grounds" are used in a range of different provisions in the Revenue Acts and consequently have well-established meanings developed through case law. Therefore officials do not agree that it is necessary to define these terms in the Tax Administration Act 1994.

However, officials consider that the wording of the provision can be tightened by removing the words "may have" to provide that the exception only applies where the Commissioner has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity.

Recommendation

That the submission be partly accepted, as detailed above.

Issue: Delegation level

Submission
(578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society)

If the amendment proceeds:

- The legislation should specify which officers of the department can exercise a judgment as to fraudulent activity. *(New Zealand Law Society)*
- Judgements as to the possible existence of fraud and decisions to issue an assessment without first issuing a NOPA need to be made at a senior level of Inland Revenue with tightly defined criteria for application. *(New Zealand Institute of Chartered Accountants)*

Comment

Section 7 of the Tax Administration Act 1994 enables the Commissioner to delegate specific powers to such officers of the department as the Commissioner thinks fit. As the delegation of his powers is a matter for the Commissioner to determine, the delegation of specific powers is set out in administrative guidelines rather than included in legislation.

Officials agree that the decision on whether there are reasonable grounds to believe that fraud exists and whether it is appropriate to issue an assessment should be made at a senior level of Inland Revenue. This is reflected in the delegations for the existing section 89C(eb) exception, which is currently delegated to the managerial level, and it is anticipated that this delegation level will be maintained.

Recommendation

That the submission be accepted in part, as discussed above.

Issue: The entire disputes process should be reviewed

Submission
(1176 – Terry Baucher, Baucher Consulting Limited)

The entire disputes resolution process should be reviewed to clarify, simplify and speed up what is now a convoluted process.

Comment

The disputes resolution process was introduced in 1996 in response to the recommendations of the Organisational Review of the Inland Revenue Department and was the subject of a comprehensive post-implementation review in 2003. As a result of that review, a number of legislative amendments were enacted in 2004, to ensure that the process is meeting its objectives of resolving tax disputes fairly and efficiently. Consequently, officials do not consider that it is necessary to conduct a comprehensive review of the disputes rules. However, officials will monitor the disputes process to ensure it continues to meet its objectives and will respond to specific issues as they arise.

Recommendation

That the submission be declined.

GST AND FINANCIAL SERVICES

Clause 164

Issue: Support proposed change

Submissions
(568– Corporate Taxpayers' Group, 576 – New Zealand Venture Capital Association Incorporated, 589 – KPMG, 578 – New Zealand Institute of Chartered Accountants, 594 – New Zealand Law Society, 597 – PricewaterhouseCoopers)

Submissions agree with proposal to treat certain activities involving actively managed investment in connection with equity securities and participatory securities as supplies of financial services.

Recommendation

That the submissions be noted.

Issue: Passive investment in equity securities and participatory securities

Submissions
(595 – AXA, 597 – PricewaterhouseCoopers)

All investors should be able to treat investments in equity securities and participatory securities as supplies of "financial services". *(AXA)*

The amendment should apply not only to activity investment but passive investment. The amendments create a bias between active and passive investment. *(PricewaterhouseCoopers)*

Comment

Balancing competing considerations – removing tax cascades while taxing the consumption of financial services

The amendment is the product of further consultation with interested parties following the commencement of rules on 1 January 2005 that allow the supply of financial services to be zero-rated in a business-to-business context. The policy intent behind those rules is to address the creation of tax cascades brought about by exempting goods and services from GST.

Tax cascades arise when irrecoverable GST incurred by a taxpayer is passed on by way of higher prices for goods and services sold by that taxpayer. In the context of equity investment, investors may require higher rates of return from investments to offset any irrecoverable GST. While this impact may not strictly be a "tax cascade", there are similar economic effects if the inability to deduct input tax results in businesses having to produce higher returns. In the context of equity investment, these effects could potentially result in the following outcomes:

- Business may need to increase prices for their goods and services if there is a need to provide higher returns to compensate for the irrecoverable tax cost.
- The tax cost may have to be absorbed by businesses through reducing the extent to which retained earnings are reinvested so that shareholders continue to receive a higher rate of return.

The removal of tax cascades, however, needs to be balanced against the policy objectives of exempting financial services. Notwithstanding the zero-rating reforms that commenced on 1 January 2005, supplies of financial services in New Zealand are generally still treated as exempt from GST. Exempting the supply of financial services effectively treats financial services providers as if they are final consumers, thereby ensuring that financial services do not escape the GST net and are to a degree aligned in this respect with other services.

When tax cascades should be removed

Consultation leading to the development of the amendment suggested that the balance between removing tax cascades and the objective of taxing financial services using exemption was weighted against activities providing active equity investment.

In relation to equity investment, the argument concerning the creation of tax cascades is strongest in cases when venture capital investment funds and investment companies provide a significant level of expertise and management to businesses in connection with making an investment in the equity of those businesses. This is because the cost of providing the expertise and management is more likely to be borne directly by the entity in which the investor has an ownership interest than would be the case with investment that is more passive in nature.

The courts in both New Zealand and the European Union have considered the circumstances when equity investment is an activity that should be included in the GST base and the providers of that activity should be able to deduct input tax. In general, the boundary depends on the nature of the investment.

Investment that is passive and involves the receipt of dividends or similar receipts is generally not considered to give rise to a taxable activity involving the provision of goods and services for a consideration. For example, a one-off business-to-business transaction and direct investment by households in equity securities would not generally constitute a taxable activity. Passive investment should be treated as final consumption and not give rise to an entitlement to deduct input tax.

If the amendment were changed in the manner suggested by submissions, officials consider there is a risk that the policy behind the financial services exemption would be undermined. The amendment aims to avoid providing concessionary treatment to the consumption of financial services by households if they choose to directly invest in the share capital of an entity. There may be instances where business-to-business investments in shares that do not meet the active test in the bill but give rise to tax cascades in a similar manner to business-to-business investment in debt. Officials are happy to discuss the details of these types of transactions with interested parties.

In the meantime, the amendment is deliberately drafted narrowly to ensure that taxpayers are not brought within the GST base because of any isolated or one-off direct equity investment and prevent households from registering for GST in connection with direct equity investment. Because of this potential risk, officials consider that a conservative approach to the amendment outweighs the potential benefits of removing every incidence of tax cascades in the economy.

Recommendation

That the submissions be declined.

Issue: Supply made for a consideration

Submissions
(597 – PricewaterhouseCoopers)

A deeming rule should be introduced to provide that investing in equity securities and participatory securities is for a consideration. The value of the supplies in proposed section 3(1)(kb) should be specified.

Comment

Officials consider that the GST Act's current definition of "consideration" is sufficiently broad to deal with the concern raised by the submission. The amendment contemplates that the supplies in the amendment will be for a consideration.

An exception to this view is the situation when the only activity is the receipt of dividends in connection with equity investment. For example, a person investing in shares will not be treated as making a supply for a consideration if the only thing received by the person is dividends. In those circumstances the person is not considered to be carrying on a taxable activity as they are not supplying goods and services for a consideration.

The amendment is directed at situations when an entity, either an investment company or venture capital fund, invests in the share capital of another entity and actively manages that investment by, for example, involvement in the strategic direction of the company or the provision of advice. The definition of "actively managed investment" is considered on page 74. The consideration given by the entity to the investor in response to this activity may take a variety of forms.

"Consideration" is typically thought of in terms of discrete amounts or obligations, such as explicit fees. "Consideration" can also take the form of margins in certain circumstances. While the application of the GST Act to margins has not been considered by the courts, the GST Act provides specific rules – for example, sections 10(12), 10(14) and 10(15A) – on the valuation of supplies that are calculated on the basis of margins, and the idea has been considered and approved in other jurisdictions.[1] Inland Revenue's guidelines on the application of the zero-rating of business-to-business supplies of financial services also recognises that financial services providers price their services in a variety of ways and accepts that consideration can be in the form of either discrete fees or margins.[2]

To deem the supply to which the amendment applies to be for a "consideration" could have the effect of widening the scope of the amendment beyond that intended. Indeed, the submission could have the effect of overruling the GST Act's definition of "taxable activity", which is intended to limit the obligation to charge and return GST to activities that are of a business-like nature. If this limitation were removed it would be possible for households to register for GST in connection with direct share ownership in companies and for one-off business holdings to be treated as taxable activities.

The submission raises a second concern about the value of the supplies to which the amendment applies. Officials note that Inland Revenue's *GST guidelines for working with the new zero-rating rules for financial services* will apply to taxpayers that seek to zero-rate active investment services under the amendment. Inland Revenue's guidelines provide commentary on valuing supplies of financial services and the application of the GST Act's apportionment rules.

Recommendation

That the submission be declined.

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[1] See *Commissioners of Customs and Excise v First National Bank of Chicago* Case C-1792/96.
[2] *GST guidelines for working with the new zero-rating rules for financial* services. See page 64, Inland Revenue Department *Tax Information Bulletin* Vol. 16 No 10 (November 2004)

Issue: Definition of "actively managed investment"

Submissions
(576 – New Zealand Venture Capital Association Incorporated, 589 – KPMG, 597 – PricewaterhouseCoopers)

The definition of "actively managed investment" should be changed so that it applies to investments that:

- are equal or greater than 10% of all the participatory securities and equity securities issued by an entity; or
- allow the investor to influence the management of the entity in which the investment is made.

Alternatively, an investor should not lose the status of actively managing an investment if as a result of subsequent events the investment falls below 10%.

Comment

Meaning of the term "actively managed investment"

As currently worded "actively managed investment" means an investment that:

- is equal to or greater than 10% of all participatory securities and equity securities issued by the entity into which the investment is made; and
- allows the investor, or a person associated with the investor, to influence the management of the business of the entity.

Submissions recommend that the two limbs be disjunctive.

Arguments against making the limbs disjunctive tests

Officials have noted under the heading *Passive investment in equity and participatory securities* that the amendment is directed at active investment in the share capital of another entity (the investee). We therefore do not agree that taxpayers should be treated as making supplies of financial services if the investment represents 10% of an investee's share capital but does not allow the investor to influence the management of the investee. To do so would potentially allow passive investment to give rise to input tax deductions. We therefore do not agree that the first limb should operate without reference to the second limb.

The second limb considers whether the investment allows the investor an active role in the management of the investee entity. The submissions from New Zealand Venture Capital Association Incorporated (576) and PricewaterhouseCoopers (597) note that the ideas behind the words "management" and "influence" are broad. Officials agree with factors identified by the New Zealand Venture Capital Association Incorporated, such as a seat on the Board, providing management advice, or involvement in the strategic direction of the company, which taxpayers should have regard to when determining whether an investment gives the investor influence.

Officials consider that without the first limb it is possible the second limb may need to be reworded to impose a higher level of management influence. It would be necessary to place a more restrictive interpretation on what constitutes "influence" to ensure that passive investment was not included in the scope of the amendment.

Officials therefore disagree that the two limbs should be made disjunctive.

Alternative suggestion

Submissions raise a second point that the definition should provide for situations when an investment interest that initially meets the criterion of an "actively managed investment" but fails following subsequent investment by other parties has the effect of diluting the initial investment.

The submission by New Zealand Venture Capital Association (576) at page 7 gives the example of three venture capitalists that take a 20% interest in a target company. After a number of years, the target company becomes successful, and additional investors buy into the target company. The effect of the subsequent investment dilutes the original investment by the venture capitalists and means that they no longer qualify to treat the investment as a supply of financial services. The submission notes that this problem can be rectified if the original venture capitalists combine their interests using another entity through which they invest. The submission considers that this is an unnecessary use of resource and recommends that the first limb of the definition require only that the initial investment exceed 10%.

Officials are concerned that if the definition is amended along the lines suggested, it would make it difficult for taxpayers to build up interests that would meet the criterion of "actively managed investment". While the problem raised by submissions may be typical of investment holdings in the venture capital sector, officials consider that the amendment should not disqualify taxpayers that seek to acquire an initial passive interest in a target company and gradually build on that interest to the point where they can influence the management of the investee.

Officials understand that investment interests where influence is exercised are usually greater than 10%. Officials acknowledge that there will be exceptions to this observation because of the mana, personality or specialist know-how possessed by an individual investor.

Officials consider, however, that these exceptions are at the margin and that the GST Act may already provide a solution, particularly if the individual investor carries on a taxable activity of providing taxable supplies such as management advice or acting as a director. These supplies would allow the investor access to input tax deductions. Officials further note that the problem identified in submissions can be addressed in the manner suggested in the submission from New Zealand Venture Capital Association. Individual investors faced with the possibility of falling below 10% can aggregate their interests in another entity to preserve their interest in the investee.

Recommendation

That the submissions be declined.

Issue: Active management exercised through an independent manager

Submissions
(576 – New Zealand Venture Capital Association Incorporated, 589 – KPMG, 597 – PricewaterhouseCoopers)

The second part of the definition of "actively managed investment" applies when an investor or a person associated with the investor is able to influence the management of the investment entity. It is common within the venture capital industry for the manager to be an independent entity.

Recommendation

That the submission be accepted. Paragraph (b) of definition of "actively managed investment" should be amended to include situations when the investor uses an independent third party to influence the management of an investee.

GST ON FRINGE BENEFITS

Clause 165

Issue: Support proposed change

Submissions
(568 – Corporate Taxpayers' Group)

The submission agrees with the proposed change

Recommendation

That the submissions be noted.

Issue: Application date

Submissions
(578 – New Zealand Institute of Chartered Accountants)

The application date of the proposed change should be either 1 October 1986, the date GST commenced, or 10 October 2000 the date the GST treatment of vouchers changed.

Comment

Officials agree that the correct policy result is not to impose GST in situations when an employer has been unable to deduct input tax in connection with providing a fringe benefit. The issue is whether the amendment should be retrospective or prospective.

When the issue of retrospective legislation has previously been considered by this Committee, officials have argued that retrospective legislation is justified when it restores or at least does not contravene the rational and legitimate expectation of all parties. This principle does not, however, justify retrospective changes in the law to implement a policy decision that, had it been made at the time, would have been reflected in the legislation.

In any event the practical consequences of retrospective legislation are not sufficiently certain for officials to recommend that the change be made retrospective.

Recommendation

That the submissions be declined.

GST GROUPING RULES

No clause (refer SOP No 45)

Issue: Clarification that representative member must be a registered person

Submission
(Matter raised by officials)

An amendment is necessary to ensure that the representative member of a GST group is a registered person.

Comment

Section 55(3) of the GST Act requires one person in a GST group to be the representative member. The section is based on the current requirement that all members of the group are registered for GST. If clause 165B is enacted, this will no longer be the case. It is arguable that a taxpayer may choose an unregistered person to be the representative member of a GST group. This potentially presents a number of systems problems in terms of Inland Revenue receiving GST returns from a person that is technically not recognised as legally being able to charge GST.

Officials recommend that section 55(3) be amended to ensure that the representative member is a GST-registered person. It is recommended that the amendment apply from 1 October 2001, in line with the application date of the amendments in SOP 45.

Recommendation

That the submission be accepted.

Issue: Drafting clarification

Submissions
(597 – PricewaterhouseCoopers)

The amendment to section 55(1) of the GST Act should clarify that the test allowing unregistered companies to be included in a GST group measures the ratio of taxable supplies to total supplies to third parties and does not include intra-group transactions. The change ensures that only supplies to persons outside the GST group are measured.

Recommendation

That the submission be accepted.

ELECTION TO ZERO-RATE SUPPLIES OF FINANCIAL SERVICES – DRAFTING CIRCULARITY

No clause

Submissions
(576 – New Zealand Venture Capital Association Incorporated, 589 – KPMG)

The reference to "registered person" in section 20F(1) should be a reference to "person".

Section 20F(1) currently requires GST-registered persons to elect to zero-rate supplies of financial services to businesses. However, if a person carries on an activity that involves supplying financial services within New Zealand that person is not considered to be carrying on a taxable activity and is prevented from registering for GST. Therefore a person making exempt supplies is not a registered person and is not able to made zero-rated taxable supplies that would enable them to register for GST.

Recommendation

That the submission be accepted. Section 20F(1) should be amended so that it refers to a "person" rather than a "registered person". Officials recommend that the amendment apply from the date the bill is enacted.

CAPITAL RAISING COSTS

No clause

Submissions
(597 – PricewaterhouseCoopers)

Businesses should be able to deduct GST incurred as part of raising capital. Recent overseas developments in the European Union and Canada support the deduction of input tax in connection with raising capital.

Comment

Officials note that the submission does not directly relate to the GST amendments in this bill. While there is an arguable connection with raising capital through the issue of equity securities and participatory securities and the amendment treating active investment in these financial instruments as a financial service, the submission seeks to widen the ground on which businesses are able to recover input tax for supplies that are currently treated as exempt supplies.

As noted under the heading *Passive investment in equity and participatory securities*, officials consider that businesses that supply financial services should be treated as final consumers. An exception to this policy applies if the financial services are:

- exported, in which case consumption occurs outside New Zealand and should be zero-rated, or
- supplied to businesses, in which case if the supplier has elected to do so, should be zero-rated to reduce the incidence of tax cascades.

In all other circumstances, officials consider that the supply of financial services should be treated as exempt supplies, and businesses should be unable to deduct GST incurred in making those supplies. This policy is consistent with the objective of GST taxing the widest range of goods and services supplied in New Zealand and recognises the practical difficulties associated with directly imposing GST on financial services.

The submission notes that some European Union member countries have started allowing businesses input tax deduction in connection with capital raising following the European Court of Justice (ECJ) decision *Kretztechnik AG v Finansamt Linz*.[3] The analysis underpinning the ECJ decision has been considered by officials, and the issue has been included in the tax policy work programme.

Officials note that under the business-to-business rules for financial services, New Zealand businesses are able to recover a greater percentage of GST incurred in connection with share capital issues to business than was previously allowed before the introduction of the rules.

Recommendation

That the submission be noted.

[3] Case C-465/03 26 May 2005.

GST ON IMPORTED SERVICES – RELATED PARTY CHARGES

No clause

Submission
(307W – KPMG)

Section 10(15C) of the Goods and Services Tax Act 1985 (the GST Act) does not contemplate the situation when a non-resident makes a supply of services to a resident where either the non-resident or the New Zealand resident (or both) are not companies or unit trusts. This omission means that the value of related party charges subject to the reverse charge cannot be reduced for any salary or interest charges.

Comment

The issue identified by the submission is not directly connected with the proposed GST changes contained in this bill.

Under the reverse charge, which imposes GST on certain imported services, taxpayers may reduce the taxable value of certain imported services to take into account internal salaries, wages and interest costs. The reduction applies when the costs are allocated from a non-resident parent or head office to a New Zealand-based subsidiary or branch.

The problem identified by the submission is one of a number of remedial legislative matters that have been identified following the introduction of the reverse charge. These issues are currently on the tax policy work programme. The concern identified by the submission will be added to this work.

Recommendation

That the submission be noted.

REMOVING GST FROM LOCAL AUTHORITY RATES

Clauses 164 and 165

Submissions
(616W – National Council of Women of New Zealand Incorporated)

The submission recommends removing GST from local authority rates.

Comment

The submission implies that the amendments in the bill to treat actively managed investment as a supply of financial services and remove GST on fringe benefits when the employer is unable to deduct input tax are a departure from the policy that New Zealand's Goods and Services Tax Act apply to widest possible range of goods and services supplied in New Zealand.

Officials disagree and note that the submission is not connected with the GST proposals in the bill. Clause 164 is designed to deal with problems arising from the exemption of certain financial services. Clause 165 is designed to ensure that fringe benefits are not subject to GST twice in certain circumstances. These amendments do not affect the size or scope of the GST base in terms of taxing final consumption in New Zealand.

Removing GST from local authority rates would on the other hand reduce the effectiveness of GST as a broad base, low rate tax.

The imposition of GST on local authority rates is justified on policy and administrative grounds. Rates are the means by which local authorities charge for the provision of community goods and services such as sewerage, libraries, flood control, and goods and services supplied directly to households, such as water. As such, rates represent consideration for a supply of goods and services.

This was the view of the Advisory Panel on Goods and Services Tax, which considered public submissions on the proposed operation of GST in 1985. The Panel observed that the application of GST on rates had caused considerable concern on the part of ratepayers, but concluded that rates should be viewed as payment for the services provided by local authorities. The services represent consumption by ratepayers and GST, being a tax on consumption, should apply.

Recommendation

That the submission be declined.

Remedial amendments

TAXATION OF BUSINESS ENVIRONMENTAL EXPENDITURE

Clauses 2(8), 11, 47, 48, 49, 132, 142 and 158

New rules for business environmental expenditure were enacted on 21 June 2005 and took effect from 10 June 2005.

The changes clarified and expanded tax deductions available for business environmental expenditure. They were made to ensure that all business operating costs, including those for dealing with environmental concerns, are taken into consideration in calculating taxable income, and that the timing of such deductions is appropriate.

A number of remedial changes were made to clarify the new business environmental rules and ensure that the original legislation has its intended effect.

The two submissions were supportive of the proposed changes to the business environmental expenditure rules.

Issue: Support for amendments

Submission
(589 – KPMG, page 42, 616W – National Council of Women of New Zealand (Inc))

The new application date for the new meaning of "industrial waste" is supported.

Recommendation

That the submission be noted.

Issue: Transfer of ERA deposits to Ministry for the Environment

Submission
(Matter raised by officials)

The section EK 16 reference to funds being transferred to the Ministry for the Environment should be removed.

Comment

The business environmental rules contain an Environmental Restoration Account (ERA) mechanism that allows business taxpayers, through making a deposit, to set aside a portion of their tax payments to pay for future site restoration and monitoring expenditure. The ERA rules were designed so that deposits in an ERA follow the related restoration liability. Therefore when taxpayers dispose of their restoration liability to another taxpayer (say, through the sale of a site) the related funds in the ERA are transferred to the new owner. It was originally thought that the liability might, in effect, be transferred to the New Zealand government (for example, where there is an orphan site). In this case, section EK 16 provided for any related ERA deposit to be transferred to the Ministry for the Environment.

Subsequent work by officials indicates that this is now unlikely. As such, it is no longer necessary to provide for a transfer of funds to the Ministry for the Environment.

Recommendation

That the recommendation be accepted.

Issue: ERA of Consolidation Group

Submission
(Matter raised by officials)

Section EK 20, which deals with the ERA of a consolidated group, should make specific reference to the ability of a nominated company to make transfers.

Comment

The current wording of section EK 20 allows the nominated company for a consolidated group to make ERA payments and applications for refunds on behalf of the consolidated group. For completeness, the nominated company should also be allowed to make and receive ERA transfers.

Recommendation

That the recommendation be accepted.

TAX DEPRECIATION TREATMENT OF PATENTS

Submission
(597 – PricewaterhouseCoopers)

There is an error in the Commentary on the bill relating to the application date, which should be acknowledged in the *Tax Information Bulletin* on the new legislation, once enacted.

Comment

The submission comments that references in the Commentary incorrectly refer to "patent applications with complete specifications lodged before 1 April 2007". The reference should instead be "patent applications with complete specifications lodged before 1 April 2005".

Officials agree that the correct reference is "patent applications with complete specifications lodged before 1 April 2005" and will clarify this in the *Tax Information Bulletin* on the new legislation once enacted.

Recommendation

That the submission be accepted.

Submission
(578 – New Zealand Institute of Chartered Accountants)

The "costs of patent rights and applications" should be defined for the purposes of the Income Tax Act so that it includes any "costs of invention" provided that these costs have not been claimed as a deduction under section DB 26 (which allows deductions for research and development expenditure) or any other provision of the Act.

Comment

The submission comments that invention costs may be "black hole" expenditure owing to investors not being able to claim this expenditure under the deductibility provisions for research and development (section DB 26) or opting to capitalise this expenditure. The submission considers that, in these circumstances, invention costs should be included in the cost of patent rights and depreciated.

As noted in the submission, in December 2005 the Commissioner of Inland Revenue released an interpretation statement in which he concluded that "invention costs" should not be included in the cost of a patent. Officials consider that this is the correct result because the patent is a separate asset which gives the holder property rights and protections over the use of a product or process. The invention may be the product or process that is patented.

To include the costs of invention in the costs of patent rights and applications would also create significant uncertainty as to whether invention costs should be immediately deducted under the research or deductibility provisions or be capitalised and depreciated as part of the cost of a patent.

It should further be noted that the government's recent *Business Tax Review* discussion document contains an option to provide deductions for so-called "black hole" expenditure, generally. This option would seem to be more applicable to invention costs for which a deduction cannot currently be claimed.

Recommendation

That the submission be declined.

Issue: Economic rate for plant, equipment or buildings with high residual value

Submission
(597 – PricewaterhouseCoopers)

The proposed application date is too broad in application so does not achieve its goal of applying section EE25 E to plant and equipment acquired on or after 1 April 2005 and buildings acquired on or after 19 May 2005. The scope of the application of this provision should be narrowed.

Comment

We agree with the submission.

Recommendation

That the submission be accepted.

Issue: Definition of "motor vehicle"

Submission
(578 – New Zealand Institute of Chartered Accountants)

The definition of "motor vehicle" should be changed to refer to vehicles not available for hire for a period of longer than one month, vehicles which are taxis, vehicles which are minibuses and vehicles which qualify for a "passenger service licence" under the Transport Services Licensing Act 1989 but not vehicles which qualify for a "goods service licence" under the same Act.

Comment

The proposed definition of "motor vehicle" is "vehicles which are designed exclusively or mainly to carry people and has seats for no more than twelve people". We consider this definition is clear and does not require definitions for such terms as "taxi" or "available for hire". A design-based approach, rather than a use-based approach, as recommended in the submission, seems to more clearly focus on the underlying asset than a use-based approach would.

Recommendation

That the submission be declined.

Issue: Amendment of section EE 25D(2)

Submission
(1221 – Ernst & Young)

Section EE 25D(2) of the Act should be amended to enable aircraft used for top dressing or spraying to be depreciated at rates under sections other that EE 25D.

Comment

We agree that section EE 25D(2) does apply to aircraft used for top dressing or spraying and this is not the policy intention.

Recommendation

That section EE 25D(2) be amended to reflect the policy intent.

DEATH AND ASSET TRANSFERS

Clause 80

Submission
(578 – New Zealand Institute of Chartered Accountants)

For the avoidance of doubt, the proposed wording in section FI 6 should be amended from "to which subpart FF applies if the beneficiary of the property is within the second degree" to "to which subpart FF applies if the person who is beneficially entitled to receive the property within the second degree".

Comment

The amendment ensures that roll-over relief applies to forestry assets at the date of a taxpayer's death, irrespective of whether a life tenant is entitled to part of the trust property, and irrespective of who the trustees of the estate are.

Officials consider that the amendment makes it clear that the roll-over applies if the beneficiary of the forest is related within the second degree to the deceased taxpayer. We consider that no further change or clarification is required.

Recommendation

That the submission be declined.

Clause 81

Submission
(597 – PricewaterhouseCoopers)

The heading to section FI 7 should be amended to read "Relationship of subpart FI to subpart CB".

Comment

Currently, section FI 7 is headed "Relationship of section FI 2(2) to subpart CB". Section FI 2(2) requires certain property to be transferred at market value for tax purposes. Subpart CB deals with income from business or trade-like activities; specifically, profits on certain sales of land are deemed to be taxable income.

If section FI 7 did not exist the effect, for the purposes of determining the amount of income relating to those transactions, property would be deemed to be disposed of at market value. Accordingly, officials consider that the heading for section FI 7 is appropriate and should not be changed.

Recommendation

That the submission be declined.

Clause 151

Submission
(578 – New Zealand Institute of Chartered Accountants)

Clause 151 should state that provisional and terminal tax due in the year in which the taxpayer's death occurs are paid by due date.

Comment

The intention is that concessionary use-of-money interest rules should apply to any income tax liability arising in relation to the period that ends with the taxpayer's death (subject to the condition that relevant liabilities are paid on time). A clarification is required to clause 151 to reflect this policy.

Recommendation

That clause 151 be amended to ensure that the concessional treatment applies only if provisional tax and terminal tax relating to the year of death are paid by the due date.

Clauses 80, 81(4), (5) and (6) and 151

Submission
(Matter raised by officials)

The commencement date for these clauses in clause 2 of the bill should be amended from 21 June 2005 to 1 October 2005.

Comment

The substantive death and asset transfer provisions were enacted in the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005. Although the Act received Royal assent on 21 June 2005, the death and asset transfer provisions did not come into force until 1 October 2005. Accordingly, the commencement date for clauses 80, 81(4), (5), and (6) and 151 should be 1 October 2005, rather than 21 June 2005.

Recommendation

That the submission be accepted.

SHARE-LENDING RULES

Clauses 2(13), 103, 123 and 142)

Submission
(729W – Ernst & Young Limited, pages 2-4)

The reference to an associated person in section ME 5(1)(ac) is unnecessary and should be removed.

Comment

The definition of "returning share transfer" in section OB 1 includes an associated person test. As part of introducing the share-lending rules, section ME 5(1)(ac) was also amended to include a reference to "a person associated with a share user".

The intention of the change was to cancel the benefit of imputation credits arising from a returning share transfer that does not qualify as a share-lending arrangement.

It has been submitted that the reference to "associated person" in the definition of "returning share transfer" is sufficient to achieve the desired result of cancelling the tax benefit obtained by a share user (or associate) in a returning share transfer. Ernst & Young Limited consider that the reference to an associated person in section ME 5(1)(ac) is unnecessary, creates unintended outcomes, particularly for those in the financial services industry, and should be removed.

Recommendation

That the submission be accepted.

Issue: Reversal of intended changes

Submission

(Matters raised by officials on the recommendation of the Rewrite Advisory Panel)

Intended changes in legislative outcomes in the Income Tax Act 2004 as part of the project rewriting the Income Tax Act should be reversed.

The provisions involved are sections DO 6 and DP 3 of the Act (sections DO 5 and DL 2 of the Income Tax act 1994) in so far as they relate to certain aquaculture and forestry expenditure incurred before the 1995-06 income year.

Comment

In rewriting sections DO 5 and DL 2 of the 1994 Act as sections DO 6 and DP 3 of the 2004 Act, application of these rules to qualifying aquaculture and forestry expenditure incurred before the 1995-06 income year was omitted. The basis for this omission was that the provision was spent.

This proposal was set out in the Exposure Draft of these provisions, released for public comment in September 2001, and also in the Income Tax Bill 2002. These draft provisions were also reviewed by private sector tax specialists. No submission received before enactment of the Income Tax Act 2004 suggested that the omission of application of these rules to qualifying aquaculture and forestry expenditure incurred before the 1995-06 income year proposal was in error. As a result, sections DO 6 and DP 3 of the 2004 Act do not apply to certain aquaculture and forestry expenditure incurred before the 1995-06 income year.

Earlier this year, the Rewrite Advisory Panel received a submission that there remain some taxpayers with qualifying expenditure incurred before the 1995-06 income year. The Panel noted that the non-application of these provisions to this expenditure was an intended change. However, the Panel recommended that officials consider reinstating the application of these rules to the qualifying expenditure.

Officials agree with this recommendation as it is clear that some taxpayers with qualifying aquaculture and forestry expenditure incurred before the 1995-06 income year will be adversely affected unless sections DO 6 and DP 3 of the 2004 Act apply to this qualifying expenditure.

Recommendation

That the proposed amendments to restore the outcomes of the 1994 Act be included in the bill and that they apply from the beginning of the 2005-06 income year, that being the commencement date of the 2004 Act for all taxpayers.

Issue: Clause 34 (sections EE 33 and EE 34 of the Income Tax Act 2004)

Submission
(1221-12 – Ernst & Young)

The proposed new sections EE 33(4) and EE 34(3) should provide that the tax depreciable cost limitations in subsections (3) and (2) respectively will not apply to items other than depreciable intangible property where the Commissioner decides that it is appropriate to use the cost of the item.

The reference to the Commissioner deciding this matter should be deleted and taxpayers should be allowed to treat their actual cost or the market value price deemed as the transfer price under other provisions of the Act as their tax depreciable cost base for all tangible items.

Comment

Sections EE 33 and EE 34 are being amended on the recommendation of the Rewrite Advisory Panel. The Panel concluded that section EE 33 contains an unintended change in law in that it is not restricted to transfers of property between associated persons, as was the case under the Income Tax Act 1994.

Clause 34 corrects this unintended change and reverses the order of sections EE 33 and EE 34 of the 2004 Act. The submission does not relate to these changes, but instead comments on a provision in sections EE 33(4) and EE 34(3), which is the same as the equivalent provision in the current Act. These subsections have not been amended by this bill but are simply a re-statement of the existing law.

Recommendation

That the submission be declined.

Issue: Section CB 11

Submission
(574 – Staples Rodway)

Section CB 11 should be amended to include the words "to the extent that the amount is derived from the carrying on or the carrying out of the undertaking or scheme". Further the scope of the section would be more appropriately confined if it was subject to sections CB 18 and CB 21 (business and investment exclusions).

Comment

This submission is making the same points on section CB 11 as has been put to the Rewrite Advisory Panel, chaired by Sir Ivor Richardson. Those submissions to the Panel have argued that the omission of the words "to the extent" has led to an unintended change in law. This argument has not been accepted by the Panel, which has stated publicly on its website that it is not persuaded that an unintended change in law has occurred in the drafting of section CB 11.

Officials agree with the conclusions of the Rewrite Advisory Panel. We also note that the submission seems to be requesting that an amendment to section CB 11 be inserted into the current bill.

Recommendation

That the submission be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants, 616W – National Council of Women of New Zealand (Inc))

Neither organisation has specific submissions to make on these changes, although the National Council of Women of New Zealand (Inc) (NCWNZ) finds the re-defined definitions helpful.

However, each submission takes the opportunity to make more general observations about the family assistance provisions in the Income Tax Act 2004.

The New Zealand Institute of Chartered Accountants comments on the complicated nature of the legislation relating to family assistance and considers that a thorough review of the legislation is needed to identify opportunities for simplification and clarity.

The NCWNZ reminds the government of its policy of a Universal Child Benefit as a more appropriate instrument to assist all families.

Comment

It is understood that New Zealand Institute of Chartered Accountants has made a submission on the exposure draft of the Rewrite of Part K of the Income Tax Act 2004. The Rewrite is the appropriate vehicle for achieving greater simplicity and clarity of the family assistance legislation.

One of the key objectives of the Working for Families package of assistance was to ensure income adequacy, with a focus on low and middle-income families with dependent children to address issues of poverty, especially child poverty. Providing assistance to all families would inevitably mean that the available funds would have to be spread more thinly, meaning there would be a less positive impact for families whose income is inadequate to meet their needs.

Recommendation

That the submissions be noted.

LIMIT ON REFUNDS AND ALLOCATIONS OF TAX

Clause 112

Submission
(578 – New Zealand Institute of Chartered Accountants)

The change is supported because it corrects an anomaly in the existing provisions.

Recommendation

That the submission be noted.

Submission
(578 – New Zealand Institute of Chartered Accountants)

The wording of clause 121 should be aligned with that of clause 161.

Comment

Clauses 121 and 161 amend the 1994 and the 2004 Income Tax Acts respectively, to extend the circumstances when tax overpaid before a breach in shareholder continuity can be refunded.

The drafting of the amendment to the 2004 Act (clause 121) incorporates a change made in the Taxation (Depreciation, Payment Dates Alignment, FBT and Miscellaneous Provisions) Act 2006 to the same underlying section. As the amendment made in the 2006 Amendment Act does not apply until the 2008-09 income year, it should not have been included in the current amendment.

Recommendation

That the submission be accepted.

FRINGE BENEFITS

Clause 115

Submission
(597 – PricewaterhouseCoopers)

The exemption in the proposed section ND 1A(1F)(b) should apply to vehicles owned or leased by the employer or associated person for five years since the beginning of the period of the employer's initial return for the vehicle.

Comment

The amendment in the bill requires that vehicles for which an initial FBT return has been made by the employer before 1 April 2006 must be valued in return periods after that date at their cost price. An exception is provided when a vehicle has been owned for at least five years from the beginning of the initial return period, in which case the employer then has the option of using either the vehicle's cost price or tax value. The reason this exception does not extend to vehicles leased for at least five years is that, as we understand, leases do not last five years and hence we wished to avoid adding further qualifications to what is already complex legislation.

However, it may be possible that an employer has both owned and leased the same vehicle for at least five years; for example, the vehicle may have been owned for three years and then sold by the employer to an associated person and leased back. The suggested change made by the submission would allow for this possibility, and we see this as being consistent with the original policy intention.

Recommendation

That the submission be accepted.

Submission
(594 – New Zealand Law Society, 578 – New Zealand Institute of Chartered Accountants)

Any interest and penalties suffered by taxpayers arising from the retrospective nature of the change in clause 115 should be waived.

Comment

The amendments in clause 115 are proposed to apply for FBT return periods beginning on or after 1 April 2006. Both the Law Society and the Institute of Chartered Accountants consider these amendments to be a fundamental change to the law enacted earlier this year. Given that taxpayers will have to file FBT returns based on their reasonable interpretation of that law for a couple of return periods before any law change is passed, the submissions argue that taxpayers should not suffer any penalties or interest if their positions are subsequently revised by back-dated changes in the law.

Officials question the extent to which the changes in clause 115 are a fundamental change rather than a clarification of the earlier law change. But we do agree that taxpayers who take a reasonable interpretation of the law should not in this instance incur penalties should the changes in clause 115 result in a revision in their FBT liability for returns made before the law change was made. Officials do not, however, agree that this waiver should extend to interest because use-of-money interest merely reflects the time value of the underpaid tax rather than being a penalty, and the Commissioner of Inland Revenue has very limited ability to waive interest.

The Commissioner can remit interest when it is consistent with the collection of the highest net revenue over time. In this regard, the Commissioner will need to consider each case on its own merits but, as a general rule, interest will be remitted when an Inland Revenue officer has given incorrect advice (for example, if the taxpayer has directly been given an incorrect date or amount for tax payment) or when the taxpayer has relied on incorrect information contained in an Inland Revenue publication. Retrospective legislative change would not, however, qualify as general grounds for a waiver.

Recommendation

That the submissions be accepted in relation to waiving penalties but declined in relation to waiving any interest.

Submission
(594 – New Zealand Law Society)

There should be public acknowledgement, such as commentary in a *Tax Information Bulletin*, that new section ND 1A(1E) represents a change in the law.

Comment

As noted in the previous submission, officials question the extent to which the changes in clause 115 are a fundamental change rather than a clarification of the earlier law change. For example, we would argue that the area of doubt relates essentially to the treatment of vehicles leased before 1 April 2006 rather than to owned vehicles. Consequently, we consider that the more appropriate focus should be on resolving the practical implications rather than on to what extent law is being changed. The proposal to waive penalties, as outlined in the previous submission response, should address any practical implications of the amendment, and this aspect would be covered in a *Tax Information Bulletin*.

Recommendation

That the submission be declined.

Submission
(578 – New Zealand Institute of Chartered Accountants)

Clause 115 should be amended to remove the proposed section ND 1A(1E)(b)(ii).

Comment

The submission considers that section ND 1A(1E)(b)(ii) is already covered by section ND 1A(1E)(b)(i) and is therefore superfluous. Officials disagree.

Provisions b(i) and b(ii) specify which vehicles have to use the cost price method. Provision (b)(i) refers to vehicles that were owned, leased or rented during the initial return period for the vehicle, being a period beginning before 1 April 2006, whereas b(ii) refers to vehicles owned, leased or rented before 1 April 2006. There is a difference in the coverage of the two provisions.

Provision b(i) covers the general case of previously leased vehicles that were already subject to FBT in return periods beginning prior to 1 April 2006. In contrast, provision b(ii) is designed to cover 9-to-5 and flip-flop leased vehicles which, because they were outside the FBT net prior to 1 April 2006, would have had no initial FBT return period before that date. Hence, removing b(ii) would enable 9-to-5 and "flip-flop" leased vehicles to be valued under the tax value option and would hence significantly reduce the tax liability below that intended in such cases.

Recommendation

That the submission be declined.

Submission
(Matter raised by officials)

How the tax value of a vehicle is calculated when it is acquired from an associated person should be clarified, in particular that if the new owner wishes to use the tax value option then:

- When the associated person had either used the cost price method or had not used any method at all, the new owner would need to use the higher of their cost price and the cost price to the associated person as the basis for their tax value.
- When the associated person had used the tax value method, then the new owner would use the higher of their cost price and the tax value of the associated person as the basis for their tax value.

This change would apply from the date of enactment of this bill.

Comment

A problem has been identified with the way that section GC 16 interacts with clause 3 of Part A of Schedule 2.

Section GC 16 requires that when a vehicle is acquired from an associated party, the new owner of the vehicle must, for FBT purposes, value that vehicle at the higher of its cost price to the associated person or the cost price to the new owner. This rule ensures that an FBT liability cannot be lowered through switching ownership of the vehicle back and forth between associated parties to get a new lower cost price each time.

Because section GC 16 predates the latest FBT changes, it does not have any rules about what is the tax value when a vehicle is transferred between associated persons. Since the aim is to produce comparable outcomes under either valuation option, then some rules are needed in this area.

The problem is highlighted by clause 3, Part A of schedule 2. According to clause 3, the tax value is the value of the vehicle as determined under subpart EE (Depreciation) at the beginning of the income or tax year, unless the vehicle is acquired partway through the year, in which case its value is its cost price. In most cases there is not a problem unless the vehicle is acquired from an associated person.

When there is an associated person, one reading of these provisions is that the cost price that is relevant if a vehicle is transferred part-way through the year is the cost price in accordance with section GC 16 (that is, the associated person's cost price) but subsequently the tax value is the value determined under subpart EE, which does not take the associated person's cost price into consideration. This is confusing and potentially provides an opportunity for reducing the FBT liability below that intended.

Association is more likely to be a problem given that a number of vehicles that were subject to 9-5 or flip-flop leases are likely to be transferred from being owned by the employee to being owned by the employer, to reduce compliance costs. Section GC 16 may apply in these cases because an employer and employee are associated if the employee has a sufficient shareholding in the company. Quite apart from these lease situations, association will also arise on an on-going basis.

The proposed approach for resolving this problem is as follows:

Anyone could use the cost price option, which would be based on the highest cost price for the associated persons, as already provided for under the legislation.

If someone wished to use the tax value option then:

- If the associated person had either used the cost price method or had not used any method at all, the new owner would need to use the higher of their cost price and the cost price to the associated person as the basis for their tax value.
- If the associated person had used the tax value method, the new owner would use the higher of their cost price and the tax value of the associated person as the basis for their tax value.

Application date

Given that the change is being publicised only as an amendment at the select committee stage, officials recommend that this amendment apply from the date of enactment.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

The provisions that value a benefit in the form of subsidised transport need to be amended to achieve the intent that the value of the benefit is 25% of the highest fare charged by the employer or another company in the same group of companies as the employer.

Comment

This remedial change to section ND 1C is to ensure that the change agreed by the select committee in relation to a group of companies that includes a transport operator (see page 97 of the officials report of 14 February 2006 to the Finance and Expenditure Committee) is given effect to. That change allowed transport benefits provided to employees of other than the transport operator to have their transport benefits valued on the same basis as employees of the transport operator if the employer of the employees and the transport operator are in the same group of companies. Changes were made to the definition of "subsidised transport" to reflect this, but no change was made to the associated valuation provisions in section ND 1C. A couple of submissions on the bill had recommended this change but it was overlooked.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

Consequential changes to cross-references in sections ND 1U and ND 1V should be made to reflect the changes made to schedule 2 as part of the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act.

Comment

Schedule 2 was changed significantly as part of the FBT changes earlier this year, but the cross-references to that schedule in sections ND 1U and ND 1V were not updated. Consequently, the changes in clauses 115C and D are to ensure that these sections correctly cross-reference the relevant parts of the revised schedule.

Recommendation

That the submission be accepted.

Submission
(Matter raised by officials)

Section DB 45 should be amended to ensure that the owner of a vehicle that is subject to a 9-to-5 or flip-flop lease is able to claim a deduction for the full amount of any depreciation, not just the business portion.

Comment

Section DB 45 was added as part of the recent changes to the FBT rules, in exchange for applying FBT to 9-to-5 and flip-flop leases. Its purpose was to provide a full deduction of the costs associated with operating a motor vehicle. Without the provision only the business portion of those costs would be deductible.

The wording of the provision covers deductions in relation to expenditure incurred in operating a motor vehicle. It has been pointed out to us that there is a question of whether this extends to depreciation, as depreciation is treated in the tax legislation as a loss in value of a capital item rather than as expenditure. The proposed solution is that section DB 45 should refer to both expenditure and depreciation loss to ensure that both are fully deductible.

Recommendation

That the submission be accepted.

DATE ON WHICH NOTICES ARE DELIVERED

Clauses 138, 139 and 140

Submission
(578 – New Zealand Institute of Chartered Accountants, 597 – PricewaterhouseCoopers)

Clauses 138 and 140 should be deleted.

Comment

Clauses 138 and 140 amend sections 14(9) and 14C(8) of the Tax Administration Act 1994 to repeal rebuttable presumptions that notices are delivered on the day on which they are postmarked. The submissions argue that these presumptions, relating to notices given by the Commissioner and notices between a taxpayer and a third party, should be retained as they provide certainty.

The presumptions are being repealed because they are of little value. They are rebuttable, so senders are able to give oral evidence that a notice was posted prior to the date of the postmark, if that was the case.

Recommendation

That the submission be declined.

Submission
(597 – PricewaterhouseCoopers)

If the submission above (that the presumption should be retained so that taxpayers who have retained postmarked envelopes received from Inland Revenue are able to rely on the presumption) is rejected, further guidance should be provided as to what evidence the Commissioner will consider in coming to his view on whether a notice would have been delivered "in the ordinary course of the post".

Comment

The Commissioner will continue to use the same rules that were used in the past. A postmarked envelope will be accepted as evidence that the notice was posted, at the latest, on the day of the postmark.

Recommendation

That the submission be accepted.

PAYROLL SUBSIDY

Submission
(Matter raised by officials)

Minor technical revision should be made to section NBB 5(5) of the Income Tax Act 2004.

Comment

A drafting error resulted in incorrect cross-reference to “subsection (3)” being used instead of a cross-reference to “subsection (4)”. The redrafted version of NBB 5(5) should include correct cross-references.

Recommendation

That the submission be accepted.

CHANGING GST TAXABLE PERIODS

Submission
(Matter raised by officials)

A legislative amendment should be made to the GST Act to fix a drafting oversight whereby GST-registered taxpayers will not be able to change between different GST taxable periods.

The error occurred as part of the recent changes to align provisional tax payments with GST payments.

Comment

Section 15A of the GST Tax Act 1985 enables provisional taxpayers to change between different GST taxable periods – for example, from paying GST monthly to two-monthly.

A number of sections, including section 15A of the GST Act, were amended by the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006. However the provisions which enable GST-registered taxpayer to change between different taxable periods was omitted.

Officials recommend that these omitted provisions be reinstated, with effect from the 2008-09 income year, being the date of the other GST changes.

Recommendation

That the submission be accepted

Issue: Allocation of research and development tax deductions

Clause 46

Submission
(597 – PricewaterhouseCoopers)

The rationale for this clarifying amendment is supported but the wording of the two new subsections is cumbersome and overly complex and should be simplified.

Comment

Officials do not agree that the drafting of the two new subsections is unwieldy. The provisions clearly state the maximum and minimum thresholds for the amount of the relevant deduction that can be allocated to an income year.

Recommendation

That the submission be declined.

Issue: Corporate migration terminology

Clauses 121, 125, 146 and 147

Submission
(597 – PricewaterhouseCoopers)

Section 29(1C)(b) of the Tax Administration Act 1994 should also be amended so that the term "emigration time" is used in that provision instead of "emigration date".

Comment

Officials agree with the submission.

Recommendation

That the submission be accepted.

Issue: Corporate migration changes

Clauses 121, 125, 146 and 147

Submission
(565 – NZBio)

Investors in companies conducting significant research and development should be excluded from the corporate migration amendments enacted in 2005.

Comment

The amendments in this bill make minor terminology corrections only to the corporate migration amendments enacted in a separate Act last year. The submission, which seeks to make substantive changes to the corporate migration rules, is therefore outside the scope of this bill.

Recommendation

That the submission be declined.

Other matters raised by officials

TEMPORARY EXEMPTION FOR NEW MIGRANTS

Submission
(Matter raised by officials)

Legislation earlier this year introduced a tax exemption for new migrants. The exemption is available to people coming to live in New Zealand on or after 1 April 2006 for the first time or after an extended absence. It lasts for four years after migration and covers most types of foreign income.

Since that legislation was enacted, three technical difficulties have been identified:

- In certain circumstances, new migrants may become tax-resident in New Zealand without qualifying for the exemption, contrary to the policy intent.
- While some new migrants may be better off without the exemption, there is currently no mechanism allowing them to opt out.
- Current law may require that resident withholding tax is deducted from income covered by the exemption.

These problems should be corrected.

Comment

Timing and eligibility

There are two ways new migrants can become tax-resident in New Zealand: by acquiring a "permanent place of abode" (making their home) here or by being present in the country for more than 183 days in a 12-month period. (Where the 183-day rule applies, a person becomes tax-resident from the first of those 183 days.)

Currently, new migrants qualify for the exemption only after they acquire a permanent place of abode in New Zealand. Focusing on permanent place of abode was intended to avoid situations where people can qualify for the exemption "too soon" – for example, where a temporary visit to New Zealand before actual migration triggered tax residence under the 183-day rule. However, it has now become clear that this approach introduces a potential mismatch between the rules for the exemption and the general tax residence rules: in certain circumstances, new migrants may become tax-resident in New Zealand without qualifying for the exemption.

Officials therefore recommend that the timing and eligibility rules for the exemption be amended, as follows:

- To avoid the possibility that a new migrant may become resident for tax purposes without qualifying for the exemption, the eligibility and timing rules for the exemption should be aligned with the general tax residence rules.

- To resolve issues associated with people qualifying for the exemption too soon, any backdating under the 183-day residence rule should be ignored for the purposes of the eligibility rules and time-limit for exemption.

Allowing people to opt out of the exemption

In certain circumstances, new migrants may be better off not receiving the exemption – for example, where they have foreign losses, or wish to claim family assistance, or have little or no foreign income and prefer to defer their claim. It was therefore always intended that people should be able to choose whether or not to receive the exemption. The legislation currently in force does not allow people to make this choice, however. Officials therefore recommend that a mechanism be introduced whereby taxpayers can opt out of the exemption if they so wish.

Removing the requirement to deduct resident withholding tax

Resident withholding tax (RWT) is required to be deducted from interest and dividends paid to New Zealand residents. RWT applies to "resident withholding income", as defined at section NF 1(2). There is currently nothing that removes foreign-sourced interest and dividends of a transitional resident from this definition. In certain circumstances – such as where an agent or trustee received the income on behalf of a transitional resident – this could mean that RWT had to be deducted from such income, notwithstanding that there was no underlying liability to tax. To avoid this, officials recommend that the definition of resident withholding income be amended to exclude income covered by this exemption.

Giving effect to these changes

Because people may be unfairly excluded from the exemption under existing law, or required to receive it contrary to their best interests, it is recommended that the changes outlined above apply retrospectively. This will mean that people are able to qualify or opt out under the new rules from the outset.

Recommendation

That the submission be accepted.

GST APRIL DUE DATE

Submission
(Matter raised by officials)

The April GST due date should be changed from the 28th of April to the 7th of May to provide more time for businesses and tax agents to file and pay GST and provisional tax.

Comment

With the enactment of the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006, the GST due date will change from the last working day of the month to the 28th of the month.

Tax agents with smaller number of clients have approached officials, concerned about the impact the GST and provisional tax changes will have on businesses' and tax agents' workloads in the April period.

In April each year tax agents ensure that businesses pay their terminal tax liability and the agents complete GST returns. From next year, GST will be due up to two days earlier in April, and from 2008 the final provisional tax instalment will move from March to April and be paid along with GST. This increases the workload of agents and reduces the timeframe for filing/paying. Also, in most years the Easter and ANZAC holidays both fall in April, and from April 2007 employees will be entitled to four weeks of annual leave. This further reduces the time available in April for businesses to provide information to tax agents and for tax agents to complete GST and provisional tax calculations before the due date. Tax agents consider that the work pressure in April could be reduced by moving the April due date to 7 May.

To address these concerns, the government has agreed to change the April GST due date from the 28th April to 7 May. This change will apply to taxable periods ending on or after 31 March 2007.

Recommendation

That the submission be accepted.

REVERSE TAKEOVERS AND CONCESSIONARY CONTINUITY RULES

Submission
(Matter raised by officials)

Technical amendments to the concessionary continuity rules that were introduced in the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006 are needed to ensure that they reflect their policy intention.

Comment

Normally, a company must have a continuity of shareholding of 49% to enable it to carry forward its tax losses for New Zealand tax purposes. In relation to imputation credits, the required continuity percentage is 66%. Concessionary rules allow for the fact that it is not practical to trace shareholders through groups of companies to non-corporate shareholders in a number of circumstances.

New provisions were inserted by the 2006 Act to provide concessionary ownership tracing rules for reverse takeovers, for example, where a widely held listed company (the initial parent) took over or merged with a larger one.

The new rules do not operate in accordance with the policy intent where:

- treasury stock or cross shareholdings are cancelled without consideration upon the takeover; or
- a subsidiary of the initial parent is a "limited attribution company", for example, a building society, co-operative company, listed company, widely-held company or a foreign company that is not a closely-held company.

We consider that the new rules should be amended as soon as possible to remove these anomalies, and that the amendments should apply for changes in ownership occurring in the 1998-99 or subsequent years, if the company files a tax return on the basis that requirements of a continuity provision are satisfied in relation to the change of ownership. More generally, the amendments should apply from 3 April 2006, the date of assent of the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006.

This amendment has been discussed with the one taxpayer that we know is affected.

Recommendation

That the concessionary continuity rules that were introduced earlier this year be amended to ensure that they apply appropriately where:

- treasury stock or cross shareholdings are cancelled without consideration upon the takeover; or

- a subsidiary of the initial parent is a "limited attribution company", for example, a building society, co-operative company, listed company, widely-held company or a foreign company that is not a closely-held company.

The amendments should apply for changes in ownership occurring in the 1998-99 or subsequent years, if the company files a tax return on the basis that requirements of a continuity provision are satisfied in relation to the change of ownership. More generally, the amendments should apply from 3 April 2006, the date of assent of the Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006.

Issue: GST associated persons definition: drafting correction

Submission
(Matter raised by officials)

The test for associating relatives in the associated persons definition in the Goods and Services Tax Act 1985 should be amended to correct an unintended drafting error in a recent amendment.

Comment

The Goods and Services Tax Amendment Act 2005 amended the test for associating relatives in the associated persons definition in section 2A of the Goods and Services Tax Act 1985 (GST Act). The purpose of the amendment was to associate persons who are in a civil union or de facto relationship. This amendment was part of a number of amendments designed to remove unjustified discrimination in the application of laws on the grounds of marital status or sexual orientation so laws are neutral on their application to different relationships and consistent with human rights obligations.

Former section 2A(5) of the GST Act provided that the test associating relatives extended to trustees for relatives. The amendment in 2005 did not maintain the effect of this provision in current section 2A(1)(c)(iv). It was clearly not intended that this aspect of the relatives associated persons test be changed. An amendment correcting this drafting error should therefore be made to the test associating relatives in section 2A of the GST Act to reinstate the trustee aspect of this test.

Recommendation

That the submission be accepted.

Issue: Extension of time bars

Submission
(Matter raised by officials)

The right of taxpayers to extend a time bar by a further six-month period in section 108B of the Tax Administration Act 1994 should be amended so that the taxpayer can do this by giving notice to the Commissioner before the end of the initial 12-month extension period. The change will correct an omission and ensure that the section works as intended.

Comment

Section 108B of the Tax Administration Act 1994 sets out the rules for extending the time bars for amending tax assessments. Subsection (1)(a) provides that the time bar can be extended by a period of up to 12 months, where the Commissioner and the taxpayer agree in writing. Subsection (1)(b) allows the taxpayer to extend the time bar for a further six months from the end of the 12 month extension period. This further six-month extension period was enacted in 2004.

Section 108B(2) requires any time bar waiver under subsection (1) to be in the prescribed form and to be signed and delivered to the Commissioner before the end of the original four year time bar period.

It was intended that the further six-month extension of the time bar in section 108B(1)(b) could be effected by the taxpayer giving notice to the Commissioner before the end of the 12-month extension period allowed in section 108B(1)(a). However, the necessary consequential amendment was not made to section 108B(2) when the further six-month extension period was enacted in 2004. A remedial amendment should therefore be made to section 108B(2) to ensure that the time bar extension provisions operate as intended.

Recommendation

That the submission be accepted.