Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Bill 2009

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

March 2010

Prepared by the Policy Advice Division of Inland Revenue and the Treasury

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Trans-Tasman portability of retirement savings

TIMEFRAMES TO IMPLEMENT THE NEW LEGISLATION

Submission
(ASB)

New Zealand-sourced retirement savings may not be transferred from Australia to a third country. This will require communication and amendments to current disclosure material in order to comply with securities legislation. The amendment process means that providers are required to amend and reprint documentation, including investment statements and prospectuses. Therefore, providers should have a suitable timeframe to implement the new legislation.

Alternatively, an exemption should be provided so that the changes do not require existing disclosure documents to be updated until the proposed rules are enacted and come into force.

Comment

Participation in the trans-Tasman portability facility will be voluntary for providers, so providers have flexibility regarding if and when they choose to offer this facility. The timeframes for implementation are, therefore, within providers' control. If it is not considered viable to reprint documentation upon enactment, later implementation by providers is possible.

Recommendation

That the submission be declined.

NON-ALIGNMENT OF INVESTMENT INCOME TAX RATES

Submissions
(ING, Workplace Savings NZ, KPMG)

If New Zealand is serious about encouraging the consolidation of retirement savings accounts here, further consideration needs to be given to aligning tax rates on investment income with the rate payable in Australia.

The recent Tax Working Group report suggested that New Zealand is currently reliant on taxing factors most harmful to economic growth, including income from capital (savings). A debate on New Zealand's savings policy, and the role of tax, needs to occur. *(KPMG)*

Comment

Portability is designed to assist labour market mobility and contribute towards achieving a single economic market with Australia. It does not aim to achieve equal tax treatment on retirement savings.

New Zealand and Australia apply different tax rates to earnings on retirement savings, with Australia's rate being lower. However Australia also taxes capital gains on equities, whereas New Zealand does not tax capital gains on Australasian equities. It is therefore not straightforward to make a comparison between the two tax regimes, or to conclude that the Australian tax environment for superannuation savings is more favourable than New Zealand's.

In addition, there are a number of factors other than the tax rate that may encourage members to transfer their savings. For example, individuals with Australian savings benefit from transferring them to New Zealand as they avoid paying multiple administration and management fees on their savings, and are able to manage more easily their savings if they are consolidated in one account in their country of residence.

Recommendation

That the submissions be declined.

WITHDRAWAL IN CASH AFTER EMIGRATION TO AUSTRALIA

Submissions
(PricewaterhouseCoopers, New Zealand Institute of Chartered Accountants)

New Zealanders who permanently migrate to Australia should have the choice of transferring their retirement savings to an Australian superannuation scheme or withdrawing their savings entirely.

This would be consistent with the original framework of the KiwiSaver regime. Furthermore, the portability of superannuation to Australian complying schemes should not remove existing rights. Individuals who permanently migrate to Australia should not be disadvantaged compared with individuals who migrate to other countries.

Comment

The introduction of retirement savings portability will support an integrated single superannuation market between the two countries by allowing New Zealanders and Australians to consolidate their financial affairs in their country of residence. Superannuation portability also builds on the unique relationship between New Zealand and Australia by supporting trans-Tasman labour mobility.

To allow the cash withdrawal of savings would compromise an objective of trans-Tasman portability, which is to assist and encourage retirement savings after emigration. A key feature of both the Australian complying superannuation scheme and the New Zealand KiwiSaver scheme is that savings are locked in until retirement age. This would also undermine the concept of an integrated single superannuation market: allowing cash withdrawals on trans-Tasman emigration would be equivalent to allowing cash withdrawals on migration within New Zealand, which is not allowed.

Recommendation

That the submissions be declined.

RING-FENCING AUSTRALIAN-SOURCED SUPERANNUATION SAVINGS

Submission
(ASB)

For providers to separately administer funds transferred from Australian superannuation schemes, further registry development, testing and time will be required. To reduce the costs and complexities of KiwiSaver administration, transferred Australian savings should be administered under the existing KiwiSaver rules. This change will ensure ease of implementation, less confusion for members and less risk of error, and will help to ease the cost of implementing further complexities to registry systems.

Comment

The arrangement on portability between New Zealand and Australia specifies that savings transferred to New Zealand may not be used to assist with the purchase of a first home or be transferred to a third country. Also, a member retains the right to access their transferred savings at 60 years of age (if they meet the Australian definition of "retirement"). These provisions are a core feature of the portability arrangements, and will ensure that portability supports labour market mobility instead of being used to take advantage of regulatory and policy differences between New Zealand and Australia.

After consultation with industry representatives, officials consider that the requirement to identify separately the original transferred amount of savings will not result in high costs and complexity for scheme providers.

Recommendation

That the submission be declined.

COMPLYING SUPERANNUATION FUNDS EXCLUDED FROM PORTABILITY

Submissions
(Chapman Tripp, ING, Workplace Savings NZ)

As complying superannuation funds essentially operate in the same way as KiwiSaver schemes, there is no persuasive policy reason for excluding them from the trans-Tasman savings portability facility.

The portability arrangements should, at a minimum, allow transfers direct from complying superannuation funds to Australian superannuation schemes. *(Chapman Tripp)*

The extension of this facility to complying superannuation funds should be included in future discussions with Australian officials. *(Workplace Savings NZ)*

Comment

Officials agree that in policy terms complying superannuation funds should be allowed to offer the portability facility. However, as the arrangement between New Zealand and Australia only refers to KiwiSaver schemes, a decision would need to be made jointly between the two countries to include complying superannuation funds.

Officials will raise this matter with Australia.

Recommendation

That the submissions be noted.

REALLOCATION OF SAVINGS IF MEMBERSHIP CONSIDERED INVALID

Submission
(Workplace Savings NZ)

Clauses 75 and 76 of the bill involve "net" amounts to be paid if an individual's membership is found to be invalid. This potentially undermines the simplicity principle and could, in many cases, require registry system changes of a significant and costly nature.

It would be preferable to retain the simplicity of the "amount transferred" (disregarding subsequent investment returns) in these sections if possible, thereby avoiding the need for additional record keeping.

Comment

Officials recognise that this presents concern for providers, as it would require additional data and potentially complex accounting.

Officials agree with the approach suggested in the submission because it is consistent with the current invalid membership rules.

Recommendation

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

TRANSFERS BACK TO AUSTRALIA IF MEMBERSHIP CONSIDERED INVALID

Submissions
(Chapman Trip, Workplace Savings NZ)

The bill proposes that if an invalid KiwiSaver enrolment is not later validated under the KiwiSaver Act's provisions, any net amount transferred from an Australian scheme must be transferred back to that scheme. This will be impossible where that scheme, for example, does not allow transfers back from KiwiSaver or otherwise refuses to accept the transferred amount. The Australian scheme may also have been wound up after the transfer.

An affected individual should be able to nominate another Australian complying superannuation scheme or, if this does not happen, Inland Revenue should be able to choose a default Australian scheme (and then notify the member).

Comment

Officials agree that an affected individual should be able to nominate another Australian superannuation scheme if their original Australian provider will not accept the transfer or no longer exists.

The transfer of savings back to Australia, if an individual's KiwiSaver membership is found to be invalid, would be administered by the provider and not Inland Revenue. This is because providers would have the direct relationship with both the member and the Australian scheme provider. This will be noted in Inland Revenue's *Tax Information Bulletin.*

Recommendation

That the submissions be accepted.

TRANSFERS IN EXCESS OF AUSTRALIA'S CONTRIBUTION THRESHOLD

Submissions
(PricewaterhouseCoopers, Workplace Savings NZ)

Individuals who migrate to Australia should be allowed to withdraw their KiwiSaver savings in part, to avoid being taxed on contributions in excess of the Australian contribution threshold. *(PricewaterhouseCoopers)*

Amounts transferred from KiwiSaver schemes to Australia should be exempt from the Australian "contributions cap", as there is little scope for abuse of the Australian tax system from excessive contributions made during this process. The exemption of such transfers should be discussed with Australian officials at some point in the future. It is not likely to be an issue in the immediate future but may become so as savers build their KiwiSaver balances. *(Workplace Savings NZ)*

Comment

Currently, officials do not consider that this is a major concern because the low dollar amounts in the KiwiSaver accounts that may be transferred. However, as these amounts grow in the future, the contributions cap may become an issue. Consequently, officials may raise this with Australian officials in the future.

Recommendation

That the submissions be declined but note that New Zealand officials may raise this issue with Australian officials in the future.

FEES FIRST DEDUCTED FROM NEW ZEALAND-SOURCED SAVINGS

Submissions
(Workplace Savings NZ, Chapman Tripp)

Proposed clause 2B of the KiwiSaver scheme rules requires fees to be first deducted from the net value of amounts not transferred from Australia. This is unreasonable and impractical as it would necessitate duplicate unit prices within KiwiSaver schemes. The costs associated with attempting to comply with such a requirement may preclude providers from offering this service.

Clause 2B should be reworded to provide that fees cannot be deducted from the amount transferred from Australia to a greater extent than in proportion to the total value of the member's accumulation in the scheme at the time. *(Workplace Savings NZ)*

The requirement that fees be deducted first from New Zealand-sourced savings (in proposed clause 2B) seems unworkable, as it would necessitate duplicate unit prices within KiwiSaver schemes. Proposed clause 2B should be deleted. *(Chapman Tripp)*

Comment

Officials agree that there are potential difficulties for providers in the identification and administration of separate fees, and that clause 2B should be deleted.

Recommendation

That the submissions be accepted.

SECTION CW 29B – INCOME COMPONENT OF THE TRANSFERRED AMOUNT

Submission
(New Zealand Institute of Chartered Accountants)

It may not be clear what part of the amount transferred from the Australian complying superannuation scheme is the income component. The rules to determine the taxable dividend in section CD 22(5) of the Income Tax Act 2007 rely on the cost of the interest, which may not be easily determined. To ensure no doubt or ambiguity, a better approach would be to refer to an "amount". As the amount originates from a transfer of funds, the language of section CW 29B should be consistent.

Comment

Because the provisions in the Income Tax Act only tax income, officials consider that the current wording of proposed section CW 29B is correct. The reference to income in proposed section CW 29B is also consistent with other exemption provisions, in particular, section CW 29.

Recommendation

That the submission be declined.

SECTION MK 8 – PAYING MEMBER TAX CREDITS TO COMMISSIONER AFTER EMIGRATION

Submission
(New Zealand Law Society)

Section MK 8 should be amended to clarify that it does not apply to a transfer under proposed clause 14B, schedule 1 of the KiwiSaver Act 2006.

Comment

Existing section MK 8 provides that, on the transfer or cash withdrawal of a member's savings after their permanent emigration from New Zealand, a provider must pay the individual's member tax credits to the Commissioner.

Officials agree that, in the absence of any amendment, section MK 8 may also apply after permanent emigration to Australia under proposed clause 14B of the KiwiSaver scheme rules. Because this is not intended, section MK 8 should be amended accordingly.

Recommendation

That the submission be accepted.

DEFINITION OF "AUSTRALIAN COMPLYING SUPERANNUATION SCHEME"

Submissions
(New Zealand Law Society, New Zealand Institute of Chartered Accountants)

As Australia's Superannuation Industry (Supervision) Act 1993 contains multiple divisions labelled "Division 2", the proposed definition of "Australian complying superannuation scheme" in the Income Tax Act 2007 and the KiwiSaver Act 2006 should be amended to refer to a specific part of the Australian Act.

Comment

Officials agree that the cross-reference is not clear. The legislation should be amended to refer to Division 2 of Part 5 of the Superannuation Industry (Supervision) Act 1993 (Aust).

Recommendation

That the submissions be accepted.

DEFINITION OF "RETIREMENT" TO AVOID CROSS-REFERENCE

Submission
(Workplace Savings NZ)

Clause 80 of the bill introduces a new clause 4B in schedule 1 of the KiwiSaver Act. This introduces a cross-reference to Australian legislation for the term "retirement". It would be preferable to define retirement in clause 4B, thus avoiding the cross-reference. It is recognised that this might then lead to an amendment being required if the relevant Australian legislation is changed at some future date.

Comment

If the definition of Australian retirement is included in the KiwiSaver Act, the Act would no longer refer to the source Australian legislation. As noted in the submission, if Australia changes its definition, the KiwiSaver Act would need to be amended also. For this reason, officials consider that the cross-reference linking to the source legislation is needed to future-proof the definition.

To ensure users' understanding of the legislation, the Australian definition of retirement will be explained in Inland Revenue's *Tax Information Bulletin*.

Recommendation

That the submission be declined.

CLAUSE 80 – CLARIFICATION OF "NECESSARY MODIFICATION"

Submission
(Workplace Savings NZ)

Clause 80 refers to "necessary modifications" for KiwiSaver scheme trustees. It is not clear what this might cover, so clarification is desired.

Comment

Australian savings can be withdrawn when an individual is retired according to the definition of "retirement" in the Australian legislation. To ensure that providers do not face onerous compliance costs in checking whether an individual meets the Australian definition of "retirement", some flexibility has been built into the KiwiSaver Act with the term "necessary modification". For example, to meet the requirement that the trustees of a KiwiSaver scheme be reasonably satisfied that an individual does not intend to become gainfully employed ever again, a statutory declaration signed by the member could be considered sufficient.

The flexibility afforded by the "necessary modification" wording may also mean that KiwiSaver scheme providers do not need to expend resources investigating and policing a member's eligibility for retirement in each individual case.

Recommendation

That the submission be noted.

PROVISION FOR NON-PERMANENT EMIGRATION

Submission
(New Zealand Institute of Chartered Accountants)

There is no provision in the rules that deals with the situation when emigration transpires not to be permanent. For example, Mr and Mrs A emigrate permanently to Australia. Both transfer their KiwiSaver balances to Australian complying funds. However, after a period of years the relationship breaks down and Mr A returns to New Zealand. Technically the requirements to transfer the fund balance are no longer met as emigration was not permanent. A provision is required for when emigration transpires not to be permanent.

On the other hand, if the test is to be at the time of emigration, then the legislation should state this.

Comment

Whether an individual has permanently emigrated is tested at the time of application to transfer their KiwiSaver savings. The fact that an individual later returns to New Zealand does not mean that emigration was not permanent at the time of application. Officials do not consider that a further amendment is necessary.

Recommendation

That the submission be declined.

KiwiSaver

ENROLMENT OF UNDER 18-YEAR-OLDS

Issue: Clarification of the requirements for guardians

Submissions
(Chapman Tripp, ING, Workplace Savings NZ)

If it remains intended that (for consistency with the requirements in the Care of Children Act 2004) all guardians must act jointly, then there should be a facility for one guardian to sign an application form while confirming (perhaps by oath or statutory declaration) that he or she is acting for both or all guardians jointly. There will be many situations where it is not practicable for the prospective member to have a form signed by all their guardians.

Receipt of an oath or declaration from a signatory should suffice to verify guardianship (or lack thereof), as it is not practicable for providers to verify guardianship reliably.

It is not apparent how a provider is to establish whether the individual has a guardian. Section 74 refers to those aged 16 years old, with no guardian, being able to enrol as if they are aged 18. If the provider is able to rely on a statement by the applicant that they have no guardian in these circumstances it would be helpful to make this clear. *(ING, Workplace Savings NZ)*

Comment

Officials consider that in practice a signed statutory declaration from a guardian would be sufficient evidence to verify their guardianship of a child. Similarly, if a child has no legal guardian a statutory declaration from the child to that effect is sufficient. Guidance on these evidential issues will be set out in Inland Revenue's *Tax Information Bulletin*.

Section 16 of the Care of Children Act 2004 states that in exercising the duties and responsibilities of a guardian in relation to a child, a guardian of the child must act jointly with any other guardians of the child. Therefore officials consider that for children under 16 years of age, agreement and joint signatures must be obtained from all of the child's guardians. A clarifying amendment should be made to ensure this.

In the case of children aged 16 to 17, because they will have to co-sign with their guardians in order to enrol in KiwiSaver, one guardian's signature will be sufficient to enrol them.

Recommendation

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

Issue: Membership-related discretions for minors in KiwiSaver

Submission
(Chapman Tripp)

The relevant provisions in the bill do not address who may exercise membership-related discretions for minors (for example, regarding investment choice) after minors have joined.

The bill could also usefully clarify that membership-related discretions can be exercised by guardians for minors. Care should be taken here, however, to avoid over-prescription in the area of requiring all guardians to act jointly and/or requiring statutory declarations.

Comment

Officials consider that membership-related discretions for under 18-year-olds can be made by either the guardian or member aged 16 and over without requiring them to be joint signatories. This will be explained in Inland Revenue's *Tax Information Bulletin* article on these amendments.

Recommendation

That the submission be noted.

Issue: Member tax credits and compulsory employer contributions for under 18-year-olds

Submissions
(ASB, ING, Workplace Savings NZ)

KiwiSaver benefits should be consistent across the board. If a working minor contributes to KiwiSaver, the minor should also qualify for member tax credits and compulsory employer contributions. *(ASB)*

Individuals aged 16 or 17 who wish to contribute through the workplace to their KiwiSaver account should be encouraged to do so by making them entitled to compulsory employer contributions (exempt from employer's superannuation contribution tax) and member tax credits. *(ING, Workplace Savings NZ)*

Comment

The entitlement age of 18 for eligibility for member tax credits and compulsory employer contributions is an existing design feature of KiwiSaver. Changing the entitlement age to 16 would create an inconsistency as employees are not subject to the automatic enrolment rules until they reach age 18. This inconsistency could create confusion for employers with their compliance obligations. Officials do not consider

that reducing the automatic enrolment eligibility requirements to 16 years old is appropriate, as under 18-year-olds could then be automatically enrolled in KiwiSaver while not fully appreciating the consequences.

Furthermore, reducing the eligibility age for compulsory employer contributions to 16 would impose additional costs on employers. Similarly, reducing the eligibility age for member tax credits to 16 would impose additional costs on the Crown. Officials do not consider this appropriate in the current fiscal and economic environment.

Recommendation

That the submissions be declined.

Issue: Age limit applies at the time of application to KiwiSaver

Submission
(New Zealand Institute of Chartered Accountants)

Clause 74(3) and (4) should be amended by adding after "16 or 17 years old" the words "at the time of application". This will clarify that the age limit applies at the time of application to remove any doubt.

Comment

Officials consider that the current legislation is already clear on this matter so the suggested amendment is unnecessary.

Recommendation

That the submission be declined.

Issue: Reference to parents as well as guardians

Submission
(New Zealand Institute of Chartered Accountants)

Clause 74(2), (3) and (4) should be amended by adding before "guardian" the words "parent or". This will clarify that parents or guardians have the same authority to bind a child, or jointly apply for enrolment. The Care of Children Act 2004 in section 15 defines "guardianship" as the same as a parent, but a guardian has a different relationship with the child than a parent.

Comment

Section 15 of the Care of Children Act defines "guardian" as including parents. The proposed amendment is therefore unnecessary.

Recommendation

That the submission be declined.

"LEASEHOLD ESTATE" – FIRST HOME WITHDRAWAL AND DEPOSIT SUBSIDY

Issue: Earlier application date to cover inadvertent applications

Submission
(New Zealand Institute of Chartered Accountants)

Clause 80(4) removes the ineligibility of individuals with a leasehold interest from the first home withdrawal or deposit subsidy in clause 8, schedule 1 of the KiwiSaver Act 2006. There is no good reason to apply this amendment from 1 July 2010 so it should apply retrospectively to cover those individuals who have inadvertently applied and been granted a first home withdrawal or deposit subsidy with a leasehold interest.

Comment

As a result of the KiwiSaver commencement date of 1 July 2007 and the minimum three-year contribution period required for eligibility for first home withdrawal and the deposit subsidy, the earliest that any member could apply or be granted either of these benefits is 1 July 2010. Therefore, there is no need for a retrospective application date.

Recommendation

That the submission be declined.

PROVISION OF ANNUAL REPORT VIA HYPERLINK

Issue: Amendment should extend to all superannuation schemes

Submissions
(ASB, Chapman Tripp, ING, Workplace Savings NZ)

It would seem logical to extend this facility to all schemes registered under the Superannuation Schemes Act 1989, to broaden the application of annual report distribution via hyperlink. This could be achieved by amending section 17 of the Superannuation Schemes Act 1989 in the same way as has been proposed to amend the KiwiSaver Act.

Comment

This bill is a taxation bill and does not propose amendments to the Superannuation Schemes Act 1989. The Superannuation Schemes Act 1989 is not administered by Inland Revenue, and policy for that Act is advised on by the Ministry of Economic Development.

Therefore any request to consider an amendment to the Superannuation Schemes Act 1989, allowing annual reports to be provided via hyperlink, should be addressed by that Ministry.

Recommendation

That the submissions be declined.

Issue: Agreement in writing to receive annual reports by hyperlink

Submission
(Chapman Tripp)

If there is to be any conditionality around providers' ability to send annual reports by hyperlink, it should suffice simply for a member to have provided his or her email address. Anything more than that would rob the amendment of any immediate utility in relation to an existing KiwiSaver member (who will, at most, simply have given email addresses and possibly much more generic consents to receipt of electronic information).

Comment

Officials consider that the requirement for members to give consent could be expedited easily. For example, a member's acceptance could be received via a check box in an email sent from the provider. This would be consistent with other consent requirements for consumer protection.

Recommendation

That the submission be declined.

TEMPORARY EMPLOYMENT – REQUIREMENT TO MAKE KIWISAVER DEDUCTIONS

Submission
(Matter raised by officials)

An amendment should be made to the KiwiSaver Act 2006 to ensure that existing KiwiSaver members who begin temporary employment are able to give their employer a KiwiSaver deduction notice requiring deductions of contributions to be made from salary or wages. This will also ensure that, provided certain other criteria are met (in section 101C), a temporary employee is entitled to receive compulsory employer contributions.

Comment

Temporary employees such as those employed for less than 28 continuous days are not enrolled automatically in KiwiSaver. However, a temporary employee can opt-in to KiwiSaver either by giving their employer a KiwiSaver deduction notice or by contracting directly with a KiwiSaver scheme provider. The KiwiSaver deduction notice requires an employer to deduct KiwiSaver contributions from an employee's salary or wages. The requirement that an employer deduct an amount for the employee's KiwiSaver scheme also ensures that, as long as certain other criteria are met, compulsory employer contributions are made to the employee's KiwiSaver account.

However, if an individual is already a KiwiSaver member and begins temporary employment, the policy intent is that such an individual should have KiwiSaver deductions made from their salary or wages, and receive compulsory employer contributions. However, the current definition of "KiwiSaver deduction notice" in the KiwiSaver Act may prevent this from happening. This appears to be an anomaly in the legislation and should be rectified.

The purpose of KiwiSaver is to encourage long-term savings for all workers. Therefore, temporary employees who are already KiwiSaver members should be able to participate in KiwiSaver and receive employer contributions.

Recommendation

That the submission be accepted.

EMPLOYER EXEMPTION FROM AUTOMATIC ENROLMENT RULES

Submission
(Chapman Tripp, Workplace Savings NZ)

The exempt employer provisions in section 25 of the KiwiSaver Act 2006 should incorporate "successor in business" provisions which are analogous to those in section 35 of the Superannuation Schemes Act 1989. *(Chapman Tripp)*

A "successor in business" provision should also ensure that the employer's exempt status is not lost due to the employer migrating its superannuation scheme to a new provider due to dissatisfaction with the existing provider's performance or service. *(Workplace Savings NZ)*

Comment

Sections 24 to 32 of the KiwiSaver Act contain the rules allowing certain employers to be exempt from the requirement to automatically enrol their new employees in KiwiSaver. Employers can apply to the Government Actuary for approval for their employees to be exempt from the automatic enrolment rules if they provide access to an approved registered superannuation scheme which complies with specific criteria.

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 introduced a provision to ensure that employers could not establish schemes which are not KiwiSaver schemes for the apparent purpose of avoiding the automatic enrolment rules. It was considered that this behaviour undermined the policy intent of KiwiSaver and the rationale behind the exemption from the automatic enrolment rules. To overcome this concern, a sunset clause was introduced for the exemption from automatic enrolment. The exemption applies only if the scheme was in existence at the date of enactment of the amending legislation (6 October 2009).

There is concern that the sunset clause is not flexible enough to take into account situations such as mergers and acquisitions. In this situation, the replacement agreement would fall outside of the sunset clause and the employer concerned would lose its exempt employer status. A successor provision would preserve relief previously enjoyed by the employer by ensuring that an agreement that succeeds and replaces an existing agreement qualifies for the same relief which applied before the merger or acquisition.

Officials acknowledge that the sunset clause was not intended to be problematic in these situations and agree that a successor provision should be included in the legislation.

Recommendation

That the submissions be accepted.

ONGOING SHARING OF KIWISAVER MEMBER ADDRESSES

Submission
(ASB)

A legislative change should be made to allow the sharing of KiwiSaver members' address updates between Inland Revenue and providers. This change would help providers with the ongoing costs of returned mail and tracing members' address details.

Comment

This submission does not relate to an item in the bill. Officials consider it would be better to consider the matter for the next available tax bill to allow submissions to be received on the proposal.

Recommendation

That the submission be noted.

MISLED/MISINFORMED MEMBERS AND INCORRECT ENROLMENTS – WITHDRAWAL PROVISIONS

Submissions
(ASB, Chapman Tripp)

An independent body (such as the Ministry of Economic Development or the scheme's independent trustee) should have the power to instruct providers to close an account if they are satisfied the closure is in the best interests of the member. A high threshold test and strict guidelines should be put in place to ensure that this process is used only in extreme circumstances. *(ASB)*

It is unclear whether the KiwiSaver Act excludes the application of remedial statutes such as the Contractual Remedies Act 1979 where KiwiSaver membership contracts are entered into in circumstances of otherwise remediable mis-selling or mistake. The KiwiSaver Act could usefully be amended to prescribe, for avoidance of doubt, that it does not limit the application of relevant contract and consumer protection legislation. *(Chapman Tripp)*

Comment

These submissions do not relate to an item in the bill. This is a significant issue that requires extensive research. However, officials are aware of the issue and may consider it further as resources allow.

Recommendation

That the submission be noted.

SHORT-PAID EMPLOYER CONTRIBUTIONS

Submission
(ASB)

The KiwiSaver Act 2006 should be amended to take the responsibility away from the trustee and place the responsibility on employers and/or Inland Revenue to follow up on short-paid compulsory employer contributions. This should be a contractual issue between employees and employers.

Comment

Officials note that this is not a submission relating to an item in the bill. It is a significant issue that requires extensive research and investigation of fiscal costs. However, officials are aware of this issue and may consider it further as resources allow.

Recommendation

That the submission be noted.

KIWISAVER HARDSHIP CLAIMS

Issue: Access to employer contributions under the significant financial hardship criteria

Submission
(ASB)

A change to the legislation should be made to remove the ability for members to withdraw employer contributions if they are facing significant financial hardship. Alternatively, members should be allowed to withdraw only their own personal contributions in cases of significant financial hardship.

Comment

Officials note that this is not a submission relating to an item in the bill. It is an issue that requires further research. However, officials are aware of this issue and may consider it further as resources allow.

Recommendation

That the submission be noted.

Issue: Discretion for trustees to pay third parties in cases of significant financial hardship

Submission
(ASB)

The trustees of some other non-KiwiSaver superannuation schemes have the discretion to pay a member's balance (in full or in part) to a third party creditor if they have proven significant financial hardship and if the trustee believes it is in the best interest of the member to do so.

KiwiSaver scheme trustees should be given the same flexibility to pay amounts directly to creditors of proven arrears. This will ensure that KiwiSaver amounts withdrawn for significant financial hardship are used for the reasons claimed.

Comment

Officials note that this is not a submission relating to an item in the bill. It is an issue that requires further research. However, officials may consider this further as resources allow.

Recommendation

That the submission be noted.

WITHDRAWING CROWN CONTRIBUTIONS FOR SERIOUS ILLNESS

Submission
(ASB)

There is nothing to prevent an individual who is suffering from a serious illness from joining KiwiSaver. Once a KiwiSaver member, they are potentially eligible for a serious illness withdrawal, therefore entitling them to withdraw the government contributions.

A legislative change should be made to ensure that, if it is proven that a member was suffering from a serious illness at the time that they joined KiwiSaver, they are unable to withdraw any Crown contributions.

Comment

Officials note that this is not a submission relating to an item in the bill. This issue will require further research. However, officials may consider it further as resources allow.

Recommendation

That the submission be noted.

Binding rulings

LEGISLATION SHOULD ENCOURAGE THE COMMISSIONER TO RULE

Submission
(New Zealand Institute of Chartered Accountants)

The overall policy intent of the changes is supported. However, the overall statutory scheme of the binding rulings regime needs to be reset to encourage the Commissioner to rule as the default or starting position. More specifically, the amendments to the rulings regime should ensure that:

- the changes encourage the Commissioner to issue a binding ruling rather than decline to rule;
- the Commissioner does not use his powers of restriction unnecessarily; and
- there is consistency of application of the law by the Commissioner and the Crown.

Comment

The binding rulings system is aimed at providing certainty for taxpayers in assessing their tax liabilities. Officials agree that restrictions to this ability need to be justifiable. Relevant factors to take into account in setting any restrictions are the need to protect the revenue base and the need for consistency in interpreting tax laws.

Several proposals in this bill are aimed at improving taxpayer certainty by clarifying when the Commissioner can rule (for example, the amendments to the prohibition of ruling on questions of fact and the discretion not to rule when a similar matter is subject to appeal). Other proposals are aimed at expanding the circumstances when a ruling can be made (for example, allowing the Commissioner to make a binding ruling in favour of one tax type only, even though the application relates to more than one or allowing promoters to apply for rulings).

None of the proposals in the bill give the Commissioner greater powers to decline to rule than currently exist.

Recommendation

That the submission be noted.

QUESTIONS OF FACT

Issue: Matters on which the Commissioner cannot rule

Submission
(Corporate Taxpayers Group, KPMG, New Zealand Institute of Chartered Accountants)

While it is accepted that the Commissioner should not generally be expected to be an "expert" in items (b) – (d) (of the definition of "proscribed question") the Commissioner should be able to rule on these matters on the basis that he is satisfied with the level of evidence provided by a taxpayer in support of either:

- their intention;
- the value of something; or
- what is commercially acceptable practice.

Inland Revenue operational/audit staff are expected to satisfy themselves of these matters on a daily basis, routinely deciding whether to audit a taxpayer or when undertaking an audit. Therefore we believe it is reasonable and appropriate to enable the Commissioner to provide a view outside of an audit context on the above matters. *(Corporate Taxpayers Group)*

Inland Revenue should be able to issue binding rulings on any matter on which it can make an assessment (for example, questions of fact, commercially acceptable practice, and generally accepted accounting practice). *(KPMG)*

Consistent with our view that the statutory scheme of the binding rulings regime should be designed to encourage the Commissioner to rule, the Commissioner should not be prohibited from giving a ruling in relation to a person's purpose or intention (proposed paragraph (b) of the definition) or what is commercially acceptable practice (proposed paragraph (d) of the definition). *(New Zealand Institute of Chartered Accountants)*

Comment

Under the Tax Administration Act 1994 taxpayers who seek rulings (currently private, product and status rulings) are not required to follow the ruling, whereas Inland Revenue must apply the law as set out in the ruling.

Officials consider there is some validity to the submitters' questioning the argument that the Commissioner does not have expertise in relation to matters such as valuation and commercially acceptable practice. However, the more general question is how Inland Revenue applies its resources. If the Commissioner were to rule on a very broad a range of matters, the time taken to make binding rulings would increase. This is not the outcome sought by submitters.

Officials consider that it is important to differentiate the rulings process from the process of considering a taxpayer's self-assessment. We note that an audit or investigation occurs after a taxpayer has made their tax self-assessment and factual matters can be the subject of more lengthy debate and expert evidence may be called for. In a ruling the Commissioner rules on the facts as provided by the taxpayer. The ability for taxpayers to seek binding rulings was intended to enable them to gain certainty in undertaking the self-assessment process. Hence binding rulings have a specific purpose rather than being a general source of assistance from Inland Revenue.

Revenue risks will arise if the Commissioner, owing to resource constraints and the need to respond in a timeframe that meets the taxpayer's business needs, is forced to make an early determination about the facts. This risk is compounded by the complexity and large dollar amounts involved in many rulings applications. This risk would arise when the facts turn out not to be as presented and the Commissioner has to argue that the ruling will not apply. The Commissioner can do this only if the arrangement is materially different from the arrangement identified in the ruling or there was a material omission or misrepresentation in the application for the ruling.

If the arrangement being ruled on is prospective the Commissioner could not sensibly determine questions of fact since something must be in existence for it to be a fact. We note that rulings are not limited to prospective transactions, however, for pragmatic reasons.

Recommendation

That the submission be declined.

Issue: Discretion to rule on intention and value

Submission
(New Zealand Institute of Chartered Accountants, PricewaterhouseCoopers)

The Commissioner should be given the option to provide a ruling regarding a person's purpose or intention, or what is "commercially acceptable practice". *(New Zealand Institute of Chartered Accountants)*

The general rule that the Commissioner cannot rule on questions of fact should be retained, but the Commissioner should have the discretion to rule on, for example, a taxpayer's intention, purpose, or the value of a business or asset.
(PricewaterhouseCoopers)

Comment

The list of criteria under which the Commissioner has a discretion not to rule is very limited. Giving the Commissioner a discretion in relation to proscribed questions of fact would reduce certainty about the issues the Commissioner can rule on. This would defeat the objective of the proposals which is to clarify what constitutes a question of fact.

Recommendation

That the submission be declined.

Issue: Commercially acceptable practice

Submission
(New Zealand Institute of Chartered Accountants)

If the purpose of prohibiting the Commissioner from ruling on what is commercially acceptable practice is to prevent the Commissioner from dictating what is or is to be "commercially acceptable practice", the Institute agrees with the proposed amendment. If this is so the wording of paragraph (d) of the definition of "proscribed question" should be reworded to clarify its meaning.

Comment

Currently the Commissioner may not rule if the application for the ruling would require the Commissioner to form an opinion as to generally accepted accounting practice or to form an opinion as to a commercially acceptable practice. Officials note that the current scope of the exclusion for commercially acceptable practice is unclear.

The proposal clarifies that the exclusion for commercially acceptable practice is limited to where that term is used in tax legislation (such as in the rules relating to the tax treatment of financial arrangements). It does not therefore prevent the Commissioner from ruling on broader matters such as the application of the general anti-avoidance provision. Ruling on anti-avoidance matters may require the Commissioner to consider the commerciality of the arrangement and the Commissioner should not be restricted in doing so.

Recommendation

That the submission be declined.

Issue: Proposal should not proceed

Submission
(Ernst & Young)

The proposed new definition of "proscribed facts" and the resulting amendments are not necessary and do not provide any further certainty or clarity for taxpayers but may open more scope for argument as to the extent to the Commissioner's powers in relation to binding rulings.

Comment

Under current sections 91E(4)(a) and 91F(4)(a) the Commissioner is prohibited from ruling on questions of fact. The Commissioner can rule on the facts as presented by the applicant, but cannot determine the correctness of the facts.

The submission appears to consider that the provisions should and do allow the Commissioner to rule on the application of the general anti-avoidance provisions in the income tax and GST legislation.

On an alternative interpretation of sections 91E(4)(a) and 91F(4)(a), however, it could be argued that the Commissioner is prohibited from making a ruling when doing so would expressly or implicitly require particular facts to be found to exist. In that case, the Commissioner may be unable to rule on fact-dependent issues such as the application of the general anti-avoidance provision or specific anti-avoidance provisions. Such a broad interpretation would be inconsistent with the understanding and application of the binding rulings provisions by taxpayers, tax practitioners and Inland Revenue since the binding rulings regime was introduced in 1994. The inability to obtain a binding ruling on questions of avoidance would reduce certainty for businesses.

Recommendation

That the submission be declined.

Issue: Use of "may"

Submission
(New Zealand Institute of Chartered Accountants)

The interpretation of the word "may" in the context of sections 91E(3), (4) and 91F(3), (4) should be clarified.

Comment

The context of sections 91E (which allows the Commissioner to make private binding rulings on request) and 91F (which allows the Commissioner to make product rulings) provide sufficient clarity for the legal interpretation of the words "may" and "may not" as they are variously used in those sections.

In sections 91E(4) (which lists the circumstances when the Commissioner may not make a private ruling) and 91F(4) (which lists the circumstances when the Commissioner may not make a product ruling), the words "may not" clearly introduce mandatory prohibitions, despite "may", on its own (that is, when "may" is unqualified by "not"), usually conveying discretion or permission.

In sections 91E(3) and 91F(3), the word “may” is not qualified by “not”. It therefore introduces a discretion and is intended to do so.

Recommendation

That the submission be declined.

TREATMENT OF INFORMATION

Issue: Response to proposal

Submission
(New Zealand Institute of Chartered Accountants, PricewaterhouseCoopers)

The Institute supports the proposed amendment which clarifies that the Commissioner may make a ruling based on the facts provided by the applicant and may inquire as to the correctness or existence of fact provided by the applicant, but is not required to do so. *(New Zealand Institute of Chartered Accountants)*

The proposed change should not be enacted. *(PricewaterhouseCoopers)*

Comment

The bill proposes that the Commissioner cannot rule as to whether a fact is correct or exists. The proposal clarifies that the Commissioner must make a ruling based on the facts provided by the applicant. If there is something apparently incorrect in the application, the proposal allows the Commissioner to question this but he is not required to do so.

The PricewaterhouseCoopers submission is concerned that the last aspect of the proposal does not sit comfortably with the proposal to introduce "proscribed questions of fact".

The aspect of the proposal that is causing concern allows the Commissioner to inquire as to the correctness of facts when there is an obvious error in the application. However, this should save time and money for both the Commissioner and the applicant.

Recommendation

That the submission be declined.

ABILITY TO RULE WHEN THE MATTER IS SUBJECT TO A CASE BEFORE THE COURTS

Issue: The restriction should be removed

Submission
(KPMG, New Zealand Institute of Chartered Accountants)

Inland Revenue should be able to issue binding rulings on matters before the courts. *(KPMG)*

The restriction on issuing a ruling when the matter is the subject of a dispute by way of objection, challenge, or appeal should be removed altogether. *(New Zealand Institute of Chartered Accountants)*

Comment

The Commissioner has a discretion under which he can decline to rule "if the matter on which the ruling is sought is subject to an objection, challenge or appeal, whether in relation to the applicant or to any other person". The provision is expressed in general terms and its scope, particularly the term "matter" is unclear. The provision does not allow for an unduly narrow interpretation such as requiring an identical transaction and the same or an associated taxpayer. At the other extreme, it would be inappropriate to apply it to all instances when an issue arises that is commonly determined in a transaction – for example, the application of the general anti-avoidance provision – as that would allow the Commissioner to turn down any ruling application on that issue. This lack of clarity does not give businesses certainty.

The bill proposes that the Commissioner's discretion not to rule on matters before the courts be limited to cases involving substantially similar issues or arrangements. Therefore, while it is proposed to retain the discretion, it is being substantially narrowed.

Narrowing, or removing, the discretion further would mean that the Commissioner would be required to rule in an area of law that is uncertain. This could result in taxpayers obtaining inconsistent outcomes. It could also result in revenue risks were the Commissioner forced to rule before a similar arrangement in existence at the same time had been tested by the courts. This is particularly so given the inability of the Commissioner to investigate facts in the rulings context (which officials recommend should be retained).

Recommendation

That the submission be declined.

Issue: The term "substantially the same" should be defined

Submission
(New Zealand Institute of Chartered Accountants)

The term "substantially the same" should be defined in the legislation or replaced with a more precise term.

Comment

The proposal narrows the scope of current section 91E(3)(b) in that it would no longer apply to a "matter on which the ruling is sought" but rather to "an arrangement on which the ruling is sought or a separately identifiable part of the arrangement, substantially the same as the arrangement subject to the objection, challenge or appeal".

The word "substantial" has been interpreted by the courts and officials understand that this imports a high threshold. There is no reason to think that the word "substantially" would be interpreted differently. Given the differing factual scenarios that could arise under the proposed new rule, officials do not consider that further definition would be particularly helpful. We note that the term "substantially" is used elsewhere in tax legislation and that an attempt at further definition has not been made there either.

Recommendation

That the submission be declined.

Issue: Should not apply to separately identifiable parts of the arrangement

Submission
(Ernst & Young, KPMG)

The references to separately identifiable parts of the arrangement should be deleted. *(Ernst & Young)*

The effect of the proposed amendment on an arrangement which is only partly the subject of a court dispute needs to be clarified. *(KPMG)*

Comment

The Ernst & Young submission notes that "the tax treatment of a "separately identifiable part of an arrangement" may differ significantly, depending on the rest of the arrangement of which it is part".

Officials agree and note that ruling on a separately identifiable part of the arrangement rather than the whole arrangement will be at the Commissioner's discretion.

However, we consider that the references to separately identifiable parts needs to be retained for those cases when there are differences in the arrangement being considered but the principal underlying feature in both is the same.

Recommendation

That the submission be declined.

Issue: The definition of "arrangement" should be widened

Submission
(New Zealand Institute of Chartered Accountants)

The definition of "arrangement" in section 3 should be widened for the purposes of the rulings regime.

Comment

The definition of "arrangement" in section 3 of the Tax Administration Act 1994 is already very broad. The same definition is used in the rulings regime and the general anti-avoidance provision and in the financial arrangement rules. A rulings "arrangement" has the additional feature of allowing the Commissioner to include in it "facts that the Commissioner considers are material or relevant as background or context".

Officials are not aware of any problems with the current definition. Basing the rulings regime on the "arrangement" concept seems appropriate as it is a regime to provide certainty and this can be achieved by ensuring consistency with usage in other areas of the law.

Recommendation

That the submission be declined.

Issue: The arrangement should be the same arrangement

Submission
(Ernst & Young, New Zealand Law Society)

Any such inability or discretion to rule should be limited to situations where the court proceedings are already in train and relate to the specific arrangement and parties who are seeking the rulings. *(Ernst & Young)*

Sections 91E(3)(b) and 91F(3)(b) should be confined to situations in which the challenge proceedings concern the same arrangement and the particular tax laws on which the ruling is sought. *(New Zealand Law Society)*

Comment

The legislation currently gives the Commissioner a discretion not to rule if the matter on which the ruling is sought is subject to appeal. The proposal narrows the current legislation in that it would no longer apply to a "matter on which the ruling is sought" but rather an arrangement on which the ruling is sought or a separately identifiable part of the arrangement, substantially the same as the arrangement subject to the objection, challenge or appeal".

If the Commissioner's discretion were exercised only in relation to the same arrangement and parties, a ruling could be sought, and given in relation to another arrangement covering the same issues as those being appealed, resulting in inconsistent outcomes for the parties. This would reduce certainty for the parties and give rise to the revenue and other risks officials identified earlier.

Recommendation

That the submission be declined.

Issue: Guidelines

Submission
(KPMG)

Inland Revenue should publicly release guidelines on what factors are taken into account in the exercise of the discretion.

Comment

Officials consider that the factors that would be taken into account in exercising this discretion are not general – that is, the exercise of the discretion will be considered on a case-by-case basis. We consider that it would be difficult to compile a useful list of facts that would determine two particular arrangements in a ruling application and a dispute to be substantially the same. Each case would involve an individual judgement based on the particular facts and their degree of similarity.

Recommendation

That the submission be declined.

Issue: The Commissioner should be required to notify an applicant that the issue is before the courts

Submission
(KPMG, New Zealand Institute of Chartered Accountants)

If Inland Revenue exercises that discretion, it should inform the taxpayer of its position on the tax law involved. *(KPMG)*

As part of this amendment the legislation should require the Commissioner to notify the applicant that the issue is before the court and what Inland Revenue's position is. *(New Zealand Institute of Chartered Accountants)*

Comment

The 1994 discussion document, *Binding Rulings on Taxation*, explained the policy intention of the discretion in section 91E(3)(b) and noted that "Inland Revenue will notify the applicant that the issue is before the court and what Inland Revenue's position is". The proposal to notify the applicant did not proceed.

As the provision applies to ruling and dispute arrangements that may involve different parties, such a requirement could be contrary to taxpayer secrecy, including under section 81.

In practice, Inland Revenue will advise an applicant affected by the provision about the dispute if the dispute is in the public domain (for example, a decision is under appeal). If both the ruling and disputed arrangement are entered into by the same person, Inland Revenue is obviously able to discuss the relevant issues.

Recommendation

That the submission be noted.

MASS MARKETED AND PUBLICLY PROMOTED SCHEME RULINGS

Issue: Authority of person making a statutory declaration

Submission
(New Zealand Institute of Chartered Accountants,)

The legislation should stipulate the level of authority of the person who is to make the statutory declaration of the promoter.

Comment

The proposal requires the person making the application, being the promoter of the arrangement, to make a statutory declaration. Any person signing the declaration is therefore doing so on behalf of the promoter. If they are falsely representing the promoter other sanctions will be available. Specifying in the legislation the minimum level of authority seems to be unnecessary.

Recommendation

That the submission be declined.

Issue: Definition of "promoter"

Submission
(New Zealand Institute of Chartered Accountants,)

The definition of "promoter" should be amended and supporting administrative practices within the Inland Revenue Department should be put in place to confirm the scope of the proposal and to ensure that a consistent view is adopted of who or what a "promoter" is.

Comment

There is a definition of "promoter" already in section 141ED(1) of the penalty provisions in the Tax Administration Act 1994. The definition provides that a "promoter" means:

> (a) A person who is a party to, or is significantly involved in formulating, a plan or programme from which an arrangement is offered; or
> (b) A person who is aware of material and relevant aspects of the arrangement and who sells, issues or promotes the selling or issuing of, the arrangement, whether or not for remuneration.

This proposal will use the same definition in sections 91FC and 91FD.

Recommendation

That the submission be declined.

DECLINING TO RULE WHEN AN ARRANGEMENT IS THE SUBJECT OF A DISPUTE

Issue: Extension of proposal to audits

Submission
(New Zealand Institute of Chartered Accountants)

The amendment to allow the Commissioner to make a ruling if the application relates to an arrangement that is being disputed, provided the application for the ruling relates to a different tax type from that being disputed, should be extended to cases when the Commissioner is auditing or investigating the taxpayer and not limited to tax type.

Comment

Under section 91E(4)(ga) the Commissioner may not make a private ruling if the application relates to an arrangement that is being disputed by way of a notice of proposed adjustment (NOPA). This provision ensures that there is no overlap between the disputes resolution process and the binding rulings regime. It also ensures that certainty for the taxpayer about the Commissioner's position is maintained.

The section is being amended to provide an exception to this prohibition which will apply if the application for the ruling relates to a different tax type from that being disputed.

In an audit or dispute, factual matters can be the subject of more lengthy debate and expert evidence. In a ruling, the Commissioner rules on the facts as provided by the applicant may be used. The arrangement is often prospective.

Any questions over the correct tax treatment of an arrangement are best resolved in the audit or dispute context if these have begun. Considering a binding ruling application can involve considerable resources on Inland Revenue's part and is not necessarily conducive to the speedy resolution of an audit or dispute. Currently the disputes process is being reviewed to further facilitate resolution; having the taxpayer able to apply for a binding ruling at the same time may be detrimental to this process.

We also note that the proposal in relation to disputes only applies when the tax type on which the ruling is sought is not being disputed. In an audit situation one tax type may be audited initially but the other tax types subsequently considered. Ruling on a particular aspect of a taxpayer's assessment could undermine the audit process. This risk is not a concern in the disputes context.

Recommendation

That the submission be declined.

Issue: Taxpayers should be able to seek a ruling when they have self-assessed

Submission
(KPMG)

Taxpayers should be able to request a binding ruling for the current tax period after their self-assessment for the current tax period.

Comment

Rulings may be sought only on prospective arrangements or on arrangements in relation to which the taxpayer has not made the relevant self-assessment and has therefore not taken the relevant tax position.

As we have noted, officials consider that it is important to differentiate the rulings process from the process of considering a taxpayer's self-assessment. Once the self-assessment is undertaken, the taxpayer may be either subject to audit or (within a four-month period) file a taxpayer-initiated notice of proposed adjustment. Officials have noted that in the case of an audit that process is better suited for reaching an outcome. If the concern is with the taxpayer notice of proposed adjustment, the issue would be best dealt with as part of the Government's current review of the tax disputes process.

Recommendation

That the submission be declined.

Issue: Application date

Submission
(Ernst & Young)

The changes should apply to all applications which have not been declined on the paragraph 91E(4)(ga) ground, or which have not been finalised and issued, before enactment of the bill.

Comment

Section 91E(4)(ga) is being amended to provide an exception to the prohibition on ruling on disputed arrangements that are the subject of a NOPA. The exception will apply if the application for the ruling relates to a different tax type from that being disputed. Currently, the proposal will apply from the date the bill is enacted.

Officials are unaware of any reason for the proposal not to apply to ruling applications which have already been lodged but have not yet been declined or finalised by the time the bill is enacted.

Recommendation

That the submission be accepted.

A RULING THAT FAILS IN PART

Issue: Agree with proposal

Submission
(KPMG, New Zealand Institute of Chartered Accountants)

The bill's amendments that are intended to allow taxpayers to rely on a binding ruling in part, based on tax type, are sensible and agree with our previous submissions on the binding rulings system. *(KPMG)*

The Institute supports the proposed amendment as it allows taxpayers to rely on parts of a ruling that they apply without having to apply all the rulings made by the Commissioner in relation to the arrangement. *(New Zealand Institute of Chartered Accountants)*

Comment

Currently under section 91EB(2) a binding ruling involving material differences with the arrangement actually undertaken is treated as fully invalid even if those differences are material only to certain aspects of the ruling. An example is when a ruling relates to both GST and income tax and the material differences relate only to the GST issues.

Amendments are proposed so that a ruling can be made invalid in part rather than only in full. The partial validity will apply if not all tax types ought to be affected by a general invalidity. The proposal will provide greater flexibility in the rulings process.

Recommendation

That the submission be noted.

Issue: Application of proposal to rulings on more than one tax law

Submission
(New Zealand Institute of Chartered Accountants)

The scheme of the rulings regime should be reconsidered to confirm that the amendment achieves the desired objective of requiring a taxpayer to apply all the Commissioner's rulings in relation to a tax type and the tax position(s) being considered.

Comment

Officials consider that a ruling which has two issues (for example, deductibility and assessability or a ruling on more than one tax) is only one, not two, rulings.

In other words, under the amended legislation, Inland Revenue's practice of treating a ruling on a number of issues as one ruling will remain unchanged. The legislation will, however, allow a ruling that is taxpayer-positive for one tax type and taxpayer-negative for another to apply when it relates to the positive outcome only.

Recommendation

That the submission be declined.

Issue: Application date

Submission
(Ernst & Young, KPMG)

The changes should apply to all applications which have not been finalised and issued before enactment of the bill. *(Ernst & Young)*

The amendments are limited to binding rulings whose application is received after the date of Royal assent for the bill. This limitation is inconsistent with the purpose of the bill to increase certainty. We submit that all existing rulings should be able to take the benefit of the amendments at any time after the date of Royal assent. *(KPMG)*

Comment

Officials agree that the application date of the amendments to section 91E(4)(ga) as they relate to allowing a partially accepted application should be amended to extend to all existing rulings.

Recommendation

That the submission be accepted.

PUBLICATION OF NOTIFICATION OF BINDING RULINGS IN THE *GAZETTE*

Issue: Agree with proposal

Submission
(New Zealand Institute of Chartered Accountants)

The Institute agrees with the proposal to no longer require the Commissioner to publish notification of rulings in the *Gazette* and instead publish this information in a publication chosen by the Commissioner.

Comment

The binding rulings legislation requires Inland Revenue to notify the making and withdrawal of public and product rulings in the *Gazette*. Public and product binding rulings are also published in full in Inland Revenue's *Tax Information Bulletin* (TIB). The TIB is available on Inland Revenue's website and a paper copy can be requested. The TIB will continue to be the main vehicle for publication.

The bill proposes to replace the requirements that the Commissioner publish the making and withdrawal of public and product rulings in the *Gazette* with requirements that the Commissioner publish this information in a publication chosen by the Commissioner.

Recommendation

That the submission be noted.

Issue: Other provisions which should be amended

Submission
(New Zealand Institute of Chartered Accountants, PricewaterhouseCoopers)

There are other sections in the Tax Administration Act 1994 requiring the Commissioner to publish the making or revocation of determinations that have been omitted from the bill. The amendment should be extended to notifications of extension of public rulings (section 91DD(2)) and status of product rulings (section 91GG(2)(a)). *(New Zealand Institute of Chartered Accountants)*

The reference to "the *Gazette*" in the following sections should also be replaced with the phrase "a publication chosen by the Commissioner" in sections 91AAl(4)(b), 91AAK, 91DD(1) and 91GG(2). *(PricewaterhouseCoopers)*

Comment

Similar amendments should be made to the following sections in the Tax Administration Act 1994:

- 91AAK (Notice of setting economic rate);
- 91AAQ (Determination of insurer as a non-attributing active CFC); and
- 91AAR(6) (Determination relating to eligible relocation expenses).

However section 91AAF(6), 91AAG(7) and 91AAI(4) provide for the revocation of provisions effective the day after publication in the *Gazette*. The *Gazette* is published weekly. The *Tax Information Bulletin*, for example, is published in most cases monthly. Officials therefore consider, due to the frequency of the *Gazette's* publication, these sections should continue to refer to the *Gazette*. The issue will be considered further at a later date.

Recommendation

That the submission be accepted.

Issue: Specification of publication

Submission
(PricewaterhouseCoopers)

The Commissioner should be required to specify the publication(s) that notices will be published in.

Comment

It is not necessary to specify the publication in which the Commissioner will publish notices. The Commissioner will publish the notices in an appropriate publication. Naming, for example, the *Tax Information Bulletin*, in legislation or regulation would mean that if the name of the publication changed the legislation or regulation would need to be updated.

Recommendation

That the submission be declined.

UNACCEPTABLE TAX POSITION PENALTIES AND USE-OF-MONEY INTEREST

Issue: Agree with proposal

Submission
(Corporate Taxpayers Group, KPMG, New Zealand Institute of Chartered Accountants)

The changes made to remove both penalties and use-of-money interest where a taxpayer has relied on the advice of the Inland Revenue are supported. *(Corporate Taxpayers Group)*

KPMG agrees with the proposed amendments clarifying that if a taxpayer has relied on official advice from Inland Revenue, the unacceptable tax position penalty and use-of-money interest cannot apply. *(KPMG)*

The Institute agrees with this proposal in principle. *(New Zealand Institute of Chartered Accountants)*

Comment

A shortfall penalty for taking an unacceptable tax position can be imposed when a taxpayer's tax position fails to meet the standard of being "about as likely as not to be correct". The penalty applies when the tax position involves a significant amount of tax. Use-of-money interest imposed on a taxpayer is charged when tax is underpaid and compensates the Crown for not having the use of its money.

It is possible that an unacceptable tax position penalty and/or use-of-money interest may apply if the taxpayer has underpaid their tax, even if this is as a result of having relied on advice provided by Inland Revenue.

Proposed sections 120W and 141B(1D) and a definition of "Commissioner's official opinion" are included in the bill to ensure that taxpayers who rely on official Inland Revenue advice will not be subject to use-of-money interest or to the unacceptable tax position penalty. The provision will apply to advice provided orally or in writing by the Commissioner as the official position of Inland Revenue and which is applicable specifically to the taxpayer (with all the relevant facts having been provided by the taxpayer).

The amendment will not apply to advice that is in the form of a private binding ruling. As the ruling is binding on the Commissioner, the taxpayer, in following the ruling, is already not be subject to interest or the unacceptable tax position penalty.

Recommendation

That the submissions be noted.

Issue: Application to Commissioner's public statements

Submission
(Corporate Taxpayers Group, KPMG, New Zealand Institute of Chartered Accountants, New Zealand Law Society)

The legislation should be extended to situations where the taxpayer has relied on general advice provided by Inland Revenue, such as commentary provided in Inland Revenue publications or on its website. *(Corporate Taxpayers Group)*

The bill should extend the exemptions from use-of-money interest and the unacceptable tax position penalty to taxpayers who rely on general statements. *(KPMG)*

The amendment should be extended to apply to the Commissioner's publicly released statements. *(New Zealand Institute of Chartered Accountants)*

The proposed new safe harbour relating to reliance on the "Commissioner's official opinion" should extend to written guidance published by the Commissioner, if applicable to the particular taxpayer and their particular circumstances. *(New Zealand Law Society)*

Comment

If the proposal were to extend to general guidance or statements Inland Revenue will not necessarily be able to determine whether a taxpayer did or did not at the relevant time rely on the advice. Alternatively, the taxpayer may interpret a general statement in a way that Inland Revenue would not agree fitted their particular case.

The unacceptable tax position penalty and use-of-money interest (which is intended to apply generally to underpayments rather than as a penalty) would therefore be relatively simple to avoid. This in turn would undermine the voluntary compliance objectives of these measures.

Section 183D of the Tax Administration Act 1994 allows the Commissioner to remit use-of-money interest if remission is consistent with the Commissioner's duty to collect over time the highest net revenue that is practicable within the law. The Commissioner's standard practice statement 05/10 sets out the Commissioner's practice in granting remission of penalties and interest. The Commissioner will remit use-of-money interest in limited circumstances, such as when an Inland Revenue officer has given incorrect advice to the taxpayer, and that advice has directly resulted in the non-compliance. The Commissioner considers each case on its merits.

The remission provisions are therefore available to taxpayers and will be applied by the Commissioner if appropriate when reliance on general guidance or statements has resulted in the taxpayer taking an incorrect position.

Recommendation

That the submission be declined.

Issue: Scope of the proposal

Submission
(Ernst & Young, New Zealand Institute of Chartered Accountants)

There needs to be clarification of the respective scope and commencement of the two new proposed provisions, of the interaction between them and of what will constitute "official departmental advice" and a "Commissioner's official opinion". The proposed new subsection 120AA(3) of the Tax Administration Act should apply only to relieve taxpayers from use-of-money interest on underpaid tax and should not prevent them being credited with use-of-money interest when tax has been overpaid when relying on the Commissioner's advice or opinions. *(Ernst & Young)*

The consequences of relying on the "Commissioner's official opinion" or "official departmental advice" should be the same. A person who overpays income tax as a result of relying on the official advice or opinion of the Commissioner should be entitled to receive use-of-money interest. *(New Zealand Institute of Chartered Accountants)*

Comment

Officials agree that the scope of the proposal needs to be clarified. If a taxpayer overpays tax, Inland Revenue should pay use-of-money interest. Both provisions should apply to oral and written advice from Inland Revenue which is provided specifically to the taxpayer. Officials recommend that clause 67 be omitted.

Recommendation

That the submission be accepted by removing clause 67.

Issue: Phrases should be defined

Submission
(New Zealand Institute of Chartered Accountants)

The term "official departmental advice" should be defined.

Further definition is required on what is meant by "advice that is standard in nature" and the term "common tax issue".

Comment

Officials are recommending that the clause containing the phrases "official departmental advice", "advice that is standard in nature" and "common tax issue" be omitted. Defining these terms in the legislation would in any case be difficult.

Recommendation

That the submission be declined.

Issue: "Solely" should be deleted from the proposal

Submission
(Ernst & Young)

The word "solely" should be deleted from the proposed new section 120W.

Comment

Under the proposed changes a taxpayer is liable to pay penalties and use-of-money interest to the extent to which these arose solely because the taxpayer relied on the Commissioner's official opinion. The inclusion of "solely" imposes an almost impossible test – if the taxpayer had relied on advice from a number of sources, including Inland Revenue, the taxpayer would not have relied on advice "solely" from Inland Revenue and could be subject to penalties and interest. Officials agree that "solely" should be deleted.

Recommendation

That the submission be accepted.

Issue: Application date

Submission
(New Zealand Law Society)

The Committee should also give consideration to bringing forward the application date of this safe harbour, so that it may apply to tax positions taken on or after the date of Royal assent, at least for opinions published as guidance for the general public or a particular group of taxpayers.

Comment

As noted previously, these proposals do not cover public statements, but rather advice provided orally or in writing by the Commissioner as the official position of Inland Revenue and which are applicable specifically to the taxpayer. In this more limited context the issue does not arise.

Recommendation

That the submission be declined.

Issue: Guidelines

Submission
(PricewaterhouseCoopers)

Inland Revenue should provide guidelines for how this provision will operate, for example, it should explain the steps that a taxpayer is required to take when seeking to rely on the Commissioner's official opinion.

Comment

Inland Revenue usually provides information to taxpayers about how key administrative processes operate following the enactment of legislation affecting those processes. The submission will therefore be considered for this purpose.

Recommendation

That the submission be noted.

CHARGING FOR BINDING RULINGS

Issue: Agree with proposal

Submission
(New Zealand Institute of Chartered Accountants)

The Institute agrees with this proposal.

Comment

Private, product and status binding rulings all incur fees that are based on recovering the cost of providing the ruling. Currently, Inland Revenue may in exceptional circumstances, at the Commissioner's discretion, waive in whole or in part any fee payable by an applicant. More flexibility is required for the exercise of the waiver.

Currently, the fees assume a GST-inclusive rate of 12.5% and do not take into account the fact that binding rulings issued to non-residents outside New Zealand may be zero-rated under the Goods and Services Tax Act 1985 and making the ruling more costly if the non-resident is not GST-registered.

The bill proposes an amendment to the Tax Administration (Binding Rulings) Regulations 1999 to provide for a more flexible fee-waiver provision based on what the Commissioner considers is fair and reasonable. The fees for zero-rated supplies of binding rulings will be reduced by the tax fraction of the fee.

Recommendation

That the submission be noted.

Issue: Guidelines

Submission
(New Zealand Institute of Chartered Accountants)

Guidelines on what the Commissioner would consider to be fair and reasonable circumstances for a fee waiver would be helpful. To ensure the policy intent of the amendments is applied in practice, a wide interpretation of "fair and reasonable" should be adopted.

Comment

The bill proposes that the waiver provision be amended based on what is fair and reasonable in the circumstances and having regard to the nature of the issues that are the subject of the application, the level of skill and experience required in the consideration of the application, and any other relevant factors. Officials consider that guidelines would be difficult to draft as what the Commissioner considers "fair and reasonable" must be determined on a case-by-case basis.

Recommendation

That the submission be declined.

OTHER MATTERS

Issue: Time limit

Submission
(New Zealand Institute of Chartered Accountants)

Time limits should be imposed on the Commissioner in the binding rulings process.

Comment

Inland Revenue has conducted an administrative review of the rulings process, and consulted with interested groups about ways in which concerns relating to timeliness can be addressed. Inland Revenue is undertaking more up-front consultation with the applicant to ensure the issues are clearly identified, allocating some ruling applications to areas of the department other than the Office of the Chief Tax Counsel and aiming to complete rulings within three months of receipt of the application.

The issues raised in a binding ruling application can be numerous and complex, therefore some flexibility in the timeframes may be needed in exceptional cases. If the legislation were amended to set out a time limit for binding rulings and the deadline could not be met, the Commissioner would issue a negative ruling – and if the taxpayer chose to withdraw the ruling application or not follow the ruling, the taxpayer would not be provided with any certainty.

Recommendation

That the submission be declined.

Issue: Content and notification of a public ruling

Submission
(New Zealand Institute of Chartered Accountants)

The legislation should be amended to state that all public rulings will apply only on a prospective basis.

Comment

Currently the Commissioner is not restricted in his ability to rule retrospectively. This may not seem desirable to taxpayers. However, in practice ruling retrospectively is only done to ensure that there is certainty when there would otherwise be a "gap" between the expiry of one ruling and the issuing of another.

Inland Revenue is aiming to ensure that a replacement ruling is issued on or before the previous one expires.

Recommendation

That the submission be declined.

Issue: Application of ruling after expiry

Submission
(New Zealand Institute of Chartered Accountants)

The Tax Administration Act 1994 should be amended to confirm the application of a public ruling in the period after the date of expiry to the date the ruling is reissued.

Comment

The submission is inconsistent with one of the key aspects of the scheme and purpose of the binding rulings legislation. The regime is intended to give the Commissioner the option of ruling for a period of time (section 91DA(1)(e)(i)) or indefinitely (section 91DA(1)(e)(ii)). Given the option of taking a binding position for a period, this means that once a ruling expires it will have no effect. The Commissioner may in those circumstances decide to "reissue" a ruling for a further period or indefinitely. In some cases he may decide not to reissue or replace a ruling at all. This could be for a range of reasons – for example, if the legislation has changed, or the arrangement does not occur or occurs so infrequently as to make the ruling largely redundant.

An automatic extension would not sit comfortably with rulings that needed to be changed or that were not appropriate for reissue.

Currently, the Commissioner does have the power to extend an expired ruling (section 91DD). This power has been exercised only once or twice but does allow the possible continuation of a view without needing to formally consult as would be the case if the ruling was reissued.

Recommendation

That the submission be declined

Issue: Definitions

Submission
(New Zealand Institute of Chartered Accountants)

The definitions "Commissioner's official opinion", "Promoter", and "Proscribed question" should be added to section 91B or included in the main body of the legislation as part of the substantive provisions that refer to these terms.

Comment

The issue of the placement of definitions is much wider than that of how the particular definitions referred to in the submission are placed. It requires a more comprehensive consideration of this structural aspect of the Tax Administration Act 1994 and needs to be considered further.

Recommendation

That the submission be noted.

Other policy matters

BETA DEBITS

Clauses 29 and 30

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 introduced a number of reforms to the international tax rules. Before the rule changes, New Zealand companies with controlling interests in foreign companies were taxed twice on the income of those companies. Firstly, they were taxed when the company earned the income (the company's income was "attributed" back to the New Zealand shareholder). Secondly, they were taxed when the money was returned to New Zealand as a dividend.

To prevent double taxation, branch equivalent tax accounts (BETAs) were used. If tax was paid on attributed income first, a credit arose in the BETA and could be used to satisfy any subsequent tax liability relating to a dividend. If tax was paid on a dividend first, a BETA debit arose and could be used to satisfy any subsequent liability for tax on attributed income.

Since the changes to the international tax rules, New Zealand companies with controlling interests in foreign companies are taxable at most once – when the income is earned by the company. BETA accounts can therefore be phased out.[1]

Transitional issues and announcement of transitional period

Although BETA accounts can be phased out, they do need to remain for a transitional period to prevent double taxation that could occur if:

- tax was paid on a dividend from a controlled foreign company, under the old rules; and
- the income from which the dividend was paid is attributed for tax purposes later than the dividend, under the new rules; and
- the attributed income is of a kind that is taxable under the new rules (that is, "passive income" such as interest or royalties).

In that event, BETA debits that arose from tax paid on the dividend should be able to be used – for a limited period – to relieve tax on passive attributed income.

For this reason, it was announced in mid-2008 that existing BETA debits could be retained and used for a period of two years.

[1] Foreign dividends are now exempt. There are some exceptions, but in those cases there is a corresponding tax deduction which can be claimed in the calculation of tax on attributed income. This prevents double taxation without the need for BETA accounts.

The conduit tax relief regime

Overlaying the taxation of interests in controlled foreign companies and the BETA mechanism, were rules to give conduit tax relief. Conduit tax relief meant that if the New Zealand company with the controlling interest in a foreign company was itself owned by a foreigner, New Zealand would not impose *any* tax on income from the interest (because it was effectively foreign-sourced income of a non-resident, even though passing through a resident company). Even though no tax was imposed by New Zealand when conduit relief was claimed, BETA credits or debits continued to arise and to be used; conduit relief was only claimed when there were insufficient credits or debits to offset all tax liabilities.[2]

The conduit tax relief rules were repealed as part of the international tax change and replaced by an active income exemption and a foreign dividend exemption. No further conduit tax relief will arise.

Developments following changes to the international tax rules

Following the changes to the international tax rules, it was brought to our attention that it was unnecessary to retain BETA debits if conduit tax relief had been claimed on the dividend that generated the debit. If conduit tax relief was claimed when the BETA debits arose, *no* tax was paid and so there is no double taxation to relieve. The income will be taxed once at most, under the new rules.

The change in the current bill

The purpose of the change in the current bill is to cancel those BETA debits that arose from dividends that were subject to conduit tax relief. There is no need for the BETA debits in that case, because there is no possibility of double taxation.

Issue: All BETA debits should be retained for a two-year transitional period

Submissions
(New Zealand Institute of Chartered Accountants, New Zealand Law Society, Corporate Taxpayers Group, PricewaterhouseCoopers, Telecom)

All BETA debits should be retained for a two-year transitional period. *(New Zealand Law Society, Corporate Taxpayers Group, PricewaterhouseCoopers, Telecom)*

[2] The continued application of the BETA mechanism was technically necessary to correctly keep track of amounts that had been relieved of tax. These amounts were "tagged" to ensure they were eventually paid out to non-residents and not to New Zealanders. If payments were made to New Zealanders from these amounts, tax was re-imposed. Without the BETA accounts, too much tax would have been re-imposed.

Cancelling BETA debits would have a retrospective effect. *(New Zealand Law Society, Corporate Taxpayers Group, PricewaterhouseCoopers, Telecom)*

The provision would retrospectively reverse conduit tax relief available before the effective date of the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009. The scheme of New Zealand's old international tax rules was to apply tax (or conduit relief) at the earlier of distribution to a New Zealand resident or attribution to the New Zealand resident under the CFC or FIF rules. *(New Zealand Law Society)*

Retrospective legislation that has a negative effect on taxpayers should be used sparingly and only when there are serious base maintenance concerns. The group cannot understand how there is now a base maintenance concern that did not exist when the detailed tax reforms began in 2006 and when the press release was issued in 2008. *(Corporate Taxpayers Group)*

Cancelling BETA debits would impact negatively on businesses that made decisions based on the previously announced two-year window. *(New Zealand Law Society, Corporate Taxpayers Group, PricewaterhouseCoopers, Telecom)*

New Zealand companies with BETA debit balances have been making decisions, issuing financial reports, and making representations to the market and shareholders on the basis of the previously announced two-year window. Telecom has made key business decisions relying in good faith on what had been, until recently, a clear publicly stated position. The proposed change will have a net cost to Telecom of more than $20 million and will require Telecom to restate its accounts and financial projections. *(Telecom)*

The proposed measure will negatively impact on ordinary business arrangements in addition to any potential mischief. *(New Zealand Institute of Chartered Accountants)*

Comment

There are essentially two types of BETA debit: one where the BETA debit was generated as a result of tax being paid on the dividend, and another where the BETA debit was generated even though no actual tax was paid on the dividend because of conduit tax relief.

If tax has been paid on the dividend there is potential for double taxation in the transition to the new international tax rules. Accordingly, it is appropriate to allow companies to continue to use these BETA debits for a two-year transitional period.

If no tax has been paid on the dividend (because of conduit tax relief) there is no potential for double taxation. If these BETA debits are not cancelled, the company that has them can use them to offset any tax on attribution of foreign income, resulting in no taxation at all.

The July 2008 commentary on the Taxation (International Tax, Life Insurance, and Remedial Matters) Bill was explicit that the transitional period for BETA debits was "intended **only** to prevent double taxation in the rare cases in which dividends have been paid significantly in advance of attributed passive income arising." [emphasis added]. Double taxation is not an issue for conduit income.

Allowing taxpayers to keep these debits will effectively prolong conduit tax relief and allow non-taxation of passive income for two years. Based on the BETA debit balances that we know about, it is estimated that retaining all BETA debits could have a potential fiscal cost of $200 million or more.

Retrospective impact

The proposed change will cancel BETA debits in cases when there is no possibility that taxation of future income will be double taxation. It will not reverse the conduit relief that applied at the time the dividend was derived and the BETA debit was generated.

However, if attributed income from an interest in a controlled foreign company is subject to tax under the new rules, there will be no *further* conduit tax relief. This means that companies that entered into arrangements when conduit tax relief was available will not get what they expected.

Sometimes when tax laws are changed, existing arrangements are "grandparented" so that the rules applying when they were entered into continue to apply after the rules changed. However, there was no grandparenting when the international tax rules were changed.

For example, New Zealanders that owned companies in "grey list" countries may have entered into arrangements on the assumption that they would enjoy an exemption from New Zealand tax on their income, but that income will be taxed under the new rules if it is "passive" income. This will occur even if the income is income out of which a dividend was paid under the old rules.

The lack of grandparenting was intentional. The international tax rule changes were part of a package that replaced the comprehensive taxation of controlled foreign company income with an active income exemption and a foreign dividend exemption. As part of the package, conduit tax relief and the grey list exemption were repealed. It was not intended that companies would be able to make use of the active income exemption for some existing arrangements while at the same time continuing to have the benefit of either the conduit or grey list exemptions for other existing arrangements.

Recommendation

That the submissions be declined.

Issue: Only those BETA debit balances that were generated after 2 June 2008 (the date of the policy announcement) should be cancelled

Submissions

(New Zealand Law Society, Telecom, PricewaterhouseCoopers)

Any perceived risk to the tax base should exist only through CFCs (and FIFs where relevant) paying disproportionately large dividends to CTR companies, in order to accelerate the taxing point for such income to maximise the extent to which it qualifies for conduit relief. *(New Zealand Law Society)*

Before 2 June 2008, dividends can reasonably be expected to have been in a "business as usual" category, and not driven by any desire to create BETA debits that could provide a benefit following the repeal of the conduit regime. *(New Zealand Law Society)*

This would target the potential mischief of companies generating BETA debits after the announcement of the Government's intention to retain BETA debits for a two-year transitional period. It would also mitigate the business uncertainty and unfairness that would occur from cancelling earlier BETA debits. *(Telecom)*

The government should introduce a specific avoidance rule if it is concerned about particular mischief arising from the transitional rules. We understand that the mischief the Government is concerned with in relation to the transitional rules is where taxpayers have created BETA debits in anticipation of the conduit tax relief rules being repealed. Specific avoidance rules could be used to target such mischief. *(PricewaterhouseCoopers)*

Comment

Cancelling only those BETA debit balances that were generated after 2 June 2008 would prevent companies from generating BETA debit balances to take advantage of the two-year transitional window *after* the policy was announced. Although such behaviour would be worrying, this is not the basic policy concern.

The basic policy concern is that retaining BETA debits arising from conduit relief – whenever they arose – effectively extends the conduit tax regime for some companies. That is, those companies can escape tax on future attributed income from controlled foreign companies, even though the conduit tax relief regime is supposed to have ceased and there is no possibility of double taxation.

In this respect the problem is more about any existing BETA debit balances, rather than newly created BETA debits.

Recommendation

That the submissions be declined.

Issue: The drafting of the clauses in the bill does not match the policy intent as expressed in the commentary and should be amended

Submissions
(Telecom, New Zealand Institute of Chartered Accountants, PricewaterhouseCoopers, New Zealand Law Society, Corporate Taxpayers Group)

The bill, as drafted, cancels all BETA debits, including those relating to actual tax paid or foreign dividend withholding payments. Cancelling such BETA debits creates double taxation. *(Telecom)*

The drafting of the provision means that BETA debits would be cancelled out for all dividends from CFCs rather than just those that were conduit relieved. *(New Zealand Institute of Chartered Accountants)*

The provision needs to be reworded as this section extinguishes BETA debits that arise from dividends where actual tax was paid, as well as BETA debits that arise where conduit tax relief was claimed in respect of the dividend.
(PricewaterhouseCoopers)

To achieve the policy intent the legislation would need to be quarantined to BETA debits from dividends which have benefited from section RG 7 (that is, dividends that have benefited from conduit relief). *(Corporate Taxpayers Group)*

The proposed new section OE 11B should be limited to BETA debits arising in respect of conduit-relieved dividends paid from 2 July 2008. *(New Zealand Law Society)*

Comment

Officials agree that the current drafting does not reflect the policy intent. The policy intent was that BETA debits would only be cancelled to the extent that they arose from dividends that were subject to conduit tax relief. To correct this, a specific reference to those BETA debits that were generated in respect of tax liabilities that were offset by conduit relief under section RG 7 needs to be added to the provision.

Recommendation

That the submissions be accepted.

Issue: The application date should be modified to ensure debits can be used against pre-reform CFC income

Submissions
(Ernst & Young)

Some modification of the legislation is required to ensure BETA debit balances remain available for use to offset income tax liabilities on attributed CFC income for pre-reform CFC years.

Comment

The submission identified a technical problem with the application date of the provisions. As the bill stands, BETA debits will be cancelled as soon as the international tax rules apply. This causes a difficulty because a company might not file an income tax return for CFC income that was earned prior to the reforms, until months after the new international tax rules take effect. In such cases the company would be unable to use its BETA debits against pre-reform income (they would already be cancelled).

In general, we accept that companies should be able to use their BETA debits to offset tax on pre-reform income (at least until the complete repeal of BETA accounts). We note that it adds some complexity to the legislation to allow this, in part because measures are required to prevent manipulation.

Recommendation

That the submissions be accepted, subject to appropriate anti-manipulation rules being included.

Issue: Clarifying how taxpayers should measure the amount of debit balance which is cancelled

Submissions
(Ernst & Young)

The legislation should clarify how taxpayers should measure the amount of the debit balance which is cancelled. More specifically, ordering rules for BETA debits and credits such as those contained in section OA 8(8)(c) should be included in the provision.

Comment

The policy is to cancel BETA debits arising because a conduit-relieved dividend has been paid and not BETA debits arising for other reasons.

If a company's BETA debits have arisen only from conduit-relieved dividends, then it is straightforward to work out how many debits to cancel (all of them).

When some BETA debits have arisen for other reasons, and BETA debits have been used to offset tax liabilities, it may be unclear which debits have been offset and which have not.

The submission suggests that the legislation should include an ordering rule to make it clear which debits have been offset and which remain.

Recommendation

That the submissions be accepted.

GIFT DUTY EXEMPTIONS

Issue: Support for the proposed exemptions

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

Corporate Taxpayers Group supports the proposed exemptions.

New Zealand Institute of Chartered Accountants supports the intent of the proposed exemptions.

Recommendation

That these submissions are noted.

Issue: Gifts to central government bodies – clause 82(3)

Submission
(New Zealand Institute of Chartered Accountants)

The rationale for exempting state service bodies covered by "section 2 of the State Sector Act 1988" is not immediately apparent. The submission questions the appropriateness of using the "state services" definition to target the application of the proposed exemption, as this would mean that the exemption would be applicable to organisations that are also subject to income tax – that is, income-tax-paying entities. The breadth of the definition should be carefully reconsidered.

Comment

The proposed exemption is intended to apply to gifts to organisations that are part of the "state services as defined in section 2 of the State Sector Act 1988", which are not educational institutions and not carried on for the private pecuniary profit of any individual.

We accept that some of the state service bodies that could benefit from the gift duty exemption are also income-tax-paying entities. However, it is important to keep in mind that the policy objectives underlying income tax and gift duty may not necessarily be the same. For example, certain central and local government entities were intended to be explicitly subject to tax to facilitate their commercial focus and to ensure that they did not enjoy an advantage over their competitors.

We also consider that the requirement in the proposed legislation that no person should be able to derive a private pecuniary benefit from a local or central government body, over and above that which would normally be permitted, should provide sufficient comfort that the exemption is appropriately targeted.

Recommendation

That the submission be noted.

Issue: Gifts to local authorities and council-controlled organisations – clause 82(4)

Submission
(New Zealand Institute of Chartered Accountants, Russell McVeagh)

If a person makes a gift to either a local authority or a council-controlled organisation, then such gifts should not be subject to gift duty. There are a large number of local authorities that receive gifts or bequests from members of the public which are used for the betterment of the area they administer. *(New Zealand Institute of Chartered Accountants)*

If there is an amalgamation of various local authorities then gift duty should not apply to that reconstruction. *(New Zealand Institute of Chartered Accountants)*

The proposed exemption should not be restricted to the tax definition of "council-controlled organisation" contained in the Income Tax Act 2007. Instead, the proposed exemption should use the definition of "council-controlled organisation" in the Local Government Act 2002. *(Russell McVeagh, New Zealand Institute of Chartered Accountants)*

Comment

The first two submissions are already covered by the proposed exemption. The proposed exemption will exempt from gift duty gifts made to either a local authority, or a council-controlled organisation. It will also cover transfers of property in amalgamation situations.

Officials agree with the third submission. The tax definition of "council-controlled organisation" was intended to exclude non-business, non-corporate entities from being eligible for the charities-related income tax exemption. We accept that this definition is not appropriate for gift duty exemption purposes as it is too restrictive.

Consequently we consider that the local government definition of "council-controlled organisation" should be used instead, as it would better meet the stated policy intentions. The local government definition of "council-controlled organisation" includes council-controlled trusts which are not in the business of making a profit but hold significant funds for charitable (or public) purposes benefiting all or a significant portion of the public within the territory of the local authority. Because there is some

uncertainty under the Charities Act 2005 whether such trusts can be registered with the Charities Commission, they would not be eligible for the current gift duty exemption that applies to registered charities and therefore donors would be required to account for gift duty on any gifts over the threshold that they make to council-controlled trusts. For this reason, it would be appropriate for gifts made to these organisations to be eligible for the proposed exemption.

Recommendation

That the third submission be accepted. This means that the local government definition of council-controlled organisation should be used to define council-controlled organisation for gift duty exemption purposes, not the tax definition of council-controlled organisation.

Submission
(Deloitte)

The exemption from gift duty for gifts made to local authorities and council-controlled organisations should apply from 1 July 2008.

Comment

The submission seeks to apply the exemption from 1 July 2008, the date on which the tax-related provisions in the Charities Act 2005 were included in the Income Tax Act 2007 and the Estate and Gift Duties Act 1968. Those provisions explicitly linked eligibility for the charities-related income and gift duty exemptions to registration as a charitable entity with the Charities Commission.

Local authorities and council-controlled organisations who were not registered with the Charities Commission *prima facie* have been subject to gift duty since 1 July 2008. Local authorities cannot be registered as a charitable entity and there is some uncertainty under the Charities Act 2005 as regards the registering of local authority trusts – that is, these entities might not have sufficient dissolution provisions that require charities to apply their funds to a charitable purpose on dissolution.

We note that there was no explicit consideration given to the gift duty treatment of gifts made to local authorities and their council-controlled organisations when the tax-related provisions in the Charities Act 2005 were being considered.

If the exemption were applied from 1 July 2008 it would preserve the exempt status of gifts made to local authorities and their council-controlled organisations without break. If accepted, this measure would have the following implications.

- Revenue cost to the Government, as donors who had paid gift duty for gifts made in the interim period (1 July 2008 to the date of Royal assent of the legislation) would be entitled to a refund. We do not consider that this cost would be large, because the total gift duty revenue collected each year is up to $3 million.

- Administrative costs for Inland Revenue, which would need to undertake reassessments and refund any gift duty paid.
- Compliance costs for donors in seeking reassessments, and compliance savings for those donors who made gifts during the interim period but did not pay the required gift duty on those gifts.

Overall, we expect the impact of this change to be very low. This is largely because of the current gift duty threshold whereby most donors keep their gifting at a rate of under $27,000 per year to avoid having to pay gift duty. There have only been two known occasions where a donor wanted to discuss gifts to a local government authority – they were advised of the potential changes to the bill, and the gifting has yet to take place.

Recommendation

That the submission is accepted.

Submission
(PricewaterhouseCoopers)

The wording of the bill does not achieve the policy intent, as the exemption does not extend to transfers of assets by local authorities.

Comment

The policy intention was to exempt from gift duty transfers of assets by local authorities to other local authorities to deal with local authority restructuring transactions. This is achieved by the current provision in the bill. Officials accept, however, that this policy intention was not clear in the Commentary to the bill.

We note that under the current scheme of the Estate and Gift Duties Act 1968, exemption from gift duty applies to gifts made to a particular donor, rather than gifts made by a particular donor. Extending the exemption to apply to gifts made by local authorities would be inconsistent with the current scheme of the Act.

Recommendation

That the submission be noted.

Issue: Gifts to donee organisations – clause 82(5)

Submission
(New Zealand Institute of Chartered Accountants)

The exemption from gift duty for gifts to donee organisations should be retrospective to overcome the fact that donations have been made by people in good faith on which no gift duty has been paid.

Comment

The submission is silent on the exact date the exemption should apply from. Officials consider that an appropriate date could be 1 April 2008. This is the date on which the limit on qualifying donations for the purposes of individuals' donation tax credit was lifted. This change would be consistent with the underlying policy intention of the proposed exemption, which is to align the gift duty treatment with the policy for encouraging greater giving to charitable and philanthropic causes.

We note that the limit on qualifying donations for the purposes of the company deduction for donations was also lifted. This change applied from the 2008–09 income year. However, any retrospective date for the proposed exemption should apply from the same date for simplicity.

As with the previous issue, applying the exemption from 1 April 2008 will involve revenue, administrative and compliance costs to the extent that gift duty has been paid on gifts to donee organisations (which are not registered with the Charities Commission) in the period 1 April 2008 to the date of Royal assent. However, we do not expect these costs to be large because the vast majority of donee organisations are in fact registered with the Charities Commission and so gifts to those organisations would already be covered by the current exemption from gift duty. About 1,400 donee organisations are currently not registered with Charities Commission. Furthermore, Inland Revenue has advised that its processing centre cannot recall coming across a situation where a liable gift had been made to a donee organisation.

Recommendation

That the submission be accepted. We recommend that the proposed exemption for gifts to donee organisations apply from 1 April 2008.

Issue: Repeal of gift duty

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

Corporate Taxpayers Group (CTG) believes that gift duty should be repealed but it appreciates that this is outside the ambit of the bill. CTG would like to see gift duty restricted to only apply between individuals, or family trusts and individuals. Specifically, CTG submits that there should be no dutiable gift in any transaction between corporate entities (including local authorities). *(Corporate Taxpayers Group)*

New Zealand Institute of Chartered Accountants believes that there is a good case for gift duty to be repealed. The current exemptions in the Estate and Gift Duties Act 1968 are well out of date. This raises the issue of whether gift duty should play a part in our tax system. Gift duty complicates family and not-for-profit transactions, adding unnecessary compliance costs and delays. Market value rules exist in the Income Tax Act to buttress other tax regimes. *(New Zealand Institute of Chartered Accountants)*

Comment

Officials consider that these submissions should be taken into account as part of the review of gift duty, which is on the Government's current tax policy work programme.

The review is focused on developing options for better targeting the application of gift duty. It will seek to ensure that the Government's intention for gift duty as a means of protecting against income tax avoidance, defeating creditors and social assistance targeting is met, and to ensure that the integrity of the tax system is maintained. Policy options arising from the review will be included in an officials' issues paper or a government discussion document, and public submissions would be sought. The document is likely to be released mid-year.

Recommendation

That the submissions are noted and will be considered as part of the current review of gift duty.

Issue: Gift duty threshold of $27,000

Submission
(New Zealand Institute of Chartered Accountants)

The gift duty threshold of $27,000 a year per person should be increased to a level commensurate with a value in today's dollars. In today's terms, the exemption would be $77,220.

Comment

This issue is being considered as part of the current review of gift duty.

Recommendation

That the submission is noted and will be part of a suite of issues being considered in the current review of gift duty.

Issue: Gift duty exemption for small gifts of up to $2,000

Submission
(New Zealand Institute of Chartered Accountants)

The exemption from gift duty for small gifts of up to $2,000 to any one recipient in one calendar year (as long as the gifts are part of the donor's normal expenses) should be increased to a level commensurate with a value in today's dollars. In today's terms, the exemption would be $5,720.

Comment

Officials recommend that this issue be considered in the current review of gift duty.

Recommendation

That this submission is noted and be considered as part of the current review of gift duty.

SUPPLEMENTARY DIVIDEND RULES

Clause 27

Issue: Amendments relating to changes enacted by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009

Submission
(Ernst & Young)

The submission does not, in fact, relate to clause 27 of the current bill, but to the changes to the supplementary dividend rules (previously known as the foreign investor tax credit rules) made by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009. Specifically, the submission seeks amendments to:

- allow supplementary dividend holding companies to continue to pay supplementary dividends to any non-resident shareholders (including non-portfolio shareholders) up to the end of an income year that includes 31 March 2011 and to claim related tax credits under section LP 2 of the Income Tax Act 2007;
- expressly provide for supplementary dividends to be paid and for related section LP 2 tax credits to be claimed (subject to the percentage interest test for relevant non-resident beneficiaries) if the registered shareholders hold shares on fixed or discretionary trusts for beneficiaries including non-residents, but those trusts are not bare trusts; and
- provide, under section RF 11B of the Income Tax Act 2007, for a nil rate of non-resident withholding tax on imputed dividends (subject to the percentage interest or tax rate tests for relevant non-resident beneficiaries) if the registered shareholders hold shares on fixed or discretionary trusts for beneficiaries including non-residents, but those trusts are not bare trusts.

Comment

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 introduced new rules for dividends paid by New Zealand companies to non-resident shareholders. The Act made changes to the supplementary dividend rules and the non-resident withholding tax (NRWT) rules. The amendments are described in the February 2010 *Tax Information Bulletin* (Vol. 22, No. 1). These domestic law changes reflect the inclusion of lower limits for NRWT on dividends in some recent tax treaties.

It is sensible to consider this submission in two parts. The first point raised relates to the transitional arrangements for supplementary dividend holding companies. The second and third points relate to the treatment of shares held through trusts (other than bare trusts).

Transitional arrangements for holding companies

The amendments made by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 mean that, from 1 February 2010, credits are no longer available for supplementary dividends paid to non-residents in respect of non-portfolio (10% or more) interests in New Zealand companies, or if the rate of tax applicable to the dividend is less than 15%. The Act also provides for the repeal of the special supplementary dividend rules for holding companies.

As a transitional measure, credits may continue to be claimed for supplementary dividends paid to supplementary dividend holding companies until 1 April 2011. This allows time for distributions to be paid through a chain of holding companies and on to non-resident portfolio investors. It is intended to deal with the possibility that a lower-tier holding company received a dividend and a supplementary dividend before 1 February 2010 but has not made a corresponding distribution by that date. The timing difference ensures that a higher-tier holding company can continue to receive supplementary dividends and correspondingly adjusted imputation credits, and therefore have a tax liability against which to use a credit claimed under subpart LP of the Income Tax Act 2007, when making a distribution to a portfolio investor.

The submission argues that holding companies should be allowed to continue to claim credits for supplementary dividends paid to non-resident non-portfolio investors until 1 April 2011. However, it would then be straightforward for foreign-owned New Zealand companies to set up holding company structures and thereby continue claiming credits for dividends paid to non-residents in respect of non-portfolio interests after 1 February 2010. This would frustrate the intention of the 2009 amendments.

The submission notes that a holding company receiving a dividend and supplementary dividend will face an additional tax charge, and possibly use-of-money interest, if those amounts are paid on to non-resident non-portfolio investors after 1 February 2010. This is necessary to prevent the use of holding company structures to avoid or defer tax during the transitional period. The granting of credits for supplementary dividends paid to non-residents assumes NRWT of 15% on those dividends, whereas a nil rate now applies to imputed non-portfolio dividends under section RF 11B of the Income Tax Act 2007.

Under section YA 1 of the Income Tax Act 2007, a supplementary dividend holding company must have an ongoing purpose of enabling the payment of a supplementary dividend to a non-resident. Supplementary dividends are no longer payable to non-residents in respect of non-portfolio holdings. Accordingly, we would not expect supplementary dividend holding companies to be maintained beyond 1 February 2010, except when this is necessary to enable payment of supplementary dividends to non-resident portfolio investors before 1 April 2011.

Treatment of shares held through trusts

The amendments made by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 distinguish between portfolio and non-portfolio interests according to the size of an investor's "direct voting interest" in a company. If a person has a direct voting interest of 10% or more, or if the tax rate applicable to the dividend is less than 15%, then credits for supplementary dividends are no longer available. Instead, a nil rate of NRWT applies, to the extent the dividends are imputed.

The submission notes that, for interests held through discretionary or fixed trusts, the 10% threshold will apply by reference to the trustee's holding, rather than according to the proportionate interests of underlying beneficiaries. This is similar to the position before 1996, when the foreign investor tax credit was available only in respect of dividends paid to non-resident portfolio investors. At that time, section LE 1(3) of the Income Tax Act 1994 set out when a person was considered a portfolio investor for these purposes. The core requirement was that they had a voting interest of less than 10% in the company and, if a market value circumstance existed, a market value interest of less than 10%.

The boundary introduced by the Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 focuses on direct voting interests, in part for consistency with related provisions in double tax agreements, but also (as before 1996) for reasons of operational simplicity. The corporate look-through provision is disapplied for the same reasons. We do not consider this approach to be inconsistent with the comments made in the Officials' Report of 23 November 1995 (cited in the submission), nor with the subsequent *Tax Information Bulletin* (March 1996, Vol. 7, No. 11).

The submission refers to the possibility that the "voting interest" test under domestic law may in certain circumstances be interpreted differently to the equivalent treaty test, which refers to "voting power". Regardless of an investor's voting interest, credits for supplementary dividends are unavailable, and a nil rate of NRWT may apply, if the rate of tax for a dividend, after taking account of any double tax agreement, is less than 15%. This ensures consistency of classification under domestic and treaty law.

Recommendation

That the submission be declined.

ANNUAL RATES OF INCOME TAX

Clause 3

Issue: Taxation of lump-sum payments of back-dated ACC compensation

Submission
(New Zealand Institute of Chartered Accountants)

An amendment should be made to the Income Tax Act 2007 to ensure that ACC loss of earnings payments received in relation to an accident in an earlier income year are not overtaxed. This could be achieved by allowing a rebate in the income year the payment is received.

Comment

The issue of the tax burden caused by payment of arrears of earnings-related compensation was raised by the New Zealand Institute of Chartered Accountants in its submission on the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill in 2008. In response to that submission officials advised that they would report to the Minister of Revenue with proposals to address the concerns raised.

The Minister of Revenue has had the opportunity to consider options and has decided that no further work will be done on providing tax relief for lump-sum payments that include arrears of an entitlement to ACC payments, for the reasons outlined below.

It would be very difficult to design tax relief that would restore recipients to the position they would have been in had the payments been made in the earlier years, because of the wide variance in the level of arrears payments, the number of years they might be for and the possibility that a benefit previously paid has had to be repaid. Any potential solution, such as spreading income to earlier years, raises complex issues – for example, the effect on income-contingent entitlements or liabilities, such as Working for Families tax credits and child support. More importantly, spreading income would move away from the fundamental tax concept of taxing the cash receipts of individuals who are not in business, in the year of payment.

An alternative would be to provide a tax credit; however, this requires a trade-off between simplicity and arbitrary results. A flat rate may be simple to administer and understand, but has the potential to both under- and over-compensate the recipient. This trade-off was recognised when options for granting tax relief for redundancy payments were being considered.

Finally, despite a tax credit being available to recipients of redundancy payments, extending this ability to ACC lump-sum arrears payments is likely to lead to further requests for tax concessions for other one-off payments such as retiring allowances and bonuses.

Recommendation

That the submission be declined.

EXEMPTION FOR NON-RESIDENT DRILLING RIG OPERATORS

Clause 9

Issue: Scope of the exemption

Submission
(PricewaterhouseCoopers)

The exemption should not distinguish between residents and non-residents. Otherwise it would create a disincentive or competitive disadvantage for non-resident companies that prefer to undertake petroleum exploration via a New Zealand subsidiary.

The exemption should also be extended to apply to income derived from suppliers of specific services to offshore drill rig operators and resident companies such as supply/support vessels.

Comment

New Zealand's domestic tax rules generally tax non-resident offshore rig operators and seismic vessels on their New Zealand-sourced income. However, in some situations where non-residents come from a country with which New Zealand has a double tax agreement, the non-resident rig operators are exempt from tax in New Zealand if they stay for less than 183 days in any 12-month period. If they stay for more than 183 days all income will result from the first day of presence in New Zealand and will be subject to New Zealand tax.

Because of this rule, prior to the exemption being introduced in 2004, non-resident offshore rig operators and seismic vessels had tended to stay in New Zealand for a period of less than 183 days. Even if further exploration would be desirable beyond the 183 day window, there were strong incentives for rigs to leave by this time. Different rigs were then required to be brought to New Zealand to complete the work, causing extra mobilisation and demobilisation costs. This also disrupted sensible exploration and development programmes.

The bill extends the existing exemption (which was due to expire on 31 December 2009) until 31 December 2014.

The purpose of the exemption is to remove the distortion created by New Zealand's double tax agreements for non-resident rig operators to operate for less than 183 days. It is not intended to subsidise oil and gas exploration more generally.

If a resident company were to operate a rig in New Zealand it would not get relief under New Zealand's double tax agreements and so would not face the same incentives to operate for less than 183 days.

Extending the scope of the exemption to cover income from companies that supply ancillary services to an offshore drill rig operator could increase the fiscal cost of the exemption but would be unlikely to further accelerate the exploration of New Zealand's offshore oil and gas reserves.

Recommendation

That the submission be declined.

ADDITIONS TO THE LIST OF CHARITABLE DONEE ORGANISATIONS – SCHEDULE 32

Individuals who donate to charitable donee organisations are entitled to a donations tax credit (formerly the donations rebate) of 33⅓ percent of the amount donated (capped to the amount of the individual's taxable income). Companies and Māori authorities who donate to charitable donee organisations are entitled to a deduction for donations up to the amount of their net income.

A charitable organisation that applies some or all of their funds outside New Zealand must be approved as a charitable donee organisation by Parliament. These organisations are listed individually in schedule 32 of the Income Tax Act 2007.

There are currently 87 named charitable donee organisations listed in schedule 32. This bill provides that Cure Kids be added to the list. Orphans' Aid International Charitable Trust has submitted that it also be added to the list.

Issue: Orphans' Aid International Charitable Trust

Submission
(Clause 34 – Parry Field Lawyers)

That Orphans' Aid International Charitable Trust be added to the list of charitable donee organisations in schedule 32 of the Income Tax Act 2007.

Comment

If an overseas-focussed charitable organisation is seeking a legislative change to be included in schedule 32 of the Income Tax Act 2007, they are currently referred to Inland Revenue tax policy officials, and must provide information about their organisation. Officials then make a recommendation to the Minister of Revenue based on this information and with reference to the Cabinet criteria which guide the policy considerations about whether to include the organisation or not.

Cabinet has established criteria for guiding the policy work around additions to the list of charitable donee organisations. These criteria were formally set out by Cabinet in 1978. The original Cabinet decision was:

> Basic criteria for adding an organisation to the list of approved "overseas" charities:
> i the funds of the charity should be principally applied towards:
> - the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or
> - the economy of developing countries*; or
> - raising the educational standards of a developing country*;
>
> ii charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;
> iii ….
> * developing countries recognised by the United Nations.

To further assist organisations seeking to be included on schedule 32, the Government released a set of guidelines in December 2009 setting out its expectations of these organisations. The guidelines respond to growing interest from organisations that see "donee status" as an endorsement of their overseas activities. The guidelines seek to downplay expectations that additions to the schedule are automatic, by making it clear that the decision by the Government to legislate is a policy decision.[3]

In making this decision, the Government considers whether the organisation is robust, transparent and has an established history of operation. This involves consultation with the Ministry of Foreign Affairs, NZAID and the Police's Strategic Intelligence Unit. The Charities Commission is also consulted.

The removal of the donations cap on the tax credit and deduction in 2008 also means careful consideration is required on the effectiveness of the organisations concerned and whether any potential exists for taxpayer funds to be misapplied or abused. Left unchecked this could lead to significant fiscal cost. It is important to look at how the organisation is structured and operated both in New Zealand and overseas. The organisation's transparency is also considered and whether there are adequate checks and balances in the management of the organisation to prevent any risk of "mission drift". Mission drift describes the situation when an organisation begins to engage in activities that are outside the scope of the organisation's rules such that, over time, it ends up carrying out activities that the New Zealand government may not want to support.

Officials are considering as many requests as possible each year. Also a wider review on overseas donee status policy scheduled for this year is being fast-tracked by officials.

Given this established process for the consideration of organisations to be included in schedule 32, officials are concerned that organisations should not be able to avoid the process by seeking inclusion in schedule 32 through the select committee process. This would effectively result in organisations jumping the queue and not being fully vetted.

Recommendation

That the submission be declined.

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[3] http://taxpolicy.ird.govt.nz/news/archive.php?year=2009&view=726.

Issue: Support for Orphans Aid International Charitable Trust

Submission
(Clause 34 – Foresee Communications Limited)

Foresee Communications Limited supports the Orphans Aid International Charitable Trust's submission that it be added to schedule 32 of the Income Tax Act 2007.

Recommendation

That the submission be noted.

TAX TREATMENT OF EMISSIONS UNITS

Issue: Treatment of units allocated to owners of fishing quota

Submission
(Sandford Limited – submitted by Deloitte)

Emissions trading units allocated to owners of fishing quota should be on capital account and so non-taxable.

Comment

The application of the Emissions Trading Scheme to liquid fossil fuels will increase the cost of diesel, which is one of the major costs in the fishing sector. Recent amendments to the Climate Change Response Act 2002 provide for the allocation of emissions units to owners of fishing quota to compensate them for the fall in value of fishing quota expected to result from the impact of the increase in the cost of diesel.

The default treatment for all unit allocations is revenue account treatment, with the exception of pre-1990 forestry. Revenue account treatment means that a tax liability will arise as a result of receipt of the units, and any increase in their value between the date of receipt and the date of their sale will also be taxable.

However, the underlying rationale for the allocation of units to the owners of fishing quota is the loss of value of that quota, which is a capital loss. It is inconsistent with this rationale for revenue account treatment to be applied to these units – capital account treatment for these units is appropriate.

As allocations to owners of fishing quota are proposed to be made in the second half of 2010, it is recommended that this amendment be made from 1 July 2010.

The Ministry for the Environment has been consulted on this issue.

Recommendation

That the submission be accepted.

Issue: Deduction for cost of timber for person carrying on a PFSI forestry business

Submission
(PricewaterhouseCoopers)

There should be a separate tax deduction in the Income Tax Act 2007 for the cost of timber for a person carrying on a permanent forest sink initiative (PFSI) business.

Comment

PFSI foresters are entitled to a tax deduction for the costs incurred in planting and maintaining their trees. All foresters (PFSI and those who grow trees for harvest) who purchase land with part-grown trees on it are required to carry forward the proportion of the purchase price attributable to the trees until those trees are harvested. PFSI foresters can harvest:

- while the PFSI covenant is in force, provided they maintain a "continuous canopy";
- at any time, if they breach their PFSI covenant;
- 50 years after entering into the covenant, if they withdraw from the covenant;
- 99 years after entering into the covenant.

PFSI foresters will be entitled to claim a deduction for the cost of timber in any of the above situations. A liability to surrender emissions units will also arise. If the emissions units originally allocated have been sold, a deduction will be available for the purchase of units to meet the surrender liability. PFSI foresters will be entitled to claim a deduction for the cost of timber in any of the above situations.

There seems to be no reason why the current, generally taxpayer friendly, forestry tax rules should be changed for PFSI foresters.

The Ministry of Agriculture and Forestry and the Ministry for the Environment have been consulted on this issue.

Recommendation

That the submission be declined.

Issue: Market value transfer rules

Submission
(Matter raised by officials)

The application of the market value transfer rule to emissions units should be clarified.

Comment

The Income Tax Act contains provisions which apply to disposals of certain items which deem those disposals to take place at market value, where the parties have used a price below market value. This is to ensure that disposals at below market value are not used as a mechanism to transfer wealth without appropriate tax consequences.

The current form of the legislation relies on trading stock rules in section GC 1 to apply a market value rule to emissions units. However, it is not clear that emissions units are trading stock. We recommend that a specific market value transfer rule be introduced for emissions units, which will also include exemptions where transactions below market value are not carried out for tax purposes.

It is recommended this amendment be made from 26 September 2008, the date the former specific anti-avoidance provision was repealed.

The Ministry for the Environment has been consulted on this issue.

Recommendation

That the submission be accepted.

Issue: Application of market value transfer rules to forestry rights arrangements

Submission
(Matter raised by officials)

The rule which deems a transfer of emissions units for less than market value to be a transfer at market value should not apply to transfers of emissions units:

- between a forestry rights holder and the landowner which is party to that forestry right;
- where those emissions units were allocated by the Crown in relation to pre-1990 forestry.

Comment

Forestry rights agreements are entered into between a landowner and another party, who will normally take responsibility for planting, maintaining and harvesting the forest. The forestry rights agreement will normally contain a clause under which revenue earned from the forest is shared between the parties. Forestry rights agreements are registered under the Forestry Rights Registration Act 1983.

The Climate Change Response Act 2002 allows only either the landowner or the holder of the forestry right to register to receive all of the units allocated for any particular piece of land, but not both. The party which receives all of the units will normally satisfy its obligations under the forestry rights agreement by transferring a proportion of the units to the other party without consideration. However, current legislation would treat that transfer as a disposal at market value, so triggering a tax liability for the transferee.

Following informal discussions with the Ministry for the Environment, the Ministry of Agriculture and Forestry and foresters outside the legislative process of this bill, we recommend that the Tax Act be modified so that a market value disposal, and a consequent tax liability, is not triggered in these circumstances. It is recommended that this amendment take effect from 1 January 2009, before the first date of allocation of emissions units for forestry.

Recommendation

That this submission be accepted.

Issue: Transfer of pre-1990 forestry emissions units to interim entities pending Treaty of Waitangi settlements

Submission
(Matter raised by officials)

The capital treatment of emissions units allocated to interim entities in relation to pre-1990 forestry land should be extended to the ultimate owners of that land where it is eventually transferred under a Treaty settlement.

Comment

A significant proportion of pre-1990 forestry land is currently held by the Crown. We are advised that much of this land is expected to eventually be transferred to Māori under Treaty of Waitangi settlements.

The Climate Change Response Act 2002 provides that the relevant Minister is to appoint a person to apply for emissions units in relation to that land. It is expected that that person will in due course transfer those emissions units to those Māori persons or entities along with the relevant land when the Treaty settlements are implemented.

Emissions units allocated in relation to pre-1990 forestry land are the only types of units which currently receive capital treatment. This is because this allocation is to compensate for the loss in the value of this land resulting from the introduction of the Emissions Trading Scheme. Capital treatment only applies to the initial recipient of the units – once they leave that person's hands they will normally have revenue account treatment, consistent with the fungible nature of emissions units.

However, this means that those Māori persons or entities who receive the emissions units from the person appointed by the Minister will hold those units on revenue account, and be taxable on any gains made on disposal. Revenue account treatment is not consistent with the underlying purpose and nature of these arrangements. Following informal discussions with the Ministry for the Environment and the Ministry of Agriculture and Forestry outside the legislative process of this bill, we recommend this amendment take effect from 1 April 2010, before the date any transfers of units are expected.

Recommendation

That this submission be accepted.

DISTRIBUTIONS TO COOPERATIVE COMPANY MEMBERS

Clauses 6, 7, 12 and 32

The amendments in effect extend a provision in the Income Tax Act 2007 that applies to resident co-operative companies that require members to hold shares in proportion to their trading stock transactions with the company (say, 1 share for each 1kg of meat sold to the co-operative). The existing provision, section CD 34, has been repealed and replaced by new section CD 34B.

Currently, a co-operative can elect to deduct a distribution to a member-shareholder when the distribution is in proportion to the member's supply of trading stock to the co-operative. The distribution is taxable to the member.

The new provision introduces some flexibility to reduce compliance costs for such co-operatives until a general review of the tax treatment of co-operative distributions takes place, planned for this year.

These co-operatives will be able to elect to deduct a distribution paid on shares that are held to back a member's **expected** trading stock transactions, not just actual trading stock transactions. They may also deduct a distribution on a limited number (20 percent) of other shares held by the member.

The new provision also allows a co-operative that elects to deduct distributions some flexibility in setting the date on which members' entitlement to dividends is determined under the Companies Act 1993.

Issue: Consistent terminology

Submission
(Fonterra, Ernst & Young)

Terminology in the existing section DV 11(3) should be amended to match that in the new section CD 34B.

Comment

Section DV 11 permits a co-operative to deduct a distribution described in proposed section CD 34B. Fonterra is concerned that inconsistent terminology between these two provisions may cause confusion, and submit that section DV 11(3) should refer to "the income year to which the distribution relates".

Recommendation

That the submission be accepted.

Issue: Election to deduct distribution

Submission
(Ernst & Young)

There should be no requirement for an irrevocable election to be made, or notice given, before deductible distributions are made. The election provisions in existing section CD 34 should be repeated in new section CD 34B.

Comment

A co-operative currently elects to deduct a distribution by giving the Commissioner notice when providing its tax return for the year in which it claims the deduction. This election then applies for subsequent years.

The timing of the election differs in new section CD 34B because of the link with Companies Act requirements. A co-operative electing to deduct distributions may also choose to be exempt from the Companies Act requirement that there be no more than 20 working days between the date on which an entitlement to dividends is determined and the date the company resolves to pay a dividend.

If a co-operative claims exemption from this requirement, the Registrar of Companies should be notified before a distribution is made. Section 34B provides that one notice serves as an election to the Commissioner and notification to the Registrar of Companies.

Although we consider that the election should therefore continue to be made before the first distribution, we agree that it is not necessary for an election to be irrevocable. In order to reduce compliance costs, companies should continue to elect deductible treatment once rather than annually. However, an election should apply until a company notifies the Commissioner otherwise, rather than being irrevocable.

Recommendation

That the submission be accepted in part and that, once made, an election to deduct distributions should apply for subsequent income years until a co-operative notifies the Commissioner otherwise.

Issue: Transition

Submission
(Ernst & Young)

In the transition from section CD 34 to section CD 34B, it should be clear that there are no gaps, and that distributions made after 1 April 2010 representing profits arising in an income year ending before 1 April 2010 are deductible in that year.

Comment

There are no gaps in the transition from section CD 34 to section CD 34B. The new rules apply to any distribution made on or after 1 April 2010. Distributions made after 1 April 2010 that relate to a year ending before that date will be deductible in that year. We have discussed this with Ernst & Young who agree that the legislation works as described.

Recommendation

That the submission be declined.

OTHER MATTERS RAISED IN SUBMISSIONS

Transitional imputation over-crediting

Submission
(Deloitte)

The penalty rules for transitional imputation over-crediting should be amended to allow for companies to pass on over-imputed credits attached to dividends received during the transitional period without penalty.

Comment

This submission concerns the penalty designed to ensure that during the two-year transitional period after the 1 April 2008 company tax cut, companies do not distribute too many over-imputed credits.

We agree that the submission is correct and will draft the appropriate amendment.

Recommendation

That the submission be accepted.

Petroleum mining foreign branch ring-fencing rules

Submission
(Greymouth Petroleum Holdings Limited)

Greymouth Petroleum Holdings Limited (Greymouth) submits that its investment in Chile should be grandparented from the foreign branch ring-fencing rules that were enacted by the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009. This legislation prevents a petroleum miner offsetting its foreign branch expenditure against its New Zealand income.

Greymouth considers that its Chilean operations meet the normal grandparenting parameters. In particular, Greymouth considers its Chilean investment should be grandparented because:

- On 17 November 2007 it was contractually committed to sign formal contracts, known as CEOPs and undertake the work programmes that were the basis of its winning bids.
- Had it not signed the CEOPs on 30 April 2008, Greymouth would have been legally liable to a claim from the Chilean Government for contractual damages (including consequential losses) and its reputation would have been damaged.

Comment

Greymouth has submitted to the Committee on this matter several times. Additionally, Ministers have also been asked to reconsider this matter a number of times. The most recent response from the Government to Greymouth was on 10 February 2010 when it advised Greymouth of its decision not to amend the petroleum mining foreign branch ring-fencing rules that were brought into effect by the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

The following timeline details the relevant aspects of this matter:

June 2007
The Chilean Government announces international bidding round for 10 hydrocarbon blocks.

October 2007
Greymouth posts bid bonds (US$100,000 per bid) and bids on five blocks.

16 November 2007
The Chilean Government announces Greymouth as the successful bidder on four blocks. Under Chilean law, Greymouth as the successful bidder is contractually bound to sign formal contracts.

4 March 2008
The New Zealand Government announces an amendment to the income tax treatment of expenditure incurred, on or after 4 March 2008, through a foreign branch of a petroleum miner. Such expenditure is no longer allowed to be offset against New Zealand petroleum mining income

30 April 2008
Representatives from Greymouth signed formal contracts (CEOPs) with representatives of the Chilean Government. The CEOPs oblige Greymouth to post performance bonds worth $28 million (the amount of expenditure committed under the CEOPs for the first three years).

2 July 2008
The Government introduces the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill that includes the petroleum mining foreign branch ring-fencing rules.

30 June 2009
The Finance and Expenditure Committee report says that the Committee considered and did not accept Greymouth's submission that its Chilean branch operations should be grandparented from the law change. However, the Committee noted that some petroleum mining companies might have difficulty fulfilling their contractual obligations under these binding contracts entered into before 4 March 2008, but only where expenditure is incurred pursuant to a binding contract entered into before 4 March 2008, and that Inland Revenue may consider recommending legislation in the future to remedy any unintended consequences.

9 October 2009
The Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill is enacted.

Officials generally support grandparenting in cases where taxpayers have invested on the basis of a specific tax legislation consequence. However, grandparenting decisions are subject to some important conditions.

Decisions to grandparent weigh-up the benefits of grandparenting, such as providing investor certainty, against the costs of grandparenting, including the fiscal costs. Grandparenting is generally limited to transactions of a specific nature that can be expected to be completed in a relatively short time.

In this case, officials recommend against grandparenting on the basis that:

- Had Greymouth had not entered into the contracts, as it did on 30 April 2008, officials consider that it would have only forfeited US$400,000 of bid bonds. The formal contracts were entered into after the law change was announced, in full knowledge of the Government's intention to change the law. This was therefore a commercial decision.
- Grandparenting in this case represents a significant fiscal risk for the Crown. Greymouth is seeking to grandparent five years of expenditure. The formal contracts specify a minimum amount that must be spent over the relevant period (the first seven years). While Greymouth has reduced the period of time it seeks to be grandparented to five years, on the basis of reducing the Crown's fiscal risk, there is no limit to the amount that Greymouth can spend over the five years in Chile and offset against New Zealand petroleum mining income.
- This fiscal risk is heightened because other taxpayers with overseas operations may also, on the basis of equal treatment, require grandparenting.
- Given that petroleum miners with foreign branches were gaining a tax advantage, not from a deliberate policy standpoint but from a gap in the legislation, it is not unreasonable to expect that at some point the Government would change the tax law to protect its taxing right on New Zealand's petroleum resources.
- The recent law change was designed to ensure that New Zealand received its proper share of benefit from its petroleum resources. As such, it should apply equally to all petroleum miners operating in New Zealand.

Recommendation

That the submission be declined.

Remedial matters

PORTFOLIO INVESTMENT ENTITIES

Issue: Application of portfolio class land loss amendment

Submission
(Ernst & Young)

Clause 22 of the bill proposes an amendment to the definition of "portfolio class land loss" to clarify that PIEs that own land offshore can allocate tax losses arising from foreign exchange contracts to investors. It is submitted that an equivalent amendment should also be made to the Income Tax Act 2004 to apply from 1 October 2007 for taxpayers' 2007–08 income years.

Comment

Officials agree. It was not intended that foreign exchange losses relating to portfolio investments in offshore portfolio land companies should be required to be carried forward by the PIE. Therefore it is appropriate that the amendment applies from the beginning of the PIE rules.

Recommendation

That the submission be accepted.

Issue: Foreign exchange losses

Submission
(KPMG)

All foreign exchange losses should be able to be passed through by the PIE to investors even if the investment relates to a greater than 20% interest in a foreign land-owning company.

Comment

Officials agree in principle that foreign exchange losses should be able to be passed through to investors. However, in relation to certain PIEs that own predominantly land, this would require the rules to distinguish and treat differently losses that relate to the land (these would be carried forward) and foreign exchange losses (these would be passed through to investors). This would require major changes to the PIE calculation rules and would increase the complexity of the rules significantly. Officials consider that the approach adopted in the bill will solve the issue of allocating foreign exchange losses for the majority of PIEs that own interests in offshore portfolio land companies.

Recommendation

That the submission be declined.

Issue: Portfolio investment entity tax rates

Submission
(KPMG)

Remedial amendments should be made to portfolio investment entity ("PIE") tax rates.

Comment

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 made changes to the tax rates on PIEs and the income thresholds so they align with the new personal tax rate structure enacted in 2008 (section 124 of the 2009 Act; schedule 6, table 1 of the Income Tax Act 2007).

However, schedule 6, table 1 does not accurately reflect the appropriate prescribed investor rates ("PIRs") and income thresholds for New Zealand resident natural person investors. Accordingly, amendments should be made to ensure the rates and thresholds are correct.

Additionally, row 2 of schedule 6, table 1 should be amended to clarify that the 30% PIR applies to all non-resident investors, whether or not they have provided a notification.

Officials recommend that the amendments apply from 1 April 2010.

Recommendation

That the submission be accepted.

Issue: Miscellaneous drafting issues

Submission
(KPMG)

Section HL 4(2)(a) and (ab) should be linked with an "or" rather than an "and".

Comment

Officials agree. Section HL 4(2) sets out the requirements for which an entity ceases to be eligible to be a PIE. Section HL 4(2)(a) sets out the requirements under sections HL 6 or HL 9 at a class level, whereas section HL 4(2)(ab) sets out the requirements under section HL 10 at an entity level.

Recommendation

That the submission be accepted.

Submission
(KPMG)

The reference to "investor membership requirement" in section HL 9(2) is incorrect and should be replaced with "investor interest size requirement".

Comment

Officials agree. This was incorrectly changed in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

Recommendation

That the submission be accepted.

Submission
(KPMG)

The reference to the "last day of the first quarter" in section HM 25(2)(a) should be amended to the "day following the last day of the first quarter".

The reference to the "last day of the second quarter" in section HM 25(2)(b) should also be amended to the "day following the last day of the second quarter".

Comment

Officials disagree. The date for cessation of PIE status is intended to be at the end of the quarter and not at the start of a new quarter.

Recommendation

That the submission be declined.

Submission
(KPMG)

Section HM 33(1) should include a requirement for a PIE investor proxy (PIP) to provide other information the Commissioner requires.

Comment

Officials disagree. This requirement has been placed within the "duties" of a PIP rather than within the eligibility requirements.

Recommendation

That the submission be declined.

Submission
(KPMG)

The reference to section HM 35(5) is not required in section HM 36(3)(b) and (c) as the taxable income/loss of the PIE is calculated under section HM 35(7).

Comment

Officials disagree. Section HM 35(5) calculates a "taxable amount". Section HM 35(7) defines the result of HM 35(5) as "taxable income" or "taxable loss". Therefore both sections are required for the purposes of section HM 36(3)(b) and (c).

Recommendation

That the submission be declined.

Submission
(KPMG)

The reference in section HM 53(2) to section HM 52 is incorrect. The correct reference is section HM 51.

Comment

Officials agree. This was incorrectly inserted in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

Recommendation

That the submission be accepted.

Submission
(KPMG)

The reference to section CX 56B in section HM 60(4) should be removed.

Comment

Officials agree. The reference is unnecessary.

Recommendation

That the submission be accepted.

Submission
(KPMG)

Section HM 69(5) should clarify that any residual formation losses available after expiry of the three-year period should be applied under section HM 68.

Comment

Officials agree that an amendment is required to ensure that residual formation losses are made available after the three-year period has expired. This should be achieved by ensuring that residual formation losses are allocated to the next attribution period.

Recommendation

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

Submission
(KPMG)

The reference to "portfolio exit period" in section 31(2B)(a) of the Tax Administration Act 1994 is incorrect and should be "portfolio investor exit period".

Comment

Officials agree.

Recommendation

That the submission be accepted.

Submission
(KPMG)

The submitter has raised the other minor drafting issues with the PIE rules. These are as follows:

- There should be an exception for "zero-rated investors" from section HM 6(2)(a).
- The reference to "correct rate" in section HM 6(2)(a) should be replaced by "prescribed investor rate".
- In section HM 6(2)(b) it should be clarified that an investor is liable for tax on any assessable income arising from proceeds for which the PIE has "no" tax liability.

- Section HM 24 should be aligned with section HL 15(2)(b). The loss of PIE status should be from the start of the next quarter.
- In sections HM 26 to 28, loss of PIE status should be from the start of the next quarter to align with current requirements.
- In section HM 30(1), the loss of foreign PIE equivalent status should be aligned with the rules for loss of PIE status.
- In section HM 46, between the steps outlined in subsections (b) and (c), there should be an investor income attribution step, for clarity.
- In section HM 60(3), subsection (3) should be reworded as follows: "the PIE has made a voluntary payment of tax under section HM 45 that is intended to satisfy its income tax liability for the period in relation to the investor, unless the multi-rate PIE applies the last notified investor rate to the voluntary repayment".

Comment

Officials consider that these drafting issues required further consideration. It is therefore recommended that they be considered further and any changes arising will be included in a future tax bill.

Recommendation

That the submission be noted.

Submission
(KPMG)

In section HM 25(3)(b) the correct references should be "the first quarter ends within three months before an announcement by the entity to its investors that it, or the relevant investor class, is winding up within 12 months of the announcement".

Comment

The exclusion in section HM 25(3)(b) is currently worded so that the further eligibility requirements do not need to be met if the relevant quarter ends more than three months before a wind-up announcement to investors. This gives rise to an anomalous outcome – that is, the further eligibility requirements do not need to be met at any time prior to a quarter ending within three months of a wind-up announcement to investors. This is unintended.

Recommendation

That the submission be accepted.

Issue: Electronic returns by PIEs

Submission
(Matter raised by officials)

A number of cross-referencing errors need to be amended in the Tax Administration Act 1994. In section 40(2)(a) there should be references to sections 35, 36AB, 36BB, 36BC and 36E. In section 36C there should be a reference to section 36AB.

Comment

These are cross-referencing amendments of a technical nature only and have been raised in the context of Transform IR, Inland Revenue's major programme to move its paper-based processing to electronic forms.

Recommendation

That the submission be accepted.

Issue: Rewrite amendment

Submission
(Matter raised by officials)

In the definition of "land investment company" in section YA 1, at the end of subsection (a) the ":" should be changed to "; and".

Comment

This unintended change was made in the rewritten legislation in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009 and should be corrected.

Recommendation

That the submission be accepted.

Issue: Credits for PIE tax liability

Submission
(Matter raised by officials)

Section LS 2 should be clarified to provide investors with a credit for the PIEs tax liability on income when that income is taxed to the investor.

Comment

In certain situations PIE income is taxed to the investor as well as the PIE. This can occur when the investor has elected a rate with the PIE that is lower than their correct PIE tax rate. To prevent double taxation, section LS 2 is designed to provide the investor with a tax credit for the PIE tax. There is a technical problem with section LS 2 as it currently does not provide a credit when the PIE's tax liability is offset by a credit at the PIE level (for example, an imputation credit). It is recommended that section LS 2 be changed to provide investors with a credit for the PIE's tax liability on that income rather than PIE tax paid. This amendment would be consistent with the policy intention of the PIE credit rules and is taxpayer-friendly. It is therefore further recommended that the change applies retrospectively from the start of the PIE rules in October 2007.

Recommendation

That the submission be accepted.

Issue: Hedging tax mismatch with FDR securities

Submission
(KPMG)

The NZ dollar hedging arrangements entered into by PIEs (and other taxpayers) in respect of fair dividend rate (FDR) equities should be excluded from the scope of the financial arrangements rules. The gain or loss on the hedge should instead be taxable as part of the FDR return.

A hedging tax mismatch will arise for a PIE because the gain or loss under a hedge is fully taxable under the financial arrangements rules whereas the taxable income in respect of the underlying equities is limited to 5% of their market value, under the FDR regime. This can result in a portfolio of offshore securities, which is perfectly hedged on a pre-tax basis, being imperfectly hedged on an after- tax basis.

KPMG has previously made submissions on this issue. Officials have agreed, in principle, with the above approach but have consistently indicated that further work and consultation was necessary to develop the detail of any solution.

Comment

Officials agree that the hedging mismatch described by the submitter can result in compliance issues for PIEs. Resolving this issue is complex and the appropriate solution is not obvious. Officials will continue to consider the issue and will include the submitter in any consultation.

Recommendation

That the submission be noted.

FOREIGN INVESTMENT FUNDS

Issue: $10,000 limit on foreign non-dividend income for qualifying companies

Submission
(KPMG)

The foreign non-dividend income requirement, under the qualifying company rules, should also take account of income under the foreign investment fund (FIF) rules (or FDR income should be excluded as it is effectively a proxy for a "fair dividend").

Alternatively, qualifying company status should cease only if the amount of foreign non-dividend income, less the amount of foreign dividend income which would be treated as arising if the FIF rules did not apply, is greater than $10,000.

Comment

Officials agree that it is appropriate that FIF income calculated under the FDR method should be excluded from the limit on foreign income in section HA 9.

Recommendation

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

Issue: Ring-fencing of certain foreign losses under qualifying company rules

Submission
(KPMG)

The ring-fencing of FIF losses under section HA 25 in the qualifying company rules should be removed.

Comment

Officials note that FIF losses that are no longer subject to the FIF loss ring-fencing rules are not within the ambit of section HA 25. This is because section HA 25 applies only to "a FIF net loss" which is now restricted to a FIF loss calculated under the branch equivalent method. Officials also note that section HA 25 only applies if an election has been made. Officials therefore consider it is not necessary to make any further amendment to section HA 25.

Recommendation

That the submission be declined.

MEANING OF CONTROLLED FOREIGN COMPANY

Clauses 18 and 85

Submission
(Ernst & Young, New Zealand Law Society)

The proposed changes to the meaning of a controlled foreign company (CFC) should be worded as "the person's control interest is no greater than a control interest in the same category held by another person; and" or as "the person's control interest is less than or equal to a control interest in the same category held by another person". *(Ernst & Young)*

That the savings provision in the proposed section 85(2)(b) be extended to include the 2005–06 income year. *(New Zealand Law Society)*

Comment

Officials agree that the amendment to section EX 1(1)(b)(i) in the Income Tax Act 2004 and 2007 in clauses 18 and 85 is intended to state that a New Zealand resident's control interests in a foreign company must be less than or equal to the control interests held in the same company by the other person.

The other subparagraphs in section EX 1 require that the other person must be a non-resident who is not an associated person of the New Zealand resident. That reflects the policy intention.

Officials agree with the New Zealand Law Society that the savings provision in clause 85(2)(b) should apply from, and including, the 2005–06 income year.

Recommendation

That the submissions be accepted.

IMPUTATION CREDITS AND TAX POOLING – AMENDMENTS TO SECTION OB 6

Clause 28

Submissions
(New Zealand Institute of Chartered Accountants, PricewaterhouseCoopers, Tax Management New Zealand Ltd, matters raised by officials)

We support the sentiment behind this amendment, but the drafting of the legislation needs to be improved. *(New Zealand Institute of Chartered Accountants)*

Proposed paragraphs OB 6(1)(b) and (c) should be removed from the bill. *(New Zealand Institute of Chartered Accountants, Tax Management New Zealand Ltd)*

Proposed section OB 6(3) should be amended by removing paragraph (a) and amending paragraph (c) so that it also deals with the situation where the intermediary transfers a deposit to another taxpayer. These changes will restore the effect of section ME 492)(ad) of the 2004 Act. Paragraphs (b) and (c) should be re-lettered (a) and (b). *(New Zealand Institute of Chartered Accountants, Tax Management New Zealand Ltd)*

Section OB 6 should provide that the credit date for an amount transferred by an intermediary from a tax pooling account to a taxpayer's tax account with the Commissioner be determined under the effective date rules in sections RP 19 and RP 20. *(PricewaterhouseCoopers)*

The drafting of section OB 6 in clause 28 of the bill should be amended to clarify that the provision:

- should not apply to a company in relation to funds it has deposited into a tax pooling account; and
- applies to a company in relation to an amount representing an entitlement to funds in a tax pooling account that the company has acquired from another person under the tax pooling rules. *(Matter raised by officials)*

Sections OB 34, OB 35, OP 9, OP 32 and OP 33 of the 2007 Act should be amended to more appropriately reflect the policy intention. *(Matter raised by officials)*

The tables of imputation credits and debits should be consequentially amended as necessary in relation to the above submissions. *(Matters raised by officials)*

Comment

The provisions of section OB 6 were the subject of a submission to the Rewrite Advisory Panel. The Panel agreed with the submission and their recommendation to amend the provision resulted in an amendment to section OB 6 being included in the first reading of the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver and Remedial Matters Bill) 2009.

The Panel had recommended that section OB 6 should be amended to correct an unintended change in outcome. The unintended change identified was that section OB 6 did not provide for an imputation credit for a company disposing of an entitlement to funds in a tax pooling account.

The Panel also noted that section OB 6 in the 2007 Act did not appear to reflect its corresponding provision in the 2004 Act. The Panel suggested that policy officials should review that issue, with a view to correcting the provision further, if necessary. In carrying out this review, the other imputation (tax pooling) provisions in the 2007 Act were reviewed. The matter raised by officials reflects the outcome of that review.

Purpose of tax pooling

The purpose of "tax pooling" is to provide a pool of funds for use by companies to reduce exposure to use-of-money interest and late payment penalties – in particular, for provisional tax. A tax pooling intermediary administers the tax pooling account, including a transfer (when requested) of funds to a taxpayer's tax account with the Commissioner of Inland Revenue.

Under the tax pooling rules, if a taxpayer pays an amount for tax into a "tax pooling account", that payment is held under trust for that taxpayer's benefit. Funds held for the benefit of a taxpayer in a tax pooling account are normally described as an entitlement to funds in the tax pooling account.

However, taxpayers may "sell" their entitlement to funds in a tax pooling account to another taxpayer. On that sale, the tax pooling intermediary transfers the entitlement to those funds to the other taxpayer.

Tax pooling and imputation credits

Under the tax pooling imputation rules, the policy is that a company is intended to have a credit in its imputation credit account (ICA) for:

- a payment for tax made into the tax pooling account (that is, the taxpayer's own deposits into the tax pooling account);
- the purchase of an entitlement to funds in a tax pooling account.

It is also possible that a purchaser of an entitlement may, instead of transferring the underlying funds to the purchaser's tax account with the Commissioner:

- later on-sell that entitlement to another taxpayer; or
- later request that the intermediary refunds to the purchasing company the funds representing that entitlement from the tax pooling account.

The tax pooling imputation rules provide specific timing rules for the imputation credit that relates to a deposit of funds or purchase of funds. These timing rules are necessary to ensure consistency with the overall objectives of:

- the tax pooling rules;
- enabling the benefit of tax paid at the corporate level to be available for shareholders; and
- the rules relating to the transfer of other tax types to a taxpayer's income tax account with the Commissioner.

The policy intention for imputation in relation to an entitlement to funds in a tax pooling account is as follows:

- The date of the imputation credit for a deposit into a tax pooling account is the date of the deposit. If an entitlement to funds is on-sold, the vendor company must debit its ICA for the amount of the entitlement sold.
- For a purchased entitlement, the date of the imputation credit for a purchased entitlement to funds in a tax pooling account is permitted to be backdated if the funds are transferred to the company's tax account with the Commissioner. The backdating of the credit is to a date selected by the taxpayer, but can be no earlier than the date of the original deposit made to the tax pooling account. Some restrictions also apply to the backdating to prevent abuse of the backdating rule.
- The date of the imputation credit for a purchased entitlement to funds in a tax pooling account that is on-sold (transferred) to another taxpayer is the date of the transfer. A debit to the company's imputation credit also arises for the amount on-sold on the transfer, because the purchased amount is not transferred to the company's tax account with the Commissioner and therefore does not represent tax paid by the company.
- The date of the imputation credit for a purchased entitlement to funds in a tax pooling account that is refunded to the company from the tax pooling account is the date of the refund. A debit to the company's imputation credit also arises for the amount on-sold, because the purchased amount is not transferred to the company's tax account with the Commissioner and therefore does not represent tax paid by the company.

Technical issues existing in the imputation credit tax pooling rules

Officials agree with the New Zealand Institute of Chartered Accountants and the Rewrite Advisory Panel that the imputation rules for tax pooling:

- should not result in a company having an imputation credit for a deposit of funds into a tax pooling account and another imputation credit when that payment is later transferred to the company's tax account with the Commissioner; and
- should not result in a company having an imputation credit for a deposit of funds into a tax pooling account, and another imputation credit when the company either on-sells the entitlement to those funds or has those funds refunded from the tax pooling account.

Section OB 6

As currently drafted in the 2007 Act, section OB 6 applies to a company that has either made a deposit into a tax pooling account or has purchased an entitlement to funds in a tax pooling account.

Officials agree with the New Zealand Institute of Chartered Accountants that the policy intention for section OB 6 is that it should apply only to a company that has purchased an entitlement in a tax pooling account. Section OB 5 addresses the imputation effects for a company that has made a deposit into a tax pooling account.

Section OB 6 in the bill should be redrafted to provide that the purchasing company has an imputation credit for the acquisition of an entitlement to funds in a tax pooling account, and further provide that the date of the credit is as follows:

- if the purchasing company requests the intermediary to transfer to the company's tax account with the Commissioner, an amount representing an entitlement to the funds in the tax pooling account, the date of the credit is determined under the effective date rules in sections RP 19 and RP 20; or
- if the purchasing company on-sells to another taxpayer that entitlement to the funds in the tax pooling account, the date of the credit is at the date the entitlement is transferred to the other taxpayer; or
- if the purchasing company requests that the intermediary refunds the funds representing the purchased entitlement from the tax pooling account to the company, the date of the credit is the date of the refund.

Other imputation (tax pooling) provisions

In addition, as recommended by the Rewrite Advisory Panel, officials have now completed a review of other imputation tax pooling provisions in sections OB 34, OB 35, OP 9(1) and (3)(b), OP 32 and OP 33. Officials have identified that those provisions contain similar drafting issues for purchased entitlements to funds as contained in current section OB 6. For example:

- Section OB 34 provides for a debit to a company's imputation credit account for a refund to the company of funds representing an entitlement in a tax pooling account. As drafted, section OB 34 applies only to a company in relation to a deposit of its own funds in a tax pooling account. Its corresponding provision in the 2004 Act applied also to a company that had purchased the entitlement to those funds in the tax pooling account.

- Section OB 35 provides for a debit to a company's imputation credit account for an amount equal to the entitlement to funds on-sold to another taxpayer. As drafted, section OB 35 applies only to an on-sale of an entitlement that was deposited by the selling company. Its corresponding provision in the 2004 Act applied also to an on-sale of the entitlement by a company that had previously purchased the entitlement to those funds in the tax pooling account.
- Section OP 9 is a provision for consolidated imputation groups that should "mirror" the effect of section OB 6. As drafted in the 2007 Act, section OP 9 contains the same drafting concerns identified by submitters and the Rewrite Advisory Panel for section OB 6. Section OP 9 should be amended in a similar manner to section OB 6.
- Sections OP 32 and OP 33 apply to consolidated imputation groups and should "mirror", respectively, the effect of sections OB 34 and OB 35. As drafted, section OP 32 has same drafting issues as identified above for sections OB 34 and OB 35. Section OP 33 as drafted in the 2007 Act is inconsistent in its language to section OB 35 and, in particular, does not refer to the intermediary's role in transferring entitlements to funds in a tax pooling account, as the trustee of those funds. Sections OP 32 and 33 should be redrafted to be consistent with the recommended drafting changes for sections OB 34 and OB 35.

Recommendations

That New Zealand Institute of Chartered Accountant's and Tax Management New Zealand Ltd's first submission be accepted, and that its second and third submissions are accepted in principle, subject to officials' comments on the intended policy outcomes.

That PricewaterhouseCoopers' submission is accepted.

That the matters raised by officials' be accepted.

CURRENCY CONVERSIONS – ADMINISTRATIVE APPROVAL FOR RATES AND METHODS OF CONVERTING FOREIGN CURRENCIES INTO NEW ZEALAND CURRENCY

Clause 33

Submissions
(Corporate Taxpayers Group, Ernst & Young, matter raised by officials)

The legislation allows taxpayers to use whatever method they have historically applied, as long as it is consistently applied by the taxpayer across income years. *(Corporate Taxpayers Group)*

Clarification is required to ensure that the Commissioner's approval is given on a general basis and does not require each affected taxpayer to make specific or repeated applications to the CIR for approval of the rates and methods used. *(Ernst & Young)*

For a provision of the Act (other than section YF 1) that provides a rate or method for currency conversion, the CIR should be empowered to determine a rate that is representative of the actual rate or close of trading spot exchange rate. *(Matter raised by officials)*

Comment

The policy intention is that the Commissioner is able to approve a currency conversion rate or method, for the purposes of determining a person's income tax obligations. This was the Commissioner's administrative practice under the 2004 Act and earlier legislation, under which the Commissioner had approved a currency rate or methods for general application.

If a taxpayer did not use a method approved by the Commissioner (either generally or a specific method approved for a taxpayer), the law required foreign currency amounts to be converted using the spot rate applying at the transaction date, unless a legislative conversion rule applied (for example, conversion of attributed CFC income expressed in a foreign currency).

The purpose of the amendment in the bill is to empower the Commissioner to approve:

- a general method or methods for converting foreign currency into New Zealand currency, which may include approval of the use of certain rates (for example mid-monthly exchange rates published by the Reserve Bank of New Zealand); and
- a specific method for converting foreign currency into New Zealand currency to suit a taxpayer's particular circumstances.

Officials agree that the bill is not sufficiently clear that the Commissioner is empowered to approve for general application (including setting of rates), methods for the conversion of foreign currency into New Zealand currency amounts for income tax purposes. Officials also agree with the Corporate Taxpayers Group that the bill is not sufficiently clear that a taxpayer would normally be required to use an approved method consistently across income years.

Officials do not agree that taxpayers should be permitted to use specific conversion methods without that method having been approved by the Commissioner, unless that specific method is provided for under an existing legislative rule. Such an approach is inconsistent with the previous administrative practice of the Commissioner and would give rise to unacceptable risks to the tax base.

Officials consider that if a taxpayer's specific conversion method had been approved by the Commissioner under the previous administrative practice at the time the 2007 Act commenced, that approval would continue to be effective.

Officials consider that, if a taxpayer applies a previously approved conversion method consistently across tax years, the amendment to section YF 1 will not require taxpayers to re-apply for approval of their method for currency conversion. This will mean that a taxpayer will need to apply where they wish to use a new currency conversion method or rate that has not already been approved for the taxpayer or as a rate or method for general application. This point can be emphasised in the TIB item on this amendment.

Section YF 1, including the amendment in the bill, applies to transactions arising in a foreign currency but for which there is no specific currency conversion rate or method (as, for example, in the calculation of income from a foreign investment fund).

However, the Commissioner has also adopted an administrative practice for specific currency conversion rules, to permit taxpayers to use an exchange rate that is representative of actual exchange rates. The purpose of this administrative practice is to minimise compliance costs for taxpayers.

Consistent with the recommendation that the submissions on section YF 1 officials consider that it would assist in minimising compliance costs for taxpayers if the Commissioner's administrative practice for specific currency conversion rules is also codified.

Recommendations

That the submission of the Corporate Taxpayers Group be declined in so far as it relates to currency conversion methods not previously approved by the Commissioner.

That the submission of the Corporate Taxpayers Group be accepted in so far as it relates to a requirement that the currency conversion method be consistently adopted across tax years.

That the submission of Ernst & Young be accepted.

That the matters raised by officials be accepted.

PAYMENTS BY RWT PROXIES – CROSS-REFERENCING ERROR IN SECTION RE 18(2)

(Matter not in the bill)

Submission
(Ernst & Young)

The definition "tax rate" in subsection RE 18(2) of the Income Tax Act 2007 should refer to clause 3, not clause 2, of schedule 1, part D.

Comment

Officials agree with the submission. The corresponding provision in the 2004 Act is section NF 1(2B), and the cross reference from the term "tax rate" was to clause 1 of schedule 14 of the 2004 Act. Clause 1 of schedule 14 of the 2004 Act corresponds to clause 3 of schedule 1, part D of the 2007 Act.

Recommendation

That the submission be accepted.

DEFINITION OF "CULTIVATION CONTRACT WORK"

(Matter not in the bill)

Submission
(New Zealand Institute of Chartered Accountants)

In schedule 4, part C, clause 2 of the Income Tax Act 2007, the definition of "cultivation contract work" should be amended to clarify that the schedular payments regime only applies to works or services provided under a contract or arrangement for the supply of labour, or substantially for the supply of labour in relation to land that is intended to be used for the cultivation of fruit crops vegetable orchards or vineyards.

Comment

Officials agree with the submission. The amendment corrects an unintended consequence from the drafting of the definition of "cultivation contract work".

The policy intention is for tax to be withheld at source (under the PAYE rules) from payments for cultivation contract work that was for labour-only services, or substantially labour-only services. As drafted, the definition could include payments for services that involved a high capital element such as the use of a combine harvester.

Recommendation

That the submission be accepted.

REWRITE REMEDIAL ITEMS – DISPOSAL OF TRADING STOCK FOR LESS THAN MARKET VALUE

Submission
(Matter raised by officials)

Sections GC 1 and EB 24(1) of the 2007 Act should be amended retrospectively:

- to correct an unidentified change in legislation as identified by the High Court with retrospective effect from the commencement of the 2007 Act; and
- include an appropriate savings provision to protect taxpayers who have taken a tax position on the basis of the wording of section GC 1 or EB 24(1) in a return of income filed before 28 October 2009.

Comment

The High Court has identified that the effect of section GC 1 of the 2007 Act contained an unintended change in legislation in a recent High Court decision (*Foodstuffs (Wellington) Co-Operative Society Limited v CIR* (CIV 2009-485-1224). That decision of the High Court was released on 28 October 2009.

The particular issue before the Court was whether the market value of shares (held as trading stock), which were cancelled on an amalgamation, was income of the shareholder. The Court held that section GD 1 of the 1994 Act (which corresponds to section GC 1 of the 2007 Act) applied and the market value of the shares was income of the taxpayer.

The taxpayer's argument was that section GD 1 required a recipient before it could apply. The Court rejected that argument, holding that section GD 1 did not require a recipient, noting that the section could apply to a sole trader who withdrew trading stock from the business for private consumption, which also did not require a recipient to be a separate person.

In the 2007 Act, both sections GC 1 and EB 24(1) address the disposal of trading stock for less than market value by one person to another person. Section EB 24(1) stems from the same policy background as section GC 1 and contains the same type of unintended legislative change identified in section GC 1 by the Court.

Officials recommend that sections GC 1 and EB 24(1) be retrospectively amended to ensure that the sections do not require a recipient of the trading stock, as noted by the High Court relation to section GD 1 of the 1994 Act.

However, taxpayers have notice of the Court's finding of the meaning of the law in the 1994 Act only from 28 October 2009, being the date the High Court released its decision in *Foodstuffs*. Until that date, it is possible that a taxpayer has taken a tax position in a return of income filed before 28 October 2009 for either of the 2008–09 or 2009–10 income years, on the basis of the plain wording of sections GC 1 or EB 24(1) of the 2007 Act. In this circumstance, a savings provision is recommended to protect taxpayers who have adopted this tax position.

Recommendation

That the submission be accepted.

NON-REWRITE REMEDIALS – REWRITE ADVISORY PANEL RECOMMENDATIONS

Issue: Section CX 16(4) – 2004 Act remedial item

Submissions
(Matters raised by officials)

Section CX 16(4) should be amended retrospectively, with an appropriate savings provision, to prevent a company from electing to treat any benefit provided to a shareholder employee as a dividend.

Section CX 17(4) of the 2007 Act should be consequentially amended, as it is the corresponding provision to section CX 16(4) of the 2004 Act.

Comment

The Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Act 2004 amended section CX 16(4), by replacing the punctuation between paragraphs (a) and (b) in section CX 16(4) of the 2004 Act. A submission to the Panel set out that this amendment had made a change to the outcome and was inconsistent with the policy intention of the rule.

The policy for section CX 16(4)(a) and (b) is that a company may elect to treat as a dividend (instead of a fringe benefit), an "unclassified benefit" provided to a shareholder-employee. This election was not available to other types of fringe benefit that were specifically listed (such as, for example, a motor vehicle).

However, as drafted, section CX 16(4) permits the company to elect that any benefit provided to a shareholder employee may be treated as a dividend. Officials agree that outcome is inconsistent with the policy intention.

The Rewrite Advisory Panel noted that the submission was not a rewrite matter, but concluded that the change in legislation produced an incorrect policy outcome. The Panel therefore recommended to officials that the provision should be retrospectively amended to restore the correct policy effect, as a minor remedial item. The Panel also recommended that the amendment should contain an appropriate savings provision to protect taxpayers who may be adversely affected by such a retrospective amendment.

Officials agree with the conclusion and recommendations of the Panel.

Recommendation

That the submissions be accepted.

REWRITE REMEDIAL ITEMS – REWRITE ADVISORY PANEL RECOMMENDATIONS

(Matters raised by officials)

Issue: Sections CB 33, DV 19 – Mutual associations and the mutuality principle

Submissions

Section CB 33 of the 2007 Act should be amended retrospectively to ensure it overrides the common law principle of mutuality in the same manner as its corresponding provision in the 2004 Act.

Section DV 19 of the 2007 Act should be amended retrospectively to ensure that an association may deduct an association rebate paid to members to the same extent as was allowed under the corresponding provision in the 2004 Act.

Comment

The Rewrite Advisory Panel has agreed with a submission that section CB 33 of the 2007 Act contains an unintended change by not overriding the principle of mutuality in the same manner as its corresponding provision in the 2004 Act (section HF 1(1)).

The principle of mutuality arises under common law. The Courts consider that a person cannot derive taxable income from mutual transactions, as a mutual transaction is of a similar nature to trading with oneself. The policy intention is for the income tax rules to override the common law principle of mutuality for amounts derived that would otherwise be income under the Act.

However, to give some effect to the mutuality principle, a "mutual association" is allowed a deduction, under section DV 19 of the 2007 Act, for a distribution to its members of net taxable profits (known as "an association rebate"). The amount of the deduction can be no greater than the part of the association's net income that arises from certain types of transactions made between the association and its members.

The Panel concluded that, consequential on the unintended change in section CB 33, section DV 19 of the 2007 Act contains an unintended change in outcome. Section DV 19 allows a deduction for the association rebate, but its current drafting results in a smaller deduction than was allowed under its corresponding provision in the 2004 Act (section HF 1(2)).

Officials agree with the Panel's conclusions and recommendation that sections CB 33 and DV 19 should be amended retrospectively.

Recommendation

That the submissions be accepted.

Issue: Section EE 51(3)(b) (2004 Act) and section EE 60(3)(b) (2007 Act) – Accumulated tax depreciation and mothballed assets

Submission

Section EE 51(3)(b) of the 2004 Act should be amended retrospectively to ensure that a depreciable asset that has been withdrawn from the business is not required when accounting for accumulated tax depreciation while the asset is not available for use in the business.

Comment

The Rewrite Advisory Panel has agreed with the submission that section EE 51(3)(b) of the 2004 Act contains an unintended legislative change. The Panel noted that this unintended change had been re-enacted as section 60(3)(b) of the 2007 Act.

The Panel recommended that sections EE 51(3)(b) of the 2004 Act and EE 6)(3)(b) of the 2007 Act should be retrospectively amended to restore the effect of the defined term "adjusted tax value" in the 1994 Act.

During the time a depreciable asset is withdrawn from a business, a taxpayer is not allowed a deduction for depreciation. In addition, accumulated depreciation is stopped at the time of that withdrawal from business use. An example where the rule is intended to apply is if a taxpayer "mothballs" an asset, such as plant or equipment, which has become obsolete and replaced.

Officials agree with the Panel's conclusion and recommendation that section EE 51 of the 2004 Act (and consequentially section EE 60 of the 2007 Act) should be retrospectively amended.

Recommendation

That the submission be accepted.

Issue: Section FM 12(2) – Interest deductions for consolidated groups

Submission

Section FM 12(2) of the 2007 Act should be amended retrospectively to disallow a deduction for interest incurred on money borrowed from another company, when both companies are members of the same consolidated group of companies.

Comment

Section FM 12(2) of the 2007 Act allows a company a deduction for interest incurred on money borrowed from another company within the consolidated group. The Rewrite Advisory Panel considers this outcome is an unintended legislative change, when compared with section HB 2(1)(d) of the 2004 Act, and has recommended that the provision be amended retrospectively.

Section HB 2(1)(d) of the 2004 Act which is the corresponding provision to section FM 12 of the 2007 Act, prevented a company within a consolidated group from being allowed a deduction for interest incurred on money borrowed from another company within the same consolidated group. This prohibition on deductibility is matched by section HB 2(1)(e) of the 2004 Act, which provided that interest derived by one company from money lent to another company within a consolidated group of companies is not income for income tax purposes.

Officials note that section FM 12(2) in the 2007 Act has inadvertently omitted the word "not", and that the consolidated companies regime reduces compliance costs by providing that many transactions within the group are ignored for income tax purposes. Therefore, officials agree with the Panel's conclusion and recommendation.

Recommendation

That the submission be accepted.

Issue: Section GB 25(3) (b) – Excessive remuneration paid by a close company to a shareholder, director or relative

Submission

Section GB 25(3) of the 2007 Act should be amended retrospectively to ensure that it does not apply to a director, shareholder or a relative of the director or shareholder who is employed substantially full-time and is participating in the administration of the business.

Comment

The Rewrite Advisory Panel has agreed with the submission that section GB 25(3) of the 2007 Act should not permit the Commissioner to re-assess a director, shareholder or a relative of the director or shareholder, if that person is employed substantially full-time and is participating in the administration of the business.

The Panel considered that section GD 5 of the 2004 Act (which corresponds to section GB 25 of the 2007 Act) did not apply to a director, shareholder or a relative of the director or shareholder who was employed substantially full-time and participating in the administration of the business.

Officials agree with the Panel's conclusions and recommendation that section GB 25(3)(b) should be amended retrospectively.

Recommendation

That the submission be accepted.

Issue: Section HA 1(1)(a) – Qualifying companies

Submission

Section HA 1(1)(a) should be amended retrospectively to replace the term "tax paid" with a phrase that is consistent with the treatment of dividends pad by a qualifying company as being fully imputed or as exempt income.

Comment

The Rewrite Advisory Panel has agreed with a submission to the Panel that the use of the phrase "tax paid" in section HA 1(1)(a) is an unintended legislative change, and has recommended that the provision be retrospectively amended. The Panel concluded that the use of the phrase "tax paid" is inconsistent with the treatment of a dividend paid by a qualifying company as exempt income, when the dividend does not have imputation credits attached at the maximum imputation ratio.

Although the drafting of section HA 1(1)(a) was intended to be read as a purpose provision, outlining the scheme of subpart HA, officials agree that the use of the phrase "tax paid" is inconsistent with the treatment of an unimputed dividend paid by a qualifying company as exempt income.

Officials agree this inconsistency might give rise to an erroneous interpretation and, therefore, agree with the conclusion and recommendation of the Panel.

Recommendation

That the submission be accepted.

Issue: Section HA 11(4), section HA 11B – Loss-attributing qualifying companies

Submission

Section HA 11(4) of the 2007 Act should be repealed and replaced retrospectively by section HA 11B to provide that a loss-attributing company that ceases to be a loss-attributing company also ceases to be a qualifying company, in the same manner as provided in section HA 11(4)'s corresponding provision in the 2004 Act (section HG 18).

Comment

The Rewrite Advisory Panel has agreed with a submission that section HA 11(4) contains an unintended change in outcome when compared with its corresponding provision in the 2004 Act and recommends it be retrospectively amended.

Officials agree that the corresponding provision in the 2004 Act (section HG 18) provides that when a loss-attributing qualifying company no longer satisfies the ongoing shareholder decision-making requirements, the company also ceases to be a qualifying company. Officials agree with the Panel's conclusion and recommendations for this issue.

Recommendation

That the submission be accepted.

Issue: Section HA 24(5) – Loss carry-forward and loss-attributing qualifying companies

Submission

Section HA 24(5) should be amended to ensure that a loss-attributing qualifying company is able to carry forward a loss balance arising in an earlier income year in which the company was a qualifying company, but prior to the company becoming a loss-attributing qualifying company.

Comment

The Rewrite Advisory Panel has agreed that section HA 24(5) incorrectly prevents a loss-attributing qualifying company from carrying forward a loss balance arising in income years, during which it was a qualifying company, and prior to it becoming a loss-attributing qualifying company.

Section HG 16(1)(c) of the 2004 Act permitted a qualifying company that later became a loss-attributing company to carry forward unused tax losses that arose during the years in which the company was a qualifying company but not a loss-attributing company.

Officials agree that section HA 24(5) does not correctly reflect the effect of section HG 16(1)(c) of the 2004 Act. Therefore, officials agree with the Panel's recommendation that the unintended change be corrected retrospectively.

Recommendation

That the submission be accepted.

Issue: Section HA 26 – Loss-attributing qualifying companies

Submission

Section HA 26 of the 2007 Act should be retrospectively amended to permit a shareholder in a loss-attributing qualifying company to elect, in the same circumstances provided for in section HG 16(2) of the 2004 Act, to defer the transfer the net loss of a loss-attributing qualifying company to shareholders of the company.

Comment

The Rewrite Advisory Panel has agreed with a submission that section HA 26 of the 2007 Act does not permit a taxpayer to elect, in certain circumstances, to defer the transfer the net loss of a loss-attributing qualifying company to shareholders of the company. The Panel noted this right existed in the corresponding provision to section HA 26, being section HG 16(2) of the 2004 Act.

Under section HG 16(2), a shareholder could elect to defer the transfer of a loss-attributing qualifying company's net loss to shareholders to the following tax year. This election could be made if the company's tax balance date was later than the electing shareholder's tax balance date and the difference in balance dates meant that waiting for the information could cause the shareholder to file their return of income later than the due date.

The Panel has recommended that section HA 26 be retrospectively amended to restore the effect of section HG 16(2) of the 2004 Act. Officials agree with the Panel's conclusions and recommendations for this issue.

Recommendation

That the submission be accepted.

Issue: Section IC 3(3) – Commonality of shareholding for groups of companies and tax losses

Submission

Section IC 3(3) of the 2007 Act should be amended retrospectively to ensure that the commonality of shareholding rules are not applied in a manner akin to the shareholder continuity rules.

Comment

The Rewrite Advisory Panel has agreed with a submission that section IC 3(3) of the 2007 Act contains an unintended legislative change. Section IC 3(3) sets out certain requirements a company must satisfy for that company to be able to offset tax losses against another company in the same group.

In section IG 1(2) of the Income Tax Act 2004, a group of shareholders was required to have at least a 66% common shareholding interest in both companies for each tax year, from the tax year the tax loss arose until the loss is offset. Provided there was at least the 66% common interest between the two companies for each year, it did not matter if the group of shareholders was different in one year from another due to transfers of shareholding.

However, in the 2007 Act, section IC 3(3) requires the lowest common shareholding after a change in shareholding to be taken into account in determining whether the 66% common shareholding threshold was breached in tax years before that change in shareholding. That outcome is inconsistent with the policy and therefore the Panel has recommended that section IC 3(3) be retrospectively amended to restore the effect of section IG 1(2) of the 2004 Act.

Officials agree with the conclusions and recommendation of the Panel that section IP 5 of the 2007 Act should be amended retrospectively.

Recommendation

That the submission be accepted.

Issue: Section IC 12 – Loss carry-forward and grouping

Submission

Section IC 12 of the 2007 Act should be amended retrospectively to permit a company to carry forward tax losses from one year to another, and then use that carried-forward loss to offset against the company's own net income for that later income year.

Comment

The Rewrite Advisory Panel has agreed with a submission that section IC 12 of the 2007 Act incorrectly prevents a company from carrying forward tax losses and offsetting those losses against its own net income for a later income year. The Panel concluded that this outcome differed from the outcome under section IG 2(6) of the 2004 Act. The Panel recommended that section IC 12 be amended retrospectively.

Section IG 2(6) of the 2004 Act prevented a company from grouping tax losses that have arisen from bad debts or share losses if the financing of the debt or shares was provided by a group company. However, section IG 2(6) did not prevent the company from carrying forward those losses for use against its own income in future income years.

Officials agree that section IC 12 of the 2007 Act does not correctly reflect the outcome given by section IG 2(6) of the 2004 Act and therefore agree with the Panel's recommendation to restore to section IC 12, the effect of section IG 2(6) of the 2004 Act.

Recommendation

That the submission be accepted.

Issue: Section IP 5 – Carrying forward losses and part-year rules

Submission

Section IP 5 should be amended retrospectively to ensure that in a year in which a company breaches the shareholder commonality or continuity requirements, section IP 5(2) does not prevent the company's tax losses from earlier tax years being carried forward to the year in which the breach of commonality or continuity occurs.

Comment

The Rewrite Advisory Panel has agreed with a submission that section IP 5 of the 2007 Act incorrectly prevents a company from carrying forward tax losses to a year in which either of the commonality or continuity of ownership rules are breached. The Panel considers that section IP 5 should be retrospectively amended.

For part-years, a company is permitted to carry forward tax losses arising in one tax year to the next tax year, provided the company satisfies both of the commonality and continuity of ownership rules. Unused tax losses carried forward may then be carried forward to the next succeeding tax year or years, until the benefit of those tax losses are fully utilised.

For a year in which a company breaches the commonality or continuity requirements, tax losses arising from earlier years may be carried forward to the year of breach and the benefit utilised for the part-year before the breach.

Officials agree with the conclusions and recommendations of the Panel relating to section IP 5 of the 2007 Act.

Recommendation

That the submission be accepted.

Issue: Section OB 32(2)(b) – Imputation credits and refunds of income tax

Submission

Section OB 32(2)(b) should be amended retrospectively to ensure that the debit to an imputation credit account for a breach in shareholder continuity is correctly adjusted for a debit for income tax refunded to the company before the breach in shareholder continuity occurred.

Comment

The Rewrite Advisory Panel has agreed with a submission that section OB 32(2)(b) of the 2007 Act limits the adjustment to a debit for breach of continuity for income tax refunded prior to the breach, to an amount that is less than the debit for the breach in continuity. The Panel has recommended that section OB 32(2)(b) should be retrospectively amended.

The purpose of this adjustment is to prevent two debits being made to a company's imputation credit account in relation income tax that refunded before the breach and for which continuity is lost.

On a breach of shareholder continuity, the company's imputation credit account (ICA) is debited for the amount of imputation credits for which shareholder continuity is not satisfied. However, as income tax refunded prior to a debit for breach of shareholder continuity also gives rise to a debit to the ICA, section OB 32(2)(b) provides an adjustment to the debit for breach of shareholder continuity to take into account the earlier debit for a refund of income tax.

Officials agree with conclusions and recommendation of the Panel for section OB 32(2)(b) of the 2007 Act.

Recommendation

That the submission be accepted.

Issue: Minor maintenance items referred to the Rewrite Advisory Panel

Submissions

The following minor maintenance items provided to the Rewrite Advisory Panel should be amended retrospectively as follows:

- Section CW 31(3) Income Tax Act 2004 should be added retrospectively to the list of unintended changes in schedule 22A.
- The definition of "amount of tax" in section YA 1 should be amended retrospectively to clarify that the meaning of "amount of tax" includes "income tax".
- The section 52(a) of the Tax Administration Act 1994 should be amended to insert "not" after "for which RWT is"

Comment

For drafting consistency, section CW 31(3) is inserted into schedule 22A to ensure that the schedule refers to section CW 31(3) and section CW 32(3), as both sections are drafted in the same manner.

The term "amount of tax" in subpart RM is ambiguous as to whether it includes income tax for the purpose of the refund rules. The amendment removes the ambiguity.

The amendment corrects a drafting error in the consequential amendment in schedule 50 of the 2007 Act.

These amendments have been referred to the Rewrite Advisory Panel as minor maintenance items and retrospectively correct any of the following:

- ambiguities;
- compilation errors;
- cross-references;
- drafting consistency, including readers' aids, for example the defined terms lists;
- grammar;
- punctuation;
- spelling;
- subsequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

Recommendation

That the submissions be accepted.

LIFE INSURANCE – TRANSITION AND TECHNICAL ISSUES

The Taxation (International Taxation, Life Insurance and Remedial Matters) Act 2009 introduced comprehensive changes to the taxation of life insurance business.

The current bill does not contain any provisions dealing with life insurance. Officials consider it desirable, however, to address the remedial matters identified below in order to provide clarity and certainty for the life insurers who are implementing the new rules, which are due to start 1 July 2010 (or earlier if the insurer elects).

The recommendations in this report are a practical response to matters that insurers have raised with officials in respect of the application of the transitional provisions. As such, the changes recommended in this report are largely technical in nature and ensure the new life insurance rules are broadly consistent with policy intent. Officials have consulted with representatives from various insurers in developing the majority of these recommendations.

Issue: Workplace group policies – definition

Submission
(Sovereign Limited, Tower Limited and AXA New Zealand)

The rules supporting the application of the transitional rules to workplace-related life policies should be extended to deal with the following situations:

- life policies provided to members of an employment-related superannuation scheme;
- broker-administered schemes that allow multiple employers (typically smaller-sized firms) to provide life insurance cover to their employees; and
- life insurance policies sponsored by industry associations.

Comment

"Workplace group policies" are life insurance policies provided by an employer or union. The policy compulsorily covers employees or union members. The rules for workplace group policies are meant to overcome practical difficulties faced by insurers in obtaining information about the underlying lives covered by the policy. The grandparenting period for these policies is up to three years instead of up to five years for most other life insurance policies. The shortened period of time is a trade-off for allowing workplace group policies to cover new lives after 1 July 2010 (the start date of the life insurance tax changes).

Life insurers note that the current rules do not adequately cover all situations when workplace group policies are sold. Specifically identified as being outside the scope of "workplace group policies" are policies sold to trustees of workplace superannuation schemes, and life policies sold to industry associations and employer-collective groups. Officials agree that the rules for workplace group life policies should be extended as suggested by submissions because they are similar in nature to life policies provided directly by employers and unions.

Recommendation

That the submission be accepted.

Issue: Workplace group policies – voluntary elements

Submission
(Sovereign Limited, Tower Limited and AXA New Zealand)

Related to the submission above, some workplace policies allow for voluntary top-ups in the amount of life cover and allow spouses of employees to be covered under the policy. Policies with these features should also be included in the transitional rules for workplace group policies.

Comment

Officials understand that these voluntary elements are generally an incidental part of workplace group life policies. Provided that the policy is in effect, for example, the policy has been issued and the insurer has received a deposit from the insured before 1 July 2010, the workplace group policy can be grandparented.

Recommendation

That the submission be accepted.

Issue: Level-premium life policies – adjustments for CPI

Submission
(Matter raised by officials)

Life insurers have asked officials to review the operation of the current rules as they apply to level-premium policies (sometimes referred to as "term life policies").

Section EY 30 provides transitional relief for level-premium policies. The purpose of the relief is to reflect that such policies have been priced on the basis of certain conditions and may not provide the insurer with the opportunity to alter premiums. The legislation limits transitional relief to level-premium policies when there is no movement in the premium.

Insurers have advised that a considerable portion of the level-term insurance market provides the policyholder with the option to index the level of cover to protect its real value. Such adjustments have a natural reflex in the premium.

Comment

The current rules were designed to cater for life policies where the insurer had little or no ability to change premiums, or for commercial reasons chose not to increase premiums in response to the taxation changes.

We have since been advised that the rules may not apply to a large proportion of the level-premium market because most policyholders choose to preserve the real value of life cover. While this increase has a reflex in the premium charged, it is usually determined by a predetermined formula that may not allow the life insurer to adjust for matters other than movements in the consumer price index (CPI). Officials consider that an increase in the premium for a level-premium policy should not remove it from the scope of the transitional rules if the increase is as a result of using a CPI formula to preserve the amount of cover under the life policy.

Recommendation

That the submission be accepted.

Issue: Group life policies

Submission
(Matter raised by officials)

Life insurers have asked officials to consider two issues concerning the application of group life policies.

- The definition of "group life master policy" (life insurance policies that cover more than one life) has a requirement that the policy is not available to the general public. The requirement is not necessary and practical.
- Section EY 30(3) needs to be clear that its application is based on an individual life in connection with group life master policies. For example, if a life policy provides cover to a couple/family and one of the lives insured results in a breach in transitional rules, the current rules would appear to disqualify the entire policy, not just the cover connected with the affected life.

Comment

These changes are recommended to ensure that the transitional rules can be applied in a practical manner.

Recommendation

That the submission be accepted.

Issue: Transitional relief for reinsurance products

Submission
(Matter raised by officials)

If reinsurance relates to workplace group life or credit card repayment insurance, the requirement to look through should be removed.

Comment

Reinsurance treaties are deemed to be group life master policies and therefore have up to five years' transitional relief as long as the reinsurer can look through to the underlying lives. This outcome is not appropriate if the underlying policy is a workplace group policy or credit card repayment insurance. These policies are subject to more concessionary criteria for compliance cost reasons and this should be reflected in the rules applying to reinsurance.

Recommendation

That the submission be accepted.

Issue: No restoration of transitional relief allowed

Submission
(Matter raised by officials)

The transitional rules could be interpreted in such a way to allow insurers at the beginning of each cover review period to reinstate life policies that breached the transitional rules in an earlier period.

Comment

Life insurance policies that breach the transitional rules during the grandparenting period should not be restored for the purposes of receiving transitional relief. The purpose of the transitional rules is to provide a single opportunity to allow life insurers to grandparent life products where contractually or commercially it would be difficult to alter the price. If a policy breaches the transitional rules (for example, when the cover under an annual renewable term policy adjusts by more than the greater of 10 percent or a movement in the CPI index), the policy is treated as being a new contract for tax purposes and should not benefit from the tax treatment under the previous rules.

Recommendation

That the submission be accepted.

Issue: Bifurcation of life insurance policies

Submission
(Matter raised by officials)

Life insurers have asked officials to allow life policies to be bifurcated. Some life policies provide multiple benefits or products relating to a life policy. Apart from non-life-related cover, the legislation does not split or divide a life policy if it has aspects that would be subject to differential tax treatment under the transitional rules.

Comment

The transitional rules are based on a "single unified supply" notion, whereby a life policy is the sum of all its parts. Most life insurance policies are a "wrapper" for a range of life-related insurance.

Life insurers have asked whether the entire life policy is disqualified or only the cover connected with that particular life product is disqualified. It is argued that without the ability to bifurcate life insurance policies, transitional relief for existing business could be unduly cut short.

Because separate rules apply to life-related products such as credit card repayment insurance, and to core life products themselves (for example, single premium, term life, annual renewable term and group life master policies), it would seem sensible that life insurers are able to split a life policy according to the rules for those products.

Any split or division of a life policy must be transparent to the policyholder, and policy documentation must clearly show that there is a separate price for each life product that forms part of the life insurance policy "wrapper".

Recommendation

That the submission be accepted.

Issue: Application of the term "cover review period" – balances that change in response to a financial arrangement or security

Submission
(Matter raised by officials)

Life insurers have asked officials to clarify the application of the "cover review period".

Comment

The "cover review period" is a means to establish a point in time for the insurer to consider whether a life policy breaches the transitional provisions, which would result in the affected life policy ceasing to qualify for grandparenting. The test is based on a per policy basis and should be considered whenever the policy is renewed (and repriced). If the repricing results in a breach of the transitional rules, transitional relief ceases.

Some life insurance products track an underlying financial arrangement (for example, a mortgage). The premium payable for the life cover will rise and fall in response to any changes to the balance of the financial arrangement.

A similar issue has been identified in respect of life policies that provide cover in connection with superannuation benefits under KiwiSaver. The life insurance cover meets any shortfall in income and capital to the desired amount. Like the mortgage protection, the amount of insurance cover will vary in accordance with the investment returns and other issues that are outside of the control of the life insurer.

Recommendation

That the submission be accepted; specifically that increases in life cover be measured at the beginning of a cover review period and contrasted against the beginning of the next cover review period.

Issue: Application of the term "cover review period" – transitional relief up to and including date of breach

Submission
(Matter raised by officials)

Life insurers have requested that relief under transitional rules should cease on the date that a life policy ceases to qualify. Currently, the relief ends at the beginning of the income year in which a breach occurs.

Comment

Related to the previous submission, insurers have asked that the transitional relief connected with an existing life policy under section EY 30(8) ceases on the date the breach occurs.

For a class of policies, a life insurer can elect to calculate a part-year transitional relief up to and including the date a breach occurs. If the life insurer does not make such an election, transitional relief will end at the start of the income year in which the breach occurs.

Recommendation

That the submission be accepted.

Issue: Definition of "savings product policy"

Submission
(Matter raised by officials)

Life insurers have asked for changes to ensure that the treatment of life policies that provide a payback of all or a portion of the premium for life risk is consistent with policy intent.

Comment

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 included changes to the definition of "savings product policy" to ensure that life policies that provide for a return of premiums paid in connection with providing life risk cover (contrasted against any savings component) were not treated as a savings product policy under the new life insurance rules. Further changes are required to ensure that the exclusion applies to situations when the entire life risk component of the premiums is repaid. Currently, the rule applies only when a portion of the total premium for life risk is repaid.

Recommendation

That the submission be accepted.

Issue: Part-year calculations

Submission
(Matter raised by officials)

The calculations for part-year adjustments need refinement.

Comment

Two issues have been identified with the treatment of reinsurance when life business is transferred.

- Section EY 5(4) should be changed so it produces an amount for reserves that is gross of reinsurance (because sections EY 23 to EY 27 calculate amounts net of reinsurance). In the absence of the change, the seller's position will reflect a situation where the reinsurance arrangement has not been assigned, as the closing balance of the reserves will not include reinsurance amounts. This outcome is contrary to what the section should achieve.

- Section EY 5(6) produces an amount for reserves that is gross of reinsurance. The section adds reinsurance into the calculation on the basis that sections EY 23 to EY 27 are net of reinsurance. This produces an incorrect amount as section EY 5(6) is intended to reflect the situation where the recipient assumes the reinsurance, therefore this should be reflected in the value of reserves carried over to the new owner.

Recommendation

That the submission be accepted.

Issue: Opening balance of OCR and UPR reserves for the first year the new rules take effect

Submission
(Matter raised by officials)

The effect of the current rules is that both the Outstanding Claims Reserve (OCR) and Unearned Premiums Reserve (UPR) may not report any movement for the first year of the new life insurance rules.

Comment

The current rules for determining the opening balance of the OCR for the first income year could arguably be read so that the amount calculated for the opening balance of the OCR will be the same as the closing balance. This would result in no movement in the reserve.

A similar problem has been identified with the operation of the opening balance of the UPR for the first income year.

The sections should refer to an amount that would have been the closing value in the prior income year as if the new rules had effect, and ensure that the calculation is made with necessary modification for the beginning of the income year when the new rules have effect.

Recommendation

That the submission be accepted.

Issue: Incorrect reference

Submission
(Matters raised by officials)

Several changes are required to correct erroneous references in the new life insurance rules.

- In section EY 24 the adjustments for "mortality" profit and reinsurance amounts already returned under the old life rules have been put in backwards (mortality profit).
- Life insurers that offer general insurance are also required to discount the balance of the Outstanding Claims Reserve. Defining "general insurance contract" by reference to IFRS 4 means that life insurers are excluded and therefore the legislation does not recognise situations when a life insurer has non-life policies.

Recommendation

That the submission be accepted.

Other matters raised by officials

RESIDENT WITHHOLDING TAX RATES: REMEDIAL AMENDMENTS

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 made changes to resident withholding tax rates (RWT) on interest income so they align with the new tax rate structure enacted in 2008. However, a number of minor technical issues have come to light, which are outlined below. Officials recommend that these be fixed.

The changes recommended are all consistent with the original policy intention.

Issue: Clarification of transition to new resident withholding tax rates for individuals and companies

Submission
(Matter raised by officials)

Amendments should be made to clarify the transition to the new 38% RWT rate for individuals and the transition to the new 30% and 38% RWT rates for companies.

Comment

An amendment should be made to clarify the transition to the new 38% RWT rate for individuals who elected the 39% rate before 1 April 2010.

A similar clarification of the transition to the new 38% and 30% rates is required for companies that chose the 39% or 33% RWT rates before 1 April 2010 or 1 April 2011 respectively.

These changes should apply from 1 April 2010, except for the transition to the new 30% company RWT rate, which should apply from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Clarification of RWT rates for trustees, Māori authorities and portfolio investment entities

Submission
(Matter raised by officials)

Amendments should be made to clarify the applicable RWT rates for trustees, Māori authorities and portfolio investment entities (PIEs).

Comment

It should be clarified that the optional 30% RWT rate for companies for the 2010–11 income year does not apply to a company that is a trustee or a Māori authority (as the RWT rates set out in table 2 of schedule 1, part D apply to these instead).

A further change is required to ensure that trustees which are PIEs are able to use the 30% company RWT rate set out in table 3 of schedule 1, part D.

Officials recommend that these changes apply from 1 April 2010.

Recommendation

That the submission be accepted.

Issue: Inland Revenue's ability to instruct interest payers to change a person's RWT rate – minor drafting

Submission
(Matter raised by officials)

The wording of new section 25A of the Tax Administration Act should be amended to make it clear that the section applies to all individuals and not just those who have elected an RWT rate.

Comment

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 introduced a new provision which allows Inland Revenue to identify individuals who are on an RWT rate that is inconsistent with their marginal tax rate and instruct interest payers to shift those individuals to the appropriate rate.

An amendment is required to ensure the section more accurately reflects the policy intent, which is that the provision should apply to all individuals who are interest recipients, whether or not they have elected an RWT rate.

Officials recommend that the amendment apply from 1 April 2010.

Recommendation

That the submission be accepted.

Issue: Optional 30% RWT rate for companies – minor drafting

Submission
(Matter raised by officials)

Comment

The Taxation (Consequential Rate Alignment and Remedial Matters) Act 2009 introduced a provision which allows for an optional 30% RWT rate to be applied by interest payers with respect to companies.

A minor amendment should be made to ensure the section more accurately reflects the policy intent, which is that the provision should apply in respect of the payer from 1 April 2010.

Recommendation

That the submission be accepted.

TAX TREATMENT OF PAYMENTS TO PUBLIC OFFICE HOLDERS

Submission
(Matter raised by officials)

Schedule 4 to the Income Tax Act 2007 should be amended to provide a rate of tax for schedular payments made to public office holders.

Background

Schedular payments are generally payments for certain services when the relationship between the parties is not strictly one of employer and employee. Schedular payments made to non-employees are subject to withholding tax. They are treated as PAYE income payments for the purposes of the PAYE rules.

The categories of payments subject to withholding tax were previously set out in the schedule to the Income Tax (Withholding payments) Regulations 1979. With the rewrite of the Income Tax Act the regulations were revoked, and the rates of tax to be withheld from schedular payments are now set out in schedule 4 of the Income Tax Act 2007.

Comment

Payments to public office holders were previously covered under "honoraria" in the 1979 withholding payments regulations, but they are not explicitly included in schedule 4 of the Income Tax Act 2007.

This means that there is now no authority for the payers of fees to public office holders to withhold tax from those payments. That problem has been compounded by the definition "honorarium" inserted into the Income Tax Act 2007 by the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009. The new definition explicitly limits the scope of the definition for the purposes of new provisions introduced in that Act relating to payments to volunteers, as well as for the purposes of schedule 4, part B (Rates of tax for schedular payments). These matters need to be rectified as a matter of urgency.

A related issue has been raised in relation to the tax treatment of payments that reimburse costs incurred by public office holders. Under the previous law, reimbursements were also subject to withholding tax. However, the regulations allowed the Commissioner to determine that a specified amount or proportion of a withholding payment had been incurred in the production of the payment and that amount or proportion was not subject to withholding tax. The ability for the Commissioner to make those determinations has been preserved in the Income Tax Act 2007.

Reimbursements of costs incurred, when paid to employees or to volunteers, are now treated as exempt income (sections CW 17 and CW 62B of the Income Tax Act 2007, respectively). This means that only the amount of remuneration or honorarium paid to these persons is treated as a PAYE income payment. This has the same effect as the Commissioner's determinations, but avoids the need for determinations to be made on a case-by-case basis. Other recipients of reimbursement payments are required to account for the payments when filing their income tax return and can claim a deduction for the actual costs incurred or apply for a determination, as indicated above.

Public office holders will often have income from multiple sources and be required to file individual income tax returns. It is therefore not unreasonable to require them to individually account for reimbursements and claim a deduction for the related costs incurred. However, there would appear to be a low risk to the revenue in requiring that tax be withheld at source only from the amounts that are effectively remuneration for them.

Recommendation

That the submission be accepted.