Taxation (Tax Administration and Remedial Matters) Bill

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

April 2011

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

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OVERVIEW

The Taxation (Tax Administration and Remedial Matters) Bill principally focuses on measures to improve the efficiency of the tax administration system and reducing compliance costs for taxpayers.

The four key items in the bill are:

- gift duty abolition;
- changes to Inland Revenue's information disclosure rules (including changes to taxpayer secrecy rules and inter-agency information-sharing rules);
- changes to the tax disputes procedure; and
- changes to the tax pooling rules.

Other matters in the bill include changes to credit card fees and a number of remedial items, such as technical changes to the portfolio investment entity rules, which ensure existing policies function as intended.

Twenty-six submissions were received on the bill, with feedback from the majority of submitters generally focussing on the four main initiatives as follows:

- Submissions largely supported the abolition of gift duty.
- Concerns were raised around the scope of the changes to the secrecy and information-sharing rules.
- Submissions on the disputes process were largely of the view that the proposed legislative changes were not comprehensive enough. Submitters were also concerned that one proposed change raised Bill of Rights Act 1990 concerns.
- Submissions on the tax pooling rules were largely favourable, although further technical amendments were requested.

This report sets out officials' detailed responses to those submissions. A number of changes to the bill, largely of a technical nature, are recommended. Officials have not, however, recommended changes to the fundamental design and structure of key policies reflected in the bill.

To address a Bill of Rights Act 1990 concern, officials have recommended a change requiring the Commissioner to issue a challenge notice for taxpayer-initiated disputes (allowing the taxpayer to take the dispute to court) within four years of the dispute starting.

Officials have also recommended the retention of the specific exception permitting the disclosure of non-identifying information when the Minister of Finance considers the release is in the public interest. This is because this exception will cover some situations when the release would not be permitted under the new relaxed general exception, which requires the disclosure to have a tax administration-related purpose.

A number of remedial matters have been raised in submissions, or by officials as a result of informal taxpayer requests. Officials have recommended remedial changes to update existing legislation, or to remedy practical difficulties with the application of recently enacted or substantially amended regimes. A number of these changes are either about to come into force or have recently taken effect and are therefore time-sensitive. As this is the last opportunity to ensure amendments are passed before the General Election, these amendments cannot be deferred to a later bill. The changes will provide certainty to taxpayers and are largely taxpayer-friendly. The resulting recommended changes include:

- depreciation rates for specialised buildings (as a consequence of the Budget 2010 changes);
- a GST matter related to the emissions trading scheme;
- ensuring that the GST changes introduced in the Taxation (GST and Remedial Matters) Act 2010, such as the zero-rating of land and apportionment rules, operate as intended. Although these will be retrospective in application (as the new rules come into force on 1 April 2011), they are taxpayer-friendly and do not relate to matters that taxpayers are expected have taken a position on before the amendments are passed;
- addressing problems with the controlled foreign company rules that came into force in 2009. The recommended solutions for these problems would be applied retrospectively to prevent unintended tax liabilities arising; and
- a change to the timing provisions for use-of-money interest deductions so that the deduction of use-of-money interest is allocated to the year in which the interest is paid.

Gift duty abolition

OVERVIEW OF SUBMISSIONS

Clause 110

The bill will effectively abolish gift duty from 1 October 2011. The Estate and Gift Duties Act 1968 will remain in force to allow for the collection of duties for gifts made before the date of abolition.

Gift duty abolition is expected to reduce compliance costs by an estimated $70 million annually and provide administrative savings of $430,000 annually. It is expected to reduce government revenue by $1 million a year. Just 0.4% of the gifts reported to Inland Revenue each year are liable for gift duty, due to the widespread use of gifting programmes.

Of nine submissions received on gift duty abolition, six expressed support for the change, while one opposed it. Submitters noted the high compliance costs, low revenue and the use of gifting programmes. Several submitters consider that gift duty is archaic and that its abolition is long overdue.

The Corporate Taxpayers Group submitted that gift duty can unduly affect ordinary business transactions when it should not intuitively have application. The New Zealand Institute of Chartered Accountants estimates that the deadweight costs imposed by gift duty are as much as three times the $70 million compliance costs estimated by officials. However, it considers that the process of gift duty abolition should be carefully managed. Davenport Harbour Lawyers noted that gift duty does not prevent people from transferring their assets to other entities, but simply increases the cost of doing so. Abolition will therefore give a greater number of New Zealanders the ability to structure their affairs as they wish. Federated Farmers submitted that gift duty has been an impediment to farm succession from one generation to the next.

Submitters have called for further work to be done in some related areas, notably in the area of relationship property rights and the law of trusts, and while some want to delay abolition, the general consensus is that gift duty should not be retained for these purposes.

TRUST USE

Submissions
(Davenport Harbour Lawyers, National Council of Women of New Zealand, New Zealand Institute of Chartered Accountants, New Zealand Law Society, New Zealand Trustee Services Limited)

Gift duty abolition is likely to increase the number of trusts and voluntary alienations of property in general. *(Davenport Harbour Lawyers, National Council of Women of New Zealand, New Zealand Law Society, New Zealand Trustee Services)*

Gift duty abolition should be removed from the bill. It could be reconsidered when legislation to regulate trusts (and to strengthen relationship property rights) has been considered. *(National Council of Women of New Zealand)*

Abolition of gift duty should be delayed until after the Law Commission's review of New Zealand trust law is completed. We are concerned that trustees may see the cessation of gifting programmes as reducing the need for annual trustee meetings, leading to an increase in non-compliant trusts. *(New Zealand Trustee Services Limited)*

Gift duty abolition is likely to lead to a heightened awareness of the importance of good trust administration and record keeping in order to ensure the validity of trusts. It will also delineate those who have not set up their trusts for valid reasons, and trusts that do not follow correct administration procedures may be wound up. *(Davenport Harbour Lawyers)*

The context of the Law Commission's work on trusts needs to be taken into account in making the decision to abolish gift duty. We recommend a staged approach towards repeal, to allow for consideration of this and other factors, particularly tax avoidance issues. *(New Zealand Institute of Chartered Accountants)*

Any reform of trust law will not address an increase in the number of trusts or any increase in dispositions. *(New Zealand Law Society)*

Comment

The Law Commission's Review of Trust Law seeks to address much broader issues than those potentially affected by gift duty abolition, including trust regulation, the use of trusts and judicial responses. Officials consider that gift duty is not the appropriate mechanism to deal with any inadequacies in New Zealand trust law, so the outcomes of the review are unlikely to affect the decision to abolish gift duty. Although gift duty has made gifting compliance intensive, it has not prevented people from gifting.

Officials see no evidence to support the claim that the abolition of gift duty will lead to an increase in the number of trusts or the value of the assets they hold. Gift duty has not prevented the considerable growth of trusts in New Zealand over the past 30 years. It should also be noted that, although gift duty abolition will reduce the compliance cost associated with gifting, there are still significant costs involved in establishing a trust, and deeds of gift will still be required to make new dispositions. Aside from cost, there are other important considerations that need to be considered when deciding whether to establish a trust, such as whether the potential settlor is willing to give up ownership and control over their assets and whether there are better ways of meeting their needs.

Gifting programmes may motivate trustees to meet once each year to complete annual gifting requirements, during which time other trust matters may also be attended to. However, it is common practice for gifting programmes to be administered through correspondence between trustees, without meetings. Officials are unaware of any evidence that would suggest that the added administrative tasks related to gifting programmes have any effect on the trustees' compliance with other aspects of trust administration.

Recommendation

That the concerns be noted, subject to officials' comments, and that the requests to defer the abolition of gift duty be declined.

RELATIONSHIP PROPERTY RIGHTS AND SUCCESSION CLAIMS

Submissions
(Davenport Harbour Lawyers, National Council of Women of New Zealand, New Zealand Institute of Chartered Accountants, New Zealand Law Society, Paul Davies Law Limited)

Repealing gift duty will render less effective already inadequate remedies under the Property (Relationships) Act and the Family Protection Act. We do not oppose gift duty abolition, but consider that the impact on relationship property rights and succession claims has been underestimated by officials. Gift duty increases the likelihood that assets will be available for distribution under the Acts, as it slows down the alienation of assets. The portion of unforgiven debt under an incomplete gifting programme may in some cases be the sole source from which compensation can be ordered. Legislative amendments to the Property (Relationships) Act and the Family Protection Act should be considered to prevent dispositions that have the effect of defeating the interests of a party under the Acts. *(New Zealand Law Society)*

We support the repeal of gift duty, but a gift of relationship property should only be effective where the parties to the relationship have received independent certified advice. (*Paul Davies Law Limited*)

Gift duty abolition should be removed from the bill and not considered again until legislation is in place to strengthen relationship property rights (and trust regulation – discussed earlier). Existing relationship property legislation is not effective in the face of family trusts. *(National Council of Women of New Zealand)*

The relationship between gift duty and matrimonial property rules should be considered before gift duty is abolished. A staged approach should be taken to repeal, to allow for consideration of this and other factors, particularly tax avoidance issues. *(New Zealand Institute of Chartered Accountants)*

People should be able to structure their affairs as they wish. The Property (Relationships) Act provides the ability to contract out of its provisions. The abolition of gift duty will be of huge benefit to those wishing to opt out of the Act, as they will no longer face arguments over outstanding debts under gifting programmes. Gift duty abolition will enable principles of testamentary freedom to be adhered to. Many practitioners believe the provisions of the Family Protection Act should be reviewed, as the social landscape in New Zealand is vastly different from that of the 1950s when the legislation was passed. *(Davenport Harbour Lawyers)*

Comment

The focus of these submissions was on the impact of the removal of gift duty on the property division scheme in the Property (Relationships) Act 1976, although the Law Society also submitted on the Family Protection Act 1955 and the Law Reform (Testamentary Promises) Act 1949. The concern is that assets transferred into trusts may not be available for property division or settling estates later on.

Most submitters on this matter agreed that gift duty should not be retained for the purposes of these Acts *(Davenport Harbour Lawyers, New Zealand Institute of Chartered Accountants, Paul Davies Law Limited).* Three requested amendments to the Property (Relationships) Act *(National Council of Women of New Zealand, New Zealand Law Society, Paul Davies Law Limited)*, and the Law Society requested consideration of amendments to the Family Protection Act and the Law Reform (Testamentary Promises) Act.

The effect of gift duty abolition on relationship property rights and succession claims was considered as part of the gift duty review. Officials consider that gift duty is not a means of addressing any perceived problems with relationship property and succession law, as gift duty does not prevent dispositions from occurring, though it has practical impact on how some dispositions are structured in terms of their timing.

The Property (Relationships) Act, Family Protection Act and the Law Reform (Testamentary Promises) Act are administered by the Ministry of Justice. The Ministry has advised that it does not consider changes to these Acts are required as a consequence of the removal of gift duty. The underlying philosophy of these Acts is that individuals are generally free to deal with their own property as they wish – any entitlement one person may have to the property of another does not arise until the actual event of separation or death.

The main perceived problem in the relationship property context arises when property is transferred into a trust, and is no longer relationship property. However, the courts are able to consider trusts and, where appropriate, provide relief under existing legislation. For instance:

- The Property (Relationships) Act allows the courts to restrain or to set aside transfers of property to trusts when there was an intention to defeat a spouse's or partner's claim at the time the disposition was made. \

- If the disposition was not intended to defeat a claim, but had that effect, the courts are able to grant compensation (although in this circumstance the court cannot set aside the trust). Compensation can include other non-trust assets or the income of the trust, but does not include the capital of the trust (the power to unwind the trust could disadvantage other beneficiaries, including children of the relationship).

- Section 182 of the Family Proceedings Act allows the court to vary the terms of an agreement or settlement (made before or after a marriage or civil union) if, at the end of the marriage or civil union, an applicant no longer derives the benefit he or she reasonably expected to receive from the agreement or settlement. This includes the ability for the courts to vest part of a trust in an affected partner, for their benefit.

There will be some cases where legislative relief is not available following the transfer of assets into a trust. However, officials consider the number is likely to be low, and there is no evidence that these cases would be significantly affected by the removal of gift duty. Further, where these cases involve joint property, the transfer of the property into a trust would have to be a combined decision. In these cases, professionals such as lawyers and accountants who provide advice on the formation of a trust should make both parties aware that the property may no longer be considered relationship property.

In some cases, it may be possible that property is transferred into a trust without the knowledge of the other party, and that person only finds out when the relationship ends (for instance a house owned by one party prior to starting the relationship). As noted above, the court can provide remedies where this has occurred if it has the intention or the effect of defeating a spouse's or partner's claim. Further, this is consistent with the principle that individuals are generally free to deal with their own property as they wish, prior to separation or death. For instance, the law does not prevent the owner of a house selling that house because the property could later be considered relationship property, nor does it prohibit spending money that could later be considered relationship property.

In the succession law context, the concern appears to be that a person may transfer property to a trust in their lifetime so that it does not fall into their estate when they die. Generally, property that is owned jointly with another person or that is disposed of while a person is alive, whether by transfer to a trust or otherwise, does not fall into their estate and is therefore not available to claimants under the Family Protection Act or the Law Reform (Testamentary Promises) Act. This is consistent with the policy that these Acts do not restrict what a person may do with their property while they are alive, including gifting that property to another person. It is not clear why transfers to a trust should be treated differently. Remedies may be available to the estate in some circumstances, such as if a gift has been made as a result of undue influence.

There is a risk that making ad hoc amendments to any of these Acts may undermine the long-standing policy that underpins them and could affect the legitimate use of trusts. For example, requiring all parties to a relationship to receive legal advice before one party to a relationship transfers assets into a trust (or makes major changes) would impose significant compliance costs on couples that have a trust for a genuine purpose, particularly when the value of the trust was relatively low. It is also likely to be unnecessary, as couples who transfer significant assets into a trust would be likely to seek professional advice.

The Law Commission is currently undertaking a comprehensive review of trust law, which is expected to be completed in 2012–13. Ministry of Justice officials will consider the implications of this work, as well as any principled basis put forward by the Law Commission for dealing with property that has been transferred into trusts. The Ministry of Justice will monitor any effects of gift duty abolition to inform the government-wide post-implementation review that will be led by Inland Revenue.

Recommendation

That the submissions be declined.

LACK OF GOVERNMENT RECORDS OF GIFTS

Submissions
(National Council of Women of New Zealand, New Zealand Institute of Chartered Accountants)

In the absence of gift duty, there will be no audit trail for gifts, enabling the defeat of creditors and proceeds of crime legislation. *(New Zealand Institute of Chartered Accountants)*

Financial information will be more difficult and expensive to access, requiring more intensive investigations, specialist training of public servants and encroachments on individual privacy. Gift duty provides a useful paper trail for the Ministry of Social Development and other government departments to determine eligibility for public benefits. *(National Council of Women of New Zealand)*

Comment

Officials note that, due to the strict secrecy requirements of the Tax Administration Act 1994, Inland Revenue cannot provide details of gift statements to private entities, the Ministry of Social Development, or any other government department generally. Therefore, gift statements are not used to determine eligibility for government entitlements such as the residential care subsidy.

Gift statements may be provided to the Official Assignee, who takes on the rights and obligations of bankrupts, and to the Police in relation to the Criminal Proceeds (Recovery) Act 2009.

Gifts to trusts are made by way of deeds of gift. These legal documents are required independently of gift duty obligations in order to establish trust ownership of assets. In the absence of a deed of gift, the courts may deem the transfer to be a loan to the trust which may be called in.

In the absence of gift statements, evidence will continue to exist in the forms of deeds of gift, land transfer records for real property, registration details for motor vehicles and banking records for cash transfers. Each of these independent records could be expected to show both the donor and the recipient of the gift, just as gift statements do.

Officials also wish to note that, although the Official Assignee regularly accesses the gift statements of bankrupts, this rarely results in recovery of value for creditors. Of 430,000 IRD numbers for which gift statements were filed between 1 July 2001 and 28 May 2010, less than 0.003% went into bankruptcy. The Official Assignee has recovered a total of $1.5 million from trusts in the past two years. In the same period, an overall total of $500,000 was recovered from all entities using the insolvent transactions provisions under the Insolvency Act 2006, and "virtually none" of this has related to book debts under gifting programmes.

Recommendation

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

IS GIFT DUTY ABOLITION A TAX CUT FOR THE WEALTHY?

Submissions
(Federated Farmers, National Council of Women of New Zealand)

New Zealand's wealthiest citizens have a continuing economic advantage of transferring assets to trusts, and as major beneficiaries of recent tax cuts, a further move to relieve them of costs is unfair. *(National Council of Women of New Zealand)*

Abolition of gift duty will cost the Government just 0.003% of total tax revenue, while relieving the private sector of $70 million in compliance costs. Gift duty has been an impediment to farm succession from one generation to the next. Although farmers must have land assets, this does not mean they have high incomes, with recent data from the Ministry of Agriculture and Forestry showing meagre incomes for farming, with poor rates of return and increasing agricultural debt. *(Federated Farmers)*

Comment

Officials note that gift duty applies only to aggregate gifts over $27,000, made by a person in any 12-month period. Therefore, abolition affects only those who have assets greater than this value and who wish to give up their legal ownership of them.

It has been noted that gifting programmes are widely used; therefore gift duty is rarely incurred, often only by mistake. The extent to which abolition can therefore be considered a tax cut is limited to the $1.5 million (before administration costs) that it raises annually, resulting from approximately 900 gift statements.

The real savings will be in compliance costs (an estimated $70 million each year). The benefit of these costs goes to private practitioners who assist with drawing up deeds and filing gift statements.

Recommendation

That the submissions be noted.

GIFT DUTY ABOLITION AND ITS POTENTIAL EFFECTS SHOULD BE WIDELY COMMUNICATED BY THE GOVERNMENT

Submissions
(Davenport Harbour Lawyers, New Zealand Institute of Chartered Accountants, New Zealand Trustee Services Limited)

The Government has a moral obligation to widely communicate the benefits and implications of gift duty abolition so that people may take advantage of the opportunity to provide protection for their families. *(Davenport Harbour Lawyers)*

The Government has not done enough to ensure practitioners and commentators are aware of the impacts of gift duty abolition. *(New Zealand Trustee Services Limited)*

The Government should make a clear public statement about the areas of law affected by gift duty abolition and how these areas will operate in the absence of gift duty. (*New Zealand Institute of Chartered Accountants)*

In its oral submission, the New Zealand Institute of Chartered Accountants expressed concern that abolition of gift duty may be interpreted as Inland Revenue's approval of all gifting arrangements, therefore a public statement on the nexus between gifting and tax avoidance should be made. (*New Zealand Institute of Chartered Accountants)*

Comment

Information on the proposed gift duty abolition has been published on Inland Revenue's policy website. Several press statements and a media conference have been given by the Minister of Revenue, resulting in considerable media coverage. Officials consider that the comprehensive Regulatory Impact Statement on gift duty abolition, available to the public on Inland Revenue and Treasury websites, provides adequate description of the areas of law affected by gift duty abolition and the action various government departments intend to take in response.

Immediately following enactment, Inland Revenue will publicise the change through its *Tax Information Bulletin* and it will issue a fact sheet detailing the impacts of abolition. Other government departments would need to consider appropriate means of communication depending on the relevance of gift duty abolition to their areas of responsibility.

Inland Revenue is currently considering publishing a technical statement to clarify that gift duty abolition will in no way validate all gifting arrangements, nor will it, in and of itself, affect whether an arrangement is considered to be avoidance.

Recommendation

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

TAX AVOIDANCE OPPORTUNITIES

Submission
(New Zealand Institute of Chartered Accountants)

There are a number of tax avoidance opportunities that may arise in the absence of gift duty. These include:

- ability to split income with people on lower incomes;
- ability to transfer income to loss-making entities;
- ability to transfer assets in order to meet minimum thresholds for the financial arrangement rules and the foreign investment fund rules;
- ability for someone with a tax liability to divest themselves of the means to pay and then to claim hardship; and
- ability to make charitable donations via others so that a higher tax rebate may be claimed.

Comment

The key feature of all the avoidance practices raised by the New Zealand Institute of Chartered Accountants is that gift duty does not prevent them. Legal title to assets (as well as any income they generate) transfers immediately when a gifting programme is set up. The outstanding debt, progressively forgiven, is of no assistance in remedying these avoidance behaviours. Gift duty can be considered to be a barrier only to the extent that the compliance costs of gifting programmes may deter some people. However, the potential tax savings of these arrangements are likely to far outweigh the costs of a gifting programme.

The submission noted that there is uncertainty about whether the above practices may constitute tax avoidance as defined in section BG 1 of the Income Tax Act 2007. Gift duty abolition, in and of itself, will not affect whether an arrangement is considered to be avoidance. Inland Revenue is currently considering publishing a technical statement to clarify this.

Recommendation

That the submissions be noted, subject to officials' comments

GIFT DUTY COULD BE TEMPORARILY RETAINED, BUT THE THRESHOLDS RAISED AND THE REQUIREMENT TO FILE NON-LIABLE GIFT STATEMENTS REMOVED

Submission
(New Zealand Institute of Chartered Accountants)

While we welcome gift duty abolition, a staged approach should be taken to allow more time for various issues to be further considered. Full abolition should be deferred, and in the interim, the threshold at which gift duty becomes payable should be raised to $80,000, in line with inflation. The requirement to file non-liable gift statements should be removed.

Comment

The key benefits of gift duty are thought to relate to the slowing down of gifting. If abolition were to be phased in, and the threshold raised in line with inflation to $80,000, this would speed up gifting to the extent that there would be little benefit in retaining it at all. It would mean that a couple could each gift $80,000 each year, so a property valued at $300,000 would take as little as 13 months to completely gift, instead of six years.

The real compliance costs of gift duty relate to engaging a practitioner to draw up the deeds required by a gifting programme. The submitter's proposed changes would still require practitioners to facilitate a market-value sale, draw up a deed of acknowledgement of debt and annual deeds of forgiveness of debt, although fewer annual deeds would be required. The result would be that much of the compliance costs of gift duty would remain in place.

The underlying policy problem of gift duty's relative ineffectiveness at preventing asset stripping would not be addressed by the submitter's alternative proposal. The potential effects of gift duty abolition were well considered during the gift duty review, involving eight government agencies. As a result, officials see little benefit in delaying abolition.

Recommendation

That the submission be declined.

CREDITOR PROTECTION

Submission
(Paul Davies Law Limited)

We support gift duty abolition, but are concerned about the effectiveness of current legislative provisions to allow the courts to claw back dispositions at the request of an affected creditor. The relevant law should be considered including an absolute right to set aside a gift within a period of time.

Comment

Three existing statutes contain provisions to allow the claw-back of dispositions for the benefit of creditors:

- Sections 204 and 205 of the Insolvency Act 2006 allow the Official Assignee to automatically cancel gifts made within two years before adjudication, or within five years if the bankrupt cannot demonstrate solvency at the time the gift was made.
- Section 292 of the Companies Act 1993 gives the Official Assignee similar powers but over shorter timeframes (6 months and 2 years).
- Subpart 6 of the Property Law Act 2007 empowers the courts to set aside property dispositions if there was an intention to prejudice the interests of a creditor-applicant. This provision is not time-limited.

In the context of these existing provisions, officials do not consider that any new creditor protection measures are necessary at this time. The Ministry of Economic Development has committed to monitor future cases brought under these Acts, and a government-wide post-implementation review will consider any effects resulting from gift duty abolition.

Recommendation

That the concerns be noted.

That the submission to reform creditor protection laws be declined.

WILL GIFT DUTY ABOLITION REDUCE COMPLIANCE COSTS?

Submission
(New Zealand Trustee Services Limited)

Gift duty abolition will increase the need for trust administration activities such as trustee meetings and record-keeping, therefore compliance costs may increase, rather than decrease by the $70 million estimated by officials.

Comment

Officials see no basis for the contention that gift duty abolition will increase the need for trust administration activities. In the absence of gifting programmes, regular trustee meetings will remain necessary for proper trust administration. However, the estimated $70 million reduction in compliance costs considered solely the average fees charged by practitioners to draw up an annual deed of forgiveness of debt, and to file this with Inland Revenue along with a gift statement. As gifting programmes will no longer be necessary, deeds of forgiveness will no longer be required.

Recommendation

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

LEGAL DEFINITION OF "GIFT"

Submission
(New Zealand Trustee Services Limited)

There is no legal definition of a "gift". Any gift over $27,000 is considered to be "extraordinary" and court decisions will be necessary to clarify this area of the law.

Comment

Officials contacted Trustee Services to better understand their concerns, and were advised that their concern is that without gifting programmes, gifted assets may be subsequently considered by the courts to be loans. Trustee Services also advised that "extraordinary gifting" is a term used on the Work and Income website.

The Estate and Gift Duties Act 1968 defines "dutiable gift" solely for the purposes of that Act. The legal definition of a gift is based on case law, and officials understand that there is considerable clarity in this area. The courts recognise gifts made by deed, by delivery or by declaration of trust. In the absence of a gifting programme, practitioners would be expected to draw up a deed of gift to ensure that ownership has passed at law. This is a more straightforward process than setting up a market-value sale, drawing up a deed of acknowledgement of debt and then drawing up annual deeds of forgiveness of debt, as is the process for a gifting programme.

While "extraordinary gifting" is not a generic legal term, "excess gifts" are referred to by the legislation under which the Ministry of Social Development administers the Residential Care Subsidy.

Entitlement to the Residential Care Subsidy is determined in accordance with the Social Security Act 1964 and the Social Security (Long-term Residential Care) Regulations 2005. Part 8 of the Regulations define a gifting period that commences five years before the date of the means assessment. Any gifting above $5,500 in each year of this five-year period (a maximum of $27,500 over the five years) will be added back into means-testing.

In addition, section 147A of the Security Act 1964 provides for instances of deprivation to be considered and adjustments made to the financial means assessment as a result. For example, outside the gifting period of the last five years, there is a gifting allowance of $27,000 in each year. Any amounts gifted above $27,000 are considered to be "excess gifts" and may be added back into the assessment of assets for Residential Care Subsidy eligibility.

Regulation 9B lists further examples that qualify as deprivation of assets in accordance with section 147A of the Social Security Act 1964. There is no time limit on the Ministry of Social Development's discretion to consider adding back assets that applicants have divested prior to commencement of the five-year gifting period. The Ministry of Social Development advises that this provision is applied regularly in practice.

The Ministry of Social Development advises that it is working to better-educate financial advisors, solicitors and accountants of the deprivation of assets provisions that apply to the Residential Care Subsidy and that there is no change to the allowed gifting levels for Residential Care Subsidy as a result of gift duty abolition.

Recommendation

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

Changes to Inland Revenue's secrecy rules

OVERVIEW OF SUBMISSIONS

The bill proposes changes to two areas of Inland Revenue's information disclosure rules. First, relaxing the taxpayer secrecy rules for tax administration purposes and secondly, in relation to Inland Revenue's ability to share information with other government agencies.

Nine submitters commented on these aspects of the bill. A number of submitters supported the goals of the amendments, being to improve speed, accuracy and administrative efficiency. Generally, submitters were concerned to ensure that taxpayer information continues to receive appropriate levels of confidential treatment and that the changes will not negatively affect voluntary compliance. Concerns were also expressed about the protection of information once it has been passed from Inland Revenue to other government agencies.

Officials recommend the retention of the specific exception permitting the disclosure of non-identifying information when the Minister of Finance considers the release to be in the public interest. This is because this exception will cover some situations where the release would not be permitted under the new relaxed general exception, which requires the disclosure to have a tax administration-related purpose.

CHANGES TO TAXPAYER SECRECY RULES

Clause 58

Issue: Clause 58 secrecy changes should not proceed at this time, particularly where there are no effective safeguards

Submission
(New Zealand Institute of Chartered Accountants)

Before the decision to amend the secrecy rules is made, Parliament should give careful consideration to how such a change will affect voluntary compliance. We do not consider that the criteria set out in proposed section 81(1B) produce effective limits on the Commissioner's ability to distribute information. Integrity of the tax system is an amorphous concept. A Standard Practice Statement is not binding on Inland Revenue and therefore it is incumbent on Parliament to provide clear legislation that gives taxpayers some certainty.

Comment

Officials agree that voluntary compliance is an important consideration. The criteria set out in the proposed section 81(1B) specifically include voluntary compliance as a factor to be considered in deciding whether to make a disclosure, which sufficiently protects the integrity of the tax system. Officials note the comments in relation to the Standard Practice Statement. The purpose of this document is to set out the process by which the Commissioner will administer the amendments and provide some examples to give guidance to officials and the public. This is to act as an interpretive aid and to enhance transparency.

Recommendation

That the submission be declined.

Issue: Rules to be included in standard practice statement should instead be in legislation

Submission
(KPMG)

We do not disagree with any of the examples set out in the Commentary to the bill. Our concern is ensuring consistency of the application of the discretion across different Inland Revenue staff and offices. The proposed Standard Practice Statement is a useful first step but we would prefer to see these rules set out in legislation to ensure they have full legal effect, with appropriate penalties for a breach.

Comment

The proposed Standard Practice Statement is intended to give both Inland Revenue staff and the public guidance on how the rules will be applied in practice, including setting out the process for assessing whether a disclosure is appropriate under the new rules. The relevant rules for assessing a potential disclosure are contained in the primary legislation (new section 81(1B)), namely that it is for the purpose of executing (or supporting the execution of) a duty of the Commissioner, and it is considered reasonable having regard to the purpose and to the specific considerations set out in the legislation.

We therefore consider that the legislation does contain the relevant rules. The Standard Practice Statement acts as an interpretive aid and process guide, rather than containing further rules. As to penalties, section 81 retains the primary obligation of Inland Revenue officers to maintain secrecy, subject only to the legislation

Recommendation

That the submission be declined.

Issue: The Commissioner should issue strong guidelines in relation to the proposed changes

Submission
(Ernst & Young)

The Commissioner should issue strong guidelines as to taxpayers' rights and ability to access the information accessed or exchanged under the proposed relaxation of the secrecy provisions in section 81.

Comment

Officials note that it is not clear from the submission whether the submitter is referring to clause 58 or 59. In relation to clause 58, Inland Revenue is issuing a Standard Practice Statement setting out process and some examples of disclosure categories. In relation to clause 59, officials agree that matters relating to taxpayers' rights and ability to access their information should be addressed as part of a Memorandum of Understanding between Inland Revenue and the agency accessing their information. This point is expanded on further in the comment on the Privacy Commissioner's submission.

Officials further note that explanatory material around both clauses will be published by Inland Revenue in a *Tax Information Bulletin* item following enactment.

Recommendation

That the submission be noted.

Issue: Proposed section 81(1B)(b) should be replaced with a provision that refers to specific situations

Submissions
(Russell McVeagh, Corporate Taxpayers Group)

The proposed amendments are inappropriately broad and should be targeted towards specific situations.

The amendments provide Inland Revenue with a very broad discretion and the factors to which it must have regard would impose very little practical restriction on the information Inland Revenue could communicate. For example, Inland Revenue could decide, as part of an investigation into a non-complying taxpayer, to communicate to that taxpayer specific confidential information relating to its competitors. *(Russell McVeagh, Corporate Taxpayers Group)*

The proposed amendment would also expose corporate taxpayers to the risk of severe commercial consequences if their secret information is disclosed. Two categories of particular concern are commercially sensitive material (for example, in relation to a proposed transaction) and information that a corporate taxpayer holds about others (for example, customers and employees). *(Corporate Taxpayers Group)*

Comment

Secrecy remains the primary obligation in section 81. This primary rule is subject to a number of existing exceptions set out in the legislation, including a general exception permitting disclosures for the purpose of carrying into effect the Inland Revenue Acts. The amendment seeks to introduce some more flexibility into the general exception, to enable sensible administrative decisions, while still retaining the primary secrecy obligation. We do not consider that a targeted, or list, approach is flexible enough. Such an approach would only cover the specific situations on the list and would not be able to be extended or varied for similar or new circumstances. In the case of new or varied situations arising, Inland Revenue would be required to seek further legislative amendment.

The Standard Practice Statement will allow Inland Revenue to use a "specific circumstances" approach to examples, while retaining the flexibility to also make disclosures in new situations that meet the criteria set out in the legislation.

In relation to the concerns raised in the context of the examples, officials note that such a scenario is addressed in the Standard Practice Statement.

Recommendation

That the submissions be declined.

Issue: The Commissioner should be required to obtain consent or a court order before releasing information

Submission
(Russell McVeagh, Corporate Taxpayers Group)

If it is not considered possible to put statutory parameters around the circumstances in which Inland Revenue can override the confidentiality of the taxpayer, another form of protection is required. We suggest an appropriate mechanism would be to require Inland Revenue to obtain consent for the disclosure from the taxpayer to whom the information relates. If consent is not given and Inland Revenue still wishes to make the disclosure, Inland Revenue should be required to apply to the District Court or High Court for an order permitting the disclosure. Such application should be on notice to the taxpayer.

Comment

Such a process would be far more restrictive than the current rules. None of the currently permitted disclosures require Inland Revenue to seek the consent of the taxpayer or consent of the courts.

It appears that the submitters may be particularly concerned about disclosures such as those which have occurred during litigation. Such disclosures occur in a specific litigation context and have been considered permissible by the Supreme Court under the existing secrecy rules. The proposed changes do not affect that decision. Officials also note that the proposed new section 81(1B) includes the commercial impact of a communication as a factor to be considered before any disclosure.

Recommendation

That the submission be declined.

Issue: Develop categories of information that can be released depending on the category of persons seeking the information

Submission
(New Zealand Institute of Chartered Accountants)

We can envisage situations when Inland Revenue would have good reason to share the identity and address of individuals but not other information such as income details. In such instances, if the information is able to be transferred, it should be subject to a law that only allows the transfer where the recipient agency can provide an assurance that the information will not be provided to other government agencies or third parties. Given the number of information-matching agreements already existing it is highly likely that without any on-transfer rules Inland Revenue information would be networked to a large number of other government entities.

Another category where information could be released is when there is some impediment to the taxpayer communicating with Inland Revenue themselves. There are certain procedures in place already in relation to allowing someone to act on a taxpayer's behalf, however something more limited might apply. Inland Revenue needs to be sure that the taxpayer has given their authority for such disclosure.

Comment

Officials do not consider that legislating particular categories of information disclosure is appropriate in the context of disclosures undertaken in the execution, or in supporting the execution, of the duties of the Commissioner. The intention of the amendment is to provide more flexibility to the already existing general exception, allowing the Commissioner to make sensible administrative decisions. Officials consider that requiring such disclosure to fit within specific legislative categories is too restrictive and will lead to further legislative complexity. Such an approach would mean that a legislative amendment would be required every time a new category of disclosure was developed, even when such disclosure was merely a variance of something already done.

The submitter appears in part to be referring to disclosures under the proposed new section 81BA (disclosures to government agencies). As discussed further below, issues around the treatment of information transferred under this provision will be dealt with by way of Memorandum of Understandings between Inland Revenue and the recipient agency. This will cover the issue raised of on-transferring information.

Officials agree that one category of information that may be able to be released under the proposed section 81(1B) is information relating to a taxpayer where that taxpayer faces some impediment in communicating directly with Inland Revenue, and wishes for some limited assistance from a support person (without giving that support person the more substantial access available via the nominated person or agent approach). Officials agree with the submitter that it is important to ensure in such situations that the taxpayer has consented to the limited disclosure to their support person.

Recommendation

That the submission be declined, except for the situation of a taxpayer facing an impediment.

Issue: Inland Revenue should not have the ability to release taxpayer information to justify its actions

Submission
(New Zealand Institute of Chartered Accountants)

The bill commentary envisages that Inland Revenue could make public information about a taxpayer if it decided it had been slighted in the media. In the recent banking cases, ANZ took proceedings against Inland Revenue to prevent it disclosing information about ANZ transactions in litigation between Inland Revenue and BNZ and Westpac. The Commissioner regarded this as necessary to carry the Inland Revenue Acts even though ANZ had not made any public statements and was not part of the proceedings.

Comment

The disclosure referred to by the submitter was undertaken in the course of litigation, rather than in the context of a media disclosure, making it a very different scenario. The key issue in the litigation referred to was whether the Commissioner, in defending proceedings brought by one bank, could use information it held about business affairs of other banks. The Commissioner had included such documents in his discovery affidavit (being an affidavit required pursuant to the discovery orders made by the courts), claiming confidentiality for the documents, but listing them as documents held by Inland Revenue that were relevant to the proceedings. The Supreme Court held that the Commissioner was entitled to so respond to the discovery order.

Recommendation

That the submission be declined.

Issue: If Inland Revenue considers it has been unfairly slighted in the media, provision can be made for the taxpayer to agree to Inland Revenue providing its perspective

Submission
(New Zealand Institute of Chartered Accountants)

Currently Inland Revenue cannot respond when a taxpayer is casting aspersions in the media. If the taxpayer were able to waive their secrecy rights and did not do so this would give the media and the public an indication of the weight that should be placed on the taxpayer's statements. This assumes that Inland Revenue would be able to say that the taxpayer has not waived their right to secrecy. Consider that Inland Revenue has demonstrated that it is not above making a pre-emptive strike even when the particular taxpayer is not involved.

Comment

Officials consider it unlikely that a taxpayer, having made damaging comments about Inland Revenue in the media, would then agree to Inland Revenue disclosing information relating to their affairs. In addition, the changes proposed to section 81 do not provide a general ability for taxpayers to waive secrecy.

Inland Revenue is not proposing to make pre-emptive media statements. Media comment is only envisaged when the taxpayer has made incorrect statements that are considered damaging to the integrity of the tax system. Such comment is likely to be extremely limited – for example, a statement to the effect that the taxpayer has not disclosed all the relevant facts or information. Officials further note that any comment in the media would require careful consideration, even when it was considered appropriate under the criteria in the proposed section 81(1B). The Standard Practice Statement contains an example working through the issue of disclosure to the media. Authority for media disclosures is likely to be restricted to Commissioner or Deputy Commissioner level.

Recommendation

That the submission be declined.

Issue: Inland Revenue should publish appropriately redacted adjudications reports

Submission
(Ernst & Young)

Given the increasing trend for tax disputes to be determined without public court hearings or decisions, the Commissioner should publish appropriately redacted adjudications reports to promote better information and transparency for taxpayers. Making this information available in forms that do not prejudice taxpayer confidentiality would better inform taxpayers about the basis of the Commissioner's views on a range of technical matters. Taxpayers would therefore be better informed in taking their own tax positions.

Comment

This matter has been raised with Inland Revenue previously. Officials are considering whether redacted adjudication reports could be published, taking into account the need to protect the interests of both the taxpayer and the Commissioner. The Commissioner is concerned to ensure that any publication would not elevate the status of adjudication decisions above what they are – which is that they are simply specific decisions on one taxpayer's facts, having regard to the arguments made in that single dispute, and they are not binding rulings.

Recommendation

That the submission be noted.

Issue: Adding a reference to the Privacy Act to clause 58

Submission
(Privacy Commissioner (supplementary submission))

We understand that the intent is to operate the section with reference to the Privacy Act. For the avoidance of doubt the Committee could consider adding a sub-clause to clause 58 making such consideration a requirement (for example, "whether the Privacy Act permits the communication of the information"). Such a provision would not assist corporate taxpayers but would provide additional assurance to individual taxpayers that their privacy will be properly considered.

Comment

Clause 58 already contains a requirement to consider the personal and commercial impact of any proposed communication. This is intended to encompass both individual privacy concerns and also corporate commercial considerations. Section 81 of the Tax Administration Act is not currently subject to the Privacy Act, and is generally more restrictive of disclosure than the Privacy Act. Officials do not consider there is any reason to amend this situation. The secrecy rules are sufficiently strict that adding another layer of mandatory considerations is unnecessary and would add administrative complexity and cost without significant benefit.

Recommendation

That the submission be declined.

Issue: Clause 58(4)(c) should be removed from the bill

Submission
(Matter raised by officials)

Clause 58(4)(c) proposes the repeal of section 81(4)(j) of the Tax Administration Act. Section 81(4)(j) provides that the Minister of Finance may authorise the communication of information of a general nature that does not reveal the identity of any taxpayer when such a disclosure is reasonable and practicable, and is in the public interest. This section may still be required in certain circumstances and should not be repealed.

Comment

The repeal of section 81(4)(j) was considered appropriate on the basis that disclosures of general, non-identifying information could be made pursuant to the proposed new rule in section 81(1B). The intention was not to remove this ability but rather to transfer the ability to assess the release of generic information to the Commissioner. Officials consider however, that there are some situations when section 81(4)(j) would permit disclosures that would not be permitted by the new section 81(1B) and the section should

therefore be retained. This is because the existing provision allows generic disclosures when the Minister of Finance considers the disclosure is in the public interest. This is a less restrictive test than that contained in proposed section 81(1B) where the disclosure must be related to a duty of the Commissioner.

An example of where section 81(4)(j) might be used is when another agency is seeking aggregate information to help it assess the success of some initiative it has undertaken. The information may be sought on an ad hoc, one-off, or regular basis. Such disclosure has no purpose related to executing or supporting the execution of a duty of the Commissioner but might be assessed as being in the public interest. The information sought is aggregated, therefore does not identify any individual taxpayer. In this situation, disclosure would not be permitted under section 81(1B) but would be permissible under section 81(4)(j).

Recommendation

That the submission be accepted.

Issue: The tax system extorts compliance

Submission
(Andrew Sheldon)

"Voluntary compliance" is a contradiction in terms. The tax system is not voluntary.

Comment

Voluntary compliance is a term used to indicate that taxpayers determine their tax obligations in the first instance. It does not mean that the decision to pay tax is voluntary or without compulsion.

Recommendation

That the submission be noted.

CHANGES TO INFORMATION SHARING RULES

Clause 59

Issue: Notification, verification and consent to sharing should be required under proposed section 81BA

Submission
(National Council of Women of New Zealand)

Inland Revenue has been known to hold incorrect information and its processes are subject to human error. Before sharing a taxpayer's information with another government department the taxpayer should be informed, verify the accuracy of the information and provide consent.

Comment

Officials acknowledge there will always be a small risk that incorrect information is held and transferred. Such information may be transferred under existing information-matching arrangements. The amendments do not mean that it is more likely that information will be incorrect. It is proposed that there be a Memorandum of Understanding between Inland Revenue and the recipient agency (which is currently the case for existing information matches and exchanges) that will address the ability of individuals to access and correct their information.

Requiring individuals to verify and give consent before their information is exchanged would add considerable administrative complexity and cost. In addition, certain individuals may not consent to their information being exchanged in circumstances where this is likely to lead to an adverse outcome (including detection of fraud). Requiring consent would significantly detract from the efficiency gains that are likely to result from this proposal.

Recommendation

That the submission be declined.

Issue: Proposed section 81BA should be removed and replaced with an information-matching provision

Submission
(Privacy Commissioner)

We support the goals of speed, accuracy and administrative flexibility, however believe these can be met through the existing information-matching provisions in the Privacy Act. The new framework is unnecessary and likely to be resource-intensive to set up. It will allow an as yet unknown amount of information to be shared with as

yet unidentified agencies. The existing information-matching framework would provide a robust and flexible mechanism for the information exchanges that Inland Revenue would like to make. Information matching is not suitable for all types of information-sharing but will work well for this case based on the information received from Inland Revenue.

Comment

Officials agree with the Privacy Commissioner that information matching, while suitable for some forms of information exchange, is not always suitable. Inland Revenue's experience is that information-matching programmes are expensive to develop and administer and are not always flexible enough to meet the needs of agencies, particularly in the delivery of joined-up services. Officials do not consider that information matching provides the necessary flexibility in this case. The proposed new information exchange framework will allow proactive provision of information which is problematic under the information-matching regime.

Recommendation

That the submission be declined.

Issue: Proposed section 81BA needs more explicit controls

Submission
(Privacy Commissioner)

If the framework proceeds there should be more explicit controls on how information is shared under it. There are some safeguards but more are needed. A sub-clause should be included that requires a written agreement between Inland Revenue and the agency receiving the information. The sub-clause should specify the details (about how the sharing will work and what safeguards are in place) that must be included in the written agreement, namely:

- the agency/agencies that can receive the information from Inland Revenue;
- the purpose for sharing the information (including any thresholds to be crossed before the sharing can occur);
- the use that can be made of the information;
- the specific information that can be transferred;
- how the security of the information will be maintained;
- details of how the information transfer will be managed;
- how agencies will provide for individuals to access and correct their personal information;
- how the agencies will seek to ensure the accuracy of the information;
- controls on the secondary disclosure of the information;

- what happens to the information when it is no longer needed (retention periods);
- how the public will be notified of the information sharing;
- how individuals will be notified before any actions are taken as a result of the information sharing; and
- how the information sharing will be monitored or reported on (for example, internally or to the Privacy Commissioner).

Comment

Officials agree that this is a sensible approach. In practice officials had anticipated that a Memorandum of Understanding would be entered into between Inland Revenue and the recipient agency (as currently occurs in relation to information matching and information-exchange arrangements). Officials therefore agree that it is appropriate for such a requirement to be included in the legislation and that the legislation specifies considerations that the Memorandum of Understanding will cover. Each Memorandum of Understanding will be negotiated with each department separately following the enactment of this proposed provision. Rather than including the full list as set out in the drafting suggested in the Privacy Commissioner's submission however, officials consider a new paragraph including the requirement for a Memorandum, and a summary of the matters to be covered in the Memorandum, would be sufficient.

Recommendation

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

Issue: Proposed section 81BA has no safeguards for the encouragement of voluntary compliance

Submission
(New Zealand Institute of Chartered Accountants)

We are opposed to the current form of the amendment as it does not provide any legislative safeguards for the encouragement of voluntary compliance. We appreciate there are some advantages to taxpayers in not having to provide the same information to multiple agencies, but we see little in the way of safeguards. There is no assurance that the information transferred will be used for the correct purpose – for example, some agencies such as Quotable Value and New Zealand Post now sell information derived from the public. There is no assurance that once the information is transferred to another entity that they will be constrained by the requirements that apply to Inland Revenue. Some of Inland Revenue's information has commercial value and could be on-sold or on-disclosed by other agencies.

Comment

Proposed section 81BA specifically includes a number of hurdles that must be met for an agency to seek access to Inland Revenue's information. Voluntary compliance is a key area of concern to Inland Revenue. Therefore there is a requirement in proposed section 81BA(3)(a) that the Minister must be satisfied that the provision of information to another agency will not unduly inhibit the provision of further information to Inland Revenue in the future.

The matter of subsequent treatment of information by the recipient agency will be dealt with in the Memorandum of Understanding between Inland Revenue and the recipient agency. It is clearly not in Inland Revenue's interest that information accessed via this framework be subsequently sold for commercial gain by another agency.

Recommendation

That the submission be declined.

Issue: Information passed between government entities should only be information that does not disclose the identity of the taxpayer

Submission
(New Zealand Institute of Chartered Accountants)

We are not opposed to the transfer of information from Inland Revenue to other government entities if the identity of the taxpayer is not revealed (i.e. the information is provided in aggregated form).

Comment

There is already provision for Inland Revenue to provide information to a range of government departments in a range of specific circumstances. In most cases this is not restricted to aggregated or non-identifying information. The intent of clause 59 is to provide a framework under which Inland Revenue can provide information to other government entities to enable either enhanced service provision to the individual, or increased efficiency of government service (for example, avoidance of entitlement overpayments). Restricting the information-sharing framework to non-identifying or aggregated information would not enable the framework to meet this intent.

Recommendation

That the submission be declined.

Issue: Safeguards that apply when information held by Inland Revenue should also apply to agencies receiving information

Submission
(KPMG)

The framework outlines useful steps to ensure only appropriate information is shared with other agencies. However, the treatment of the information once received by the other agency is also of critical importance. The safeguards that protect information when it is held by Inland Revenue should also apply to the recipient agency, with sufficiently stringent penalties for misuse of the information.

Comment

The issue of subsequent treatment of information by the recipient agency will be dealt with in the Memorandum of Understanding between Inland Revenue and the recipient agency. It is clearly important from Inland Revenue's perspective that information accessed via this framework is treated appropriately by the recipient agency.

Recommendation

That the submission be noted.

Issue: Clause 59 should be reviewed to ensure taxpayers do not suffer in any way as a result of Inland Revenue information being made available to other departments

Submission
(Hutt Valley Community Law Centre)

Taxpayers provide their information to Inland Revenue on the trust that this information will be kept in confidence. In giving this information to Inland Revenue taxpayers are assured that they have no reason to fear it will be given to anyone else, or used for any other purpose. Clause 59 would be a detour from the initial objective of taking that information from taxpayers and would thereby constitute a breach of the trust with which the information was given.

The provision should be reviewed to ensure that taxpayers do not suffer in any way as a result of any disclosures to other departments. It is hoped that such access to details and information by others will not be used to the detriment of the taxpayer.

Comment

Officials agree that taxpayers expect and receive a high degree of confidentiality around the information they provide to Inland Revenue. Officials note that Inland Revenue already discloses or shares a range of information for a variety of reasons under existing legislation.

Officials anticipate that many uses of the proposed framework will enable the provision of better, more timely services to individuals. There will, however, be some uses that result in some detriment to a taxpayer, the most likely being if they are receiving some entitlement or service to which they are not entitled. The framework cannot (and should not) exclude such disclosures. These types of disclosure already occur under existing information-matching programmes, albeit in a more constrained and cumbersome way. Officials also note that there is potentially some benefit to such individuals – for example, they will not be accumulating significant debts that will need to be repaid, perhaps with penalties. There will also be administrative gains.

Recommendation

That the submission be declined.

Issue: Threshold of "uneconomic" in proposed section 81BA is too high

Submission
(Matter raised by officials)

The threshold requiring that the provision, collection or verification to or by the requesting agency is "uneconomic" set out in subparagraph 81BA(1)(a) is too high and should be amended.

Comment

This aspect of the threshold test in proposed section 81BA is intended to ensure that sharing under the new framework only occurs when there are cost efficiencies, either to the agencies involved or to individuals (through the reduction of duplication of information provision). Officials consider that the term currently contained in the bill, that the provision, collection or verification to or by the requesting agency is "uneconomic" is too high and could be interpreted to allow information sharing only when it was unaffordable for the requesting agency to collect the information separately. The test is not intended to be so onerous. Officials consider that a more appropriate test of inefficiency should be substituted.

Recommendation

That the submission be accepted.

Disputes

OVERVIEW OF SUBMISSIONS

Eight submissions were received on the changes to the tax disputes process contained in the Tax Administration Act 1994. Submissions were received on wider concerns with the disputes process generally as well as the changes proposed in the bill. Of these wider concerns, two were most prevalent:

- that taxpayers should have a unilateral right to opt out of the disputes process; and
- that the Commissioner should be subject to more legislated timeframes.

Officials understand the concerns giving rise to these submissions – that taxpayers are being "burnt off" by an overly long and elaborate disputes process. However, officials disagree with submitters that legislation is the best way of addressing these concerns.

Inland Revenue has very recently introduced fundamentally revised systems to administer disputes. These processes are set out in two standard practice statements (SPSs) and include improved documentation, bilateral opt-out guidelines and most significantly, independently facilitated conferences. It is anticipated that the revised administration will result in a more efficient and satisfactory process, particularly for smaller disputants.

The Minister of Revenue has agreed that these SPSs should be given an opportunity to work and has requested that a further review take place in two years – once the revised administrative systems have been given time to "bed in". If significant taxpayer concerns then remain, further legislative measures can be considered at that time.

REMOVAL OF THE SMALL CLAIMS JURISDICTION OF THE TAXATION REVIEW AUTHORITY

Clauses 43(5), 63, 65, 73, 74, 90–93, 97, 98, 100, 101 and 103–107

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

The small claims jurisdiction of the Taxation Review Authority (TRA) should be maintained and the procedure for small claims should be reformed. The repeal of the small claims jurisdiction does not address the underlying problem of excessive costs for smaller disputants. (*New Zealand Institute of Chartered Accountants/New Zealand Law Society, KPMG*)

The Committee should instruct officials to proceed with the development of a low-cost fast-track process to resolve small-sum tax disputes. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

The process for using the small claims jurisdiction should be streamlined or, alternatively, taxpayers should have access to an informal hearing process that does not follow legal or technical rules and is non-precedential. *(KPMG)*

New Zealand should consider the adoption of a simplified tax disputes process for small claims, such as exists in Australia, Canada and the United Kingdom. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

Comment

Submitters generally agree that the existing small claims procedure does not work as originally intended. There are several possible reasons for this, including the lack of appeal rights and the limited means by which a disputant can elect to use the small claims jurisdiction.

Officials agree that smaller claims should generally be handled differently from complex, larger ones. However, we do not agree that separate legislative and court processes are required to resolve problems with smaller claims.

Instead, we consider that good administrative practices, coupled with the inherent flexibility of the TRA as a hearing authority, provide the appropriate outcome. As a commission of enquiry, the TRA has considerable flexibility in its procedures, including allowing a taxpayer to represent themselves or be represented by their accountant. The TRA has the ability to ask questions to ensure that the "right" result is reached, irrespective of the expertise of the presenting parties.

Following recent administrative changes set out in Inland Revenue standard practice statements (SPSs), a dispute under $75,000 will involve the following steps:

1. Commissioner issues a notice of proposed adjustment (NOPA).

2. Taxpayer responds with a notice of response (NOR), which can be a short document/statement.
3. A conference (facilitated by a senior independent Inland Revenue officer) will take place to provide an opportunity for the parties to discuss the key concerns and reach a settlement, if possible.
4. If the dispute is unresolved, the taxpayer is able to take the case directly to the general jurisdiction of the TRA.

The recent SPSs also include guidelines for the length of the Commissioner's NOPA. For example, when a dispute involves less than $5,000 of core tax, the NOPA should not exceed 5 pages in length, and when the dispute concerns a single issue, the NOPA should not exceed 10 pages. It is anticipated these shorter NOPAs will further reduce compliance costs for taxpayers.

Officials consider that the process outlined is appropriate for a small dispute. Having a process more truncated than this would defeat the objectives of the disputes process to ensure that cases are well-prepared – and the respective parties' positions understood – before the case goes to court.

Officials do not consider comparisons with overseas jurisdictions to be particularly helpful in this context. The procedures for small claims in Australia, the United Kingdom and Canada were discussed in the disputes issues paper released in July 2010. The paper noted that New Zealand has a unique tax disputes resolution system that requires various steps in the process to be completed before the issue of an assessment. The same point was also noted in the submission from New Zealand Institute of Chartered Accountants and the New Zealand Law Society. Although a specialist process appears to be appropriate in the systems of some other countries, within the New Zealand system, officials consider that administrative solutions are preferable to a separate legislative system for small claims.

Finally, it is important to recognise that a "small" claim does not necessarily equate to a "simple" claim. Some claims involving relatively small amounts of money raise complex legal issues that may have significant precedential value to the particular taxpayer or to a wider section of the taxpayer community (for example, a specific industry group).

Recommendation

That the submissions be declined.

THE "CHALLENGE NOTICE" AND OPT-OUT FOR TAXPAYER-INITIATED DISPUTES

Clauses 67 and 70

Submissions
(KPMG, Russell McVeagh, Corporate Taxpayers Group, Hutt Valley Community Law Centre, Ernst & Young, New Zealand Institute of Chartered Accountants/New Zealand Law Society)

The proposal to introduce a "challenge notice" should not proceed. Because the proposals do not provide any certainty that a challenge notice will be issued at all, they effectively require the Commissioner to give "permission" before the taxpayer can issue a challenge in the courts. This breaches section 27(3) of the Bill of Rights Act 1990, which protects a citizen's right to bring civil proceedings against the Crown in the same way as civil proceedings against individuals.

The current section 138B provides taxpayers with certainty of access to the courts and should be retained.

The suggestion in the Commentary to the bill that the changes proposed by clause 70 would level the playing field between taxpayers and the Commissioner is incorrect because the Commissioner is not compelled to take various steps in the process and the Commissioner has various rights under the process (such as the ability to apply to the court for a truncated process) that are not afforded to taxpayers. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

The provision is potentially retrospective because it does not carve out disputes that have already begun. *(Russell McVeagh)*

If the challenge notice provision is to proceed, the Commissioner's refusal to issue such a notice should be a disputable decision that can itself be challenged. *(Ernst & Young)*

Comment

The changes in clauses 67 and 70 are designed to ensure that, unless an exception applies, the full process is followed irrespective of whether the Commissioner or the taxpayer initiated the dispute. It is intended that the challenge notice be equivalent to an amended assessment for taxpayer-initiated disputes; that is, the final step in the process that launches the challenge right (a right to begin litigation). Officials consider this is still an appropriate objective.

The changes are not intended to provide a block to taxpayers appearing before the courts. However, officials have been advised by Crown Law that the disputes process cannot be indefinite without raising Bill of Rights Act 1990 concerns, and the lack of statutory timeframes in the taxpayer-initiated disputes process does raise the theoretical possibility of the process stagnating.

To address these concerns, officials consider that a timeframe should be introduced for the proposed challenge notice. The timeframe should be set to ensure symmetry between the taxpayer-initiated and Commissioner-initiated disputes processes.

We therefore recommend that the Commissioner should be compelled to produce a challenge notice within four years of the commencement of the dispute (that is, the issuing of the taxpayer's NOPA).

The timeframes set out in the relevant SPSs anticipate the disputes process being completed well within this four-year period. However, to make the timeframe shorter could provide a perverse incentive for taxpayers to begin disputes because they would be guaranteed a faster outcome than under the Commissioner-initiated process. This is an important consideration given that many taxpayer-initiated disputes are complex and may involve difficult questions of interpretation, including how the general anti-avoidance legislation applies. This is to be expected, as the benefit of a taxpayer-initiated dispute is that it protects the taxpayer from the imposition of penalties.

Another consideration is that the Commissioner is required to allocate resources to audit functions as well as disputes. The recommendation would therefore allow this resource to be allocated over a four-year period, irrespective of the genesis of the dispute.

Having a timeframe for the issue of a challenge notice would not be effective without a sanction being in place for a failure to comply. Officials consider that, if a challenge notice was not issued in time, the Commissioner should be deemed to accept the position set out by the taxpayer. This should address the points raised in the Ernst & Young submission.

Officials recommend that this issue be reconsidered in two years' time, along with the review of the administrative changes proposed by the Minister of Revenue.

Officials agree with the Russell McVeagh submission that the revised rules should only apply to disputes where the taxpayer's NOPA is received after the enactment of the bill.

Recommendation

That the submissions calling for the removal of the challenge notice provision and reinstatement of the existing section 138B(3) be declined.

That submissions raising concerns about the Bill of Rights Act 1990 be accepted and addressed by imposing a four-year statutory timeframe on the Commissioner for issuing a challenge notice.

That this recommendation be reviewed by officials in two years' time.

That the relevant provisions only take effect for disputes begun after enactment of the bill.

REFUSAL TO ACCEPT THAT EXCEPTIONAL CIRCUMSTANCES APPLY

Clauses 43(7), 64 and 71

Submissions
(Ernst & Young, New Zealand Institute of Chartered Accountants/New Zealand Law Society)

Section 138E(1) of the Tax Administration Act 1994 should be amended to ensure the taxpayer may dispute the Commissioner's refusal to issue the requisite section 89K(1) notice. *(Ernst & Young)*

The proposed amendment to the "disputable decision" definition should be clarified to make it clear that taxpayers are entitled to challenge the Commissioner's discretion without having to go through the disputes process first. The submission also questions whether the "disputable decision definition" should still refer to section 89L. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

The Commissioner should be required to make a decision on whether to accept late documents within one month. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

Comment

The amendments to section 89K are designed to introduce a new limb to the "exceptional circumstances" test. The Commissioner will have the discretion to accept dispute documents submitted out of time when the taxpayer has a demonstrable intention to enter into or continue the disputes process.

If the Commissioner refuses to exercise the discretion in the taxpayer's favour, it is intended that the taxpayer will immediately be able to challenge that decision in the TRA. This is to avoid the substantive dispute (if it is to continue) being unduly delayed by the discretionary decision itself being taken through the disputes procedure or judicial review proceedings.

Submitters are concerned that the legislation does not adequately reflect this policy, and have indicated there is some confusion over whether the whole disputes process is required to be followed in these circumstances. Officials agree that clarification is required. This will be achieved by stating that the Commissioner's decision under section 89K is, for the purposes of the specific challenge right, treated as a disputable decision.

As noted under the next submission heading, it is intended that the Commissioner will publish guidelines on what is considered to be a "demonstrable intention to dispute".

Officials agree that a timely decision by the Commissioner is desirable and that the Commissioner should be required to make a decision on whether to accept late documents within one month of receiving the document. As suggested by the New Zealand Institute of Chartered Accountants/New Zealand Law Society submission, failure to do so should allow the taxpayer to exercise their discretion to have the decision (or lack of) reviewed by the courts.

With regard to section 89L, the provision that decisions made under that section are not "disputable" has been moved in the bill to section 138E(1)(e)(iv). Officials are comfortable that this amendment will result in the status quo being maintained.

Recommendation

That the submission that there is a one-month time limit on the Commissioner's decision be accepted.

That the submission that the wording of the specific challenge right be clarified be accepted.

That the submission relating to whether "disputable decision" definition should still refer to section 89L be declined.

ACCEPTING LATE DOCUMENTS

Clause 64

Submission
(PricewaterhouseCoopers)

The Commissioner should have a general discretion to accept late documents and should not be limited by the proposed "intention to dispute" test or alternatively the Commissioner should have a discretion to extend the deadline by which a document must be provided.

If the "intention to dispute" test is to be retained, the legislation should clarify how this test applies or at a minimum, Inland Revenue should issue guidelines to clarify the issue.

Comment

Officials do not consider that a general discretion to accept late documents or extend deadlines is appropriate. This would have the potential to render deadlines meaningless and allow tax disputes to stagnate indefinitely. If a general discretion were permitted, it could also be inadvertently applied differently in different cases, leading to unfairness and uncertainty in the process.

The "intention to dispute" test has been proposed as a way of ensuring that taxpayers with a genuine grievance are not denied advancing their dispute because of procedural technicalities. To protect the integrity of the tax system, timeframes must be robust and only relaxed in exceptional cases. To this end, Inland Revenue, as proposed by the submission, intends to release an interpretation statement on the "intention to dispute" test after enactment of the bill.

Recommendation

That the submission be declined in part. That an Inland Revenue interpretation statement be issued on the "intention to dispute" test to clarify how the test applies.

SCOPE OF THE EVIDENCE EXCLUSION RULE

Clauses 70 and 72

Submission
(Russell McVeagh, Corporate Taxpayers Group)

The evidence exclusion rule contained in section 138G of the Tax Administration Act 1994 and modified by clause 72 of the bill should also apply to disputes that are subject to the fast-track procedure introduced by clause 70 of the bill.

Comment

The evidence exclusion rule (EER), as modified by clause 72 of the bill, applies to limit the parties to the issues and propositions of law contained in their respective statements of position (SOP). This means the parties cannot raise new issues or propositions of law in a hearing authority (unless leave of the relevant hearing authority is obtained), but are not limited to the facts and evidence in their SOP.

Submitters generally support the amendment to the EER. However, some have suggested that the rule should also apply to disputes that are subject to the fast-track procedure introduced by clause 70 of the bill. This procedure effectively provides taxpayers with an ability to begin a dispute and then have immediate access to the courts in two set circumstances:

- when the dispute is materially identical to a dispute that the taxpayer has engaged in for previous periods (and that dispute is before the courts);
- when the taxpayer is correcting a position that is dependent on a position adopted by another taxpayer (for example, a company is adjusting its income because losses it has received from another company have been disallowed).

The new fast-track procedure is being introduced to expedite access to the courts for disputes that are identical to existing court cases. This is designed to allow these ancillary disputes to "catch up" to the substantive dispute in the expectation that, once the ancillary dispute reaches court, the court will use its powers to consolidate the two proceedings. It is therefore anticipated that both disputes will be heard "as one" and the EER will apply in a consistent manner accordingly.

Recommendation

That the submission be declined.

DRAFTING MATTERS

Clauses 68, 69 and 70

Issue: Whether the wording in clauses 68 and 69 is sufficiently clear as to which challenge is relevant

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

The wording in proposed clauses 68 and 69 should be amended to "the day on which that challenge …" to clarify that the relevant challenge is the challenge to the Commissioner's decision under section 89K, not any other challenge between the parties.

Comment

Officials agree with the submission.

Recommendation

That the submission be accepted.

Issue: Drafting changes should be made to proposed section 138B(4)(c)(ii)

Submission
(Russell McVeagh)

Proposed section 138B(4)(c)(ii) should be redrafted so that it correctly applies when a taxpayer is affected by a position taken by another taxpayer.

Comment

Proposed section 138B(4)(c)(ii) is designed to provide a direct equivalent for taxpayer-initiated disputes to section 89C(k) (which applies to disputes initiated by the Commissioner). The wording used in the bill reflects this by reproducing the section 89C(k) wording.

However, officials agree that the last part of the wording: "…the Commissioner has made, or is able to make, an assessment…", may not be clear in the context of adjustments proposed by a taxpayer. The suggestion that the reference point should be "the subject of court proceedings" seems appropriate.

Recommendation

That the submission be accepted, to the extent that the wording relates to disputes already before the courts.

OTHER MATTERS RAISED ON DISPUTES

Issue: No opt-out right exists in Commissioner-initiated disputes

Submissions
(KPMG, PricewaterhouseCoopers, Russell McVeagh, Corporate Taxpayers Group, Ernst & Young, New Zealand Institute of Chartered Accountants/New Zealand Law Society)

Taxpayers should be given a legislative right to opt out of disputes initiated by the Commissioner. This would allow taxpayers the opportunity to progress the matter directly to court in situations when the taxpayer sees little benefit from engaging in the full disputes process. This opt-out right could take effect either immediately after the exchange of the NOPA and NOR *(PricewaterhouseCoopers, Russell McVeagh)* or after the conference phase *(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants/New Zealand Law Society).* Taxpayers in disputes of less than $50,000 should have the right to opt out at any time. *(KPMG)*

Taxpayers should have a right that mirrors the Commissioner's ability to apply to the High Court to have the process truncated. *(New Zealand Institute of Chartered Accountants/New Zealand Law Society)*

Comment

The submissions for legislating for a taxpayer opt-out reflect a concern that taxpayers are "burnt off" by the full disputes process.

To address these concerns, Inland Revenue recently published revised SPSs on the administration of the disputes process. These SPSs include guidelines on when the Commissioner will agree to opt out of the disputes process, so the dispute can progress straight to court. Criteria for the Commissioner agreeing to opt out include that the core tax in dispute is $75,000 or less.

Under the guidelines, an opt-out will also be agreed to if a materially identical dispute is either before the courts or has previously been considered by Inland Revenue's Adjudication Unit.

Although submitters consider reliance on administrative practices to be inferior to a legislative right, officials are concerned that legislating for administrative practice can have unforeseen consequences and result in further litigation about the application of any new provision. It is expected that the revised administrative practices (as set out in the SPSs) will result in a more satisfactory disputes process for taxpayers.

The Minister of Revenue is aware of the competing arguments and has requested that a review of the effectiveness of the administrative opt-out guidelines (and other key administrative measures) be conducted in approximately two years' time.

Officials do not agree with the suggestion that taxpayers should have a right to apply to the High Court for an order that the process be truncated. The provision that allows the Commissioner to make such an application is rarely used in practice. When it is used, it is either as a revenue-protection provision, which prevents taxpayers from unduly delaying the process when they know that the Commissioner's four-year statutory time-bar may work in their favour, or as a cost-saving mechanism when there are numerous substantially similar disputes that are not suitable for test-case treatment.

The new opt-out guidelines are likely to result in more cases being truncated and therefore less need for the taxpayer to apply to court. In addition, taxpayers now know when the Commissioner will agree to a truncated process, providing comfort about whether a particular dispute will go through a truncated or the full disputes process. In cases when the dispute is not specifically covered by the opt-out guidelines, taxpayers will still be able to request that the Commissioner agree to opt out.

Recommendation

That the submissions be declined.

Issue: The Commissioner should be subject to more statutory timeframes in the disputes process

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

There are numerous steps in the disputes process when the Commissioner is not under any explicit timeframe for advancing the dispute. Leaving these intermediate timeframes to administrative practice is harmful to the integrity of the tax system because delay can result in increased costs for the taxpayer through the accumulation of legal fees and use-of-money interest. Also, there are no effective sanctions for failure to meet administrative timeframes. The Commissioner should be subject to roughly the same legislative timeframes that the Tax Administration Act 1994 places on taxpayers.

Comment

The recently released Inland Revenue SPSs set out timeframes for each intermediate step of the disputes process. If these administrative timeframes are not going to be met, approval from a senior Inland Revenue manager is required. This increased accountability on Inland Revenue staff has resulted in timeframes being met in all but a few instances. In those instances the documents have been issued as soon as possible after the timeframe has lapsed.

Administrative timeframes allow Inland Revenue staff to appropriately allocate resources to particular disputes. If rigid statutory timeframes were in place, there is a risk that smaller disputes will be reprioritised, and potentially extended out, to ensure that larger disputes meet the statutory timeframe.

It is also worth noting that, although timeframes are not provided for each step of the disputes process, the Commissioner is nevertheless subject to the four-year statutory time-bar for amending assessments. Given that most disputes arise following an Inland Revenue audit of past years' activities, adhering to this time-bar will in many cases be sufficient motivation for the Commissioner to advance the dispute in a timely manner.

The Minister of Revenue has requested that the effectiveness of administrative timeframes in the SPS be reviewed in two years' time.

Recommendation

That the submissions be declined.

Issue: The test case provisions of the Tax Administration Act 1994 should be repealed

Submission
(Russell McVeagh, Corporate Taxpayers Group)

The current test case procedures set out in the Tax Administration Act 1994 should be repealed and any test case situations should be dealt with through the High Court's general jurisdiction to stay proceedings in tax matters.

Comment

In the 2010 issues paper, *Disputes: a review*, officials signalled (as noted in the Corporate Taxpayers Group submission) that their preferred option was to continue to have a tax-specific test-case procedure, but one where test-case designation and other relevant matters is determined by the High Court.

Ministers agreed that this option should be more fully explored with the Ministry of Justice to ensure that the appropriate balances are struck between efficient test-case designation procedure for tax cases and the workload of the High Court more generally. This has not yet proceeded because of other tax work programme priorities. However, it is anticipated that further consultation will result in changes to the test-case rules in a future tax bill.

Officials believe that repealing the existing rules would create unnecessary confusion in the short-term, if repeal were to be used as a temporary solution.

Recommendation

That the submission be declined.

Issue: Use-of-money interest should be suspended in certain circumstances

Submission
(PricewaterhouseCoopers, New Zealand Institute of Chartered Accountants/New Zealand Law Society)

Use-of-money interest should be suspended for the course of a dispute *(PricewaterhouseCoopers)*; if the Commissioner fails to meet an imposed deadline *(New Zealand Institute of Chartered Accountants/New Zealand Law Society).*

Comment

Use-of-money interest (UOMI) is a "no fault" concept, designed to be administratively workable by ensuring that exceptions are kept to a minimum. Suspending UOMI for the period of a dispute could therefore be seen as a mechanism for encouraging non-compliant taxpayers to "stop the clock" by engaging in the disputes process.

Suspending UOMI when the Commissioner fails to meet an administrative deadline would not recognise the fact that some administrative deadlines relate to periods when both parties to a disputes exert a certain degree of control, such as the conference. For example, a blanket suspension of UOMI for a failure by the Commissioner to advance to the next stage of the dispute following the conference would not take into account the fact that taxpayers can also delay the process.

In any event, the Commissioner does exercise a degree of discretion when quantifying UOMI. If an undue delay in the process is attributable to Inland Revenue, remission of UOMI will be considered.

Recommendation

That the submission be declined.

Issue: Whether, in a dispute that does not involve the exchange of SOPs, the Commissioner should be limited in court to the "grounds of assessment" and the taxpayer to their legal grounds for dispute

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

When a dispute is truncated, there needs to be a statutory rule which limits the Commissioner to grounds of assessment and an equivalent rule limiting taxpayers to their legal grounds for dispute.

Comment

Currently there are two sets of rules, depending on whether SOPs have been exchanged as part of the dispute:

- If SOPs have been exchanged, the evidence exclusion rule will apply to limit the parties on the issues and propositions of law that can be raised in court.
- If SOPs have not been exchanged, there are no statutory limitations on matters that can be raised.

Officials consider this to be a generally desirable outcome – parties are either bound by their court documents or their SOPs. A truncated disputes process is a means of getting a dispute to court faster than it would otherwise. In these circumstances, it is logical for the court documents to be the most important feature of the dispute. The taxpayer's argument is set out in their Notice of Claim (in the TRA) and the Commissioner's argument is set out in the Notice of Defence. The court holds the parties to the content of those documents unless there are sound reasons for deviating from them.

To limit the Commissioner to the grounds on which an assessment is reached would result in one party (the Commissioner) being bound to a pre-court document, with the other party (the taxpayer) producing their first "binding" document as part of the court process. Such a rule could see the taxpayer raise an issue for the first time as part of the Notice of Claim. If the Commissioner were bound to the grounds of assessment, the court's approval to respond would presumably have to be sought.

Although having the issues in a dispute identified early is consistent with the policy behind the disputes process, officials do not consider that binding only one party to their pre-court documents is a desirable way of achieving this aim.

Recommendation

That the submission be declined.

Issue: Whether the disputes resolution process meets its stated policy objectives

Submission
(PricewaterhouseCoopers)

The current disputes process is ineffective as a resolution process and the policy objectives of the disputes process are not being met. The Government should carry out a review of the effectiveness of the disputes resolution process and consider changes accordingly.

Comment

The current disputes resolution process reflects the recommendations of the Richardson Review undertaken in the early 1990s. Although many concerns have been raised about the administration of the disputes process and how much of the process should be explicitly legislated for there have previously been no serious suggestions that the fundamentals of the process should be revisited.

Administrative changes recently introduced by Inland Revenue and the legislative amendments proposed in the bill should significantly improve the effectiveness of the disputes process and better align it with its stated policy objectives.

As mentioned previously in this report, the Minister of Revenue has requested a further review of the effectiveness of the process in approximately two years' time. Such a review would, as a matter of course, consider how the process is working within its policy objectives.

Recommendation

That the submission be declined.

Issue: The consequences of breaching the evidence exclusion rule are not set out in the bill

Submission
(PricewaterhouseCoopers)

The bill should set out the consequences of breaching the EER, particularly, whether the omission of an issue from a SOP means that the relevant party is excluded from raising it in further proceedings.

Comment

Officials consider this issue to be reasonably clear. The proposed drafting of the EER (in section 138G(1) of the Tax Administration Act 1994, as amended by clause 72) provides that the "Commissioner and the disputant may raise in the challenge only the

issues and propositions of law that are disclosed in the Commissioner's and disputant's statements of position". Section 138G(2) provides a hearing authority with a discretion to allow new issues or propositions of law to be raised in certain circumstances.

There have been numerous court cases that have referenced the EER. Most of these revolve around a party trying to exclude the other disputant from advancing a proposition on the basis that it is "new". This appears to confirm that the starting presumption is that entirely new issues or propositions of law will be excluded from court proceedings unless an exception applies. Officials consider the wording of the legislation, as applied by the courts, provides sufficiently clear consequences for breaching the EER without the need for specific legislation on the matter.

Recommendation

That the submission be declined.

Issue: Should the taxpayer or Commissioner be required to produce a SOP

Submission
(PricewaterhouseCoopers)

Given that both the NOPA and the SOP are required to cover the same issues and propositions of law, SOPs may not serve any useful function and are potentially an exercise in repetition. As a result, the SOP should not be a legislative requirement. Instead, the NOPA or NOR, with further submissions after the conference phase should suffice for the adjudication process.

Comment

Officials agree there can be some repetition in the content of a NOPA/NOR and SOP. However, it is considered that the SOP is an important document in focussing the dispute for the adjudication process and any subsequent court proceedings.

If a dispute has gone through the conference phase, it is likely that some issues have been resolved and those that are remaining have been further refined. Having the NOPA or NOR supplemented by further submissions, as the submission suggests, may result in longer documents that contain redundant material.

In any event, a degree of repetition does not necessarily equate to significant time or compliance costs for the disputants. Having a single SOP that contains all the relevant issues and propositions of law to which the EER applies is considered preferable to supplementing the initial disputes documents, which may have been superseded by subsequent discussions.

Recommendation

That the submission be declined.

Issue: Whether the entire disputes process, particularly the administrative functions of the Commissioner's Adjudication Unit, should be legislated for

Submission
(Corporate Taxpayers Group)

The approach favoured by Inland Revenue and reflected in the bill, that legislative change be kept to a minimum, provides taxpayers with little certainty about how disputes will proceed. Leaving parts of the disputes process open to the discretion of the Commissioner is harmful to the tax system. Having an uncertain process discourages taxpayers from challenging the Commissioner's view, particularly when the courts have held that the Commissioner is not bound to follow non-statutory parts of the process.

The disputes process should therefore be legislated as far as practically possible. Consistent with this view, the adjudication phase should be legislated for to provide taxpayers that do engage in the entire process the opportunity for the arguments to be independently reviewed within Inland Revenue.

Comment

Officials consider that a disputes process that is guided by statute rather than rigidly controlled by it is preferable in most instances. One of the main recommendations of the Richardson Committee was that disputes should have every opportunity to be resolved before reaching the courts. Key to this are the adjudication and conference phases of the process, which could be compromised by adherence to inflexible statutory processes.

Other considerations include:

- More legislation leads to more disputes about the scope of the legislative provisions, resulting in substantive disputes being delayed by ancillary litigation about the process.
- Disputes that take the longest are generally more complex and can have the highest potential revenue impact. In these cases it is more important to focus on the resolution of the dispute rather than adhering to detailed statutory rules about the process (which could also cause unnecessary delays for smaller disputes).
- Strict timeframes around latter parts of the process may encourage Inland Revenue staff to "front-load" the dispute, lessening the possibility of an early resolution.

Recommendation

That the submission be declined.

Issue: Whether the Commissioner and the taxpayer should be allowed to apply jointly to the High Court for a consent order to extend the time period for the Commissioner's NOR

Submission
(Ernst & Young)

Section 89L should be amended to allow taxpayers and the Commissioner to make joint applications to the High Court for a consent order to extend the time period for the Commissioner to provide a NOR.

Comment

Under section 89H, if the Commissioner does not provide a NOR within two months of receiving the taxpayer's NOPA, the Commissioner is deemed to have accepted the taxpayer's position. Officials agree in theory with there being an ability to extend the response period in appropriate circumstances. Because it would be a joint submission, taxpayers would still retain a considerable degree of control over when the NOR was to be received.

However, this is not an issue that has been consulted on as part of the amendments in the bill. Given the concerns expressed in submissions about timeframes, officials consider this issue should be subject to the full generic tax policy process. It is therefore a matter that we suggest be included in the anticipated review of the disputes process in two years' time.

Recommendation

That the submission be declined.

Issue: The Commissioner should publish redacted adjudication reports

Submission
(New Zealand Institute of Chartered Accountants)

When an adjudication occurs, Inland Revenue should publish the adjudication report in redacted form so that taxpayers can understand the legal outcome and reasoning on those facts, while still protecting the identity of the taxpayer concerned.

Comment

Inland Revenue is considering the competing arguments for publishing redacted adjudication reports. However, given that adjudication itself is not legislated for, there seems little benefit in legislating for publication of the subsequent reports. As such, officials consider this is a matter that is best dealt with through ongoing dialogue between the Institute and the relevant areas of Inland Revenue.

Recommendation

That the submission be declined.

Tax pooling

OVERVIEW OF SUBMISSIONS

Clauses 33 – 35 and 79

Five submissions were received on tax pooling. In general the submissions were supportive of the amendments proposed. Some technical issues were raised. A number of further amendments are recommended by officials, to either clarify the proposed legislation or make further changes.

Issue: Pooling provisions in the bill generally

Submission
(Tax Management New Zealand)

The proposals in the bill are unduly bureaucratic and burdensome to both the private and public sectors. They will require Inland Revenue to incur precisely the kinds of low productivity costs the Government is trying to drive out of the public sector. The concerns expressed in the Regulatory Impact Statement can be met in ways which meet the objective of not exposing the Government to undue tax risk, while reducing costs.

Comment

Officials consider the proposed amendments deal with the concerns raised in the Regulatory Impact Statement by removing the restrictions for taxpayers who use their own funds. Taxpayers who purchase funds will be allowed to acquire these on the expectation of having tax to pay which will shift Inland Revenue's focus from checking the vast majority of tax pooling transfers to only needing to check a very small minority. Additionally, when over-purchases occur the proposed amendments provide for the over-purchased funds to be used by the taxpayer in one of three different ways without having to revisit the original transfer request with the tax pooling intermediary. The reduction in compliance costs of the proposed amendments will be significant for intermediaries, tax agents, taxpayers and Inland Revenue, while still balancing the need to protect the revenue base.

Recommendation

That the submission be declined.

Issue: Early balance dates and the 60-day limit

Submission
(Tax Pooling Solutions, Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

We support the extension of the 60-day time limit for the transfer of tax pooling funds but consider that it should be extended to 90 days. *(Tax Pooling Solutions)*

The time limit for using tax pooling to pay current year income tax should be further extended to 80 to 85 days at a minimum. The 75-day time limit is still an issue in a leap year. *(Corporate Taxpayers Group)*

The time limit for using tax pooling to pay current year income tax should be further extended to 85 or 90 days. *(New Zealand Institute of Chartered Accountants, Tax Management New Zealand)*

Comment

Officials note that the purpose of the amendment is to deal with problems with some early balance dates (mostly December balance dates) and that the amendment was specifically requested by submitters. Officials agree that the proposed time limit will still be a problem for some early balance dates in a leap year. Officials propose that it is appropriate that an amendment is made so that in a leap year, for some early balance date taxpayers, the time limit is 76 days.

Recommendation

That the submissions be declined but that in a leap year, for October, November and December early balance date taxpayers the time limit is 76 days.

Issue: Removal of the 60-day time limit to access deposit funds for associated persons

Submission
(Tax Pooling Solutions)

Taxpayers who want to access funds held by a tax pooling intermediary to meet their provisional or terminal tax liabilities must do so within 60 days of their terminal date to use the funds at backdated credit dates. New section RP 17B(4)(b) provides that the time limit will no longer apply for "own funds" provided the taxpayer is not overdue in filing their return for the tax year. The proposed removal of the time limit for own funds is supported. However, the 60-day time limit should also be removed with respect to funds deposited by a member of the same group of companies, partner in the same partnership or other related party described in section 173M(2)(a)-(f) of the Tax Administration Act 1994.

If a person makes a tax payment directly to the Commissioner rather than into a tax pool, section 173L of the Tax Administration Act 1994 allows excess tax to be transferred to related parties at the date the tax was paid. There is no time limit on such transfers. There should be the same ability to make transfers to related parties from funds deposited in tax pooling accounts. Imposing a time limit on the use of funds deposited in a tax pool by a related party unfairly disadvantages taxpayers who deposit into tax pooling accounts.

Comment

Officials agree that an amendment to remove the time limit for own funds should be extended to apply to a member of the same group of companies based on the membership of the group at the time of deposit or purchase, and use of the tax pooling funds. This is because companies in the same group operate as one economic entity and often will make one deposit into a tax pooling account for the benefit of all their group members. Group companies often will not know their exposure to tax until inter-group transactions are completed, including end-of-year loss offsets and subvention payments. This makes it very difficult for group companies to determine when and how much they should deposit individually, but they will know globally what their tax exposure is. Officials agree that as currently drafted, the proposed amendments would only allow the depositing group member to use the deposit as its own funds. The other members would be treated as having acquired the funds if they use them. Officials consider the benefits of the 66% commonality provisions in the Income Tax Act for group companies should not be constrained by the pooling rules as this would create compliance costs for group companies. This will ensure tax pooling is consistent with the practice by group companies to make provisional tax payments directly into the tax account of only one member and following the filing of the all of the groups' tax returns, request transfers within the group to allocate the payments following the elections to make loss offset sand subvention payments. In the absence of this amendment, group companies would have to make individual deposits into a tax pooling account, creating unnecessary compliance costs that do not arise if payment is made directly to the Commissioner. In both situations group companies should have the same treatment apply.

Non-group companies, partners in a partnership and other related parties are not treated as the same economic entity and cannot make loss offsets or subvention payments. These entities are able to make their own deposits and use these funds to pay their own taxes and (with the changes proposed in the bill) will be able to continue to do so with fewer restrictions than currently apply. Extending the use of deposits to include other associated taxpayers as suggested would not be appropriate. It would create compliance risks and administrative burdens on intermediaries, tax agents and the Commissioner over who would be authorised to instruct an intermediary to ask the Commissioner to make a transfer, and who the Commissioner would be able to discuss this with should there be a problem with a transfer.

If this time limit were removed for non-group companies, partners in a partnership and related parties, the pooling regime would be undermined. It would result in tax pooling funds being able to be used to meet tax obligations of related parties that the related party could not obtain itself from a tax pooling intermediary if the time limit to file income tax returns were missed. For example, if a taxpayer failed to file their tax return by the due date, they are not able to use tax pooling after 60 days (the bill proposes 75 days) have passed from their terminal tax date. If however the taxpayer

were able to transfer backdated pooling funds to an associate, that associate could then transfer the funds back to the taxpayer after they were received. This circumvents the tax pooling rules by misuse of the transfer rules.

If an associated person were to receive backdated tax pooling funds, these would not be their own deposit. This would create inequities between associated taxpayers and non-associated taxpayers, who acquire other taxpayers' funds as the bill proposes restrictions to how purchased pooling funds can be used if these are not applied to meet income tax obligations. Additionally it would allow associated taxpayers to meet historic tax arrears (for example PAYE, GST and Child Support) through the use of another taxpayer's tax pooling deposits which is proposed to be restricted to "own" deposited funds only.

Administrative burdens would also be imposed upon tax pooling intermediaries to keep detailed records of all deposits that are transferred to associated persons. Disclosures would be required by intermediaries at the time of the transfer of funds from the tax pooling account and a verification process would need to be applied by Inland Revenue to check each transfer to ensure that the parties are related.

Recommendation

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

Issue: Obligations that cannot be quantified

Submission
(Tax Pooling Solutions)

The proposed amendment to allow a taxpayer to transfer funds from a tax pooling account to its taxpayer account in anticipation of an income tax obligation that cannot be quantified at the time of transfer is supported. Such transfers are currently rejected due to "excess funds".

Section RP 19B clearly only applies when a taxpayer purchases funds from a tax pool for expected tax liabilities. It does not apply when a taxpayer transfers funds that it has deposited itself. This, along with the reference to the transfer of the "amount of the funds deposited by the person under section RP 18" in section RP 17B(7)(b), suggests that there are not intended to be any restrictions on the transfer of funds deposited by a taxpayer into a tax pool itself. A taxpayer should be able to transfer all of its own funds to its taxpayer account at any time, regardless of whether the taxpayer currently has any obligation in respect of the anticipated tax liability or such a transfer would result in "excess funds". This is the correct approach.

The beginning of section RP 17B(7)(b) refers to the transfer of funds from a tax pooling account to "meet an obligation to pay tax". A taxpayer who expects to incur tax liabilities that are not yet quantified does not have an "obligation" in respect of such liabilities so, as drafted, this section would prevent a taxpayer transferring the total amount of funds that it deposited into the tax pool if that amount was in excess of

its then current tax obligations. This means that taxpayers can transfer purchased funds to meet expected tax liabilities but cannot use their own funds to do so.

Comment

The submitter states that a taxpayer cannot use *own* funds to pay more tax than they owe. This is not correct. However, taxpayers who *buy* funds will only be able to transfer what they owe (subject to new section RP 19B which allows taxpayers to use funds in a pooling account towards the payment of a future liability if certain criteria are met). The amendments mean that people who use their own funds will be able to transfer *the total amount of their deposit* as long as they do so within 75 days of their terminal tax date if they have not filed their tax return, or at *any time* if they have filed a return.

Officials consider that the provision should be clarified so that it is clear that an exception is being made and to clarify the relationship between sections RP 17B(7)(b) and RP 19B. That is, section RP 17B (7)(b) is subject to section RP 19B.

Recommendation

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

Issue: Transfer of purchased tax pooling funds that become "excess tax"

Submission
(Tax Pooling Solutions)

Proposed section RP 19B(5)(b) states that if a transfer under section RP 19B results in excess tax, the amount is "transferred with an effective date that is no earlier than the date on which the Commissioner received the later request". It is unclear what the "later" request refers to. There appears to be only one "request" – the request to transfer the funds from the tax pooling account. Presuming that this is the "request" referred to in section RP 19B(5)(b), that is unfair to transfer the funds with an effective date no earlier than the date of the transfer request. The Commissioner has had the use of those funds from the original date of deposit and the taxpayer has paid interest to the intermediary to purchase funds with that effective date. Such excess tax should retain its effective date and, if it is refunded to the taxpayer, the Commissioner should pay use-of-money interest to the taxpayer from the effective date until the refund date. If it does not, the Commissioner would receive a windfall gain and compliant taxpayers would be unfairly penalised.

Comment

Officials note that the reference to "later" date refers to the use of tax pooling funds that have not been applied to meet income tax obligations. For example, if a taxpayer owes $5,000 provisional tax and expects their terminal tax will be $10,000, they will be able to purchase $10,000 at backdated credit dates and have this transferred to their tax account. If, when they file their return, their tax obligation turns out to be only

$7,500, they will have a $2,500 credit resulting from purchased tax pooling funds. The proposed amendments allow this $2,500 to be transferred to meet other non-income tax obligations, or transferred to other taxpayers. However backdating the credit date of the $2,500 would create a compliance risk. Taxpayers could deliberately over-purchase tax pooling funds to deal with their own or associated taxpayers' tax debts that tax pooling should not be used for, such as child support obligations. Additionally, such transfers would also undermine the effective date restrictions contained in the transfer rules by circumventing these through over-purchasing tax pooling funds.

The proposed amendment will not restrict taxpayers from using purchased tax pooling funds at backdated credit dates to meet their own provisional tax or income tax obligations. Officials will ensure that the explanatory commentary of the proposed rules contains examples to ensure that this is made clear.

Officials note that taxpayers will continue to receive use-of-money interest on any excess tax refunded to them or that is unable to be applied at backdated effective credit dates.

Recommendation

That the submission be declined.

Issue: New effective dates

Submissions
(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

Clause 34 amends section RP 19(3) by extending the situations when a taxpayer who requests a transfer to their account from a tax pool cannot have that transfer effective from the date that the money was deposited in the pool. Current section RP 19(3) allows the effective date to be the date the amount was actually deposited in the tax pool so long as the 60-day limit is met (proposed to be extended by the bill to 75 days). The proposed change would make the effective date of a transfer of funds not originally deposited by the person to be no earlier than the date the obligation of the person to pay the tax arises. The intention of this change appears to be to prevent taxpayers using tax pooling to eliminate imputation credit account deficits. This change is inappropriate from a policy perspective. There is no reason why a taxpayer who discovers, say in June 2011, that they have an imputation credit account debit at say 31 March 2010, should not be able to remedy that debit by acquiring a tax pooling deposit with an effective date before 31 March 2010, say 15 January 2010. The Government has had the tax since 15 January 2010.

Comment

Tax pooling is not intended to be used to meet further income tax obligations that arise when an imputation credit account has a debit closing balance at the end of an

imputation year. Making the change as suggested will circumvent the imputation credit account rules which do not allow for backdated payments to meet or eliminate further income tax obligations. In addition, making the change as suggested would create a compliance risk. That is, there would be no incentive for companies to ensure their imputation credit accounts are nil or in credit as at 31 March if they can use tax pooling at retrospective dates to correct debits. This would result in taxpayers borrowing funds from the Government to pay shareholders dividends with imputation credits attached.

Recommendation

That the submission be declined.

Issue: Establishing an "obligation" to pay tax before requesting a transfer to taxpayer's own tax account

Submissions
(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

Clause 33(3) of the bill proposes to replace subsection RP 17B(4) of the Act. The general purpose of the replacement is to remove certain obstacles to taxpayers requesting transfers to their own accounts from a tax pool, which have given rise to unfair and arbitrary outcomes. However, the most significant unnecessary obstacle is retained. This is the requirement that before a taxpayer requests a transfer from the tax pool into a person's account, the person must have established an obligation to pay tax. Accordingly there is no reason for the Government to refuse to accept a transfer of any amount of tax from a tax pool to a taxpayer account to pay provisional or terminal tax, provided the time limit is met (applicable only if a taxpayer is using a deposit acquired from another person). Removing the requirement for taxpayers to establish an obligation before requesting a transfer will greatly reduce the amount of checking and liaising required by Inland Revenue, intermediaries and agents. Proposed section RP 17B(4) should therefore be amended by replacing the words "satisfy an obligation for" with the word "pay".

We note the concerns expressed at paragraph 22 of the Regulatory Impact Statement, and are confident that they can be met in other ways. In particular, the restrictions on requesting transfers from a tax pool should be subject to the same transfer rules that restrict transfers of excess tax. At present, the rules applying to transfers from a tax pool are significantly more onerous. *(Tax Management New Zealand)*

Taxpayers should not have to establish an "obligation" to pay tax before requesting a transfer to their own tax account. *(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants)*

Comment

Officials consider the proposed amendments deal with the concerns above by providing no limit/restriction for using a taxpayer's own funds, provided the tax return for that tax year is received by the due date. The return is necessary for reasons of voluntary compliance and revenue forecasting.

For purchased funds the proposed pooling amendments will allow taxpayers to make purchases on the expectation of owing tax. If a taxpayer over-purchases funds they will be allowed to use these funds to meet other obligations with certain restrictions on using backdated credit dates.

These restrictions are necessary as the transfer rules do not allow taxpayers to use funds at backdated credit dates that have been purchased from other taxpayers, and tax pooling should not be able to be used to achieve this outcome. Otherwise taxpayers could purchase funds and obtain backdated effective dates to use them to meet obligations that tax pooling was never intended to meet. Officials consider such use would undermine the transfer rules, and create revenue risks and disincentives to voluntary compliance.

Recommendation

That the submissions be declined.

Issue: Restrictions on transfers

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

Clause 33(7) imposes limits on the amount a person can request to be transferred to their own account from a tax pool. For example, if the person is acquiring a deposit made from another person to pay terminal tax, the maximum amount they can ask to be transferred is the amount of terminal tax payable. There should not be a restriction on the amount that a person can transfer.

Comment

Officials consider that having no restrictions on using purchased tax pooling funds is a compliance risk. It removes the incentive for non-compliant taxpayers to be compliant as they know they can avoid all of the consequences by buying another taxpayer's funds. The consequences referred to are late payment penalties and use-of-money interest that would otherwise be payable. It would also provide opportunities for taxpayers to pay tax arrears that tax pooling is not intended to meet – for example, unpaid child support obligations. Additionally, the general transfer rules would be circumvented by allowing more purchased funds than the tax the taxpayer owes to be transferred at backdated credit dates. If a taxpayer can transfer more purchased funds at backdated credit dates, these could be transferred to associated taxpayers to meet

their obligations – for example, historic tax arrears, which tax pooling is not intended for. Officials consider that the proposed amendments to allow taxpayers to use excess purchased funds, with certain restrictions, deal with the issues appropriately, while balancing the risk to the revenue base of misuse of the transfer rules to avoid interest and penalties that pooling cannot be used to mitigate.

These restrictions will not apply to taxpayers who deposit their own funds (if they meet their return filing obligations), because if the taxpayer had made a deposit of those funds into their own tax account instead of a tax pooling account, they would be able to use them at the date of deposit to meet any of their own tax obligations without restrictions. It is therefore only appropriate to apply the same treatment to taxpayers who make their own deposits into a tax pooling account.

Recommendation

That the submission be declined.

Issue: Own deposit funds and return filing requirement

Submissions
(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

Tax pooling requests funded by a taxpayer's own deposit should not be subject to a "return filing" restriction. *(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants)*

The return filing requirement is not appropriate. If taxpayers are seeking to transfer their own funds from the tax pool to their individual tax account, they should be able to do so freely. It is nonsensical to impose any restrictions on such a transfer, when taxpayers are free to transfer other tax overpayments between different tax types and periods without any return filing restriction. Subsection (4) should only apply to transfers of tax deposits acquired from other taxpayers. It is not clear what is meant by the words "their return filing requirement". Presumably the requirement is to have filed the income tax return for the year in question before the request is made, whether or not on a timely basis. If section RP 17B (4) continues to apply to transfers of money deposited by the person requesting the transfer, the nature of the "return filing" requirement should be explicitly stated. *(Tax Management New Zealand)*

Comment

Currently there is a time limit on the use of a taxpayer's own deposit funds (the funds that a taxpayer deposits into a pooling account themselves). Taxpayers must access their own deposits in pooling accounts within 60 days of their terminal tax date in order to apply the pooling the deposits against an income tax liability effective at the date at which the deposit was originally made.

The amendment proposed in the bill removes this time restriction for "own deposit funds" subject to a return being filed on time.

The return filing restriction ensures that pooling users and non-pooling users are treated equitably in terms of return filing obligations. In addition, removing the restriction on using "own funds" creates a compliance risk that pooling users can delay the payment of tax indefinitely when they do not file their tax return by the due date. It would remove the incentive to file and pay.

Tax pooling should not provide an incentive for a lesser standard of compliance with return filing obligations by users as opposed to non-users of pooling funds. The same applies to users who make their own deposits as opposed to those who purchase funds.

The proposed amendments also provide consistency with the general transfer rules which also contain restrictions on some credit transfers if a tax return is not filed at the time of the request. For example, if provisional tax has been overpaid, it generally cannot be refunded until the tax return is filed to establish the amount that has been overpaid.

The return filing requirement applies only to the tax year for which tax pooling funds are intended to be used. This will be made clear in the explanatory item that officials will prepare, and will include examples.

Officials note that there would be other issues with removing the time limit and having no return filing restriction. For pooling monies the Government's revenue is not recognised until the earlier of the return being filed or the pooling funds being released into the taxpayer's account. Removing the 60-day rule will remove any incentive for pooling funds to be released quickly and as a consequence the Government will be reliant on a return in order to book or recognise the income.

Recommendation

That the submissions be declined.

Issue: Application of pooling rules to voluntary disclosures

Submission
(Tax Pooling Solutions, Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

We support the extension of the tax pooling rules so tax pooling funds can be used to satisfy an increased liability resulting from a voluntary disclosure when there has not been a previous assessment. *(Tax Pooling Solutions)*

Tax pooling should be extended to voluntary disclosures by taxpayers who have not filed tax returns. A taxpayer who does not realise that a tax liability exists and therefore does not file a return will not be able to use tax pooling when the error is discovered and a voluntary disclosure is made. Officials should consider linking of the requirement to the penalties regime so that it applies when the taxpayer is not subject to a late payment penalty – then the requirement to have filed a return should be waived or alternatively there may be merit in having a rule which considers a taxpayer's compliance history. *(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)*

It is inequitable that tax pooling is not extended to a person who makes the error of thinking that they have no tax to pay at all (whether RWT, income tax or some other tax), and therefore does not file a return or make a self-assessment. It is nonsensical and bad policy to deny a person the right to use tax pooling (which reduces but does not eliminate the amount of interest on late paid tax which the person has to pay) at the same time as excusing the person entirely from paying late payment penalties. *(Tax Management New Zealand)*

In many cases, the amendments deny taxpayers the ability to use tax pooling if they have not complied with their tax obligations. This imposes (a) an arbitrary punishment for the underlying offence, which will already have been subject to an intended and carefully calibrated penalty; (b) a very significant administrative burden for Inland Revenue, taxpayers, accountants and tax pooling intermediaries. Any request to use tax pooling must be vetted by Inland Revenue to ensure that the taxpayer has been compliant in the relevant respects. If they have not been, the request should be rejected. Under current practices, Inland Revenue will not provide any information to the intermediary as to why the rejection has occurred. The result is that rejected requests to use tax pooling, which make up a very small proportion of the total, require all requests to be vetted, and result in a need for personal intervention in a system which should work mechanically and inexpensively. *(Tax Management New Zealand)*

Comment

Officials agree the proposed amendments do not resolve the issue for all taxpayers. Officials consider that proposed new section RP 17B(3)(ab) – which will allow for pooling funds to be used for a voluntary disclosure when there has not been a previous assessment, provided the relevant return has previously been filed for the year – should be accompanied by a Commissioner discretion and apply only in limited circumstances.

In exercising the discretion, the Commissioner would have regard to the compliance history over the previous two years (filing and paying) and other factual information available to the Commissioner at the time (such as whether the person cannot reasonably have been expected to have known of their obligations). This ensures that in exercising discretion the Commissioner is satisfied that each occasion of non-compliance is not a deliberate act or a continuation of failures because of the taxpayer's inadequate or poorly applied internal controls.

The taxpayer should be required to have the ability to use pooling funds confirmed to them in writing before backdated pooling funds are used.

Officials suggest that the ability to use tax pooling when making a voluntary disclosure when no return has been filed should be limited to income tax and RWT because tax pooling cannot be used for all other tax types except if an amended assessment has been made. If a taxpayer has not filed a non-income tax return then an amended assessment would not result from a voluntary disclosure and hence tax pooling should not be available in these cases. Otherwise the integrity of the tax pooling system and voluntary compliance would be affected by creating a disincentive to comply with non-income tax return filing obligations because tax pooling could be used at a later date through a voluntary disclosure. The exception proposed for RWT is to address the concerns raised by submitters that Inland Revenue does not require an RWT payer to file a nil return if no RWT has been paid. Other tax types require the taxpayer to file a nil return. Since the use of tax pooling for non-income tax revenues is based on amending a previously filed return, it is appropriate to extend the use of backdated tax pooling funds to RWT where no return was filed because the taxpayer believed that they had no liability to pay RWT.

Officials consider that this proposed Commissioner discretion should be reviewed after one year, with specific regard to the impact of the discretion on voluntary compliance and administration cost to Inland Revenue.

Officials will ensure that explanatory material prepared in relation to the proposals contains specific examples of where it is likely that the discretion will apply.

Recommendation

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

Issue: Definition of "amount of tax"

Submission
(Tax Pooling Solutions)

We support the proposed amendment to the definition of "amount of tax".

Comment

The definition of "amount of tax" is currently restricted to the five withholding payments set out in that section. This was not the intention. Amendments made in 2009 intended to extend the definition to include amended assessments of most taxes, where the initial liability is increased. The proposed amendment therefore aims to reflect the policy intent that amounts of income tax, FBT and GST are included within the definition for the purposes of the pooling rules.

Recommendation

That the submission be noted.

Issue: Transfers within tax pooling accounts

Submission
(Tax Pooling Solutions)

Section RP 18(2) should be amended to clarify the beneficial ownership of tax deposits that have been transferred from one taxpayer to another but which remain in the tax pool can be transferred.

Comment

Officials consider that the appropriate way to address this concern is for tax pooling intermediaries to deal with this in the commercial contracts entered into with clients who are buyers and sellers within the intermediary's tax pool. The provisions around holding funds in trust are obligations imposed on intermediaries and the Commissioner will not know that a depositor has sold their funds to another client of a tax pooling intermediary. That is a commercial transaction which is outside the responsibility the Commissioner is charged with in administering a tax pooling account.

Recommendation

That the submission be declined.

Issue: Section RP 19B – requirements

Submissions
(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants, Tax Management New Zealand)

Section RP 19(B) should apply regardless of whether taxpayers have met other obligations. *(Corporate Taxpayers Group, New Zealand Institute of Chartered Accountants)*

The "good behaviour" restrictions in proposed section RP 19B(3) should be removed. It is arbitrary and untargeted for taxpayers to be denied the ability to use tax pooling for such non-compliance. Proposed section RP 19B(4) should not be enacted. *(Tax Management New Zealand)*

Comment

Section RP 19B(3) ensures that the Commissioner has all of the necessary information when a request for purchased tax pooling funds is received to determine what the taxpayer's provisional tax obligations are, as these are generally based on prior year terminal tax obligations from tax returns.

Not having prior year tax returns when taxpayers wish to use purchased pooling funds would prevent the Commissioner from being able to process tax pooling transfer requests until the return is filed, unnecessarily creating a large administrative burden and compliance costs for taxpayers and intermediaries. Officials consider that the clarity around this requirement is desirable to avoid these burdens and costs.

Section RP 19B(4) ensures that any backdated credit date for purchased funds is limited to the tax year in which the funds are used. Otherwise taxpayers would be able to circumvent other specific provisions – for example, by meeting unpaid imputation closing balances in prior tax years before the dates the imputation rules allow, or paying historic tax debts, such as child support, or transferring the funds to associated taxpayers to meet their unpaid historic tax debts.

Recommendation

That the submissions be declined.

Issue: Disclosure to pooling intermediaries by Inland Revenue

Submission
(Tax Management New Zealand)

The bill proposes a number of changes to section 81, generally with the aim of allowing exceptions to the secrecy requirement where appropriate (clauses 58 and 59). There is a much more fundamental issue regarding secrecy than those dealt with currently in the bill. The issue is the basis on which Inland Revenue communicates with tax agents.

Tax Management New Zealand, tax agents and Inland Revenue currently spend much more time than necessary dealing with situations when Inland Revenue believes that a taxpayer has not met the requirements for a tax pool transfer. Inland Revenue will not discuss with tax pooling intermediaries any matter concerning a taxpayer which does not pertain directly to a tax pooling request. In particular, when Inland Revenue rejects a tax pooling request, it usually will not tell the intermediary why.

The intermediary must go to the taxpayer or their agent to find out. Inland Revenue justifies this on the basis of the secrecy obligation in section 81 of the Tax Administration Act 1994. It will, on the other hand, discuss a person's tax matters with their accountant or their lawyer as freely as if they were discussing those matters with the person themselves. There is no statutory basis whatsoever for this breach of the secrecy obligation. The only basis for it is that the person has authorised their accountant or lawyer to act on their behalf. It is entirely appropriate and sensible for Inland Revenue to recognise that authorisation. The problem we are experiencing is that the responsible officials are not prepared to apply that recognition of an agency relationship to tax pooling intermediaries. There is no basis for that. The matter should be dealt with by Inland Revenue recognising its error and communicating with properly authorised tax pooling intermediaries to the extent necessary to make the tax pooling system work. However, if Inland Revenue really does not believe it can do that, the matter needs to be dealt with by amending the law. Logically such an amendment would have to deal with all taxpayer agents, not just tax pooling intermediaries.

Comment

Officials note that an amendment as proposed by the submitter (i.e. having the same status as tax agents in this regard and having access to tax payment details) does not have clear support from other submitters. Officials also note that Inland Revenue already has well-established processes which ensure that appropriate information is provided to tax pooling intermediaries and that contact with taxpayers and their authorised tax agents occurs in a timely manner to resolve any tax pooling transfer issues.

Section 81 imposes a statutory obligation of secrecy on Inland Revenue officers which requires a specific legislative exception before taxpayer-specific information can be released to any third parties. This is necessary to protect the integrity of the tax system and the perception of that integrity by taxpayers. The amendments to section 81 in the bill maintain the primacy of the secrecy obligations while allowing the Commissioner flexibility to fulfil tax administration duties.

That said, officials consider that the existing proposed amendment to the secrecy rules that relate to the Commissioner's ability to disclose information for tax administration purposes (clause 58 of the bill) would enable the provision of more information to a tax intermediary and enable the Commissioner to disclose information for the purpose of resolving the query. Officials will include this as an example in the proposed Standard Practice Statement.

Officials also note that the proposed amendments to remove restrictions for "own funds" and allowing purchased funds to be transferred on the expectation of a tax debt will significantly reduce the number of transfers that currently need to be queried. This will substantially reduce the amount of interactions currently required with tax pooling intermediaries.

Recommendation

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

Issue: Technical and drafting issues

Submission
(Tax Pooling Solutions)

1. Section RP17B(4)(a) refers to transfers being made "within 75 days from their terminal tax date". It implies that the transfer must be made between the terminal tax date and the date 75 days later and cannot be made prior to the terminal tax date. It should be amended to read "on or before the date 75 days after their terminal tax date".

2. Section RP 17B(4)(b), as amended by the bill, refers to funds being deposited by the taxpayer itself. This is inconsistent with other sections of the Income Tax Act which refer to intermediaries making a deposit in a tax pooling account "on behalf of" a person (for example, sections RP 17B(1) and RP 18(1)). Section RP 17B(4)(b) should be amended for consistency.

3. Sections RP 19 and 21 of the Income Tax Act refer to the tax pooling intermediary asking the Commissioner for transfers and refunds from the tax pooling account respectively. In practice, Inland Revenue always takes transfer and refund instructions from the intermediary's trustee and has confirmed to us in writing that they would never take instructions directly from the intermediary. This helps protect intermediaries' clients from fraud and is relied on by a number of our clients. The legislation should be amended to reflect current practice.

Comment

Drafting issue 1

Officials agree that the suggested clarification is appropriate.

Drafting issue 2

Officials agree that a clarification is appropriate to reflect that the taxpayer's intermediary makes the deposit of the taxpayer's funds into the tax pooling account on behalf of the taxpayer.

Drafting issue 3

Officials note that the tax pooling rules do not require a tax pooling intermediary to use an independent trustee, only that taxpayers' deposits are held in trust. Additionally at least one intermediary has chosen not to use an independent trustee and it would not be appropriate to remove this choice by requiring intermediaries to only provide instructions to Inland Revenue via a trustee.

Recommendation

Drafting issue 1
That the submission be accepted.

Drafting issue 2
That the submission be accepted, subject to officials' comments.

Drafting issue 3
That the submission be declined.

Issue: Deductibility of interest

Submission
(Ernst & Young, Tax Management New Zealand)

Section 120OE of the Tax Administration Act should be amended so that none of the section DA2 general limitations can apply to limit deductibility. *(Ernst & Young)*

Clause DB 3B of the bill should be amended to ensure that when a person pays to acquire a deposit, the portion of that payment that is deemed to be interest should be deductible under section DB 3B. *(Tax Management New Zealand)*

Comment

Officials agree that to the extent that fees paid to a tax pooling intermediary to purchase funds represent the interest component, they be deductible to the taxpayer. For the avoidance of doubt, the amount able to be deducted by a taxpayer should be treated as taxable income to the intermediary.

Recommendation

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

Issue: Amendments, to and reversals of, incorrectly requested transfers

Submission
(Matter raised by officials)

Officials propose an amendment to section RP 20 of the Income Tax Act 2007 to clarify that the Commissioner can decline to process, or amend, or reverse a tax pooling transfer.

Comment

Currently, when taxpayers ask their intermediaries to process transfers that do not comply with the tax pooling rules Inland Revenue will decline to process the transfer or amend the transfer to comply with the tax pooling rules. But in cases when a tax pooling transfer is found to be incorrect after it has been processed, Inland Revenue will amend the transfer or reverse it.

The Commissioner's authority to do so is inherent in that the transfer was not requested, or processed, in line with the tax pooling rules. For the avoidance of doubt, officials consider that the Commissioner's ability not to process, amend or reverse a tax pooling transfer should be explicitly set out in the tax pooling rules.

Recommendation

That the submission be accepted.

Issue: Additional amendments required

Submission
(Ernst & Young)

Section RP 17 of the Income Tax Act will need additional amendments to achieve the stated objective of extending access to tax pool funds for taxpayers with increased liabilities.

Comment

Officials consider that the proposed provision meets the policy intent and that no amendment is required.

Recommendation

That the submission be declined.

Other tax administration matters

AUTHORITY FOR THE COMMISSIONER OF INLAND REVENUE TO IMPOSE FEES FOR CREDIT CARD PAYMENTS

Submission
(Ernst & Young)

There should be legislative clarification that the proposed 1.42% fee for paying amounts by internet or telephone credit card transfers is not a "tax", "penalty" or "interest" and that it should be deductible if there is an appropriate taxable business nexus.

Comment

Clause 80 allows the Commissioner of Inland Revenue to charge a credit card fee on tax and social liability transactions. However, individuals based overseas who wish to pay their student loan and child support liabilities via credit card will not be charged the fee. This is to encourage compliance.

Clause 80 describes the credit card fee as a "fee for the service" which differentiates it from a tax, penalties or interest. Whereas tax is a Crown imposition the fee charged on credit card transactions in respect of tax and social liabilities is not – it is a fee passed on to taxpayers for using a credit card as a method of paying their tax or social liabilities.

Whether the credit card fee is deductible or not should be determined by current rules on deductibility.

Recommendation

That the submission be declined.

Remedial matters

SHAREHOLDER CONTINUITY: DIRECTORS' KNOWLEDGE PROVISION

Clauses 38 and 87

Issue: Support for amendments to the directors' knowledge provision

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

Submitters support the amendments to the directors' knowledge provision as simplifying a provision which has been difficult to apply.

Comment

Officials are pleased that submitters are supportive of the amendments, which are intended to provide more certainty and clarity on the scope of the directors' knowledge provision (section YC 15 in the Income Tax Act 2007 and section OD 5(5) in the Income Tax Act 2004) and provide more ease of application. This is achieved by removing minor off-market transactions, i.e. share transactions occurring outside a recognised stock exchange, from the scope of the provision.

Recommendation

That the submission be noted.

Issue: The directors' knowledge provision should be repealed

Submission
(Ernst & Young)

The directors' knowledge provision should be completely repealed in order to achieve the stated aims of removing uncertainty and reducing compliance costs.

Comment

Officials note that the objective underlying the amendments is to provide clarity and certainty to the existing provision. A complete repeal would require further consideration by officials and would not be consistent with the policy intent underlying the provision, which is that it is an anti-avoidance rule to prevent the structuring of share transfers to take advantage of the shareholder tracing concessions.

Recommendation

That the submission be declined.

Issue: Structure of directors' knowledge provision

Submission
(New Zealand Institute of Chartered Accountants)

The section structure of the directors' knowledge provision with conditions precedent set out in subsection 1(a), followed by an exclusion, should be changed as it makes interpretation difficult. Instead, the section should be replaced with a structure which sets out when the section applies and when it does not apply.

Comment

Officials acknowledge that the structure of the directors' knowledge provision does not provide ease of interpretation in certain areas. However, it is unclear that replacing the section with the structure suggested by the submitter would remedy this issue.

Recommendation

That the submission be noted.

Issue: Alternative approach suggested

Submission
(PricewaterhouseCoopers)

While it is acknowledged that amendments are required to the provision, it is submitted that the proposed amendments in the bill will create more complexity and uncertainty. The submitter suggests that the provision should instead be amended to exclude listed companies from its scope and provide that certain types of off-market transactions, such as dividend reinvestment plans and employee share schemes, are automatically ignored.

Comment

Officials disagree that the amendments contained in the bill will create more complexity and uncertainty than the status quo. The amendments will have the effect of providing that certain types of off-market transactions, such as dividend reinvestment plans and employee share schemes, are disregarded under the provision (subject to meeting the relevant thresholds).

Recommendation

That the submission be declined.

Issue: The word "sale" in new section YC 15(1)(b)(iv) should be replaced

Submission
(Russell McVeagh)

The word "sale" in new section YC 15(1)(b)(iv) should be replaced by "transfer", so that the section applies to transfers that are made for no consideration, such as gifts, settlements on trusts and inheritances.

Comment

Officials agree that transfers which are made for no consideration should also be included within the scope of new section YC 15(1)(b)(iv). This is consistent with the policy intent underlying the amendments.

Recommendation

That the submission be accepted.

Issue: The phrase "the company's shareholders" in new section YC 15(1)(b)(v) should be replaced

Submission
(Russell McVeagh)

In new section YC 15(1)(b)(v), "the company's shareholders" should be replaced by "any person", so that the section applies to a transfer of shares to a person who is not a shareholder prior to the transfer.

Comment

Officials agree, as the policy intent is that the section should apply to a transfer of shares to a person who is not a shareholder prior to the transfer – for example, employees.

Recommendation

That the submission be accepted.

Issue: Certain transactions not covered in new section YC 15(1)(b)(v)

Submission
(Russell McVeagh)

In new section YC 15(1)(b)(v), the word "transfers" does not pick up the issue or cancellation of shares, or the granting of options over shares.

Comment

Officials agree that the section should apply to other transactions involving shares, such as issues, cancellations, and the granting of options over shares. The policy intent is that the section should cover these types of transactions when the company is one of the parties.

Recommendation

That the submission be accepted.

Issue: Employee share schemes when shares are issued to a trustee

Submission
(Russell McVeagh)

The situation when shares are issued under an employee share scheme to a trustee of a trust which then (at a later time) transfers those shares to employees should be specifically addressed, as it would not be covered by the current wording of new section YC 15(1)(b)(v).

Comment

Officials understand that the above situation is a common occurrence. Accordingly, we agree with the submission given that it is consistent with the policy intent that minor off-market transactions such as employee share schemes should be covered by section YC 15(1)(b)(v).

Recommendation

That the submission be accepted.

Issue: Clarification of scope of new section YC 15(1)(b)(v)

Submission
(New Zealand Institute of Chartered Accountants)

The wording of proposed new section YC 15(1)(b)(v) means that it could apply to both on- and off-market transactions.

Comment

The policy intent is that subparagraph (v) should cover off-market share transactions involving the company as a party which in aggregate are less than 5 percent of the shareholding in a company in the income year. Officials consider that drafting changes arising from submissions should help to ensure that the legislation reflects the policy intent.

Recommendation

That the submission be noted.

Issue: Clarification on measurement of 5% limit in new section YC 15(1)(b)(v)

Submission
(Ernst & Young)

Further clarification is required on the time at which the 5% limit referred to in new section YC 15(1)(b)(v) is to be measured.

Comment

The policy intent is that measurement of the 5% limit is on an income-year basis. Officials consider that this is clear from the drafting of the new section. Officials would also note that section YC 15 as a whole applies at a time when a company does not meet the requirements of a continuity provision but for the application of the tracing concessions contained in sections YC 10 and 11. This is stated under section YC 15(1)(a).

Recommendation

That the submission be declined.

REMEDIAL AMENDMENTS TO TAX STATUS OF NEW ZEALAND SUPERANNUATION FUND

Issue: Support for amendments

Clauses 21, 39 and 40

Submission
(Guardians of the New Zealand Superannuation Fund)

We support the remedial amendments to clarify the New Zealand Superannuation Fund's tax status.

Recommendation

That the submission be noted.

Issue: Clarification that the Crown is resident in New Zealand

Clause 39

Submission
(New Zealand Institute of Chartered Accountants)

The proposal to clarify that the Crown is resident in New Zealand for tax purposes should not proceed because it is unnecessary and may result in unintended consequences or conflict with other enactments.

Comment

The amendment clarifies that the Crown is a resident of New Zealand. Under New Zealand's tax treaties, a condition for obtaining treaty benefits (such as lower withholding tax on foreign dividends) is that the recipient of the income must be resident in the other country.

In 1995 the OECD Model Tax Convention was amended to clarify that a government of a country was resident in that country. The Commentary to the Convention states that the 1995 amendment conformed to the existing understanding of most OECD countries.

Since 1995, New Zealand's treaty practice has been to include the OECD Model Tax Convention wording in its treaties. However, pre-1995 treaties do not always have this wording. This can leave the situation unclear. Amending New Zealand's domestic residence rules would be a useful clarification.

In terms of consequences for other branches or divisions of the Crown, it should be noted that this change simply codifies our current understanding that the Crown is resident in New Zealand, so it is difficult to see how this conflicts with other enactments. The proposed change to the residence rules will not affect the existing tax obligations or exemptions of other instruments of the Crown.

Recommendation

That the submission be declined.

Issue: Drafting

Clause 39

Submission
(New Zealand Institute of Chartered Accountants)

The drafting should be changed from "Her Majesty the Queen in right of New Zealand" to "Her Majesty in right of New Zealand in public office", or to "the Crown".

Comment

We consider that either "Her Majesty the Queen in right of New Zealand" or "the Crown" would be acceptable.

However, we note that the term "Her Majesty the Queen in right of New Zealand" is consistent with the reference to Crown-owned banking groups in proposed clause 57 of the Taxation (International Investment and Remedial Matters) Bill.

Recommendation

That the submission be declined.

PIE REMEDIALS

Issue: Definition of "land investment company"

Submission
(KPMG)

The definition of "land investment company" in section YA 1 of the Income Tax Act 2007 should be amended to accommodate intra-group financing between land investment companies and PIEs in the same tax group.

Comment

Officials agree that the PIE rules should accommodate intra-group financing between land investment companies and PIEs in the same tax group. Officials note that there are a number of ways this could be achieved. For example, the desired outcome could be achieved by amending the definition of "land investment company" (as suggested by the submitter) or by amending the grouping rules in subpart IC of the Act. Both would achieve the same result. Officials recommend that the drafters of the bill determine the best method for addressing this issue.

Recommendation

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

Issue: Single investor class for a listed entity

Submission
(KPMG)

When a listed entity becomes a multi-rate PIE there should be no restriction on the number of investor classes the entity can have.

Comment

Officials agree with the submission. Section HM 14(2) requires that if an entity is a company listed on a recognised exchange in New Zealand, it must have only one investor class of which each investor must be a member. This restriction should only apply to listed PIEs. Accordingly, we recommend that section HM 14(2) be amended to allow a listed entity that becomes a multi-rate PIE to have more than one investor class.

Recommendation

That the submission be accepted.

Issue: Voluntary payments of tax by a multi-rate PIE

Submission
(KPMG)

Section HM 45(1) should be amended to enable multi-rate PIEs to make voluntary tax payments even if an investor does not reduce their interest in an investor class of the PIE.

Comment

Officials agree with the submission. There is no policy reason to prevent multi-rate PIEs from making voluntary payments independent of whether an investor reduces their investment in a PIE.

Recommendation

That the submission be accepted.

Issue: Re-entering as a PIE (five-year rule)

Submission
(KPMG)

The Commissioner of Inland Revenue should have the discretion to waive (or reduce) the five-year restriction on re-entering the market as a PIE in circumstances where a fund loses PIE status, such as a result of an event outside of their control.

Comment

Officials see no reason to relax the five-year rule. The five-year rule prevents entities from becoming a PIE for five years if the entity failed to meet the investment or investor requirements. Accordingly, the five-year rule provides an appropriate incentive for PIEs to operate within the eligibility criteria. Nevertheless, the submitters have raised an important issue concerning the rules that apply when a PIE no longer meets the eligibility criteria and the consequences of this. Officials will consider these issues further.

Recommendation

That the submission be declined.

Issue: Loss of PIE status under section HM 25

Submission
(KPMG)

The date of the loss of PIE status specified in section HM 25(2) should be amended to be consistent with the date that operated before the PIE tax rules were rewritten.

Comment

Officials agree. Section HM 25(2) specifies the date of the loss of PIE status as the last day of the first quarter or, the last day of the second quarter – depending upon whether the failure to meet the requirements was significant and within the control of the entity. However, the provision that applied before the PIE rules were rewritten (section HL 15(2)), provided that the date for loss of PIE status was the first day of the following quarter in which the entity ceases to be eligible to be a PIE.

This change should be retrospective to the commencement of the rewritten PIE rules (1 April 2010).

Recommendation

That the submission be accepted.

Issue: Notice requirements to exiting investors

Submission
(KPMG)

The PIE rules currently require a PIE that performs its tax calculations quarterly to provide an investment statement to any investor that leaves the PIE. The notice must be given by the end of the month following the quarter in which the investor exited the PIE. This should be amended to apply only when the PIE has elected to treat the investor as a zero-rated investor (i.e. it has not made a voluntary tax payment in respect of the investor).

Comment

Official agree with the submission and recommended an amendment to section 31C(2) of the Tax Administration Act 1994 to resolve the issue. If the PIE has made a voluntary payment of tax on behalf of the investor, that investor does not need to include the income in their tax return. There is therefore no need for the PIE to provide income details to the investor in such a short time-frame. It is reasonable for PIEs in this situation to provide investor statements in the same time-frame required for non-exiting investors – by the 30 June that follows the relevant income year.

Recommendation

That the submission be accepted.

Issue: Māori authorities receiving imputation credits from PIEs

Submission
(PricewaterhouseCoopers)

A provision should be inserted in subpart OK to provide a credit to a Māori authority credit account when a Māori authority is attributed imputation credits by a PIE.

Comment

Official agree with the submission. Such an amendment would bring the treatment of Māori authorities in line with the treatment currently afforded to companies through section OB 9B, which provides that companies that are attributed imputation credits by a PIE receive a credit to their imputation credit accounts. The amendment will allow a Māori authority to effectively pass on imputation credits that it receives, thereby avoiding any double taxation.

Officials recommend the amendment be made retrospective to the beginning of the PIE regime, 1 October 2007. This will require amendments to both the 2004 and 2007 Income Tax Acts.

Recommendation

That the submission be accepted.

Issue: Prescribed investor rate – proposed new section HM 57B(1)

Clause 20

Submission
(Ernst & Young)

The proposed new section HM 57B(1) should refer to sections BC 2 to BC5 as well as to section BD 1(5).

Comment

Official see no reason for new section HM 57(1) to refer to sections BC 2 to BC5 (the core provisions). The core provisions in part B of the Income Tax Act 2007 apply to the entire Act. If reference was made to the core provisions, in this way, it would set a precedent for other new sections. This was not what was intended. The reason that section HM 57(1) refers to section BD 1(5) is to exclude it when a recent migrant calculates their prescribed investor rate.

Recommendation

That the submission be declined.

Issue: Grouping of listed PIEs for GST purposes

Clause 22

Submission
(Ernst & Young)

Clarification is required on whether or not the proposed limitation on the ability of listed PIEs to group with other companies for income tax purposes should also apply to their ability to group register for GST purposes.

Comment

New section IC 3(2C) provides that a listed PIE can only group with its wholly owned subsidiaries. Officials agree that this limitation should not prevent a group of companies that includes a listed PIE from grouping for GST purposes provided they meet the other relevant criteria.

This amendment would bring the grouping of listed PIEs for GST purposes in line with the treatment currently afforded to multi-rate PIEs. Accordingly, officials consider that an amendment to section 55 of the Goods and Services Tax Act 1985 is warranted to allow listed PIEs to be part of a group for GST purposes.

Recommendation

That the submission be accepted.

Issue: Potential double-counting of taxable income

Clause 19

Submission
(BDO Wellington Limited)

The remedial measure to ensure that taxable income is not double-counted should be made retrospective.

Comment

Officials agree with the submission. The bill amends the PIE rules to ensure taxable income is not double-counted when calculating a person's prescribed investor rate. This amendment currently has an application date of 1 April 2011. However, the possibility of this double-counting income has existed from the introduction of the PIE regime, 1 October 2007. Accordingly, we agree this remedial measure should have retrospective effect.

Recommendation

That the submission be accepted.

Issue: Investor size requirements – charities

Submission
(Tyndall Investment Management)

Registered charitable trusts should be permitted to hold more than 20 percent of a PIE.

Comment

Officials see no mischief in allowing a registered charitable trust to hold more than 20 percent of a PIE, nor should a charity be required to invest alongside at least 19 or more persons in each investor class, provided that all income derived by the charity is exempt under sections CW 41 or CW 42, which relate to the income of charities.

If this submission were accepted it would allow a charity to control a PIE. This would be contrary to the general principle that PIEs should be widely held. Previous submissions on this issue have been declined on this basis. This restriction prevents a person from controlling a PIE and using it as their own personal investment vehicle, as this could provide a tax advantage compared with investing directly.

However, after further consideration, officials consider that there is no mischief in allowing a charity to control a PIE if that income would be exempt regardless. The income would not be taxed whether income was derived directly or through a PIE. The mischief that the requirement to be widely held avoids, is therefore not apparent.

Recommendation

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

Issue: Section LS 2 – tax credit for trustees in a multi-rate PIE

Submission
(Matter raised by officials)

Section LS 2 should be amended to enable trustees who have chosen to have a non-zero prescribed investor rate (PIR) to receive a tax credit.

Comment

There is currently an error in section LS 2 that means a trustee who has chosen to have a non-zero PIR is unable to receive a tax credit for tax paid by the PIE when the PIE flows income through to the trustee. Section LS 2 requires that the trustee's income must not be deemed excluded income by section CX 56. However, CX 56(2) states that section CX 56 does not apply to trustees who have chosen a set rate. Consequently, an amendment to section LS 2 should be made to correct this error, therefore enabling trustees to receive a tax credit.

This change should be retrospective to the commencement of the rewritten PIE rules (1 April 2010).

Recommendation

That the submission be accepted.

Issue: Section HM 6(1)(a) – "other persons"

Submission
(Matter raised by officials)

The words "other persons" should be omitted from section HM 6(1)(a).

Comment

The reference to "other persons" is not necessary and its removal will enhance the clarity of the section. The removal of "other persons" will also make section HM 6(1)(a) better reflect the principles found in sections HG 1 and HG 2, which relate to the tax treatment of joint ventures and partnerships.

This change should be retrospective to the commencement of the rewritten PIE rules (1 April 2010).

Recommendation

That the submission be accepted.

Issue: Section HM 36(1) investor class

Submission
(Matter raised by officials)

The words "and an investor class" should be omitted from section HM 36(1).

Comment

The reference to "and an investor class" is not necessary and its removal will enhance the clarity of the section.

This change should be retrospective to the commencement of the rewritten PIE rules (1 April 2010).

Recommendation

That the submission be accepted.

Issue: Calculating transitional residence prescribed investor rate

Clause 20

Submission
(Matter raised by officials)

An addition should be made to the proposed new section HM 57B, providing that section CW 27 should also be disregarded for the purposes of calculating a person's prescribed investor rate (PIR).

Comment

Transitional residents (taxpayers who satisfy the requirements of section HR 8(2)) are able to treat foreign-sourced investment income as exempt under section CW 27. This reduces their New Zealand taxable income, enabling them to potentially select a lower PIR. This is not appropriate as PIEs are able to derive income from New Zealand. Officials therefore recommend that proposed new section HM 57B be amended so that the transitional resident exemption does not affect an investor's PIR.

Recommendation

That the submission be accepted.

Issue: Calculating amounts attributed to investors

Clause 17

Submission
(Matter raised by officials)

Further clarification is required for the proposed new change to section HM 36(3)(e)(i) specifically whether "ongoing" fees relate to the fund or the investor.

Comment

The bill replaces the words "ongoing management and administration" in section HM 36(3)(e)(i) with "ongoing management or ongoing administration". Officials recommend making a remedial change to clarify that "ongoing" refers to fees that are ongoing for the fund, not for the investor.

Recommendation

That the submission be accepted.

Issue: Revenue account investors in PIEs

Submission
(Matter raised by officials)

Revenue account investors that derive exempt income under sections CX 56B and CX 56C, which relate to distributions from PIEs, should not be allowed a deduction for the cost of their shares or units.

Comment

Officials recommend making a remedial amendment to clarify that revenue account investors cannot obtain a deduction for the cost of their shares or units when they are not taxable on the proceeds of those shares or units under sections CX 56B or CX 56C. As the proceeds of the shares or units are not taxed, their purchase should not be deductible.

Recommendation

That the submission be accepted.

LISTED PIES – GROUPING OF TAX LOSSES

Clause 22

Submission
(Ernst & Young)

The wording of proposed section IC 3(2C) "the PIE owns 100%" should be re-written as "the listed PIE owns 100%".

Comment

Officials consider that it is implicit in the wording of the proposed section that "PIE" refers to "listed PIE". Furthermore, the wording is consistent with that used in the section of the Act which contains restrictions on the grouping of multi-rate PIEs.

Recommendation

That the submission be declined.

IFRS PROVISIONS

Overview of submissions

The Taxation (Tax Administration and Remedial Matters) Bill includes remedial amendments to International Financial Reporting Standards (IFRS) legislation included in the Taxation (Business Taxation and Remedial Matters) Act 2007. The original legislation primarily affects the spreading of income and expenditure on financial arrangements. There were some minor aspects relating to other matters. All the remedial amendments in this bill in respect of IFRS relate to financial arrangements.

It is not intended that these changes represent a fundamental shift in policy regarding the original legislation. One submission suggested a ground-up rewrite of the legislation but it is not considered that is required at this point and any such move would need to be subject to wide consultation.

Issue: Integral fees where the modified fair value method applies

Clause 8

Submission
(Ernst & Young)

Subparagraphs EW 15(1)(a)(i) and EW 15(1)(b)(i) should be amended in a manner similar to that proposed in clause 8 of the bill for subparagraphs EW 15(1)(a)(ii) and (b)(ii).

The submitter has not provided a rationale for its proposal.

Comment

For IFRS taxpayers, the modified fair value spreading method is based on the fair value method. The consideration for the fair value method is defined to ignore non-integral fees (which is an accountant's term). The consideration for the modified fair value method should also ignore non-integral fees, but this was inadvertently not specified in the original legislation. The amendment is to correct that error.

The modified fair value method is not available to non-IFRS taxpayers and therefore amendments as proposed by Ernst & Young to the methods used by non-IFRS taxpayers are not relevant.

Recommendation

That the submission be declined.

Issue: Anti-arbitrage rules for the use of the fair value method

Clause 9

Submission
(Corporate Taxpayers Group)

The proposed amendment included in the bill should be extended to provide for:

- a method that follows the fair value methodology provided for in IFRS;
- an alternative method, if the alternative:
  - has regard to the purposes of the financial arrangement rules under section EW 1(3); and
  - is for a financial arrangement similar to one to which the method in Determination G29 may apply; and
  - results in the allocation to each income year of amounts that are not materially different from those that would have been allocated using the method set out in Determination G29.

The amendment should also be extended to apply to the Income Tax Act 2004.

Comment

Several amendments were made in 2009 to the anti-arbitrage rules. These rules are intended to prevent income and expenditure from being deferred or advanced on two financial arrangements which are in a designated hedging relationship (an accountant's term). However, in amending the rules the ability to use the fair value method for financial arrangements that are used to hedge other financial arrangements (being agreements for the sale and purchase of property in foreign currency subject to a determination method) was inadvertently denied. The amendment proposes to correct this error, allowing the fair value method to be used in these circumstances. The correction will be on very specific terms and we are not proposing to alter the application of the anti-arbitrage rules or the taxation of the agreements for sale and purchase of property in foreign currency under Determination G29.

The submitter's first two proposals go further than the remedial nature of the amendment intends, as the discussion in the submission is focused on agreements for sale and purchase of services and other financial arrangements similar to those dealt with by Determination G29. The widening of the scope of the rules in relation to other financial arrangements needs to be the subject of the usual tax consultative process and is outside the scope of these remedial amendments. Consideration of those matters will be given by officials at the earliest opportunity.

Officials agree with the third submission that the amendments be extended to apply to the Income Tax Act 2004.

Recommendation

That Corporate Taxpayers Group's first two submissions be noted, and that the third submission that the amendments be extended to apply to the Income Tax Act 2004 be accepted.

Issue: Timing of base price adjustment when changing from fair value method to another method

Clause 10

Submissions
(Ernst & Young)

Clarification is required as to the date at which the base price adjustment calculations must be performed and the date at which taxpayers must be treated as having paid market value amounts for the financial arrangements under section EW 46B.

Section EW 46B should also be amended to remove or replace the reference to the "date of change".

Comment

When taxpayers change from the fair value method to another spreading method they are required to perform a base price adjustment (BPA). The current rules state that this BPA is to be performed when the change of method occurs. The intended meaning of this is for taxpayers to perform the BPA at the end of the relevant income year; however, it is apparent that the current wording does not make this clear and is causing some confusion. Accordingly, the bill was intended to clarify this rule by explicitly stating that the BPA calculation is to be performed at the end of the income year in which the change of method occurs. However, section EW 46B was not amended in the bill and officials agree that amendments are necessary to give proper effect to the proposal.

Recommendation

That the submissions be accepted.

Issue: Review of subpart EW

Submission
(Ernst & Young)

Subpart EW should be generally reviewed in relation to application of its provisions.

Comment

Officials understand the nature of the submission to be a complete review of the rules for financial arrangements even though it is stated very briefly. A complete review of the rules would require considerable work and is not currently on the tax policy work programme. In the meantime the remedial changes should proceed.

Recommendation

That the submission be noted.

USE-OF-MONEY INTEREST DEDUCTIBILITY

Clauses 5, 6, 82, 83, 96 and 97

Issue: Agree with the proposal

Submission
(KPMG)

We support clarifying that use-of-money interest payable to Inland Revenue is deductible.

Comment

The amendment clarifies that use-of-money interest (UOMI) is deductible for tax purposes. The clarification will ensure that the policy intention when the UOMI rules were introduced is met, namely, that UOMI is deductible and that it ensures consistency, in particular between companies (for whom interest is generally deductible) and other taxpayers. The amendment will ensure symmetry in treatment for tax purposes so that UOMI is both taxable and deductible.

Recommendation

That the submission be noted.

Issue: Application date of the proposal

Submissions
(BDO Auckland, Ernst & Young, New Zealand Institute of Chartered Accountants, Staples Rodway Taranaki Limited)

The application dates for the new sections DB 3B (of the Income Tax Act 2004 and Income Tax Act 2007) and section DB 2 (of the Income Tax Act 1994) in the bill should be changed so they apply retrospectively from the enactment of the Act without any limitation. Inland Revenue should provide assurances it will amend any previous assessments when requested by taxpayers when UOMI has not been claimed (under section 113 of the Tax Administration Act 1994). *(BDO Auckland)*

The ability to claim deductions for UOMI in respect of the 2005–06 to 2009–10 income years should not be restricted to those who had claimed deductions in returns filed by 23 November 2010 (or in relation to the 2009–10 income year, had not filed their returns by that date). *(Ernst & Young)*

Taxpayers who have incurred UOMI (under the Tax Administration Act 1994 or the earlier Income Tax Act provisions) should be entitled to claim a deduction for any UOMI that has not already been claimed. *(New Zealand Institute of Chartered Accountants)*

The changes to the deductibility of UOMI should apply to taxpayers who sought the deduction in a notice of proposed adjustment rather than through a tax position taken in a return of income. *(New Zealand Institute of Chartered Accountants)*

Taxpayers who have conceded the deduction in Inland Revenue's favour should be entitled to have their assessment reopened. *(New Zealand Institute of Chartered Accountants)*

The amendment should also apply to taxpayers who at the date of introduction of the bill have a live dispute with Inland Revenue regarding the deductibility of UOMI. *(Staples Rodway Taranaki Limited)*

Comment

As currently drafted the amendment will apply retrospectively from the 1997–98 income year (the start of the UOMI rules) to taxpayers who have claimed deductions for UOMI in returns filed before the date of introduction of the amending legislation. The amendment will also apply to the 2010–11 and later income years.

To eliminate a taxpayer's exposure to shortfall penalties, a taxpayer can file a return on a conservative basis and then file a notice of proposed adjustment (NOPA) on a less conservative basis. As penalties are calculated by reference to the tax position taken in a self-assessment, rather than in a NOPA, the risk of shortfall penalties applying is negated.

As noted in the Institute's submission, a taxpayer who does not claim a deduction for UOMI in their return but does so in a subsequent NOPA, would not benefit from the amendment.

Officials agree with the submission and recommend the application date be changed to allow the amendment to apply also to taxpayers who claim a deduction for UOMI in a NOPA filed before 24 November 2010 (being the date the bill was introduced).

Officials do not agree with submissions proposing that the application date should be changed to allow a deduction for all taxpayers who have been subject to UOMI since 1996. Such an amendment could mean a large but unquantifiable number of assessments would need to be reopened. We are also concerned about the unbudgeted fiscal cost of such an amendment. If people have already claimed a deduction for UOMI, the amendment will not affect Budget forecasts; that is not the case for new deductions that have not previously been claimed.

Recommendation

That the submission that the application date should be changed to allow the amendment to apply also to taxpayers who claim a deduction for UOMI in a NOPA filed before 24 November 2010 be accepted.

That the submissions proposing the amendment should apply to all instances when the taxpayer has been subject to UOMI since 1996 be declined.

Issue: Time limitations on refunds should be turned off

Submission
(New Zealand Institute of Chartered Accountants)

The respective provisions of subpart RM that imposes the time limitations on refunds should be turned off.

Comment

Under section RM 2 of the Income Tax Act 2007, the Commissioner may refund tax if the four-year period for the amendment of an assessment has not ended. The four-year period can be extended to eight years in certain circumstances – for example, if the refund arises from a clear mistake or simple oversight of the taxpayer.

These amendments apply retrospectively from the 1997–98 income year (the start of the UOMI rules). Officials agree the time limitations on the Commissioner refunding tax should not apply to prevent these amendments being effective.

Recommendation

That the submission be accepted.

Issue: Relationship with the general limitations

Submissions
(BDO Wellington Limited, Ernst & Young)

If the policy intention is that UOMI should be tax deductible for all taxpayers, the proposed legislation should override the employment limitation. *(BDO Wellington Limited)*

Deductibility of UOMI should not be subject to any section DA 2 general limitations and all such limitations should be expressly excluded. *(Ernst & Young)*

Comment

As currently drafted, the amending provision overrides only the capital limitation. Officials agree with the BDO Wellington submission that the proposed legislation should also override the employment limitation. In addition, we consider the private limitation should be overridden. This will mean the new section is consistent with section DB 3 which allows for the deduction of expenditure incurred in calculating or determining tax liabilities.

Recommendation

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

That the second submission be declined.

Issue: Timing of the deduction

Submissions
(BDO Auckland, Ernst & Young, New Zealand Institute of Chartered Accountants)

Sections EF 4(2) to (4), EF 5 (2) to (4) and EF 6 of the Income Tax Act 2007, which set out the rules for determining in which income year UOMI is assessable or deductible, should be repealed. *(BDO Auckland, New Zealand Institute of Chartered Accountants)*

There should be clarification as to how the references to income years are intended to interact with section EF 5 (or its predecessors) and whether they refer to the income years to which the UOMI would be allocated or those in or for which the underlying income tax or other liability arose. *(Ernst & Young)*

Comment

As noted in the comments on the application date previously, currently the deduction is allocated to the same year to which the tax liability relates, the following year or to the income year following the income year in which the Commissioner issues the notice of amended assessment. If there is a dispute involving court proceedings which is eventually resolved in the Commissioner's favour, the current rules could inappropriately allocate the deduction to a year many years earlier than the year in which the interest is paid. The current rules also inappropriately allocate a deduction to the year of assessment in cases when the taxpayer simply fails to pay any relevant tax when the UOMI may not be paid until much later (if at all).

Officials recommend that the timing provisions be amended to provide for the deduction of UOMI in the year in which the UOMI is paid. We think this approach provides taxpayers with certainty on this issue and deals appropriately with the problematic cases described above.

Importantly, a paid approach is also consistent with the timing of assessability – UOMI is assessable in the year the Commissioner pays the interest. Officials have discussed this issue with the New Zealand Institute of Chartered Accountants, which is comfortable with this approach.

When a payment is received by Inland Revenue it is first allocated to interest (in accordance with section 120F(1) of the Tax Administration Act 1994). If the taxpayer is paying their debt off over time, deductions may need to be made in more than one year which officials acknowledge may increase a taxpayer's compliance costs. However, we consider that the approach recommended above is more taxpayer-friendly and appropriate than delaying the deduction of the UOMI until all of the debt has been paid.

Therefore, officials agree with the submission that sections EF 4(2) to (4) (which set out the timing for the assessability of UOMI) and sections EF 5 (2) to (4) and EF 6 (which set out the timing for the deductibility of UOMI) of the Income Tax Act 2007 should be repealed.

Officials do not consider that this amendment should be retrospective. We are concerned that there could be disputes currently in progress on the timing of the deduction and do not want to interfere with that process. These amendments should therefore apply for the 2011–12 and later income years.

Recommendation

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

INTER-CORPORATE DIVIDEND EXEMPTION

Clause 4

Issue: Application of the extension of the inter-corporate dividend exemption for Māori authorities

Submissions
(Corporate Taxpayers Group, PricewaterhouseCoopers)

The Group is highly supportive of the removal of the common balance date requirement from section CW 10. *(Corporate Taxpayers Group)*

1. The amendment should not apply retrospectively to Māori authorities. Alternatively, a Māori authority should be able to elect whether the amendment applies retrospectively.

2. A Māori authority should have the right to elect prospectively that the section does not apply to a future dividend.

Many Māori authority groups are made up of a Māori authority that is a company and a wholly owned corporate subsidiary or subsidiaries that may have different balance dates.

The proposed change will produce the following three unintended consequences and will adversely affect many Māori authorities that are companies and the members of those Māori authorities.

- The effective tax rate imposed on a Māori authority will differ depending on whether that Māori authority is a trust or a company.

- Members of a Māori authority that is a company will receive less cash from any distributions than would the beneficiaries of a Māori authority that is a trust and will suffer tax at the company rate of income derived by the Māori authority's subsidiary or subsidiaries.

- The retrospective application of the proposed change may mean that Māori authorities may, unwittingly through no fault of their own, have treated distributions incorrectly and underpaid provisional tax. *(PricewaterhouseCoopers)*

Comment

The amendment to section CW 10 has two policy objectives:

- to facilitate the movement of capital within a wholly owned group of companies, without taxation being a distortionary or inhibiting factor; and

- to reduce unnecessary compliance costs upon those companies having differing balance dates that use non-dividend methods to move capital around the wholly owned group company. These costs arise because at present, if the wholly owned groups of companies do not have the same balance date, the exemption in section CW 10 does not apply.

The amendment seeks to remove this common balance date requirement, as it is considered to serve no useful policy purpose.

In relation to the application of section CW 10 to Māori authorities, and the points raised in the submission, officials note that it is intended that the exemption in section CW 10 for dividends should apply to a Māori authority group that consists of a wholly owned group of companies.

Submissions 1 and 2 – PricewaterhouseCoopers

1. The removal of the common balance date requirement should not apply retrospectively to dividends derived by a Māori authority. Alternatively, that a Māori authority should be able to elect whether the amendment applies retrospectively.

2. Alternatively, that a Māori authority should be able to elect whether the amendment applies retrospectively.

Officials agree that the removal of the common balance date requirement from section CW 10 is intended to benefit taxpayers and not create an adverse consequence. We agree with the submitter that this amendment could give rise to adverse consequences for provisional tax and the ratio of Māori authority credits attached to distributions to members.

Officials agree that the amendment should not apply retrospectively for a Māori authority, and consider this should be made explicit in the application rule.

Officials do not consider that an elective approach to address retrospectivity is appropriate, as it is intended that section CW 10 should apply generally to a wholly owned group of companies that are all Māori authorities.

Submission 3 – PricewaterhouseCoopers

3. A Māori authority should have the right to elect prospectively that the section does not apply to a future dividend.

The submission seeks a change to the policy for the taxation of Māori authorities, to the effect that section CW 10 should not apply to wholly owned groups of companies consisting of Māori authorities.

The submission is made on the basis that the exemption for a dividend under section CW 10 will result in less cash being available for members and gives rise to a difference in the effective rate of tax applying to Māori authorities, depending on the whether the authority is structured as a trust or a company.

Officials consider this submission is seeking a change in policy for the application of the company taxation rules to Māori authorities. In addition, officials do not agree that amendment to section CW 10 will result in an adverse effect on either:

- the tax burden of a Māori authority that is a company; or
- the quantum of cash received by a member of a Māori authority.

A policy objective of the Māori authority rules is to ensure that the passing of income through these entities does not unduly give rise to income tax disadvantages for their members.

A comparison of the effect for a Māori authority (a company or a trust) deriving an exempt or assessable dividend from a subsidiary company is set out in Table 1. The table assumes that the same cash dividend is paid and maximum imputation credits are attached to the dividend.

Table 1: Year 1

	Dividend exempt MA Co	**Dividend assessable MA Co**	**Dividend assessable MA trust**
Subsidiary Co			
Cash dividend paid	700	700	700
IC attached	300	300	300
Māori authority			
Net income	0	1000	1000
Income tax liability	0	195	195
Less tax credit for IC	0	195	195
Terminal tax	0	0	0
Tax loss to carry forward (converted imputation credits)	0	538	538
Māori authority account balance at year end **	300	130	130
Cash available to distribute to members	700	700	700

** Māori authority credit 170 attached to taxable distribution

Table 1 illustrates that:

- The exemption under section CW 10 does not affect the amount of cash that a Māori authority may distribute to its members.
- There is no difference in the tax borne by a Māori authority when comparing the derivation of an exempt or assessable dividend. In each case, the underlying tax is borne by the Māori authority, and no additional tax is borne by the authority.
- The benefit of the imputation credits attached to all dividends derived by a Māori authority (whether exempt or assessable) is recorded in the Māori authority credit account, and is available to attach to taxable distributions to members.

Therefore, officials do not agree with the submitter that section CW 10 has an adverse effect on Māori authorities or members, and consider that the submission should be declined.

Recommendation

That:

- The submission from the Corporate Taxpayers Group in support of the amendment to section CW 10 be noted.
- The submission from PricewaterhouseCoopers that the amendment should not apply retrospectively to Māori authorities be accepted.
- The submission that alternatively, a Māori authority should be able to elect whether the amendment applies retrospectively be declined.
- The submission that a Māori authority should have the right to elect prospectively that the section does not apply to a future dividend be declined.

Issue: Grouping of attributed CFC net losses

Clauses 22B–22H

Submission
(Matter raised by officials)

Section IQ 4 should clarify that the effect of section IQ 2B must be taken into account in determining the amount of attributed in controlled foreign company losses that may be made available and used within a wholly owned group of companies.

Comment

The new CFC rules enacted in late 2009 introduced a policy change from comprehensive taxation of CFCs to taxation of their passive income only.

As a result of this change, it was decided that losses accumulated during the period of comprehensive taxation should effectively be given less than their normal value when used during the period of taxation of only passive income.

Section IQ 2B contains the transitional rules to achieve this effective write-down of past losses. Section IQ 2B applies to losses arising from the earlier taxation regime and carried forward under section IQ 1B. It is also intended that section IQ 2B should apply to a profit company in a wholly owned group of companies that receives the benefit of a grouped attributed CFC net loss.

This policy intention is implied in the calculation in section IQ 2B, because it adjusts losses arising under the comprehensive taxation rules by reference to the ratio of the group's total (old) comprehensive income to the group's attributed (passive) income. The policy reason for this rule is to prevent losses being transferred to obtain a tax advantage for the group as a whole.

Therefore section IQ 4 (grouping of attributed CFC losses) should be amended to provide consistency with section IQ 2B, to clarify that:

- section IQ 4 applies after the loss company has applied section IQ 2B; and
- if a loss company in a wholly owned group elects to make attributed CFC net losses available to a profit company in that wholly owned group, section IQ 4 should take into account the effect of section IQ 2B in determining the amount of loss made available or used within the wholly owned group.

As this amendment provides further clarification for the operation of section IQ 2B, officials consider this amendment should apply to all income years beginning on or after 1 July 2009, with a savings provision for taxpayers who have taken a tax position prior to the date of report-back of this bill, based on the current wording of section IQ 4.

Recommendation

That the submission be accepted.

BRANCH EQUIVALENT TAX ACCOUNT RULES

Clauses 29 and 31

Issue: Definition of "tax liability"

Submission
(Ernst & Young)

The definition of "tax liability" in proposed new sections OE 7(7)(b) and OP 101(4C)(b) of the Income Tax Act 2007 should be amended.

Comment

The bill makes various technical and drafting changes to improve the clarity of the branch equivalent tax account (BETA) rules and achieve consistency with the position under the Income Tax Act 2004. These include changes to clarify the formula for converting excess BETA debits – amounts covered by a valid election but not needed to offset an income tax liability – into a tax loss.

As currently drafted, the formula in the bill refers to the amount by which the valid election exceeds the income tax liability "for the attributed CFC income". The submitter correctly points out that the reference should instead be to the income tax liability of the relevant company, allowing for the offset of current-year domestic losses. This would be consistent with the position under the Income Tax Act 2004. Corresponding changes should also be made to sections OE 7(6) and OP 101(4B).

Recommendation

That the submission be accepted.

Issue: Section OE 7(8)

Submission
(Matter raised by officials)

Section OE 7(8) of the Income Tax Act 2007 will become redundant following enactment of the bill and should be repealed.

Comment

Once the amendments in this bill are enacted, sections OE 7(3) and OE 7(3B) will achieve the outcome that section OE 7(8) is intended to achieve. Accordingly, section OE 7(8) will become unnecessary. It should therefore be repealed with effect from the beginning of the 2008–09 income year. The bill already provides, at clause 31(7), for the equivalent repeal of section OP 101(5).

Recommendation

That the submission be accepted.

REMEDIAL AMENDMENT TO THE THIN CAPITALISATION RULES

Clause 13

Submission
(Ernst & Young)

The proposed change to the section FE 6 definition of "adjust" to refer to group finance costs should be expressed as applying only prospectively – for example, for income years beginning on or after 1 April 2011 (at the earliest).

Comment

There is an amendment in the bill to close a potential loophole in the thin capitalisation rules.

The thin capitalisation rules prevent multinational groups from taking excessive interest deductions in New Zealand and were broadened in 2009 to apply to New Zealand-headquartered multinationals. At that time, an exemption was provided if total interest deductions were less than a minimum amount.

The minimum threshold should have been calculated for an entire group of companies. We consider that this is the only interpretation that would make the exemption apply sensibly, but this is not reflected in the legislation. That is, the minimum threshold is currently calculated separately by each company within the group. The bill fixes this problem, with effect from the date of the bill's introduction.

The submitter has requested that the amendment not apply until enactment of the bill, or later.

We consider there is a balance to be struck between allowing taxpayers to rely on the law as in force on the one hand, and protecting the tax base from opportunistic behaviour on the other.

Some taxpayers may be unaware of the measure in this bill or of the fact that the existing legislation is not effective, and so may take a tax position (file tax returns) on the basis of the law as written until the amendment is in force and they see a new copy of the Act. This is perfectly reasonable behaviour.

However, other taxpayers who have become aware of the potential loophole since the publication of the bill may take advantage of it between introduction and enactment.

A compromise position which has been suggested to us by the Committee's independent advisor and which we are partly in favour of is to keep the current application date (the date of the bill's introduction) in general but prevent the amendment applying to tax positions taken before enactment of the bill.

We are proposing a slight variant of this position which would stop the amendment applying to a tax position taken before the report-back date of the bill. This would more effectively prevent opportunistic behaviour. There is some risk that some taxpayers acting in good faith could be caught unawares by the amendment (if they file a tax return before enactment). However, since the provision in question is quite technical and likely to apply only to taxpayers with commercial and business acumen, we consider this to be unlikely. We think it is a reasonable assumption that these taxpayers or their advisors who have to apply the provision (either in its current or amended form) would be aware of a tax bill that had been introduced.

Recommendation

That the submission be noted and that officials' alternative recommendation (that the amendment applies from the date of introduction but not to tax positions taken before the report-back date of the bill) be accepted.

CONTROLLED FOREIGN COMPANY REMEDIAL AMENDMENTS

Submission
(Matter raised by officials)

Some controlled foreign companies with income from a liability are taxed on that income when expenditure from the liability would not be deductible. This should be remedied.

Comment

New controlled foreign company (CFC) rules were introduced in 2009. Under those rules, investors in a CFC are taxed on the "passive" income of the CFC, such as interest or royalties. Other (active) income is not taxed.

We have become aware of a CFC that has had income from a liability. This is unusual, but has occurred because of a large foreign exchange gain on money the CFC has borrowed (the gain is larger than the interest expense on the loan).

Under the CFC rules, this income from a liability is treated in the same way as passive interest income and is therefore taxable. This tax treatment aligns with the treatment of financial arrangement income for domestic companies. However, special features of the CFC rules mean that foreign exchange losses on the same debt would not be deductible in the case we have seen. This differs from the tax treatment accorded to domestic companies.

This leads to an outcome in which every foreign exchange gain that exceeds interest expense is taxable, but any losses are non-deductible. Assuming movements in the exchange rate broadly average out over time, this leads to substantial amounts of tax being paid even though there is no gain ever realised. In the specific case we have seen, the tax liability is likely to be tens of millions of dollars.

There may be cases when it is appropriate to recognise income and deny deductions, but this case does not seem to be one of them.

We therefore recommend a remedial amendment to ensure that, in appropriate circumstances, income from an exchange rate gain on a liability may be either ignored or offset against corresponding losses in other years.

The amendment would apply retrospectively, to prevent unintended tax liabilities from arising.

We would make it clear that the amendment is an interim solution. The problem is affecting taxpayers now, so should be solved quickly but further consultation over time may lead to an improved legislative solution in future. We therefore recommend that the change should apply only temporarily (until the end of the 2012–13 income year) while further work is undertaken on the underlying policy issue.

Recommendation

That the submission be accepted.

Issue: Foreign shares held by active insurance CFCs

Submission
(Matter raised by officials)

Under the CFC rules, a New Zealand insurance company that uses a controlled foreign company (CFC) to conduct an insurance business offshore can apply to the Commissioner of Inland Revenue for a special exemption from the CFC rules. This is provided as a temporary measure until more detailed rules are developed for applying an active income exemption to active financial CFCs.

A core part of running an insurance business is investing in financial markets. This helps to ensure that the insurer has sufficient income to pay their policyholders when claims are made. Under the existing exemption for insurance CFCs, income from bonds held by qualifying insurance CFCs will be exempt, but income from foreign shares will not.

An exemption should be added to the foreign investor fund rules for foreign portfolio shares that are held by an insurance CFC that obtains the special CFC exemption.

Comment

Under the existing tax rules, we "look through" CFCs (including active CFCs) and attribute income from foreign shares held by a CFC as though the New Zealand investor held the foreign shares directly. In contrast, CFCs that hold bonds are treated as holding the bonds themselves.

As a consequence of this approach a New Zealand insurance company with an insurance CFC will be required to attribute income from any foreign shares that are held as part of the CFC's insurance business.

This result is inconsistent with the fact that no New Zealand tax will be payable on bonds when these are held by insurance CFCs that qualify for the special exemption.

Because the core business of insurance CFCs involves making investments in financial markets, it is not appropriate to tax foreign shares or bonds when these investments are used to support the insurance business.

One condition for getting the special exemption is that the CFC's investments must be commensurate with the insurance policies that the CFC sells in its jurisdiction. This prevents the CFC from holding an excessive amount of investment assets. The Commissioner of Inland Revenue would be able to revoke the exemption if this occurred.

The treatment of offshore insurance income will be reviewed in the context of the taxation of passive income earned by financial institutions. Officials intend to begin work on this later this year.

Recommendation

That the submission be accepted.

REMEDIAL CORRECTION: FIXED-RATE SHARES AND COMPARATIVE VALUE METHOD

Submission
(Matter raised by officials)

As part of the 2009 international tax reforms, dividends received by companies generally became exempt. An exception was fixed-rate shares held by companies which were defined as "fixed-rate foreign equity".

As part of this change an existing reference to "fixed-rate shares" was replaced with "fixed-rate foreign equity". This unintentionally limited the provision to fixed-rate shares held by companies (whereas previously it also applied to individuals and trustees). We recommend a retrospective remedial amendment be made to correct this.

A secondary issue is that there are a few references to "fixed-rate shares" in other parts of the Income Tax Act that are not mentioned in the definition of a fixed-rate share. It is therefore unclear whether this definition applies to these sections, and if so, which parts of the definition would apply as the definition of a "fixed-rate share" can have slightly different meanings in different parts of the Act. Some cross-references should be inserted to clarify this.

Comment

The fair dividend rate method, which is the standard way of taxing offshore portfolio investment, is not available for certain debt-like investments referred to in the legislation as "non-ordinary shares".

The definition of a non-ordinary share is contained in section EX 46(10). Section EX 46(10) used to refer to "fixed-rate shares". This was changed to "fixed-rate foreign equity" in 2009, which had the unintended consequence of limiting the provision to fixed-rate shares held by companies (whereas previously it also applied to individuals and trustees).

The unintended change should be reversed or some individual and trustee taxpayers will be under-taxed. Others (particularly those who make losses) will be over-taxed.

The reversal of the change should be retrospective, but should optionally not apply to people who have taken a tax position before enactment. This would ensure that taxpayers would not face any additional tax, whether they had been applying the rules as they were intended to be applied or applied them in accordance with the unintended change.

Recommendation

That the submission be accepted.

Issue: Thin capitalisation – apportionment of interest

Clause 13

Submission
(Ernst & Young, Matter raised by officials)

The wording of section FE 6(3)(a)(i) should be amended to apply prospectively. *(Ernst & Young)*

The effect of section FG 8(2) of the 2004 Act should be restored to section FE 6 as an addition to clause 13 of the bill. (*Matter raised by officials)*

Comment

In relation to the submission raised by Ernst & Young, the amendment corrects an obvious cross-reference error to section FE 14, which is a provision that is unrelated to section FE 6. The correction is necessary because the cross-reference to section FE 14 is obviously incorrect as the subject matter of section FE 14 is unrelated to the provisions of section FE 5.

Under the transitional provisions of the 2007 Act, where a legislative provision is unclear, taxpayers are directed to the corresponding provision in the 2004 Act to assist in interpreting the unclear provision in the 2007 Act. The corresponding provision in the 2004 Act cross-refers to the corresponding provision for section FE 3 in the 2007 Act.

In relation to the matter raised by officials: section FG 8(2) of the 2004 Act provided that, in relation to a wholly owned group of companies, the interest apportionment provided for under section FE 6 could be allocated electively across companies within the group of companies.

This matter is a rewrite maintenance item, as it has the effect of restoring a provision inadvertently omitted from the 2007 Act, which provided a compliance cost reduction measure for wholly owned groups of companies.

Officials consider this concessional measure should be restored to the 2007 Act with application from the 2008–09 income year.

Recommendation

That the submission from Ernst & Young be declined.

That the matter raised by officials be accepted.

Issue: Thin capitalisation and on-lending concession

Clause 14

Submissions
(Corporate Taxpayers Group, Ernst & Young)

The Group is supportive of the proposed amendment in clause 14 to ensure that the on-lending concession also applies to corporate taxpayers, as is the case in the Income Tax Act 2004. *(Corporate Taxpayers Group)*

Section FE 12(1) should be rewritten as "the debt percentages of a taxpayer's New Zealand group and world wide group are calculated under the rules set out in sections FE 13 to FE 1I". *(Ernst & Young)*

Comment

Officials agree that the drafting of section FE 12 could be improved, and that the suggested wording is a useful aid for the drafter's consideration.

Recommendation

That the submission that the drafting for the amendment to section FE 12 should be improved be accepted, subject to officials' comments.

Issue: Foreign tax credits

Clause 23

Submission
(Ernst & Young)

In addition to the amendments proposed to section LJ 1(2)(a), similar amendments are required to other provisions to ensure consistency throughout all relevant provisions.

Consequential amendments would also be required within sections LJ 1(1), LJ 2 and LJ 5 and YA 1 "foreign-sourced amount" to ensure consistency in the drafting.

Comment

This amendment replaces the words "not derived from New Zealand" with "sourced from outside New Zealand". The amendment is made to correct an unintended change in outcome in the legislation, and arises from a recommendation made by the Rewrite Advisory Panel.

The change in outcome identified by the Panel was that the existing words "not derived from New Zealand" excluded the possibility that an amount of income could have a source in a foreign jurisdiction and in New Zealand at the same time, because two different source rules applied. The Panel concluded that the 2004 Act allowed a foreign tax credit for foreign tax paid on income even if the income was also sourced in New Zealand.

Officials consider that the concept of "foreign-sourced amount" should not be amended. This term is fundamental to the operation of the policy of taxing income in New Zealand on a source and residence basis. In particular, if a non-resident derives a foreign-sourced amount it is not taxed in New Zealand. Therefore, the term "foreign-sourced amount" cannot possibly include income having both a New Zealand and foreign source.

Officials also consider that it is unnecessary to amend the concept of "segment of foreign-sourced income" to include a reference that it is sourced from outside New Zealand. The use of that concept in sections LJ 1(1), LJ 2, LJ 5 and LJ 7 is to connect the income with the foreign source with the foreign tax paid on that income.

Whether that income is also derived from New Zealand is irrelevant for that purpose, and would likely serve to confuse the reader.

Recommendation

That the submission be declined.

Issue: Further income tax payable for debit balance in imputation credit account

Clause 28

Submission
(Ernst & Young)

The formula proposed to be inserted in section OB 67 by clause 28 does not operate appropriately.

The proposed new section OB 67(2) should be rewritten as "in relation to two tax years that are consecutive, the liability for further income tax at the end of the second tax year is reduced by the first year adjustment" and paragraph (a) should be deleted from the proposed new section OB 67(2B). The proposed amendment to section OB 67(5) is not then required and should be deleted.

Comment

Officials agree that the drafting for the amendment to section OB 67 could be improved, and that the suggested wording is a useful aid for the drafter's consideration.

Recommendation

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

Issue: Rewrite Advisory Panel recommendations

Submission
(Matter raised by officials)

The following unintended changes in law identified by the Rewrite Advisory Panel should be corrected by further remedial amendments and be included in this bill.

Comment

Base price adjustment calculation – sections EW 31(4) and DB 11

The Rewrite Advisory Panel has identified that, in section EW 31(4) (in both the 2004 and 2007 Acts) and its related deduction provision in Part D, it is unclear whether the provision produces the same outcome as the corresponding provision in the 1994 Act.

Section EW 31(4) of the 2004 and 2007 Acts requires a taxpayer to perform the base price adjustment for a financial arrangement on disposal or maturity of that financial arrangement. The base price adjustment is a "wash-up" calculation, which requires a taxpayer to compare total cashflows (received and paid) under the terms of the arrangement against the income and deductions from that arrangement.

If the base price adjustment produces a negative result, the negative amount is treated as interest expenditure. The "normal rules for deductibility of interest" are applied to determine whether that negative amount is deductible (i.e. incurred in deriving income, or carrying on a business, or incurred by certain companies).

If any part of that negative result is not deductible under the "normal rules of deductibility for interest", then an automatic deduction is allowed to the extent the remaining negative amount represents a "reversal" of assessable income derived in prior years or in the current income year.

The Panel considers that it is unclear whether the 2007 and 2004 Acts provide the automatic deduction for a "reversal" of assessable income and that both Acts should be amended to remove this uncertainty, with retrospective effect to the beginning of the 2005–06 income year.

Officials agree with the Panel's conclusion and its recommendation on this issue.

Recommendation

That the submission be accepted.

Leases with inadequate rent – section GC 5 2007 Act

The Rewrite Advisory Panel has considered a submission that the scope of section GC 5 has been narrowed by using the term "a property" rather than the term "any property", as in its corresponding provision in the 2004 Act. The submission argued that the section could be read as constrained to leases of real property.

The Panel did not agree with the submission but suggested that section GC 5 be clarified to ensure that it is clear from the outset it applies to leases of real and personal property.

Officials agree with the Panel's conclusion and recommendation that the wording of section GC 5 should be improved.

Recommendation

That the submission be accepted.

Lump sum payments on the occasion of retirement – sections DC 1 and EA 4

The Panel has considered a submission relating to section DC 1 of the 2004 and 2007 Acts. This provision allows a deduction of lump sum payments made on retirement if they are not deductible under any other provision of the Act. The Panel has concluded that the provision contains an intended change in the timing rule when compared with the 1994 Act, and that change should be identified in the schedule of intended changes in both the 2004 and 2007 Acts. The Panel has also recommended that a form of savings provision be available if a taxpayer has taken a tax position based on the wording of the 1994 Act.

Under the 1994 Act, the corresponding provision to section DC 1 was amended in 2002. This amendment was to permit payments of monetary remuneration in the form of lump sum retiring payments made within the 63 days following the end of an income year to be deductible in that income year if the expenditure had been incurred and deductible in that income year.

However, section DC 1 and its corresponding earlier provisions did not apply to monetary remuneration as this is deductible on the basis it is incurred in carrying on a business.

The courts have identified a few limited circumstances to which section DC 1 applies. Examples of the types of payments that the courts have identified as deductible under this provision are:

- a payment to secure a restraint of trade (i.e. a capital payment, and a capital receipt for the former employee);

- a payment for expenditure incurred after the business has ceased (normally not deductible); and
- an ex gratia payment to a retiring employee (an ex gratia payment deductible under this provision has no connection to employment, nor is it incurred in carrying on a business).

As none of these types of payment are capable of being within the 63-day rule, the connection of section DC 1 to the 63-day rule is inappropriate, and the rewrite of the provision stated the deduction is timed on a payment basis. The Panel agrees this is the appropriate basis of timing these types of payments.

Officials agree with the Panel's conclusion and its recommendation to amend the intended changes schedule in the 2004 Act. However, officials consider that as there would then be no difference between the 2004 and 2007 Acts for section DC 1, it is unnecessary to note section DC 1 as an intended change in the 2007 Act. Officials agree with the recommendation to provide an appropriate savings provision for a taxpayer who has taken a tax position based on the wording of the 1994 Act.

Recommendation

That the submission be accepted.

Meaning of employee – sections RD 3, OB 1 "employee" and OB 2

The Panel has agreed with a submission that section RD 3 of the 2007 Act contains an unintended change in law affecting the meaning of "employee". A consequence of this unintended change is that shareholder-employee is not subject to fringe benefit tax because a shareholder-employee is not within the meaning of "employee", as defined in section YA 1 of the 2007 Act.

An employee is defined in the 2007 Act, broadly, as person who is entitled to receive income that is subject to PAYE. A shareholder-employee of a close company (company with five or fewer shareholders) may elect to opt out of the PAYE rules in relation to drawings taken from the company in anticipation of a salary being subsequently declared.

A shareholder-employee who opts out of the PAYE rules should be subject to the FBT rules. The Panel and officials agree that the 2007 Act does not achieve this outcome.

The Panel has recommended that the 2007 Act should be amended retrospectively to the beginning of the 2008–09 income year to correct this unintended change. The Panel also recommends that the amendment include a savings provision for taxpayers who have adopted a tax position based on the existing wording within section RD 3 for the period up to the Panel's decision on 30 November 2011.

Officials agree with the conclusions and recommendations of the Panel for this issue.

Recommendation

That the submission be accepted.

Calculation of taxable income and loss grouping – section BC 5 and IP 4

The Panel has considered a submission that the meaning of "subtracting an available tax loss from net income," does not mean the same thing as "offset against net income". In addition, the Panel has also considered a consequential submission that the part-year loss grouping rules may not restrict the use of part-year losses to not more than the net income of the group company for that same part-year.

The Panel did not agree with the submitter that there is an unintended change, but did note that the drafting of the part-year loss rule in section IP 4 could benefit from a minor clarification.

Officials agree with the Panel that there is not an unintended change, and also that he clarity of the part-year loss rule in section IP 4 could be improved with effect from the beginning of the 2008–09 income year.

Recommendation

That the submission be accepted.

Available subscribed capital account – section OZ 5

The Panel agrees with a submission that section OZ 5(1)(d) of the 2007 Act contains an unintended change. The change has arisen because the adoption of a positive phrasing for the provision in the 2007 Act has inadvertently resulted in a reversal of the outcome for the provision.

The Panel recommends that the drafting in section OZ 5(1)(d) be corrected retrospectively to the beginning of the 2008–09 income year.

Officials agree with the conclusion and recommendations of the Panel.

Recommendation

That the submission be accepted.

Issue: Minor maintenance items referred to Rewrite Advisory Panel

Submission
(Matter raised by officials)

The following minor drafting matters should be corrected by further remedial amendments and be included in this bill, with application to:

- the 2008–09 and later income years for amendments to the 2007 Act; and
- the 2005–06 and later income years for amendments to the 2004 Act.

Section	Act	Amendment
CD 32	ITA 2007	Correction to cross-reference.
CD 44(7)(b)	ITA 2007	Drafting error corrected.
DV 19(1), (4), (6)	ITA 2007	Drafting clarity improved for certain transactions with members of the association.
EC 16(3) EC 16(3)	ITA 2007 ITA 2004	Correction to cross-reference. Correction to cross-reference.
EF 5(2) EF 5(2)	ITA 2007 ITA 2004	Correction of terminology. Correction of terminology.
Subpart IQ IQ4	ITA 2007	Improve the introductory provisions for subpart IQ, which set out the purpose for subpart IQ (section IQ 1 — section IQ 2). Improve the clarity of section IQ 4, which permits the grouping of attributed CFC net losses.
LJ 7(4) LJ 8(5) LK 1(8)	ITA 2007 ITA 2007 ITA 2007	In each provision, clarify the time for due date of certain payments is 30 days after the later of the two options.
OB 80(2)	ITA 2007	Correction of terminology.
RD 5(8)	ITA 2007	Correction to cross-reference.
RD 6(1)(a)	ITA 2007	Correction to cross-reference.
80KF	TAA	Correction to cross-reference.

Comment

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;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

Recommendation

That the submission be accepted.

GST CHANGES

Overview

The Taxation (GST and Remedial Matters) Act 2010 enacted a number of changes to the Goods and Services Tax Act 1985, including:

- strengthening the GST rules to prevent "phoenix" fraud schemes by requiring vendors to zero-rate certain transactions that involve land;
- simplifying the change-in-use rules; and
- amending the definitions of "dwelling" and "commercial dwelling" to provide greater clarity over when GST applies to residential and commercial accommodation.

In the process of implementation consultation that followed enactment of the new rules, a number of issues have arisen that require legislative clarification. The following recommendations seek to ensure that the rules enacted by the Taxation (GST and Remedial Matters) 2010 Act operate as intended.

As the changes are for the purpose of clarifying the rules, it is recommended that most changes apply retrospectively.

Issue: Section 21F – input tax adjustment on disposal of goods or services

Submission
(Matter raised by officials)

Section 21F of the GST Act should be amended to take into account the new zero-rating rules.

Comment

Section 21F of the GST Act, which applies to supplies made on or after 1 April 2011, governs the availability of an unclaimed portion of the input tax on disposal of goods or services. Thus, if a person has used goods or services for mixed purposes and has not claimed the full input tax deduction, the person may be entitled to an additional input tax deduction if they dispose of those goods or services in the course or furtherance of a taxable activity.

The amount of the deduction that is available under the provision is calculated by reference to a formula. However, although the formula works as intended when the GST is charged at the standard rate on both the acquisition of goods or services and their subsequent disposal, it provides an incorrect result when the original acquisition or the subsequent disposal have been subject to GST at the rate of 0%.

Officials recommend that section 21F be extended to situations when the goods or services have been acquired or sold at the rate of 0%.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Entitlement to input tax deductions when the change in use is a result of the changes in the GST Act

Submission
(Matter raised by officials)

The change-in-use adjustment rules (as they apply to goods and services acquired before 1 April 2011) should be amended to allow input tax adjustments to be made when the change in use occurs as the result of the changes to the definitions of "dwelling" and "commercial dwellings".

Comment

Accommodation provided by GST-registered persons is generally taxable unless it is expressly treated as an exempt supply. The GST Act exempts the supply of accommodation in a "dwelling", but not accommodation that is in a "commercial dwelling". The main reason for exempting the supply of accommodation in a dwelling from GST, as described in the 1985 *White Paper on Goods and Services Tax*, was to ensure that those in rental accommodation were not disadvantaged compared with owner-occupiers. For this reason, the definition was intended to apply to situations when there was a reasonable level of substitutability between renting and owning a home.

This goal was arguably not being achieved because of the potentially wide interpretation of the definition of "dwelling". To ensure the clarity of the definition, the definitions of "dwelling" and "commercial dwelling" were amended in section 2(1) of the Taxation (GST and Remedial Matters) Act 2010.

The new definitions will have an effect, from 1 April 2011, of reducing the number of supplies that will be treated as exempt supplies of dwellings. Consequently, some suppliers of accommodation that were treated as exempt before 1 April 2011 will be required to start charging GST in respect of those supplies after 1 April 2011.

If a supplier has been treated as making exempt supplies of accommodation before 1 April 2011, they were likely not able to claim input tax deductions in respect of their acquisitions. If these suppliers are required to charge GST on their supplies after 1 April 2011, they should be able to claim input tax deductions on those previous acquisitions so that the GST cost is not unduly borne by the business.

An example is a GST-registered person who has several properties that are leased – some which were previously within the "dwelling" definition and some which were not. Under the narrower definition all properties will be in the GST net and will therefore give rise to GST when supplied as accommodation. In some cases, the GST liability will also be a result of the $60,000 registration threshold having been reached.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Section 78F – the requirement to provide a registration number of the recipient

Submission
(Matter raised by officials)

Section 78F should be amended to require a GST-registered recipient to provide their registration number to the supplier.

Comment

The new zero-rating rules, which will apply from 1 April 2011, will require a supply that involves land to be zero-rated for GST purposes when both the supplier and the recipient are registered for GST and certain other conditions are met.

As part of the process, section 78F requires the recipient to provide a statement in writing to the supplier on whether they are or expect, among other things, to be registered for GST.

In contrast, section 75(3B) requires the supplier of a zero-rated supply to maintain sufficient records to enable the registration number of the recipient to be ascertained.

Officials recommend that two sections be reconciled by amending section 78F to require the recipient to also provide their registration number (if they are registered for GST) to the supplier.

It is recommended that the proposed change should apply from the date of enactment of the Taxation (Administration and Remedial Matters) Bill.

Recommendation

That the submission be accepted.

Issue: Information requirements for zero-rating transactions that involve undisclosed agencies

Submission
(Matter raised by officials)

The GST Act should be amended to allow an agent for an undisclosed principal to make limited representations to the supplier for the purposes of the zero-rating rules.

Comment

To help the supplier decide whether a supply of land should be zero-rated, section 78F requires the recipient to provide to the supplier the information regarding their registration status and intentions in respect of land. Officials have also recommended earlier in this report that the recipient should provide the registration number to the supplier.

In making their acquisitions, a purchaser may use an agent to acquire the goods or services on their behalf. In some situations, the agency may be done on the basis that the identity of the de facto purchaser (i.e. the principal) will remain unknown to the supplier.

The purpose behind the undisclosed agency will be defeated if, in order to zero-rate the supply of land, the undisclosed principal has to reveal their identity and provide their registration details to the supplier. Moreover, since in undisclosed agency situations the supplier will be unaware of the identity of the recipient, the supplier will not be able to satisfy the requirements in section 75(3B) to maintain sufficient records to enable them to ascertain the name and address of the recipient and the registration number of the recipient.

To ensure that the information requirements for the zero-rating rules do not obstruct commercial practices, it is recommended that when an undisclosed agency is involved, the name, address and registration number of the recipient is not required to be provided to the supplier but:

- The agent for the undisclosed principal must be registered for GST at the time the binding agreement for sale and purchase is concluded.
- The agent will be required to maintain the name, address and registration number of the principal.

- The supplier must maintain the name, address and registration number of the agent.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Exclusion of certain dwellings from zero-rating rules

Submission
(Matter raised by officials)

The GST Act should be amended to deem the supply of land that falls under section 14(1)(d) to be separate from the supply of any other real property included in the supply.

Comment

Section 14 lists supplies that must be treated as exempt supplies for GST purposes and includes a sale by the registered person, in the course of or furtherance of their taxable activity, of a dwelling that has been used for making supplies of accommodation for a period of five years or more before the date of supply.

The new zero-rating rules which apply from 1 April 2011 will require a supply that involves land to be zero-rated if certain conditions are satisfied. In theory, a sale of land that falls under section 14(1)(d) would also be zero-rated if it were supplied as part of a larger supply of land.

There are no policy reasons for zero-rating rather than exempting such supplies of land used for dwelling. Therefore, it is recommended to amend the legislation to deem the supply of land that falls under section 14(1)(d) to be a separate supply from the supply of any other real property included in the supply.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Section 21B – input tax deductions in respect of taxable use by partnerships

Submission
(Matter raised by officials)

The application of section 21B should be extended to situations where the person's partnership uses the goods and services for making taxable supplies.

Comment

As part of the changes enacted in the Taxation (GST and Remedial Matters) Act 2010, section 21B allows a registered person to claim input tax deductions for goods and services purchased by them before registration.

The section applies when, before becoming a registered person, a person acquires goods and services that were subject to GST, and later registers for GST and uses the goods and services for making taxable supplies.

In some situations the person may, however, conduct their business through a partnership and allow the partnership to use, in making taxable supplies, the goods and services that were acquired by the person when they were not registered. To ensure that the business choice of acting through a partnership does not prevent the input tax from being claimed, it is proposed to extend the application of section 21B to situations where the person's partnership uses the goods and services for making taxable supplies.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Drafting amendment in section 11(8C)

Submission
(Matter raised by officials)

A drafting amendment is required in section 11(8C).

Comment

New zero-rating rules introduced by the Taxation (GST and Remedial Matters) Act 2010 apply to supplies made "on or after" 1 April 2011.

Section 11(8C) which allows, subject to certain conditions, to elect to apply the new rules before 1 April 2011, refers to the time of supply that is "after" 1 April 2011.

To ensure consistency with related provisions in the Act, section 11(8C) should be amended to refer to "on or after" 1 April 2011.

It is recommended that the proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Application of the definition of "principal place of residence"

Submission
(Matter raised by officials)

The definition of "principal place of residence" should be amended to clarify that it has different respective meaning under the zero-rating and apportionment rules.

Comment

A number of provisions in the GST Act, namely those concerned with the definition of "dwelling" and the zero-rating of supplies that involve land, use the term "principal place of residence". However, although the term used is the same, it is intended to have slightly different meanings within the context of different provisions. Thus, in the context of the definition of "dwelling" the "principal place of residence" is intended to mean premises which are being supplied as accommodation to a person and which the person occupies as their main residence for the duration of the agreement. In the context of the zero-rating provisions, the "principal place of residence" is intended to indicate land which is used by its owner or their relatives as their main place of residence.

Section 2(1) is the definitions section of the GST Act. Among other things, it defines the "principal place of residence", as the term should be understood in the context of the definition of "dwelling". However, owing to an oversight, the definition is also stated to apply to the zero-rating provisions in the GST Act.

It is recommended to amend the definition of "principal place of residence" by deleting references to the zero-rating sections of the GST Act.

The proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

Issue: Application of the definition of "land"

Submission
(Matter raised by officials)

The definition of "land" should be amended by deleting references to the apportionment rules sections of the GST Act.

Comment

For the purposes of the recently enacted zero-rating rules, to reduce any uncertainty regarding which transactions should be treated as involving "land" and to ensure that most land-related supplies that give rise to "phoenix" fraud concerns are zero-rated, section 2(1) was amended to include a new definition of "land". The new definition of "land" is very broad.

The term "land" is also used in a number of provisions concerned with the apportionment of input tax. In the context of those sections, "land" is intended to be interpreted more narrowly.

Owing to an oversight, the definition of "land" in section 2(1) is also stated to apply to the apportionment provisions in the GST Act.

It is recommended to amend the definition of "land" by deleting references to the apportionment sections of the GST Act.

The proposed change should apply retrospectively from 1 April 2011.

Recommendation

That the submission be accepted.

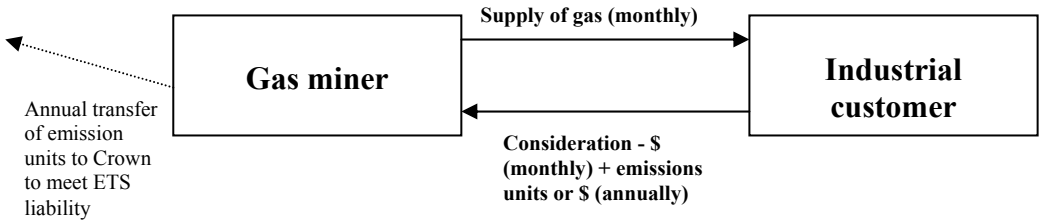
GST TREATMENT OF CERTAIN EMISSIONS UNITS TRANSACTIONS

Submission
(Mitsui E&P Australia Pty Ltd, New Zealand Oil and Gas Ltd)

Contracts between gas suppliers and gas purchasers where one element of the consideration is a future supply of emissions units give rise to valuation and timing issues. These issues could be addressed by allowing parties which are GST-registered and fully taxable to agree the value of goods and services.

Comment

Businesses which mine natural gas for domestic consumption have an obligation under the New Zealand Emissions Trading Scheme (ETS) to surrender emissions units to the Crown. Some of those businesses supply gas to large industrial consumers, including electricity generators. A number of suppliers are requiring their customers to pay consideration for their gas supplies in both cash and emissions units. This is illustrated by the diagram below.



The Goods and Services Tax Act 1985 values a supply by reference to the market value of the consideration paid for it. This would be straightforward if the emissions units were supplied straight away – the value of the supply of gas would be the cash paid and the value of the emissions units. Valuation difficulties arise here because the emissions units are to be supplied in the future – potentially as long as 15 months after invoicing for the supply of gas. It is difficult to value the future supply of emissions units – the price of emissions units varies according to supply and demand, and there are few derivative transactions in emissions units in New Zealand which could be used as a reference.

When one GST-registered business makes a taxable supply of goods or services to another GST-registered business (which acquires that taxable supply for the purpose of making taxable supplies itself), the output tax liability of the supplier is exactly matched by the input tax liability of the recipient. Accordingly, the value at which that supply takes place is largely immaterial from a revenue perspective.

This is already recognised in provisions which deal with transactions between associated persons when the recipient acquires the supply for the principal purpose of making taxable supplies. Our view is that this principle can be extended to the situation raised by the submitters.

Recommendation

That the submission be accepted.

DEPRECIATION MATTERS – SCHEDULE 39: "FISH PROCESSING BUILDINGS"

Submission
(Deloitte)

Schedule 39 of the Income Tax Act 2007 should be amended to include "fish processing buildings". Other assets that should also be considered for inclusion are "grandstands and other racecourse buildings" and "tannery buildings" affected by acid.

Comment

This submission relates to changes introduced in Budget 2010 legislation and has effect from the beginning of the 2011–12 income year. Officials agree with the submission concerning "fish processing buildings" and "tannery buildings" affected by acid. Schedule 39 lists items that are special excluded depreciable property – i.e. buildings that are excluded depreciable property are similar to buildings with estimated useful lives of less than 50 years. Special excluded depreciable property continues to be depreciable at its existing depreciation rate after the 2011–12 income year.

According to historic depreciation rates, "fish processing buildings" have a diminishing value depreciation rate of 6%. This is in line with other items currently listed in schedule 39. In addition, officials understand that "fish processing buildings" are similar to "buildings with prefabricated stressed-skin insulation panels", which have an estimated useful life of 33.3 years. Consequently, fish processing buildings should be included within the schedule 39 list of special excluded depreciable property.

"Tannery buildings" affected by acid are regarded as having an estimated useful life of 33.3 years and therefore should also be included in schedule 39.

The current depreciation rate for "grandstands and other racecourse buildings" is based on an estimated useful life of 50 years. Therefore, these buildings should not be included in schedule 39.

Recommendation

That the submission be accepted, in relation to fish processing buildings and tannery buildings affected by acid.

"TAX ADVISOR" DEFINITION

Issue: Inconsistencies arising from the definition of "tax advisor"

Submission
(New Zealand Law Society, Russell McVeagh)

The Tax Administration Act 1994 should be amended to address inconsistencies arising from the fact that legal practitioners are not within the definition of "tax advisors". Amendments should be made to allow:

- Legal practitioners to make statutory declaration required for "tax contextual information" when claiming the non-disclosure right in respect of tax advice documents. This is a procedural change, and it does not affect the scope of the non-disclosure right nor the requirement to disclose tax contextual information.
- A defence to the imposition of a penalty for not taking reasonable care of reliance on a legal practitioner's advice, consistent with the existing rule for reliance on a tax advisor's advice.

Comment

Officials note that this submission raises issues that would require further analysis as part of the Government's tax policy work programme.

Recommendation

That the submission be noted.

Issue: Non-disclosure right should apply, however the Commissioner obtains the information

Submission
(New Zealand Law Society)

The non-disclosure right should apply, however the Commissioner obtains the information, whether directly under the Commissioner's powers or through exchanges of information with other government departments.

Comment

Officials note that this submission raises issues that would require further analysis as part of the Government's tax policy work programme.

Recommendation

That the submission be noted.

REFUND OF OVERPAID TAX PAID ON BEHALF OF POLICYHOLDERS

Issue: Amendment required

Submission
(Deloitte on behalf of TOWER Limited)

Change is needed to the Income Tax Act 2007 to allow the refund of overpaid tax paid on behalf of policyholders for tax liabilities created under the former taxation rules for life insurance business.

Comment

Officials have discussed the question of refunding overpaid tax balances with the taxpayer concerned. The solution proposed by the submitter raises broader policy questions about the extent to which tax credits created by tax payments, for example – imputation credits, should be generally refundable.

Officials consider that the submitter's proposed solution requires additional thought and should not be included in this bill at this time.

Recommendation

That the submission be noted.

WORKING FOR FAMILIES – DEPENDENT CHILDREN'S INCOME

Submission
(Matter raised by officials)

A change is required to remove an anomaly in the legislation relating to income assessed for Working for Families (WFF) tax credits. Legislation was enacted in 2010 to take into account a dependent child's investment income that is above a threshold of $500 a year when determining eligibility for WFF tax credits.

Eligibility for WFF tax credits is based on "family scheme income". The current legislation counts the children's income in both the family scheme income of the principal caregiver and then again in the family scheme income of their spouse, civil union partner or de facto partner. Therefore, it is counted twice.

Section MB 11 of the Income Tax Act 2007 should be amended to prevent such double counting of the dependent children's income.

Comment

The amendment will remove an anomaly in the legislation and ensure that the dependent children's income for the WFF tax credit purposes be counted once for a family unit.

The amendment should apply from 1 April 2011.

Recommendation

That the submission be accepted.

PROCEDURE IN DISTRICT COURT WHEN DEFENDANT ABSENT FROM NEW ZEALAND

Submission

(Matter raised by officials)

Section 159 of the Tax Administration Act 1994 should be updated to refer to filing a "notice of claim" rather than posting a "duplicate or sealed copy of the summons".

Comment

Section 159 of the Tax Administration Act 1994 states that:

> … in an action in a District Court for the recovery of tax, if the defendant is absent from New Zealand or cannot after reasonable inquiry be found, service of the summons may, with the leave of a District Court Judge, be effected by posting a duplicate or sealed copy of the summons in a letter addressed to the defendant at the defendant's present or last known place of abode or business, whether in New Zealand or elsewhere.

The provision refers to the posting of the duplicate or sealed copy of "the summons". However, the current District Court Rules 2009 provide that a plaintiff starts a proceeding by filing a "notice of claim".[1]

The use of the word "summons" appears to relate to rule 74 of the District Court Rules 1948 whereby ordinary and default actions by a plaintiff were begun with a form of summons and plaint note. It appears updates to section 159 of the Tax Administration Act 1994 were overlooked when the changes were made to the rules governing civil procedure used in the District Court under the District Courts Rules 1992 and subsequently the District Courts Rules 2009. This means that that when the Commissioner is making an application pursuant to section 159 of the Tax Administration Act 1994, an additional application is required requesting that the Judge consider that the words "Notice of Claim" be substituted for "summons" in section 159.

The words "the summons" in section 159 of the Tax Administration Act 1994 should be replaced with "a notice of claim".

Recommendation

That the submission be accepted.

[1] Rule 2.10 District Court Rules 2009.

ERROR IN THE DRAFTING OF THE MĀORI AUTHORITY TAX TABLE

Submission
(Matter raised by officials)

An amendment is needed to correct an error in the tax rates in the Māori authority tax table in the Income Tax Act 2007, as a result of tax rate changes made by the Taxation (Budget Measures) Act 2010.

Comment

Table 4 of schedule 1 of the Income Tax Act 2007 sets out the resident withholding tax rates for taxable Māori authority distributions. The "default" rate, which applies when a member has not provided their IRD number, is the maximum personal marginal rate of 33%. When an IRD number has been provided, the withholding rate is the Māori authority rate of 17.5%. These rates are correct.

However, Table 4, in setting out the conditions for which the lower rate can be used, provides that the distribution "does not meet the condition for the 0.38 rate in row 2". The reference to the 38% rate is an incorrect reference to the previous highest marginal rate. This reference was overlooked when the personal tax rate changes announced in Budget 2010 came into force. In other words, following enactment of the Taxation (Budget Measures) Act 2010, there is no 0.38 rate in row 2.

To avoid any confusion, and to remedy an obvious error, officials submit that the reference to the "0.38 rate in row 2" be amended to the "0.33 rate in row 2".

Recommendation

That the submission be accepted.