Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill

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

Volume 2

Reforming the Income Tax Act definitions of "associated persons"

Relocation and overtime meal allowances

Payroll giving

Stapled stock provisions (SOP 224)

Research & Development

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Reforming the Income Tax Act definitions of “associated persons”

OVERVIEW

Clauses 7, 10–13, 18, 40, 41, 57, 82, 120, 152, 182, 183, 186, 188, 201–203, 408, 414, 415, 431, 436, 477, 502, 503 and 624

The bill makes amendments to strengthen and rationalise the definitions of "associated persons" in the Income Tax Act 2007.

The definitions are mainly used in an anti-avoidance capacity to counter non-arm's length transactions that could undermine the intent of the income tax legislation. The changes are consistent with a key theme of the government's tax policy work programme, which is ensuring that the income tax system is robust. This is supported by the high priority that protection of the tax base has in the current economic and fiscal environment.

There are currently a number of major weaknesses in the definitions, in particular, those applying to land sales. These weaknesses pose a risk to the tax base which the bill addresses by introducing a number of amendments to the income tax legislation. The main changes:

- deal with the weaknesses in the current definitions in relation to trusts. In particular, there will be new tests focussing on a trust's settlor (that is, the person who provides the trust property);
- provide more robust rules aggregating the interests of associates to prevent the tests for associating two companies and a company and an individual being circumvented by the fragmentation of interests among close associates; and
- implement a tripartite test associating two persons if they are each associated with the same third person, thereby making the associated persons tests as a whole more difficult to circumvent.

The bill also rationalises the current income tax definition of associated persons and other income tax provisions that employ a similar concept, such as the definition of "related persons" in the dividend rules. This represents a significant simplification and makes the associated persons concept in the Income Tax Act more coherent.

Twenty-six submissions were received on the associated persons proposals in the bill. Submissions were opposed to the proposals in the bill. Officials have worked with those who made submissions on recommending refinements to the new associated persons definitions in the bill to prevent any overreach while still addressing weaknesses in the current definitions that, for example, allow property developers to escape tax by operating through closely connected entities.

The refinements to the bill will, for example, ensure that energy consumer trusts will not be associated with members of the public as a result of the reforms. This report explains why people cannot be associated through community trusts. It is not the policy intent for such trusts that have a public nature or their beneficiaries to be adversely affected by the reforms. The tripartite test has been narrowed to address concerns that it could apply more widely than is necessary to protect the tax base. To reduce uncertainty, officials recommend not proceeding with the changes to the dividend and fringe benefit tax rules.

A number of submissions have criticised the current legislative policy that land dealers, developers and builders are generally taxed on all their land sales and cannot claim to hold non-taxable investment property portfolios. It is not envisaged that this policy on land sale gains will be narrowed. The changes in the bill would mean that the policy is properly achieved by closing some gaps in the current law.

Officials note that the reforms are not all "one-way" and some current tests have been narrowed in the bill. For example, the ambit of the "relatives" test has been reduced from four to two degrees of blood relationship to reduce compliance costs. The "habitually acting in concert" test has also been removed to improve certainty.

The application date changes that the Minister of Revenue has asked the Committee to consider will ensure that the associated persons reforms will not have any retrospective application. The changes mean that the reforms will generally apply for the 2010–11 and subsequent income years. However, for the purposes of the land provisions, the reforms will generally apply to land acquired on or after the date of enactment.

REFORMS SHOULD NOT PROCEED

Submissions
(15 – WHK Taylors, 39 – Russell McVeagh, 47 – Grant Thornton, 53 – Ernst & Young, 54 – Business New Zealand, 57 – Tomlinson Paull, 61 – Trustee Corporation Association of New Zealand, 62 – Minter Ellison Rudd Watts, 67 – New Zealand Institute of Chartered Accountants, 70 – Deloitte)

The proposed amendments are too extensive and result in unintended consequences.

Officials should undertake a comprehensive review of the current tests, the historical and policy reasons for their introduction (including in relation to developers/real property) and for their application to particular rules. Against that properly informed background, officials should then determine whether any fiscal concerns are already adequately addressed by the current levels of applicable "association" in the rules.

The changes to the associated persons tests would represent a significant barrier to business and should be withdrawn from the bill to allow further consideration.

The proposals need to be considered together with the wider land tax policies. If the government decided to review the associated persons rules, the proposals should be publicly consulted in a government discussion document. It is incumbent on Parliament to ensure that it limits the associated persons provisions to those persons who it considers should be subject to tax.

Comment

The bill contains amendments to strengthen and rationalise the definitions of "associated persons" in the Income Tax Act 2007. These definitions are mainly used in an anti-avoidance capacity to counter non-arm's length transactions that could undermine the intent of the income tax legislation. There are a number of significant and generally recognised weaknesses in the definitions and, in particular, the definition which applies to land sales. The amendments in the bill will address these weaknesses.

The associated persons reforms in the bill have been developed in accordance with the generic tax policy framework. This has included a full consultation process and has involved a comprehensive review of the current definitions. In particular, an issues paper was released in March 2007 which allowed an opportunity for people to comment on the proposals. Significant modifications were made to the proposals in response to the extensive submissions on this issues paper. Officials have also continued to engage in discussions with interested parties since the 2007 issues paper. In response to submissions on the bill, further modifications have been recommended by officials.

Recommendation

That the submissions be declined.

APPLICATION TO LAND PROVISIONS

Submissions
(11 – M Scott, 15 – WHK Taylors, 32 – KPMG, 39 – Russell McVeagh, 47 – Grant Thornton, 53 – Ernst & Young, 57 – Tomlinson Paull, 58 – nsaTax, 61 – Trustee Corporation Association of New Zealand, 62 – Minter Ellison Rudd Watts, 67 – New Zealand Institute of Chartered Accountants, 68A – Corporate Taxpayers Group, 70 – Deloitte)

The integrity of the tax system is at risk because of the arbitrary and unfair nature of the taxation of certain land transactions, even more so under the proposals in the bill relating to associated persons. Therefore, the associated persons rules in the land provisions in sections CB 9 to CB 11 should be repealed.

Land should be capable of being held on capital account if that is the taxpayer's purpose. There does not seem to be any policy reason why taxpayers should not structure their land holdings to clearly differentiate between property held for indefinite or long-term rental purposes and property held on revenue account.

The current exclusions in the land provisions such as those for residential land, business premises and investment land should be extended.

The land provisions require extensive amendments to remove inconsistencies and make them more coherent. For example, Section CB 10, which relates to land development or subdivision businesses, is redundant because of section CB 12 (schemes for development or division begun within 10 years), and should be repealed.

The Valabh Committee proposed a rebuttal nomination scheme which would have allowed taxpayers to specify the purpose of a land acquisition and be taxed accordingly. This is a better policy approach than what is proposed in the bill.

It seems timely to question whether the 35 year-old policy in relation to real property is still good policy today. The wider policy aspects of the land tax rules should be reviewed contemporaneously with the review of the associated persons rules.

Parliament should reconsider whether the so-called "10-year sale rule" in the taxation of land provisions is appropriate at all, or whether it should be modified in some way.

The introduction of a wide associated persons test to land transactions is an inappropriate way to target base maintenance concerns and the application of the proposed associated persons rules to land transactions should be more carefully targeted to situations where there is an actual threat to the tax base.

Essentially, the law should provide a mechanism that allows persons associated with property developers to hold property on capital account, if in fact it is held on capital account.

Comment

Officials note that when Parliament enacted the current land sale tax rules in 1973, it expressly provided that land dealers, developers and builders could not generally hold land on capital account. This means that all gains on properties sold by property developers within 10 years of acquisition are taxed in most cases.

Parliament's intent to strengthen the tax provisions relating to land sale gains and, in particular, restrict the ability of land dealers, developers and builders to hold land on capital account, is clear from the parliamentary debates.

The land sale tax rules are buttressed by associated persons rules that are designed to prevent land dealers, developers and builders escaping tax if they structure the ownership of their investment properties through an associate.

This legislative policy can currently be circumvented by some relatively simple structures. For example, a property developer can arrange for a trust, settled by that developer and under which the developer is a beneficiary, to acquire land. The property developer is not, under the current associated persons rules, associated with the trust, so the trust is not taxed on any subsequent sale of the land within 10 years of acquisition.

It is unlikely that Parliament intended that the current legislative policy on land sale gains – which is that land dealers, developers and builders should generally be taxed on all their land sales and cannot claim to hold non-taxable investment portfolios – could be circumvented by such structures. The changes in the bill would mean that this legislative policy is better achieved by closing some gaps in the current law.

It is not envisaged that the current legislative policy on land sale gains will be narrowed.

Officials note a considerable number of modifications have been made to the associated persons tests for the purposes of the land provisions so they cover situations under the effective control of property dealers, developers and builders, but do not apply to other situations.

A number of submissions have also suggested extensive amendments to various aspects of the land provisions such as the exclusions for residential land and business premises, and how transactions between associated persons are treated. These submissions are outside the scope of the associated persons reforms which are primarily concerned with defining when persons are associated with each other.

The Valabh Committee proposal involving a nomination scheme has not been proceeded with mainly because of the large compliance and administration costs that such a proposal would entail.

Recommendation

That the submissions be declined.

Issue: Application of aggregation rule to managed funds

Submission
(18 – Staples Rodway)

There should be an exception from the aggregation rule in section YB 2 on voting interests for portfolio investment entities (PIEs) or entities eligible to be PIEs.

Comment

Officials agree that a widely held fund should not be adversely affected because of the personal land dealings of the directors of that fund. After further consultation with Staples Rodway, this issue can be best addressed by including an exclusion, for the purposes of the land provisions, in the test associating two companies in section YB 2 for a company that is a portfolio investment entity (PIE) or that is eligible to be a PIE.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Scope of aggregation rule

Submission
(15 – WHK Taylors)

The intended scope of the application of the aggregation rule in sections YB 2 and YB 3 is unclear. The intent of how the aggregation rule applies should be clarified in the legislation and the commentaries. In particular, is the aggregation rule focused on countering the fragmentation of shareholder interests or does it act as a tripartite test?

Comment

The aggregation rule is an element of the companies tests in sections YB 2 and YB 3. For example, in determining whether two companies are associated under section YB 2, a person is treated as holding anything held by persons associated with them under sections YB 4 to YB 14. The examples on pages 81 and 82 of the commentary on the bill illustrate how the aggregation rule applies.

The aggregation rule is designed to prevent the companies tests in sections YB 2 and YB 3 being circumvented by the fragmentation of interests among associated persons, resulting in the interest thresholds in those sections not being met. The aggregation rule does not act as a separate associated persons test.

Recommendation

That the submission that the legislation be amended be declined. It is noted that the *Tax Information Bulletin* article on the legislation will confirm that the aggregation rule is an element of the companies tests and is not a separate tripartite test.

Issue: Application of the aggregation rule and the tripartite test

Submissions
(35 – PricewaterhouseCoopers, 53 – Ernst & Young, 57 – Tomlinson Paull, 67 – New Zealand Institute of Chartered Accountants)

The tripartite test in section YB 14 should not be applied as part of the aggregation rule because it could result in that rule applying too widely. Therefore, the aggregation rules in sections YB 2(4) and YB 3(4) should refer to sections "YB 4 to YB 13" and not to sections "YB 4 to YB 14".

The combination of association under the tripartite test and the aggregation provisions proposed in sections YB 2(4) and YB 3(4) could possibly involve some reiterative effect. This could give rise to significant overreach in the context of land transactions. The interaction of these provisions should be clarified.

Comment

Officials do not agree that the tripartite test should not be applied as part of the aggregation rules in the company-related tests. The example on page 88 of the commentary on the bill involves the application of the tripartite test in the aggregation rule, which ensures that a closely held arrangement is treated as associated.

In relation to the example in the PricewaterhouseCoopers submission, officials do not consider that the two companies would necessarily be associated under the proposed rules. This is because the husband would be treated as holding only the wife's share in the partnership, including her share in the development company. For example, if the wife only held, say, a 20 percent share in the partnership, the husband would be treated under the aggregation rule as holding only that 20 percent share. Therefore the two companies would not be associated. However, if the wife held a 60 percent share in the partnership, the two companies would be associated under section YB 2 because there would be a group of persons (the husband and the wife) holding at least 50 percent of the voting interests in both companies. This would be an appropriate application of the new associated person rules.

Officials note that the tripartite test in proposed section YB 14 cannot act reiteratively because the two persons associated with each other under that test cannot be associated with the same third person under the tripartite test itself. This is illustrated in the example in page 88 of the bill commentary – The Trust and A are not associated with A's spouse under the tripartite test.

For the associated persons reforms to be effective, the aggregation rule in the company-related tests needs to incorporate the tripartite test.

Recommendation

That the submissions be declined.

Issue: "Control by any other means" limb

Submission
(35 – PricewaterhouseCoopers)

The "control by any other means" limb under the "two companies test" in section YB 2 should be removed. Alternatively, Inland Revenue should provide more definitive guidance as to how it is to be interpreted and applied.

Comment

The removal of the "control by any other means" limb in the test associating two companies has never been part of the proposal to reform the associated persons definitions. In particular, the removal of this limb was not raised in the issues paper *Reforming the definitions of associated persons* published in March 2007.

Officials consider that the "control by any other means" limb acts as a buttress to the other limbs of the tests associating two companies which are based on voting and market value interests. The role of the limb also needs to be kept in perspective. It mainly acts as a backstop only to the primary voting interest test.

Officials note there is a reasonable body of case law on the meaning of "control" in the company context, such as the House of Lords decision in *British American Tobacco Company Ltd* v *IRC* [1943] AC 335. This body of case law provides the appropriate guidance on the "control by any other means" limb.

Recommendation

That the submission be declined.

Issue: Test associating a company and a person other than a company for the purposes of land provisions

Submission
(35 – PricewaterhouseCoopers)

The test in proposed section YB 3(6) and (7) should not apply to associate a company and a trust or trustee. Therefore, these provisions should only associate a company and a person who is a natural person (and not a trustee).

Comment

If a trustee wholly owns a company, it follows that the trustee and company should be associated for the purposes of the land provisions. There is no reason in principle to limit association to when the shareholder is a natural person only (not acting in a trustee capacity).

The submission refers to the reference on page 82 of the bill commentary to the "company-individual" test to describe section YB 3. This reference is intended to be a short-hand term only for "a company and a person other than a company".

Recommendation

That the submission be declined.

Issue: Aggregation rule for purposes of land provisions

Submission
(Matter raised by officials)

The proposed rule aggregating the interests of certain associates in the test in section YB 3 associating a company and person other than a company for the purposes of the land provisions needs to be modified to ensure that the rules work as intended. The example on page 88 of the commentary on the bill involving a person's spouse settling a trust which wholly owns a family company would not be covered under proposed section YB 3(6) if person A was a property developer. Such a closely held arrangement should be covered in the context of the land provisions.

Officials propose that the aggregation rules in section YB 3(6) and (7) should be replaced with a rule where a person is treated as holding anything held by persons associating with them under sections YB 4 (the limited version applying for the purposes of the land provisions), YB 7, YB 8, and YB 10 to YB 14. This means that the beneficiary-related trust tests and the general relatives test would not apply in the aggregation rule in the test associating a company and a person other than a company for the purposes of the land provisions.

Recommendation

That the submission be accepted.

Issue: Threshold in the company and person other than a company test

Submission
(32 – KPMG)

The required shareholding interest for a company and a person other than a company under section YB 3 should remain at 50 percent or more for particular sections.

Comment

The threshold for associating a company and a person other than a company in the general associated persons definition has always been 25 percent. In particular, officials note that the threshold for this test in the land provisions has always remained at 25 percent since its original enactment in 1973.

Although the associated persons definition currently applying for certain provisions (in particular, the "1988 version provisions") uses a 50 percent threshold, we consider it is desirable to have a consistent threshold for associating a company and a person other than a company. Given that the 25 percent threshold is used most widely in the Income Tax Act, it is appropriate to adopt this threshold.

Recommendation

That the submission be declined.

Issue: Company acting in its capacity as trustee of a trust

Submission
(35 – PricewaterhouseCoopers)

The proposed section YB 3(8) is unnecessary.

Comment

Section YB 3(8) provides that for the purposes of section YB 3 (the test associating a company and a person other than a company), a person other than a company includes a company acting in its capacity as a trustee of a trust.

Officials note that the general position under the Income Tax Act is that a company acting in its capacity as trustee of a trust is treated as a trustee and not treated as a company (specific recognition of this position in relation to the voting interest definition which forms the basis of the main voting interest limb in section YB 3, is set out in the *Tax Information Bulletin*, April 1992, page 23). Section YB 3(8) ensures that this continues to be the position in section YB 3, which refers to a "person other than a company". Section YB 3(8) makes it clear that the reference to a "person other than a company" includes a corporate trustee. We therefore consider that this clarifying provision will be helpful to readers of the legislation.

Recommendation

That the submission be declined.

Issue: Modifications to companies tests for listed or widely held companies

Submission
(62 – Minter Ellison Rudd Watts, 77 – Westpac)

Modifications should be made to the applicable determination of "voting interest" and "market value" to ensure that the rule is workable in practice in relation to listed or widely held companies. These modifications would be generally consistent with current sections YC 10 and YC 11 in relation to the continuity provisions.

Comment

The modifications in sections YC 10 and YC 11 to the measurement of voting and market value interests for certain listed and widely held companies were specifically designed for the purposes of the continuity provisions which mainly relate to the ability of companies to carry forward and use tax losses and tax credits.

The associated persons definitions, which also use voting and market interest concepts, have never incorporated the modifications to the measurement of voting and market value interests now contained in sections YC 10 and YC 11. The former section OD 8(3) of the Income Tax Act 2004, also contained a tripartite test but again, did not include the above modifications. This definition was applied in a wide range of operative provisions in the Income Tax Act, such as the depreciation, transfer pricing, thin capitalisation, share lending, and international tax rules. Officials therefore consider there is no reason to depart from the long-standing position of not applying the modifications to the determination of voting and market value interests now contained in sections YC 10 and YC 11 in the new associated persons definitions.

Recommendation

That the submission be declined.

RELATIVES TEST – MODIFYING THE DEFINITION OF "DE FACTO RELATIONSHIP"

Submission
(67 – New Zealand Institute of Chartered Accountants)

The de facto relationship test should apply only for the purposes of the land provisions if the de facto relationship has been in existence for at least three years or longer.

Comment

The Income Tax Act 2007 uses the definition of "de facto relationship" in the Interpretation Act 1999, which treats two people in a de facto relationship as associated if they live together as a couple in a relationship in the nature of a marriage. This definition is used throughout the Income Tax Act and is not limited in any provision to a relationship which has lasted for at least three years. Officials consider that the Income Tax Act should continue to take a consistent approach to the meaning of a de facto relationship and therefore are not in favour of limiting the definition for the purposes of the land provisions only.

Importantly, the current associated persons definition that applies for the purposes of the land provisions already associates people in a de facto relationship whether or not that relationship has lasted for three years. Therefore the bill is maintaining the status quo in this area.

Recommendation

That the submission be declined.

TRUST TESTS

Issue: Scope of trustee for relative test

Submission
(15 – WHK Taylors)

The trustee for relative test in section YB 5 may apply more widely than intended.

Comment

Officials agree that the trustee for relative test in section YB 5 should not apply for the purposes of the land provisions. This would be consistent with the land provision exclusions in the other beneficiary-related tests in sections YB 6 and YB 9.

Recommendation

That the submission be accepted.

Issue: Scope of beneficiary-related trusts tests

Submissions
(15 – WHK Taylors, 32 – KPMG, 48 – PricewaterhouseCoopers for nine electricity lines companies, 68A – Corporate Taxpayers Group)

Energy consumer trusts should be excluded from the trustee and beneficiary test in section YB 6 because of their public nature.

Discounts to consumers from electricity lines companies owned by consumer trusts should be excluded from the dividend definition. Currently consumers, while beneficiaries of the company's shareholding trust, are not treated as associated with the shareholder. Therefore the requirement in section CD 6(1)(a)(ii) is not satisfied. However, changes proposed in the bill are likely to result in the discounts being treated as dividends from 1 April 2009.

The scope of the trustee and beneficiary test in section YB 6 and the settlor and beneficiary test in section YB 9 are too broad and should not be adopted. In particular, the trustee and beneficiary test in section YB 6 should be amended to associate a trustee and a beneficiary only where the trust was established mainly to benefit that beneficiary.

Comment

The beneficiary-related trusts tests are important elements of the new associated persons provisions and are necessary if the provisions are to be effective. Exceptions have been included in these tests so that they do not apply for the purposes of land provisions. These exclusions are designed so that the beneficiary-related tests do not apply too broadly.

Officials agree that energy consumer trusts established under the Energy Companies Act 1992 should be excluded from the test associating trustees and beneficiaries and the trustee for relatives test. This is because such trusts (having a very large pool of beneficiaries) are public in nature and do not pose a risk to the tax base. These large public trusts are quite different in nature from private trusts, which are intended to be covered by the test associating trustees and beneficiaries.

We agree that discounts to consumers from electricity lines companies should not be treated as dividends. Excluding energy consumer trusts from the trustee and beneficiary and trustee for relatives tests, along with the recommendation in this report not to proceed with certain changes to the dividend rules, will address concerns that the reforms could mean these discounts could be treated as dividends.

Officials consider that the unit trust that administers bonus bonds should also be excluded from the test associating trustees and beneficiaries, and the trustee for relatives test. This unit trust is excluded from the unit trust definition in section YA 1 of the Income Tax Act 2007 and therefore is not treated as a company. This means that the trust-related associated persons tests apply to it.

Recommendation

That the submissions be accepted, subject to officials' comments.

Issue: Exclusion for charitable organisations in beneficiary-related tests

Submissions
(72 – Russell McVeagh)

The beneficiary-related tests in sections YB 6 and YB 9 will have significant unintended consequences when the beneficiary of many trusts is the same charity. The trustee and settlor of each such trust would be associated with the trustee and settlor of all such trusts without being aware of the fact.

The proposed tripartite test in section YB 14 should be amended so it does not apply if parties are associated under section YB 6 (trustee and beneficiary test) or section YB 9 (settlor and beneficiary test).

Comment

Officials agree that the beneficiary-related tests in sections YB 6 and YB 9 could have unintended consequences when the beneficiary of many trusts is the same charity. This issue is best addressed by excluding "charitable organisations" (as defined under section YA 1 of the Income Tax Act 2007) from the definition of "beneficiary" for the purposes of sections YB 6 and YB 9. This would ensure that trustees and settlors of trusts which have the same charity as a beneficiary would not be associated.

The separate recommendation in this report that the tripartite test apply only to associate persons if they are each associated with the same third person under different associated persons tests, will also assist in addressing concerns about over-reach.

Recommendation

That the submissions be accepted, subject to officials' comments.

Issue: Exception in trustee and beneficiary test for purpose trusts

Submission
(32 – KPMG)

An exemption should apply when an association arises because of eligibility to benefit under a purpose trust, such as a community trust.

Comment

Officials note that because purpose trusts do not at law have beneficiaries, the beneficiary-related tests in the associated persons rules are not relevant to these trusts.

In particular, "community trusts" referred to in the Community Trusts Act 1999 are expressly stated to be purpose trusts. These trusts were established to hold the shares in the successor companies to the former trustee banks.

Therefore it is not necessary to exclude purpose trusts such as community and charitable trusts from the definition of "trustee" in the trustee and beneficiary test in section YB 6. However, there are several existing references in the Income Tax Act 2007 that refer to a beneficiary of a community trust (sections HC 21(3) and HC 32(2)). These references are incorrect and should be amended to refer to a person who receives a distribution from a community trust.

Recommendation

That the submission be declined.

That existing references to a beneficiary of a community trust be amended.

Issue: Scope of two trustees with common settlor test

Submissions

(15 – WHK Taylors, 57 – Tomlinson Paull, 62 – Minter Ellison Rudd Watts, 68A – Corporate Taxpayers Group, 70 – Deloitte)

The two trustees with common settlor test in section YB 7 is too broad. For example, it could result in the entire client bases in a law firm being associated to each other because the firm's lawyers were the nominal settlors of clients' trusts. Therefore, this test should be either removed or modified to apply only to a settlor who has a beneficial interest in the trust property. The test should also only apply to settlors who have made settlements on or after 1 April 2009.

Professional trustees such as the trustee companies should be excluded from the operation of the proposed sections YB 7 to YB 9.

Comment

Officials do not consider that a professional advisor who acts as a nominal settlor will be treated as a common settlor for the purposes of the associated persons definitions. This is because under the nominee look through rule in section YB 21 of the Income Tax Act 2007, it is the client that would be treated as the settlor rather than the professional advisor, who is merely acting as a nominee. This interpretation is specifically supported by Inland Revenue's *Tax Information Bulletin*, November 1989, paragraph 6.93. The nominee look through rule in section YB 21 is the successor provision of section HH 1(1) of the Income Tax Act 2004 (which concerned nominal settlements).

We note that professional trustees such as the trustee companies often act as the trustee of unit trust investment vehicles. Because unit trusts are treated as companies for income tax purposes, it is the companies-related tests – in particular, section YB 3 – that will be mainly relevant. The 25 percent threshold in section YB 3 would ensure that investors are typically not associated with the unit trust.

The two trustees with common settlor test is an important element of the new associated persons provisions and is necessary if the provisions are to be effective. Officials consider that it is not appropriate to limit the application of this test to trusts settled on or after 1 April 2009 as this would significantly limit the effectiveness of the new provisions.

Recommendation

That the submissions be declined.

Issue: Definition of "common settlor"

Submission
(Matter raised by officials)

For the purposes of the test associating two trustees with a common settlor in section YB 7, two persons who are married, in a civil union, or in a de facto relationship should be treated as the same person.

Comment

It may be possible to circumvent the new associated persons definition in the bill by the use of "mirror trusts" – that is, spouse A settles a family trust for the benefit of spouse B and spouse B settles another family trust for the benefit of spouse A. Officials consider that the test associating two trustees with a common settlor should apply to such mirror trusts. To ensure this, it is necessary to amend section YB 7 of the bill to treat persons who are married, in a civil union, or in a de facto relationship as the same person for the purpose of identifying a common settlor.

Recommendation

That the submission be accepted.

Issue: Scope of trustee and settlor test

Submission
(15 – WHK Taylors, 32 – KPMG, 70 – Deloitte)

The trustee and settlor test in section YB 8 is too broad. Therefore, this test should be either removed or modified to apply only to a settlor who has a beneficial interest in the trust property. The test should also only apply to settlors who have made settlements on or after 1 April 2009.

Comment

The trustee and settlor test is an important element of the new associated persons provisions and is necessary if the provisions are to be effective. Officials consider that it is not appropriate to limit the application of this test to trusts settled on or after 1 April 2009 as this would significantly limit the effectiveness of the new provisions.

We also consider that the settlor basis of many of the trust-related associated persons tests is consistent with the settlor focus of the trust taxation rules in the Income Tax Act.

Officials note that the separate recommendation in this report that the tripartite test apply only to associate two persons if they are each associated with the same third person under different associated persons tests will also assist in addressing concerns about overreach.

Recommendation

That the submission be declined.

Issue: Exception in trustee and settlor test for charitable trusts

Submissions
(32 – KPMG, 68A – Corporate Taxpayers Group)

Philanthropic settlements on charitable and non-charitable trusts are a common occurrence. All persons making settlements on these trusts are associated with the trust. The tripartite test would associate all such persons.

In the corporate environment, corporates can gift funds to various trusts; these trusts will now be associated.

Comment

Officials agree that there should be an exception for charitable trusts in the trustee and settlor test in section YB 8. An exception would prevent donors to charitable trusts being associated with each other. A charitable trust under the Income Tax Act 2007 is required to be registered as a charitable entity under the Charities Act 2005 and is therefore subject to the regulatory requirements of that Act. Officials do not consider that these entities pose a risk to the tax base and therefore it is not necessary to include them in the trustee and settlor associated persons test.

Officials do not consider that this exception should be extended to non-charitable trusts as they are not subject to the same level of regulation as charitable trusts registered under the Charities Act 2005. However, we consider that the separate recommendation in this report that the tripartite test apply only to associate two persons if they are each associated with the same third person under different associated persons tests will address concerns about overreach in this area.

Recommendation

That the submissions be accepted, subject to officials' comments.

Issue: Definition of "settlor"

Submissions

(39 – Russell McVeagh, 62 – Minter Ellison Rudd Watts, 68A – Corporate Taxpayers Group, 70 – Deloitte)

The settlor concept for the purposes of the associated persons rules would be better targeted by focussing on persons who truly control or materially influence the trust's affairs and benefits from it.

The definition of "settlor" should not include a person who provides financial assistance to a trust or who makes settlements on the trust of less than a prescribed amount (perhaps $5,000). Otherwise, beneficiaries who do not charge interest on credit current account balances and professional advisors who make nominal settlements on a trust would be treated as settlors.

The definition of a "settlor" should be defined to include the settlor only when they have some ongoing relationship with the trust.

Comment

The settlor-based test of association (common settlor, trustee-settlor and settlor-beneficiary tests in new sections YB 7, YB 8 and YB 9) use the definition of "settlor" set out in section HC 27, with the modification that a settlor does not include a person who provides services to a trust for less than market value. This modification was designed to prevent a professional advisor who provides services at no charge being treated as a settlor.

The current definition of "settlor" in section HC 27 is used extensively in the Income Tax Act. In particular, the definition in section HC 27 is used in the current common settlor and trustee-settlor associated persons tests. These tests are applied in a wide range of operative provisions in the Income Tax Act such as the depreciation, transfer pricing, thin capitalisation, share lending and international tax rules. The extensive use of this definition is consistent with the settlor-based focus of the trust taxation rules in the Income Tax Act.

We consider that the submissions to treat as settlors only persons who control or materially influence or who have some ongoing relationship with the trust would introduce an undesirable subjective element to the definition of "settlor". It would also lead to application of the settlor-based tests being uncertain.

It would be inappropriate to have a blanket exclusion from the settlor definition for persons who provide financial assistance (for example, an interest-free loan) to a trust because these amounts could be very substantial. The current settlor definition does not contain a minimum threshold and officials consider that this approach should be maintained for the purposes of the associated persons reforms.

Professional advisors who make nominal settlement on a trust are not treated as settlors under current law – this treatment will continue under the associated persons reforms. This point is discussed under the previous "Scope of two trustees with common settlor test" issue. Officials also consider that beneficiaries who have received distributions and are not paid interest on their credit current account balances are not treated as settlors.

Recommendation

That the submissions be declined.

Issue: Scope of trustee and person with a power of appointment or removal

Submission
(15 – WHK Taylors, 39 – Russell McVeagh, 68A – Corporate Taxpayers Group, 33 – Investment Savings and Insurance Association of NZ Inc)

The test in section YB 11 associating a trustee and a person with a power of appointment or removal of the trustee is too broad and should be either removed or modified to apply only to an appointor if the tax base is threatened. The test should also only apply where the appointor has a beneficial interest under the trust. Alternatively, section YB 11 should apply only if the person has both the power of appointment and removal or just the power of removal.

Comment

This test in section YB 11 is intended to complement the test associating a trustee and settlor in section YB 8. In many cases, a settlor of a trust, as the author of the instrument creating and governing administration of the trust, retains the power to appoint or remove trustees. However, this power could be reposed in a separate person. Officials consider there is sufficient connection between a trustee of a trust and the person who has the power to appoint or remove the trustee to justify treating them as associated persons. For the associated persons definitions to be effective, it is considered necessary to include this test. Officials do not support attempting to limit the application of this test only to avoidance situations where the tax base is threatened because of the uncertainty this approach entails. Neither would officials support limiting the test to situations where the appointor has a beneficial interest under the trust because the nature of a discretionary trust means an appointor could be made a discretionary beneficiary after the power of appointment is exercised.

Recommendation

That the submission be declined.

Issue: Appointors who are professional advisors

Submission
(57 – Tomlinson Paull)

The trustee-appointor test in proposed section YB 11 could give rise to significant overreach when professional advisors are nominated as appointors. This test, coupled with the proposed tripartite test, would result in completely unrelated trusts being associated, merely because a trusted advisor has been granted the power to appoint or remove trustees.

Comment

Officials agree the trustee-appointer test in proposed section YB 11, in conjunction with the tripartite test, should not associate otherwise unrelated trusts because a professional advisor acting in their capacity has been granted the power to appoint or remove trustees by their clients. The nominee look through rule may not apply to attribute this power to clients.

Officials consider that this concern is addressed by the separate recommendation in this report that the tripartite test apply only to associate two persons if they are each associated with the same third person under different associated persons tests.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Exceptions for employee trusts

Submission
(Matter raised by officials)

An exception for employee trusts in section YB 15 should be made for the test associating a trustee of a trust and a person who has the power of appointment or removal of the trustee.

Comment

The various trust-related tests, other than the test in section YB 11 associating a trustee of a trust and a person who has the power of appointment or removal of the trustee, contain exceptions in section YB 15 for certain employee trusts. It would be consistent if section YB 15 also contained an employee trust exception in relation to section YB 11.

Recommendation

That the submission be accepted.

PARTNERSHIP TESTS

Issue: Scope of partnership and partner test

Submission
(15 – WHK Taylors, 68A Corporate Taxpayers Group)

A partner and a partnership should not be associated in all circumstances. Instead, they should be associated only if a partner has a 25 percent or greater share in the partnership.

Comment

Since the enactment in 1968 of the first associated persons definition in the Income Tax Act, a partner and their partnership have always been associated regardless of the share a partner has in the partnership. It has not been part of the reform proposals to change this long-standing position.

Officials consider that it is appropriate to always associate a partner and their partnership given the transparent treatment of partnerships for income tax purposes, which involves attributing any activity of a partnership to its partners.

A separate associated persons rule is being implemented for limited partnerships. A limited partnership and a limited partner will only be associated if the limited partner has a partnership share of 25 percent or more in the limited partnership. The treatment is appropriate because a limited partner cannot be involved in the management of the partnership (unlike a partner in a general partnership). Therefore, a limited partner is more akin to a shareholder in a company which has a 25 percent interest threshold for association under section YB 3.

Recommendation

That the submission be declined.

Issue: Scope of partnership and associate of partner test

Submission
(1 – Bell Gully, 15 – WHK Taylors, 35 – PricewaterhouseCoopers, 53 – Ernst & Young, 57 – Tomlinson Paull, 62 – Minter Ellison Rudd Watts, 68A – Corporate Taxpayers Group)

The partnership association tests in sections YB 12 and YB 13, in conjunction with the tripartite test, creates the apparently unintended consequence that a partner will be associated with the associates of the other partners in the partnership.

It is also considered that a partnership and an associate of a partner are too remote to be associated in all circumstances.

Comment

Officials agree that it is not intended to associate a partner with the associates of other partners in the same partnership. This issue is best addressed by omitting section YB 13, which associates a partner's associates with the partnership.

It is noted that an associate of a partner (for example, the spouse of a partner) would still be associated with the partnership under the tripartite test, which associates two persons if they are each associated with the same third person. For example, the spouse of a partner is associated with the partner under the relatives test in section YB 4. The partner is associated with the partnership under section YB 12. Therefore, the spouse and the partnership will be associated under the tripartite test in section YB 14.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Amendments to partnership and partner test

Submission
(Matter raised by officials)

The test for association for a limited partnership in section YB 12(2) should be amended so it applies only to a limited partner and not a general partner in a limited partnership.

An aggregation rule should also apply for the purposes of section YB 12(2).

Comment

Currently, section YB 12(2) switches off the primary test for associating a partnership and a partner in subsection (1) in relation to limited partnerships. However, this exclusion should be limited to the limited partners and not the general partner in a limited partnership. This limitation would be consistent with the current section YB 16(1B). This would also mean that a general partner in a limited partnership will be associated with the partnership under section YB 12(1).

Under section YB 12(2), a limited partnership and a limited partner will only be associated if the limited partner has a partnership share of 25 percent or more in the limited partnership. This approach has been adopted because a limited partner is more akin to a shareholder in a company which has a 25 percent interest threshold for association under section YB 3. It would be consistent with this approach for an aggregation rule such as that contained in section YB 3(4) to also apply for the purposes of the limited partnership test in section YB 12(2). This test would ensure

that for the purposes of determining whether a limited partner and a limited partnership are associated, a person is treated as holding anything held by their associates.

Recommendation

That the submission be accepted.

Issue: Ambiguity in limited partnership tests

Submissions
(33 – Investment Savings and Insurance Association of NZ Inc,
35 – PricewaterhouseCoopers, 68A – Corporate Taxpayers Group, 67 – New Zealand Institute of Chartered Accountants)

The proposed sections YB 12 and YB 13 should be amended to clarify whether and if so, in what circumstances a general partner or a person associated with a general partner is associated with a limited partnership.

For general partners who do not economically share in the profits or losses of a limited partnership, the legislation should be clarified so that they are not associated. Alternatively, a general partner should be associated with a limited partnership only if they have a 25 percent or more interest in that partnership.

The test associating a partnership and an associate of a partner in section YB 13 should be amended to achieve its intended outcome.

The limited partnership tests in sections YB 12(2) and YB 13(2) should include a discretion for the Commissioner to disregard any partnership share of 25 percent or more where the share in the limited partnership held by the limited partner corresponds to control or influence of less than 25 percent.

Section HG 2 of the Income Tax Act 2007 which provides that partnerships are transparent should be made consistent with new section YB 12 which only associates a limited partner who has a 25 percent or more interest in a limited partnership.

Comment

The drafting issue of whether a general partner is associated with a limited partnership has been addressed under the previous heading "Amendments to partnership and partner test". Officials consider that because a partner in a general partnership is always associated, the general partner in a limited partnership should also always be associated with the partnership.

The submission relating to the wording in section YB 13 is superseded by the recommendation to omit this provision.

Officials consider that the submission to insert a discretion in the limited partnership associated persons test would introduce a subjective element which would not be desirable. It would also lead to the application of the test being uncertain.

We do not consider it necessary to amend section HG 2 of the Income Tax Act 2007 in relation to limited partnerships, given the specific nature of section YB 12 which only associates limited partners who have a 25 percent or more interest in a limited partnership.

Recommendation

That it be noted that the submissions relating to the drafting of the limited partnership tests in proposed sections YB 12 and YB 13 have been addressed under previous headings.

That the submission to amend section HG 2 of the Income Tax Act 2007 be declined.

TRIPARTITE TEST – SCOPE

Submissions
(32 – KPMG, 39 – Russell McVeagh, 58 – nsaTax, 68A – Corporate Taxpayers Group, 70 – Deloitte)

The scope of the tripartite test in section YB 14 is too wide in its application, will give rise to unintended consequences and should not be enacted in its current form. For example, it could result in every beneficiary under an energy consumer trust being associated with each other in conjunction with the trustee for a relative test in section YB 5. These tests will likely be detrimental to the Crown revenue, at least in the short-term, with the declining property market.

In the context of land transactions, the exceptions contained in section YB 14(2) should be expanded to include section YB 5 (which relates to the association of a person and a trustee for a relative).

Comment

The tripartite test in the bill, which associates two persons if they are each associated with the same third person, currently contains a number of exceptions to ensure it does not apply more widely than is necessary to protect the tax base. For example, partners in a partnership will not be automatically associated under the tripartite test.

Officials consider that the scope of the tripartite test should be narrowed so that the test applies only to associate two persons if they are each associated with the same third person under different associated persons tests. This amendment would address a number of examples raised in submissions of where the tripartite test could apply more widely than is necessary to protect the tax base. The exceptions in the current section YB 14(2) could be largely subsumed by this modification to the tripartite test.

The tripartite test should also not apply if two persons are both associated with the same third person under any of the companies-related tests in sections YB 2 or YB 3. Currently, the exceptions in sections YB 14(2)(a) and (b) apply only if two persons are both associated with the same third person under the same companies-related tests – that is, persons A and B are both associated with person C under the two companies test in section YB 2, or are both associated with person C under the company and person other than a company test in section YB 3. The exceptions do not currently apply if person A is associated with person C under section YB 2 and person B is associated with person C under section YB 3 – the amendment proposed by officials would provide an exception to the tripartite test in this case.

In response to a submitter's example involving an energy consumer trust, officials have separately recommended in this report that these trusts be excluded from the trustee and beneficiary test in section YB 6 and the person and trustee for relative test in section YB 5. In addition, officials have also recommended that the person and trustee for relative test not apply for the purposes of the land provisions.

Officials note that a submission's reference to the reforms possibly reducing Crown revenue given the current declining property market does not take into account the application date of the associated persons reforms. In particular, the new associated persons definitions will generally apply only to land acquired on or after the date of enactment of this bill.

Recommendation

That the submissions be accepted, subject to officials' comments.

USE OF EXISTING ANTI-AVOIDANCE PROVISIONS

Submissions
(15 – WHK Taylors, 39 – Russell McVeagh, 67 – New Zealand Institute of Chartered Accountants)

The existing anti-avoidance provisions in the Income Tax Act 2007, including the general anti-avoidance provision in section BG 1, should be used to counter transactions that threaten the tax base.

Alternatively, the associated persons rules should apply only in cases of proven tax avoidance.

Expanding definitions of associated persons rather than applying the anti-avoidance provisions in appropriate circumstances will result in transactions being subject to tax where there is no policy justification for imposing tax.

Comment

The types of transactions and structures that the amendments are directed against raise significant tax base concerns.

The submissions argue that the associated persons reforms are unnecessary because the types of transactions and structures causing concern should be countered under the various anti-avoidance provisions in the Income Tax Act 2007. Although it is possible that Inland Revenue could be successful in applying the anti-avoidance provisions against these types of transactions and structures, this may involve litigation, the outcome of which is not certain. Also, any possible litigation involving the anti-avoidance provisions can take considerable time to complete. Officials do not consider that it is sufficiently certain or timely to rely on the anti-avoidance provisions to address the types of transactions and structures causing concern.

The best way of protecting the tax base with sufficient certainty and in a timely manner against the type of transactions and structures causing concern is to proceed with the proposed amendments. This is supported by the high priority that protection of the tax base has in the current economic and fiscal environment.

Recommendation

That the submissions be declined.

DIVIDEND AND FRINGE BENEFIT TAX RULES – PROPOSAL TO REMOVE ASSOCIATED PERSONS TEST SHOULD NOT PROCEED

Submission

(54 – Business New Zealand, 61 – Trustee Corporations Association of New Zealand, 68A – Corporate Taxpayers Group, 67 – New Zealand Institute of Chartered Accountants)

Removing the associated persons requirement from the dividend and fringe benefit tax (FBT) rules would undermine various arrangements outside the shareholding or employment relationship, including very common business practices that in most instances have no adverse effect on the New Zealand economy and which can be very important during times of recession when cash flow is short. For example, a plumber may lend a bricklayer some specialist tools without any payment made. They agree that when the plumber needs to borrow some tools used for bricklaying, he can do so without cost. Under the new rules this would be classified as a dividend and therefore taxable.

The proposed amendments could have wide-reaching and unintended consequences. There will be a greater perceived level of subjectivity in the dividends test and accordingly the potential for greater scrutiny in audit vis-à-vis considering dividends through an objective association test. The proposed amendments should not be made because of the compliance costs which will arise from needing to understand the new rules.

Comment

Officials acknowledge that the changes to the dividend and FBT rules would result in some situations being less certain than they are currently. Presently, if a person is not a shareholder or associated with a shareholder, they do not need to be concerned with the dividend rules. Under the proposed changes, the fact that they are neither a shareholder nor associated with one is not sufficient to provide certainty on the dividend issue. Officials consider this potential uncertainty outweighs the conceptual advantages of the proposed approach.

Recommendation

That the submission be accepted.

RATIONALISATION OF ASSOCIATED PERSONS DEFINITIONS

Submission
(39 – Russell McVeagh, 57 – Tomlinson Paull)

Officials consider that the current multiplicity of definitions creates unnecessary complexity in the Act which increases compliance and administrative costs. However, we consider that complexity per se is not objectionable, despite related compliance costs, if the outcome is an appropriately targeted base-maintenance measure. Removal of this flexibility and substitution with a one-size-fits-all universal test of association makes such an approach impossible and ignores the good policy reasons for having a range of tests.

The current definitions of associated persons should be consolidated into two definitions: a broad-based definition that would apply for some purposes (for example, for international tax purposes) and a narrow definition that would apply for certain other purposes (such as the taxation of land transactions).

Comment

An objective of the associated persons reforms is to rationalise the various income tax definitions of associated persons and make the tax law more coherent. Officials consider that the current multiplicity of definitions has mainly an historical origin: the specific definitions were mainly conceived in response to shortcomings in the general definition, and there are no convincing policy reasons for retaining the current multiple definitions, which can be significantly rationalised.

Officials consider the reform of the associated persons definitions retains sufficient flexibility. For example, a considerable number of modifications have been made to the associated persons tests for the purposes of the land provisions so they cover situations under the effective control of property dealers, developers and builders, but do not apply to other situations. In particular, the beneficiary-related tests in proposed sections YB 5, YB 6 and YB 9 will not apply for the purposes of the land provisions – this modification prevents cases where there would otherwise be potential overreach of the new rules.

Recommendation

That the submission be declined.

RATIONALISATION OF OTHER PROVISIONS

Issue: Replacing the company control definition

Submission
(53 – Ernst & Young)

There needs to be further review and amendment of provisions in the Income Tax Act 2007 which refer to "control" or related words, particularly in relation to the subpart FE thin capitalisation rules.

Comment

As a rationalisation measure, the bill repeals section YC 1, which defines when a company is treated as being under the control of any persons – its function will be performed by the new associated persons definition.

Officials do not agree that the repeal of section YC 1 creates any additional uncertainty over the meaning of "control by any other means". This is because section YC 1 does not define "control by any other means". The new associated persons definition and other provisions in the Act, such as the thin capitalisation rules, continue to use the "control by any other means" wording which is not defined in the Act. Therefore, the meaning of this wording is left to be determined by common law concepts.

Officials note that there is a reasonable body of case law on the meaning of "control" in the company context, such as the House of Lords decision in *British American Tobacco Company Ltd* v *IRC* [1943] AC 335. This body of case law provides guidance on the "control by any other means" wording.

Recommendation

That the submission be declined.

Issue: Replacing the related person definition

Submissions
(15 – WHK Taylors, 32 – KPMG, 35 – PricewaterhouseCoopers, 47 – Grant Thornton, 57 – Tomlinson Paull, 58 – nsaTax, 67 – New Zealand Institute of Chartered Accountants)

The related person definition should not be replaced with the new associated persons definition. Alternatively, the related persons rules in section CD 44(11) to (17) should be repealed.

The aggregation rule in current section CD 44(16) should be retained because the related party capital gains provisions were not intended to apply to capital gains made with the adult children or other close relatives of the shareholders in the vendor company.

The modifications in the associated persons definition that apply for the purposes of the land provisions should also apply for the purposes of the capital gains exclusions in section CD 44.

Comment

The bill proposes to replace the related person definition in section CD 44(15) to (17) with the new associated persons definition. The two definitions are conceptually similar, and the function of the related person definition can be performed by the new associated persons definition. Replacing the related person definition with the new associated persons definition is also a worthwhile simplification measure.

The current related person rules are used to determine the amount of the capital gain exclusion from a dividend arising from the realisation of a capital asset in the course of a company's liquidation. It is outside the scope of the associated persons reforms to consider the removal of this feature of the dividend rules.

The advantage of rationalising provisions which embody an associated persons concept, such as the related persons definition in the dividend rules, cannot be fully realised if there is no change to the current scope of those rules such as the aggregation rule in section CD 44(16). Officials note that the aggregation rule in section CD 44(16) is not limited to infant children as is the case in the land provisions.

Official do not consider that the modifications in the associated persons definition that apply for the purposes of the land provisions should also apply to section CD 44. This is because the transactions that give rise to capital gains could relate to property other than land.

Recommendation

That the submissions be declined.

Issue: Scope of counted associate amendment

Submission
(32 – KPMG)

The "counted associate" definition in section CD 22(9) should be modelled on the land sale rules.

Comment

The amendment in clause 12 of the bill to the counted associate definition in section CD 22(9) is limited to making that provision's description of discretionary beneficiaries consistent with other references in the Act. The submission's reference to where the shareholder is a company relates to a current feature of the "counted associate" definition which is not being amended by this bill.

Recommendation

That the submission be declined.

APPLICATION DATE

Issue: Change to application date

Submission

(35 – PricewaterhouseCoopers, 53 – Ernst & Young, 68A – Corporate Taxpayers Group, 70 – Deloitte)

Given that the bill will not have been enacted before the commencement of the 2009–10 income year and is unlikely to be enacted before 1 April 2009, we submit that the application dates be deferred.

Comment

The associated persons amendments in the bill currently generally apply for the 2009–10 and subsequent income years. However, for the purposes of the land provisions, except for section CB 11, the reforms apply to land acquired on or after 1 April 2009. For the purposes of section CB 11, the reforms will apply to land on which improvements are begun on or after 1 April 2009. These application dates were set when it was expected that the July bill would be enacted before 1 April 2009.

The Minister of Revenue has asked the Committee to consider a change to the application date for the associated persons reforms as a result of the bill being enacted later than originally expected. In particular, the general application date for the associated persons reforms (excluding the land provisions) should be changed to the 2010–11 and subsequent income years. In the case of the land provisions, except for section CB 11, the reforms should apply to land acquired on or after the date of enactment. For section CB 11 (disposal within 10 years of improvement: building business), the reforms should apply to land on which improvements are begun on or after the date of enactment.

The suggested changes to the application date will ensure that the associated persons reforms do not have retrospective effect.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Deferral of application date to allow further consultation

Submission
(32 – KPMG, 32A – KPMG)

The associated persons amendments should be deferred until further consultation can occur. The significant impact on taxpayers and transactions of the proposed changes means they should not be rushed through without proper regard for the consequences. Further work is needed to refine the proposals.

Comment

The associated persons reform has been developed in accordance with the generic tax policy framework. This has included a full consultation process. In particular, an issues paper was released in March 2007 which provided an opportunity for people to comment on the proposals. Significant modifications were made to the proposals in response to the extensive submissions received. Officials have also continued to engage in discussions with interested parties since the 2007 issues paper's release. In response to submissions on the bill, further modifications have been recommended by officials to the proposals in the bill.

The current submission would require the associated persons reforms to be removed from the bill to allow a further round of consultation. Given the extensive consultation that has been undertaken throughout the associated persons reform process, officials do not support this suggestion.

Recommendation

That the submission be declined.

Issue: Application date of replacing related person definition with associated person definition

Submission
(35 – PricewaterhouseCoopers)

The proposed replacement of the related person definition with the associated persons definition should not have retrospective application to any transaction with an associated person (who is not currently a "related person") that has occurred since 31 March 1988.

Comment

Officials agree that the legislation should be clarified to ensure that the replacement of the related person definition with the associated person definition has prospective application only. In particular, it should apply only to transactions with associated persons occurring on or after the application date of the new associated person reforms.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Application of changes to Fisheries Act 1996

Submission

(49, 49A – Seafood Industry Council)

The current associated persons definition that applies for the purposes of the Fisheries Act 1996 should continue to apply after the enactment of the new associated persons definition in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill.

Comment

The Fisheries Act 1996 uses the associated persons definition in the Income Tax Act 2007. The proposals in the bill to strengthen the associated person definition have been developed for income tax purposes rather than fisheries' purposes. Officials do not have a policy concern with the changes in the bill not applying for the purposes of the Fisheries Act. Therefore, from a policy perspective, officials agree with the submission to allow the current associated persons definition in the Income Tax Act to continue to apply for the purposes of the Fisheries Act.

The only concern that officials have with the submission is that it is not an ideal long-term situation because it requires users of the Fisheries Act to have access to old tax legislation. However, the Ministry of Fisheries has advised Inland Revenue officials that they intend to address this issue in the medium-term by amending the Fisheries Act so that it contains its own definition of associated persons. On this basis, officials consider it is appropriate to accept the submission.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Definition of "international tax rules"

Submission

(53 – Ernst & Young)

The reference to the new associated persons definitions in section YA 1 of the international tax rules should be refined or the subsection YB 2(6) exclusion should be qualified.

Comment

Officials agree that the reference to the new associated persons definitions in the section YA 1 definition of "international tax rules" (clause 404(68) of the bill) should be clarified. Because a general definition of associated persons will apply to the international tax rules from the application date of the associated persons reforms in the bill (expected to be the 2010–11 income year), paragraph (a)(xiv) of the "international tax rules" definition (which currently refers to the 1988 version provisions) should be omitted from that date. The current paragraph (a)(xiv) of the definition should be amended from "the commencement of the Income Tax Act 2007" to refer to "the parts of subpart YB that apply for the purposes of the 1988 version provisions".

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Associated persons for GST purposes

Submission
(35 – PricewaterhouseCoopers)

The test in section 2A(1)(h) of the Goods and Services Act 1985 associating the trustee of a trust with the trustee of another trust where the same person is settlor of both trusts should be amended so that it does not apply if the trust is a charitable or non-profit body.

Comment

The bill amends only the associated persons definitions in the Income Tax Act. The submission is seeking to amend the associated persons definition in the Goods and Services Act 1985 which is not the objective of these reforms. Therefore the submission is outside the scope of the bill.

Recommendation

That the submission be declined.

Issue: Clarification that trust tests do not apply to unit trusts

Submission
(62 – Minter Ellison Rudd Watts, 77 – Westpac)

It should be clarified that the trustee-related tests in sections YB 5 to YB 11 are not applicable to unit trusts because unit trusts are treated in all respects as companies for the purposes of the Income Tax Act.

Comment

The trustee-related tests would not apply to unit trusts because unit trusts are treated as companies for the purposes of the Income Tax Act. Therefore it would be the company-related tests in sections YB 2 and YB 3 that would apply to unit trusts. This position results from a unit trust being included in the definition of "company" in section YA 1 of the Income Tax Act 2007. Officials do not consider this treatment requires further clarification for the purposes of the associated persons tests.

The treatment of unit trusts has been subject to the Income Tax Act rewrite process. If a person wishes to raise an issue related to this rewrite process, it should be directed to the Rewrite Advisory Panel, which considers and advises the government on issues arising from the rewrite of the Income Tax Act.

Recommendation

That the submission be declined.

Issue: Application of voting and market value interest tests to fiscally transparent entities

Submission
(53 – Ernst & Young)

Further consideration should be given to clarifying and describing in the legislation how the voting and market value interest tests in subpart YC of the Income Tax Act 2007 should apply for associated persons and other purposes where fiscally transparent or hybrid entities (such as limited partnerships) are involved.

Comment

Officials note that this submission relates generally to how the voting and market value interest tests in subpart YC apply to fiscally transparent entities. Any consideration of this issue is distinct from the associated persons reforms in this bill and would be a separate exercise.

Recommendation

That the submission be declined.

Relocation and overtime meal allowances

OVERVIEW

Clauses 34, 35, 42, 485, 545, 547 to 549, 616, 617 and 619

The amendments to the Income Tax Acts 1994, 2004 and 2007 ensure that payments by employers when relocating their employees, and providing them with overtime meal allowances are exempt from income tax and fringe benefit tax if certain criteria are met. The changes were signalled in an officials' issues paper, *Tax-free relocation payments and overtime meal allowances*, released in November 2007, and are designed to remove uncertainty about whether and when these payments are tax-free to employees that receive them.

To further reduce uncertainty, the changes apply to payments made over the past four years, as well as to future payments. By statute, Inland Revenue is generally unable to re-assess an income tax liability beyond four years.

Ten submissions were made on this part of the bill and were generally supportive of ensuring that the two allowances were non-taxable.

Five submissions expressed concern, however, that specifically making two allowances non-taxable would imply that all other allowances would be taxable. They suggest Inland Revenue undertakes a general review of the tax treatment of all allowances before any legislative changes are contemplated. This is a misunderstanding, as the bill does not remove the more general provision that determines whether allowances are tax-free or taxable. All it does is carve out two allowances to ensure that they are non-taxable when the general provision might otherwise suggest that they were taxable.

REVIEW OF ALLOWANCES

Clauses 34, 35, 547, 548 and 616

Submission

(32 – KPMG, 38 – New Zealand Council of Trade Unions, 46 – Employers and Manufacturers Association (Northern), 54 – Business New Zealand, 67 – New Zealand Institute of Chartered Accountants)

There should be a general review of allowances to determine their tax status. This would help to remove uncertainty about the tax treatment of other allowances. The Commissioner promised a review back in 1996. The appropriate starting point for a review is general consultation under the generic tax policy process to determine what general principle should apply.

Comment

Officials are not averse to the idea of a general review of allowances under the generic tax policy process if it is shown to be warranted. We have been endeavouring to establish whether there is a problem in practice. Based on the feedback we have received on whether a wide range of non-taxable allowances would suddenly become taxable, we do not consider a general review to be warranted. Furthermore, there are very limited resources available to undertake such a review given the significant number of projects already on the tax policy work programme.

It is important to note that the bill does not remove the more general provision that determines whether allowances are tax-free or taxable. Nor does it affect those allowances, such as additional transport costs, that already have their own exemption. All it does is carve out two more allowances to ensure that they are non-taxable when the general provision might otherwise suggest that they were taxable.

To help determine whether other allowances are non-taxable, Inland Revenue intends to finalise the interpretation guideline of the current law in this area that was first circulated for comment in late 2007. This guideline was a key outcome of the review that the Commissioner indicated in 1996 would be undertaken given concerns following changes to the legislation in 1995.

Although it ultimately depends on the detail of each specific case, it would appear on the information available that many of the examples of allowances raised to date would likely continue to be non-taxable. During our various rounds of consultation on the proposed legislative changes, officials asked whether there were other allowances that, like relocation and overtime meal payments, needed to be specifically legislated as non-taxable. The only concrete example has been the sustenance allowance raised by Deloitte on behalf of NZ Post, which we are recommending be included in the legislative changes. This is discussed later in our responses.

Recommendation

That the submission be declined.

REVERT TO PREVIOUS LEGISLATIVE TEST

Clauses 35, 548 and 616

Submissions
(38 – New Zealand Council of Trade Unions, 67 – New Zealand Institute of Chartered Accountants)

The current test of whether an allowance or reimbursement can be paid tax-free (as per section CW 17) should be returned to an "incurred" test and the government should consult under the generic tax policy process to determine what allowances should be tax-free. In the event that this submission is not accepted, then the law should be returned to an "incurred" test with an exclusion for capital items. *(New Zealand Institute of Chartered Accountants)*

In the event that the submission for a general review is not accepted, then the law should be returned to an "incurred test", with an exclusion for capital test. *(New Zealand Council of Trade Unions)*

Comment

In 1995, changes were made to the tax treatment of allowances. The need for the Commissioner to determine whether an allowance was taxable or exempt was removed, putting the onus instead on the taxpayer to determine this. Also the test was changed from whether the expenditure was incurred as a necessary part of the employee's earning their income to one based on whether the expenditure would have been deductible by the employee were it not for the prohibition in the Income Tax Act that employees cannot claim expenses in relation to their employment.

The New Zealand Institute of Chartered Accountants has suggested that this change went beyond what was intended. Officials consider that beyond precluding reimbursements for capital expenditure as intended, any difference between the two tests is largely semantic and of little practical difference in determining whether an allowance or reimbursement is taxable or non-taxable. This is because an incurred test would still require the expenditure to be incurred in deriving the employee's income. Consequently, reverting to an incurred test would be unlikely to achieve an outcome materially different from continuing with the current law supplemented by the interpretation guideline.

Recommendation

That the submissions be declined.

OTHER ALLOWANCES SHOULD ALSO BE SPECIFICALLY EXEMPTED

Clauses 35, 548 and 616

Submission
(32 – KPMG, 68 – New Zealand Institute of Chartered Accountants)

The present proposal to allow only two specific forms of tax-free allowances does not go far enough and should be expanded to other allowances that are commonly paid by employers – for example, clothing and footwear.

Comment

We do not consider this to be necessary. As noted in an earlier response:

- The bill does not remove the more general provision that determines whether allowances are tax-free or taxable.
- To assist in determining whether other allowances are non-taxable, Inland Revenue intends to finalise the interpretation guideline of the current law in this area that it first circulated for comment in late 2007.

Although it ultimately depends on the detail of each specific case, it would appear on the information available that many of the examples of allowances raised to date would likely continue to be non-taxable. The interpretation guideline, for example, discusses the circumstances in which clothing and footwear allowances would be non-taxable, such as when they involve protective clothing or uniforms.

Recommendation

That the submission be declined.

TREATMENT OF DEPRECIATION

Clauses 34, 547 and 616

Submission
(Matter raised by officials)

The words “depreciation loss” should be added after the word “expenditure” in the general provision that determines whether an allowance is non-taxable (section CW 17) to ensure that allowances that provide for some element of depreciation are not precluded from being non-taxable.

Equivalent changes should be made to the 1994 and 2004 Income Tax Acts.

Up to the date of assent, however, these changes should apply only in relation to past positions taken.

Comment

Many employees use assets that they own during the course of their work. Employers often provide allowances to reimburse employees for the costs associated with the use of these assets for work purposes. Tool allowances and mileage allowances are prime examples. Arguably part of the reimbursement relates to the depreciation of those assets.

The main provision in the Income Tax Act determining whether allowances are non-taxable, section CW 17, refers only to payments to cover expenses. The Income Tax Act treats depreciation as a capital loss rather than as an expense. Accordingly, there is an issue as to whether the wording in section CW 17 adequately covers all elements that an allowance might cover. To remove this doubt, officials recommend that section CW 17 should refer to both “expenditure” and “depreciation loss”.

Given that the changes in relation to relocation payments and overtime meal allowances are being backdated to the 2002–03 income year, similar changes to incorporate “depreciation loss” should be made to the equivalent provisions in the 1994 and 2004 Income Tax Acts.

Up to the date of assent, however, these changes should be confined to past positions taken, to ensure that only those taxpayers that had genuinely included a depreciation element in their allowances would be able to utilise this change.

Recommendation

That the submission be accepted.

Issue: Reasonable daily travel distance requirement

Clauses 35, 548, 616 and 619

Submissions
(32 – KPMG, 67 – New Zealand Institute of Chartered Accountants)

In relation to the requirement for the employee to have relocated their home base, employers should be able to decide whether or not an employee has relocated as a consequence of the employer’s needs, subject to a “reasonableness test”. The application of this test should not be unduly restricted by Inland Revenue guidelines. *(KPMG)*

The requirement that the relocation is required because the employee’s workplace is not within reasonable daily travelling distance from the employee’s residence should be removed. In the alternative, if the “reasonable daily travelling distance” requirement is retained, the term should be defined or guidelines regarding its interpretation be issued as soon as possible. *(New Zealand Institute of Chartered Accountants)*

Comment

Officials agree that employers can largely be relied upon to confine their reimbursements to reasonable relocation expenses because their natural inclination is to minimise the costs that they incur. Nevertheless, the existence of an exemption for one form of expenditure will naturally create an incentive to recharacterise other forms of expenditure to take advantage of that exemption. This provides justification for limiting the scope of the exemption.

One of the proposed limitations is that the relocation of the employee’s home base must be necessary to carry out the job. If the employee could have commuted to the new job from an existing home base there would appear to be a clear monetary private benefit involved when the employer pays for the relocation costs and, in principle, this should be taxable.

This suggests the need for some form of distance requirement before a move could be considered a qualifying relocation. Options considered were that the employee’s existing home must not be within reasonable daily travelling distance of the new workplace (the United Kingdom approach) and a specific minimum distance test (the United States approach). Both these requirements do, however, involve some compliance costs. The United Kingdom’s approach requires assumptions to be made about what is “reasonable”, although reasonableness is a common concept within accounting. The United States’ approach is more certain in this regard but is less flexible in handling genuine local relocations, such as within a major city where traffic congestion and transport difficulties may make shorter distance relocations more justifiable.

A third option, and the one appeared favoured by the submissions, would be to leave it to employers to decide whether there has been a home base relocation that they wish to pay for, on the basis that employers will be reluctant to pay for relocations that are not related to work. While this would generally be the case, there could be some instances, particularly for senior appointments, when a salary recharacterisation could be achieved by relocating locally to coincide with taking up a new appointment.

On balance, our preference, backed by consultation, was to adopt the United Kingdom's approach. In terms of the reasonableness aspect, we note that the reasonable daily travelling distance is not defined in the United Kingdom's legislation. Instead taxpayers are expected to apply common sense and take account of local conditions. The usual time taken to travel a given distance is an indication of whether that distance is reasonable. For example, in the United Kingdom employees living within larger cities commonly travel much greater distances or take longer to travel the same distance to work than do employees elsewhere. In the New Zealand context, transport difficulties in the major cities may make long distance commuting less likely.

We consider that the small additional compliance costs associated with this requirement are warranted in light of the reduced opportunity for salary recharacterisation.

Since a number of submissions from our various rounds of consultation asked for guidelines from Inland Revenue on what is meant by "reasonable travelling distance", we will be developing these in time for the legislation's enactment. We are happy to work with key stakeholders to develop a set of practical guidelines that are not too restrictive.

Recommendation

That the submissions that there should not be any specific home base change or a reasonable travelling distance test requirement be declined.

That the submission that there should be no Inland Revenue guidelines on how to interpret "reasonable travelling distance" be declined.

That the submission that the guidelines be issued as soon as possible be accepted.

Issue: Developing guidelines on reasonable daily travelling distance

Clauses 35, 548, 616 and 619

Submission
(68 – Corporate Taxpayers Group)

The Corporate Taxpayers Group would like to work with officials on the guidelines prepared on the issue of what is not within a reasonable daily travelling distance of the employee's former residence.

Comment

Officials are happy to work with the Corporate Taxpayers Group and other key stakeholders on developing the guidelines.

Recommendation

That the submission be accepted.

Issue: Ensure that relocation and overtime meal payments are tax-free

Clauses 35, 548, 616 and 619

Submission
(38 – New Zealand Council of Trade Unions)

The current provisions should be amended to ensure that payments made by employers when relocating their employees and providing them with overtime meal allowances are exempt from income tax and fringe benefit tax.

Comment

Officials agree with this submission as the purpose of the proposed legislative changes is to achieve this very objective.

Recommendation

That the submission be accepted.

Issue: Estimates of relocation expenses

Clauses 35, 548 and 616

Submission
(32 – KPMG, 35 – PricewaterhouseCoopers, 53 – Ernst & Young, 67 – New Zealand Institute of Chartered Accountants)

As a compliance reduction measure, employers should be allowed to reimburse employees for relocation expenses by way of a reasonable estimate of expenses rather than be required to reimburse on the basis of actual expenditure.

Comment

The exemption will apply only to actual expenditure incurred. Hence, paying an employee a relocation allowance would not generally qualify unless it could be shown that the allowance covers costs that were actually incurred. Similarly, any amount paid by the employer in excess of the actual amount incurred will be taxable, even though a particular expense is on the list.

We appreciate that when there is a significant number of employees relocating over the year that the requirement to reimburse actual costs might mean additional compliance costs for employers. We consider this requirement to be necessary, however, given the potentially high variation in the costs of relocating from employee to employee and the potential magnitude of the expenses. Otherwise, general allowances bearing no semblance to actual expenditure in a particular case could be paid as salary substitutes.

Recommendation

That the submission be declined.

Submission
(68 – Corporate Taxpayers Group)

There should be a degree of pragmatism and leniency when it comes to the satisfaction of new section CW 17B(2) which requires the amount paid to be no more than the actual cost, particularly given that full evidence dating back possibly to October 2001 may not be available to employers. We suggest less restrictive wording in the equivalent sections of the 1994 and 2004 Income Tax Acts.

Comment

We acknowledge the passage of time may have made it more difficult to substantiate that previous payments covered actual eligible expenses. Accordingly, a degree of pragmatism is required in applying the test. But rather than trying to reflect this in the legislation, we suggest that it be handled administratively. Practically, the issue is more likely to be of relevance for those relatively few employers that are likely to seek refunds or credits because they have paid tax on relocation payments. Those

employers are more likely to have the necessary information given that the cases that we are aware of where tax has been paid arose from reassessments.

Recommendation

That the submission be declined.

Issue: Time limit on eligible relocation expenses

Clauses 35, 548 and 616

Submissions
(32 – KPMG, 67 – New Zealand Institute of Chartered Accountants, 68 – Corporate Taxpayers Group)

A time limit for paying relocation claims is not needed. Instead there should be a test to assess whether there is a sufficient nexus between the expenditure and the employee's relocation. But if there is to be a time limit, it should also recognise that when relocation occurs early in the income year, some of the expenditure can be incurred late in the preceding income year. *(KPMG, Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants)*

If there is to be a limit, it should run from the beginning of the income year prior to the income year in which the employee relocates to the end of the next income year. The limit should refer to "tax year" rather than "income year". *(Corporate Taxpayers Group)*

The time limit should just be a requirement that the expenditure has to be incurred by the end of the tax year following that in which the relocation occurs. *(Matter raised by officials)*

Comment

The intention is that to qualify for the tax exemption the expenditure for a particular relocation must be incurred, or the benefit provided, before the end of the income year following the one in which the employee starts the new job or moves to the new location. The purpose of this requirement is to provide a cut-off, to avoid expenditure some years later being attributed to the relocation when that expenditure would have no bearing on the employee's decision to relocate. In practice, most relocation costs will be incurred close to the time of relocation so the time limitation will not generally be a difficulty.

The draft legislation also requires the expenditure to have been incurred no earlier than the beginning of the income year in which the relocation takes place. Officials agree with submissions that this requirement is not needed and instead the other tests can be relied on to ensure an adequate nexus between the expenditure and the relocation. Expenditure in advance of relocation is quite feasible given the various preparations that a relocation can involve.

We agree that the provisions should refer to "tax year" rather than "income year" to remove any doubt over whose income year is involved. Tax year is a defined term and generally means the period from 1 April and ending on 31 March.

Recommendation

That the submission that there be no time limit be declined.

That the submission that the time limit should just be a requirement that the expenditure has to be incurred by the end of the tax year following that in which the relocation occurs, be accepted and note that this will address the submissions that called for the beginning of the time limit to begin earlier than the income year in which the relocation takes place.

That the submission that the limit should refer to "tax year" rather than "income year" be accepted.

Issue: Treatment of temporary moves that become permanent

Submission
(53 – Ernst and Young)

The section CW 17B(3)(b) qualification should be omitted or amended to provide that the time limit applies from the start of the income year in which the relocation becomes permanent for any further relocation expenditure which is the result of the change from temporary to permanent relocation.

Comment

The bill generally does not distinguish between temporary and permanent relocations. For example, there is no minimum requirement on the length of time that an employee has to stay in the new location. The only reference to temporary moves is in relation to allowing more flexibility around the time limit.

The draft legislation, however, omits to say what time limit applies when a temporary move becomes a permanent relocation. The intention is that if the earlier temporary move had not been treated as an eligible relocation against which claims had been made, the temporary move would be ignored. We agree that the legislation should make this clear.

Recommendation

That the submission be accepted in part, so that the legislation makes it clearer what time limit applies when a temporary move is ignored.

Issue: Application date

Clauses 35, 548, 616 and 619

Submissions
(32 – KPMG, 67 – New Zealand Institute of Chartered Accountants)

To remove any residual doubts about reassessments of previous tax positions, either all tax positions taken in relation to relocation expenses and overtime meal allowances before the law change should be affirmed or the retrospective application date should be extended to match the period that Inland Revenue could reassess. *(KPMG)*

The backdating of the application date to 2002–03 will not provide any cover for taxpayers who have made tax-free relocation and overtime meal payments before that date. To be effective, the changes need to be made retrospective to the date when the current legislation was enacted. *(New Zealand Institute of Chartered Accountants)*

Comment

The submissions question whether the Commissioner's ability to reassess taxpayers is limited in this instance to four years, as per the statute bar.

The uncertainty about whether the statute bar would apply is a technical argument and should not be a problem in practice. Officials therefore consider that there is no need to take the application date back beyond the 2002–03 income year as contemplated in the draft bill.

Furthermore, reaffirming all previously taken tax positions would not provide tax credits to those who had paid tax, which was a key reason for making the change retrospective.

Recommendation

That the submissions be declined.

Issue: Commissioner's determination specifying eligible relocation expenses

Clause 485

Submission
(35 – PricewaterhouseCoopers, 68 – Corporate Taxpayers Group)

The draft determination issued on 21 November 2008 should be finalised by the Commissioner immediately following enactment of the bill.

Comment

Officials intend to finalise the list of eligible relocation expenses in time for the bill's enactment. This was the reason why the draft determination setting out the suggested list was circulated by Inland Revenue late last year for comment.

Recommendation

That the submission be accepted.

Issue: Additional items for list of eligible relocation expenses, including catch-all

Clause 485

Submissions
(24 –New Zealand Law Society, 35 – PricewaterhouseCoopers, 67 – New Zealand Institute of Chartered Accountants)

There are a number of payments commonly made to expatriates and relocating employees which should be included on the list, for example:

- visits to the new location before the actual move to scope matters such as accommodation options and schooling for children;
- property management fees paid to real estate agents engaged to manage the employee's family home (if it is rented out);
- travel insurance paid in respect of moving to the new location and any pre-move visits to the new location;
- language lessons, if the employee is moving somewhere where they are unable to speak the main local language;
- costs incurred in cancelling utility connections in their current location;
- "home leave" travel costs;

- costs incurred in relocating to a "developing country", which might be considered a fringe benefit in a developed country, but which are a required expense for someone relocating from New Zealand.

The following items should also be included in the list of eligible relocation expenditure:

- any loss on sale of a family home;
- the GST charged on goods transported into New Zealand;
- fees for the employee and their immediate family to attend training and employment consultation, provided these costs are incurred within, for example, 12 months of the relocation;
- the costs incurred in sending a child to a school of a comparable standard to the school they attended previously;
- costs incurred on, for example, family reunion visits and compassionate travel;
- the costs involved in obtaining a host-country driving licence;
- the costs involved in the purchase of reasonable furniture and electrical goods if it is decided not to transfer these from the previous location;
- any other incidental costs in relation to the relocation, up to a maximum of $1,000. *(PricewaterhouseCoopers)*

The following items should be included on the list of eligible relocation expenditure:

- the cost of immigration applications (including application fees, x-rays, doctors' reports, police reports and other special documentation);
- charges for currency exchange on moving money to New Zealand;
- house valuation costs;
- LIM reports (or similar);
- customs clearance costs;
- storage costs at the new location before obtaining a permanent residence;
- costs associated with complying with New Zealand customs regulations;
- statutory obligations that arise on importation of cars, vans, boats and trailers (for example, compliance certificates and modifications required to comply).

The list should also include a "catch-all" clause. *(New Zealand Institute of Chartered Accountants)*

Comment

The legislation proposes that the Commissioner issue a list of eligible relocation expenses. New section 91AAR of the Tax Administration Act 1994 provides some parameters around the Commissioner's proposed power to issue such determinations.

Section 91AAR(3) sets out the factors that the Commissioner may take into account when considering whether a type of expenditure necessarily arises from a relocation of an employee rather than being costs, including capital costs, that would have been incurred gradually over time, irrespective of whether an employee had relocated. In this regard, factors that may be borne in mind are whether the expenditure is really a substitute for salary and wages, whether employers generally treat the expenses as relocation expenses and the difficulty and costs of measuring any private benefit element. Losses on the sale of a house, for example, would not be considered to qualify as they are a potentially sizable capital loss that may have accumulated over time.

As noted earlier, Inland Revenue issued a draft determination in November 2008 for comment, setting out a suggested list of eligible relocation expenses. The items referred to above can be considered by the Commissioner, alongside the suggestions made directly to the Commissioner on the draft determination.

Officials confirm that the intention is that the list would also include a "catch-all" category to cover miscellaneous relocation expenses.

Recommendation

That the submissions be noted, and the items suggested be considered by the Commissioner along with the submissions made directly to the Commissioner on the draft determination.

Issue: Nature of the list – ability to amend the determination and whether it should be a fixed list for earlier years

Clause 485

Submissions
(24 – New Zealand Law Society, 35 – PricewaterhouseCoopers)

A mechanism should be put in place so that the determination can be amended easily as omissions are identified and agreed with the Commissioner. *(New Zealand Law Society)*

In relation to earlier income years (those starting from the 2002–03 income year), the list of eligible relocation expenses should be a fixed list.

But for future income years, the Commissioner should be able to add and delete items from the list provided the Commissioner gives adequate notice of any amendment. *(PricewaterhouseCoopers)*

Comment

Draft section 91AAR(4) already provides for a determination to be altered, subject to the Commissioner giving at least 30 days notice of the implementation date of any change. A person affected by a determination may challenge the determination under the Disputes Procedures and Challenges parts of the Tax Administration Act.

The aim is to get from the outset as comprehensive a list as possible so that changes to the list items will then need to relate only to future income years. Nevertheless it is important to have the ability to backdate changes as taxpayers may subsequently realise that a relocation expense item that they have been paying or reimbursing tax-free in the past has been omitted from the list and it should be on the list.

Recommendation

That submissions recommending a mechanism be put in place so that the determination can be amended easily as omissions are identified and agreed; and that the Commissioner be able to add and delete items from the list, provided the Commissioner gives adequate notice of any amendment be accepted. Note that the draft legislation already provides for this.

That the submission recommending that the list be fixed in relation to earlier income years be declined.

Issue: Nature of the list – inclusive or definitive

Clause 485

Submissions
(24 –New Zealand Law Society, 32 – KPMG, 67 – New Zealand Institute of Chartered Accountants)

The list should be an "inclusive" list. *(New Zealand Institute of Chartered Accountants)*

The relocation expenses that can be reimbursed tax-free should not be restricted to a list determined by the Commissioner as this will unnecessarily constrain employers in the types of reimbursements that they make, and the list could become outdated. The legislation could establish broad principles, coupled with a list of common expenses. If the list approach is to be retained:

- the types of expenses should be broadly defined; and
- there should be no restrictions based on monetary limits, either as an overall cap or for specific items. *(KPMG)*

The determination should be kept as general as possible. A finite list may result in some valid employee relocation payments being denied tax-free status to which they should be entitled. *(New Zealand Law Society)*

Comment

A list of all eligible relocation expenses provides greater control and certainty over the expenses that would be tax-exempt than the converse approach of allowing any expenses other than those on an ineligible list or having a list that provides just examples of the main items that would be included. This is why the legislation provides for a list that covers all eligible expenses.

Submissions on an earlier version of the list indicated a preference for more detail rather than broadly defined items – for example, whether an amount includes GST, or specifying insurance separately rather than referring to just removal costs.

We agree that there should not be an overall cap on the amount of relocation expenditure and none is included in the legislation. A concern with placing a cap on the amount of exempt expenses is that it could preclude some socially optimal relocations because it would not recognise variations in employees' costs, which can be significant, depending on factors such as an employee's family size. Also, with the exception of the catch-all for miscellaneous relocation expenditure, no dollar limits are contemplated for individual items on the list.

Recommendation

That the submission that the list just provide an indication or examples of the types of expenditure that would be eligible be declined.

That the submission that there should not be an overall cap on the amount of relocation expenditure be accepted, and note that none is included in the legislation.

Issue: Mechanism for claiming overpaid tax in previous periods

Clauses 35, 548 and 616

Submissions
(35 – PricewaterhouseCoopers)

A special legislative mechanism should be introduced so employers can claim overpaid tax.

Inland Revenue should provide guidance on what will constitute "corroborating material" when making a claim.

Inland Revenue should establish a simple procedure for employers to claim past overpaid FBT and provide guidance to employers on how to claim a refund.

Comment

Given that the legislative changes in relation to relocation and overtime meal payments are being backdated to the 2002–03 income year, some taxpayers will be entitled to a credit for over-paid tax if they paid tax on past qualifying payments. These adjustments will be handled through Inland Revenue's standard administrative practices. Section 113 of the Tax Administration Act enables the Commissioner to amend the relevant assessments. Our information is that adjustments are likely to be claimed only in relation to some relocation payments.

There was general agreement with the suggestion in the officials' issues paper of November 2007 that employers should receive the credit for over-paid PAYE when they have grossed-up the payment to compensate the employee for the tax impost. The issues paper also noted that a special legislative mechanism might be needed to achieve this. On further consideration, a special legislative mechanism was decided not to be necessary. Inland Revenue already has administrative practices in place that enable credits to be given for over-payments of PAYE. An employer can request an adjustment to a past employer monthly schedule, which the Commissioner will do on the receipt of corroborating material.

Similarly, as would normally occur, employers receiving these credits should be adjusting their taxable income when they have treated the past PAYE payment as a cost of business.

This process may involve employers incurring some additional compliance costs but our assumption is that there are not many employers who have paid tax on the payments and not significant numbers of employees involved. Trying to set up a special process for employers proved to be too complicated given the need to also give some employees adjustments to redress the fact that they will have received lower entitlements (for example, for family assistance) and had higher liabilities (for example, child support) as a result of the payments being previously subject to income tax.

Employers who have overpaid fringe benefit tax on relocation benefits will be able to obtain a credit for that overpaid fringe benefit tax by amending the relevant FBT returns. We consider this to be a relatively simple mechanism.

Guidance on what would be expected, including in terms of corroborating evidence, will be provided in Inland Revenue's *Tax Information Bulletin* which will be published once the bill has been enacted.

Recommendation

That the submission for a special legislative mechanism to enable employers to claim overpaid tax be declined.

That the submission that Inland Revenue provide guidance on what will constitute "corroborating material" when making a claim, be accepted and note that this will be covered in a *Tax Information Bulletin*.

That the submission that Inland Revenue establish a simple procedure for employers to claim past overpaid FBT and provide guidance to employers on how to claim a refund be accepted, and note that the mechanism will be through the standard approach of an employer revising its relevant FBT returns.

Issue: Application to expatriate employees

Clauses 35, 548, 616 and 619

Submission
(32 – KPMG)

Further consideration should be given to expatriate employees who have been relocated from one jurisdiction to another. For example, the treatment of additional taxes payable as a consequence of the employee being assigned.

Comment

The proposed legislative changes in relation to relocation payments are intended to cover not only relocations within New Zealand but also relocations out of and into New Zealand. The changes are of relevance to those employees who are relocating out of New Zealand if they retain their tax residence in New Zealand, which is the case for public servants who are posted overseas. The draft list of eligible relocation expenses reflects this wide range of possible relocations. Submissions on that list will be considered over the coming months.

Tax-free reimbursement of ongoing costs is not considered, however, to be appropriate as these are more akin to salary and wages substitutes. There is a range of allowances that employees receive that are currently treated as taxable and should continue to be treated as such. Cost of living allowances and tax equalisation allowances are two examples. The fact that taxes and/or living costs are higher in a country would normally be reflected in the salaries paid in those countries and should not be considered a relocation expense.

Recommendation

That the submission be declined.

Issue: Interrelationship with accommodation element of employment income

Clause 21

Submission
(32 – KPMG)

In relation to accommodation, there should be an exemption provided under section CE 1(c) to mirror the amendments to section CX 19(1)(b) to exempt amounts that, if they had been paid, would be exempt income under section CW 17B.

Comment

Section CE 1(c) ensures that the market value of accommodation provided by an employer to an employee is income to the employee. If the provision of accommodation would qualify as an eligible relocation expense, it should be excluded from being income to the employee. Consequently, officials agree with the submission that section CE 1(c) should be amended accordingly.

Recommendation

That the submission be accepted.

Issue: Interrelationship with entertainment tax

Clauses 35, 548 and 616

Submissions
(35 – PricewaterhouseCoopers, matter raised by officials)

The limitation rule in the entertainment tax rules that limits entertainment expenditure deductions to 50 percent should not apply to payments for overtime meals. Section DD 4(3) of the Income Tax Act should be amended so that it refers also to new section CW 17C. *(PricewaterhouseCoopers)*

Expenditure on meals that qualifies as eligible relocation expenditure should also be exempted from the limitation on entertainment expenditure deductions. *(Matter raised by officials)*

Comment

Officials agree that section DD 4(3), which specifically excludes expenditure on overtime meals from the limitation on entertainment expenditure deductions should, as a consequence of the changes in the bill, refer to section CW 17C rather than section CW 17 as it currently does.

Furthermore, we consider that the expenditure on meals that qualifies as eligible relocation expenditure should also be exempt from the limitation on entertainment expenditure deductions.

Recommendation

That the submission be accepted.

That expenditure on meals that qualify as eligible relocation expenditure should also be exempt from the limitation on entertainment expenditure deductions.

OTHER CONSEQUENTIAL CHANGES

Clauses 35, 548 and 616

Submission
(Matter raised by officials)

Several references in other sections of the Income Tax Act that currently refer to the main provision that determines whether allowances are taxable or non-taxable also need to refer to the new provisions relating to relocation payments and overtime meal allowances. The relevant sections in the 2007 Act are:

- section DD 10(a) relating to reimbursement and apportionment of entertainment expenditure;
- section EA 3(7) relating to prepayments; and
- definition of "employee" in section YA 1.

Comparable changes are also needed in the 2004 and 1994 Income Tax Acts.

Comment

These amendments are merely consequential changes as a result of carving out the relocation payments and overtime meal allowances from the more general provision that determines whether allowances are taxable or non-taxable. The amendments ensure that the rules covered by the amendments (as referred to above) continue to apply also to the two carved out allowances.

Recommendation

That the submission be accepted.

Issue: Definition of "overtime"

Clauses 35, 548 and 619

Submission
(46 – Employers and Manufacturers Association (Northern), 54 – Business New Zealand)

The words "when the employee has worked more than two hours beyond their ordinary hours on the day" should be omitted from the meaning of "overtime" in clause 35 of the bill.

Comment

The submission seems to be concerned that the current wording of the "overtime" definition implies that two hours overtime must be worked before an employee is eligible to be paid for overtime. Officials are not convinced that this is the implication and it certainly was not the intention of the current wording in the bill. However, to remove any doubt we agree that the two-hour reference can be removed from the definition of "overtime". Given that this time limit is important, we recommend that it be included instead in section CW 17C(2) as one of the eligibility requirements for the meal to be exempt. We have discussed this change with Business New Zealand, and they are comfortable with it.

Recommendation

That the submission be accepted.

Issue: Requirement to do at least two hours overtime

Clauses 35, 548 and 619

Submission
(68 – Corporate Taxpayers Group)

The requirement that at least two hours of overtime has to be worked is too strict, particularly for certain types of workers. Consequently, there should be no time limit and instead meal allowances should not be taxable as long as the payment of the allowance is not a substitute for the employee's ordinary remuneration. Or the definition of "overtime" could be buttressed by excluding any arrangements which have been entered into for the purpose of defeating the intention of the exemption.

Comment

A time limit is important to avoid an employee working only a few minutes of overtime to get a non-taxable overtime meal allowance. Officials understand that two hours is the standard time that employers require before they pay an overtime meal allowance so this limit should fit with current practice. Having instead a specific rule in relation to overtime that either excluded salary substitutes or any arrangements which have been entered into for the purpose of defeating the intention of the exemption would likely create uncertainty about what it meant in practice.

Recommendation

That the submission be declined.

Issue: Overtime meal allowances determined by industrial awards

Clauses 35, 548 and 619

Submission
(68 – Corporate Taxpayers Group)

The rules on the documentary evidence required to support the quantum of allowance paid should be relaxed to specifically state that an amount determined with reference to an industrial award satisfies the evidential requirements.

Comment

Officials consider it is important that the amounts paid for overtime meals should either represent actual costs incurred or a reasonable estimate of those costs rather than having particular amounts automatically sanctioned. If amounts are paid out with no intention of expenditure actually being incurred, the amount paid equates to a salary substitute and should be taxed.

We consider that the draft legislation is already sufficiently wide to accommodate the situation raised in the submission and, consequently, we would generally expect there to be no issue in terms of amounts specified in industrial awards qualifying in practice. As the submission acknowledges, this would arguably already be covered by the legislation on the assumption that the award amounts are based on a reasonable estimate of the costs to be incurred. Furthermore, verification is not required if the actual amount spent is under $20.

We do, however, agree with the alternative suggestion that any concerns in this regard could be addressed through the commentary in the *Tax Information Bulletin* to be published by Inland Revenue after the bill's enactment.

Recommendation

That the submission be declined.

Issue: Meals provided to postal delivery workers

Clauses 35, 548 and 619

Submission
(74 & 74A – Deloitte)

The exemption for overtime meals should extend to cover meal allowances paid to postal delivery workers actively involved in the delivery of mail.

Comment

Deloitte is raising this matter on behalf of NZ Post Limited which has several thousand postal workers that carry out their employment duties outside. These employees do not have access to the usual employer-provided drink facilities that employees working in offices would normally have access to. NZ Post indicates that this liquid refreshment (which includes energy drinks) is particularly needed given the physical activity being undertaken by the postal workers actively involved in delivering mail. Moreover, because these workers are required to carry bags of mail, either on foot or by bicycle, they do not have the capacity to carry the energy drinks with them.

NZ Post consequently provides a daily "meal" allowance of around $14, so employees can purchase the required refreshments along the work route if the employee completes 7.5 hours of work on the day. This is consistent with ensuring the health and safety of these employees. NZ Post has been treating this allowance as non-taxable for decades. On average, a postal worker would receive around $300 from these allowances, with their wages being $30,000 to $40,000 a year.

Officials agree that this meal allowance should be non-taxable and recommend that the legislative changes be widened to encompass it. It recognises the additional costs associated with the particular situation and even though it covers a "meal" which would be of private benefit, it also covers refreshments (adjusted for the relevant circumstances) that are normally provided by employers at no cost to their employees.

We do not, however, consider that the draft legislative changes suggested in the submission are the best way to achieve this (for example, there is no need for a cut-off date and to refer to health and safety).

Instead we envisage exempting sustenance payments using generic wording that picks up a number of the key attributes of a postal delivery worker's job, which in combination are seemingly unique, as follows:

- the employees employment agreement requires them mainly to work outdoors; and
- to undertake a long period of physical activity that does not take place in a single location; and
- the employee works a minimum of seven hours on the day the allowance relates to, without recourse to the employer's premises; and

- because of the nature of the employee’s work, it is not practicable on the day for the employer to provide refreshments as an employer would in the normal course of their business.

We will continue to discuss the exemption wording with the submitter.

As a consequential change, the sustenance payment should also be exempted from entertainment tax.

Recommendation

That the submission, as modified, be accepted.

Issue: Defining “meals”

Clauses 35, 548 and 619

Submission
(74 – Deloitte)

A definition of “meals” should be included in the legislation to ensure that it covers drinks as well as food.

Comment

This submission was made with reference to the previous submission on postal delivery workers. The submission’s concern is that “meal” could be interpreted to be restricted to “food” and, therefore, would not include a situation such as that of the postal delivery workers, when drinks or energy drinks are purchased and consumed.

“Food” according to the Oxford dictionary means any substance taken in to maintain life and growth. This would seem to be wide enough to cover drink. Moreover, tax case law has indicated that drink can form part of a meal. In these circumstances it seems unnecessary to define “meals”.

Recommendation

That the submission be declined.

Payroll giving

OVERVIEW

Clauses 232, 233, 235, 236, 379, 384, 402, 403, 408(23), 408(38), 408(89), 408(99), 442(1) and (3), 443, 447, 458 and 504

Eleven submissions were received on the proposed payroll-giving scheme. Five confirmed their support for the concept of payroll giving and the tax credit mechanism of delivering tax relief on payroll donations. Even so, most submissions were concerned to ensure that the compliance costs of the scheme for employers were kept to an absolute minimum, otherwise the benefits of the scheme might not be fully realised.

A common theme throughout submissions was the need to provide greater clarity in legislation on the following matters:

- that participation in payroll giving is voluntary for employers and employees;
- the roles and responsibilities of employers, employees and donee organisations; and
- sanctions for non-compliance.

For the most part officials agree with the submissions as they would ensure that underlying policy intentions are achieved, improving the overall integrity of the scheme.

A further prevailing theme in submissions has been the desire for the legislation to prescribe the details of the payroll-giving scheme arrangement. As proposed, the bill simply provides for the tax mechanism to deliver tax relief for payroll donations on a pay-period basis. It does not prescribe the nature of the arrangements or relationships between employers, employees and donee organisations, or how the schemes should be set up. Matters that would need to be decided upon by the relevant parties include:

- the process for establishing a scheme that works best for all parties concerned;
- the use of intermediaries;
- the level of employee education about payroll giving;
- the process for selecting donee organisations to participate in the scheme;
- the number of donee organisations that can participate in the scheme;
- the level of engagement between donee organisations and employee donors; and
- any minimum payroll donation threshold.

The non-prescriptive nature of the proposed scheme is intended to provide flexibility to allow relevant parties to work together to establish schemes that work best for them and to manage the associated costs. A key policy outcome of payroll giving is that it has the potential to establish genuine partnerships between businesses and the community, while supporting employees' community activities.

The voluntary nature of the scheme also reflects the ethos of giving, and sets up a system that facilitates, but does not mandate, giving.

We propose to outline these points in Inland Revenue's publication, *Tax Information Bulletin*, which will be published following enactment of the bill.

The proposed scheme would deliver payday tax relief on payroll donations by way of a tax credit. Employees would receive a tax credit on the amount of their donation made each payday. Employers would offset the credit against the PAYE calculated on the employee's gross pay. The tax credit would be calculated on the set rate of 33⅓%. Employees who make payroll donations would not have to keep receipts or wait until the end of the year to claim the tax benefit of their donations. The scheme would also operate in addition to the current end-of-year tax credit claim system. Therefore, employees who do not or are not able to give through payroll giving can still claim tax relief on their donations through the end-of-year process.

SUPPORT FOR PAYROLL GIVING

Submission
(19 – Volunteering New Zealand, 24 – New Zealand Law Society, 32 – KPMG, 37 – Inter-Church Working Party on Taxation, 62 – Minter Ellison Rudd Watts)

The submissions support the concept of payroll giving and the tax credit mechanism for delivering the tax relief.

Recommendation

That the submissions be noted.

"VOLUNTARY" NATURE OF THE SCHEME

Clause 236

Issue: Participation in payroll giving should be voluntary for employers

Submission
(35 – PricewaterhouseCoopers, 37 – Inter-Church Working Party on Taxation, 46 – Employers and Manufacturers Association (Northern), 68A – Corporate Taxpayers Group)

The bill should clearly provide that payroll giving is voluntary for employers and employees.

Comment

Proposed section LD 4 provides that tax credits for payroll donations are available to a person who is an employee whose employer files their employer monthly schedule[1] electronically and who chooses to make a payroll donation in a pay-period. This section suggests that if an employee chooses to make a payroll donation, his or her employer is obliged to offer payroll giving. This outcome was not intended.

Participation in payroll giving is intended to be voluntary for both employers and employees. To correct this matter, officials recommend that proposed section LD 4 be amended to make it clear that the scheme is also voluntary for employers.

Recommendation

That the submission be accepted.

Issue: Employers would be morally obliged to offer payroll giving to their employees

Submission
(68A – Corporate Taxpayers Group)

The scheme might not necessarily be voluntary for employers in practice. Should an employee express a desire to participate in payroll giving, employers could feel morally obliged to offer the scheme to their employees even though the scheme is intended to be voluntary for employers. If the employer chooses not to offer payroll giving, they could be seen as socially irresponsible and could portray their organisation in an unfavourable light.

[1] An employer monthly schedule provides pay-period information on employee salaries and wages, PAYE deductions and other social policy-related deductions.

Comment

Officials acknowledge the point made in this submission. Even so, payroll giving is all about establishing genuine partnerships between the parties concerned. The voluntary nature of the scheme should enable employers to weigh up the potential compliance costs of offering payroll giving to their employees against the benefits in the context of corporate social responsibility and the possibility of aligning their business objectives with the work of certain community organisations. It is also noted that the scheme will operate in addition to the current end-of-year tax credit claim system. Therefore, employees who do not or are not able to give through payroll giving could still claim tax relief on their donations through the end-of-year process.

Recommendation

That the submission be noted.

THE ELIGIBILITY CRITERIA FOR PARTICIPATING IN THE SCHEME

Clause 236

Issue: Extend payroll giving to all employers

Submission
(67 – New Zealand Institute of Chartered Accountants)

Payroll giving should be made available to all employers and not just to those who file their employer monthly schedules electronically.

Comment

As mentioned previously, employers are required to electronically file their employer monthly schedules before they can participate in payroll giving. This requirement was necessary because the paper form of the employer monthly schedule could not be easily amended to capture the relevant payroll donation information. Therefore, it was not practicable to extend payroll giving to employers who file their employer monthly schedules in paper form.

Officials note that any employer with access to a computer and the internet can file electronically using Inland Revenue's secure IR-file system. Inland Revenue provides relevant support and education to employers who choose to file their employer monthly schedules in this way.

As already noted, if an employee wishes to make a donation and their employer does not file their employer monthly schedule electronically, the employee can use the current end-of year tax credit claim process.

Recommendation

That the submission be declined.

Issue: Employers who offer payroll giving should be required to electronically file their PAYE income payment forms

Submission
(Matter raised by officials)

An amendment to the eligibility criteria in proposed section LD 4 is necessary to require employers to file their PAYE income payment forms electronically.

Comment

Like the paper form of the employer monthly schedule, there are space limitations in the paper form of the PAYE income payment form. The PAYE income payment form contains summary PAYE and other deductions information and accompanies the payment of PAYE.

Officials consider that this requirement should be part of the eligibility criteria for employers who wish to offer payroll giving to their employees.

Recommendation

That the submission be accepted.

Issue: Payroll giving should be available to people who earn income from employment

Submission
(Matter raised by officials)

An amendment to the eligibility criteria in proposed section LD 4 is necessary to clarify that people who earn income from employment are able to participate in a payroll-giving scheme.

Comment

As currently drafted, the bill would treat the Accident Compensation Corporation (ACC), the Ministry of Social Development and Inland Revenue as employers when payments of ACC compensation and attendant care payments, paid parental leave and means-tested benefits are made. This outcome was not intended.

Payroll giving was intended to apply to employees who earn income in connection with their employment. People who receive payments of ACC compensation and attendant care payments, paid parental leave and means-tested benefits should not be permitted to make payroll donations from these payments. Officials note that there would be practical difficulties in making payroll giving available to people who receive such payments.

Recommendation

That the submission be accepted.

Issue: Employees having satisfied their tax and other statutory obligations

Submission

(32 – KPMG, 67 – New Zealand Institute of Chartered Accountants)

The bill should be amended to allow the employer to rely on the statement or assurance given by the employee that they have satisfied any tax obligation that they may have or any other statutory requirement that they may be obliged to meet from their salary and wages. This would help to minimise compliance costs for employers. Furthermore, any subsequent square-up should be between the employee and Inland Revenue.

Comment

Proposed section LD 7 provides that a person could only make payroll donations for a pay-period if they have satisfied all of their tax obligations (including, student loan and child support payments and KiwiSaver obligations) and any statutory requirements that they are obliged to meet from their wage and salary income. This requirement was intended to ensure that people paid their tax and social policy obligations from their employment income before making payroll donations. It was also intended that this requirement would apply on a pay-period basis.

As drafted, the bill does not impose any requirement on employers to verify that an employee is meeting all of their tax and other statutory obligations from their salary and wages before making any payroll donations. This aspect would help to reduce compliance costs on employers. We consider that in practice the employer would make the required pay-period tax and social policy deductions and any other deductions required to be made from an employee's salary and, if there are sufficient funds, make the necessary adjustments for payroll donations.

Officials also consider that proposed section LD 7 should be amended so that it better reflects the stated policy intention.

Recommendation

That the submission be declined, but that proposed section LD 7 be amended so that it better reflects the stated policy intention.

THREE-MONTH TIMEFRAME FOR TRANSFERRING PAYROLL DONATIONS

Clause 447

Submission
(19 – Volunteering New Zealand, 24 – New Zealand Law Society, 62 – Minter Ellison Rudd Watts)

The three-month timeframe for payroll donations should be shortened. This period is too long given the potential for an employer to become insolvent in the current economic environment.

Comment

Proposed section 24Q of the Tax Administration Act 1994 requires employers or PAYE intermediaries to transfer payroll donations to the relevant recipient donee organisations within three months from the end of the pay-period in which the donations were deducted from the employee's pay.

The three-month timeframe is designed to encourage employers to transfer payroll donations to the relevant recipient donee organisations in a timely manner. It also seeks to help offset some of the employer compliance costs associated with the administration of the scheme by transferring small amounts of money to donee organisations frequently.

In the event of an employer becoming insolvent and any payroll donations not being transferred to the relevant recipients, the tax credit for those payroll donations would be extinguished and the employer would be responsible for paying the resulting shortfall in PAYE. This is further discussed under the section *Issue: Shortfall in PAYE when a payroll donation tax credit is extinguished*. Additionally, the employee would have recourse to the employer for the payroll donations not transferred, a matter also discussed under the section *Issue: Payroll donations held in trust for employees*.

On balance, officials consider it important to minimise as far as practicable the compliance costs for employers. The three-month timeframe helps to achieve this result.

Recommendation

That the submission be declined.

PAYROLL DONATIONS SHOULD BE HELD IN TRUST FOR EMPLOYEES

Submission
(19 – Volunteering New Zealand, 24 – New Zealand Law Society, 62 – Minter Ellison Rudd Watts)

The bill should provide that payroll donations are held in trust for employees until those donations have been transferred to the relevant recipient organisations.

Submissions raised concerns about the risk of employers becoming insolvent and the employees losing their entitlement to payroll donations that have not yet been transferred to the relevant recipient organisations.

Comment

The proposed scheme is silent on whether payroll donations held by the employer during the three-month timeframe are held in trust for employees or the donee organisations.

Officials consider that payroll donations that have not been transferred should be held in trust for the employees. As previously mentioned, in the event of an insolvency the payroll donation tax credit would be extinguished and the employer would become liable to the resulting shortfall in PAYE. Additionally, the employee would have the right to claim compensation or redress from the employer for the payroll donations that had not been transferred. If payroll donations were treated as being held in trust for the employee, the employee's claim on the assets or income of the employer would be treated in the same way as trust monies. Officials agree with this submission.

Recommendation

That the submission be accepted.

TRANSFERRING PAYROLL DONATIONS TO DONEE ORGANISATIONS

Clause 447

Issue: Responsibility for confirming the status of donee organisations

Submissions
(24 – New Zealand Law Society, 32 – KPMG, 35 – PricewaterhouseCoopers, 37 – Inter-Church Working Party on Taxation, 62 – Minter Ellison Rudd Watts, 68A – Corporate Taxpayers Group)

Employees should be responsible for ensuring that payroll donations are made to an eligible recipient of a payroll donation and required to confirm that a recipient entity is in fact a donee organisation. It would be unfair to place the onus on employers as it could expose them to claims from their employees for compensation for not determining properly the eligibility of the recipient entity. *(New Zealand Law Society, Minter Ellison Rudd Watts)*

Employers should be responsible for ensuring that payroll donations are made to a donee organisation. This is simply a matter of checking that a chosen entity is listed on Inland Revenue's website as a "donee organisation". *(Inter-Church Working Party on Taxation)*

Employers should not be responsible for monitoring the list of eligible organisations to ensure that the selected donee organisations are still entitled to receive charitable donations. Otherwise, employers would face significant compliance costs given the potential large range of donee organisations employees could ask donations to be made to. For example, there are 1,334 donee organisations with names beginning with the letter "A" alone. *(Corporate Taxpayers Group)*

Inland Revenue should provide further guidance to employers on what entities are donee organisations. *(PricewaterhouseCoopers)*

Comment

To be eligible to receive tax relief on payroll donations, these donations must be provided to a donee organisation.

Proposed section 24Q of the Tax Administration Act 1994 requires employers to check that the recipient entity chosen by the employee is in fact a donee organisation. A donee organisation is an organisation that is approved by Inland Revenue or that is approved by Parliament and listed in schedule 32 of the Income Tax Act 2007. A full list of donee organisations can be found at www.ird.govt.nz.

Officials consider that given the accessibility of the Inland Revenue list of donee organisations, it seems reasonable to require employers to check whether an entity is on the list. Employers can manage the compliance costs associated with this requirement by limiting the number of donee organisations that can participate in their payroll-giving scheme. Furthermore, this requirement does not preclude employers from requiring that their employees confirm if the chosen organisation is a donee organisation. Therefore, officials do not recommend any change to the legislation.

We agree, however, that Inland Revenue could raise employer and employee awareness about the donee organisation list through Inland Revenue's *Tax Information Bulletin*.

Recommendation

That responsibility for confirming the status of eligible recipients should remain with the employer.

That Inland Revenue publicise the donee organisation list.

Issue: Record-keeping requirements to verify the transfer of payroll donations

Submission
(32 KPMG, 35 – PricewaterhouseCoopers, 67 – New Zealand Institute of Chartered Accountants)

The record-keeping requirements for verifying that payroll donations have been transferred to the correct donee organisation should be clarified.

Comment

Proposed sections 22(2)(ed) and 22(2)(ke) of the Tax Administration Act 1994 provide that employers must maintain sufficient records to enable Inland Revenue to determine the transfer of an employee's payroll donation to the recipient of that donation.

Officials consider an employer's bank statement showing the transfer of funds to the recipient would constitute a sufficient record. This matter should be clarified in Inland Revenue's *Tax Information Bulletin*, which will be published following enactment of the bill.

Recommendation

That the submission be noted.

Issue: Donee organisations should issue receipts for payroll donations

Submissions
(35 – PricewaterhouseCoopers, 67 – New Zealand Institute of Chartered Accountants)

The bill should require that the entity receiving a payroll donation issues a receipt or other form of acknowledgement to the employee. *(New Zealand Institute of Chartered Accountants)*

Inland Revenue should also have mechanisms in place to ensure it can determine when a donation has not been paid to the relevant recipient, or when the recipient is not an eligible donee organisation. For example, the issuing of a tax invoice by the recipient could be an appropriate audit mechanism to ensure payments have been received, and to confirm which entity has received them. *(PricewaterhouseCoopers)*

Comment

As proposed, there is no requirement in the bill for donee organisations to issue receipts to employees who have made payroll donations. The reason for this was to avoid the potential for "double-dipping" – where employees claim tax relief on their payroll donations throughout the year and then use the receipt to claim the tax credit through the end-of-year tax credit claim process.

Because of the potential threat of double-dipping, we do not recommend that donee organisations who receive payroll donations be required to issue receipts to employees.

Recommendation

That the submissions be declined.

Issue: Disclosure of the name of the recipient organisation to Inland Revenue

Submission
(35 – PricewaterhouseCoopers)

The name of the recipient organisation should be included in the employer monthly schedule. Requiring employers to keep a record, and file details with Inland Revenue of the entities to whom an employee has made a donation, would be a way of monitoring whether donations have been paid to eligible entities and provide an audit trail when determining whether a payroll donation has in fact been transferred.

Comment

Officials do not consider it necessary for employers to provide the name of the recipient organisation in the employer monthly schedule. The proposed record-keeping and disclosure requirements should be sufficient for Inland Revenue to undertake effective audits of payroll-giving schemes.

Recommendation

That the submission be declined.

SHORTFALL IN PAYE WHEN A PAYROLL DONATION TAX CREDIT IS EXTINGUISHED

Clause 236

Issue: Incorrect calculation of the payroll donation tax credit

Submission
(35 – PricewaterhouseCoopers)

The bill should clarify who is responsible for correcting any errors in calculating the payroll-giving tax credit and the process and timeframe to be followed.

Comment

Under current law, the responsibility for correcting errors that flow through the employer monthly schedule rests with the employer (section RD 4(1) of the Income Tax Act 2007). As the payroll donation tax credit flows through the employer monthly schedule and affects the amount of PAYE payable by the employee, the employer would be responsible for correcting any errors relating to the tax credit.

The process for correcting these errors would require the employer to contact Inland Revenue about the relevant adjustments to be made. If the employer does not correct the error, proposed section LD 5 would apply. Section LD 5 provides that an incorrect tax credit is extinguished and the correct amount is included in the employee's tax credits for PAYE income payments (salary and wages) for the tax year under section LB 1 of the Income Tax Act 2007.

Officials consider that the process and responsibility for correcting any errors in PAYE resulting from an incorrectly calculated payroll donation credit should follow the current process for correcting shortfalls in PAYE. These matters should also be fully explained in Inland Revenue's *Tax Information Bulletin*, which is published following enactment of the legislation.

Recommendation

That the submission be accepted, and that the process and responsibility for correcting any errors in PAYE resulting from an incorrectly calculated payroll donation credit should follow the current process for correcting errors in PAYE.

That this process should be further explained in Inland Revenue's *Tax Information Bulletin* on the legislation.

Issue: Employer fails to transfer the payroll donation to the relevant recipient

Submissions

(32 – KPMG, 62 – Minter Ellison Rudd Watts, 67 – New Zealand Institute of Chartered Accountants)

The bill should clarify what happens when a tax credit is extinguished as a result of an employer failing to pass on payroll donations, and who is responsible for correcting the resulting shortfall in PAYE. *(KPMG, New Zealand Institute of Chartered Accountants)*

If the employer fails to transfer an employee's payroll donation in circumstances where an eligible recipient has been identified, Inland Revenue should not be able to recover the shortfall in PAYE from the employee. *(Minter Ellison Rudd Watts)*

Comment

Proposed section LD 6(1)(a) provides that when an employer fails to transfer payroll donations to the relevant recipients within the three-month timeframe, the payroll donation tax credit is extinguished. If this occurs, the employee would have an additional PAYE liability to pay for the relevant pay-period.

Under current law, the employer is responsible for deducting PAYE from an employee's pay and then paying this amount to Inland Revenue. If there is a shortfall in PAYE deducted from the employee's pay, the employer is also responsible for correcting and paying this shortfall. As the payroll-giving tax credit is treated in the same manner as PAYE, it follows that the employer would be responsible for correcting any shortfalls in PAYE resulting from the extinguishment of a payroll donation tax credit. If the employer fails to correct the shortfall, the employee would be expected to do so as provided in section RD 4(1) of the Income Tax Act 2007 and section 168 of the Tax Administration Act 1994.

If the failure on the part of the employer is a simple mistake – for example, the employer inadvertently transfers the payroll donations to the wrong recipient, the employer could be expected to take remedial action to correct the mistake and, if so, the tax credit should be reinstated.

If the failure on the part of the employer is deliberate – for example, the employer pockets the payroll donations or the employer knowingly transfers the payroll donation to the wrong recipient, the tax credit should be extinguished and the correct amount included in the employee's tax credits for PAYE income payments under section LB 1 – that is, it is corrected as part of the end-of-year square-up process. Because the shortfall arises from a deliberate act of the employer, it would be unnecessary to provide for the payroll donation tax credit to be reinstated. In the event that the employer fails to correct the shortfall, Inland Revenue would recover the amount from the employee. Although this approach might seem unfair given that the shortfall arises due to employer fault, it is important to remember that the employee would be able to seek compensation or redress from the employer for failing to transfer the payroll donations to the relevant recipient.

The penalties for employers failing to transfer payroll donations to the relevant recipients are explained in the next section of this report, "Penalties".

Recommendation

That the submissions be declined, and the process and responsibility for correcting any shortfall in PAYE resulting from the employer failing to transfer payroll donations to the relevant recipient should follow the current process for correcting shortfalls in PAYE.

Issue: Employer transfers the payroll donation to an ineligible recipient

Submission
(68A – Corporate Taxpayers Group)

The bill should clarify what happens when a tax credit is extinguished as a result of an employer mistakenly transferring the donations to an ineligible recipient. If employers have taken reasonable care in determining that the tax credit applies – for example, by checking that the relevant charity is listed with the Charities Commission, the tax credit should not be adjusted.

Comment

Proposed section LD 6(1)(b) provides that when an employer transfers the payroll donation to an ineligible recipient, the payroll donation tax credit is extinguished. If this occurs, the employee would have an additional PAYE liability to pay for the relevant pay-period.

As outlined in *Issue: Employer fails to transfer the payroll donation to the relevant recipient*, the process and responsibility for correcting errors and paying any shortfall as a result of the payroll donation tax credit being extinguished should follow the current process for correcting shortfalls in PAYE.

If the failure on the part of the employer is a simple mistake – for example, the employer mistakenly transfers the donations to an ineligible recipient, the employer could be expected to take remedial action to correct the mistake and the tax credit should be reinstated.

If the failure on the part of the employer is deliberate – for example, the employer deliberately or knowingly transfers payroll donations to an ineligible recipient, the tax credit should be extinguished and the correct amount included in the employee's tax credits for PAYE income payments under section LB 1 and corrected as part of the end-of-year square-up process. Because the shortfall arises from a deliberate act of the employer, it would be unnecessary to provide for the payroll-giving tax credit to be reinstated. In the event that the employer fails to correct the shortfall, Inland Revenue would recover the amount from the employee, as discussed in the previous item.

The penalties for employers failing to transfer payroll donations to the relevant recipients are set out in the next section, “Penalties”.

Recommendation

That the submission be declined, and the process and responsibility for correcting any shortfall in PAYE resulting from the employer failing to transfer payroll donations to the relevant recipient should follow the current process for correcting shortfalls in PAYE.

PENALTIES – CLARIFYING THE SANCTIONS FOR NON-COMPLIANCE

Submissions
(32 – KPMG, 35 – PricewaterhouseCoopers, 68A – Corporate Taxpayers Group)

Clarification should be provided on what penalties, if any, should apply if the failure to transfer payroll donations to a relevant recipient is not deliberate. *(KPMG)*

The bill should clarify who bears the cost of errors and what penalties, if any, would be imposed if a false donation claim is filed. Any penalties and costs imposed on employers as a result of errors should be minimised. *(PricewaterhouseCoopers)*

If employers have taken reasonable care in determining the tax credit applies – for example, by checking that the relevant charity is listed with the Charities Commission, the tax credit should not be adjusted and no penalties or use-of-money interest should be payable. *(Corporate Taxpayers Group)*

Comment

Proposed section RD 2(1)(b) provides that the payroll donation tax credit provisions are part of the PAYE rules. Therefore, the normal penalty and use-of-money-interest charges that apply to the determination and payment of PAYE also apply to the payroll donation tax credit. It would be a question of fact and degree whether the current late payment penalties or any of the shortfall penalties would apply and application of penalties would be on a case-by-case basis.

The only additional penalty for payroll giving is contained in proposed section 141E (1)(c) of the Tax Administration Act 1994. This provides that employers are subject to a 150% penalty for evasion if the employer knowingly does not transfer the payroll donations to a relevant recipient within the three-month timeframe, or the donation is passed to an ineligible recipient. The penalty is imposed on the payroll donation tax credit that is extinguished, because the credit would represent the short-paid PAYE.

Officials agree that the interrelationship between the payroll-giving provisions, the PAYE rules and the penalty and use-of-money interest rules should be clarified. This clarification should be outlined in Inland Revenue's publication, the *Tax Information Bulletin*.

Recommendation

That the submissions be noted. Further clarification on how the PAYE rules, the penalty and use-of-money interest rules and the specific tax evasion penalty for payroll giving should be provided in Inland Revenue's *Tax Information Bulletin*.

APPLICATION DATE

Submission
(35 – PricewaterhouseCoopers)

There should be at least six months from the date the legislation is passed into law until the date the scheme is implemented.

Comment

Officials note that the application date for the scheme needs to be reviewed.

The bill envisages the scheme coming into operation from 1 April 2009. However, employers cannot begin the scheme until the bill has been enacted or they would be acting outside the law. Employers and payroll software designers also need time to promote the scheme to employees and build the necessary changes into their software packages. Inland Revenue also needs time to communicate the changes and amend its systems. This suggests the application date should be set on a date that is after the bill has been enacted.

On the other hand, the payroll-giving scheme is keenly awaited by charities and should therefore be available as soon as is practicable after enactment rather than waiting until the start of an income year (for example, 2010–11).

After consideration of all of these factors, we recommend that the legislation for the payroll giving scheme should take effect three months after the date of enactment.

Recommendation

That the submission be accepted in part, but that the application date for the proposed scheme apply three months after the bill has been enacted.

MINIMUM PAYROLL DONATION AMOUNT

Submission
(35 – PricewaterhouseCoopers, 37 – Inter-Church Working Group on Taxation)

There should be a minimum donation amount to any one recipient before the payroll-giving tax credit is available.

Comment

No minimum payroll donation amount was specified under the payroll-giving scheme. In line with the non-prescriptive nature of the proposed payroll giving scheme, it was decided that this would be left to the employer and employee to determine any minimum threshold.

Submissions noted that a minimum donation amount would be consistent with the current donation tax credit system. Under that system individuals must make a cash donation of at least $5 to a single donee organisation before the tax credit can be claimed at the end of the year.

Officials do not support prescribing a minimum payroll donation amount in legislation as we consider that this could deter employees from participating in payroll giving.

Recommendation

That the submission be declined.

CONSISTENCY WITH YEAR-END TAX CREDIT SYSTEM

Submission
(35 – PricewaterhouseCoopers)

Differences between the end-of-year donation tax credit scheme and the proposed payroll-giving scheme should be kept to a minimum. Individuals who are able to participate in payroll giving will be in a better position than those who are not able to do so because of the time value of money. To address this difference, those individuals who are unable to participate in payroll giving should be allowed to claim tax credits on their donations on a monthly or quarterly basis.

Comment

Officials agree that the differences between the end-of-year tax credit scheme and the payroll-giving scheme should be kept to a minimum. However, we acknowledge that there will be some differences because of the specific design features of each scheme.

We do not support allowing individuals to claim the end-of-year donation tax credit throughout the year either on a monthly or quarterly basis because:

- the donation tax credit applies to donations up to an individual's taxable income for the year in which the donations are made; and
- there would be significant administrative costs associated with allowing tax credit claims during the year.

Recommendation

That the submission be declined.

TWO RATES FOR THE PAYROLL DONATION TAX CREDIT

Submission
(24 – New Zealand Law Society)

The payroll-giving tax credit should have the following two rates:

- 33⅓% for employees earning less than the threshold for the top marginal income tax (currently $70,000); and
- 39% for employees earning greater than the threshold for the top marginal income tax rate.

The New Zealand Law Society is concerned that the proposed flat tax credit rate of 33⅓% will discourage employees in the 39% marginal income tax bracket from making charitable donations. The Society considers that if the rationale behind the payroll-giving scheme is to create the foundation for a stronger culture of giving in New Zealand, higher income earners should be given a full deduction through a 39% PAYE tax credit to encourage them to make donations.

Comment

The single rate of 33⅓% was adopted to ensure consistency with the tax benefit delivered under the current donation tax credit system and is considered to be more equitable because all employees receive the same tax benefit regardless of their marginal tax rate.

Recommendation

That the submission be declined.

ALTERNATIVE GIVING OPTIONS FOR EMPLOYEES

Submission
(54 – Business New Zealand, 67 – New Zealand Institute of Chartered Accountants)

Inland Revenue should have a communications programme established around alternative solutions if an employee wishes to give through their payroll, but is unable to with their current employer.

Comment

Inland Revenue, the Office for the Community and Voluntary Sector and the Treasury are developing a communication and assistance plan to help raise public awareness and encourage take-up of the tax and charitable-giving initiatives. These initiatives include the lifting of the caps on charitable donations made by individuals and companies (which applied from 1 April 2008), the proposed payroll-giving scheme and clarifying the tax rules for volunteer reimbursements and honoraria.

The communications plan will state that the only alternative to payroll giving for donors is to give directly to donee organisations and to claim the tax benefit on their cash donations at the end of the tax year.

Recommendation

That the submission be noted.

TAX DEDUCTION MECHANISM

Submission
(54 – Business New Zealand)

A tax deduction mechanism should replace the tax credit mechanism as the mechanism for delivering payroll-giving tax relief.

Comment

Two options were put forward in the October 2007 discussion document, *Payroll giving: providing a real-time benefit for charitable giving* – the tax deduction mechanism and the tax credit mechanism.

Under the tax deduction mechanism, donations would be deducted from an employee's gross pay. This would reduce the employee's taxable income and, as a result, alter the employee's social policy entitlements and obligations. PAYE would be imposed on the net amount. An immediate tax benefit would be received by way of a reduction in the amount of the PAYE required to be withheld. The tax benefit would be at the employee's marginal tax rate.

Under the tax credit mechanism, employees would receive a tax credit on the amount of their donations made each payday. Employers would offset the credit against the PAYE calculated on the employee's gross pay, and the tax credit would be calculated on a set rate of 33⅓ percent.

The tax credit mechanism was preferred over the tax deduction mechanism as being more equitable because all employees would receive the same tax benefit regardless of their marginal tax rate. Furthermore, the tax credit mechanism does not alter the level of an employee's taxable income, and therefore does not affect the employee's social policy entitlements and obligations that use taxation income as the basis of their calculations – for example, Working for Families, student loans, child support and KiwiSaver.

Recommendation

That the submission be declined.

CENTRAL PAYMENT PROVIDER

Submissions
(64 – Payroll Giving Limited, 67 – New Zealand Institute of Chartered Accountants, 68A – Corporate Taxpayers Group)

The proposed payroll giving scheme should specifically provide for the option of a central payment provider. This would require a two-year "safe harbour" for donors on their annual level of donations relative to their taxable income. This proposal would be compatible with Inland Revenue systems for the exchange of taxpayer data that were implemented for KiwiSaver. *(Payroll Giving Limited)*

Inland Revenue could assume the responsibility for paying the donations made through payroll giving to donee organisations. If Inland Revenue were to administer the scheme, employers could make just the one payment to Inland Revenue, which could more easily distribute the payments to the relevant donee organisations within the three-month timeframe. Furthermore, it would be easier for Inland Revenue to monitor whether the charity is eligible and Inland Revenue would ensure that the money is passed onto the relevant recipient. This would deal with a significant risk of funds being misappropriated by unscrupulous employers, as there are limited checks and balances in place. Employees will have comfort that all funds have been properly passed on to the correct donee organisations. *(New Zealand Institute of Chartered Accountants, Corporate Taxpayers Group)*

In the event that Inland Revenue does not act as a payment intermediary and given the risks for employers in administering the scheme, Inland Revenue should select a small group of approved payment intermediaries. Inland Revenue would be able to more easily monitor the payment intermediaries, rather than the outputs of all the employers in the country. *(Corporate Taxpayers Group)*

Comment

Although payment intermediaries may form part of a payroll-giving scheme arrangement, they are not mandatory.

This approach provides greater flexibility and choice for employers seeking to offer payroll giving to their employees. It also takes into account the current arrangements that existing employers have in place for directing payroll donations to charitable or philanthropic causes. For example, some employers use United Way as a payment intermediary, while ANZ National Bank has set up its own charitable foundation (which itself is a donee organisation) to determine how its employees' payroll donations are applied.

Officials see clear simplification benefits for employers and employees in using payment intermediaries. However, catering for a central payment provider is likely to involve considerable change to the design of the proposed scheme and significant cost which would defer implementation of payroll giving for at least another 12 months.

It may be that the concept of a central payment provider could be revisited after the scheme has "bedded" down.

Recommendation

That the submissions be declined.

TECHNICAL AMENDMENT – REMOVING THE NEED TO SPECIFY THE TOTAL DONATION AMOUNT

Clause 408(38)

Submission
(Matter raised by officials)

The requirement to specify the "total donation" amount in the employer monthly schedule should be removed as it is unnecessary.

Comment

The proposed definition of "employer monthly schedule" requires the payroll donation amounts to be specified in the schedule. This explicit requirement is considered unnecessary at this time.

Recommendation

That the submission be accepted.

Stapled stock provisions (SOP 224)

OVERVIEW

Stapled stock is a debt security attached to a share so that the two must be traded together. Supplementary Order Paper No 224 (SOP) proposes to treat the debt component (referred to here as "stapled debt") of certain stapled stock instruments as shares for tax purposes, with the interest treated as dividends. The purpose of this proposal is to protect the tax base from excessive interest deductions achieved through these arrangements.

Nearly all modern company tax systems hinge on a distinction between debt (money lent, with an expectation of regular income and/or repayment) and equity. "Equity" implies participation in the profits and losses of a company (hence "equity risk"), usually through ordinary shares.

New Zealand's established practice is to tax debt and shares based on their legal form, rather than their economic substance, but with certain specific exceptions where legislation overrides legal form. For example, a "debt" that pays a return dependent on the profits of the company is treated as a share for tax purposes.

The government has become concerned that, under the current law, stapled stock could be treated as shares for commercial purposes (such as accounting, regulation and credit rating), but as debt for tax purposes. Even though the interest payment is effectively a substitute for a dividend, the interest would be deductible. Stapled stock could lead to significant revenue loss if issued to non-resident and tax-exempt investors.

The matter became urgent in early 2008 when several large, widely held companies were actively considering public issues of debt legally stapled to ordinary shares. Officials estimated that these arrangements would have an annual revenue cost in the order of $90 million. The proposed new rule was announced on 25 February 2008 and was to apply from that date.

The scope of the proposed rule is narrow. Stapled stock has not previously been issued, to our knowledge, by a listed New Zealand company. Arrangements that do not result in interest deductions, and debt stapled to a share before the announcement, are excluded. As a result of consultation in mid-2008, the rule excludes arrangements in which the issuing company is not a party, or debt is stapled only to a fixed-rate share (a debt substitute).

Submissions on the SOP focussed mainly on the need to target arrangements that present a genuine risk to the tax base, and to avoid unintended consequences. As a result, officials recommend some further narrowing of the scope of the new rules, along with technical changes to ensure that the rules operate as intended.

Issue: Reconsider the need for the stapled stock rule

Submissions
(32 – KPMG, 68 & 68A – Corporate Taxpayers Group)

The rule should be reconsidered on the basis that:

- The changes were introduced in an ad hoc, hasty manner that could result in poor policy and undermine investor confidence.
- Stapled stock is used in other countries for non-tax reasons: any tax minimisation effects are only a by-product.
- Companies can minimise tax by gearing up their debt instead of stapling.
- The changes could increase financing and transaction costs.
- The proposals favour companies with a non-resident parent, able to have up to 75 percent debt under thin capitalisation rules, over widely held New Zealand-owned companies that would issue shareholder debt as stapled debt for commercial reasons. *(KPMG)*

The rule applies more widely than is justified and will undermine investor confidence in the tax policy process. It will create a further preference for 100 percent ownership of New Zealand businesses by non-residents because closely held companies can achieve the same tax effect without "legal" stapling. As currently drafted, all shareholder debt in a public company (which by definition requires that debt to be stapled) would become "offensive" from a policy perspective. *(Corporate Taxpayers Group)*

Given that the "potentially offending transactions" (the arrangements contemplated in early 2008) are now no longer proposed, the measure should be removed from the bill and subject to further consultation to develop the correct framework upon which reform should be based. *(Corporate Taxpayers Group)*

Comment

Officials agree that there is a need to further reduce the scope of the stapled stock rule. Our recommendations are set out under the more specific submission points that follow.

The potential revenue cost of the contemplated transactions was discussed in the section "Overview". Officials consider that the new rule will not have the consequences claimed in submissions for the following reasons:

- The very narrow scope, including only newly stapled instruments of a type that has not, to our knowledge, been issued by a listed New Zealand company.
- The rule is consistent with the past practice of recharacterising certain specific financial instruments at the extreme margin.
- Officials consulted with taxpayers on draft legislation, and the select committee process has provided a further opportunity for taxpayers to make submissions.

The argument that companies can, instead of issuing stapled stock, increase their debt by simply increasing their gearing overlooks an important fact. Stapled stock allows companies to overcome normal commercial, regulatory and tax law barriers to excessive debt and interest deductions. If companies with a non-resident parent enjoy an advantage when issuing shareholder debt, any such advantage is long-standing, is not the result of the current proposal, and is constrained by other tax rules.

Recommendation

That the submissions be declined.

Issue: Exclude widely held and listed companies

Submission
(32 – KPMG)

To avoid favouring companies with a non-resident parent, the rule should exclude widely held companies and unit trusts or companies listed on the NZX. Stapled stock allows these companies to increase their debt ratios to the same extent as companies with a non-resident parent.

Comment

Most of New Zealand's biggest companies are widely held (meaning, in general terms, that ownership and control is spread among a large number of investors). Their potential to increase their interest deductions is at the core of the base maintenance concerns arising from stapled stock.

Furthermore, the proposed new rule does not give companies with a non-resident parent any tax advantage that does not exist under the current law. As noted under the previous submission, any tax advantages that these companies enjoy are long-standing, not the result of the current proposal, and constrained by other tax rules.

Recommendation

That the submission be declined.

Issue: Exclude companies subject to thin capitalisation and other rules or with certain shareholder characteristics

Submissions

(32 – KPMG, 33 – Investment Savings and Insurance Association of NZ Inc, 36A – Russell McVeagh, 60 – Commonwealth Bank of Australia (New Zealand) Group, 62 – Minter Ellison Rudd Watts, 68 & 68A – Corporate Taxpayers Group)

Companies should not be subject to the new rule if they are (or opt to be) subject to the thin capitalisation rules, on the grounds that these rules provide adequate protection against excessive interest deductions. *(KPMG, Commonwealth Bank of Australia, Minter Ellison Rudd Watts)*

The transfer pricing rules, which apply to loans from non-resident controlling shareholders, also protect the tax base from excessive interest deductions. (*Commonwealth Bank of Australia)*

An exclusion from the stapled stock rule should be made where:

- thin capitalisation rules are met;
- the debt is subject to a market rate of interest; and
- the debt is to be repaid at face value on maturity.

Such arrangements do not present an undue risk to the tax base. *(Investment Savings and Insurance Association of NZ Inc)*

Members of a New Zealand banking group should be excluded because the thin capitalisation rules for banks, which require a minimum level of equity, provide sufficient tax base protection in that industry. *(Russell McVeagh)*

Stapled stock is not an undue risk to the tax base if:

- the issuing company is subject to or elects to be subject to the normal buttresses of the thin capitalisation and transfer pricing rules; or
- the shareholders are all resident non-exempt taxpayers (or where the non-resident and exempt taxpayers hold less than, say, 10 percent of the shares on issue).

Excluding stapled stock from the rule in these cases would avoid discouraging foreign direct investment. Companies should be able to have as much debt as current rules allow using whatever instruments they believe provide the best commercial result. *(Corporate Taxpayers Group)*

Comment

The thin capitalisation and transfer pricing rules protect the tax base by limiting interest deductions.

The thin capitalisation rules cap the level of debt (usually at 75 percent of assets) on which a company can deduct interest. These rules apply to companies with a non-resident controlling shareholder, but will apply to more companies under proposed changes to the taxation of New Zealand companies' direct investments abroad. The transfer pricing rules do not allow deductions of amounts paid to a non-resident related party above an "arms-length" price. This applies to interest just as it does to other expenses.

The assumption that the thin capitalisation and transfer pricing rules adequately protect against excessive interest deductions overlooks the key concern with this type of financial instrument. Stapled stock, being debt for tax purposes but equity for other purposes, allows companies to significantly increase their interest deductions, even within the scope of the thin capitalisation and transfer pricing rules. Stapled stock could also help companies to concentrate shareholder debt among the shareholders who can most benefit from it. Furthermore, treating stapled stock as debt when a company complies with thin capitalisation and transfer pricing rules, but as equity when it breaches those rules, could add substantial compliance and administration costs.

The Corporate Taxpayers Group's submission that the stapled stock rule should not apply if all shareholders are resident, non-exempt taxpayers could also add compliance and administration costs. Listed companies would need to constantly gather information about their shareholders from share registrars and recharacterise their stapled stock accordingly. In addition, non-discrimination rules in New Zealand's international tax treaties can limit the effect of tax rules based on shareholder residency.

Recommendation

That the submissions be declined.

Issue: Exclude if dividends on share are at fixed rate before conversion

Submission

(36A – Russell McVeagh, 60 – Commonwealth Bank of Australia (New Zealand) Group)

The submissions seek a wider exclusion for debts stapled only to shares of a certain type.

The submissions argue that the stapled stock rule should not apply if a debt is stapled only to a share that would be a fixed-rate share if only those dividends payable before conversion of the share were taken into account. Furthermore, they argue that this exclusion should ignore any dividend arising as a result of a formula, reflecting generally accepted market practice, for converting the share into another type of share.

According to the submissions, these changes are needed to achieve the intent of the current exclusion for debt stapled only to a fixed-rate share. They would help Australian banks with a New Zealand branch to comply with Australian bank regulations at minimum cost.

Comment

The current rule does not apply to debts stapled only to a "fixed-rate share". This term is defined in the Income Tax Act, but has been widened for the purpose of this exclusion. In general it refers to a share that is similar to a debt because all dividends are at a fixed rate or have a fixed relationship to a recognised market interest rate.

Debt stapled only to a "fixed-rate share" is not equivalent to an ordinary share, because a fixed-rate share is a "debt substitute", offering a return equivalent to an interest rate. Therefore, debt stapled only to a fixed-rate share is to be excluded from the stapled stock rule. However, the view expressed by submissions is that debt stapled to certain convertible preference shares that are similar to fixed-rate shares warrants the same exclusion.

A "convertible preference share" may or may not be a fixed-rate share. It typically offers a regular, fixed-rate dividend for a certain number of years, and then is exchanged for ordinary shares of a certain value (similar to paying back a debt). In some cases, the terms of a convertible preference share may change to those of an ordinary share (so the investor's return depends on the value of ordinary shares, which depends on the company's performance). Some conversions may combine both of these approaches (involving a change of terms and an issue of new shares up to a certain value).

The proposal suggested by submissions would mean that a debt stapled to a convertible preference share would not be subject to the stapled stock rule as long as all dividends paid before conversion are at a fixed rate, or have a fixed relationship to a recognised market rate of interest. However, potential gains (equity risk) at the point of conversion or later mean the share may not be a debt substitute, but more akin to an ordinary share. A debt stapled to such a share should not be excluded from the stapled stock rule. Therefore, officials do not recommend ignoring all potential gains on or after conversion.

In addition, because of the rarity and complexity of these arrangements, the resulting danger of admitting arrangements that mimic ordinary shares, and the availability of simpler arrangements that achieve the same broad commercial objective, we do not recommend attempting to define all situations where a convertible preference share is a debt substitute.

We do, however, recommend dealing with two specific reasons, highlighted by the submissions, why an essentially "fixed-rate" share might fail to meet the definition of a "fixed-rate share". These variations typically arise when a preference share converts to a fixed value of ordinary shares (often including a small fixed premium on the amount originally invested). They do not add significant equity risk and should be ignored for the purposes of the exclusion.

The draft wording of the exclusion for debt stapled only to a fixed-rate share already allows for a dividend reflecting transaction costs expected to be incurred by the investor as a result of conversion of a preference share to an ordinary share. Typically such a dividend is provided by discounting the value of the ordinary share around three or four percent when calculating the number of new shares needed to match the value of the preference share. The purpose may not be specified. The rule should instead simply allow for any fixed gain on conversion of up to five percent of the amount subscribed for the share. This makes for simpler drafting and widens the exclusion.

In addition, the rate of conversion from one type of share to a fixed value of another type of share (equivalent to a fixed-value return of funds) depends on the estimated value of the other share. This value is typically estimated based on trades over the 20 trading days before conversion. An increase in the market value of the other share in the estimation period could result in the investor receiving a higher value of new shares than was intended. A potential small gain in value may take the share outside the usual fixed-rate share definition.

Recommendations

That stapled debt should be excluded from the rule if it is stapled only to a share that would be a "fixed-rate share" but for dividends arising from:

- a fixed gain of no more than five percent of the amount subscribed for the share, upon conversion to another class of share; or
- an increase in the price of another class of share during up to 30 days (allowing for a degree of flexibility) before conversion to the other class, of a number determined by the price observed in that period.

That, if this recommendation is agreed, the exclusion limited to discount factors used to compensate for expected transaction costs should be removed, because it will be redundant.

Issue: Amendments to thin capitalisation calculations

Submission
(32 – KPMG, 68A – Corporate Taxpayers Group)

Stapled debt should not be treated as debt for thin capitalisation purposes while treating it as equity for other tax purposes, as this would be inequitable.

The Corporate Taxpayers Group considered that implementing the rule would be complex, given the need to obtain shareholder residency information from share registrars each time a company undertakes a thin capitalisation calculation (although few companies are likely to issue stapled debt given the changes in the bill).

Comment

Under the new stapled stock rule, a stapled debt is to be treated as a share for most purposes. However, recharacterising stapled stock as a share for all tax purposes, regardless of the circumstances, could allow it to be used to circumvent the thin capitalisation rules. If a company is near the thin capitalisation limit on issuing debt, it could instead issue debt stapled to a small amount of equity and pay resident taxpayers, who benefit from imputation credits, fully imputed dividends at a post-tax rate of return. This would be economically equivalent to paying deductible interest.

For this reason, if stapled debt subject to the proposed rule is issued, it would usually be treated as debt for the limited purpose of the thin capitalisation rules. The exception would be if the debt was stapled proportionately to all shares in the company, and not concentrated in the hands of those who gain little tax advantage from holding debt.

Under the current drafting, the test to determine whether the debt is stapled proportionately to all shares in the company is applied at the time when the debt security is issued. The debt could easily cease to be stapled proportionately to shares, for example, as a result of the issue of new shares, or a de-stapling of some of the debt and shares. Officials consider that this test should instead be applied at the relevant time, which is when total group debt is measured under the thin capitalisation rules.

Recommendation

That the submission be declined, but that the test of whether debt is stapled in proportion to all shares in the company be applied when total group debt is measured under the thin capitalisation rules.

Issue: Deduction of expenditure incurred in borrowing

Submission
(32 – KPMG)

Under the proposal, a deduction would be denied for expenditure incurred in borrowing money secured by or payable under the stapled debt security. An amendment is needed to ensure that a deduction is only denied to the extent that borrowings are secured against the debt component of the stapled stock (as distinct from the share component).

Comment

The submission is in line with the draft legislation, and the draft legislation does not need to be amended to achieve this policy intent. As currently drafted, the proposed rule denies deductions in relation to a “stapled debt security”, being the debt component (referred to in this report as the “stapled debt”) of the overall stapled stock arrangement.

Recommendation

That the submission be declined.

Issue: Outbound stapled stock should be taxed at fair dividend rate (FDR)

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

When the rule applies to stapled stock issued to New Zealanders by offshore companies, the combined debt and equity returns of stapled stock should be taxed as one under the FDR method of taxing outbound portfolio investments. This would fairly reflect the economic position and limit the cost of having to identify, track and tax two separate instruments.

Comment

The stapled stock will not apply unless the interest would otherwise be deductible against New Zealand income. For the submission to be relevant, New Zealanders would have to own stapled stock issued by an offshore company, and the company would have to apply the funds raised by the stapled stock in a New Zealand branch of the company. This would be a relatively rare scenario. In any case, it is not within the scope of the current amendments to override the rules determining when the FDR method should be applied.

Recommendation

That the submission be declined.

Issue: Meaning of "stapled"

Submissions
(33 – Investment Savings and Insurance Association of NZ Inc, 35 – PricewaterhouseCoopers, 36B – Russell McVeagh, 68A – Corporate Taxpayers Group)

The term "stapled" is too broad and uncertain. As a result, it is unclear whether the following situations will be subject to the stapled stock rule:

- when a shareholders' agreement or an agreement of a similar nature implies but does not require that the debt and equity instruments be disposed of together;
- when an investor who holds shares and debt within a business where the debt and equity are disposed of together, but were not required to be disposed of together;
- when a financing arrangement, shareholders' agreement or similar agreement outlines or assumes that equity and debt will be disposed of together but only in certain circumstances;

- when, without the shareholder holding the debt, the shares would lose their value or vice versa. That is, there is not formal agreement that the debt and equity must be traded together but it is common practice, and an investor would not hold the shares without also having lent money to the entity. *(Investment Savings and Insurance Association of NZ Inc, PricewaterhouseCoopers)*

The provision should be limited to "stapling" requirements contained in the terms of the debt security, the share, or the constitution of the issuer. The issuer company must often be party to shareholders' agreements for corporate law reasons. Applying the rule to such agreements would have significant unintended consequences. *(Russell McVeagh)*

It is unclear whether a company is "party" to a stapling arrangement simply because it is party to the debt and equity instruments themselves. *(Corporate Taxpayers Group)*

Comment

The submissions raise a concern that the proposed definition of "stapled" is too broad.

To fall within the proposed definition of "stapled", an arrangement would need to meet two requirements.

The first requirement is that a debt security "can, or ordinarily can, be disposed of only together with the share". This wording is used elsewhere in the Income Tax Act, and there is no history of dispute over its meaning. The words imply a requirement (albeit with possible exceptions), not a mere expectation or assumption or the possible exercise of a choice.

The second requirement is that a company that issued the debt security or the share must be a party to the stapling arrangement. This is intended to exclude conventional "shareholder agreements" that limit separate trading of debt and shares in smaller companies. These shareholder agreements were not the focus of the policy announcement in February 2008.

However, submissions have highlighted that many of these shareholder agreements have the relevant company as a party, and so would be subject to the stapled stock rule as currently drafted.

Widely held companies are not known for using shareholders' agreements to bind debt and shares in the same way as closely held companies. To do so, they would most likely incur significant transaction costs. However, we cannot be certain that it will not occur.

To balance these concerns, officials recommend adopting the submitters' proposal to include only those stapling arrangements made under the terms of the debt, the share, or the constitution of the issuer, but only for companies that are not widely held. A "widely held company" is defined in the Income Tax Act 2007 as one that has no less than 25 shareholders and is not a closely held company. A "closely held company" is, essentially, one controlled by five or fewer persons.

Recommendation

That, for companies that are not widely held, the stapled stock rule should only apply when the debt and share are stapled under the terms of the share, the debt, or the constitution of the company.

Issue: Debt securities offering no return or a conditional return

Submission
(35 – PricewaterhouseCoopers)

A debt security that ordinarily pays no interest, discount or premium to the holder, but is capable of doing so in certain circumstances, such as if interest is payable if demanded by the shareholders, should be excluded from the rule.

In some shareholder financing arrangements, it would be unclear whether a debt "…gives rise to an amount for which the company would have a deduction…" as required in the draft definition of a "debt security". A positive exclusion for debt instruments that do not bear interest and are not issued for a discount or a premium would clarify the intent and remove uncertainty.

This circumstance may arise when a shareholder provides debt funding to a company in proportion to their shareholding, with a shareholder's agreement and possibly a requirement in the company's constitution that the debt and shares are not to be traded separately.

Comment

The definition of "a debt security" proposed in the draft legislation is based on the definition of "total group debt", a term introduced in 1995 and used to determine a company's debt ratio under the thin capitalisation rules. Officials are not aware of any dispute indicating that the meaning of this term is unclear.

Stapled debts offering no deductions are excluded from the proposed rule because they do not result in firms paying interest in substitution for dividends to reduce tax. In contrast, having interest payable if demanded by shareholders suggests a significant risk, with payments demanded in "good years" to distribute profits in a tax-effective way. It would not be appropriate to exclude such an arrangement from the stapled stock rule.

The more ambiguous arrangements referred to by PricewaterhouseCoopers are most likely to be found in agreements among shareholders of smaller companies. Under the previous submission point, on the meaning of the term "stapled", officials recommended not including these shareholder agreements in the stapled stock rule.

Recommendation

That the submission be declined.

Issue: What happens when an existing debt becomes stapled or unstapled?

Submissions

(33 – Investment Savings and Insurance Association of NZ Inc, 35 – PricewaterhouseCoopers)

Greater clarity is needed on the effect of an existing debt becoming stapled or unstapled so that a debt that becomes unstapled is treated as a normal debt, with deductions available and the issuer able to repay in part or whole without stepping through the share repurchase rules. *(Investment Savings and Insurance Association of NZ Inc, PricewaterhouseCoopers)*

Transitional rules or guidance is needed to confirm how to reclassify as a share a stapled debt that the issuer has treated as debt, especially where this is retrospective. *(PricewaterhouseCoopers)*

Comment

Officials agree there is a need to clarify certain effects of the stapling of an existing debt to a share, or the de-stapling of a debt and a share.

The stapled stock rule only applies when a debt security is stapled to a share. If an existing debt security is stapled to a share, then thereafter it is treated as a share "issued by the company" if it falls within the stapled debt security rule. If a debt security is de-stapled, the rule no longer applies. The transitional tax effects of stapling and de-stapling are intended to flow accordingly. However, the submissions have drawn officials' attention to two matters that need clarification.

First, it needs to be clarified that stapling of an existing debt is equivalent to a subscription for new shares, and a de-stapling after which the debt security ceases to be a share (rather than becoming a share under another provision) should be treated as a share cancellation. This will ensure that the appropriate adjustments are made to a company's available subscribed capital, and an appropriate amount is treated as a dividend or, alternatively, treated as a return of capital upon de-stapling.

Secondly, the legislation should make it clearer that interest deductions are available if the stapled debt ceases to be treated as a share under the stapled stock rule.

With the narrow targeting of the rule, it is unlikely that any debts will need to be re-classified as a share retrospectively.

Recommendation

That stapling of an existing debt to a share should be treated as a subscription for shares, and that de-stapling be treated as a share cancellation with interest deductions subsequently available (unless other features of the arrangement, such as stapling to another share, cause the debt to continue to be treated as a share).

Issue: Exclusion – arrangements before 25 February 2008

Submissions
(33 – Investment Savings and Insurance Association of NZ Inc, 35 – PricewaterhouseCoopers)

Arrangements made before the announcement of the policy on 25 February 2008, and particularly ongoing employee share schemes, should be excluded from the new rule, even if stapling occurred later. Companies will face compliance and commercial issues if there are different tax treatments for stapled stock issued to employees as part of an ongoing programme before and after that date. *(PricewaterhouseCoopers)*

The Investment Savings and Insurance Association expressed the same concerns regarding ongoing unit trusts.

Comment

In theory, there would be practical problems for an employee share scheme or unit trust where debt was stapled both before and after 25 February 2008 as part of an on-going programme. However, continued issues of stapled stock under such schemes would raise the same policy concerns as other new issues of stapled stock.

Moreover, policy officials are not aware of any actual employee share scheme or unit trust that would be subject to the stapled stock rule. Some Australian unit trusts have issued stapled stock. To be affected, a non-resident unit trust would need to apply the funds raised in a New Zealand branch, which is very rare. If a specific example is identified, officials would consider whether any remedial action is required.

Recommendation

That the submissions be declined.

Issue: Date of application

Submission
(35 – PricewaterhouseCoopers)

Given the uncertainty around the legislation and when it will be enacted, the new rule should not apply until on or after the date it is enacted.

Comment

Inevitably, some uncertainty will exist around the legislation until it has been enacted. However, deferring application until enactment would leave in place a significant revenue risk until enactment, and create uncertainty around the date from which the new rule will apply.

Recommendation

That the submission be declined.

Issue: Unclear when stapled debt and share treated as one share

Submission
(35 – PricewaterhouseCoopers)

It is unclear from the current drafting whether a stapled debt security and share are intended to be one share for all purposes or only where the underlying share is a non-participating redeemable share. Therefore, section FA 2B(3) should be amended to read "a stapled debt security and a share to which it is stapled are treated as a single share where the underlying share to which the debt security is stapled falls within one of the following…".

Comment

PricewaterhouseCoopers' proposed wording would not be consistent with the policy intent.

The draft legislation treats the stapled debt as a separate share for nearly all purposes under the Act. However, when deciding whether the stapled debt or the share to which it is stapled meet certain definitions the two parts are to be considered together, in line with their economic substance.

This is consistent with the general approach of taxing debt and shares based on their legal form, with exceptions only when required to avoid undue risk to the tax base. The affected definitions identify shares that are "debt-like". Stapled stock could be used to defeat the purpose of the definitions if both parts were not taken into account.

Recommendation

That the submission be declined.

Issue: Treating stapled debt and share as one share means no share cancellation

Submission
(68A – Corporate Taxpayers Group)

Treating the share and stapled debt as one share when applying the definition of a "non-participating redeemable share" means that redemptions of stapled debt will be inappropriately treated as a taxable dividend if the debt is redeemed. If the two parts are treated as one share, the redemption cannot be a share cancellation.

Comment

Under the proposed rule, the stapled debt and share would be treated as one share when testing whether either part is a non-participating redeemable share. However, when applying the remainder of the tax rule governing share cancellations, the two parts remain separate shares that can be separately cancelled.

The definition of a "non-participating redeemable share" is found in the off-market share cancellation rule, which determines how much of an amount paid on cancellation of a share is treated as a tax-free return of capital, and how much is treated as a dividend. It is unlikely that a stapled debt will ever be a non-participating redeemable share, but its redemption may be treated partly or wholly as a non-taxable return of capital under another test.

Recommendation

That the submission be declined.

Issue: Section reference in proposed stapled stock amendments

Submission
(32 – KPMG)

In clause 542B, the reference should be changed to section FA 2B(2).

Comment

The clause amends the Income Tax Act 2004, and refers correctly to proposed section FC 2B of that Act, set out in clause 578D of the draft legislation.

Recommendation

That the submission be declined.

Issue: Definition of a "fixed-rate share"

Submission
(35 – PricewaterhouseCoopers)

The definition of a "fixed-rate share" in the stapled securities rule should clarify the weight to be put on each of the three indicators that a dividend is "the equivalent of the payment of interest on money lent".

Comment

While there may be value in considering this matter in the future, it is outside the scope of the stapled stock proposal. The "fixed-rate share" definition to be used to exclude certain arrangements from the stapled stock rule combines and expands two existing fixed-rate share definitions. The meaning of the "equivalent of interest" wording has not led to any notable dispute, and changing it could have wider implications.

Recommendation

That the submission be declined.

Issue: Should exclude hybrid instruments

Submission
(35 – PricewaterhouseCoopers)

The legislation should exclude debt-equity hybrid instruments such as convertible notes, unless they are stapled to another security. Such instruments are generally treated for tax purposes as part debt and part equity. These parts can only be disposed of together.

Comment

No amendment is needed to achieve the intent of the submission. The stapled stock rule will only apply if an apparently separate debt and share must be traded together. It would not apply to a convertible note unless it is stapled to another security (a share).

Recommendation

That the submission be declined, noting that the draft legislation already achieves the submission's policy intent.

Issue: Definition of "stapled"

Submission
(Matter raised by officials)

Paragraph (b) of the proposed definition of "stapled" should be amended by inserting the words "the company that issued" after the words "the company that issued the debt security or". This will more clearly allow for the possibility that different companies are involved.

Recommendation

That the submission be accepted.

Issue: Definition of "non-participating redeemable preference share"

Submission
(Matter raised by officials)

There is a possible circularity in the proposed treatment of cancellations of stapled debts treated as shares. Therefore, we propose that a stapled debt and share should not be aggregated when applying subparagraph (b)(iii) of the definition of a non-participating redeemable share in section CD 22(9) of the Income Tax Act 2007, or its predecessor in the Income Tax Act 2004.

Recommendation

That the submission be accepted.

Research & Development

OVERVIEW

Clauses 47, 243–247, 273, 279, 280, 284, 287, 296, 307, 325–329, 331, 336, 337, 339, 343, 424, 433, 466, 467, 474–476, 490, 491, 509 and 511

Since the introduction of this bill the R&D tax credit has been repealed and, as a result, a number of the provisions are no longer necessary. However, the credit continues to be administered for the year that it was in place (the 2008–09 year). Those making submissions have proposed remedial amendments and some possible enhancements to the tax credit covering eligibility issues, eligible expenditure, the repeal of the tax credit and administrative issues.

At the time the tax credit was repealed, the government signalled further work to align the tax credit legislation with the policy intention in a number of areas. This report recommends several amendments as a result of that work.

Several submissions propose other changes that would significantly broaden the scope of the credit for the year that it is in force. These are not supported in principle because there is no incentive effect in retrospectively broadening the provisions and it would merely create a windfall gain to taxpayers.

Issue: "On-behalf" rules

Submission
(68A – Corporate Taxpayers Group)

The "on-behalf" tests should be relaxed so that a claimant does not need to meet all three of the tests. This would better reflect commercial realities.

Comment

The tests require claimants to show that they control the R&D activity, bear the financial risk associated with the project, and effectively own the results. Some groups, such as partnerships and unincorporated joint ventures are able to apply the tests as a group.

The submission seeks to relax the rules further, so that the purpose of the test becomes one of deciding which party in a joint arrangement should receive the concession. They point out that current formulation means that some R&D activities carried out in New Zealand are ineligible for the concession.

This issue was debated at the time the tax credit was introduced. Officials do not agree with the submission for two reasons. First, the design of the tests is intended to achieve more than the result sought by the Corporate Taxpayers Group. It aims to provide a high value concession to the party making investment decisions about what R&D is undertaken, to compensate them for creating spillover benefits that are captured by other firms in the local economy.

The absence of any one of the three tests could undermine that objective. For example, if the claimant bore no financial risk, then they are not funding any of the spillover benefits from the activity that are captured by other firms and therefore do not need to be compensated for them. If the firm does not own the results of the activities it is poorly placed to exploit the results. Lastly, if a firm does not control the R&D activity (for example, determining the direction of the work and making decisions to stop unproductive lines of work) it is unlikely that they are the party making decisions about what R&D should be undertaken.

Secondly, given that the credit has been repealed, amending the policy in line with the submission, for the 2008–09 income year the tax credit was in place, which finishes on 31 March 2009 for most taxpayers, would create a retrospective windfall gain, at some cost to the Crown, with no effect on future incentives for R&D.

Recommendation

That the submission be declined.

Issue: Company groups

Submission
(34 – Zespri)

It should be possible to apply the business test, the minimum threshold, and the three "on-behalf" tests to wholly owned groups of companies rather than only to individual firms.

Comment

To qualify for the tax credit, a claimant must:

- be in business;
- incur at least $20,000 of eligible expenditure in the year;
- control the R&D activity;
- effectively own the results of the R&D activity; and
- bear the financial risk associated with the activity.

As pointed out in the submission, this can be problematic for larger firms that separate aspects of their operation for commercial purposes. For example, a firm may locate its R&D division in one subsidiary but hold any resulting intellectual property in another subsidiary to separate risky undertakings from assets.

The submission points out that wholly owned companies, which are essentially one economic unit, would be eligible for the tax credit if they restructured their activities so that one member in the group carried out all the necessary functions. Requiring firms to amalgamate these functions, which previously were carried out in separate subsidiaries within the group, in order to be eligible for the tax credit, is inefficient and it would create unnecessary compliance costs.

Officials largely agree with the submission. The location of the business activity and control of the R&D in a New Zealand-based separate entity within the group would not undermine the objective of maximising spillover benefits for the local economy. Some New Zealand firms have adopted the practice of locating the ownership of intellectual property offshore, for other tax and commercial reasons. The spillover benefits arising at the location of the firm that owns the results of the R&D activity is likely to be the smallest contributor to the overall spillover benefits from the activity. Therefore it is not considered vital to the policy that the subsidiary owning the results should be a New Zealand resident as long as the group owning the subsidiary is based in New Zealand.

An important question is the level of commonality sufficient for firms to be considered part of the same economic entity for the purposes of the tax credit. We consider that the wholly owned grouping (100 percent commonly owned) suggested by the submission would exclude many firms that have small holdings that reflect the participation in the enterprise by innovators and investors. A more appropriate test is that applied to group companies for income tax purposes (with 66 percent or more commonality of ownership).

A central feature of the tax credit is that the incentive should go to the party making the investment decision. Given the level of commonality most appropriate for the amendment is that of group companies (rather than wholly owned groups) we do not consider it is appropriate to extend the amendment to cover the financial risk test. In effect this means that the subsidiary in the group bearing the financial risk of any R&D expenditure is the party that will claim the tax credit for that expenditure. This restriction is also necessary to prevent two members of the group from claiming a credit for R&D expenditure that is deductible to both of them. For example, if one member pays another for the R&D activity, both would meet the deductibility requirement and both would meet the financial risk test (applied to the group as a whole) for essentially the same R&D expense.

Similarly, we do not consider that the minimum threshold should be applied on a group basis. The threshold is relatively low and should be within the reach of large firms for whom these grouping issues arise.

Recommendation

That the submission be accepted in part and that, subject to officials' comments on the location of the relevant group members, companies be able to satisfy as a group the requirements that the claimant:

- be in business;
- control the R&D activity; and
- effectively own the results of the R&D activity.

That the submission that wholly owned groups should be able to apply the minimum expenditure threshold and the financial risk test as a group be declined.

Issue: Government agencies

Submission
(Matter raised by officials)

It should be made clear that all Crown entities, as defined in the Crown Entities Act 2004, are not eligible for the tax credit.

Comment

The tax credit rules require a claimant to be in business or to be an industry research co-operative. Some Crown agencies are specifically excluded from eligibility.

Crown agencies that can meet the business test and that are not specifically excluded are eligible for the tax credit. This is contrary to the policy of the tax credit, which aims to incentivise R&D carried out by private sector businesses. The exclusion does not apply to State Owned Enterprises, which remain eligible for the credit.

Recommendation

That the submission be accepted.

Issue: Feedstock rule

Clause 424

Submission
(68A – Corporate Taxpayers Group)

The feedstock rule should be amended to make it clear that where a valuable output is produced as part of an R&D testing process, only the cost of the inputs is potentially denied the credit.

Comment

This issue was raised by the Corporate Taxpayers Group with officials before the repeal of the tax credit. The government announced on repeal that the feedstock rule would be reviewed.

The feedstock rule operates to restrict the availability of the R&D tax credit when, as part of an R&D process, a valuable output is produced. For example, a paper manufacturer might be developing a new process, and produce saleable quality paper during testing. If the costs incurred in the testing process were $10 of materials and $40 of other costs, and the end product was worth $60, some or all of the costs may be denied the credit. While the original intention of the provision was to deny the credit for the materials only ($10 above), the legislation has been interpreted as denying the credit for all costs ($50 above).

The legislation should be amended to make the original intention clear.

Officials also recommend that other minor amendments be made to address matters such as the scope of the application of the provision (it should not, for example, apply to the construction of prototypes) and remove an unnecessary duplication in the drafting.

This proposal has been discussed with the Corporate Taxpayers Group, which agrees it is consistent with the policy intent of the credit and supports the amendment. We have also consulted in detail with the New Zealand Institute of Chartered Accountants, Ernst & Young and KPMG. They all support the proposed amendment.

Recommendation

That the submission be accepted, and that the feedstock rules be limited in application only to inputs of items and materials that are the subject of testing.

Issue: Eligibility of labour R&D costs for the credit

Submissions

(35 – PricewaterhouseCoopers, 68A – Corporate Taxpayers Group)

The credit should be available in full on capitalised labour R&D costs (such as design and testing), whatever the ultimate use of the underlying asset. *(PricewaterhouseCoopers)*

That an upfront credit should be available for design labour costs. *(Corporate Taxpayers Group*)

Comment

This is another issue that was raised before repeal of the R&D tax credit, and which the government undertook to review to ensure the legislation conformed to the original policy intent.

Complex rules apply when capital expenditure is incurred as part of an R&D project. If the capital expenditure is incurred in developing a depreciable intangible asset or a tangible asset which is intended to be solely used in R&D, the credit is available in full. If capital expenditure is incurred in developing a non-depreciable tangible asset which is not solely intended to be used in R&D, the credit is available (if at all) only on the depreciation which arises when the asset is used in R&D (for example, for testing).

This is not the right outcome when the expenditure is incurred on something like the labour costs of design or testing. This is R&D expenditure under the narrowest definition, and limited eligibility for the credit is not consistent with the original policy intent. Moreover, it is not consistent with the approach indicated during consultation when the credit was being developed.

Accordingly, officials recommend that the credit be available in full for the labour R&D costs of design and testing, which are capitalised, whatever the ultimate purpose of the underlying asset. Care should be taken, however, to ensure that labour costs which are incurred in constructing these assets are not automatically given the credit. We also propose a requirement for capital expenditure, that replicates the effect of the deferred salary expenditure rule so that firms can claim the credit only in relation to salaries that are paid out.

This change has been discussed with the Corporate Taxpayers Group and is supported. It considers that the change is consistent with what the Group and officials consider is the policy intent of the rules when introduced. We have also consulted in detail with the New Zealand Institute of Chartered Accountants, Ernst & Young and KPMG. They all support the proposed amendment.

Recommendation

That the submissions be accepted.

Issue: Costs capitalised after R&D is completed

Submission
(68A – Corporate Taxpayers Group)

In certain circumstances, no credit is available for R&D costs because there is no depreciation on the asset being developed while the R&D is being done. An amendment should be made to allow a deemed depreciation calculation to apply for the purposes of the tax credit in these circumstances.

Comment

There are circumstances in which no tax credit is available because of the way the credit is designed. If the credit were ongoing, these would be reviewed and, where appropriate, recommendations made for change. As the tax credit is now repealed, and any change can only be retrospective, officials do not support the amendment proposed in the submission.

Recommendation

That the submission be declined.

Issue: Removal of internal software development cap

Submission
(68A – Corporate Taxpayers Group)

The $3 million internal software development cap should be removed.

Comment

The internal software development cap is a base protection measure intended to reduce fiscal risk associated with the tax credit. Its removal would likely expose the government to high cost but potentially low-value R&D claims. Other jurisdictions, such as Canada, have experienced very large internal software development claims, such as from banks and insurance companies. A discretion to raise the cap is available if a case is made to the Minister of Finance.

As the tax credit is now repealed, to change this retrospectively would also have no incentive effect and provide a windfall gain.

Recommendation

That the submission be declined.

Issue: Scope of internal software development cap

Submissions
(68A – Corporate Taxpayers Group)

The internal software development cap should apply only where the purpose of the R&D activity was *wholly or mainly* the development of software. Where the software development is only a facet of a wider project the cap should not apply.

The internal software cap grouping rules should be less restrictive. A 66 percent commonality of shareholding should be required for a group to be an internal software development group.

The boundary between external and internal software development is uncertain and the cap should not apply to software developed for selling or leasing when it is also used internally.

Comment

The $3 million software development cap applies to all internal software development. Grouping rules ensure that the cap cannot be avoided by spreading internal software development expenditure over multiple companies or other entities.

Officials do not support the loosening of these restrictions as this would apply only retrospectively to the 2008–09 year and have no incentive effect on taxpayers.

Also, in the case of the first submission, our concern is that it may also be relatively easy to recharacterise software developed mainly for an independent project as software developed as part of a wider project. Our understanding is that such behaviour has occurred in Australia.

Our concern with weakening the grouping rules is that it may allow internal software development to be structured in a way which by-passes the cap. The potential revenue risk if the cap is not successful could be significant.

In relation to the third submission, we do not support relaxing the rule that software used in-house is internal software development even if it is also sold or licensed to third parties. Without this rule a financial institution, for example, could provide an implicit licence to customers to use its internal back-office software and charge a small fee for the use of those systems. The software would then be seen as licensed to all the institution's customers and therefore an argument presented that the software was not internal-use software and therefore eligible for the tax credit. We received advice that this type of situation could be a problem, so the rules were extended to cover it at the Select Committee stage of the introduction of the R&D provisions.

Recommendation

That the submissions be declined.

Issue: Grant funding – third party co-funding

Submission
(68A – Corporate Taxpayers Group)

Third party contributions that are a condition of a grant should be eligible for the tax credit.

Comment

The rationale for providing government subsidies for R&D activities is to compensate firms for benefits that accrue to society (spillover benefits) rather than to the firms. Generally, firms are unable to capture all the benefits of the R&D that they undertake.

This matter was debated at the time the credits were introduced. Expenditure met with funds that are required as a condition of a grant is not eligible for a tax credit. This is because the R&D project is already subsidised by the grant. Required co-funding (whether it is funded directly by the grant recipient or by a third party) is part of the contribution that the government expects from the relevant private sector firms towards the work. Providing both forms of subsidies for the same R&D activity would therefore be a double subsidy.

While in principle the double-dipping concern could be dealt with by contemporaneous changes to grant funding and R&D tax credit rules, as the changes would be only retrospective this option is not recommended.

Recommendation

That the submission be declined.

Issue: Repeal of the tax credit

Clauses 245 and 246

Submission
(Matter raised by officials)

A number of technical amendments, including removal of clauses 245 and 246, are required to the bill and the Tax Administration Act 1994 as a consequence of the repeal of the R&D tax credit.

Comment

Clauses 245 and 246 amend the timing rules for the tax credit so that R&D salary expenditure that is paid out in a year after the R&D is performed would be eligible for the tax credit in the year in which the salary is actually paid. Similarly, overseas expenditure that has been carried forward to a subsequent income year would be eligible for a tax credit at the time there is sufficient local expenditure to make a claim.

These amendments are no longer necessary because the tax credit only applies to R&D performed in the 2008–09 income year and it was explicitly stated as part of the repeal that expenditure that would otherwise become eligible for a tax credit after the 2008–09 year, in relation to R&D activities performed in that year, would not be eligible for the concession. Officials therefore recommend that the clauses be removed.

Other minor technical amendments are also necessary to the rules for administering the credit as a consequence of its repeal.

Recommendation

That the submission be accepted.

Issue: Timing adjustments

Clauses 245 and 246

Submissions
(35 – PricewaterhouseCoopers)

The proposed changes to the timing rules for deferred employee remuneration and overseas expenditure should be rationalised to make them easier for taxpayers to follow.

The proposed exclusions from the timing rules should also apply to bonus entitlements determined after the income year in which the R&D activity occurs.

The $20,000 minimum expenditure requirement should not apply to deferred employee remuneration in the year in which it is paid out

Comment

Officials recommend above that clauses 245 and 246 be removed as the tax credit will be claimable only for the 2008–09 income year. These submissions are therefore no longer relevant.

Recommendation

That the submissions be declined.

Issue: Petroleum mining development expenditure

Clauses 245 and 246

Submissions

(35 – PricewaterhouseCoopers, 68A – Corporate Taxpayers Group)

The proposed exclusions from the timing rules should also apply to deferred petroleum development expenditure. *(PricewaterhouseCoopers, Corporate Taxpayers Group)*

"Offshore" petroleum mining, which is subject to New Zealand income tax, should be treated as R&D performed in New Zealand. *(Corporate Taxpayers Group)*

Comment

While petroleum mining exploration expenditure is not eligible for the tax credit, expenditure on R&D activities which are included in petroleum mining development expenditure is eligible.

However, the combination of the requirement that the expenditure be deductible and the seven-year spreading rule for petroleum mining development expenditure means that the credit is available for only 1/7th of the revenue expenditure for each year. This does not apply to capital expenditure. All capital expenditure that meets the requirements of the rules will be eligible As the tax credit will be available only for one year, this means that only 1/7th of the R&D expenditure that is on revenue account and that is incurred in the 2008–09 year in petroleum mining development will be entitled to a tax credit. The first submission seeks an amendment so that all the expenditure incurred in a year will be eligible.

It is not clear that the current law provides the right outcome. The intention of the tax credit was to encourage R&D expenditure, and there is no reason why the specific petroleum mining timing rule should apply to limit its availability. However, the only sensible amendments that can now be made are those which have retrospective effect to the date of commencement of the tax credit. An amendment which is retrospective and unanticipated by those entitled to it cannot have an incentive effect, and will purely be a windfall gain to recipients.

Officials have discussed the influence of the availability of the tax credit on the petroleum mining sector with a number of advisers, and none have suggested that petroleum miners have taken into account the availability of the credit, either on a 1/7th or a full-year basis, in their decisions on whether to carry out R&D activities. Also, we have been told that the amendment in relation to capital design costs, discussed earlier, will significantly reduce the amount of expenditure that is not eligible for the credit.

We therefore do not recommend any change be made in this area.

The same argument applies to the second submission. As the tax credit is now repealed, other than the changes signalled at the time of the repeal, we do not support changes that retrospectively broaden the scope of the credit as this has no incentive effect and creates a windfall gain to taxpayers.

Recommendation

That the submissions be declined.

Issue: Eligible expenditure

Submissions
(68A – Corporate Taxpayers Group)

An amendment is required to ensure that a tax credit is available for supporting R&D expenditure (such as feasibility studies) incurred in a year before the main R&D activity.

Consideration should be given to a new "other" class of expenditure for expenditure that is currently not eligible (for example, compensation for the opportunity cost of participating in a trial).

Pre-business expenditure on R&D should also be eligible for a tax credit.

Comment

R&D can be either a "core" activity (that is, an experimental activity) or a support activity (an activity that, while not experimental in itself, is required to conduct the core activity).

The tax credit rules do not require expenditure on supporting R&D to be incurred in the same year or before expenditure on core R&D, although they do require that the core activity takes place. Therefore officials do not consider that an amendment is needed to clarify this point.

Given the repeal of the tax credit from the 2009–10 income year, amendments to extend the types of expenditure eligible for a tax credit in the 2008–09 year would have no incentive effect and result in windfall gains. Therefore we do not support them.

Recommendation

That the submissions be declined.

Issue: Claw-back of imputation credits

Submission
(68A – Corporate Taxpayers Group)

There should be no claw-back of tax credits paid to a company when the company makes distributions to shareholders.

Comment

This matter was debated at the time the tax credit was introduced. There is a partial claw-back of tax credits paid to a company when the company makes distributions to its shareholders. To remove the claw-back would move more entities away from the economically correct position and involve significant fiscal cost. Officials do not support any change to this position, especially as now any change would be retrospective only and have no incentive effect.

Recommendation

That the submission be declined.

Issue: Changes to response period for notices related to R&D tax credits

Clauses 433 and 474

Submission
(67 – New Zealand Institute of Chartered Accountants)

The wording of the new response period provision in the Tax Administration Act 1994 should be amended so the start date of the response period in proposed section 89AB(4)(a), (b) and (c)(i) is the date of issue of the initiating notice and not the date the initiating notice is received in an office of the department. Additionally, the reference to "that Act" in proposed section 89AB(4)(c) is confusing and should be changed to the Income Tax Act 2007.

Comment

Proposed section 89AB of the Tax Administration Act 1994 is a rewrite of the "response period" definition in current section 3(1) of the same Act. The rewrite ensures that the response periods for notices relating to R&D tax credits are consistent with other time limits relating to the tax credit. It was not the intention of the rewrite to change the response periods in cases that do not relate solely to an amount of R&D tax credit. Officials therefore agree that proposed section 89AB(3)(a), (4)(a) and (b) be amended so the start date of the response period is the date of issue of the initiating notice and not the date the initiating notice is received in an office of the department. Proposed section 89AB(4)(c) concerns a notice relating solely to an amount of R&D tax credit and should not be amended.

We do not agree that the reference to "that Act" in section 89AB(4)(c) is confusing. The use of this term is standard drafting practice, and it is clear from section 89AB(4)(c) that "that Act" refers to the Income Tax Act 2007.

Recommendation

That the submission be accepted in part, subject to officials' comments.

Issue: Filing detailed R&D returns on behalf of partners

Clauses 466 and 467

Submission
(68A – Corporate Taxpayers Group)

Requiring partners to individually file R&D returns could increase compliance costs for taxpayers and also result in confusion if there is inconsistency in the positions taken by individual partners.

Comment

Currently the legislation allows partnerships to file a detailed statement. When this happens, all the R&D relating to a partnership and the partners is required to be on the same detailed statement. This means that partner A has to disclose to partner B the R&D partner A is doing on their own behalf. The amendment in the bill addresses this problem by requiring individual partners to file a detailed statement rather than the partnership.

The amendment also streamlines the process in situations when a partner is a member of more than one partnership doing R&D, and particularly when they are also in an internal software development group.

Recommendation

That the submission be declined.

Issue: No credit until detailed statement is filed

Clause 244

Submission
(68A – Corporate Taxpayers Group)

Clarification may be required so that a taxpayer can claim the R&D tax credit in their tax return, due to be filed before the detailed statement, and so that the tax credit is also factored into the appropriate year's residual income tax. These issues could be addressed by allowing the tax credit to be available only once the detailed statement is filed.

Comment

Proposed section LH 2(8) provides that no tax credit arises before an R&D detailed statement is provided. Information contained in the detailed statement is necessary for Inland Revenue to properly process the claim. The submission supports the amendment but queries whether this creates a problem because taxpayers claim the tax credit in their tax return and factor in the credit in calculating the residual income tax, both of which occur before the detailed statement is filed.

The intention is that, if a detailed statement is not filed, the credit is treated as if it never existed. It is still intended that taxpayers claim the credit in their return and factor in the tax credit in calculating residual income tax. This should be clarified.

Recommendation

That the submission be accepted.

Issue: Change to response periods for notices related to R&D tax credits

Clauses 433 and 474

Submission
(68A – Corporate Taxpayers Group)

The proposed changes to response periods for filing a notice of proposed adjustment (NOPA), should be amended so that if an R&D tax credit adjustment has been included in a NOPA with other issues, the portion of that NOPA which relates to R&D tax credits will have a response period of one year (or two years if the temporary extension applies).

Comment

The normal tax rules allow a four-month opportunity for taxpayers to amend a tax return. However, because the R&D tax credit raises particular risks, different time periods for amendment were considered desirable. It is therefore appropriate that the proposed two-year response period only relates to a notice of proposed adjustment (NOPA) that relates solely to R&D tax credits.

Officials do not agree that this rule should be extended so that when an R&D tax credit adjustment has been included in a NOPA with other issues, then the portion of the NOPA that relates to the R&D tax credit is treated as having a response period of two years, while the other issues will still have the general four-month response period. We consider that the benefits of such a change would be outweighed by the cost of the extra complexity that would be introduced into the rules relating to filing of a NOPA.

Recommendation

That the submission be declined.

Issue: Requirements for a notice of proposed adjustment relating to an R&D tax credit

Clauses 475 and 476

Submission

(68A – Corporate Taxpayers Group)

The new amendments relating to a notice of proposed adjustment (NOPA) in sections 89D and 89DA of the Tax Administration Act 1994 are unnecessary. Given that a tax credit will only arise once a detailed statement is filed, the Commissioner will not be able to issue an assessment in relation to a tax credit before a detailed statement is provided.

Comment

The new amendments to sections 89D and 89DA of the Tax Administration Act 1994 ensure that a claimant cannot dispute an assessment of an R&D amount until an R&D detailed statement (under sections 68D or 68E) has been provided for the tax year. This ensures Inland Revenue has the necessary information about a claimant's R&D activities before a dispute commences. Officials therefore consider that these amendments are necessary.

There are several time limits which are specific to the detailed statement under sections 68D and 68E of the Tax Administration Act 1994. Officials propose that the new amendments in sections 89D and 89DA be further clarified so that a claimant can only dispute an assessment of an amount of R&D by providing a detailed statement within the time limits required under sections 68D or 68E.

Recommendation

That the submission to remove the new amendments in sections 89D and 89DA be declined.

That the proposal to further clarify these proposed sections be accepted.

Issue: Reviewing the R&D detailed statement as a return

Submission

(Matter raised by officials)

The R&D detailed statement is currently a tax return for the purposes of the Tax Administration Act 1994. Consequently, under section 36(3) of that Act, a claimant must retain a signed, hardcopy transcript of the detailed statement. Section 23 of the same Act also requires this transcript to be retained for seven years after the end of the income year to which the return relates. Another consequence of the detailed statement being a tax return is that shortfall penalties (section 141 of the Tax Administration Act 1994) may apply to the position taken by claimants in the detailed statement. Officials recommend that these features, as well any shortfall penalties that result from the detailed statement being a tax return, are switched off.

Comment

The R&D detailed statement is a completely electronic form that claimants of the R&D tax credit must complete and submit electronically. The requirements to sign and to retain a hardcopy transcript of the detailed statement for seven years are inconsistent with the electronic nature of the detailed statement itself. Officials therefore recommend that these tax return features are "switched off" for the detailed statement.

Although the detailed statement is a tax return, it acts more like a disclosure form. Officials therefore recommend that any shortfall penalties that would apply as a consequence of the detailed statement being a tax return are also "switched off". This means that the details in a detailed statement are not considered as a "tax position" taken by the claimant. The figures in the detailed statement should, if completed correctly, reflect the R&D tax credit figure claimed in a claimant's return of income. The R&D tax credit figure claimed in a claimant's return of income is a tax position taken by a claimant and therefore, will still be subject to all the shortfall penalties under the Tax Administration Act 1994. The absolute liability and knowledge offences (sections 143 and 143A of the Tax Administration Act 1994) will also still continue to apply to the R&D detailed statement.

Recommendation

That the submission be accepted.

Issue: Minor rewrite changes to R&D provisions

Clauses 284, 328 and 339

Submission
(Matter raised by officials)

Proposed sections OP 35(1B), OK 14B(1)(a) and OB 37(1)(a) require minor rewrite changes.

Comment

Minor rewrite changes to proposed sections OP 35(1B), OK 14B(1)(a) and OB 37(1)(a) will ensure that these provisions give full effect to the policy intent of the R&D tax credit amendments.

Recommendation

That the submission be accepted.

Portfolio investment entity rules

OVERVIEW

The portfolio investment entity (PIE) rules were enacted in 2007 with application from 1 October 2007, to support the introduction of KiwiSaver. The rules remove a number of tax disadvantages for people investing via managed funds that elect to be PIEs.

The PIE amendments contained in this bill are generally of a technical nature and will ensure that the PIE rules reflect existing practice and the intended policy. A number of submissions were received on the technical aspects of these rules.

The bill also rewrites the PIE rules to ensure the rules are consistent with the plain language drafting approach that has been adopted more generally across other parts of the Income Tax Act.

The remedial amendments contained in this bill and the recommendations contained in this report would, if adopted, amend both the current and rewritten PIE rules.

GENERAL COMMENTS ON REWRITE OF PIE RULES

Issue: Terminology used in PIE rules

Submission
(31 – NZ Funds, 32 – KPMG, 33 – Investment Savings and Insurance Association of NZ Inc, 62 – Minter Ellison Rudd Watts)

The terminology used in the current PIE rules should not be changed as the current terms are now commonly understood. In addition, changes to the terminology in the legislation will require changes to PIE documentation which will result in extra costs.

Comment

The rewritten PIE provisions in the current tax bill are the last of the major parts of the Income Tax Act to be rewritten.

Officials have recommended (see below) that the rewritten PIE rules be deferred until 1 April 2010 to prevent retrospective application. This deferral will provide time for the managed fund industry and Inland Revenue to change the relevant terminology for written material. This should alleviate some of the submitters' concerns.

Recommendation

That the submission be declined.

Issue: Application date of rewritten PIE rules

Submission
(Matter raised by officials)

The application date for the rewritten PIE rules should be deferred from 1 April 2009 to 1 April 2010.

Comment

The Minister of Revenue has written to the Chair of the Committee requesting that the application date for the rewritten PIE rules be deferred from 1 April 2009 to 1 April 2010.

The PIE rules operate on a tax-year basis, that is, from 1 April each year. Because this bill will be enacted after 1 April 2009, it is highly desirable for the rewritten PIE rules to be deferred until 1 April 2010 to prevent them having any retrospective application.

Recommendation

That the submission be accepted.

BECOMING A PIE

Issue: Listed PIEs should be able to elect to be portfolio tax rate entities

Submission
(18A – Staples Rodway)

There should be an option for PIEs that are listed on a recognised exchange to elect to be portfolio tax rate entities.

Comment

Officials agree with the submission as it is consistent with the policy intention of the PIE rules. This change should apply from 1 April 2009.

Recommendation

That the submission be accepted.

Issue: Active company exclusion should be reconsidered

Submissions
(32 – KPMG, 62 – Minter Ellison Rudd Watts)

The proposed changes to preclude active land-owning companies from setting up PIEs should be reconsidered. *(KPMG)*

The proposed rules for income sources relating to income derived from a lease of land in section HL 10(2)(b)(iii) of the Income Tax Act 2007 (section HM 12(b)(iv) of the rewritten provisions in the bill) should not apply where land holdings are separated by an active business into a PIE to raise funds from new investors by way of an offer made to the public. *(Minter Ellison Rudd Watts)*

Comment

The policy intent of the PIE rules has always been that PIEs should be passive investment vehicles, such as managed funds. The existing PIE rules therefore prevent companies with active operations from becoming PIEs.

PIEs are able to hold land, as well as shares and debt investments, since prudent investment management principles generally require portfolio investments to be diversified. Widely held companies can be PIEs if their main activity is to lease land and buildings to people who run businesses on those premises, since passive income includes rent from leases (but not payments from licences to occupy). Listed property trusts that own commercial buildings would generally fall into this category.

The PIE rules were not, however, designed for active businesses that hold most of their assets in land – such as airports, hotels and rest homes.

The proposed amendments in the bill referred to by KPMG were announced in 2007. Consistent with the original policy intent of the PIE rules, these amendments prevent active land-owning companies from using certain loopholes in the law to set up PIEs – for example, by separating the land and active business parts of the business into different companies.

Officials also do not agree that an entity with an associated entity that runs an active business from which it derives rental income from land should be able to be a PIE simply because the entity running the active business previously sought funds from new investors by way of a public offer. The treatment suggested in the submission would be inconsistent with the core policy principle of the PIE rules that PIEs should be deriving the majority of their income from non-active sources.

Recommendation

That the submissions be declined.

Issue: Public unit trusts

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

The current investor interest size requirement in section HL 9 should be retrospectively amended so that there is no investor interest size requirement for a portfolio investor class that, if treated as a unit trust, would meet the requirements of one or more of paragraphs (a) and (c) to (e) of the definition of a public unit trust. This should be in addition to the current provision which applies for an investor who would meet those requirements.

Comment

Officials consider that the correct interpretation of the investor interest size requirement in relation to certain funds in section HL 9(2) is that it applies to the class rather than the investor. This is consistent with the policy intent of the provision.

Officials agree that the provision be expanded so that the public unit safe harbour can also apply at the investor level. As this amendment is consistent with existing policy and practice, it should apply from 1 October 2007.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Exception for community trusts

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

In the new investor interest size requirement rules, section HL 9 of the Income Tax Act 2007 (section HM 21(1) of the rewritten provisions in the bill) "community trusts" should be added to the list of investors to which exceptions apply, after Auckland Regional Holdings.

Comment

Officials agree that as community trusts are established to manage public assets they are analogous to other entities that have been exempted such as the Earthquake Commission and Auckland Regional Holdings. The amendment should apply from the start of the 2009–10 income year.

Recommendation

That the submission be accepted.

Issue: Portfolio investor proxy

Submissions
(33 – Investment Savings and Insurance Association of NZ Inc, 32 – KPMG, 35 – PricewaterhouseCoopers, 60 – ASB, 62 – Minter Ellison Rudd Watts)

We propose that the use of "investor" in the investor interest size requirement rules in section HL 9 be amended to ensure that where a portfolio investor proxy is concerned, the underlying investor is the person who is limited to holding 20 percent or less of the class, rather than the portfolio investor proxy.

A more compliance-efficient approach would be to allow a portfolio investor proxy to be an excluded investor, subject to a notification requirement at certain levels of holdings. *(KPMG)*

Comment

Officials agree that a look-through approach should be taken, provided that the portfolio investor proxy assumes the obligations of the PIE being invested into. As this amendment is consistent with existing policy and practice, it should apply from 1 October 2007.

While the second submission has some merit, we consider that the current PIE rules, combined with the recommended amendments, would achieve the outcome that KPMG requests.

Recommendation

That the first submission be accepted.

That the second submission be declined.

Issue: Investor size requirements – charities

Submission
(60 – ASB)

Registered charities should be permitted to hold more than 20 percent of a PIE.

Comment

Officials do not consider there is a policy basis for having an exception in the general investor size requirement for charities. If this submission were accepted, it would provide the opportunity for charities to control PIEs, which was not the intention of the rules.

Recommendation

That the submission be declined.

Issue: Exemption for investor interest size

Submission
(32 – KPMG)

There should be provision similar to the less than 20 persons provision in the investor membership requirement in section HL 6(1)(j) in the investor interest size requirement in section HL 9 for certain small classes of investors in multi-class superannuation funds.

Comment

Officials agree with the submission.

As this amendment is consistent with existing policy and practice, it should apply from 1 October 2007.

Recommendation

That the submission be accepted.

BECOMING A PIE – TRANSITIONAL ISSUES

Issue: Treatment of excess foreign investor tax credits

Submission
(32 – KPMG)

The legislation should clarify how a PIE that has excess foreign investor tax credits before becoming a PIE can claim the value of those credits after becoming a PIE.

Comment

Officials consider that the current rules allow excess foreign investor tax credits to be carried forward and used for a future tax year. We note there is no provision allowing the credits to be converted into formation losses.

Recommendation

That the submission be declined.

Issue: Tax credits for supplementary dividends carried forward upon transition into PIE

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

The tax credits from supplementary dividends should be grossed up at the company tax rate on the date of entry into the PIE rules and treated as formation losses. This change should apply retrospectively from 1 October 2007.

Comment

Officials consider that, under current income tax rules, PIEs can carry forward excess imputation credits which reduce the tax liability of the PIE as a whole. The provision relating to credits received by a portfolio tax rate entity or portfolio investor proxy in section HL 29 does not preclude this result. This is consistent with the rule that unless a general provision is specifically "switched off" in relation to a PIE it should be treated as applying to a PIE.

Recommendation

That the submission be declined.

Issue: Portfolio class land-loss restriction on non-land losses

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

The proposed land-loss restriction in the rewritten rules in section HM 64 applies to all losses of an investor class. It should be restricted to losses arising from the investments in land or shares in the land investment companies when the required investment threshold is satisfied for the land-loss restriction to apply.

The above scenario could be corrected by amending the definition of "land investment company" to exclude foreign PIE equivalents (referred to as "foreign investment vehicles" in the 2007 Act).

Comment

The submission points out that, in certain circumstances, tax losses of PIEs that own predominantly land (or shares in companies that own predominantly land) caused by foreign exchange losses on hedging contracts can be trapped at the PIE level. The policy intention of the PIE rules was not to allow the flow-through of losses for PIEs owning predominantly land. This was to alleviate the revenue risk of land PIEs generating large tax losses and passing these through to investors. While the foreign exchange losses on hedging can be seen as separate to the land investments, accepting the treatment suggested in the submission is likely to result in a large revenue risk. In addition, the foreign exchange instruments that provide the hedge are integral to the overall land investment and should not be separate from a tax perspective. We therefore recommend that the submission is not accepted.

Recommendation

That the submission be declined.

Issue: Master fund expenditure passed up to a PIE

Submission
(32 – KPMG, 33 – Investment Savings and Insurance Association of NZ Inc, 61 – Trustees Corporations Association of New Zealand)

There should be no restrictions on how much expenditure is passed up to a particular PIE under the proposed changes to the rules on expenditure specific to certain entities in subpart DV.

Alternatively, if the proposed restrictions on expenditure are retained, there should be guidelines on how expenditure should be apportioned.

Comment

Officials have reconsidered the issue and agree that the restrictions proposed in the bill are not practical. The master fund should be allowed to use the expenditure to offset income of the investor across one or more classes in which the investor has an interest. However, the maximum amount of expenditure that can be transferred should be limited to the investor's portion of the PIE's income for the relevant calculation period or periods of the PIE. This will prevent expenditure in excess of the investor's share of the PIE income being rebated to the PIE for the benefit of the investor – which would be an inappropriate result.

The amendment should apply from 1 April 2008, which is the same as the application date for the main expenditure transfer rules as they apply to PIEs.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Formula for calculating maximum deduction for master funds that are portfolio tax rate entities

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

The current rules should be amended so that the provision that calculates the maximum deduction for expenditure transferred to master funds that are portfolio tax rate entities in section DV 6 should not apply.

Comment

Officials agree that the current rules should be amended so that the provision that calculates the maximum deduction for expenditure transferred to master funds that are portfolio tax rate entities in section DV 6 should not apply. The amendment should apply from 1 April 2008, which is the same as the application date for the main expenditure transfer rules as they apply to PIEs.

Recommendation

That the submission be accepted.

Issue: Minimum threshold for paying rebates

Submission

(31 – NZ Funds)

PIEs that calculate income and pay tax on a quarterly basis should not have to refund amounts that are less than $5 (representing their share of a tax credit) to investors who have fully exited the PIE.

Comment

The issue raised in the submission is part of a broader matter concerning the extent to which PIEs should receive rebates for losses when investors exit funds.

Recommendation

That the submission be declined.

TAX CREDITS AND LOSSES

Issue: Formation loss available – reference to basic tax rates in schedule 1

Submission
(35 – PricewaterhouseCoopers)

The definition of "rate" for the purpose of the formula used to calculate the amount of formation loss available for allocation to an investor class in section HL 30(7)(c) should be amended to correct an incorrect clause of schedule 1. It should be amended to refer to "the rate of tax for companies set out in schedule 1, part A, clause 2".

Comment

Officials agree that the definition of "rate" for the purpose of the formula used to calculate the amount of formation loss available for allocation to an investor class in section HL 30(7)(c) should be amended to correct an incorrect clause of schedule 1. It should be amended to refer to "the rate of tax for companies set out in schedule 1, part A, clause 2".

The amendment should apply from 1 April 2008, when the Income Tax Act 2007 came into effect.

Recommendation

That the submission be accepted.

Issue: Tax credits allocated to a zero-rated investor with income from a portfolio tax rate entity

Submission
(20 – BDO Spicers)

The 2004 and 2007 legislation should clarify that a zero-rated company investor can claim a tax credit (other than a foreign tax credit) in its imputation credit account that is allocated to it by a portfolio tax rate entity.

Comment

Officials consider that the 2004 and 2007 legislation is already sufficiently clear that tax credits can be claimed by company investors in portfolio tax rate entities. The only situation where this is not currently the case is for imputation credits, and the amendments contained in the bill will ensure that imputation credits allocated by a portfolio tax rate entity to a company investor can be recorded in the company's imputation credit account.

Recommendation

That the submission be declined.

Issue: Investor interest adjustment

Submissions

(33 – Investment Savings and Insurance Association of NZ Inc, 60 – ASB)

The rules for adjustments to investors' interests or to distributions in section HL 7 of the Income Tax Act 2007 (section HM 48 of the rewritten provisions in the bill) should be amended to require a PIE to adjust an investor's interest or a distribution to reflect the investor's prescribed investor rate within a reasonable time period – that is, that no specific date be prescribed in the legislation.

Inland Revenue support material should advise that a "reasonable time period" would include payment made by the later of 30 June or 60 days of receipt of a PIE rebate for a PIE in a net-rebate position.

The provision that causes the PIE to lose its PIE status because it has not met the investor interest adjustment requirement should be removed.

Comment

Officials agree that PIE status should not automatically be lost when this requirement is not satisfied within the required time period. This issue can be addressed with a provision allowing the Commissioner to extend the period within which this requirement must be met.

The amendment should apply from 1 April 2008.

Recommendation

That the submissions be accepted in part, subject to officials' comments.

FILING AND INFORMATION REQUIREMENTS

Issue: Providing information to zero-rated investors

Submission
(60 – ASB)

Portfolio investor proxies should be required to provide investors with information pertaining to their PIE investments no later than 31 July following the tax year instead of 30 June.

Comment

Officials understand the concerns raised in the submission. However, delaying the date on which information is required to be provided to investors later than 30 June, may adversely impact compliance for those investors as many will have 7 July tax return filing requirements.

Recommendation

That the submission be declined.

Issue: Annual attribution – portfolio investor proxy's exposure to penalties and UOMI

Submission
(60 – ASB)

To ensure that provisional PIE tax payments based on third-party information are correct, portfolio investor proxies should be allowed until 31 July to make any additional PIE tax payments.

Comment

Officials understand the concern raised in the submission. However, commercial imperatives should ensure that the portfolio investor proxy receives details of the income it should be allocating to investors within an appropriate timeframe. Officials therefore recommend that the submission be declined.

Recommendation

That the submission be declined.

INVESTORS – PRESCRIBED INVESTOR RATE

Issue: Zero-percent prescribed investor rate for individuals

Submission
(31 – NZ Funds)

An individual PIE investor with an effective marginal tax rate of 0% should be able to elect a prescribed investor rate of 0%, upon application to Inland Revenue.

Comment

Officials do not support the submission for the following reasons:

- The proposal would add significant complexity to the PIE rules.
- There could be a high cost to Inland Revenue in administering the application process.
- The proposal would be asymmetrical as investors could elect a 0% rate and flow through losses when they are in a loss position, and when they are in a positive income situation they could elect a non-flow-through treatment and have their tax rate capped at 30%.
- It could be viewed as inequitable as investors that incurred an unexpected loss during the year would be disadvantaged relative to those with historical losses that could elect a 0% at the start of the year.

Recommendation

That the submission be declined.

Issue: Prescribed investor rate for trustees

Submission
(61 – Trustees Corporations Association of New Zealand)

PIE legislation for trustees should allow trustees to choose a "prescribed investor rate" of 12.5% or 21%. The tax paid then by the PIE will not be a final tax and the income allocated to the trustee will be taxable in the hands of the trustee or beneficiaries. The tax paid by the PIE will be available as a credit to either the trustee or beneficiaries.

Comment

Officials agree. Allowing trusts to elect a lower PIE rate than 30% with the PIE income taxable at the trust level (and a credit for tax paid at the PIE level) should help certain trusts with provisional tax payments.

This amendment should apply from 1 April 2009.

Recommendation

That the submission be accepted.

INVESTORS – INCOME ALLOCATED BY THE PIE

Issue: Individuals and inadvertent errors

Submission
(31 – NZ Funds)

Portfolio investor allocated income should not be excluded income to a person who has accidentally elected a prescribed investor rate that is too high for that individual.

Comment

Officials do not support the submission for the following reasons:

- The proposal would add significant complexity to the PIE rules.
- There would be a very high cost to Inland Revenue in administering the application process.
- The proposal would be asymmetrical as investors could elect a 0% rate and flow through losses when they are in a loss position, and when they are in a positive income situation they could elect a non-flow-through treatment and have their tax rate capped at 30%.
- It removes the current incentive for people to elect the correct rate up-front.
- The current rules already allow individuals to change their PIE tax rate at any time during the calculation period (usually a year).

Officials also note that investors can change their portfolio investor rate before the end of the relevant period.

Recommendation

That the submission be declined.

Issue: Zero rate investors in provisional tax PIEs

Submission
(32 – KPMG)

A zero-rated investor in a provisional tax PIE should be entitled to make use of its share of tax credits to offset tax on the allocated income. This should also be reflected in the rewritten PIE rules.

Comment

The policy intent behind introducing provisional tax PIEs was to provide the key benefits of the PIE rules but with lower compliance costs. As part of this approach to keep compliance costs low, losses are carried forward at entity level rather than allocated to individual investors. To allow zero-rated investors to make use of their share of tax credits would be inconsistent with the policy intent of introducing provisional tax PIEs. Officials note that provisional tax PIEs have the option to become full PIEs (portfolio tax rate entities) and in this case, zero-rated investors can make use of their share of tax credits.

Recommendation

That the submission be declined.

Issue: Corporate investors in PIEs – no relief on subsequent distribution of excluded income

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

Excluded PIE income derived by a company investor that is a public unit trust (that is not a PIE) should retain its non-taxable character when the public unit trust distributes that income to its shareholders. This change would require retrospective amendment to the application date of the PIE rules.

Comment

A deliberate design feature of the company tax rules is that amounts that are exempt or excluded from tax at the company level are taxable if they are distributed to shareholders as a dividend. The issue described in the submission was considered and not accepted when the PIE rules were designed. It is therefore recommended that the submission be declined.

Recommendation

That the submission be declined.

GENERAL ISSUES

Issue: Certificate of exemption for RWT

Submission
(31 – NZ Funds)

PIEs should be automatically exempt from RWT and should not be required to apply for certificates of exemption from RWT.

Comment

Officials consider that the main concern underlying the submission (ongoing compliance costs for PIEs) can be accommodated through a change to Inland Revenue administrative processes. This would entail PIEs being granted open-ended RWT exemption certificates. While this would not remove the up-front requirement for PIEs to apply for an RWT exemption certificate, it would reduce compliance costs as future applications would not be necessary.

Recommendation

That it be noted that the concern underlying the submission has been addressed.

Issue: Application of fund withdrawal tax rules to superannuation funds that have elected to be portfolio tax rate entities

Submission
(33 – Investment Savings and Insurance Association of NZ Inc, 32 – KPMG, 60 – ASB)

The fund withdrawal tax of an investor should not be allowed to affect the PIE taxable income calculations relating to other investors in the portfolio tax rate entity. The amount of fund withdrawal tax deducted from an investor should be payable as a separate tax payment (outside of the PIE tax rules). This can be by way of a new fund withdrawal tax payment form. The portfolio tax rate entity will make the payment annually, no later than 30 June, which will represent deductions made from withdrawals for the tax year to 31 March. For example, for a portfolio tax rate entity with a 31 March balance date, the initial year payment due on 30 June 2009 would include deductions made from withdrawals from the start date as a portfolio tax rate entity to 31 March 2009.

Comment

Officials consider that this issue can be dealt with by ensuring that income that a PIE derives under the fund withdrawal tax rules should be treated as income to which no investor has an entitlement. This effectively results in the PIE accounting for the tax separately and paying tax at the PIE tax rate of 30%. The amendment should apply from the start of the 2008–09 income year.

Recommendation

That the submission be accepted, subject to officials' comments.

Issue: Currency hedging and FDR investments

Submission
(32 – KPMG, 33 – Investment Savings and Insurance Association of NZ Inc)

Fully hedged foreign assets which are subject to the fair dividend rate (FDR) within a PIE should be fully subject to FDR. The hedging should also be taxed under FDR. This would ensure that 100 percent hedging before tax would also be 100 percent hedging after tax for all investors in the PIE.

Comment

Officials agree conceptually that there is an argument that foreign exchange contracts that have been entered by a PIE to fully hedge the PIE's assets that are subject to FDR should be subject to FDR along with the foreign asset that is hedged. This approach would allow PIEs to create an effective post-tax hedge for their investors. In addition, this approach should result in less volatile revenue flows for the government as the gain or loss on the foreign exchange contract would be neither taxable nor deductible.

However, further work and consultation with the managed funds' industry is necessary to develop the detail of any solution. It is therefore recommended that officials consider this submission further in consultation with the PIE industry with a view to introducing a legislative change later this year.

Recommendation

That officials consider this submission further in consultation with the managed funds' industry and other interested parties.

Issue: Consolidated tax group including portfolio tax rate entities

Submission
(33 – Investment Savings and Insurance Association of NZ Inc)

The provisions relating to common ownership and wholly owned groups of companies (section IC 4) should be amended to clarify that a wholly owned group of companies can include portfolio tax rate entities and that this can apply to a portfolio tax rate entity that owns 66 percent of the voting interests in portfolio land companies.

Comment

The policy intention of the grouping rules as they apply to portfolio tax rate entities is that the benefits of the wholly owned group rules apply when a portfolio tax rate entity parent owns 100 percent of the underlying companies and the underlying companies are portfolio tax rate entities or portfolio land companies. The submission is correct that this policy intention has not been reflected in the rewritten provision in the bill. Officials therefore recommend that the bill be amended to confirm the policy intention.

The amendment should apply from the recommended application date of the rewritten PIE rules – that is, 1 April 2010.

Officials, however, do not agree that the 100 percent ownership requirement be reduced to 66 percent as this would undermine the policy intention of the PIE rules.

Recommendation

That the submission be accepted in part.

Issue: Imputation credit of ICA company passed on by portfolio tax rate entity

Submission
(20 – BDO Spicers)

An imputation credit account (ICA) company is allowed an imputation credit for the amount of imputation credit allocated to it by a portfolio tax rate entity, from 1 April 2008. The Income Tax Act 2004 should similarly be amended so the provision applies for the 2007–08 income year.

Comment

Officials agree that an ICA company should be allowed an imputation credit for the amount of imputation credit allocated to it by a portfolio tax rate entity.

Recommendation

That the submission be accepted.

DRAFTING ISSUES

Issue: Minor drafting issues – Income Tax Act

Submission
(Matter raised by officials)

A number of minor technical amendments to the PIE rules should be made to ensure that they achieve their policy intent.

Comment

Several submitters have raised a number of useful minor drafting points that officials consider should be incorporated into the current PIE rules to ensure they achieve their intended effect.

Recommendation

That the submission be accepted.

Issue: Remedial amendments to rewritten PIE rules

Submission
(Matter raised by officials)

A number of amendments should be made to the rewritten PIE rules to ensure that they are an accurate translation of the current rules.

Comment

A number of submitters have raised useful drafting points in relation to the rewritten PIE rules that officials consider should be taken into account in the rewritten rules. Similarly, we have identified some minor drafting points that will ensure that the PIE rules operate as intended.

Recommendation

That the submission be accepted.

Penalties

OVERVIEW

The Taxation (Business Taxation and Remedial Matters) Act 2007 introduced a number of changes to the penalty rules in the Tax Administration Act. Officials have recommended that the following amendments be made to clarify practice and policy intent. They have not required detailed consultation, although officials have discussed the amendments with the New Zealand Institute of Chartered Accountants.

As these amendments clarify the policy intent they apply from the dates the amendments in the Taxation (Business Taxation and Remedial Matters) Act 2007 apply.

GRACE PERIODS

Issue: Pre-emptive instalment arrangements

Submission
(Matter raised by officials)

If the taxpayer enters a pre-emptive instalment arrangement, the grace period should not apply.

Comment

The Taxation (Business Taxation and Remedial Matters) Act 2007 amended the late payment penalty to provide a grace period under which Inland Revenue notifies a taxpayer the first time a payment is late rather than imposing an immediate late payment penalty. If payment is not made by a certain date, the penalty will be imposed.

To encourage taxpayers to contact Inland Revenue as soon as possible, the second stage of the initial late payment penalty is not imposed if a taxpayer enters an instalment arrangement before the due date for payment of tax (this is known as a pre-emptive instalment arrangement).

To provide a further incentive for taxpayers to contact Inland Revenue as soon as possible, officials recommend that the grace period is not applied for the period when a pre-emptive instalment arrangement is entered into but would apply at a later date if the taxpayer inadvertently misses a payment. This amendment also reinforces the policy of the grace period – that it ensures that taxpayers who inadvertently miss a payment are not penalised.

Recommendation

That the submission be accepted.

Issue: Application to the first default identified

Submission

(Matter raised by officials)

The grace period should apply to the first default identified by Inland Revenue.

Comment

It is possible for Inland Revenue to apply a grace period and then determine that the grace period should have been applied to an earlier period. For example, when a return is filed late, and a grace period has already been applied to a subsequent return when it should have been applied to the late return.

To ensure that the taxpayer benefits from the grace period, the grace period should be applied to the first default identified by Inland Revenue.

Recommendation

That the submission be accepted.

NOT PAYING EMPLOYER MONTHLY SCHEDULE (EMS) AMOUNT PENALTY

Issue: Imposition of the late payment penalty on the EMS penalty

Submission
(Matter raised by officials)

A late payment penalty should not be imposed on the EMS penalty.

Comment

An EMS penalty is imposed when an employer files an employer monthly schedule but does not pay some or all of the tax it should. The penalty was introduced in 2008 and is aimed at encouraging employers to comply by providing an incentive for them to pay tax associated with employer monthly schedules on time. It is imposed each month if the tax is not paid or the employer has not entered an instalment arrangement. A late payment penalty is imposed when taxpayers do not pay their tax, and any previous penalties imposed, on time. It too is imposed each month the amount remains unpaid.

Currently the EMS penalty is also subject to the late payment penalty.

To ensure that penalties do not accumulate too quickly, and are not disproportionate to the non-payment, officials recommend that the EMS penalty not be subject to the late payment penalty.

The amount of tax not paid will still be subject to late payment penalties as well as use-of-money interest.

Recommendation

That the submission be accepted.

Issue: Negotiation periods

Submission
(Matter raised by officials)

Employers wishing to enter an instalment arrangement should not be subject to the EMS penalty when they are negotiating an arrangement.

Comment

Currently, an employer who files an employer monthly schedule but does not pay the tax may be liable to an EMS penalty. Before the penalty is imposed the taxpayer will be warned that if they do not pay or enter an instalment arrangement a penalty will be imposed the following month.

To encourage employers to enter instalment arrangements, officials recommend that the EMS penalty should not be imposed when an employer is negotiating an instalment arrangement. If an instalment arrangement is not entered into or payment is not made, the employer will be warned and the EMS penalty will then be imposed.

Recommendation

That the submission be accepted.

Issue: Corrected amounts

Submission
(Matter raised by officials)

If the amount on the EMS changes, the EMS penalty should be calculated using the lesser of the corrected figure and the unpaid amount.

Comment

Currently, the EMS penalty is imposed on the lesser of the unpaid amount and the amount shown on the EMS when it is filed. Officials consider that if the employer corrects the schedule, the penalty should be calculated on the lesser of the corrected amount and the unpaid amount.

Recommendation

That the submission be accepted.

Issue: Ordering rule for payment

Submission
(Matter raised by officials)

The legislation should set out a rule for the application of a payment when an EMS penalty has been imposed.

Comment

If an EMS penalty has been imposed and a payment is then made, the payment should first be applied to the EMS penalty and then to the core tax owing. If the payment is not applied to the penalty first, taxpayers would pay the core tax and the penalty would remain outstanding with the risk that the penalty is never paid.

Similar rules apply for late payment penalties and use-of-money interest.

Recommendation

That the submission be accepted.

Issue: Assessment of the EMS penalty

Submission
(Matter raised by officials)

The EMS penalty should not be assessed in the same way as the tax to which it relates and the Commissioner should not give a notice of assessment to the taxpayer.

Comment

Under section 94A(2), a shortfall penalty is assessed in the same way as the tax to which it relates, and under section 111, the Commissioner must give a notice of assessment to the taxpayer. The EMS penalty is a shortfall penalty. However, unlike other shortfall penalties it is imposed each month that an EMS amount is not paid and is therefore more like a late payment penalty.

Before an EMS penalty is applied, the employer is warned. When the penalty is applied, the employer receives another letter and a statement setting out the penalty and the core tax, therefore it is not necessary to send a separate notice of assessment. Officials consider that the EMS penalty should not be assessed in the same way as the tax to which it relates and the Commissioner should not give a notice of assessment to the taxpayer. This would mean that the EMS penalty and the late payment penalty are imposed in the same way.

Recommendation

That the submission be accepted.

Issue: Imposition of the EMS penalty on amounts less than $100

Submission
(Matter raised by officials)

The EMS penalty should not be imposed on amounts of $100 or less rather than amounts of less than $100.

Comment

Penalties and interest are not charged on small amounts. In the current legislation, the EMS penalty is not imposed if the unpaid amount is **less than $100**. The legislation should be amended so that the penalty is not charged on amounts of **$100 or less** to ensure that it is consistent with other similar provisions.

Recommendation

That the submission be accepted.

Issue: Imposition of penalties and interest on amounts of $100 or less

Submission
(Matter raised by officials)

Section 183F should be amended to apply on a tax-type basis rather than to the total amount outstanding.

Comment

Under section 183F, small amounts of penalties and interest are not charged. Officials also consider that the provision should be amended to apply on a tax-type basis rather than the total amount outstanding. This would still reflect the intention of the provision, which is that small amounts of penalties and interest are not charged but ensure that separate taxes are considered separately. Similar amendments should also be made to the late payment penalty and use-of-money interest provisions.

Recommendation

That the submission be accepted.

Issue: Removing tax agent status should not be a disputable decision

Submission
(Matter raised by officials)

The decision to remove a tax agent from the list of tax agents or not to list a person as a tax agent should not be a disputable decision.

Comment

Following an amendment in the Taxation (Business Taxation and Remedial Matters) Act 2007, Inland Revenue must keep a list of tax agents. Inland Revenue has the ability to remove a person from the list or not list a person, if it is concerned that continuing to list the person as a tax agent would adversely affect the integrity of the tax system.

Operational guidelines set out the circumstances in which the discretion might be exercised. Before making a decision not to list or remove a person from the list, Inland Revenue is required to give a tax agent notice of the intention to revoke the agent's status and give reasons for the intended revocation. The agent will be given a 30-day period (or a shorter period if Inland Revenue is concerned that there is a substantial risk to the revenue and a longer period if such a period is appropriate in the circumstances) in which to resolve the matters raised in the notice of intended revocation.

Because sufficient time is allowed for the affected agent to comment and for those comments to be taken into account, officials consider that the decision of the Commissioner should not be a disputable decision. Tax agents will still be able to judicially review Inland Revenue's decision.

Recommendation

That the submission be accepted.

Issue: No new due date for default assessments

Submission

(Matter raised by officials)

The requirement to set a new due date should be amended so that it does not apply when the Commissioner makes a default assessment.

Comment

The Taxation (Business Taxation and Remedial Matters) Act 2007 amended section 142A to allow a new due date to be set by the Commissioner, regardless of whether a return has been filed. The amendment ensures that both late payment penalties and shortfall penalties are not imposed if the taxpayer has not filed a return. For example, before the amendment to section 142A, if a return had not been filed and some time later Inland Revenue determined that there was income and a return was necessary, late payment penalties would apply from the original due date for payment with a possible shortfall penalty also imposed.

As currently drafted, the amendment also applies if the Commissioner makes a default assessment. A default assessment is an estimation of tax liability and remains in place until the taxpayer files a return. A default assessment is likely to present a slightly larger debt than a self-assessment, and thereby encourage taxpayers to file returns.

Given that a default assessment is made when there is a concern about non-compliance and a taxpayer has not filed a return, and that the assessment is reversed when the return is filed, officials consider it appropriate that a new due date is not set when a default assessment is made. When the return is filed, a new due date will be set.

Recommendation

That the submission be accepted.

KiwiSaver remedial amendments

REMOVAL OF THE EMPLOYER TAX CREDIT ANNUAL SQUARE-UP

Submission
(Matter raised by officials)

The employer tax credit annual square-up contained in the bill should not proceed.

Comment

Employer tax credits were removed by the Taxation (Urgent Measures and Annual Rates) Act 2008. The proposed square-up would therefore only be applicable for the 2008–09 tax year.

The compliance and administration costs to employers and Inland Revenue do not justify a one-off square-up. Many employers do not have payroll software and it would be necessary to perform the complicated calculations manually. The small amounts involved in most square-up payments, particularly for small businesses, may not make it worth claiming.

A number of employer agencies have been consulted. They acknowledged that the square-up is likely to be too small to worry about claiming given the compliance costs involved and would be more trouble than it is worth for small to medium businesses and those without automatic payroll software.

Recommendation

That the submission be accepted.

Issue: Calculation of the employer tax credit

Clauses 258–261

Submission
(67 – New Zealand Institute of Chartered Accountants, 68A – Corporate Taxpayers Group)

The legislation should be amended to relate the calculation of the employer tax credit to the employer's contributions actually made, subject to a maximum of $1,042.86.

A taxpayer with fortnightly pay days should have the ability to elect to merely claim $20 per week per employee based on the number of payroll days that fall within that month.

Comment

Employer tax credits were removed by the Taxation (Urgent Measures and Annual Rates) Act 2008, so the submission is no longer relevant.

Recommendation

That the submission be declined.

Submission
(79 – Michael Chamberlain)

The employer tax credit (ETC) annual square-up should proceed. The formula for calculating the employer tax credit in MK 10 of the Income Tax Act 2007 results in an under-calculation of the correct amount of ETC. The amount of a square-up may be significant and therefore worthwhile for an employer to claim.

Comment

The submission raises concerns about whether an employer would receive the full amount of the employer tax credit. Inland Revenue's interpretation of current legislation is that the calculation in section MK 10 correctly delivers the vast majority of the ETC to employers. This addresses the submission's concerns.

Recommendation

That the submission be noted.

CLAIMING ENTITLEMENT TO THE EMPLOYER TAX CREDIT ANNUAL SQUARE-UP

Clause 260

Submission
(67 – New Zealand Institute of Chartered Accountants)

Proposed section MK 12B(b) requiring that employers must claim their entitlement to any employer tax credit (ETC) square-up should be removed.

Comment

Employer tax credits were removed by the Taxation (Urgent Measures and Annual Rates) Act 2008, so any ETC square-up would only be applicable for the 2008–09 tax year. As a result of the administration and compliance costs involved, officials are recommending that the square-up not proceed. If this recommendation is accepted, the submission will no longer be relevant.

Recommendation

That the submission be declined.

CREDITABLE MEMBERSHIP – COMMISSIONER'S DISCRETION TO BACKDATE MEMBER TAX CREDIT

Clauses 408(28) and 613(4)

Submission
(67 – New Zealand Institute of Chartered Accountants)

The Commissioner should have to backdate creditable membership if there is a delay in employee deductions being made, rather than the backdate being discretionary.

Comment

The proposal requires an employee to request that Inland Revenue nominates a start date, if the date for their creditable membership has been delayed for reasons outside their control. For administrative reasons, this backdating should be subject to the exercise of the Commissioner's discretion and is also necessary as a safeguard against abusive practices.

Recommendation

That the submission be declined.

REPEAL OF SECTION 13 (EMPLOYMENT IN SCHOOLS) – APPLICATION DATE

Clause 531

Submission
(63 – Chapman Tripp)

The repeal of section 13 should take effect from when the amending legislation is enacted and not be backdated to 1 October 2008.

Comment

Backdating the repeal of section 13 to 1 October 2008 would adversely affect Ministry of Education employees who were automatically enrolled after that date as a result of changing from one state or state-integrated school to another. When the repeal takes effect, any automatic enrolments during the backdating period would be retrospectively invalidated. Subsequently, the legal position – such as an employee's membership in a KiwiSaver scheme – is unclear. If the repeal of section 13 is not backdated but instead takes effect from when the legislation is enacted, this legal uncertainty would be avoided.

Recommendation

That the submission be accepted.

EXEMPT EMPLOYER PROVISIONS – SUNSET CLAUSE

Clause 532

Submission
(67 – New Zealand Institute of Chartered Accountants)

There should be no general limitation on superannuation schemes (clause 532) as this restricts genuine employers from setting up schemes with possibly better benefits for employees. Rather, legislation should target specific employers who abuse the rules.

Comment

The proposed provision does not impose a general limitation on employers setting up superannuation schemes for their employees. The amendment is to deal with a concern that a number of employers are establishing superannuation schemes that qualify as an exempt employer scheme for the apparent purpose of avoiding the automatic enrolment rules of KiwiSaver. Under the KiwiSaver Act an employer is not required to automatically enrol new employees into KiwiSaver if they are registered as an exempt employer. This provision was introduced to reduce the compliance costs on employers that already had superannuation schemes in place that met the requirements of the exempt employer rules when KiwiSaver was introduced.

This undermines the policy intent of the automatic enrolment rules of KiwiSaver and the rationale for the exempt employer rules.

Recommendation

That the submission be declined.

REFUNDS OF EMPLOYER CONTRIBUTIONS IF EMPLOYEE OPTS OUT

Clause 535

Submission
(62 – Minter Ellison Rudd Watts)

The amendment to section 100 of the KiwiSaver Act 2006 proposed in clause 535 is unnecessary, as amendments to the Employment Relations Act 2000 cover any situation in which the proposed amendment to section 100 may apply.

Comment

The proposed amendment to section 100 of the KiwiSaver Act requires Inland Revenue to refund to the employer any compulsory employer contributions if an employee opts out of KiwiSaver. Under this proposal, the refund cannot be used to offset tax debt. Section 101B of the KiwiSaver Act specifies that compulsory employer contributions may be paid in addition to an employee's salary or wage. To avoid the possibility of reducing an employee's total remuneration, any contributions must be refunded by Inland Revenue to the employer so they can be passed on to the employee. Clause 535 will therefore bring section 100 into line with the amended section 101B.

Recommendation

That the submission be declined.

Submission
(67 – New Zealand Institute of Chartered Accountants)

Clause 535 amending section 100 of the KiwiSaver Act should be deleted.

Comment

As compulsory employer contributions may form part of an employee's total remuneration package, if an employee opts out of KiwiSaver such contributions must be returned by Inland Revenue to the employer so they are available to be refunded to the employee. The ability to use a contribution to offset tax debt prevents the employer from using it to refund the employee.

Recommendation

That the submission be declined.

SECTION 101FB – REFERENCE TO SECTION 34

Clause 538

Submission
(67 – New Zealand Institute of Chartered Accountants)

The cross-reference in proposed section 101FB(1)(b) should be to section 34(1) not section 34(2).

Comment

Officials agree.

Recommendation

That the submission be accepted.

GRACE PERIOD FOR EMPLOYERS – OPTING IN AND AUTOMATIC ENROLMENT

Clause 538

Submission
(67 – New Zealand Institute of Chartered Accountants)

Section 101FB(1)(b) should be deleted. Section 101FB(1)(a) talks about automatic enrolment, whereas section 101FB(1)(b) is in relation to opting in. Therefore, there cannot be a circumstance where both apply.

Comment

A preferred solution would be to make paragraphs (a) and (b) of section 101FB(1) alternatives rather than conjunctive. That would cover both automatic enrolment and opting in directly to a KiwiSaver scheme provider, whereas the submission's proposal would cover only automatic enrolment. An employer should not have to face unlimited liability to back-pay compulsory employer contributions if an employee who is not eligible for automatic enrolment opts in directly through a provider and the employer is not informed.

Recommendation

That the submission be accepted, subject to officials' comments.

SECTION 101FB – GRACE PERIOD FOR EMPLOYERS

Clause 538

Submission
(67 – New Zealand Institute of Chartered Accountants)

Section 101FB should be deleted. The employee should not be disadvantaged if other parties such as the employer and Inland Revenue make errors concerning automatic enrolment and compulsory employer contributions.

Comment

Section 101FB limits an employer's liability to back-pay any unpaid compulsory employer contributions in the event of their non-compliance with the automatic enrolment provisions of KiwiSaver. Requiring employers to back-pay all unpaid compulsory employer contributions is not considered by officials to be a fair option, particularly because employees who are not subject to automatic enrolment can opt in at any time. The proposed grace period strikes a balance between the employer's obligation to automatically enrol (and make employer contributions) and the employee's obligation to make contributions from salary or wages. Furthermore, an employer's open-ended liability under the status quo is administratively complex. A grace period would be simpler to administer while maintaining an incentive for employers to comply with their KiwiSaver obligations.

Recommendation

That the submission be declined.

SECTION 101FC MINIMUM AMOUNTS APPLYING TO "HYBRID" SCHEMES

Clause 538

Submission
(10 – New Zealand Society of Actuaries)

Section 101FC should be amended so that it also applies for contributions to "hybrid" schemes.

Comment

New section 101FC introduces a rule so that an employer may not be required to make a top-up contribution if an employee is a member of a KiwiSaver scheme and an existing employer superannuation fund. As long as the amount of the contributions to the existing employer fund is calculated using the same compulsory employer contribution rate, there is no additional compulsory employer contribution payable (even if the dollar amounts are uneven as a result of a different salary basis being used).

As currently drafted, the provision applies only to "other contributions" that meet the requirements of section 101D(5)(b). The provision should be extended to include "hybrid" scheme amounts as such amounts can be deducted from the amount of compulsory employer contributions required to be paid.

Recommendation

That the submission be accepted.

SECTION 101FC MINIMUM CONTRIBUTION RATE

Clause 538

Submission
(10 – New Zealand Society of Actuaries)

Proposed section 101FC should be amended to provide that employers are not required to pay a top-up if the amount of "other contributions" is calculated using a percentage at least as great as the compulsory employer contribution rate.

Comment

Section 101FC requires that the amount of other contributions be calculated at the same percentage as the relevant compulsory employer contribution rate in section 101D(4). This proposal will also apply to those employers contributing at a higher rate than the required compulsory employer contribution rate, so these employers do not have to pay a top-up if the requisite conditions are met.

Recommendation

That the submission be accepted.

SECTION 101FC – REPLACE BY AMENDED FORMULA IN SECTION 101D(1)

Clause 538

Submission
(62 – Minter Ellison Rudd Watts)

Proposed section 101FC should be removed, and the calculation of compulsory employer contributions in section 101D(1) be amended to incorporate its function.

Comment

Officials acknowledge that the formula proposed in the submission would achieve the same result as section 101FC. However, it would complicate the calculation of the amount of a compulsory employer contribution in section 101D for those employers who do not make other contributions.

Recommendation

That the submission be declined.

MORTGAGE DIVERSION FIXED DOLLAR AMOUNT – APPLICATION DATE

Clause 541

Submission
(67 – New Zealand Institute of Chartered Accountants)

Clause 541 should apply from 16 October 2008. There were serious problems in implementing the mortgage diversion facility, which resulted in the KiwiSaver Amendment Regulations (No 2) to address those issues. Those regulations had effect from 16 October 2008, and therefore the application date of clause 541 should be the same.

Comment

The current application date of 1 July 2008 does not give rise to any problems.

Recommendation

That the submission be declined.

MINIMUM CONTRIBUTION RATES FOR EXEMPT EMPLOYERS WITH COMPLYING SUPERANNUATION FUNDS

Submission
(Matter raised by officials)

Section 64(1) of the KiwiSaver Act 2006 concerning contribution rates should be amended to apply to exempt employers with complying superannuation funds.

Comment

The Taxation (Urgent Measures and Annual Rates) Act 2008 amended the contribution rate rules in section 64 of the KiwiSaver Act. It is not clear how the amended provision applies in relation to exempt employers with complying superannuation funds. In particular, the contribution rates in the amended section may not necessarily apply to employees of exempt employers who do not belong to KiwiSaver schemes. Officials consider that section 64 should be amended to ensure that the minimum contribution rates apply to exempt employers with complying superannuation funds.

Recommendation

That the submission be accepted.

DEFINITION OF OTHER CONTRIBUTIONS – REMOVAL OF SECTION 101D(5)(A)

Submission
(62 – Minter Ellison Rudd Watts)

Section 101D(5)(a) of the KiwiSaver Act should be removed from the definition of "other contributions".

Comment

Officials do not consider there are any problems caused by the current drafting, and so no changes are necessary.

Recommendation

That the submission be declined.

OFFSET OF "HYBRID" SCHEME CONTRIBUTIONS AGAINST COMPULSORY EMPLOYER CONTRIBUTIONS

Submission

(10 – New Zealand Society of Actuaries)

The hybrid schemes amount in section 101D(6) of the KiwiSaver Act should be amended to add an allowance for the amount of employer superannuation contribution tax payable on this employer contribution.

Comment

Under the KiwiSaver Act an employer who is contributing to an employee's existing superannuation scheme can offset the amount of those contributions against the amount of compulsory employer contributions to KiwiSaver. The amount that can be offset is the amount the employer is required to pay, including the amount of employer superannuation contribution tax that is payable on such contributions. As the rules applying to hybrid scheme amounts do not refer to an employer's superannuation contribution, the legislation does not provide any certainty that such amounts are inclusive of the amount of employer superannuation contribution tax payable. The policy intent is that it should and this is reflected in Inland Revenue's *Tax Information Bulletin* (April 2008) on the matter.

Recommendation

That the submission be accepted.

MORTGAGE DIVERSION – USE OF PAST CONTRIBUTIONS

Submission
(Matter raised by officials)

Mortgage diversion should apply only to contributions made after a person joins the mortgage diversion facility and not to a member's previous contributions as well.

Comment

Currently, the wording of section 229 of the KiwiSaver Act could be interpreted as allowing up to half of a member's total KiwiSaver funds to be diverted, including all past contributions. It is the policy intent that past contributions cannot be used under the mortgage diversion facility and the legislation should be clarified accordingly.

Recommendation

That the submission be accepted.

FIRST HOME WITHDRAWAL FOR MEMBERS THAT HAVE MADE A CONTRIBUTION VIA INLAND REVENUE

Submission
(Matter raised by officials)

Schedule 1, clause 8(1) of the KiwiSaver scheme rules should be amended to clarify that the provision applies to a member at the earlier of satisfying either paragraph (a) or (b), provided that the member also satisfies the criteria in paragraph (c).

Comment

Schedule 1, clause 8 of the KiwiSaver scheme rules sets out the requirements for withdrawing funds for the purpose of purchasing a first home.

The current wording in clause 8(1) creates confusion with the use of "a member", "any other member" and "any member", and the use of "and" linking each paragraph. With this wording, if a person joins KiwiSaver directly through a scheme provider and contributes only via the provider, no matter how long they have been a member as soon as they send a contribution via Inland Revenue, the three-year time period for first home withdrawal restarts from the date the contribution was received by Inland Revenue.

Officials recommend that, provided a member has not already made a withdrawal under clause 8, eligibility to withdraw funds under clause 8 applies to the earlier of paragraph (a) or (b).

Recommendation

That the submission be accepted.

KIWISAVER SCHEME RULES – WITHDRAWAL OF FUNDS ON DEATH

Submission
(63 – Chapman Tripp)

Clause 9 of the KiwiSaver scheme rules should be amended to stipulate that a deceased member's balance must be paid either in the manner currently prescribed or, where the requisite conditions are met, in accordance with section 65(2) of the Administration Act 1969. Such an amendment should be considered to have taken effect from 1 July 2007.

Comment

Current law requires that probate or letters of administration be presented to trustees of a KiwiSaver scheme before a deceased member's funds can be withdrawn. This results in additional compliance costs for the member's personal representative as a result of legal expenses and delays associated with attaining probate or letters of administration.

The accumulated funds in a KiwiSaver scheme should also be able to be paid out in a manner similar to that set out in section 65 of the Administration Act 1969 for certain superannuation funds. That is, trustees of a superannuation fund can pay a prescribed amount (currently not exceeding $11,000) from that fund direct to a named person without awaiting probate or letters of administration. This would be in addition to the current probate or letters of administration procedures.

Recommendation

That the submission be accepted.

SCOPE OF THE EMPLOYER SUPERANNUATION CONTRIBUTION TAX EXEMPTION

Submission
(Matter raised by officials)

The scope of the employer superannuation contribution tax exemption amended by the Taxation (Urgent Measures and Annual Rates) Act 2008 should be clarified.

Comment

This is a clarifying amendment to ensure that all employer contributions to KiwiSaver and complying superannuation funds, for members aged between 18 and 65, that were eligible to be exempt from ESCT up to the matching level of 2 percent before 1 April 2009 continue to be exempt from ESCT on and after 1 April 2009.

Recommendation

That the submission be accepted.

DEFINITION OF "MEMBER CREDIT CONTRIBUTION"

Submission
(Matter raised by officials)

The definition of "member credit contribution" in section YA 1 of the Income Tax Act 2007 (and in section OB 1 of the Income Tax Act 2004) should be amended to exclude the $1,000 kick-start payment and the member tax credit.

Comment

In determining the amount of the member tax credit payable to a member, section MK 4 of the Income Tax Act 2007 takes into account the total yearly amount of a person's member credit contributions for all of their KiwiSaver scheme amounts and complying superannuation fund amounts. The definition of "member credit contribution" in section YA 1 is an amount of a superannuation contribution to a KiwiSaver scheme or complying superannuation fund, excluding employer contributions and contributions diverted under the mortgage diversion facility. The $1,000 kick-start payment and the member tax credit have not been excluded from this definition. The policy intent is that they should be excluded, otherwise members can "double-dip" by including these Crown contributions in the calculation of the member tax credit.

Officials therefore recommend that an amendment be made to exclude the $1,000 kick-start payment and member tax credit from the definition of "member credit contribution".

Recommendation

That the submission be accepted.

EMPLOYMENT RELATIONS (BREAKS, INFANT FEEDING, AND OTHER MATTERS) ACT 2008 – KIWISAVER-RELATED AMENDMENTS

Submission
(17 – Association of Superannuation Funds of New Zealand)

Provisions in the Employment Relations (Breaks, Infant Feeding, and Other Matters) Act 2008 – which make it grounds for personal grievance if an employee is adversely affected because they are a member of KiwiSaver scheme – should be amended to limit the scope of these provisions to situations where an employee's salary or wages are reduced because of compulsory employer contributions.

Comment

These provisions were repealed in the Employment Relations Amendment Act 2008. In addition, section 101B of the KiwiSaver Act was amended by the Taxation (Urgent Measures and Annual Rates) Act 2008 to ensure that compulsory employer contributions are in addition to an employee's salary or wages when an employee joins KiwiSaver or changes employment. However, employers and employees have the ability as part of good faith negotiations to contract out of this general requirement.

Recommendation

That the submission be declined.

Miscellaneous remedials

RWT EXEMPTION FOR TOKELAU AND NIUE INTERNATIONAL TRUST FUNDS

Submission
(Matter raised by officials)

Section 32E(2) of the Tax Administration Act 1994 should be amended to include the Tokelau International Trust Fund and the Niue International Trust Fund so their trust income is not subject to resident withholding tax.

Comment

The Tokelau and Niue international trust funds were established by the New Zealand government in 2000 and 2004 respectively and trust deeds for the trust funds were subsequently executed, with the parties to the trust deeds agreeing to ensure that the trust funds would be exempt from all direct taxation.

Amendments were made to relevant tax legislation to ensure that the contributions received, income earned and distributions made by the Tokelau and Niue international trust funds would be exempt from taxation.

However, resident withholding tax (RWT) has continued to be deducted from interest income earned by the funds in New Zealand. This is because a bank is obliged to withhold RWT unless Inland Revenue issues a certificate of exemption from RWT to the trust fund and the bank establishes that the trust fund holds the certificate. To be granted an exemption certificate, the trust funds must be included in the list in section 32E(2) of the Tax Administration Act 1994. By an oversight, section 32E(2) was not amended to include the Tokelau and Niue International Trust Funds.

Officials therefore recommend an amendment be made so that the Tokelau International Trust Fund and the Niue International Trust Fund are listed in section 32E(2) of the Tax Administration Act 1994.

Recommendation

That the submission be accepted.

GIFT DUTY – GENERAL POWER OF APPOINTMENT

Submission
(Matter raised by officials)

The definition of "general power of appointment" should be reinserted in the Estate and Gift Duties Act 1968.

Comment

The Estate Duty Repeal Act 1999 repealed from the Estate and Gift Duties Act 1968 (EGDA) a number of definitions that were no longer relevant since estate duty had been repealed. One of the definitions that was repealed was "general power of appointment".

This term is, however, used in paragraph (e) of the definition of "disposition of property" in section 2(2) of the EGDA and is relevant for gift duty purposes. It was not intended in 1999 to repeal any provisions that apply for gift duty purposes.

Officials therefore recommend that the definition of "general power of appointment" be reinserted in the EGDA.

Recommendation

That the submission be accepted.

VALUE OF ACCOMMODATION PROVIDED BY EMPLOYER

Submissions
(35 – PricewaterhouseCoopers, 53 – Ernst & Young)

Section CX 28 of the Income Tax Act 2007 should be amended to ensure that the provision of accommodation by an employer is not subject to FBT.

Section RD 5(8) should refer to section CE 1(c) instead of section CE 1(1)(c).

Comment

As the provision of accommodation by an employer to an employee is treated as salary or wages and subject to income tax, it should not be subject to FBT as well.

The reference to section CE 1(1)(c) is correct.

Recommendation

That the submission on CX 28 be accepted.

That the submission amending the reference to section CE 1(1)(c) be declined.

CONTRACTORS PROVIDING SERVICES TO THE AGRICULTURE, HORTICULTURE AND VITICULTURE INDUSTRIES

Submission
(Matter raised by officials)

Changes are proposed to the schedular payments rules (formerly withholding payments). The current wording and scope of "horticultural contract work" in schedule 4, Part C of the Income Tax Act 2007, which deals with tax evasion by contractors who provide services to the agriculture, horticulture and viticulture industries, is unclear and should be amended.

Comment

Officials propose that the term "horticultural contract work" be changed to "cultivation contract work" and include – payments by growers in the agriculture, horticulture and viticulture industries to contractors that are substantially for the supply of labour, and payments by vegetable growers that are substantially for the supply of labour. Officials also propose that this definition specifically exclude payments to pack houses and management entities.

Currently, the term "horticultural contract work" could catch contractors with a high capital component, or entities such as post-harvest facilities. This was not the intent of the rules as these entities are generally compliant and do not pose a threat to the revenue. In contrast, vegetable growers are not currently included within the definition and there is evidence of non-compliance within this sector. The new "cultivation contract work" definition that is proposed will ensure that those intended to be caught by the schedular payments rules are included, while those who are not, are excluded. The changes are supported by the industries concerned and will give them certainty while aligning current administrative practices with the law.

Officials propose that these changes apply from 1 April 2010.

Recommendation

That the submission be accepted.

THRESHOLD FOR ATTRIBUTION OF PERSONAL SERVICES INCOME

Submission
(67 – New Zealand Institute of Chartered Accountants)

Section GB 27(2)(c) attributes income from personal services to the individual performing the services in certain circumstances. The bill proposes to raise the threshold at which the rules apply to $70,000 in 2009, $75,000 in 2010, and to $80,000 in 2011. However, the amendments relating to 2010 and 2011 should not apply.

Comment

The threshold at which the personal services attribution rules apply is intended to be the same as the threshold at which the top tax rate begins to apply. As a result of the Taxation (Urgent Measures and Annual Rates) Act, the threshold is not changing in 2010 or 2011. Accordingly, the threshold at which the personal services attribution rules apply should be $70,000.

Recommendation

That the submission be accepted.

NON-RESIDENT ENTERTAINER

Clause 386

Submission
(35 – PricewaterhouseCoopers)

Section RD 19(2) should not be repealed as it confirms that the income tax liability of a non-resident entertainer should equal the amount of tax withheld, if the only amount of income derived by the entertainer in a tax year is from a schedular payment.

Comment

The policy for the taxation of a person whose only New Zealand-sourced income is derived for services as a non-resident entertainer is that the person may choose to either file a return of income and claim expenses, or elect to be non-filing taxpayer.

Section RD 19(2) as currently drafted prevents a non-resident entertainer from electing to file an annual return of income.

The repeal of section RD 19(2) is linked to the amendment to the definition of non-filing taxpayer. Together, these amendments are intended to ensure that a non-resident entertainer, whose only New Zealand-sourced income is for services provided as a non-resident entertainer, is permitted to elect to be a non-filing taxpayer.

Under the Income Tax Act 2007, the income tax liability for a non-filing taxpayer is equal to the amount of tax withheld from the income of the person. That is the outcome sought by the submission and it is therefore unnecessary to retain section RD 19(2).

Recommendation

The submission be declined.

TAX RELIEF ON REDUNDANCY PAYMENTS SHOULD BE MADE AVAILABLE TO PERSONS APPOINTED A DIRECTOR FOR ADMINISTRATIVE/SECRETARIAL PURPOSES

Submission
(67 – New Zealand Institute of Chartered Accountants)

The redundancy rebate should be made available to persons (not being shareholders) who are appointed a director of a company for administrative/secretarial purposes only. The amendment should be retrospective from 1 December 2006.

Comment

The redundancy tax credit (rebate) provisions include certain exclusions to mitigate the risks associated with the availability of tax relief for redundancy payments. One exclusion applies to company directors, who are often in a position to influence both redundancy contracts and the event of redundancy.

In the time available, we have not fully reconsidered the matter. However, our view is still that the line that was drawn is appropriate. As with any hard line, there may be the odd person who is disadvantaged, however, we have integrity concerns if the line were to be moved.

Recommendation

That the submission be declined.

ADDITIONS TO THE LIST OF DEPRECIABLE LAND IMPROVEMENTS

Clause 423

Submissions
(35 – PricewaterhouseCoopers, 67 – New Zealand Institute of Chartered Accountants)

Clause 423(2) should be amended to include indoor land improvements. An alternative is that indoor sports grounds with purpose-built surfaces should be depreciated separate from the building under the "building fit-out" asset category.

Comment

The provisions will enable taxpayers to claim depreciation deductions for purpose-built surfaces if the surface is a land improvement that previously did not meet the definition of "depreciable land improvement".

Officials consider that an indoor purpose-built surface will generally form part of a building and buildings that are already depreciable land improvements. With respect to the alternative submission, the Commissioner already has the power to determine whether a type of indoor surface is a separate item of depreciable property (from the building) and can, where appropriate, allow a separate depreciation rate. For these reasons we do not support the submissions.

Recommendation

That the submissions be declined.

Submission
(67 – New Zealand Institute of Chartered Accountants)

The term "grounds" should be replaced by "facilities".

Comment

The term "facilities" is a broader term and it may better cater for development of the law in this area.

Recommendation

That the submission be accepted.

DRAFTING ISSUES

Income Tax Act

In 2007, around 3,500 pages of the New Zealand tax legislation were enacted. This legislation included the Income Tax Act 2007. At 2,800 pages, this Act represented the fourth and final stage of the project begun in 1994 to rewrite the income tax law in plain language style.

As an inevitable consequence of the rewriting process there has been a temporary but large increase in the number of remedial amendments necessary to maintain the tax law in sound working order. This increase is in part because very few remedial amendments have been enacted since December 2007. Of the remedial amendments proposed below, approximately 115 are typically of a minor nature and intended to correct matters such as incorrect numbering and cross-references, printing errors, incorrect terminology used, punctuation issues, and omitted words.

Other amendments are of a less clerical nature, and arise both as rewrite issues, including submissions to the Rewrite Advisory Panel, and as clarification of policy in business as usual drafting. These 160 or so amendments affect provisions in the Income Tax Act 2007, Income Tax Act 2004, Tax Administration Act 1994, KiwiSaver Act 2006, Stamp and Cheque Duties Act among others. Of these, 30 issues were referred to the Rewrite Advisory Panel for resolution.

In addition to the 119 remedial amendments included in the bill at introduction, officials recommend that the Committee proposes the inclusion of about 150 further remedial amendments, the need for which has been discovered since introduction of this bill, and which include the items referred to the Rewrite Advisory Panel.

Amending Acts passed after this bill introduced

Several Acts that amend tax Acts have been enacted since the bill was introduced to Parliament. They include the Climate Change Response (Emissions Trading) Amendment Act 2008, the Taxation (Urgent Measures and Annual Rates) Act 2008, and the Taxation (Business Tax Measures) Act 2009. Numbering and cross-references in the bill need to be adjusted to take into account the changes made by those Acts. Officials recommend that the Committee proposes the inclusion of such amendments.

The schedule of amendments follows.

Schedule of remedial amendments

Recommendation

That the following submissions be accepted.

Section	Description of issue / proposed resolution	Comment
INCOME TAX ACT 2007		
BE 1	Replace "PAYE payments" with "PAYE income payment" in all places it appears, including defined terms list. In subsection (5) replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Improves consistency of language. Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
CC 8B	Insert section CC 8B.	A clarification arising from a recommendation of the Rewrite Advisory Panel. This amendment provides that disposals and redemptions of a commercial bill is income of a non-resident if the disposal or redemption is sourced in New Zealand and the non-resident is not subject to the financial arrangement rules in relation to the commercial bill.
CD 5	Insert subsection (2B) to refer to cancellation or repurchase of shares.	A clarification arising from a recommendation of the Rewrite Advisory Panel. The section now provides that consideration paid by a company to a shareholder because of a cancellation of shares or a repurchase of a company's shares is a transfer of value.
CD 25(4)	Insert reference to "amount distributed on acquisition".	Corrects an unintended change in law recommended by the Rewrite Advisory Panel. This amendment clarifies that ASC should only be reduced by the amount paid for the shares held as treasury stock for more than 12 months or cancelled within 12 months (subject to the amount paid for the shares not exceeding the ASC per share calculated under the ordering rule).
CE 1	Insert in new subsection (2), the words "living premises".	This amendment clarifies that a benefit provided to an employee by way of accommodation includes a wide range of living arrangements provided by the employer.
CS 1	In subsection (1)(a)(i), replace "employer's superannuation contribution" with "employer's cash superannuation contribution". Replace subsection (7)(b).	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
CS 2	In subsections (2), (3) and (10), replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
CS 6(1)(d)	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").

Section	Description of issue / proposed resolution	Comment
CS 7(2)–(5)	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
CW 9	Amend section CW 9 to ensure that it does not exempt foreign dividends derived from non-attributing portfolio FIFs.	This corrects an unintended change in law in the 2007 Act relating to the international tax reforms for certain types of dividends.
CX 13(2)	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
CX 28	Replace the term “board” with the term “accommodation”.	This amendment provides drafting consistency with the amendment to section CE 1 for benefits provided by way of accommodation to employees.
DB 3(4)	Insert in subsection (4) that section DB 3 overrides the capital limitation in section DA 2.	A clarification arising from a recommendation of the Rewrite Advisory Panel that improves readability.
DB 53(1)	Amend subsection (1) to provide that paragraphs (1)(a) and (1)(b) are alternatives.	A clarification arising from minor items referred to the Rewrite Advisory Panel. Corrects an unintended change in law.
DC 7	In subsections (1) and (1B), replace “contribution” with “superannuation contribution”.	Improves readability.
DC 13(5)(d)	Replace subsection (5)(d).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. This amendment clarifies that the prohibition against dealing with dividends arising from an employee share purchase scheme applies to the trustee of the scheme.
DS 4(5)	Replace “subpart YB (Associated persons and nominees)” with “the provisions of subpart YB (Associated persons and nominees)”.	Improves readability.
DT 2(1)(b)	Replace “subpart YB (Associated persons and nominees)” with “the provisions of subpart YB (Associated persons and nominees)”.	Improves readability.
DU 12(3)(b)	Replace subsection (3)(b).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. The amendment ensures that the provision refers to the aggregate amount of exploration and development expenditure incurred by the mining company reduced by the current year’s exploration and development expenditures.
EE 21(5) to (8)	Amend section EE 21 to clarify that its application is restricted to the pool of depreciable property and that it does not apply to any individual item in the pool of depreciable property.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
EE 55	Remove reference to “items”, consequential to the amendment to section EE 21(5) to (8).	This amendment provides drafting consistency with the correction of an unintended change in law in section EE 21 (see previous item), as recommended by the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
EF 2	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation contribution").
EW 31(9)(a)	Amend subsection (9)(a) to ensure that the base price adjustment calculation for a cash basis holder of a financial arrangement refers to all income derived under the financial arrangement. This amendment ensures the cash basis holder includes cash basis income in the base price adjustment calculation.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
EX 1(2)(a)	Replace "foreign investment vehicle" with "foreign PIE equivalent".	Improves readability.
EX 32(9)(d)	Replace "investors by the trust" with "investors to the trust".	Corrects a drafting error.
EX 65(5)(b)	Replace "sections EX 34 to EX 43" with "sections EX 31 to EX 43".	Corrects cross-references.
EY 11	In subsections (7) and (11), replace "contribution" with "superannuation contribution".	Improves readability.
EZ 38(6)	Replace "EZ 41(8)(ii)" with "subsection (8)(ii)".	Corrects a cross-reference.
FA 2	Consolidate subsections (3) and (4) in new subsection (4). In subsection (6), insert an exclusion for convertible notes.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
FB 9	Clarify that the application of section FB 9 is restricted to financial arrangements that come within the criteria set out in section EW 10(6).	A clarification arising from minor items referred to the Rewrite Advisory Panel.
FC 4	Amend section FC 4 to clarify that the relief under the provision applies if a charity is to be a beneficiary of the deceased person's estate. Amend section FC 4 to ensure that the rollover relief does not apply to a transmission of property of an estate to an administrator or executor of the estate.	The clarification regarding charities is a clarification arising from minor items referred to the Rewrite Advisory Panel. The amendment to the scope of the rollover relief is a remedial measure to restore the original policy intention. This amendment is prospective.
FE 4	Amend section FE 4 to correct the cross-referencing to operative provisions and to consequentially clarify the definition of "reporting bank".	Corrects cross-references and improves readability. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
FE 6(3)(a)	After sections "DB 6 to DB 8" insert "(which relate to deductions for interest expenditure)".	Improves readability. A clarification arising from minor items referred to the Rewrite Advisory Panel.
FE 36(3)	Amend subsection (3) to clarify where the requirements are not conjunctive.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
FM 31	Amend section FM 31 to restore the 2004 Act's tax treatment for grandparented consolidated companies.	A clarification arising from minor items referred to in the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
FN 8	Amend section FN 8 to clarify that a New Zealand-resident company that is a member of a trans-Tasman imputation group is deemed to be part of a resident imputation subgroup.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
FO 16	Insert subsection to clarify that the amalgamating company does not derive income or have a deduction on transfers of depreciable property in a resident's restricted amalgamation.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
GB 32	In compare note, replace "GC 15(1)-(3)" with "GC 15", and correspondingly amend schedule 52.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
HA 9(2)	Replace "order in Council" with "Order in Council".	Corrects a typographical error.
HA 11(5)	In subsection (5), clarify that it has the same outcome as the corresponding provision in the 2004 Act.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
HA 16	In section HA 16, clarify that it has the same outcome as the corresponding provision in the 2004 Act.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
HC 7(2)	Replace "section HC 33" with "section HC 35".	Corrects a cross-reference.
HC 27	Amend section HC 27 to ensure that a person who satisfies the requirements of the section cannot be a settlor.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
HC 35(4)(a)	Restore the threshold that applied in the 2004 Act.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
HL 29(11)(a)(i)	Replace "late" with "later".	Corrects a drafting error arising from minor items referred to the Rewrite Advisory Panel.
HR 8	Amend subsections (1)–(3) to clarify that a transitional resident is not treated as a non-resident generally for the purposes of the Act. Amend subsection (4) to permit a person to choose not to be a transitional resident, and also insert subsection (7) to provide for this election mechanism.	A clarification arising from minor items referred to the Rewrite Advisory Panel. Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
IA 7(5)	Amend subsection (5) to clarify that the ring-fencing provisions in subpart IQ that apply to an attributed CFC net loss do not include the provisions that determine the surplus amount of an attributed CFC net loss referred to in section IQ 2(3).	A clarification arising from minor items referred to the Rewrite Advisory Panel.
IA 8(1)(a)	Repeal subsection (1)(a), non-resident entertainer.	A clarification arising from minor items referred to the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
ID 3	Replace subsection (1) to clarify that, for the purposes of the section, a loss company that is a member of a consolidated group and the companies in the consolidated group must satisfy the commonality rules during the period the loss company meets the requirements to carry the loss forward.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
IP 1(1)(a)	Amend section IP 1 to ensure that the part-year rules apply as intended when a company enters a group or leaves a group during the year.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
IQ 2(3)	In subsection (3), clarify that if the maximum amount allowed to be subtracted from net income exceeds the ring-fenced income limitation, the excess amount is converted to an ordinary net loss to carry forward.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
IQ 3	In subsection (2), clarify that, when applying ring-fencing to FIF net losses, if the maximum amount allowed to be subtracted from the person's net income exceeds the ring-fenced income limitation, the excess amount is converted to an ordinary net loss to carry forward.	This amendment clarifies how the surplus amount for FIF net losses referred to in section IA 2(4)(f) is determined.
IQ 5(3)	In subsection (3), clarify that, when applying ring-fencing to FIF net losses, if the maximum amount allowed to be subtracted from the person's net income exceeds the ring-fenced income limitation, the excess amount is converted to an ordinary net loss to carry forward.	This amendment clarifies how the surplus amount for FIF net losses referred to in section IA 2(4)(f) is determined for group companies.
LB 4	Amend section LB 4 to clarify that the tax credit arising under subparts MD and ME (Working for Families and the Minimum Family Tax Credit, respectively) is reduced by the amount of any instalments of the tax credit due in the current year that have been used to repay an overpayment of subpart MD or ME credits in earlier years.	A clarification arising from minor items referred to the Rewrite Advisory Panel.
LB 7(4)(b)	Replace "schedule 4, part H" with "schedule 4, part I", and clarify that the provision applies to a person who has not provided an IR number, or has a special tax rate certificate in relation to the schedular payment.	This amendment clarifies the operation of the rule for persons who have not provided an IR number to the payer and to persons who have a special tax rate certificate in relation to the schedular payment. The amendment also corrects a cross-reference.
LC 4(4)	In subsection (4), in the formula, replace "0.020" with "0.20".	Corrects a drafting error arising from minor items referred to the Rewrite Advisory Panel.
LJ 1	Relocate subsection (3) as section LJ 2(6)–(7). Add subsection (6) to clarify the relationship with section YD 5.	Improves readability. A clarification arising from minor items referred to the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
LJ 2	Replace subsection (2) to clarify the maximum foreign tax credit allowed. Add subsections (6)–(7), see section LJ 1.	This amendment clarifies that the maximum foreign tax credit allowed cannot exceed the amount of New Zealand tax payable as calculated under section LJ 5. This amendment improves readability in relation to determining the foreign tax credit allowed for a person who derives income from a FIF that is not income under the FIF rules.
LJ 3	Replace section LJ 3.	This amendment clarifies the nature of foreign income tax.
LJ 5	Amend subsections (5) and (6) to restore the outcome under the corresponding provisions of the 2004 Act.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
LJ 7	Replace section LJ 7.	Improves readability. This clarification arises from minor items referred to the Rewrite Advisory Panel.
LK 1	Amend section LK 1, insert an equivalent to section LC 1(3A), LC 4(1), (10), and section (11) of the Income Tax Act 2004.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
LK 2(2)(b)	Amend the definition of "tax paid" in section LK 2(2)(b) to omit "in relation to the person's attributed CFC income".	A clarification arising from minor items referred to the Rewrite Advisory Panel. The amendment ensures that the calculation in section LK 2(1) apportions the total tax borne by the CFC based on the income interest of the person holding the attributed income interest.
LP 4	Insert in the additional requirement, that before calculating a market value interest, a market value circumstance must exist.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
MA 7	In definition of "full-time earner" replace subsection (1)(a) with subsection (1), and replace cross-references in subsection (2).	Corrects cross-references.
MB 4	Replace subsection (1) to refer to major shareholder, and treatment of dividends.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
MC 5(1)	Replace "the person referred to in section MC 2 and child referred to in section MC 4" with "the person referred to in section MC 2 or the child referred to in section MC 4".	A clarification arising from minor items referred to the Rewrite Advisory Panel.
MC 6	Omit paragraph (b)(ii).	A policy change that ensures that a person in receipt of a veteran's pension is not excluded from receiving the in-work tax credit, parental tax credit or minimum family tax credit.
MC 8	Insert subsection (2).	This amendment clarifies the relationship between section MC 8 and MD 6. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
MC 10	In subsection (4), replace "subsection 2" with "subsection (3)".	Corrects a cross-reference.
MD 6	Insert new subsection (2).	This amendment clarifies the relationship between sections MC 8 and MD 6. A clarification arising from minor items referred to the Rewrite Advisory Panel.
MD 7	In subsection (1), replace "subsection (1)" with "subsections (2) and (3).	Corrects a cross-reference.

Section	Description of issue / proposed resolution	Comment
MD 9	Insert in subsection (2)(a) the qualification that a person who derives "qualifying" income will not fail to satisfy the requirements of section MD 9 if that person also derives income that excludes a person from eligibility for the in-work tax credit. Amend subsection (3) to provide a list of PAYE income (other than that referred to in section MD 8) that also may exclude a person from eligibility for the in-work tax credit.	Improves readability. This is a clarification arising from minor items referred to the Rewrite Advisory Panel. This is to clarify that recipients of parental leave payments are not precluded from entitlement to in-work payment.
MD 10	In subsection (3)(d)(ii), replace "paragraph (a)" with "paragraph (i)".	Corrects a cross-reference.
ME 3	Replace the formula in subsection (2), and consequentially amend the meaning of "adjusted income" in section ME 3(3)(a)(i).	Corrects a drafting error in the formula. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
MF 5	Replace subsection (2) to refer to tax year.	Corrects a drafting error relating to the extent of the joint and several liability imposed under the section. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
MF 6	Replace section MF 6.	This amendment corrects an unintended change in law. The amendment restores the effect of section MD 1(3A) of the 2004 Act under which the Commissioner could apply a current year instalment of a Working for Families tax credit to pay an earlier year's overpayment of instalments of a Working for Families tax credit. This is a clarification arising from items referred to the Rewrite Advisory Panel.
MK 13(1)(a)	Replace "section MK 12(1)(b) and (c)" with "section MK 12(1)(c) and (d)".	Corrects cross-references.
MZ 3	Add new section MZ 3 to incorporate section KD 1(1)(e)(i) and (vi) of the Income Tax Act 2004.	This amendment corrects an unintended change in law. Section KD 1(e)(i) and (iv) of the 2004 Act excluded refunds of income equalisation (and adverse event) deposits from the calculation of the Family Scheme income on which the Working for Families tax credits are based. This rule was intended to apply until the end of the 2009–10 income year and was inadvertently omitted from the 2007 Act. This amendment restores the provision.
OA 8	Amend paragraph (b) to more closely correspond to the outcome under section HG 13(6) of the Income Tax Act 2004.	Improves readability. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
OB 1, OB 2	Omit section OB 1(1)(a)(i) and (3); amend section OB 2(1), defined term list.	The section as drafted prevents Australian companies that are not NZ residents from being an Australian ICA company. The amendment corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
OB 2	Amend section OB 2 to reflect section ME 1A of the Income Tax Act 2004, as inserted by section 155 of the Taxation (Business Taxation and Remedial Matters) Act 2007.	This amendment corrects the 2007 Act to reflect the policy change made by section 155 of the Taxation (Business Taxation and Remedial Matters) Act 2007.
OB 34(4)	Amend subsections (4) and (5) to more clearly correspond to sections ME 5(2)(ea) and (eb) of the 2004 Act.	This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
OB 39	In subsection (1), omit the reference to CTR companies.	Corrects a drafting error.
OB 61	Repeal subsection (7).	Improves readability. This amendment is to remove an unnecessary provision, as the subject matter is relocated to section OP 6 (see later in this report).
OB 71	Amend subsections (1), (4), (5), (9) to remove the presumption that the ICA must have a debit balance.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
OD 1(2)	Replace "a tax year" with "a tax year as set out in section OD 3(2)".	Improves readability.
OD 3	Amend section OD 3 to ensure that the CTR account must be maintained from the start of the imputation year in which election is made.	Corrects a drafting error to ensure the provision correctly reflects the effect given by section MI 2(1)–(3) of the 2004 Act.
OD 16	Amend subsection (3)(b) to refer to 34 percentage points.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
Table O6, row 2	Amend the table in row 2 to refer to a CTR credit attached to dividend paid.	Ensures the table is consistent with the text of section OD 10.
OP 6	Insert new subsections to reflect the effect of sections ME 14(3B) to ME 14(6) of the 2004 Act, and consequentially update table O2 to reflect the insertion of the new provisions.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
OP 44(6) to (8)	Insert new subsections to reflect the effect of section ME 14(1A), of the 2004 Act and consequentially amend table 20 to reflect the insertion of the new subsections.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
OP 78	Replace "has" with "maintain".	Improves readability.
RA 5(a)	Insert subsection (2) to clarify the time at which the amount of tax is to be withheld.	Improves readability.
RA 5(c)	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
RA 6	Insert subsection (4) to clarify the time at which the amount of tax is to be withheld.	Improves readability.
RA 10(1)(a)	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").

Section	Description of issue / proposed resolution	Comment
RA 15	Clarify the tax types to which each paragraph is to apply.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. A savings provision protects the position of taxpayers who have adopted a tax position based on the words of the 2007 Act, as enacted.
RA 20	Insert new subsection (2).	The amendment clarifies that in a resident's amalgamation for the purpose of determining whether the amalgamated company comes within the threshold for monthly PAYE returns is met, the amalgamated company is treated as having paid the PAYE that was paid by the amalgamating company in the prior income year.
RA 23(2)	Replace "An amount of tax for an employer's superannuation contribution" with "ESCT".	Improves drafting consistency.
RA 21(4)	Replace "subsection (2)" with "subsection (3)".	Corrects a cross-reference. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
RA 23(2)	Omit subsection (2) as it refers to repealed Tax Administration Act provisions.	This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
RB 3	Amend subsection (2), (h) replaced with (f).	Corrects a cross-reference, as recommended by the Rewrite Advisory Panel.
RC 34	Replace subsections (2) to (6) to update terminology.	Improves readability. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
RD 3	Amend subsections (3) and (4).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. This amendment is to ensure the provision has the same effect as section OB 2(2) of the Income Tax Act 2004 (application of the PAYE rules to shareholder employees of close companies).
RD 5(1)(b)(ii)	Replace "subsections (2) to (7)" with "subsections (2) to (8)".	Corrects a cross-reference.
RD 5(6)(a)	Add subsection to refer to accommodation benefits provided in relation to employment treated as income under section CE 1(1)(c).	This amendment is consequential to amendments to section CE 1(1)(c). It arises from minor items referred to the Rewrite Advisory Panel.
RD 11	Add subsection to incorporate regulation 6(3) of Withholding Payments Regulations.	Corrects an unintended change in law.
RD 13(1)(a)	After "salary or wages", insert "referred to in section RA 5(1)(a)".	Corrects a cross-reference.
RD 17	In subsection (1), omit "the sum of the extra pay".	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. This amendment ensures the extra pay is not included twice in the calculation in section RD 17.
RD 22(3)	Replace subsection (3) with subsections (3) and (3B).	This amendment clarifies that the threshold for a "small business option" for PAYE purposes is based on the aggregate of PAYE and ESCT paid in the prior periods. The amendment is also consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").

Section	Description of issue / proposed resolution	Comment
RD 54	Insert in compare note “GC 15(3), (4)”.	Improves readability. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
RD 60(1)(a)	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RD 61(1)(a), (6)	Subsection (1)(a): Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”. Subsection (6): Replace “referred to in subsection (1)” with “withheld under section RA 5(1)(a) and (c)”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”). Improves drafting consistency.
RD 65	Amend subsections (1), (2), (3), (4), (7), and (11) to define “employers’ superannuation cash contribution”.	The amendment in subsection (1) ensures that section RD 65 applies only to employer superannuation contributions made in cash. The other subsections are consequentially amended.
RD 67	In the opening words for section RD 69, replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”. Replace paragraph (a) with “(a) if the employer chooses under section RD 69(1), the amount determined under schedule 1, part D, clause 1 (Basic tax rates: income tax, ESCT, RSCT, RWT, and attributed fringe benefits); or”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”). Improves drafting consistency.
RD 68	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”. Add subsection 2.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”). Improves readability.
RD 69	Replace the heading with “Choosing different rates for employer’s superannuation cash contributions”. In subsection (1), replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Improves drafting consistency. Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RD 70	In subsection (1), replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RD 71	In paragraph (a), replace “an amount of tax” with “an amount of tax withheld”. In paragraph (c), replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Improves drafting consistency. Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).

Section	Description of issue / proposed resolution	Comment
RE 2	In subsection (1), omit "resident in New Zealand". In subsection (3)(c), omit "paid to a person resident in New Zealand who is acting as agent or nominee of a non-resident".	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. These amendments ensure that the RWT rules apply to interest paid in New Zealand.
RE 3	Replace subsection (1)(a), (b) with a new subsection (1)(a).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. This amendment clarifies that a person paying resident passive income to a holder of a certificate of exemption is not required to withhold RWT from that payment.
RE 11 and RE 12	Amend section RE 11(3), RE 12(3)(a) to correct the cross-references to schedule 1.	Corrects cross-references, as recommended by the Rewrite Advisory Panel.
RF 2	Replace subsection (2)(b) and in subsection (2)(c), replace "section CX 56" with "section CX 56C". In subsection (5), after "investment society dividends", insert "or a royalty".	The amendments to section RF 2(2) correct cross-references. The amendment to section RF 2(5) corrects an unintended change in law, as recommended by the Rewrite Advisory Panel, to ensure that certain royalties paid to non-residents are subject to NRWT. A savings provision protects taxpayers who have relied on the provisions of the 2007 Act as enacted.
RF 9	In subsection (1), replace "section RF 8(1)(d) to (f)" with "sections RF 8 and RF 10".	Corrects a cross-reference.
RF 10	In subsection (2), replace formula (removing brackets). After subsection (5), insert subsection (5B).	Improves readability. The amendment to section RF 10(5) corrects an unintended change in law, as recommended by the Rewrite Advisory Panel, to ensure that to the extent a non-cash dividend derived by a non-resident is fully imputed, that dividend has a zero rate of NRWT.
RF 12	Replace section RF 12.	The amendment corrects an unintended change in law, as recommended by the Rewrite Advisory Panel, to ensure that certain interest payments have a zero rate of NRWT.
RF 12B	Insert section RF 12B.	Improves readability. This section contains provisions relocated from section RF 12 relating to interest jointly derived by non-residents.
RF 12C	Insert section RF 12C.	The amendment to section RF 12 corrects an unintended change in law, as recommended by the Rewrite Advisory Panel, to ensure that payments made by a New Zealand branch of a life insurer that has elected to be treated as a company for New Zealand's income tax purposes bears a zero rate of NRWT.
RG 5	Amend subsection (2) to replace "section RF 2(5) and (6)" with "RG 4".	Corrects cross-references.
RG 6	Amend subsection (3)(a) to replace "section RF 2(5) and (6)" with "RG 4".	Corrects cross-references.

Section	Description of issue / proposed resolution	Comment
RG 7	Amend subsection (2)(b), to replace “section 32M of the Tax Administration Act 1994” with “section RG 6”.	Corrects cross-references.
RM 10	Amend subsection (1) to indicate that section LB 4 may adjust the amount of the credit.	This amendment is consequential on the correction to sections LB 4 and MD 6.
RP 6	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RP 7	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RP 11	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RP 13	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
RZ 3(3)	Insert “the year before” after “residual income tax”.	Corrects a drafting error. This is a clarification arising from minor items referred to the Rewrite Advisory Panel.
RZ 4(1)(c)	After “2007–08 income year” insert “or an earlier income year”.	Corrects a drafting error to reflect the corresponding provision in the 2004 Act.
YA 1 “accommodation”	Insert new definition for “accommodation”.	This amendment is consequential to the amendment for section CE 1(1)(c).
YA 1 “agricultural, horticultural, or viticultural company”	Replace “in schedule 4, part C” with “in the definition of horticultural contract work in schedule 4, part C”.	This amendment corrects an unintended change in law, as recommended by the Rewrite Advisory Panel to ensure that the rule applies only to those companies performing the listed activities.
YA 1 “consolidated FDPA group”	Replace “FDPA” with “FDP”.	Corrects a drafting error. This arises from minor items referred to the Rewrite Advisory Panel.
YA 1 “employee”	In paragraph (c)(ii), insert reference to schedule 4, parts A and I.	This amendment corrects an unintended change in law, as recommended by the Rewrite Advisory Panel to ensure that FBT rules operate as intended.
YA 1 “employee’s superannuation accumulation”	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).
YA 1 “employer”	In paragraph (c)(i), replace “RD 5(1)(b)(iii), (2),” with “RD 5(1)(b)(iii), (3)”. NB: As introduced this was listed as “employee”. This term has been replaced by “employer”.	This amendment corrects an unintended change in law, as recommended by the Rewrite Advisory Panel to ensure that FBT rules operate as intended.
YA 1 “employer monthly schedule”	Replace “employer’s superannuation contribution” with “employer’s cash superannuation contribution”.	Consequential on amendment to section RD 65(1) (definition of “employer’s superannuation cash contribution”).

Section	Description of issue / proposed resolution	Comment
YA 1 "employer sourced superannuation savings"	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
YA 1 "employer's superannuation contribution"	Replace the definition with: "employer's superannuation cash contribution" as defined in section RD 65(1) (Employer's superannuation cash contributions); and "employer's superannuation contribution" means a superannuation contribution made by an employer for the benefit of 1 or more of their employees.	The amendment clarifies the distinction between employers' superannuation contributions made in cash and non-cash contributions. These distinctions are important for the operation of the KiwiSaver and ESCT rules.
YA 1 "ESCT"	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
YA 1 "ESCT rate threshold amount"	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
YA 1 "fully imputed"	Insert definition.	Improves readability.
YA 1 "income from employment"	Insert paragraph (d), expand definition to include excluded income for purposes of section DA 2(4)	This amendment clarifies that expenditure incurred by an employee in relation to a fringe benefit is subject to the employment limitation in section DA 2.
YA 1 "lease"	In paragraph (f)(i), replace "(c)" with "(d)".	Corrects a cross-reference.
YA 1 "member credit contribution"	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
YA 1 "non-resident entertainer"	Replace paragraphs (b) and (c) by the following: "(b) undertakes a Part F activity".	This amendment ensures that this definition refers to the new definition of "Part F activity".
YA 1 "Part F activity"	Insert the definition of "Part F activity".	This amendment inserts an index entry referring to the location of the definition of "Part F activity".
YA 1 "PAYE income payment form"	Replace "employer's superannuation contribution" with "employer's cash superannuation contribution".	Consequential on amendment to section RD 65(1) (definition of "employer's superannuation cash contribution").
YA 1 "schedular income"	In paragraph (f), replace "RE 4(4)" with "RF 2(3)".	Corrects a cross-reference as recommended by the Rewrite Advisory Panel.
YA 1 "secured amounts"	Insert definition for "secured amounts" as defined in section HG 11(12).	This amendment inserts the index entry for the term "secured amounts" that was inserted into the 2007 Act by section 19 of the Taxation (Limited Partnerships) Act 2008 but not referenced in section YA 1.
YA 1 "trading stock"	In paragraph (b), insert a reference to section EB 24. Replace paragraph (c) to clarify the relationship of section GC 1(3) with the general definition of trading stock.	This amendment clarifies the relationship of the definition of "trading stock" to sections EB 24 and GC 1(3). These amendments arise from minor items referred to the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
YB 21 “compare note”	Replace “OD 9” with “HH 1(1), OD 9”.	Corrects a cross-reference.
YC 4 “compare note”	Replace “OD 4(4)” with “OD 4(3)(d), (4)”.	Corrects a cross-reference.
YC 6(4)	Replace “section YC 19” with “section YC 20”.	Corrects a cross-reference.
YD 3	In subsection (4)(b), replace “head” with “head office”.	Corrects a drafting error.
YD 4 “compare note”	Replace “section OE 1(4)” with “subsections FB 2(2), OE 1(4)”.	Corrects a cross-reference.
YZ 2	Insert section YZ 2.	This amendment re-enacts the effect of savings provisions from the 2004 Act (section YA 5B).
Schedule 4, Part C, clause 1	Repeal paragraph (e) and replace definition of “horticultural contract work” with “cultivation contract work”.	This amendment includes a minor policy change to include schedular payments for horticultural work on fruit trees within the PAYE rules.
Schedule 4, Part F	Amend definition of “schedular entertainment activities” by inserting a new definition of “Part F activity”.	Improves readability by distinguishing the circumstances under which the rule applies to a resident and a non-resident.
Schedule 5, clause 3(c)	Replace clause 3.	Improves readability.
Schedule 20, clause 1	Insert “preparation” after “applies”.	Corrects an unintended change in law as recommended by the Rewrite Advisory Panel.
Schedule 20, clause 2	For clause 2, column 2, replace “6” with “45” in the second column.	Corrects an unintended change in law as recommended by the Rewrite Advisory Panel.
Schedule 25	Part B heading: replace with “Foreign entities to which the FIF exemptions do not apply”. Shoulder references insert “EX 31”, “EX 32”, “EX 39”, “EZ 32”.	Improves readability.
Schedule 51	Add entry for section MC 6, omission of veteran’s pension.	This amendment reflects the policy change made for section MC 6, to be effective from the commencement of the 2007 Act.
Schedule 52	Part A, item GC 15(1)-(3), column 2: replace “GC 15(1)-(3)” with “GC 15”. Part B, item GB 32, column 2: replace “GC 15(1)-(3)” with “GC 15”.	Corrects cross-references.
Schedule 52	Part A, item GC 15(3), (4), column 2: add “RD 54”. Part B, item RD 54, column 2: replace “ND 1S” with “GC 15(3), (4), ND 1S”.	Corrects cross-references.
Schedule 52	Part A, item HH(1)-(4), (8), (10): add “YB 21”. Part B, item YB 21: insert “HH 1(1)” before “OD 9”.	Corrects cross-references.

Section	Description of issue / proposed resolution	Comment
Schedule 52	Part A, item KD 3(1): add "qualifying person". Part B, item KD 3(1): add "qualifying person".	Corrects cross-references.
Schedule 52	Part A, column 1: replace "OD 4(4)" with "OD 4(3)(d), (4)". Part B, item YC 4, column 2: replace "OD 4(4)" with "OD 4(3)(d), (4)".	Corrects cross-references.
Schedule 52	Part B, item IC 7, column 2: replace "IG 2(2), (11)" with "IG 2(2)(d), (11)".	Corrects cross-references.
INCOME TAX ACT 2004		
CC 8B	Insert section CC 8B.	A clarification arising from a recommendation of the Rewrite Advisory Panel. This amendment provides that disposals and redemptions of a commercial bill is income of a non-resident if the disposal or redemption is sourced in New Zealand and the non-resident is not subject to the financial arrangement rules in relation to the commercial bill.
CD 4	Insert subsection (2B).	A clarification arising from a recommendation of the Rewrite Advisory Panel. The section now provides that consideration paid by a company to a shareholder because of a cancellation of shares or a repurchase of a company's shares is a transfer of value.
CD 17(4)	Insert reference to "amount distributed on acquisition".	A correction of an unintended change in law as recommended by the Rewrite Advisory Panel. This amendment clarifies that ASC should only be reduced by the amount paid for the shares held as treasury stock for more than 12 months or cancelled within 12 months (subject to the amount paid for the shares not exceeding the ASC per share calculated under the ordering rule).
CE 1	Insert in new subsection (2) the words "living premises".	This amendment matches the change to section CE 1 of the 2007 Act.
CF 1(2)	Repeal paragraph (f) and subsequent paragraphs and replace (f) and (g).	Improves readability.
CW 33	Omit "associated person" from the defined terms list.	Improves drafting consistency.
CX 24	Replace the term "board" with the term "accommodation".	This amendment matches the change in section CS 28 of the 2007 Act.
CX 41	In subsection (1)(d)(i), insert after the words "for which they would be allowed a deduction", the words "before the application of section DF 1".	Improves readability.
DB 3	Insert in subsection (4) that section DB 3 overrides the capital limitation in section DA 2.	A clarification arising from a recommendation of the Rewrite Advisory Panel that improves readability.

Section	Description of issue / proposed resolution	Comment
DC 12(5)(d)	Replace subsection (5)(d).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. This amendment clarifies that the prohibition against dealing with dividends arising from an employee share purchase scheme applies to the trustee of the scheme.
DU 12	Replace subsection (3)(b).	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel. The amendment ensures that the provision refers to the aggregate amount of exploration and development expenditure incurred by the mining company reduced by the current year's exploration and development expenditures.
EE 21	Amend to clarify that application is restricted to the pool of depreciable property and that it does not apply to any individual item in the pool of depreciable property.	Corrects an unintended change in law, as recommended by the Rewrite Advisory Panel.
EE 46	Remove reference to "items", consequential to the amendment to section EE 21(5) to (8).	This amendment provides drafting consistency with the correction of an unintended change in law in section EE 21 (see previous item), as recommended by the Rewrite Advisory Panel.
OB 1 "accommodation"	Insert new definition for "accommodation".	This amendment matches the change for section YA 1 of the 2007 Act.
OB 1 "income interest" (b)	Replace "EX 14" with "EX 8".	Corrects a cross-reference.
OB 1 "portfolio investor rate"	(a): replace "33%" with "30%". (b): add provision that definition applies only if investor has abided by request to provide tax file number (*see* also 31B of the TAA 1994).	This amendment is part of the reform that permits the Commissioner to override a rate incorrectly selected by an investor. The exercise of this discretion would result in the default portfolio investor rate of 30% applying.
TAX ADMINISTRATION ACT 1994		
3	Replace definition of "late filing penalty".	Corrects a cross-reference.
New Part 2B	Insert new Part 2B after section 15B.	This amendment inserts Part 2B to reinsert the inoperative amendment in schedule 50 of the Income Tax Act 2007.
24P	Replace "sections 24B, 24H, and 24I" with "section RD 22 of the Income Tax Act 2007 and sections 24B, 24H, 24I, and 24L".	Corrects cross-references.
32A	Replace the term "employer's superannuation contribution" with "employer's superannuation cash contribution".	The amendment is consequential to the amendment of section RD 65(1) of the 2007 Act, and is to provide drafting consistency.
32B	Replace the term "employer's superannuation contribution" with "employer's superannuation cash contribution".	The amendment is consequential to the amendment of section RD 65(1) of the 2007 Act, and is to provide drafting consistency.
36A(2)	Replace "certificate" with "payment form".	Drafting consistency, arising from minor items referred to the Rewrite Advisory Panel.

Section	Description of issue / proposed resolution	Comment
68C(2)	In the opening words, replace "section KJ 1 of the Income Tax Act 2004" with "section MK 1(1) of the Income Tax Act 2007". In subsection (2)(b), replace "meets the requirements of section KJ 2(d)" with "resides mainly in New Zealand". In subsection (2)(c), replace "section KJ 2(a) to (c), (e) and (f)" with "section MK 2(1)(a) to (c), (d)(i) and (ii)".	Corrects cross-references. Improves readability. Corrects cross-references.
80KLB	Insert new section 80KLB.	The new section re-enacts the effect of section MD 1(3A) of the 2004 Act that granted the Commissioner the power to recover overpaid tax credit. This corrects an inadvertent omission of a provision from the 2007 Act.
85G	In subsection (1)(c), omit "of that Act".	Improves readability.
120KD	In the example, in the line "Three interest start dates apply", replace "29 April," with "8 May,".	Corrects an incorrect date.
139AA(1)(a)	Replace "RD 23(2)" with "RD 22(2)".	Corrects a cross-reference.
141B(8)	Replace "subsection (2)(b)" with "subsection (2)".	Corrects a cross-reference.
141J	Repeal subsection (3).	This amendment ensures that other penalties may be reduced under other provisions of the Tax Administration Act.
156A(1)	Replace paragraphs (a) and (b), and insert new paragraph (c).	This amendment adds the non-electronic late filing penalty to the list of penalties to which the rule applies, and replaces the term "in respect of" with "for" to improve drafting consistency.
225A(2)(b)(iii) and (iv)	Omit "under that Act".	Removes an incorrect reference.
TAXATION REVIEW AUTHORITIES ACT 1994		
16(3)(b)	Replace "section 22" with "sections 22 or 22B".	Corrects cross-references.
KIWISAVER ACT 2006		
4 "Crown contribution" (b)	Replace "section KJ 1 of the Income Tax Act 2004" with "section MK 1 of the Income Tax Act 2007". Replace "section KJ 5(2)" with "section MK 5".	Corrects cross-references.
14(1)(d)	Replace "section OE 1(5) of the Income Tax Act 2004" with "section YD 1(7) of the Income Tax Act 2007".	Corrects a cross-reference.
57(1)(d)	Replace "paragraph (h) of the definition of complying fund rules in section OB 1 of the Income Tax Act 2004" with "schedule 28, clauses 4(a) and 5(a) of the Income Tax Act 2007".	Corrects cross-references.

Section	Description of issue / proposed resolution	Comment
128A	Replace "section KJ 1 of the Income Tax Act 2004" with "section MK 1 of the Income Tax Act 2007".	Corrects a cross-reference.
128C(1)	Replace "paragraph (cc) of the definition of complying fund rules in section YA 1 of the Income Tax Act 2007" with "schedule 28, clause 2(c) of the Income Tax Act 2007".	Corrects a cross-reference.
Schedule 1	In clause 14(1), replace "section KJ 1 of the Income Tax Act 2004" with "section MK 1 of the Income Tax Act 2007". In clause 17(1), replace "section KJ 1 of the Income Tax Act 2004" with "section MK 1 of the Income Tax Act 2007". In clause 17(1)(a), replace "Income Tax Act 2004" with "Income Tax Act 2007". In clause 17(1)(c), replace "the number of included days under section KJ 3 of the Income Tax Act 2004 is wrong" with "they have got the time for which the member meets the requirements of section MK 2 of the Income Tax Act 2007 wrong".	Corrects cross-references and terminology.
STAMP AND CHEQUE DUTIES ACT 1971		
86F	In the definition of "paid and payment": replace "paragraph (c)" with "paragraph (a)".	Corrects a cross-reference.