Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Bill

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

April 2019

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CONTENTS

GST on low-value imported goods

OVERVIEW

In principle, Goods and Services Tax ("GST") should apply to all consumption that occurs in New Zealand, as this ensures that the system is fair, efficient and simple. Under the current rules, however, GST is not typically collected on imported goods below the customs *de minimis* of $60 of duty owing (this typically equates to a parcel with a value of $400 if GST is the only duty).

When GST was introduced in 1986, few New Zealand consumers purchased goods from offshore suppliers, and online shopping did not exist. At that time, the compliance and administrative costs that would have been involved in taxing imported goods under the *de minimis* outweighed the benefits of taxation.

The growth of e-commerce means the volume of imported goods on which GST is not collected is becoming increasingly significant. Many are concerned that the current tax settings place New Zealand suppliers of low-value goods at a competitive disadvantage relative to offshore suppliers. The non-collection of GST on low-value imported goods has also resulted in a growing gap in New Zealand's GST revenue base (estimated to be around $130 million in 2017–18).

The amendments proposed in the Bill apply GST to imported goods valued at or below $1,000 supplied by offshore businesses to consumers in New Zealand. They would require the offshore supplier to register for and return GST on these supplies. Offshore suppliers may have the option to also charge GST on their supplies of goods over $1,000 to consumers in New Zealand.

The New Zealand Customs Service ("Customs") will cease to collect any form of duty on consignments valued at $1,000 or less, except for tobacco products or alcoholic beverages. Customs will however continue to collect GST and other duties on imported parcels valued above $1,000 and undertake risk assessment on all consignments for prohibited goods and accurate valuation. The proposed amendments contain rules to prevent double taxation by requiring Customs to not collect GST on goods that have already had GST collected on them at the point of sale by the offshore supplier.

Offshore suppliers would not be required to return GST on supplies to New Zealand GST-registered businesses, nor would they be required to provide tax invoices. Furthermore, as with domestic suppliers and offshore suppliers of remote services, offshore suppliers would only be required to register for and return GST when their taxable supplies to New Zealand consumers exceed $60,000 in a 12-month period.

A range of other amendments are also proposed focusing on implementation. The overall package of amendments is intended to maintain the broad base of New Zealand's GST system and to create a level playing field between domestic and offshore suppliers of low-value goods.

Submissions expressed general support for collecting GST on low-value imported goods supplied by offshore businesses. However, a number of submitters expressed the view that the proposed application date of 1 October 2019 does not provide enough time for offshore suppliers and electronic marketplaces to make the required systems changes. In addition, several submitters consider that where double taxation occurs (that is, GST is collected by both the supplier at the point of sale and by Customs at the border), the responsibility for providing a refund should not be on the supplier, but instead either Customs or Inland Revenue should provide refunds to consumers.

The proposed rules for electronic marketplaces were another major focus in submissions, with a number of submissions noting that the proposed regime imposes a significant compliance burden on operators of electronic marketplaces.

Other submissions suggested technical changes to improve the certainty or practicality of the rules. This included suggestions for allowing the affected suppliers more flexibility with how they apply the rules to accommodate their different business models and processes.

All legislation references within refer to the Goods and Services Tax Act 1985, unless otherwise noted.

GENERAL SUBMISSIONS

Clauses 4 to 19 and 23 to 39

Issue: General support for collecting GST on low-value imported goods

Submission
(Amazon, CAPEC New Zealand, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Gurpreet Gill, KPMG, PwC, Retail NZ, Steve Cornwall, Trade Me)

Most submitters expressed in-principle support for applying GST to low-value imported goods supplied by offshore suppliers to New Zealand consumers.

A number of these caveated their support with specific concerns, which are set out below.

Some submitters specifically expressed support for the proposed offshore supplier registration system. *(CAPEC New Zealand, Gurpreet Gill, Retail NZ)*

Comment

Officials welcome the support but acknowledge the concerns with various aspects of the GST proposals. This report notes the specific concerns raised by submitters as separate issues.

Recommendation

That the submission be noted.

Issue: Not in favour of the proposed collection model/other collection models preferred

Submission
(Alibaba and eBay, Amazon, Chartered Accountants Australia and New Zealand, Ian Sanders, R Perry, Sven Frontin-Rollet, Trade Me)

Submitters expressed a range of different concerns with the proposed offshore supplier registration system, most notably around the potential impacts on trade and consumers' access to goods from offshore.

Some of these submitters disagree with the rationale for the proposals, noting there are non-tax reasons why consumers shop online from offshore suppliers and that in many cases the goods are simply not available within New Zealand. *(Ian Sanders, R Perry, Sven Frontin-Rollet)*

Others have expressed in-principle support for collecting GST on low-value imported goods but consider there are fundamental problems with the proposed collection model *(Amazon, Trade Me)*. As outlined below, three submitters have referenced alternative collection models based on collection by goods transporters (that is, freight carriers and New Zealand Post) or an extension to the existing border collection system, which they consider would better achieve the Government's objective of competitive neutrality between domestic and offshore suppliers with less unintended consequences *(Alibaba and eBay, Amazon, Trade Me)*. One submitter felt that other options (based on collection at the border or collection by goods transporters) were not fully considered *(Trade Me)*.

Four submitters were concerned that the proposals (if enacted) may result in some suppliers and electronic marketplaces ceasing to ship goods to New Zealand, or reducing the range of products they ship to New Zealand. *(Alibaba and eBay, R Perry, Sven Frontin-Rollet, Trade Me)*

While being generally supportive of the proposed offshore supplier registration system, one submitter considered it to be an interim solution that will eventually be superseded by technology that will allow the government to receive information about the flow of goods in real time and impose tax accordingly. *(Chartered Accountants Australia and New Zealand)*

Comment

A number of alternative collection models – including lowering the *de minimis* under the existing collection system and collection by goods transporters – were analysed by officials. Collection by Customs or by goods transporters were also both considered by the Tax Working Group which, consistent with the finding of the Productivity Commission in Australia, concluded that offshore supplier registration is the most viable model at present for collecting GST on low-value imported goods. This finding is also consistent with New Zealand officials' own analysis, which found that the total cost of collection would likely exceed the extra revenue collected and the flow of goods across the border would be impeded, potentially resulting in significant delivery delays for consumers and substantial costs for the goods transportation industry.

The extent to which collection by transporters may eventually become a viable alternative is uncertain. At present, the current lack of electronic advance data in the international postal system poses a major limitation. Even once electronic advance data becomes fully available in the international postal system, the extent to which the *de minimis* could realistically be lowered under a logistics-based collection model is not clear. Given the overwhelming majority of goods imported by consumers are valued at less than $150, there is a chance that any feasible reduction in the *de minimis* under such a system may not be sufficient to address the problem. However, officials will continue to monitor developments to see if this model (as well as other models) may become a superior option in the future.

Officials acknowledge the risk that consumer choice, trade and competition may be adversely affected if compliance is too onerous for offshore suppliers and marketplaces. To minimise this risk, the proposals in the Bill have been designed to minimise compliance costs to these businesses as much as is practicable. Officials are encouraged by the direct engagement that has taken place to date with businesses affected by the proposals, who have made it clear in their discussions with officials that their intention is to comply with the rules.

Officials also acknowledge the point that consumers purchase goods online from offshore suppliers for a number of reasons, including convenience and access to a wider product range. However, ideally the tax treatment should not be a factor in consumers' purchasing decisions.

Recommendation

That the submissions opposing the proposed offshore supplier registration system be declined, but the point that the proposed collection system may only be an interim solution and submitters' concerns about the potential impact on consumer choice be noted.

Issue: Trade issues

Submission

(Alibaba and eBay, R Perry)

Submitters have voiced concerns about the potential impact of the proposals on New Zealand's diplomatic relationships with its trade partners, as well as the compliance of the proposed legislation with New Zealand's free trade obligations.

One submitter considered that the proposals would be detrimental to trade relations with China. *(R Perry)*

A joint submission from two electronic marketplaces considered the proposed legislation to be a violation of the principle of national treatment under Article III of the World Trade Organisation's General Agreement on Tariffs and Trade:

"Under Article III, each country commits to not levy additional taxes on imported goods over comparable domestic goods. However, under the Bill, a merchant selling an imported product through an online marketplace must pay GST from the first dollar of sales to New Zealand, while a merchant selling a competing product in New Zealand receives a $60,000 exemption from GST." *(Alibaba and eBay)*

Comment

Officials specifically consulted the Ministry of Foreign Affairs and Trade in the development of the proposals and are comfortable that the proposals are not inconsistent with New Zealand's international obligations, including in relation to free trade.

In its final report on the inquiry into the similar offshore supplier registration system legislated in Australia, the Australian Productivity Commission ("the Commission") considered the issue of whether Australia's law could be a breach of international trade agreements. While the Commission noted that the different treatment of foreign and domestic goods sold through an electronic marketplace by a supplier below the A$75,000 registration threshold may pose some risks, the Commission considered there were good reasons to consider the model to be compliant with Australia's international trade agreements. For instance, low-value goods will still cross the border without being stopped for revenue collection purposes, so there will not be added delays at the border. This is also true of New Zealand's proposal.

Officials further note that the European Union has committed to an offshore supplier registration system which includes similar rules for marketplaces.

Recommendation

That the submission and officials' comments be noted.

Issue: Post-implementation review of the rules

Submission
(Alibaba and eBay)

The submitters recommend establishing an Inland Revenue-led industry working group (including marketplaces, logistics providers, payments systems providers and retailers) to undertake a review of the regime's practical implementation twelve months after any legislation is passed.

Comment

The Government will review the low-value goods threshold three years after the implementation of the rules. The Government has also directed officials from Inland Revenue, Customs and Treasury to continue to monitor the future viability of other collection models to see if the practical issues with these models can be overcome.

Officials consider that it would be a bit premature to undertake a review of the implementation of the legislation twelve months after it was passed, as after a year of the law being enacted the rules would have only been in effect for a few months.

Officials consider that undertaking any review three years after the rules' implementation would be more informative, as by then there should be enough experience with the rules to identify any significant ongoing implementation issues.

Recommendation

That the submission be declined.

Issue: Application date of the rules

Clause 2(14)

Submission

(Accountants + Tax Agents Institute of New Zealand, Alibaba and eBay, Amazon, CAPEC New Zealand, Chartered Accountants Australia and New Zealand, Deloitte, PwC)

Submitters have expressed concern about the proposed application date of 1 October 2019, noting that this leaves little time between the likely bill enactment date and the start of the new rules. Submitters consider that offshore suppliers cannot be expected to invest in making information technology systems changes until the law is enacted, as the proposed rules are not finalised and may yet be subject to change. They have noted that there may not be enough time after the rules are finalised for offshore suppliers to register for New Zealand GST and make the systems changes necessary to collect GST on low-value goods supplied to New Zealand consumers by 1 October 2019.

A number of submitters have suggested 1 April 2020 as a more realistic application date.

One submitter considered that the proposed legislation itself is complex, and there are numerous types of supply chain models. The submitter commented that offshore sellers would need to make significant systems and technology changes once they have digested how the rules will apply to them. *(PwC)*

Submitters also verbally advised the Committee on 13 March 2019 that suppliers were being asked to make significant changes for e-commerce by a number of countries and “New Zealand is in the queue”.

Some submissions noted the technical challenges for large electronic marketplaces that service a global customer base, which mean the required systems changes will need to be carefully planned and tested to ensure they do not create errors that interfere with other parts of their systems. *(Alibaba and eBay, Amazon)*

One submission noted the risk that electronic marketplaces and suppliers (that do intend to comply with the proposed legislation) may be left with little choice other than to temporarily cease shipping goods to New Zealand from 1 October until the required systems changes are ready. *(Alibaba and eBay)*

The submission also stated the systems changes that have been implemented to comply with Australia’s new legislation cannot be simply adapted for New Zealand, as “Australia’s GST system is different to New Zealand’s and therefore substantial additional investment will still be required to comply”. *(Alibaba and eBay)*

Comment

Officials have considered the arguments for and against delaying the application date.

Officials acknowledge submitters' concerns that it may be difficult for some offshore suppliers to implement the necessary systems changes within the short time period between enactment (expected to be July 2019) and the proposed application date (1 October 2019).

The proposed application date of 1 October 2019 was first announced when the discussion document was released in May 2018 and was confirmed when the Bill was introduced in December 2018. However, planning and testing is required to change systems and it is difficult to start developing the changes until the final requirements are certain.

Officials are aware of the potential risks, particularly that some suppliers may temporarily block or suspend their sales to New Zealand consumers for several months until they are able to implement the necessary systems changes.

On the other hand, delaying the application date by six or twelve months would delay the benefits of the proposal in terms of achieving fairness and a level playing field for New Zealand retailers.

Delaying the application date would also have a large fiscal cost as between six to twelve months of additional GST revenue would no longer be collected in respect of the relevant low-value goods.

Many of the affected suppliers already have experience in building similar systems for Australia, Switzerland and some US states. They should also have strong commercial incentives to implement the necessary systems ahead of the application date in order to avoid negative publicity and to maintain their market presence as otherwise consumers may seek out alternative providers.

For these reasons, officials ultimately recommend retaining the 1 October 2019 application date.

Recommendation

That the submission be declined.

Issue: Initial six-month taxable period

Clause 18(2)

Submission
(Matter raised by officials)

The Bill proposes that offshore suppliers of low-value imported goods would have quarterly taxable periods if their only supplies in New Zealand are of low-value imported goods and/or remote services – meaning that these offshore suppliers would be required to file GST returns quarterly. However, offshore suppliers that become liable to register from the start of the new rules because their only New Zealand supplies are low-value imported goods would have the option of having a six-month taxable period for the first six months. This means they would not be required to file their first GST return until 7 May 2020 (assuming a 1 October 2019 application date).

The current drafting of this rule does not technically apply to offshore suppliers that make supplies of both remote services and low-value imported goods who become liable to register for GST in New Zealand as a consequence of the low-value imported goods rules. Officials recommend that a change be made so that these suppliers would also have the option of having a six-month taxable period for the first six months of the rules.

Recommendation

That the submission be accepted.

Issue: Transitional rule for certain contracts entered into before application date

No clause in Bill

Submission
(Matter raised by officials)

Some imported goods may be successively supplied under a fixed term subscription that spans the proposed application date (one possible example is a magazine subscription). The Bill as introduced would require adjustments of the consideration for supplies of low-value imported goods made under such contracts (as payments made after the application date would be subject to GST). These adjustments may be administratively difficult for suppliers.

To minimise compliance costs, officials consider it is appropriate to provide a transitional rule for fixed-term contracts entered into before the application date, similar to existing transitional provisions that were provided for the GST rate change in 2010 and for the introduction of GST on remote services in 2016.

Such a rule would allow suppliers to treat periodic payments under the contract as not being successive supplies if the consideration for the supply is set or reviewed for periods of 396 days or less during the term of the agreement. This means that if the supplier elects that this transitional rule applies, payments made after the implementation date would not subject to GST for the term of the agreement or up to 396 days from the date the contract was entered into (whichever is earlier).

Recommendation

That the submission be accepted.

Issue: Compliance and enforcement

Submission
(Alibaba and eBay, PwC, Retail NZ, R Perry, Steve Cornwall, Trade Me)

Submitters have expressed differing views on the likely level of compliance with the proposals and their enforceability:

"… In our opinion, the current design will result in high rates of non-compliance." *(Alibaba and eBay)*

"Australia was in a similar position, but successfully introduced an offshore supplier registration system for GST last year… Before the implementation of offshore registration for services and intangibles there was also concern about uptake and non-compliance. That has also proved not to be a major issue and over 200 merchants have registered to date." *(Retail NZ)*

"It seems like the Government is relying on overseas suppliers to declare whether they supply more than $60k p.a. of goods into NZ so they need to register for GST… It is pretty straightforward for people to set up offshore accounts to pay for such goods or just use a confidential escrow service such as Paypal." *(R Perry)*

"… Low levels of compliance without an effective enforcement regime will not actually fix the distortion in practice, and will create a new competitive distortion (between marketplaces and suppliers that do comply with the GST regime, and those that don't)." *(Trade Me)*

Two submitters have suggested enforcement strategies to maximise compliance with the rules – one submitter stating that New Zealand must continue to strengthen its network of agreements with other jurisdictions on mutual co-operation, information exchange and assistance in tax matters *(PwC)*. The other suggested enforcement strategy is addressed below as a separate issue.

Comment

Our tax system relies for the most part on voluntary compliance. Key to encouraging voluntary compliance is making the rules as simple as possible to comply with. Inland Revenue's experience with similar rules applying to imported "remote" services suggests that making the rules easy to comply with leads to good compliance outcomes, although there will still be some non-compliance.

Inland Revenue will monitor compliance and use a range of methods to detect non-compliance. New Zealand has agreements with other countries on mutual co-operation, information exchange and assistance in tax matters. These agreements cover an extensive network of jurisdictions, including our major trading partners. The agreements mean New Zealand can request that our treaty partners (that is, other foreign tax authorities) provide information about foreign taxpayers. In addition, Inland Revenue and Customs will share information and work together to help identify non-compliant suppliers. Inland Revenue will also work with the Australian Tax Office ("ATO") which has successfully implemented similar GST rules for offshore suppliers selling low value goods into Australia.

When non-compliance is detected, Inland Revenue will register the supplier for GST and issue a default assessment of the GST liability. This debt would then be registered with the New Zealand courts. Using our international agreements, the debt would then be registered and pursued in the courts of the country that the supplier is based in.

New Zealand also has agreements with some foreign tax authorities allowing them to collect unpaid GST on New Zealand's behalf. Alternatively, Inland Revenue could order persons based in New Zealand that owe money to non-compliant offshore suppliers to instead pay those funds to Inland Revenue.

Although in its early days, the Australian experience to date suggests that non-compliance may not be a significant problem in practice. The ATO has reported that it has had over 1,100 businesses register for GST under Australia's new legislation and that the GST revenue raised from the measure for the first quarter of the law being in effect was $81 million – four times the $17.5 million per calendar quarter that was forecast in the Australian Budget.[1]

This success is consistent with New Zealand's experience with the rules applying GST to supplies of remote services, which has seen over 265 offshore businesses register to date and $131 million in GST revenue collected for the 2017–18 tax year.

Recommendation

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

Issue: Border enforcement of GST collection by offshore suppliers

Submission
(Steve Cornwall)

The submitter considers that Customs should instruct suppliers to place a bar code on parcels where they have collected GST on those items. All parcels that do not have a bar code should be held by Customs.

Comment

Officials do not consider the above suggestion to be a viable option. Collection at the border on low-value goods as a comprehensive back-stop to the proposed offshore supplier registration system would be costly to administer, with the collection costs likely to outweigh any extra GST revenue generated. The risk of double taxation in situations where the supplier had collected GST on a low-value item would also be significantly higher, particularly for postal items.

Non-collection of GST on a low-value item by an offshore supplier would also not necessarily be an indicator of non-compliance. Under the proposals, there are two situations where an offshore supplier is not required to collect and return GST on a supply of low-value imported goods to a New Zealand customer:

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[1] https://www.afr.com/news/policy/tax/treasury-gets-amazon-bonus-on-unexpected-gst-on-overseas-products-20190221-h1bj11

- Offshore suppliers would not be required to collect GST if they are below the $60,000 registration threshold.
- Business-to-business supplies are excluded from the rules, meaning that offshore suppliers are not required to collect GST on supplies to GST-registered businesses. This is revenue neutral as the business purchaser would typically claim the full amount of GST back from Inland Revenue in its GST return.

There would be costs in resources and delivery delays if Customs had to distinguish between goods from suppliers that had legitimately not collected GST and those from non-compliant suppliers.

Recommendation

That the submission be declined.

Issue: Education and publicity campaign

Submission
(CAPEC New Zealand, Deloitte, PwC)

Submitters encouraged Inland Revenue to undertake an education campaign about the proposed rules (from the time the law is passed) and to focus on ensuring that offshore suppliers have access to clear guidance to help them understand and comply with their new obligations.

One submitter recommended adopting an awareness raising approach similar to Australia's in communicating the proposed rules. The submitter specifically mentioned road shows in countries that are major exporters to Australia allowing suppliers to ask questions and obtain information about the changes and information sheets that the ATO produced. *(CAPEC New Zealand)*

Another submitter further recommended that the enforcement of the new rules should initially have a large "education and encouragement" element, rather than a punishment approach. *(Deloitte)*

Comment

Officials agree that clear and effective communication of the proposed legislation will be essential to the successful implementation of the proposals. It is also recognised that the obligations imposed on offshore suppliers under these proposals may be unfamiliar to some suppliers and will require systems changes to be implemented, which may result in mistakes being made or registration being delayed. These situations will be considered on a case-by-case basis and penalties and interest may be remitted under the Commissioner of Inland Revenue's existing discretion (see sections 183A and 183D of the Tax Administration Act 1994) when it is appropriate.

The existing discretions can be exercised when the Commissioner is satisfied that the non-compliance has been caused by an event or circumstance that provides reasonable justification or excuse for the omission, or when the Commissioner is satisfied that the remission is consistent with the duty to collect, over time, the highest net revenue that is practicable within the law (for example, when there is a genuine oversight or a one-off error).

Following enactment of the legislation, Inland Revenue will develop and provide tailored educational material that will be easily accessible to offshore suppliers. This should ensure the obligations imposed on offshore suppliers are clear, thus avoiding simple errors and misunderstandings. Inland Revenue will also engage directly with affected offshore suppliers, marketplaces and redeliverers to raise awareness of the rules and to notify businesses when the registration process is available.

Recommendation

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

Issue: Flexibility in the rules to reduce implementation costs for suppliers

Submission

(KPMG, Trade Me)

Submitters have requested that the provisions in the Bill that apply GST to low-value imported goods allow for greater flexibility to enable affected businesses to comply with the new rules in the most cost-efficient manner.

Comment

Officials acknowledge the points raised by submitters about the need for flexibility in the rules. The businesses affected by these proposals have different business models and processes, and therefore will take different approaches to comply with the rules in the way that is most cost-efficient for them.

Officials consider the desire for flexibility needs to be balanced against the policy aim of having clear and simple rules. There is a risk that too much flexibility and optionality may detract from the transparency and coherency of the rules and generate confusion and uncertainty. Officials are also mindful there is a risk with delegated powers that the discretion might not be applied consistently, which could result in unfair outcomes.

This report therefore considers requests for greater discretion or flexibility on a case-by-case basis as part of the individual issues raised by submitters.

Recommendation

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

Issue: Cooperation between Inland Revenue and Customs

Submission
(Deloitte)

Inland Revenue and Customs need to prioritise co-ordinating their efforts to implement the proposed system, including working together to resolve any issues during and after implementation.

Comment

Inland Revenue and Customs have worked together in the development of the proposals and will continue to do so when the legislation is implemented.

Recommendation

That the submission be noted. The submission does not require any change to the Bill.

Issue: Support for the proposed $1,000 threshold

Clause 5(2)

Submission
(Chartered Accountants Australia and New Zealand, PwC, Trade Me)

Some submitters indicated that they support the proposed $1,000 threshold. One noted that, compared with the original proposal for a $400 threshold, the $1,000 threshold should minimise compliance costs for suppliers and deliver a better consumer experience. *(PwC)*

Another submitter supported the removal of duties on consignments valued under $1,000. However, as this change will not be in the Bill itself, the submitter would like to see this change formally documented at the same time the Bill is passed. *(Trade Me)*

Comment

Officials welcome the support for the proposed $1,000 threshold.

As one of the submitters has noted, the proposed change in the customs *de minimis* (being the threshold applied by Customs in determining whether it collects GST and other duties on imported goods at the border) to a $1,000 threshold is not included in the Bill. This change will be achieved through an amendment to regulation 70 of the Customs and Excise Regulations 1996. Customs expects to share an exposure draft of the amendment regulations with interested stakeholders in advance of the proposed changes coming into force on the same date as the amendments to the GST Act.

Recommendation

That the submission be noted. The submission does not require any amendment to the Bill.

Issue: The term "distantly taxable goods"

Clause 6

Submission
(Chartered Accountants Australia and New Zealand)

The phrase "distantly taxable goods" is difficult to say and may be a difficult concept for consumers. The accessibility of the rules may be improved by using more user-friendly terminology.

Government should consider whether there is a phrase that is more accessible and more memorable, such as "taxable overseas goods" ("TOGs").

Comment

Officials consider the term "distantly taxable goods" to be the most accurate way of describing the goods subject to the proposed rules, given the exceptions that may apply.

For example, high-value goods will be subject to the rules if the supplier has elected under proposed section 10C to charge GST on its supplies of high-value goods, so "low-value goods" is not a sufficiently accurate term to use in the legislation to describe the types of goods subject to the proposals. Goods that are sourced from within New Zealand will be subject to the rules if they are supplied through an electronic marketplace by a non-resident underlying supplier, so "imported goods" or "overseas goods" would not be a strictly accurate description either.

Recommendation

That the submission be declined.

Issue: Possible GST leakage on goods valued between $400 and $1,000

No clause in Bill

Submission

(Chartered Accountants Australia and New Zealand, PwC)

Two submitters have expressed concern that the proposed increase in the customs *de minimis* for collecting GST and other charges on imported goods at the border could create a significant hole in the rules in relation to goods valued between $400 and $1,000, where these goods are supplied by unregistered offshore suppliers (being suppliers that are not liable to register for GST under the rules or that will not register and comply with the rules).

These submitters are concerned this may result in a change in supplier and consumer behaviour, suggesting that careful consideration should be given to this issue *(PwC)* and the behavioural response from consumers and suppliers should be monitored *(Chartered Accountants Australia and New Zealand)*.

Comment

As submitters have pointed out, an increase in the customs *de minimis* to $1,000 may incentivise consumers to purchase goods valued between $400 and $1,000 free of GST from offshore suppliers that would be below the registration threshold. However, it is unclear how significant an issue this might be in practice. For instance, it is not clear how many offshore suppliers that would be below the registration threshold would sell goods to New Zealand consumers through their own website or mail order (as opposed to selling goods on an electronic marketplace that would be liable to collect GST on offshore goods sold on its marketplace, including those sold by underlying suppliers below the $60,000 registration threshold).

Officials have estimated that approximately $22 million in GST was collected on consignments valued between $400 and $1,000 that were imported by consumers in 2017–18. While a $1,000 threshold does potentially put this GST at risk, officials expect that most of this currently collected GST would continue to be collected under the proposed rules, largely owing to the inclusion of the proposed rules for electronic marketplaces and redeliverers.

A $1,000 threshold may even have some benefits for collecting GST on goods valued between $400 and $1,000, including:

- increasing the number of suppliers with a liability to register by increasing offshore suppliers' level of "supplies in New Zealand" (as supplies of goods valued between $400 and $1,000 would also be treated by the GST Act as supplies made in New Zealand);
- reducing the risk of GST not being collected on goods between $400 and $1,000 owing to undervaluation (because, even if the supplier undervalued the goods for customs purposes, the marketplace operator will collect the correct amount of GST in the situation where the goods are supplied through a GST-registered electronic marketplace); and
- reducing the reliance on visual checks of labels on parcels to identify when goods sent by international mail are above the *de minimis*.

Officials note that the Government has committed to a post-implementation review of the level of the proposed $1,000 threshold, which is to take place three years after the implementation of the rules. Officials from Inland Revenue and Customs will also monitor any behavioural responses from offshore suppliers and consumers in the time between the initial implementation of the rules and the post-implementation review.

Recommendation

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

Issue: Collection of tariff duty

No clause in Bill

Submission
(Retail NZ)

The proposed legislation does not deal with current level playing field issues around tariff duty. Tariff duty is currently collected at the border on consignments valued at more than around $225, but the legislation increases that threshold to a flat $1,000. This exacerbates the issues relating to duty and New Zealand-domiciled businesses will continue to suffer a competitive disadvantage as a result.

The practical constraints around collecting tariff duty on low-value goods are understood by the submitter, who supports their removal. However, until such time as tariffs are eliminated on a multilateral basis, the submitter recommends the Government continues to look at sensible ways of collecting tariffs on goods worth less than $1,000. In the event that current international trade disputes lead to an escalation of tariffs on inbound goods, the submitter considers the Government should prioritise solutions to this issue.

Comment

Officials acknowledge the concern raised by the submitter. While the proposals will improve the playing field in relation to GST, they do not deal with (and in a small number of cases may negatively impact) the playing field issues in relation to tariff duty.[2]

New Zealand has few remaining tariffs (the significant relevant tariffs for retailers are up to 10% on clothing and a 5% tariff on some fabrics) and our free trade agreements have already eliminated these tariffs for many countries (including China, Australia and – from 2020 – the 10 ASEAN countries, under the ASEAN Australia New Zealand free trade agreement). Consequently, over 90 percent of goods entering New Zealand are not charged a tariff.

In 2017–18, $3.23 million was collected in tariff duty on consignments valued at or below $1,000, compared with approximately $5.2 million in the 2016 calendar year. The amount of revenue from tariff duty is expected to continue to reduce over time as a result of New Zealand's implemented free trade agreements progressing toward agreed tariff eliminations. The revenues involved are therefore much less significant than the growing gap in GST collection on low-value imported goods, and the best way to level the playing field in relation to tariffs is to negotiate free trade agreements which eliminate these tariffs for all importers (retailers and consumers).

Finally, in some cases, New Zealand businesses importing goods will also benefit from the proposed removal of tariffs on consignments valued at or below $1,000 as they would also no longer be required to pay any tariff duty on these consignments.

Officials have referred the submission to the Ministry of Business, Innovation and Employment, being the government agency responsible for tariff policy.

Recommendation

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

Issue: Legislative authority for the customs *de minimis* and clarification of the effect and intention of section 12(4)(c)

No clause in Bill

Submission
(KPMG)

The submitter is concerned that it is not clear from reading the Bill alone when GST will or will not be collected by Customs on low-value imported goods (as the proposed change in the customs *de minimis* to $1,000 based on the value of the consignment will have an impact, and this change is not included in the Bill). In particular, the submitter is concerned that it is not clear that GST will not be collected by Customs on low-value consignments imported by GST-registered businesses and has requested clarification of how the *de minimis* is applied by Customs to goods imported by GST-registered businesses.

[2] As tariff duty will not be collected on imported consignments valued below $1,000, but will often be collected when retailers import items subject to tariffs as these businesses would typically import these items in a consignment valued above $1,000.

The submitter considers the effect of the low-value goods threshold should be clearly stated and the effect and intention of section 12(4)(c) reviewed.

Comment

Regulation 70 of the Customs and Excise Regulations 1996 provides the legislative authority for the *de minimis* applied by Customs for collecting duty (which is defined to include GST) on imported goods. The *de minimis* is currently set at $60 of duty. The effect of this is that GST is not collected at the border on most imported consignments valued below $400, including consignments imported by GST-registered businesses.

There are few exceptions to the *de minimis*, the main ones being for alcohol and tobacco products. There is no exception to the *de minimis* for goods imported by GST-registered businesses specifically.

As mentioned earlier, Customs expects to share an exposure draft of the amendment regulations to Regulation 70 with interested stakeholders at a later date. Officials consider it is appropriate that the *de minimis* is set in the Customs and Excise Regulations, as the *de minimis* also applies to other customs duties, not just GST.[3]

From the start of the proposed new rules, Customs will collect GST on all consignments above the $1,000 threshold (including those imported by GST-registered businesses), except where notification is provided to Customs that GST was collected at the point of sale by the supplier. Notification of GST being collected at the point of sale should only be provided to Customs if the goods are covered by the offshore supplier registration system proposed in the Bill (meaning that offshore goods in an ordinary supply by a resident GST-registered business, for example, would still have GST collected at the border if the goods are imported into New Zealand and the value of the consignment is above $1,000).

Section 12(4)(c) of the GST Act is unrelated to the *de minimis*. The intention of section 12(4)(c) is to prevent potential "double-dipping" where, in the absence of the rule, a GST-registered business that has paid GST on the importation of goods to Customs might obtain a drawback or refund of the GST from Customs, while at the same time being entitled to make an input tax deduction in its GST return for the import GST. The effect of section 12(4)(c) is that a GST-registered person is not entitled to a drawback or refund of GST from Customs if the registered person is entitled to claim an input tax deduction from Inland Revenue for the GST paid to Customs.

Recommendation

That the submission be noted. The submission is addressed in the above comment and the effect of the proposed change to the *de minimis* will be explained further in the guidance.

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[3] For example, the *de minimis* applies in respect of tariff duty, but does not apply to goods subject to excise taxes such as alcohol and tobacco.

Issue: Treatment of multiple item shipments

Clause 6

Submission
(PwC)

Unlike the Australian rules, the proposals do not contain detailed rules for how sellers may treat multiple item shipments, where some goods may be above $1,000 and some below. That is, GST will only apply to the individual items of distantly taxable goods in a consignment that are $1,000 or less.

In theory this simple approach has appeal but, at a practical level, it may create complexity as it requires sellers to apportion customer orders into items that attract GST and those that do not.

Comment

Clear and detailed guidance on what suppliers are required to do, including the GST treatment of shipping charges for mixed consignments, will be provided in an upcoming special report to be published on Inland Revenue's Tax Policy website shortly after the legislation is enacted, and will also be included in the *Tax Information Bulletin*.

Officials note that where suppliers choose to charge GST on their supplies of high-value goods, the treatment of multiple item shipments should generally be straightforward (as GST would generally apply to all the goods in the consignment, regardless of whether the individual items are above or below the $1,000 threshold).

Recommendation

That the submission be noted. The GST treatment of multiple item shipments will be explained in the guidance.

EXCEPTION TO BORDER COLLECTION TO PREVENT DOUBLE TAXATION

Issue: Drafting of exception to border collection on low-value goods imported in consignments above $1,000

Clause 16

Submission
(Chartered Accountants Australia and New Zealand, PwC, KPMG)

Submitters have suggested that the proposed amendment to section 12(1) and proposed new section 12(1B) be redrafted to clarify the following:

- That the proposed exception to the collection of GST by Customs on low-value imported goods that have already had GST collected by the supplier at the point of sale only applies to supplies within the scope of proposed section 8(3)(ab), rather than section 8 generally. An ordinary supply by a resident GST-registered person of goods yet to be imported should not be excluded from having GST collected at the border. *(PwC)*
- The meaning of the phrase "tax accounted for by the registered person" *(Chartered Accountants Australia and New Zealand, KPMG).* Submitters have suggested that the words "accounting" and "accounted" in proposed sections 12(1B)(a) and (c) are replaced with the words "charging" and "charged" respectively.

Comment

Under the proposals, offshore suppliers would be required to collect GST on goods that are individually valued at $1,000 or less. Customs would collect GST on imported consignments valued above $1,000.

An imported consignment with a value above $1,000 may include low-value imported goods that have had GST collected at the point of sale by the offshore supplier. Therefore, for the purpose of preventing double taxation, the proposed amendment to section 12(1) provides an exception to the collection of GST by Customs on low-value imported goods that have already had GST collected by the supplier.

Officials agree that the scope of the proposed amendment to section 12(1) is broader than intended, as it applies to supplies of imported goods by New Zealand-resident businesses. The only supplies by residents that are intended to fall within the scope of the exception are supplies of imported goods that are actually made by a non-resident, but are treated for GST purposes as being made by a resident redeliverer or marketplace operator under the amendments in the Bill.

Officials also agree that the use of the phrases "accounting for" and "accounted for" are inaccurate in the context of proposed section 12(1B), which sets out the information that the supplier is required to take reasonable steps to ensure is available to Customs for the proposed exception in section 12(1) to apply. As noted in two of the submissions, it is unlikely that at the time the goods are imported that the supplier will have "accounted for" the GST (that is, returned and paid the GST to Inland Revenue).

Officials will revise the drafting of the relevant provisions to address the points raised by submitters and will consult submitters on the revised drafting.

Recommendation

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

Issue: Exception to border collection on low-value goods is inconsistent with self-assessment

Clause 16

Submission
(Chartered Accountants Australia and New Zealand)

Proposed section 12(1B) is inconsistent with the principle of self-assessment.

Comment

As the submitter notes, self-assessment is a fundamental principle in tax administration. Proposed section 12(1B) could be said to be a departure from this principle. Under the proposed section, Customs will assess and collect GST on items imported in consignments over $1,000 unless it is provided with information in a specified form to show that GST was already collected at the point of sale by the supplier.

The reason for the inclusion of the rule is to provide a workable basis for Customs to determine whether GST was already collected by the supplier at the point of sale. Without the proposed exception to collection by Customs in the situation where the information available to Customs indicates that GST was already collected by the supplier, the incidence of potential double taxation under the proposals would be higher.

Recommendation

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

Issue: Clarification of "an item of goods in a consignment"

Clause 16(2)

Submission
(Chartered Accountants Australia and New Zealand)

The proposed section refers to "an item of goods in a consignment". The rule should also apply to any good imported individually and not as part of a consignment. The wording of the section should be clarified.

Comment

Under the Customs and Excise legislation, a good imported individually is treated as a consignment in itself. Therefore, when goods are imported individually, the rules for preventing double taxation would still apply, meaning that GST should not be collected on the good by Customs if GST was already collected at the point of sale.

Recommendation

That the submission be noted. The submission is addressed in the above comment and will be further explained in the guidance materials.

Issue: Collection of GST on tariff duty

Clause 16(1)

Submission
(Matter raised by officials)

GST is only one type of duty collected by Customs on imported goods. For instance, Customs also collects tariff duty, as well as GST on that tariff duty. The rationale for this is that, as a consumption tax, GST should apply to the full landed value of the goods, which includes applicable tariff duty.

Under the proposed offshore supplier registration system, Customs will continue to collect tariff duty on consignments over $1,000, including on any low-value items in the consignment.

For the purposes of preventing double taxation, a proposed amendment to section 12(1) switches off Customs' ability to collect GST on imported goods if GST was collected on that good at the point of sale. However, this amendment as it is currently drafted would also switch off Customs' ability to collect GST on tariff duty in certain situations, which is not intended.

In the situation where an imported consignment containing low-value goods has a combined value over $1,000, Customs would collect cost recovery charges and tariff duty (if any) on the consignment, even if GST had been collected at the point of sale on some or all the goods in the consignment. However, if GST had been collected at the point of sale on an item in the consignment that is subject to tariff duty, the amendment as currently drafted would prevent Customs from being able to collect GST on that duty.

Officials recommend the proposed exception in section 12(1) be amended, so that GST may still be collected on tariff duty in the situation described above. This would provide neutrality between the situation where Customs collects GST on a high-value item that is subject to tariff duty, and the situation where low-value goods that are subject to tariff duty are imported in a consignment with a combined value in excess of $1,000.

Tariff duty (and GST on tariff duty) would not be collected on goods in consignments valued at or below $1,000.

Recommendation

That the submission be accepted.

INFORMATION REQUIREMENTS FOR PREVENTING DOUBLE TAXATION

Issue: Alternative information requirements for preventing double taxation

Clauses 16(2) and 24

Submission
(Alibaba and eBay, CAPEC New Zealand, KPMG)

Proposed new section 12(1B) requires certain information to be provided to Customs to confirm that GST was already collected by the supplier at the point of sale and therefore will not be collected at the border. This information is the name of the registered person who is accounting for GST on the supply; the item; and the rate of tax accounted for by the registered person. The Bill does not contain any ability to agree alternatives to this prescribed form with Customs or Inland Revenue.

Two submitters have suggested providing additional flexibility in the legislation to allow for alternative approaches on what information will be sufficient to satisfy Customs that GST was collected by the supplier at the point of sale, so that GST will not be charged again at the border *(Alibaba and eBay, KPMG)*.

Another submitter noted that many offshore suppliers shipping goods into New Zealand are also selling goods into Australia, and therefore are already required to register under Australia's GST law for low-value imported goods *(CAPEC New Zealand)*. The submitter has suggested that consideration be given to allowing dual use of Australian supplier registration numbers.

Comment

Officials consider it is appropriate to allow the Commissioner to agree with suppliers on alternative information requirements for preventing double taxation as submitters have suggested, provided that the Comptroller of Customs also agrees to the alternative information requirements.

Officials further recommend the removal of the requirement to state the rate of tax charged on each item that has had tax charged at a rate of more than zero. Given that New Zealand currently has a single standard rate of GST (being 15%), this requirement is not necessary.

Recommendation

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

Issue: Guidance on Customs' procedures and how information for preventing double taxation is to be made available to Customs

Clauses 16(2) and 24

Submission

(Chartered Accountants Australia and New Zealand, EY, Trade Me)

Submitters are concerned that it is not clear how the information required to be made available to Customs for the purpose of preventing double taxation will be provided, and have suggested that better guidance is issued by Customs and Inland Revenue regarding the form in which the information will be received by Customs. Submitters have made the following suggestions:

- Customs should be capable of accepting the required information in all the following forms: import entry, receipt inside the package with the goods, daily electronic transmittal of all transactions. Customs should put systems in place to process the information they will be receiving. *(Chartered Accountants Australia and New Zealand)*
- Government should consider including the information on how Customs will collect and process the information required on both the Customs and Inland Revenue websites. In addition, it would be useful to include this guidance on other government agencies' websites, such as the Ministry of Business, Innovation and Employment's website on doing business in New Zealand (business.govt.nz). *(Chartered Accountants Australia and New Zealand)*
- Guidance on the administrative procedures to be followed by Customs in collecting the required information, including process flows and the role of customs agents would benefit stakeholders. *(EY)*

Comment

Customs' existing documentation will be amended to include additional information and stakeholders will be consulted. Guidance materials will be issued by both Customs and Inland Revenue, and Customs will provide assistance to new stakeholders. The Conference of Asia Pacific Express Carriers ("CAPEC") has also offered to work with suppliers to help them comply with information requirements.

For non-mail items, the "reasonable steps" requirement would be met if:

- the supplier (being the actual supplier of the goods, as well as the supplier for GST purposes) includes the relevant information contained on the receipt or tax invoice for the goods in the commercial documentation provided to the freight forwarder, carrier or customs broker, for use in completing the customs documents on behalf of the importer. The person responsible for completing the customs documentation would then include this information in the customs documentation;
- an operator of an electronic marketplace (who is treated under the proposals as the supplier for GST purposes) includes GST information on commercial documentation which it requires the seller of the goods to pass through the logistics chain on its behalf.

In relation to mail items, the transmission of this information through the international postal network may not currently be accommodated under current systems. Therefore, for goods transported by post, providing a receipt (required to be issued under proposed section 24BAB) to the customer would currently be sufficient to meet the reasonable steps requirement. The customer would be able to provide the receipt to Customs to prevent Customs from collecting GST again on items that had GST collected by the supplier.

Officials note that what will constitute reasonable steps in relation to mail items is expected to change in the future, owing to the increased availability of electronic advance data in the international postal network over the next few years.

Recommendation

That the submission be noted. The submission is addressed in the above comment and will be further explained in the guidance materials.

Issue: Competitive neutrality between freight and post

Clause 24

Submission
(CAPEC New Zealand)

The international postal network competes with members of the Conference of Asia-Pacific Express Carriers ("CAPEC") in the parcel delivery industry. A large number of offshore suppliers ship goods through the postal pathway without any requirement to report information on these parcels through an electronic manifest or inward cargo report.

The submitter is concerned this gives the postal pathway a direct advantage over other carriers, because Inland Revenue will not be able to capture supplier registration numbers relating to these shipments for monitoring and enforcement purposes. This will potentially see non-compliant offshore suppliers ship goods by international mail in order to avoid detection, thus advantaging the postal channel over the freight channel.

The submitter considers that competitive neutrality between the postal and freight channels will only exist if the postal channel also provides supplier registration numbers.

Comment

For goods imported through the freight pathway, Customs currently collects information on consignments electronically from customs brokers, freight forwarders and carriers prior to the arrival and clearance of the goods. This information includes the value of the consignment, the country of origin, the consignor (usually the supplier of the goods) and the importer (usually the buyer). From 1 October 2019, supplier registration numbers and information indicating which goods in a consignment have had GST collected at the point of sale will also be provided electronically to Customs where this information is provided to the customs broker, freight forwarder or carrier by the supplier of the goods.

Currently, electronic information on mail items is generally not available, although this is starting to change. Customs is working with New Zealand Post to obtain and use electronic advance data as soon as possible.

Customs and Inland Revenue are working together to see how best to share information to assist Inland Revenue to monitor compliance. In the interim period until electronic advance data becomes fully available in the international postal network, Customs will advise Inland Revenue where it sees any patterns that it considers will be of interest.

Officials also note that under Inland Revenue's existing information collection powers, Inland Revenue would be able to request other information (such as retail banking data) for monitoring and enforcement purposes.

Recommendation

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

Issue: Requirement for name of the registered person

Clause 24

Submission
(Matter raised by officials)

In the situation where a supplier, redeliverer or marketplace operator has collected GST on the supply of low-value imported goods, proposed new section 12(1B) requires the information provided to Customs to sufficiently identify the registered person who has collected GST at the point of sale. Proposed new section 24BAC requires the registered person to take reasonable steps to ensure that its registration number is available to Customs at the time of importation, but not its name.

In many cases, Customs would already receive information about the name of the person that is responsible for returning GST (Customs already collects information about the consignor, who would typically be the actual seller of the goods or, in the redeliverer case, this would be the redeliverer). However, Customs does not currently collect information about the identity of the marketplace operator in the situation where imported goods are supplied through an electronic marketplace.

Officials recommend that in addition to providing its registration number, a registered person required to return GST on a supply of low-value imported goods would need to take reasonable steps to ensure that its name is available to Customs at the time of importation of the goods. This would provide two data points for identification and data matching purposes, so that Customs and Inland Revenue data may be more easily matched for monitoring and enforcement purposes.

Officials note that the name of the registered person is already required to be included on the receipt required to be issued to the consumer for the purposes of double taxation. Therefore, officials do not consider that an additional requirement to take reasonable steps to ensure the name of the registered person is included in the customs documentation would be onerous. This is because this information would likely be included in the documentation that would be provided by the supplier to the transporter or customs broker in the absence of the suggested amendment.

Recommendation

That the submission be accepted.

Issue: Receipts for supplies of low-value imported goods

Clause 24

Submission
(KPMG)

The new section 24BAB of the GST Act should include a provision allowing a supplier to agree with the Commissioner an alternative set of information to be included in a receipt for the supply of low-value imported goods. There may be other information that can be provided by the supplier apart from the information prescribed in section 24BAB, or other ways that a supplier can show that GST has been charged on the supply of the goods.

Comment

Proposed new section 24BAB provides that a registered person who makes a supply of low-value imported goods must provide a receipt to the recipient containing a number of particulars. The purpose of requiring the supplier to provide a receipt is to give the recipient a document evidencing that GST has been collected on the goods supplied to them. This can then be used to ensure the goods are not taxed again at the border when the goods are imported, thus serving as a back-stop mechanism to prevent double taxation in the situation where GST information has not been included in the customs documentation.

Officials agree there may be other information that can be included in a receipt by the supplier apart from the information prescribed in section 24BAB. Officials consider that it would be sensible and pragmatic to allow the Commissioner to agree an alternative set of information to be included in a receipt as suggested by the submitter, subject to Customs' agreement. As the submitter has noted, such a provision would be similar to the existing provision in the GST Act allowing the Commissioner to alter the requirements of a tax invoice where certain requirements are met.

Recommendation

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

REFUNDS WHERE DOUBLE TAXATION HAS OCCURRED

Issue: Customs or Inland Revenue should refund GST when double taxation occurs

Clause 17

Submission

(Chartered Accountants Australian and New Zealand, EY, KPMG, PwC, Trade Me)

Several submitters disagreed with the proposed requirement for the supplier to provide a GST refund in the situation where double taxation occurs, stating that either Customs or Inland Revenue should be responsible for providing refunds instead of the supplier *(Chartered Accountants Australia and New Zealand, KPMG, Trade Me)*. While not expressing a firm preference either way, one submitter noted that requiring the supplier to reimburse consumers when double taxation occurs may be less popular with consumers than a simple standardised process through Customs. *(PwC)*

A number of submitters also suggested that either Customs or Inland Revenue should provide the refund if the consumer is unsuccessful in obtaining a refund from the supplier *(Chartered Accountants Australia and New Zealand, EY)*, or if the occurrence of double taxation is not the fault of the supplier *(Chartered Accountants Australia and New Zealand)*.

Comment

It is expected that double taxation would be a rare occurrence under the proposals. This is mainly because the vast majority of consumer imports are well below the current *de minimis* (under the proposals, Customs would only collect GST on imported consignments valued above $1,000).

The Bill also proposes a tiered approach for preventing double taxation in the situation where goods are imported by consumers in consignments valued above $1,000:

- The first safeguard is the requirement for the supplier to take reasonable steps to ensure that GST information is available to Customs at the time of importation. Since $1,000 is the threshold where a full import entry is required to be completed (and therefore a customs broker would likely be engaged to complete the import documentation), this requirement should be effective for preventing double taxation on goods imported through the freight pathway – provided that suppliers comply with this requirement by passing the relevant information through the logistics chain (as described in the officials' comment under *Issue: Guidance on Customs' procedures and how information for preventing double taxation is to be made available to Customs*).
- The second safeguard is the requirement for the supplier to issue a receipt to the consumer showing relevant GST information, which the consumer can provide to Customs as evidence that GST was paid at the point of sale.

In the rare instances where double taxation does occur, officials consider that placing the responsibility for providing a refund on the supplier is the best of the available options, for the following reasons:

- It would provide suppliers with more incentive to take reasonable steps to prevent double taxation.
- Australia has the same requirement. It is desirable for the New Zealand system to closely match the equivalent Australian system to reduce the potential for confusion and errors by suppliers. In most instances, customs brokers should be able to avert double taxation and avoid the need for a refund as they will receive details about GST from the suppliers.
- It would be administratively difficult for Customs to provide refunds. To provide a refund, Customs would need validation from two sets of documents confirming:
  - that the supplier had collected GST on the purchase; and
  - the value of the goods.
- Relying solely on a supplier invoice provided by the consumer would more easily allow fraud to occur, as supplier invoices can be doctored.
- Having Inland Revenue provide refunds to consumers might result in higher compliance costs, for two reasons:
  - It is not likely that consumers would find it intuitive to approach Inland Revenue for a GST refund (being a party that they had not otherwise had any interaction with in relation to the transaction).
  - If the obligation to provide a refund was instead placed on Customs or the supplier, the consumer would likely only need to provide one set of documentation evidencing that they had been double-taxed. If, on the other hand, Inland Revenue was responsible for providing refunds, two sets of documentation (one evidencing that GST had been paid to the supplier, and the other evidencing that GST had been paid to Customs) would be required (or, at a minimum, evidence that GST was paid to the supplier and a declaration from the consumer that GST was also paid to Customs on importation of the goods).

Officials consider there would be disproportionate administration costs involved in verifying whether a supplier was at fault or whether the supplier had refused to issue a refund, if a government agency were to provide a refund in these cases. A supplier unwilling to provide a refund may also be unwilling to provide documentation showing that GST was charged, so it is unclear how helpful this option may be for consumers in practice.

Recommendation

That the submission be declined.

Issue: Customs should provide information to suppliers evidencing that GST was paid on importation

Clauses 17 and 26(5)

Submission
(KPMG)

If the submission that Customs or Inland Revenue should refund the GST is not accepted, Customs should be required to provide information to the supplier that GST has been collected on importation to confirm that the consumer did pay GST on importation.

Comment

Where Customs collects revenue, it provides a receipt to the customs broker or importer, which the consumer may use in seeking a refund from the supplier. It would not be cost-effective for Customs to deal with the supplier directly, and under the proposed offshore supplier registration system the relationships are between the supplier and the consumer and the supplier and Inland Revenue.

Officials consider it is desirable for the New Zealand refund process to match the Australian one in order to reduce confusion for suppliers and to facilitate compliance.

Recommendation

That the submission be declined.

Issue: GST refund should be the amount paid to Customs

Clauses 17 and 26(5)

Submission
(Trade Me)

If the submission to require Customs to provide GST refunds where double taxation occurs is not accepted, the submitter suggests that the supplier should be able to claim an input tax deduction for the GST paid by the consumer to Customs. This would enable the supplier to refund the consumer for the total amount of GST that the consumer paid to Customs.

Comment

Officials consider that refunding consumers for the amount of GST paid to Customs (as opposed to the amount of GST the supplier collected at the point of sale) would be more onerous for suppliers. This is because the supplier would need to know precisely how much the consumer paid to Customs, meaning that it would need to obtain a receipt from the consumer showing the amount of GST paid to Customs.

In cases of double taxation, the Bill as it is currently drafted only requires the consumer to provide a declaration to the supplier that GST was paid to Customs.

Recommendation

That the submission be declined.

Issue: Support for marketplace rules

Clauses 5(1), (3), (6), 35 and 36

Submission
(Chartered Accountants Australia and New Zealand)

The submitter has indicated its support of the amendments extending the rules for electronic marketplaces and approved marketplaces that are already in place under the remote services regime to the low-value imported goods context.

Comment

Officials welcome the support for the amendments.

Recommendation

That the submission be noted.

Issue: Significance of the electronic marketplace provisions and compliance costs for marketplaces

Clause 35

Submission
(Alibaba and eBay, KPMG, PwC, Trade Me)

Several submitters have commented on the significance of the proposed extension of the existing electronic marketplace rules to supplies of low-value imported goods and have especially noted the significant compliance costs that this will impose on electronic marketplaces for goods. Specific points that submitters have raised include the following:

- The proposed "supplier model" imposes costs and obligations on parties who are not the supplier. *(KPMG)*
- The marketplace provisions will be crucial in terms of the overall success of the rules. *(PwC)*
- The successful implementation of GST on remote services does not demonstrate the simplicity of imposing a GST liability on electronic marketplaces for goods. In the vast majority of cases, the collection obligation for GST on remote services is imposed on businesses directly controlling both the supply and pricing of services and intangibles with relatively standardised pricing. Electronic marketplaces for goods, on the other hand, generally do not control the pricing or supply of goods sold by third parties. *(Alibaba and eBay)*
- The development cost of adjusting electronic marketplaces that service a global market to meet local demands is significant. Suggestions that this is a simple or costless process for electronic marketplaces are simply incorrect. *(Alibaba and eBay)*

- It is unfair to shift expensive compliance costs onto electronic marketplaces, rather than taking steps to increase collection by working in collaboration with electronic marketplaces. *(Alibaba and eBay)*
- It is disproportionately expensive for marketplaces that provide an online classified-style platform to build automated systems to comply with complicated GST collection obligations. *(Trade Me)*

Comment

Officials see the rules for electronic marketplaces as being key to the success of the proposals. It is expected that the inclusion of these rules would maximise compliance with an offshore supplier registration system by imposing the bulk of the compliance obligations on a relatively small number of relatively large businesses, who are estimated to account for a sizeable proportion of the goods being imported into New Zealand by consumers.

Officials acknowledge that the proposed rules do impose potentially significant compliance costs on operators of electronic marketplaces. Officials also recognise that the way that electronic marketplaces for goods work is different to how electronic marketplaces for intangibles typically work, particularly in relation to the marketplace's degree of involvement in or control over the delivery of the product itself.

Having said this, officials consider that aggregate compliance and administration costs under the proposals would be significantly higher in the absence of the electronic marketplace rules, as many more entities would be required to register for and collect and return GST to Inland Revenue. Officials note that, aside from the administration and enforcement benefits, the main rationale behind the electronic marketplace rules is to minimise aggregate compliance costs across the entire system by minimising the number of entities that are required to register under the rules.

Recommendation

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

Issue: $60,000 threshold should be applied to sales by underlying suppliers

Clause 35

Submission
(Alibaba and eBay)

The submitter considers the Bill should be amended so that operators of electronic marketplaces are not required to collect GST on supplies by merchants with sales to New Zealand consumers below $60,000.

Comment

Excluding sales by suppliers below the $60,000 registration threshold from the electronic marketplace rules would require marketplace operators to determine which of their suppliers make less than $60,000 of supplies to New Zealand annually and configure their systems to only collect GST on sales by suppliers that are clearly above the $60,000 registration threshold. This would increase complexity and compliance costs under the rules.

Further, while an electronic marketplace operator would be able to calculate the value of an individual supplier's sales through its own marketplace, it would not know how much the supplier sold to New Zealand consumers outside of the marketplace (that is, through the supplier's own website or mail order, or on other electronic marketplaces).

Allowing electronic marketplaces to not charge GST where an underlying supplier's annual sales through the marketplace are below $60,000 would in some cases mean that the underlying supplier would be required to register for GST (thus increasing aggregate compliance costs). If the marketplaces that the supplier uses to sell goods to New Zealand collected the GST instead, the supplier may not be required to register at all.

Underlying suppliers on marketplaces may also be incentivised to continually create new identities whenever they get near the $60,000 registration threshold to avoid having GST collected on their sales.

Officials note that a non-resident supplier that is below the $60,000 registration threshold may potentially be quite a large business, as only its supplies to consumers in New Zealand would count towards the registration threshold – whereas all supplies made by New Zealand-resident businesses (including supplies to non-residents and to GST-registered businesses) count towards the $60,000 registration threshold.

Officials also note that GST would be paid on imported goods purchased from offshore suppliers below the $60,000 registration threshold under alternative collection models that are based on collection at the border by Customs or by transporters, or that are based on consumers paying GST to the government by way of an app or online portal after the goods have been delivered.

Recommendation

That the submission be declined.

Issue: Clarification of when an electronic marketplace will be responsible for GST

Clause 35(4)

Submission
(Trade Me)

The submitter has expressed concern that there is uncertainty around the situations where an operator of an electronic marketplace would or would not be treated as the supplier of goods sold on its marketplace by a third-party seller. The submitter has raised the following specific questions:

- Would a marketplace that authorises the charge for a supply merely on behalf of the seller (or as a processing agent for the seller) still be considered to authorise the charge for the supply, and therefore be liable for GST on the supply?

- Would a marketplace directly or indirectly set a term or condition under which the supply is made if the operator has a contract with the seller that requires the seller to comply with the marketplace's listing policies, including a requirement that goods sold comply with New Zealand law, but leaves it to the seller to set all of the terms and conditions under which an individual supply is made?

Comment

Under the proposed amendments to section 60C of the GST Act, an operator of an electronic marketplace would be treated as the supplier of goods that are sold on its platform by a third party (the underlying supplier) unless all the following conditions are met:

- The documentation provided to the recipient identifies the supply as made by the underlying supplier and not the marketplace.
- The underlying supplier and the operator of the marketplace have agreed in a document signed by them that the underlying supplier is liable for the payment of tax.
- The electronic marketplace does not:
  - authorise the charge to the recipient;
  - make or authorise the delivery to the recipient; or
  - directly or indirectly set a term or condition under which the supply is made.

The meaning of "authorise the charge for the supply to the recipient" is intended to be broad and cover the situation where the marketplace authorises the charge on behalf of the supplier or as a processing agent for the supplier.

An electronic marketplace would authorise the charge to the recipient if it communicates the liability to pay to the customer, or otherwise influences whether or at what time the customer pays for the supply. This may be done by initiating the process through which the recipient is charged, and includes situations where the marketplace connects the recipient to a third-party payment processor who receives the marketplace operator's instruction. To authorise the charge, it is not necessary for the marketplace operator to collect or receive the payment, or that it is involved in each of the steps in the payment authorisation process.

The meaning of "directly or indirectly set a term or condition under which the supply is made" is also very broad. This concept looks beyond the formal contractual relationship to the influence exercised by the marketplace operator. To be responsible for GST on supplies because of this requirement, it is not necessary that the marketplace operator has any direct involvement in determining the contractual arrangements between underlying suppliers and buyers using the marketplace.

A requirement for underlying suppliers to comply with the marketplace's listing policies would in many cases mean that the marketplace does (at least indirectly) set a term or condition under which the supply is made, meaning that the marketplace operator would be responsible for GST on the supply. However, this may not be true in all cases and would depend on what the marketplace's specific listing policies are.

Officials do not consider that a requirement in a contract between the marketplace operator and the underlying supplier that goods sold on the marketplace must comply with New Zealand laws and regulations would in itself mean that the marketplace "directly or indirectly sets a term or condition under which the supply is made". However, there are other common marketplace listing policies that would meet this test. In practice this means there will be very limited circumstances where an electronic marketplace operator will not be responsible for GST on sales made by a non-resident underlying supplier though its marketplace.

Comprehensive guidance, including illustrative examples of situations where a marketplace operator would or would not be treated as the supplier of low-value imported goods for GST purposes, will be provided in an upcoming special report on the rules shortly after enactment of the legislation.

Recommendation

That the submission be noted. The submitter's questions are addressed in the above comment and will be further explained in the guidance materials.

Issue: Risk of electronic marketplaces structuring around the rules and potential impacts on consumer protections

Clause 35(4)

Submission
(Trade Me)

The submitter is concerned that electronic marketplaces who are only caught by the proposed rules because they set some of the terms and conditions under which offshore sellers make sales on their platforms would be able to structure their way out of being responsible for GST on third-party sales.

The submitter considers that such marketplaces could do this very easily by simply ensuring they do not (directly or indirectly) set any of the terms and conditions under which sales on the marketplace are made, and considers there is a real risk this would reduce the level of protections provided by marketplaces to consumers using these websites. Specifically, the submitter has cited an ATO Law Companion Ruling which provides an example of a marketplace that indirectly sets terms under which a supply is made by requiring use of its grievance or dispute management procedure for sellers and buyers[4], and has commented that:

"We believe New Zealand consumers would be disadvantaged if classified marketplaces changed their business models to remove grievance and dispute management practices. We think this would be bad policy. New Zealand's policy framework should encourage e-commerce sites to implement trust and safety processes, and ensure that goods sold comply with New Zealand laws and other consumer protection mechanisms, rather than discourage this."

To ensure that electronic marketplaces are not incentivised to reduce the level of protections they provide to consumers, the submitter considers that the coverage of the proposed marketplace rules should be broader so that the likes of online classified-style marketplaces that provide a messaging service between buyers and sellers and social media marketplaces are clearly captured. The submitter has further suggested that examples be included in the legislation to accompany the re-drafted provisions.

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[4] https://www.ato.gov.au/law/view/document?DocID=COG/LCR20182/NAT/ATO/00001, see paragraph 89 on page 15.

Comment

Given the breadth of common marketplace listing policies that the "directly or indirectly set a term or condition under which the supply is made" wording would cover, it is not clear that it would be simple for an established marketplace that already (at least indirectly) sets some terms and conditions for sales on its platform to change its business model to avoid the proposed rules. Further, it may be the case that there are counteracting reasons why it may not be commercially viable for such electronic marketplace operators to reduce their involvement in or exert less influence over transactions on their platforms such that they do not (even indirectly) "set a term or condition under which the supply is made".

For instance, in an online shopping environment – and possibly even more so in a cross-border online shopping context – consumers already have strong incentives to purchase from trusted websites that have consumer-friendly policies. It seems likely that marketplaces that set terms and conditions that provide greater protection to consumers using their websites would enjoy a competitive advantage because of this. Having said this, officials understand the submitter's concern and acknowledge that this might be a potential risk. Inland Revenue officials will monitor whether marketplaces change their existing business structures in response to the rules to see if this risk transpires in practice.

Officials do not consider the drafting changes suggested by the submitter are necessary as there is a very limited set of situations in practice where an electronic marketplace operator would not be responsible for GST on a supply of low-value imported goods made on its platform to a consumer in New Zealand. Officials consider that the amendments to section 60C in the Bill already achieve the policy intention of making the electronic marketplace rules as broad as possible within the constraint of ensuring the rules are workable.

Recommendation

That the submission be declined, but the specific concerns around the potential adverse impacts on consumer protections be noted.

Issue: Goods in New Zealand sold over a marketplace

Clause 6

Submission
(Trade Me)

The submitter has expressed concern that goods in New Zealand will be captured by the proposed rules when these goods are sold over a marketplace by a non-resident, and does not see any policy rationale for why the proposed rules have been drafted in this way. The submitter considers there are instances where this would be unfair to its sellers.

The submitter recommends that the phrase "and the goods are outside New Zealand at the time of supply" be inserted at the end of proposed new section 4B(1)(c)(ii), with a requirement that marketplace operators can only treat goods as being inside New Zealand if they have information that supports this.

Comment

There is a practical reason why the electronic marketplace rules are proposed to apply to supplies of goods by non-resident underlying suppliers without regard to where the goods are located at the time of supply. The rules proposed in the Bill would require operators of electronic marketplaces to determine the residency of their underlying suppliers; a further requirement that GST should not be charged if the marketplace operator has information that the goods are already situated in New Zealand may make the rules more complex for electronic marketplaces to apply in practice.

Officials understand that one of the submitter's main concerns is in relation to goods that are listed for sale on an electronic marketplace by a person that has moved from New Zealand to Australia, or moves relatively frequently between Australia and New Zealand. Examples of this that the submitter has raised relate to the situation where the goods are to be picked up by the buyer from a place in New Zealand. In the specific scenario where the goods are picked up by the buyer (rather than either the supplier or the marketplace operator arranging delivery of the goods to the buyer), the operator of the marketplace would not be required to collect GST on the sale. This is because the proposed rules hinge on the goods being delivered to a place in New Zealand, where the delivery is made, arranged or assisted by the supplier of the goods (or by the underlying supplier, if a marketplace operator is treated as the supplier for GST purposes).

In other situations, where there may be some complexity involved in determining the residency of an underlying supplier and the marketplace operator has information that the goods are located in New Zealand, officials suggest that the ship-from location of the goods could be used as one of the two pieces of information required to support the conclusion that the underlying supplier is a New Zealand resident. Officials also note the proposed ability for the Commissioner to agree with marketplace operators on alternative methods for determining the residency of underlying suppliers in situations where the default methods are too difficult to apply in practice, or where there are good reasons why an alternative method might be more accurate.

The submitter cited another example of non-resident suppliers importing goods into New Zealand before listing the goods for sale on an electronic marketplace. In this instance, the non-resident underlying supplier may be able to make use of the proposed amendment to the rule in section 60(1C) which treats a supply of goods to a consumer in New Zealand through an electronic marketplace as two separate supplies. This would allow the underlying supplier (if registered for GST in New Zealand) to make an input tax deduction for any New Zealand GST incurred in making the supply, including import GST paid to Customs.

Recommendation

That the submission be declined.

Issue: Discounts offered by marketplaces provision

Clause 12(2)

Submission

(Chartered Accountants Australia and New Zealand, EY, KPMG)

Submitters have commented that the drafting of the valuation provision that applies in the situation where an electronic marketplace offers a discount for goods sold on its platform by a third-party seller could be clearer. Submitters have suggested the following drafting changes:

- That the language of the provision be simplified by deleting the phrase "if the amount of the reduction would otherwise form part of the consideration for the supply". *(EY)*
- The phrase "does not include the amount of a reduction" in section 10(7D) is ambiguous. The wording should be amended to make it clear that the consideration on which GST will be payable by the marketplace operator is the amount, net of any discount or reduction provided by the marketplace operator. *(Chartered Accountants Australia and New Zealand, KPMG)*
- If the dependent clause is omitted, the relevant part of the provision reads "the consideration for the supply does not include the amount of a reduction… in the price of the supply for the recipient". Supplies are made to recipients, rather than for recipients. If "for" is intended to refer to the price, rather than the supply, then the phrase "for the recipient" is not needed. *(Chartered Accountants Australia and New Zealand)*

One submitter has also commented that the example provided on page 50 of the *Commentary* to the Bill is unclear, and has requested that a clear example be included in the upcoming special report. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials agree that the drafting of the provision could be clearer and will consult submitters on a revised draft of the provision to ensure that the points raised by submitters are addressed. Guidance on the rule, including a clear example of the calculation, will also be provided in the special report and in the *Tax Information Bulletin* following enactment of the legislation.

Recommendation

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

SAFE HARBOUR RULES FOR ELECTRONIC MARKETPLACES AND REDELIVERERS

Clause 37

Issue: General support for safe harbour rules

Submission
(Chartered Accountants Australia and New Zealand, PwC)

Submitters have expressed general support for the safe harbour rules in proposed new sections 60F and 60G, but have noted some concerns with specific aspects of the rules. These specific concerns, along with improvements suggested by submitters, are noted as a separate issue below.

Comment

Officials welcome the support for the safe harbour rules.

The proposed safe harbour rules are intended to address the practical issue for electronic marketplaces and redeliverers where they may not have paid enough GST on a supply of goods that was actually made by a third party, as a result of:

- having insufficient information to determine that the supply is of “distantly taxable” goods to a consumer in New Zealand; or
- relying on inaccurate or misleading information provided by a third party (such as the actual seller of the goods).

Recommendation

That the submission be noted. The submission does not require any amendment to the Bill.

Issue: Practical concerns with the safe harbour rules

Submission
(Alibaba and eBay, KPMG, PwC, Trade Me)

Submitters have made a number of comments on the drafting of the proposed safe harbour rules:

- The drafting of section 60G is difficult to understand and will not be simple to apply. An overall purpose provision should be included to aid interpretation, and careful consideration should be given to simplifying the detailed drafting style of this aspect of the rules. *(PwC)*

- Proposed section 60G(1) prescribes an exhaustive list of situations where a marketplace operator or a redeliverer will not be liable for GST on sales because it has relied on incorrect or misleading information provided by an underlying supplier or by a consumer. The section should not be an exhaustive list, but rather should be an inclusive list of situations where a marketplace operator or a redeliverer will not be liable for GST on supplies of low-value imported goods where it has relied on incorrect or misleading information provided by another party. *(Alibaba and eBay, KPMG)*
- The requirement for a marketplace operator to obtain a declaration from the underlying supplier that they are resident in New Zealand under proposed section 60G(2)(a)(iii) should be removed. *(KPMG)*
- Section 60G(5) should also include the location from where the goods are being shipped as one of the items of information that a marketplace operator can rely on in determining the residency of the underlying supplier. *(KPMG)*
- In the situation where the marketplace operator does not know the address the goods are to be delivered to, the operator should be able to use items of information to determine the customer's likely residency status at the time of the transaction (rather than the analysis hinging on where the person is "usually located"). For instance, it would be helpful if the ability to agree on an alternative method for determining the country or territory the goods are most likely to delivered to could be expanded to cover alternative information requirements for determining the residency of buyers that move between Australia and New Zealand frequently. *(Trade Me)*

One submitter also noted that when the law is enacted, Inland Revenue will need to put in place an efficient process so that agreements between the Commissioner and marketplaces can be made in a timely manner before the proposals come into effect. *(PwC)*

Comment

Officials agree with the drafting points raised by submitters. Officials will consider ways to improve the clarity and breadth of section 60G, and have taken on board the specific suggestions of removing the requirement for electronic marketplace operators to obtain declarations from underlying suppliers and including the location from where the goods are shipped as one of the items of information that may be used to determine the underlying supplier's residency status. Officials will consult with submitters on a revised draft of the provisions.

Officials note the recommendation that Inland Revenue will need to prioritise putting in place an efficient process for agreeing alternative methods with electronic marketplaces and redeliverers once the law is enacted.

Recommendation

That the submissions be accepted.

Issue: Separate valuation methodologies for determining whether goods are low value goods and for calculating GST

Clauses 12(2) and 13

Submission
(Chartered Accountants Australia and New Zealand, Trade Me)

Under the proposed rules, a supplier must first determine whether goods are "low-value goods". If the goods are low-value goods, the supplier must then charge GST based on the value of the supply. However, the valuation methods for determining whether goods are low-value goods and for calculating the amount of GST are different.

One submitter has noted that it is important that offshore suppliers be made aware of the distinction, and has recommended that a clear explanation is included in the upcoming special report on the rules and in the information given to overseas businesses looking to register for GST. This information should include examples of the calculation under each valuation method. *(Chartered Accountants Australia and New Zealand)*

Another submitter has noted that consumers benefit from the full price of goods (including freight) being clearly displayed at the time of purchase. The submitter considers it is inappropriate to reduce the value of the goods by the cost of transport, insurance charges and duties, which they state is inherently hard for online classified-style electronic marketplaces to calculate. The submitter recommends that marketplaces should be able to use the total purchase price when assessing GST liability. *(Trade Me)*

Comment

Officials acknowledge that having two different valuation methods for the purposes of determining whether goods are "low-value goods" and the amount of GST to be returned on a supply of low-value goods could be confusing. The upcoming special report on the rules (as well as other information provided to affected businesses) will contain a clear explanation of the two valuation methods, including examples of each calculation.

At the time of the release of the discussion document, *GST on low-value imported goods: An offshore supplier registration system*, feedback was sought on whether requiring suppliers to use just one consistent valuation method for both purposes (being the total amount paid for the item including freight and associated insurance but excluding GST) might be a better approach.

Most submitters on the discussion document who commented on this issue favoured taking the same approach as Australia, which is to require suppliers to use a reasonable estimate of the "customs value" of an item (referred to in the Bill as "entry value") when determining whether goods are low-value goods. A reasonable estimate of the customs value would generally be the amount paid for the item (excluding GST) less any clearly separable charges paid by the customer for freight and insurance. Submitters cited the following reasons for this preference:

- Consistency with Australia's similar new legislation would be more familiar for suppliers, electronic marketplaces and redeliverers that have registered under Australia's new law, and therefore may be easier for these businesses to implement and generate less confusion than the alternative approach.
- Using an approximation of the customs value may be easier for websites that enable consumers to purchase goods via an online checkout process. Because delivery charges are typically not known until the customer proceeds to the checkout, it may be easier to set up systems to add GST where the value of the good is $1,000 or less before the addition of insurance and freight charges. The collection of GST on the delivery charges can be accommodated by adding GST to the delivery charge at the end of the process.
- If instead the overall transaction value (including freight and insurance) was the basis for determining if a good is above or below the threshold, whether GST applies would not be determined until the very end of the process. From a customer experience perspective it is preferable that the prices quoted by the supplier include all applicable taxes.
- The inclusion of freight and insurance charges in the declared values on customs documents would be difficult for freight forwarders and customs brokers to ascertain on a consignment-by-consignment basis and may provide greater incentives for the declared freight values to be different to what was actually paid by the consumer.

Further, because the $1,000 threshold would be applied by suppliers on an item-by-item basis in determining whether to charge GST, officials note that basing the low-value goods threshold on the total transaction value of an item (including freight and insurance) would require apportionment of delivery charges in instances where the customer pays a single delivery charge for multiple goods. This could potentially be complex, and therefore may increase compliance costs for suppliers.

Officials do not see any reason why requiring suppliers and marketplaces to use an approximation of the customs value to determine whether GST is required to be collected on an item should prevent websites from displaying the full shipped price of goods to consumers where the amount of freight and insurance is known. Officials also note that the amount of GST would still be calculated on the overall transaction value (or full landed value) of the goods, including freight and insurance, which means that suppliers would not be able to substitute between the price of the goods and any explicit charges for freight and insurance to reduce the amount of GST payable.

Recommendation

That the submission that the overall transaction value be used for determining whether goods are low-value goods be declined, but the comments about the need for clear guidance on the two valuation methodologies be noted. The valuation methodologies will be explained in the guidance.

Issue: Valuation rule in section 10(7E) for calculating the amount of GST

Clause 12(2)

Submission

(Chartered Accountants Australia and New Zealand, David Johnston)

One submitter has raised a number of technical issues with the rule in proposed section 10(7E), which is intended to ensure that GST is calculated on the full landed value of the goods, including any extra amounts charged by the supplier for delivery and associated insurance.

- Proposed sections 10B(2)(a) and 10B(3) in the Bill allow a supplier to use "a reasonable estimate of the transport and insurance charges… when the item leaves the country", although this approach does not appear to be reflected in proposed section 10(7E).
- There appears to be a lack of clarity as to how the GST on freight and associated insurance costs should be calculated.
- In addition, offshore suppliers will sometimes not know the cost of freight or insurance at the time of sale, and they will need to reimburse consumers for over charged freight or insurance costs. In these cases, the lack of clarity above means it is not clear whether the offshore supplier can use a "reasonable estimate" or whether subsequent adjustment to GST returns will be required.

The submitter recommends that the proposed legislation be clarified, and that offshore suppliers be allowed to use a reasonable estimate of the transport and insurance charges at the time of sale when calculating GST. *(David Johnston)*

Further, two submitters consider that section 10(7E) is unclear as to what types of services are intended to be covered by the provision, and have requested that:

- The types of services covered by the rule are described in the upcoming special report *(Chartered Accountants Australia and New Zealand)*;
- The proposed legislation is clarified, so it is clear in section 10(7E) that freight and associated insurance costs are included in the value of the goods for the purpose of calculating the amount of GST *(David Johnston)*.

Comment

The intention behind proposed section 10(7E) is to ensure that GST generally applies to additional amounts paid by a consumer purchasing low-value imported goods for services that are closely related to the supply of the low-value imported goods, where these services are arranged or facilitated by the supplier of the goods. Such services include (but are not necessarily limited to) international freight and associated insurance.

In the scenario described in one of the submissions, where the supplier does not know the total cost of freight and insurance and charges the consumer a fee based on an estimate of this cost, GST would apply at the time of supply to the full amount of the fee charged by the supplier. However, if the supplier subsequently refunds the consumer some amount of the fee because it had overestimated the freight and insurance cost, then technically an adjustment in the supplier's GST return would be required under the credit note provisions in the GST Act.

Officials understand the submitter's point is that some offshore suppliers and marketplaces may not want to incur the compliance cost of adjusting their GST returns in the situation where they reimburse consumers for overestimated freight and insurance costs, even though making such adjustments would reduce the amount of GST these businesses are required to pay to Inland Revenue.

Officials consider that the practice described in the submission of reimbursing consumers for overestimated freight and insurance costs is likely unique to a relatively small number of offshore suppliers and marketplaces, and therefore may not warrant the inclusion of a specific exception to the requirement to make an adjustment. Further, it seems likely that it would only be in rare situations that the supplier would have filed its GST return before reimbursing the customer. For these reasons, officials consider that it would be rare for an adjustment to be required to a subsequent GST return as a result of reimbursing the customer for overestimated shipping costs, and therefore an exception from the requirement to make an adjustment is not necessary.

While officials acknowledge that section 10(7E) could be more explicit that freight is intended to be covered by the provision, officials are hesitant to include an explicit reference to freight or transportation services. This is because the rule is intended to apply broadly to services that are provided directly in connection with the goods, and so an explicit reference to freight might narrow the scope of the rule (or be interpreted as narrowing the scope of the rule) to freight and associated insurance, or to services that are related or similar to freight. While an explicit reference to insurance has been included in the wording of the provision, this is because officials consider that insurance is unlikely to be covered by the "directly in connection" test – whereas freight would meet this test.

While not incorporating the specific suggestions from submitters into the revised drafting of the provision, officials have made some changes to the drafting to improve the clarity of the provision.

Guidance on the rule, including examples of the types of services that might be covered by the provision and how to calculate the amount of GST on freight and insurance charges, will also be provided in the upcoming special report and in the *Tax Information Bulletin* following enactment.

Recommendation

That the submissions requesting that section 10(7E) be amended to explicitly refer to freight and that adjustments not be required where freight charges are partially reimbursed be declined. Detailed guidance on the rule will be provided following enactment of the legislation.

Issue: Clarification of "entry value" where goods are already in New Zealand

Clause 13

Submission
(EY)

To determine if an item is a low-value good, suppliers will be required to assess the item's entry value in accordance with proposed section 10B. Reasonable estimates are permitted of certain transport and insurance charges and of tax and duty due. Section 10B should also clarify the manner of determining the entry values of goods already located in New Zealand (when supplied through a marketplace), as the Bill does not cover this situation.

Comment

Goods that are already located in New Zealand at the time of supply are included in the definition of "distantly taxable goods" in the limited situation where these goods are supplied by a non-resident underlying supplier through a marketplace. In practical terms, this means that operators of marketplaces would not distinguish between goods that are already in New Zealand at the time of supply (being the earlier of when an invoice is issued for the supply or a payment is received) and those that are not.

In the situation where the goods are not actually shipped from an overseas jurisdiction but are instead sourced from a place in New Zealand, the intention is that a reasonable estimate of an item's entry value would be the price paid by the customer for the item, exclusive of any explicit transport or insurance charges and any amounts included in the price for tax and duty. However, as the submitter has pointed out, the Bill does not provide for this outcome. Officials agree that the determination of the goods' entry values in this situation should be clarified in the Bill.

Recommendation

That the submission be accepted.

Issue: Clarification of exchange rates

No clause in Bill

Submission
(CAPEC New Zealand)

The submitter is concerned that where the price of a good is expressed in a foreign currency, the supplier would be required to determine whether the goods are low-value goods using either a buy NZD rate or a midpoint rate (being an exchange rate that is between the sell NZD and buy NZD rate).

Since New Zealand Customs currently uses a sell NZD rate (set on a fortnightly basis) to calculate whether goods are above the *de minimis*, the submitter is concerned there is an increased risk of double taxation if the supplier is required to use a buy NZD rate or a midpoint rate.

Comment

Suppliers will be allowed to use sell NZD rates to determine whether goods are low-value goods (as well as for the purpose of determining how much GST is required to be returned in New Zealand dollars when filing their GST returns).

The Bill imposes no restrictions on the specific type of exchange rate that suppliers may use, meaning that suppliers have a choice of using a sell NZD rate, midpoint rate or buy NZD rate.

Clarification on this point will be provided in the upcoming special report and in the *Tax Information Bulletin* following enactment.

Recommendation

That the submission be noted. The submission is addressed in the above comment and will be further explained in the guidance materials.

Issue: "Entry value" versus "customs value"

Clause 5(2)

Submission
(Matter raised by officials)

The proposals in the Bill apply GST to goods that individually have an "entry value" of $1,000 or less.

The valuation methodology that "entry value" refers to is more commonly referred to as "customs value", being the widely used terminology in the goods transportation and logistics industry. The Australian legislation applying GST to supplies of low-value goods imported into Australia also refers to "customs value".

Officials recommend that the references to "entry value" in the Bill be replaced with "customs value" to minimise potential confusion for suppliers, goods transporters and customs brokers.

Recommendation

That the submission be accepted.

SUPPLIES TO NEW ZEALAND GST-REGISTERED BUSINESSES

Issue: Support for the business-to-business exclusion

Clause 9(6)

Submission
(Chartered Accountants Australia and New Zealand, PwC)

Two submitters indicated their support of the proposed exclusion of business-to-business supplies from the scope of the rules.

One submitter commented that the decision to tax only supplies to private consumers (rather than all New Zealand residents, including GST-registered businesses) creates an additional compliance burden for suppliers. However, on balance, the submitter considered this to be justified given the risk to the tax base if suppliers were not compliant, but businesses could claim back GST on purchases. The submitter further noted the Australian law also only applies to supplies to private consumers, and therefore the main suppliers should already be accustomed to applying this rule for Australia. *(PwC)*

Comment

Officials welcome the support for the amendments.

Recommendation

That the submission be noted. The submission does not require any amendment to the Bill.

Issue: Clarification that suppliers are able to issue a document that fulfils the requirements of a tax invoice and a GST receipt

Clause 23(2) to (6)

Submission
(Deloitte)

The submitter recommends that clear guidance is issued to confirm that suppliers are able to issue documents that qualify both as a tax invoice and as a GST receipt required to be issued to consumers for the purposes of preventing double taxation. Enabling overseas suppliers to issue a single document regardless of the business-to-consumer or business-to-business nature of the supply will streamline administration in many instances and could encourage higher levels of compliance.

Comment

The Bill proposes an amendment to extend an existing rule that allows a non-resident supplier of remote services that has incorrectly charged GST on a business-to-business supply to issue a tax invoice to the customer. Under the amendment, a non-resident supplier of low-value imported goods would be able to issue a tax invoice for a business-to-business supply where GST had been incorrectly charged, provided that the value of the supply is $1,000 or less.

The current drafting of the amendment does not clearly allow an offshore supplier to issue a tax invoice in the situation where the charging of GST on a business-to-business supply was deliberate. For instance, it is clear from the guidance materials issued on the rule from when it was first introduced that the ability to issue a tax invoice was only intended to apply in the situation where GST had been inadvertently charged on a business-to-business supply.

Provided that the value of the supply is $1,000 or less, officials see little concern in allowing suppliers that principally make business-to-consumer supplies to simply charge GST on a business-to-business supply of low-value imported goods, as there is little risk of missing trader fraud associated with low-value supplies.

Officials therefore recommend a further amendment to clarify that if the value of a supply of low-value imported goods is $1,000 or less, non-resident suppliers may simply charge GST without being required to determine whether the customer is a consumer or a GST-registered business. In this situation, there is no reason why an offshore supplier should not be able to issue a single document that fulfils the requirements of both a full tax invoice and a receipt required under proposed section 24BAB. Clear guidance confirming that offshore suppliers are able to do so will be provided following enactment of the legislation.

Recommendation

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

Issue: Deduction prohibition for GST-registered recipients of low-value imported goods

Clause 19(8)

Submission
(Deloitte)

An existing rule in section 20(4C) of the GST Act prohibits a New Zealand GST-registered business from claiming an input tax deduction for a supply of remote services that it has acquired from a non-resident supplier if the consideration for the supply exceeds $1,000. The submitter questions the need for the proposed extension of this rule to the situation where a GST-registered business purchases imported goods from a non-resident and the value of the supply is above $1,000.

While the submitter understands this requirement is being inserted because of the risk of potential missing trader fraud and accepts that section 20(4C) is a valid requirement in respect of remote services, the submitter questions whether the risk of fraud is as high for goods.

At a minimum, the submitter recommends the Commissioner should have discretion to allow a New Zealand GST-registered business to claim input tax deductions on high-value imported goods where the non-resident supplier has a good compliance history with Inland Revenue. Many overseas entities are likely to want to charge GST on all sales of goods into New Zealand for systems simplification reasons. In such an environment, compliance costs will be increased if non-resident suppliers are required to make direct GST refunds if they have charged GST to New Zealand business customers who are not allowed to claim back GST in the usual way.

Comment

New Zealand and a number of overseas jurisdictions have had past experience with GST fraud on certain types of high-value business-to-business supplies, including even in a purely domestic (as opposed to cross-border) context. Officials are concerned that allowing non-residents to charge GST on high-value supplies of imported goods to GST-registered businesses may therefore create a real revenue risk from missing trader fraud (that is, where the supplier would not return the GST collected to Inland Revenue but the purchaser, which could be an associated entity, can still claim back GST on the purchase).

Therefore, while officials are comfortable with allowing non-residents to charge GST on low-value business-to-business supplies, officials consider the proposed extension of the deduction prohibition rule in section 20(4C) is justified given the specific concern about high-value supplies.

Officials recognise that the submitter's suggestion of having a Commissioner discretion to allow some "trusted" non-resident suppliers to charge GST on high-value business-to-business supplies of imported goods may be one way to alleviate this concern. However, given the severity of the potential risk, officials consider that such a discretion would likely be exercised less often than the similar proposed discretion to allow suppliers to charge GST on supplies of high-value imported goods to New Zealand consumers. This could lead to perceptions of unfairness, as there is a chance that such a rule may end up being perceived as a concession for large, well-known offshore suppliers but not for smaller offshore suppliers that Inland Revenue knows little about and who may equally want to charge GST on high-value business-to-business supplies.

Recommendation

That the submission be declined.

Issue: Missing cross-reference in provision validating supplier's treatment of supply

No clause in Bill

Submission
(Matter raised by officials)

Existing section 24(5D) applies in the situation where GST is incorrectly charged at the rate of 15 percent on a business-to-business supply of remote services and the offshore supplier opts to provide the recipient with a tax invoice. The section re-characterises the supply as being subject to GST at the rate of 15%, validating the supplier's treatment of the supply. To achieve this outcome, section 24(5D) refers to "circumstances where section 8(4D) was incorrectly applied to the treatment of the supply" (section 8(4D) being the provision that excludes business-to-business supplies of remote services from GST).

Since the business-to-business exclusion in section 8(4D) only applies to supplies of remote services (and not supplies of low-value imported goods), the addition of a cross-reference to section 8(4E), being the exclusion for business-to-business supplies of low-value imported goods, is necessary for the provision to work correctly in the low-value imported goods scenario.

Recommendation

That the submission be accepted.

Issue: Claiming New Zealand input tax

Clause 14(1)

Submission
(Matter raised by officials)

To allow offshore suppliers to claim input tax deductions for goods and services acquired for use in making supplies to GST-registered New Zealand businesses, the Bill proposes to allow these suppliers to zero-rate their supplies of low-value imported goods to New Zealand GST-registered businesses.

However, the zero-rating approach currently proposed in the Bill may be unfamiliar and complex for offshore suppliers. It would also not address the issue of input tax recovery for offshore suppliers to the extent that the use of the relevant inputs is unrelated to making taxable supplies to New Zealand customers (for instance, the expenses relate to an offshore business activity of making supplies to other non-residents). Offshore suppliers of remote services and low-value imported goods should be entitled to claim their New Zealand expenses back, so that GST is neither a tax borne by businesses nor a tax on consumption occurring offshore.

To ensure cross-border business-to-business neutrality, special rules applying to non-resident businesses that do not make any supplies in New Zealand were introduced in 2011 to allow these businesses to claim refunds of GST incurred on business expenses. For the purposes of claiming input tax, a deduction rule in section 20(3L) of the GST Act allows non-resident businesses registered under the special rules to claim back any input tax that relates to their worldwide taxable activity (for example, GST incurred in sending employees to a conference in New Zealand). However, offshore suppliers of remote services and low-value imported goods cannot take advantage of the special rules, as to qualify for these rules the non-resident business must not make any taxable supplies in New Zealand.

For cross-border neutrality reasons and to simplify the rules for offshore suppliers, officials recommend that the zero-rating proposal currently in the Bill be removed in favour of extending the existing deduction rule in section 20(3L) to offshore suppliers of remote services and low-value imported goods.

Officials have previously consulted with some stakeholders on the suggested approach and these stakeholders were supportive of this approach. Officials will also consult submitters on the drafting of the amendments.

Recommendation

That the submission be accepted.

OPTION TO CHARGE GST ON SUPPLIES OF HIGH-VALUE GOODS

Clause 13

Issue: Support for the rules allowing suppliers to charge GST on high-value goods

Submission
(Deloitte, Trade Me)

Submitters have expressed support for the policy of allowing offshore suppliers, marketplaces and redeliverers to elect to collect GST on supplies of high-value goods (being goods that are individually valued above $1,000).

Comment

Officials welcome the support for the amendments.

The rules in proposed new section 10C will allow suppliers who meet certain requirements to elect to collect and return GST on goods above $1,000 supplied to New Zealand customers. The rules consist of:

- a self-assessed test, which suppliers may use to determine their eligibility to charge GST on their supplies of high-value goods (being goods valued above $1,000) to consumers in New Zealand; and
- a Commissioner discretion to allow suppliers not meeting the self-assessment test to charge GST on supplies of high-value goods.

The rules should eliminate compliance costs for suppliers in distinguishing between low and high-value goods, in the situation where these compliance costs are likely to be disproportionate to the potential revenue risk associated with replacing the collection of GST on the supplier's high-value goods at the border with collection by the supplier at the point of sale. This would apply where the total value of high-value goods supplied to New Zealand consumers is relatively low, or where there is otherwise no good reason to consider that allowing the supplier to charge GST on high-value goods supplied to New Zealand consumers poses a significant revenue risk (for instance, because the supplier has a good tax compliance history).

Recommendation

That the submission be noted. The submission does not require any amendment to the Bill.

Issue: 95 percent threshold in the self-assessed test

Submission
(EY)

The submitter considers that the 95 percent threshold appears arbitrary, noting that general feedback it has received from stakeholders is that the threshold for the self-assessed test is too high. The submitter has suggested 75 percent as a threshold that would more effectively reduce compliance costs for suppliers.

Comment

Under the self-assessed test as drafted in the Bill, suppliers would be entitled to elect to collect GST on supplies of high-value goods if 95 percent or less of the total value of goods sold to customers in New Zealand is of goods that are individually valued at or below $1,000.

Officials agree that a 75 percent threshold would make the test easier for suppliers to apply and reduce compliance costs. New Zealand's experience with the legislation applying GST to imported services and digital products (known as the remote services rules) has shown it is generally worth making the design of the rules as simple and easy as possible for offshore suppliers to comply with. Doing so tends to produce good compliance outcomes. Officials consider that the suggested 75 percent threshold strikes an appropriate balance between minimising compliance costs (being the main purpose of the test) and minimising potential risk to the Crown revenue.

Recommendation

That the submission be accepted.

Issue: Complexity of the self-assessed test

Submission
(PwC)

The submitter considers that proposed section 10C (containing the rules allowing suppliers to charge GST on their supplies of high-value imported goods) is unnecessarily lengthy and complex. Given that its ultimate intention is to reduce compliance costs for suppliers, the submitter is concerned that the provision may not be used as it may be too difficult for suppliers to apply.

The submitter has suggested that it be replaced with a very simple provision allowing the Commissioner to agree that a supplier may collect GST on all its supplies, taking into account various matters including the overall mix of low and high-value supplies and the supplier's general history of tax compliance.

Comment

While the intention behind the self-assessed 95 percent test is relatively simple, officials acknowledge that the drafting of the provisions is complex. However, on the basis of other submissions received, it appears that some suppliers of low-value imported goods would find it useful to charge GST on their high-value goods using the rule, rather than being required in all cases to apply for approval to charge GST on high-value goods supplied to New Zealand consumers. Where suppliers are unsure that they meet the test, the option of applying to the Commissioner for an exercise of her discretion would still be available.

For these reasons, officials recommend that the self-assessment test is not removed entirely, and instead improvements be made to make the test more user-friendly (such as decreasing the proposed threshold from 95 percent to 75 percent and making the test a one-off assessment by removing the requirement to check annually whether the test was met for the previous period).

Officials will consider what drafting simplifications can be made and will consult with interested submitters on any revised drafting of the provisions. Detailed guidance will also be provided in an upcoming special report on the rules following enactment of the legislation and in the *Tax Information Bulletin*.

Officials will also focus on ensuring that material on the Inland Revenue website explaining the self-assessed test is clear and concise.

Recommendation

That the submission be declined.

Issue: Clarification of how the election applies to goods already in New Zealand

Submission
(EY)

The submitter has requested clarification of how the election to charge GST on supplies of high-value goods works for goods already situated in New Zealand (that is, in circumstances where the goods are supplied through a GST-registered electronic marketplace).

Comment

An operator of an electronic marketplace would be able to elect to charge GST on supplies of high-value goods if it reasonably believes that 95 percent or more of the total value of goods sold on its marketplace in the initial year of the election by non-residents to New Zealand consumers will be low-value goods. In assessing whether or not this test is met, the operator of the marketplace would include any goods supplied by a non-resident, regardless of where the goods are located at the time of supply.

A marketplace operator that makes the election would be treated as the supplier of any high-value goods supplied to a New Zealand consumer by a non-resident underlying supplier – including any goods that are already in New Zealand at the time of supply.

The upcoming special report will explain the rules.

Recommendation

That the submission be noted. The submission is addressed in the above comment and will be further explained in the guidance materials.

Issue: Compliance history of the taxpayer should be put into context

Submission
(Chartered Accountants Australia and New Zealand)

In considering whether a supplier that does not meet the self-assessment test may charge GST on its supplies of high-value goods, proposed section 10C(4)(a) requires the Commissioner to consider the compliance history of the registered person and any associated persons.

The compliance history must be taken in context. Other countries may have different tax laws and different tax regimes. Moreover, it may be necessary to give compliance with some regimes more weight than others – for example, in some jurisdictions the Base Erosion and Profit Shifting (BEPS) rules have been enacted in response to particular concerns, so non-compliance may be as a result of the legislative framework at the time or commercial arrangements entered into prior to the law change.

Comment

Officials note the points raised by the submitter. In practice, the Commissioner will consider the supplier’s compliance history on a case-by-case basis in determining whether to grant her discretion to allow a supplier to charge GST on its supplies of high-value imported goods.

Recommendation

That the submission be noted.

OTHER ISSUES

Issue: Clarification of application of the registration threshold

No clause in Bill

Submission
(CAPEC New Zealand)

The submitter has requested clarification of whether charges for shipping would be counted towards the $60,000 registration threshold when determining if an offshore supplier of low-value imported goods is required to register for GST.

Comment

The value of a supply of low-value imported goods would generally be inclusive of any explicit freight or insurance charges charged by the supplier to the New Zealand consumer. This would generally apply even in the situation where there is a separate zero-rated supply of international transportation, as a rule in proposed section 10(7E) requires amounts charged for shipping to be included in the valuation of the supply for the purposes of calculating the amount of GST to be returned. Therefore, in calculating the total value of their supplies of goods and services in New Zealand to determine whether they are above the $60,000 registration threshold, offshore suppliers are required to include amounts they have charged for shipping.

Under section 51 of the Goods and Services Tax Act 1985 (the GST Act), non-resident suppliers of low-value imported goods will be required to register for GST if the total value of their supplies of goods and services in New Zealand:

- in the past 12 months exceeded NZ$60,000 (unless the Commissioner of Inland Revenue is satisfied that their supplies in the next 12 months will not exceed this threshold); or
- in the next 12 months is expected to exceed NZ$60,000.

Under the amendments proposed in the Bill, supplies by a non-resident of low-value imported goods will count towards the registration threshold where the supply is to a consumer.

Recommendation

That the submission be noted. The submission is addressed in the above comment and will be further explained in the guidance materials.

Issue: Clarification that the proposals do not apply to alcohol and tobacco

Clauses 13, 35(4) and 36(4)

Submission
(Matter raised by officials)

The proposed rules allowing suppliers to charge GST on their supplies of high-value imported goods apply too widely, as proposed section 10C(3) would arguably treat any supply of high-value goods as a supply of "distantly taxable goods" if the goods are delivered at a place in New Zealand. For example, the provision may be interpreted as potentially applying to supplies of alcohol and tobacco, even though alcoholic beverages and tobacco products do not meet the definition of "distantly taxable goods" in proposed new section 4B.

Similarly, proposed sections 60C(2)(b)(iii) and 60D(2)(c)(iii) in the rules for electronic marketplaces and approved marketplaces also apply too widely. These provisions would arguably treat <u>any</u> supply of low-value goods made through a marketplace as a supply of distantly taxable goods by the marketplace operator, if the underlying supplier of the goods is a non-resident and the delivery of the goods at a place in New Zealand is made, arranged or assisted by either the marketplace operator or the underlying supplier. Similar to the issue with proposed section 10C(3), the marketplace provisions could be interpreted as extending to supplies of alcohol and tobacco.

Officials recommend that the drafting of these provisions be clarified so that it is clear that supplies of alcohol and tobacco are not subject to the proposed rules in any way.

Recommendation

That the submission be accepted.

Issue: Misrepresentations by consumers to avoid GST on remote services

Clauses 7(3) and 32(2)

Submission
(Matter raised by officials)

Existing sections 5(27) and 51B(7) provide the Commissioner with discretion to require a person to register and pay GST that should have been charged on a supply of remote services, when:

- the person has knowingly provided information that is altered, false or misleading, which leads to GST not being charged on the supply; and
- the person has repeatedly and knowingly provided altered, false or misleading information, or the amount of GST that was not charged is substantial.

Section 5(27) as it is currently drafted only applies in the situation where a consumer misrepresents that they are a GST-registered business in order to avoid being charged GST. However, it is clear from the *Commentary* on the Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Bill that the policy intention was the provision should also apply in the situation where a New Zealand-resident consumer acquiring remote services from an offshore supplier deliberately provides false, altered or misleading information that leads the supplier to incorrectly conclude that the person is not resident in New Zealand.[5]

Officials recommend that section 5(27) be amended so that it will also apply in the situation where a consumer deliberately provides false, altered or misleading information pertaining to his or her location or residency status for the purpose of avoiding paying GST.

Given the ability for offshore suppliers to have New Zealand-resident agents and the proposed extension of the existing marketplace rules for remote services to marketplaces operated by New Zealand residents, the suggested amendment to section 5(27) should cover the situation where a consumer deliberately provides false, altered or misleading information to a resident agent or marketplace operator. An amendment to section 51B(7) should also cover this situation.

Recommendation

That the submission be accepted.

[5] See the example on page 83 of the *Commentary*.

Ring-fencing residential property deductions

OVERVIEW

The Bill proposes to ring-fence deductions in respect of residential rental properties to the extent the deductions exceed income from the properties. This means the excess deductions cannot be used to reduce tax on other income. The proposed rules would apply from the start of the 2019–20 income year.

Under current tax rules, rental property investors can deduct interest and other expenses (other than capital improvements) as these expenses relate to earning taxable rental income. In many cases these expenses exceed their rental income, which generates a tax loss even though the overall investment may still be profitable due to the capital gains that can be realised on the sale of the property. Most rental property investors hold their property on capital account and are not subject to tax on the capital gain on sale.

Currently, investors can use losses from the rental properties to offset their income from other sources (such as salary and wages), thus reducing their income tax liability. Tax losses are common in the New Zealand rental market – 40 percent of taxpayers with residential investment property report rental losses, with the average loss per taxpayer being $7,235 a year.

This may create an uneven playing field between property investors who are buying property in anticipation of capital gain, and owner-occupiers. Currently, investors can have part of the cost of servicing their mortgages subsidised by reduced tax on other income sources, helping them to outbid owner-occupiers.

While rental housing is not formally tax-favoured, there is an argument that it may be under-taxed given that tax-free capital gains are often realised when rental properties are sold. The fact that rental property investments are often persistently loss-making indicates that expected capital gains are an important motivation for many investors purchasing rental property.

Under the proposal, deductions for residential properties would be ring-fenced to the extent they exceed residential property income (including income on disposal). This effectively means that investors will no longer be able to offset residential property losses against their other income (for example, salary or wages, or business income), to reduce their tax liability.

This proposal is aimed at making the tax system fairer, and improving housing affordability for owner-occupiers by levelling the playing field between investors and home buyers.

Matters raised in submissions

There were 283 submissions made on the rental ring-fencing proposal.

Almost all submitters opposed the measure (268 of the 283 submitters). The main reasons given were that the proposal:

- is based on an incorrect underlying rationale of there being unfairness in the system;
- is at odds with New Zealand’s global approach to income and deductions;
- would treat one class of investments differently to others; and
- would have negative impacts, particularly on rents.

Many submitters also considered that the proposal should not proceed while the Government is considering the Tax Working Group's recommendations, as the response to those recommendations may mean the measure could become obsolete within a short period of time.

There was also opposition to the proposed application date of the start of the 2019–20 income year. Submitters did not consider that application date would give affected taxpayers sufficient time to understand the new requirements or have the opportunity to restructure their investments if appropriate.

A number of submissions were received on the complexity of the drafting of these provisions in the Bill. It was strongly submitted that the provisions should be completely rewritten so they can be easily comprehended, particularly given the wide range of taxpayers who would be subject to the proposed rules and need to be able to understand them. It was submitted that as currently drafted the provisions are excessively complex, not fit for purpose, and are not consistent with the 1994 rewrite principles. A number of suggestions for improvement were made.

A number of submissions were received on the technical detail of the proposed design of the ring-fencing rules. The main issues raised related to the land the rules should apply to, the use of ring-fenced deductions, and the interposed entity rules.

Refer to Appendix I to view the list of individual submitters who raised particular issues.

SUPPORT FOR / OPPOSITION TO REFORM

Clauses 49 and 65

Issue: Support for ring-fencing deductions for loss-making residential rental properties

Submission
(Corporate Taxpayers Group, Chris Perera, Frank McCulloch, Jeffrey Cate, Melanie Kilfoyle)

The Corporate Taxpayers Group at a macro level, supports measures that address the perceived distortion in the residential property market.

One individual submitter who supported the proposal considered that it was fair, but also noted that it will cause problems (such as rent increases).

Another individual submitter considered ring-fencing losses to be a worthy proposal, which would enable more families to purchase their own homes. The submitter stated that in recent years, numbers of investment property portfolios have grown significantly due to the ease of using excessive financial leverage to obtain bank loans for purchase. The submitter noted that investors holding large numbers of properties were contributing to decreased home ownership.

One submitter referred to the proposal as a progressive step. The submitter noted that ring-fencing of losses does not affect long-term property investors. However, in the submitter's opinion, highly-geared speculative investors have damaged the way property investors are perceived.

Recommendation

That the submissions be noted.

Issue: Opposition to ring-fencing deductions for loss-making residential rental properties

Submission
(Akeda Trust, Auckland Property Investors Association Incorporated, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Focus Holdings Ltd, For Tomorrow Ltd, Gabbie Limited, Generate Accounting Group Limited, Real Estate Institute of New Zealand, RKV Investments Ltd, Ghuznee Holdings Ltd, KPMG, New Zealand Property Investors Federation, PwC, Young Property Consultants Ltd, and 252 individual submitters – see the attached Appendix)

There was strong opposition to the proposal, with 268 of the 283 submitters opposing the measure. The main reasons for this being that:

- the Government is currently considering the Tax Working Group's recommendations, which may mean the measure becomes obsolete within a short period of time;
- the rationale for the measure is based on an incorrect underlying assumption that there is unfairness in the system and that owner-occupiers are disadvantaged compared to investors;

- the measure is at odds with New Zealand's tax policy framework and non-schedular settings;
- the measure would treat one class of assets differently to other investments;
- there was concern that the measure will negatively impact on rents and the rental housing stock; and
- the measure may not have the desired impact on affordability for owner-occupiers.

Three individual submitters expressed no clear preference for or against the proposal.

Comment

These concerns are discussed in more detail below.

Recommendation

That the submissions be noted.

OBJECTIONS TO THE PROPOSAL

Clauses 49 and 65

Issue: Deferral until Tax Working Group recommendations considered

Submission
(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, Generate Accounting Group Limited, KPMG, PwC)

Submitters considered that the proposals should be deferred. This was on the basis that if the Government adopts the recommendations of the Tax Working Group in relation to taxation of capital gains from land, the ring-fencing rules would become obsolete, or at the very least the case for them would be weakened.

Submitters appreciated that the Government has not yet responded in full to the Tax Working Group's final report, and that there would be a time lag before any recommendations are implemented, but considered that proceeding with the proposal at this time would involve a significant amount of resources being spent on something that may just be repealed.

One submitter commented that similar rules were introduced in Australia in the 1980s and were subsequently abandoned with the introduction of a capital gains tax. The submitter considered that to have a capital gains tax and ring-fencing would impact the supply of residential rental accommodation at a time when there is a recognised shortage. It was also submitted that this would have a fiscal impact for the Government.

Comment

The Government has announced that it will not be introducing a capital gains tax. That announcement supersedes this submission point.

One of the primary rationales for the proposal is that landlords are currently able to fully utilise residential rental tax losses to reduce tax on their other income even though not all of the economic income from the rental property is taxed, as typically any gain on sale is untaxed.

It is also noted that numerous countries tax capital gains but nonetheless restrict the use of rental losses or negative gearing.

Recommendation

That the submissions be declined.

Issue: Incorrect underlying assumption that investors have an unfair advantage over home buyers

Submission

(Auckland Property Investors Association Incorporated, EY, New Zealand Property Investors Federation, and 15 individual submitters – see the attached Appendix)

It was submitted that there is a fundamental error in the assumption that tax deductibility for rental property allows investors to outbid owner-occupiers. It was submitted that rental property is not tax advantaged, and that in fact homeowners actually have an advantage over investors as the imputed value of the accommodation they receive is not taxed. It was submitted that the proposal not be introduced as the playing field between investors and home buyers is not unequal.

It was also submitted that the proposal may not have the effect of "levelling the playing field" between property speculators and investors and owner-occupiers – one of the stated objectives. It was considered that the proposal may instead simply result in a change of the composition of investors, with investors with more equity replacing low equity investors who are driven out of the market.

One submitter noted that first home buyers are at an advantage compared to investors, because first home buyers have access to first home buyer grants and KiwiSaver funds. One submitter considered it is first home buyers, not investors, that are pushing up house prices.

Comment

Investment housing is currently taxed under the same rules that generally apply to other investments and is not formally tax favoured. The main tax preference for housing is for owner-occupied housing. This is because the benefits from owner-occupied housing are not taxed. If two people owned houses and rented these out to each other, each would be taxed on the rental income they receive. If instead they live in their own houses, no tax is levied on the implicit rental income they receive. This tends to bias housing choices in favour of owner-occupation for owner-occupiers with substantial equity. However, mortgage interest and other expenses are not deductible for owner-occupiers, and this will offset or more than offset this bias for owner-occupiers with lower amounts of equity. The proposed loss ring-fencing loss rules would reduce the bias in favour of rental housing for highly leveraged housing.

It is possible that the proposal may result in a change of the composition of investors, with investors with more equity replacing lower equity investors. However, the proposal could also help improve home buyers' ability to compete with investors.

Recommendation

That the submissions be noted.

Issue: Contrary to New Zealand's tax policy framework

Submission
(Chartered Accountants Australia and New Zealand, Ghuznee Holdings Ltd, PwC)

Submitters commented that the proposal is contrary to New Zealand's tax policy framework, and that concepts of gross income and global deductions are fundamental to the New Zealand tax system. It was submitted that this proposed "schedular" approach was unprincipled, and that alternatives which do not depart from the fundamental frameworks should be preferred. One submitter commented that, for example, the same objective could be achieved with a capital gains tax on the sale of land.

Comment

The proposed ring-fencing rules are an exception to the general approach in the Income Tax Act 2007, under which income and deductions are generally looked at on a global basis, with tax being payable in respect of a person's net income from all sources.

Recommendation

That the submissions be noted.

Issue: Investment property treated differently to other assets

Submission
(Generate Accounting Group Limited, PwC, and 91 individual submitters – see the attached Appendix)

It was submitted that the proposal is not good policy, as it means one sector of the economy or asset class is being treated differently from others. Submitters considered that this means the proposal in fact runs contrary to the stated goal of fairness.

It was also submitted that the current tax rules do not result in a specific tax advantage only available to residential rental investment properties warranting specific rules to remove this perceived "tax advantage". It was noted that currently negative gearing may also occur in other industries – for example, farms and businesses may also negative gear, making losses in the initial stages and using them to offset income generated by other means (including by commonly-owned companies).

Individual submitters said that ring-fencing losses for rental properties is unfair, singles out one business, and discriminates against residential rental property investment compared to any other business or investment in New Zealand. If implemented, it would create an imbalance. It is a business that should be treated like any other. Expenses should be able to be deducted from gross income.

Comment

Investment housing is currently taxed under the same rules that generally apply to other investments and is not formally tax favoured. However, there is an argument that it may be under-taxed given that tax-free capital gains are often realised when rental properties are sold. There is an argument that to the extent deductible expenses in the long-term exceed income from rents, those expenses in fact relate to the capital gain, so should not be deductible unless the capital gain is taxed.

However, officials agree that this is not unique to investment housing or land. Other investments, especially if highly-geared, may produce losses which are able to be offset against other income, and untaxed capital gains. The loss ring-fencing proposal would, as submitters have commented, treat residential investment property differently to other investments. That said, there is an argument that there may be greater scope for under-taxation in respect of housing compared to other assets, as housing may potentially be more easily geared than other assets and there may be a higher expectation of capital gains.

Recommendation

That the submissions be noted.

Issue: Impact on rents and housing stock

Submission
(Auckland Property Investors Association Incorporated, Generate Accounting Group Limited, For Tomorrow Ltd, Gabbie Limited, New Zealand Property Investors Federation, Real Estate Institute of New Zealand, PwC, and 178 individual submitters – see the attached Appendix)

Some submitters commented that it is unclear what impact the proposed rules would have on property speculation generally, property prices, or rent levels. Submitters stated that the proposal is poorly thought through, irresponsible, and politically motivated. They said that no proper analysis has been done to estimate impacts of the policy. Some also noted that there is a significant uncertainty as to the effects of the policy and that Inland Revenue itself is not sure of the impacts of the policy. Some believed that there was no consultation with the affected landlords.

One submitter commented that they would like to see independent economic modelling undertaken to examine and calculate the likely effect ring-fencing will have on the rental market, and that before any decision on the proposal is made, the Government should produce an impact statement on the likely effects of ring-fencing on rental prices and the supply of rental accommodation.

Other submitters felt strongly that the proposal would negatively impact the rental market. It was considered that this would occur for two reasons:

- through investment property owners passing on the cost of the reduced benefit to renters through increased rents; and
- by making rental ownership less appealing as an investment, leading to a reduction in rental properties and increased pressure on the rental market, which would in turn drive rents up.

The majority of individual submitters believed that this measure will cause rents to increase. Many noted that such increases are inevitable as a result of the combined effect of this measure and additional pressure from the healthy homes standards.

Submitters considered that the fact residential rental property is likely to have losses shows that landlords are subsidising the living costs of their tenants. It was also noted that those making losses are likely to be landlords with recently purchased properties, but that eventually those properties would become profitable and investors would start to pay tax. It was also noted that rental property owners take on the risk of mortgage interest rates increasing. Submitters commented that it is already difficult enough to provide new rental property in New Zealand and would only become more so if the proposal goes ahead, as losses would not be available when cashflow is poor, which would make it much harder for many to buy a rental property.

It was considered that the proposal puts the interests of first home buyers above renters, and that it would be an irresponsible measure to introduce at a time when New Zealand has a shortage of rental properties.

Individual submitters noted that New Zealand already has a housing crisis, and that this policy would make the situation worse, including increasing homelessness. Many said that the proposal will result in a greater need for state houses. Some considered that the Government's increased housing costs as a result of this proposal would be higher than if private landlords were not dis-incentivised to provide rental accommodation. Some did not believe that the Government alone is able to provide enough affordable homes for the housing market. Many believed that the housing and rental markets will suffer severe consequences, and some thought that these markets will collapse.

Some noted that house prices went up not because of speculators but because of restrictive planning rules which reduce supply, and lack of industry capacity.

Submitters considered that the proposal would have the greatest negative impact in low yielding areas, as it is most difficult to provide rental property in these areas. It was noted that Auckland has the lowest average rental yields in New Zealand, so would be the hardest hit area, but that it also has the fastest growing population in the country so the greatest requirement for more rental properties.

Submitters commented that if the policy driver was to improve housing affordability or better access to housing, the proposed rules were a poorly targeted tool, as the risk that rents could increase would negatively impact on access to housing.

Numerous submitters noted that either they or their clients were considering selling their rental properties in anticipation of the proposed changes.

Comment

Rental loss ring-fencing will reduce after-tax rental returns for some landlords. This could encourage the transfer of housing stock from investment housing (that is, rental housing) to owner-occupier housing, putting pressure on the remaining rental stock. On average, owner-occupied housing tends to have fewer people per house. This suggests that the transfer of housing stock from rental to owner-occupied may reduce the amount of housing available for each remaining renter unless there is an adequate flow of new housing onto the rental market. This may lead to increased rents. Landlords may also pass on their rental losses to tenants in the form of increased rents. There are other ways that this and other policies could impact the rental market.

Officials note there is significant uncertainty about the net impact of the policy on the housing market, especially on the rental market. Overseas experience underlines the uncertainty in the direction and magnitude of housing market impacts. For example, negative gearing was banned in Australia between 1985 and 1987, and while rents spiked in Sydney during this period, they were flat or falling across much of the rest of the country. The exact relationship between the tax changes and observed changes in rent is unclear.

A Regulatory Impact Assessment was produced for this reform. In that and other advice officials have provided the Government, it was noted that rental loss ring-fencing could result in renters being adversely impacted through higher rental prices. This could in turn increase fiscal costs to the Government, most directly from higher income-related rent subsidy costs and accommodation supplement costs. While loss ring-fencing could lead to increased rents, on the other hand, it could improve housing affordability for home buyers. Officials have stressed that the net impact of these effects is uncertain.

Officials note that Westpac's 2018 report, *Tax and house prices*[6], similarly did not quantify the likely impact of the loss ring-fencing proposal on rents, but noted that they would increase, while house prices would be expected to decrease by up to six percent, and home ownership rates would increase.

Recommendation

That the submissions be noted.

Issue: Other impacts on tenants

Submission

(74 individual submitters – see the attached Appendix)

One submitter stated that "a move against a property investor is a move against a tenant". Many submitters stated that in addition to having to increase rents (discussed above) they would also have to reduce maintenance on their rental properties, which would detrimentally affect the tenants. Some noted that tenants are going to be more negatively affected than property owners.

Some submitters noted that not every tenant wants to buy their own home; this may simply be their choice. Additionally, many tenants would not have the required deposit to buy a property, and some may choose to have a different life style rather than saving for a deposit.

One submitter noted the changes will result in rental properties being let only to "upper quartile" tenants, with the rest missing out. Three submitters noted that at risk and "marginalised" / the most needy (for example, mentally ill people) will not be able to get rental accommodation.

One submitter noted that the changes are going to result in increased tension between tenants and landlords.

[6] Westpac, *Tax and house prices*, 19 June 2018: https://www.westpac.co.nz/assets/Business/Economic-Updates/2018/Bulletins-2018/Tax-and-House-Prices-June-2018.pdf

Comment

While the proposal could result in some deferral of repairs and maintenance compared to what may otherwise be the case, this may only be at the margin, as many submitters have commented that losses usually only arise in the early years of an investment property being held, and then become profitable. It is also noted that certain repairs and maintenance will not be able to be deferred, given the healthy homes standards regulated for under the Healthy Homes Guarantee Act 2017.

Recommendation

That the submissions be noted.

Issue: Impact on affordability for owner-occupiers

Submission
(Real Estate Institute of New Zealand, and 48 individual submitters – see the attached Appendix)

It was submitted that removing the ability to offset losses against other income could skew investment decisions without improving affordability of owner-occupied housing. For example, investors may choose to increase their investment in owner-occupied housing rather than in rental properties, which could counter any potential impact on housing affordability, and has the potential to increase rent prices.

Some submitters said that the consequences of the policy far outweigh any perceived benefits. Many believed that the policy will not achieve its stated outcomes, saying it will not level the playing field, will not assist but further disadvantage first home buyers (as increased rents would impede their ability to save for a deposit), and will decrease voluntary compliance. Some submitted that the current system is working fine as it is.

Comment

The advice Inland Revenue and the Treasury have provided the Government has been that loss ring-fencing could lead to increased rents, but on the other hand, it could improve housing affordability for home buyers. Officials have stressed that the net impact of the effects on the housing market is uncertain.

Westpac's 2018 report, *Tax and house prices*, noted that house prices would be expected to decrease by up to six percent, and home ownership rates would increase. On the other hand, it was also noted that rents would increase (though the extent to which this might be expected to be the case was not quantified).

Recommendation

That the submissions be noted.

Issue: Impact on investors (owners of residential rental properties)

Submission
(Focus Holdings Ltd, New Zealand Property Investors Federation, and 222 individual submitters – see the attached Appendix)

The majority of submitters are owners of residential rental properties in New Zealand. Many such submitters noted that they own between one and four residential rental properties.

The submitters noted that being a residential property owner is hard work ("sweat equity"), which is a result of sacrificing the owner's lifestyle. Many owners already incur high compliance costs as a result of healthy homes regulations, necessary maintenance, council rates. It was also noted that investors can no longer claim depreciation on buildings. Submitters pointed out that residential property owners carry risks, and often top up rental shortfalls (when the rent received does not cover all of the expenses relating to the property).

A number of submitters that are owners of residential rental properties noted that they strive to keep their rental properties in good order and already provide more than required by government standards for rental properties. This benefits their tenants. They pointed out that the benefit they provide to society, for example through subsidising their tenants' living costs, accepting tenants with children and pets, and providing tenants with high quality accommodation. Some submitters said that their tenants have better quality homes than they do themselves.

Submitters consider that existing (and particularly small) owners will be detrimentally affected because of the increased costs to run their rental properties. Costs will increase because of the inability to offset their losses against other income. Many noted that owners do not intend to make losses in perpetuity, and availability of deductions is not a reason to enter the residential rental property market. They explained that losses normally only occur in the first years of owning a residential rental property, after which the property will returns taxable profits. Sometimes, there may be a loss due to an unexpected large maintenance outlay (for example, due to damage to the property). One submitter noted that tenants do not look after rental properties. The ability to offset losses against other income is seen as essential to being able to continue provide rental housing.

The submitters noted there would be different impacts on different categories of owners of residential rental properties: existing owners, potential owners (those considering purchasing a rental property), small owners (owning one to two rental properties), and large owners.

Submitters commented that they may have to either sell their properties because of the changes, increase their rent, or reduce and defer maintenance on the rental properties. Some noted that the first port of call would be to reduce maintenance and to increase rents, but if it is insufficient, they will sell. Some noted that they will not develop their properties to make them able to house more tenants. Many believed that the owners of rental properties will be dis-incentivised.

Only large or highly-leveraged investors will not be negatively affected. Many submitters (among them one investor with a large number of properties) said that larger investors will buy the properties of smaller investors forced to leave the residential rental market because they can no longer afford to remain there.

Many submitters considered that there is an unjustified prejudice against investors in rental properties, and that the effect of this proposal is penal. They submitted that their investments are being undermined. It was submitted that the proposal would seriously impact on and impair the ability for New Zealanders to save for their retirement. Submitters questioned why they are being penalised for taking initiative in relation to their financial futures and reducing their burden on the state in their retirement. Some noted that their investment in residential rental properties was to enable their children to purchase their first home.

A number of investors believed that the Government alone cannot resolve New Zealand's rental crisis, using the phrase "killing the goose which lays a golden egg".

Some noted that they invest in residential rental properties because of future capital gains and/or an ability to rely on a passive income stream. Some said that they expected that their gains will be modest.

Many have pointed out to the differences between residential rental property investors and speculators. The investors are there long-term, whereas speculators intend to make a quick return. They pointed out that speculators are already taxed under the bright-line test.

One submitter noted that the current law is too protective of tenants.

One submitter noted that new rules will impact adversely on leasehold property owners.

Recommendation

That the submissions be noted.

APPLICATION DATE AND PHASED INTRODUCTION

Clauses 49 and 65

Issue: Retrospectivity, application date, and phased introduction

Submission

(Accountants + Tax Agents Institute of New Zealand, Andrew Clist, Baucher Consulting Limited, Bill Stark, Capital Accounting Associates Limited, Chartered Accountants Australia and New Zealand, David Rowell, Deidre Mellamphy, Generate Accounting Group Limited, Jacky Cheung, Justin Harness, KPMG, Matthew Dawe, Megan Graham, New Zealand Property Investors Federation, PwC, Real Estate Institute of New Zealand, Rob Rimmer, Sarah Wilson, Stephen Cruttwell, Steven Law)

The application date generally

It was submitted that the short timetable between the introduction of the Bill (5 December 2018) and the proposal that the ring-fencing rules take effect from 1 April 2019 was insufficient time to consider and submit on the proposed legislation for what is a substantial policy change.

Some submitters suggested that if the rules are progressed, they should apply from 1 April 2021 at the earliest. It was considered that the proposed commencement date of 1 April 2019 does not give affected taxpayers sufficient time to comply with the new requirements or have the opportunity to restructure their investments if appropriate.

Further, it was noted that the Government is considering extending the taxation of capital gains, in which case the rules may become obsolete. Submitters considered that it would be inefficient and result in undue compliance costs if taxpayers are required to comply with such complex rules for a potentially short time before they are repealed.

Retrospectivity – particularly for early balance date taxpayers

It was submitted that the regime should not have retrospective effect. It was noted that while the proposed rules will apply retrospectively for all taxpayers, this is particularly unfair for early balance date taxpayers, as their 2019–20 income year may have commenced prior to the Bill even being introduced. It was submitted that the proposed rules should instead apply from the start of the 2020–21 income year for early balance date taxpayers.

Phased introduction

Alternatively, it was submitted that given the complexities, the significant policy impact, and the proposed short timetable, the rules should be phased in. It was considered that phasing the rules in would allow investors sufficient time to modify or work out existing contractual arrangements, or to assess the impact of the changes on their circumstances and make adjustments if required. It was also noted that phasing the rules in may also mean rental prices could increase more gradually, which would be fairer to tenants.

Some submitters considered that the rules should be phased in over a three-year period as they considered was suggested in Inland Revenue’s Issues Paper, or over five years as per the Labour Party 2017 election manifesto.

Others submitted that the Committee should seriously consider adopting the phased introduction suggestions made by the Treasury and the Ministry of Business, Innovation and Employment ("MBIE"), as outlined in the Regulatory Impact Assessments.

One submitter considered that Inland Revenue's concerns over precedent and complexity were over-stated.

Grandparenting

Other submitters proposed was that there should be grandparenting for existing investors as at either the time the Inland Revenue Issues Paper was released for consultation, or the date the Bill was introduced.

Comment

Application date and retrospectivity

It is proposed that the rules will apply from the start of the 2019–20 income year. For taxpayers with a standard balance date, their 2019–20 income year began on 1 April 2019. For some taxpayers with earlier balance dates, their 2019–20 income year could have begun as early as 2 October 2018. These application dates would be before the Bill is expected to be enacted in mid-2019.

The impact of this is mitigated somewhat by the Bill having been introduced before the start of the income year, for standard balance date taxpayers. This is not the case for some early balance date taxpayers, though it is noted that the proposed rules have been well signalled.

The main features of the rules, and the proposal that the rules would apply from the start of the 2019–20 income year, were announced and consulted on in an Issues Paper that was released in March 2018. This was at least five months before the start of 2019–20 income year for those with early balance dates, and 12 months before the start of the income year for those with standard balance dates.

Furthermore, because the proposals limit how deductions can be offset against income, taxpayers would not be required to take a tax position until the date that they file their income tax return for the 2019–20 income year.

The deadlines for filing income tax returns for the 2019–20 income year will be well after the enactment date. Taxpayers with early or standard balance dates will have until 7 July 2020 to file their tax return for the 2019–20 income year. This is expected to be approximately 12 months after the Bill is enacted.

Taxpayers are also able to apply to Inland Revenue for an extension of time to file their income tax return. The maximum period for an extension of time that can be granted is to 31 March 2021 for the 2019–20 income year, which would be approximately 20 months after the Bill is enacted.

Finally, it is noted that the number of early balance date taxpayers who would be affected by the proposed rules is very small, with just 0.01 percent of the potentially affected taxpayers having early balance dates (99.4 percent have standard balance dates, 0.31 percent have late balance dates, and 0.3 percent are unknown).

Phased introduction

The March 2018 issues paper sought submissions on whether the rules should be applied in full from 2019–20 (as per the current Bill) or phased in over three years. Phasing the rules in would allow affected existing investors more time to adjust to the new rules, or to rearrange their affairs before the rules apply in full.

Inland Revenue officials consider that, on balance, there is a stronger argument to apply the rules in full from the outset for all properties. This is on the basis that it would create additional complexity, and that tax law changes are not typically phased in and such an approach could result in a precedent-setting risk.

Grandparenting

Grandparenting would exclude existing rental properties from the proposed loss ring-fencing rules. This would greatly limit the application of the policy and could be seen as unfairly disadvantaging new landlords that purchase rental properties after the start of the 2019–20 income year. It would encourage landlords to hold on to loss-making rental properties that they purchased prior to 2019–20 rather than invest in new properties (including new builds).

Recommendation

That the submissions be declined.

ALTERNATIVES TO THE PROPOSAL

Clauses 49 and 65

Issue: A *de minimis* or cap on claiming rental losses, and exemptions

Submission

(Adrienne O'Sullivan, Andrea Thompson, Baucher Consulting Limited (oral submission), David Rowell, Grant Dickson, Jacky Cheung, Kathy Fray, Lesley Quirk, Megan Graham, Melanie Kilfoyle, New Zealand Property Investors Federation, nsaTax Ltd, PwC, Sally Rae, Stephen Cruttwell, Tania Tang, Teresa Elder, Virenda Gupta)

It was suggested that an alternative, more targeted approach to the proposal, would be to have *de minimis* or cap on claiming rental losses. It was suggested this could be done by reintroducing specified activity loss rules for rental properties. These rules limited the losses for an income year for particular activities to the lesser of the income from that activity or $10,000.

Submitters noted that the proposed rules are complex, confusing and onerous, and would impose significant compliance costs on many taxpayers who are substantially unaffected by the rules. It was felt that a *de minimis* or cap on claiming rental losses would reduce the obligation to comply with the rules.

One submitter noted that its research showed that the average New Zealand property makes a loss of approximately $9,000 in the first year of ownership. It was suggested that if ring-fencing was applied to losses greater than approximately 20 percent above this level (say above $10,000), this would allow the average New Zealand property to continue being provided as a rental, which would reduce the impact on rental supply and rent prices.

Another submitter suggested a *de minimis* or cap could be set at $5,000 (a maximum $1,650 tax benefit), and that this would remove a large portion of investors from having to comply with these rules. It was considered that the rules would be unlikely to achieve the policy objectives for taxpayers with such a low annual tax benefit. In particular, the submitter considered that the rules would not alter the behaviour of taxpayers getting such a low tax benefit, so would have no impact on the housing market, but would create additional significant compliance costs and result in significant non-compliance. It was considered that the rules should be targeted at those who highly gear their rental properties, creating significant tax losses in favour of tax-free capital gains.

Some individual submitters asked for a *de minimis* cap of $5,000-$10,000, or for the rules to not apply for a certain number of properties per investor (for example, one or two).

Some individual submitters asked for tiered allowance caps: for example, that an investor can claim 100 percent of the losses in the first year following the introduction of the rules (or the first year of ownership for new investments), with a 20 percent reduction in each subsequent year. Another submitter suggested a model when 90 percent of losses can be offset in the first year, with 10 percent being carried over to the next; in the second year the ratio of losses that can be utilised in that year to losses that have to be carried over is 75% / 25%; and then it is capped at 50% / 50%. The submitter noted that remaining credit should be refundable if the property is sold.

Some individual submitters suggested that the rules should not apply to:

- one rental property;
- one rental property for the first 5-10 years of ownership;
- small landlords;
- houses complying with government regulations;
- certain expenses (for example, repairs and maintenance, bank interest);
- existing rental properties (grandparenting these); or
- investors' next-of-kin, if investors have a proven track record of investing in residential property.

Comment

The rationale for the proposal, that there is unfairness in investors using rental losses to reduce their tax on other sources of income, exists irrespective of the level of losses a particular taxpayer makes.

Many of the suggestions would make the rules substantially more complex.

It is also noted that under the proposal excess deductions would not be lost, but carried forward and available for use in future income years when rental profits are being made.

Recommendation

That the submissions be declined.

Issue: That the rules apply only to interest expenditure

Submission
(KPMG)

It was suggested that an alternative approach would be for the rules to apply only to interest expenditure. This was considered a more targeted approach, if the concern is in relation to highly leveraged properties. Applying the rules to only interest expenditure would mean that other expenses could be deducted even if that resulted in a loss (for example, if there were significant repairs and maintenance in a particular year), and it would only be excess interest deductions that would be ring-fenced.

Comment

Interest will generally be the largest deductible expense, leading to rental properties being loss-making. Therefore, applying the rules only to interest would be an approach that would more specifically target highly leveraged properties. However, this would add some additional complexity to the rules, as opposed to the current proposal which just looks at whether the property is profitable or loss-making overall.

Also, there may be an argument that excluding some expenditure from the rules (in particular, repairs and maintenance costs) could somewhat cut across one of the intended aims of the proposal. This is because repairs and maintenance to a property will feed into the ultimate potential capital gain, and it is the non-taxation of capital gains that is essentially the source of the under-taxation of investment housing, and the perceived unfairness in that regard.

Recommendation

That the submission be declined.

Issue: A modified form of thin capitalisation rules

Submission
(Baucher Consulting Limited)

It was suggested that an alternative would be a modified form of the thin capitalisation rules. This would mean that deductions could only be claimed for interest on debt up to a certain percentage of the value of the property.

Comment

It is considered that a modified form of thin capitalisation rules would be substantially more complex and more difficult for many investors to comply with.

Recommendation

That the submission be declined.

Issue: Focus on supply-side measures

Submission
(Anne Tseng, Chris Perera, Di Yu, Gabbie Limited, Ilya Zharenikov, Kim Meichtry, Klodia Kamberi, Zikon Leung)

It was submitted that instead of the proposed rules, the focus should be on reforming the Resource Management Act 1991, and opening up more land and speeding up development. The comment was made that the issue is one of supply, and we cannot solve it by taxing our way out.

Submitters considered that instead of implementing the proposed rules, the Government should address the issue of housing supply by:

- building more houses, releasing more land, addressing outdated local Government building regulations;
- subsidising new apprenticeships in building and construction;
- investing more in KiwiBuild;
- building more state homes; and
- providing rent-to-buy schemes and low interest government loans to lower income families.

Comment

It is acknowledged that supply-side issues are a crucial part of the housing equation, and that demand-side measures such as this proposal can only go so far in attempting to address affordability and access to housing.

Recommendation

That the submissions be noted.

Issue: Other suggested alternatives

Submission

(Annelies Guyan, Barry Saxon, Beatrice Ezpeleta, Di Yu, Cliff Ah Kit, David and Vikki Bacon, Debbie Roberts, Dilipchandra Balachandran, Eduarda Abissamra, Frank Wang, Haraish Rajpal, Ian Muir, Ilya Zharenikov, Joshua Jones, Kevin Cox, Kim Meichtry, Michael Stubbs, Reece Chamberlain, Roger Matheson, Stephen Cruttwell, Tracey Swift, Vicki Haylock, Yvonne Grant-Martens)

The submitters asked for the focus to be shifted from the ring-fencing rules to other measures, such as:

- ensuring that rental homes are healthy to live in;
- providing financial education;
- providing incentives to investors;
- incentivising investors to remedy properties suffering from delayed maintenance;
- increasing focus on speculators (noting that they are different from investors), for example by increasing the bright-line to 7-10 years;
- ensuring tax compliance of multi-nationals;
- recovering existing taxes due;
- allowing a tax credit for costs associated with compliance with local Government regulations;
- requiring tenants to take greater responsibility for the care of their rental properties;
- restoring depreciation on buildings (for example, at 4 percent per annum using the straight line method);
- not taxing KiwiSaver savings at marginal rates;
- taxing women less than men because women are paid less;
- reducing taxes and living costs;
- redirecting KiwiBuild funds to state housing; and
- allowing income splitting for married couples not on benefit.

Recommendation

That the submissions be noted.

COMPLEXITY OF LEGISLATION

Clauses 49 and 65

Submission
(Anthony Whitehouse, Baucher Consulting Limited, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Melanie Kilfoyle, New Zealand Law Society, nsaTax Ltd)

A number of submitters strongly submitted that the provisions for this proposal in the Bill should be rewritten so they can be more easily comprehended. As currently drafted, it was considered that the provisions are excessively complex and are not consistent with the 1994 rewrite principles.

Submitters made suggestions for improvement, including: moving the provisions to another subpart (either a new subpart, or within subpart E (timing)), organising the provisions better, and including interpretive aids such as a contents section, purpose provision, flowcharts, use of subheadings, and supporting examples.

Some submitters suggested simplified drafting for numerous provisions, in particular to avoid repetitive terminology, and to remove new undefined terms and terms that may create confusion.

Comment

It is acknowledged that the drafting of the proposed rules in the Bill is complex. These provisions have been redrafted, taking on board the submissions. Officials consider the redrafted provisions to be substantially easier to read, with simpler language, more succinct phrasing, a more intuitive structure, and an overview of what is covered in the provisions at the outset. It is proposed that the redrafted provisions be inserted into subpart E (*Timing*).

Officials have consulted on the revised drafting with a number of submitters and they consider it much clearer, easier to understand and significantly improved compared to the original drafting.

Recommendation

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

PROPERTY THE RULES APPLY TO

Clauses 49 and 65

Issue: Support for the rules not applying to mixed-use assets, farmland, or other business properties

Submission
(New Zealand Property Investors Federation)

The submitter commented that notwithstanding their objection to the proposal, they agreed that the rules should not apply to other property-related industries (for example, baches that are sometimes rented out, farmland, or other business premises).

Recommendation

That the submission be noted.

Issue: Leased land

Submission
(nsaTax Ltd)

It was submitted that the rules should apply to land either owned or leased by a taxpayer – they currently would only apply to land owned by a taxpayer.

Comment

The provisions would apply to land let by a taxpayer, not just to estates in fee simple. The definition of "land" in the Income Tax Act 2007 includes "any estate or interest in land", which would include a leasehold estate, and the definition of "own" refers to having an estate or interest in land. If a taxpayer with leased land derived income from that land (for example, by sub-letting it), the rules would apply to potentially limit the deductions that may be allocated to the income year, just as they would to a taxpayer who derived income from land they owned in fee simple.

Recommendation

That the submission be declined.

Issue: Overseas land and foreign exchange losses

Submission

(Corporate Taxpayers Group, Chartered Accountants Australia and New Zealand, Deloitte, EY, KPMG)

Submitters considered that the rules should not apply to overseas property, given the aim of the proposals is to level the playing field between property speculators and investors and home buyers in New Zealand. It was considered that there is no rationale for subjecting overseas land to these rules.

In addition, it was considered inappropriate that a taxpayer could have income in a year from a foreign rental property, including foreign exchange gains on foreign debt, and then in a subsequent year have a foreign exchange loss resulting in losses that are ring-fenced. As an alternative to carving out overseas property, it was submitted that the rules should not apply to foreign exchange losses in relation to overseas land, and these should be able to be separated out and treated as deductible.

It was noted that the rules applying to land outside of New Zealand would create high compliance costs for individuals temporarily relocating to New Zealand and renting out property owned in their home country, and that in these instances foreign exchange movements may be the cause of the losses.

It was also submitted that if land outside New Zealand is not excluded, an exclusion should be available for an overseas residence of a “transitional resident”, if the property would or could be their main home if living overseas. It was considered that this would be in line with the policy rationale for the transitional residence rules, being to encourage non-residents to migrate to New Zealand.

Comment

Officials consider that it would be seen as unfair for deductions in relation to loss-making overseas investment properties to be able to be offset against New Zealand income where such deductions in relation to New Zealand investment properties are not.

The rationale that the proposal would level the playing field between investors and home buyers is only one of the rationales for these rules. In addition, it is considered there is a perception that it is unfair for deductions in relation to loss-making properties to be able to be offset against income from other sources when the capital gains may not be taxed, or may be taxed at a lower rate.

Overseas rental properties of New Zealand taxpayers are in our tax base, so it is sensible for all residential losses to be subject to the same rules.

There is currently a project on the tax policy work programme looking at issues in respect of the financial arrangements rules and foreign mortgages. Officials consider that the issue in relation to foreign exchange losses that submitters have raised should be considered as part of that project.

Recommendation

That the submissions be declined.

Issue: Mixed-use land

Submission
(Chartered Accountants Australia and New Zealand, nsaTax Ltd)

It was submitted that there should be clarification on when the rules would apply to mixed use land (for example, a two-storey building with a shop downstairs and a let apartment upstairs).

One submitter commented that the proposed legislation does not deal with land that is used for both residential and commercial purposes, and suggested that a mechanism should be developed to specify how the two components should be measured.

Comment

The proposed rules would apply to "residential land" as currently defined in the Income Tax Act 2007, with some specific exclusions. The definition of "residential land" was introduced with the bright-line test, and excludes farmland and land "used predominantly as business premises".

Inland Revenue will be consulting soon on draft guidance as to what it means for land to have been used "predominantly" as business premises.

Recommendation

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

Issue: Revenue account land – the notification requirement should be removed

Submission
(nsaTax Ltd)

It was submitted that the notification requirements in the provision carving out revenue account property from the scope of the rules should be removed for dealers, developers, builders and those acquiring land for the purpose or intention of disposal. It was considered nonsensical to provide a carve-out from the ring-fencing rules for these taxpayers yet impose onerous reporting requirements on them. It was noted that taxpayers with multiple development properties would not typically record holding costs separately for each property. It was also noted that these entities will already be identified to Inland Revenue as dealers, developers or builders by virtue of their industry activity, and will most likely be GST-registered in relation to the activity. It was considered that any further notification was unnecessary and would increase compliance costs considerably even though such land is outside the proposed rules.

Comment

It is noted that the proposed carve out for revenue account land would not require taxpayers with multiple development properties to record holding costs separately for each property. If all of the properties in a taxpayer's portfolio were on revenue account the properties would be within the exclusion.

However, under the proposed rules, there are two notification requirements.

The first proposed notification requirement

The first notification requirement currently proposed is that taxpayers notify the Commissioner that the land will be taxed on sale. It is accepted that this is not necessary for properties that will be taxed on sale because they are held in a land-related business (for example, a dealing or development business). Officials therefore recommend that properties that will be taxed on sale under section CB 7 of the Income Tax Act 2007 be excluded from the operation of the proposed rules, without there being any notification requirements.

However, officials consider that this first notification requirement is appropriate for properties held on revenue account outside of those businesses (for example, a property that was acquired with the intention of disposal, where the taxpayer is not in the business of dealing in land). Most investors do not hold their properties on revenue account, but for those that do officials consider it appropriate that the exclusion for revenue account property only apply where it is known that the property will be taxed on sale and this is acknowledged by the taxpayer.

The second proposed notification requirement

The second notification requirement currently proposed is that:

- the taxpayer notify the Commissioner of their income and deductions that relate to the particular property on revenue account (this could be done by submitting an IR3R (Rental income schedule for that property); or
- if they do not that, all the properties they have are on revenue account and they have notified the Commissioner of that in relation to each property.

As noted above, officials agree that there do not need to be any notification requirements for property that will be taxed on sale under section CB 7 of the Income Tax Act 2007 (for example, land held in dealing and development businesses).

For other properties (for example, properties bought with the intention of disposal) officials consider that this second notification requirement could be amended. Officials think it would be sufficient if the taxpayer is able to separately identify the deductions that relate to the revenue account property, unless all of the properties they have are on revenue account, in which case this would not be necessary. While many taxpayers do notify the Commissioner of their income and deductions for each property they own, officials consider that this requirement could be removed.

Recommendation

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

Issue: Revenue account land – compliance burden on taxpayers, and unfairness to some taxpayers

Submission

(Accountants + Tax Agents Institute of New Zealand)

The submitter questioned the practicality of the provision carving out revenue account property from the scope of the rules (proposed section DB 18AF). It was considered that this provision would appear to require taxpayers to provide and retain substantial information relating to property which will be taxed, and that this would place a considerable compliance burden on such taxpayers.

The submitter also considered that the provision would unfairly exclude taxpayers who dispose of property that is taxed under the bright-line (or another provision where taxation is contingent on conditions being met). The submitter's view was that if disposals are taxed under the bright-line or other provision, there was no valid policy reason for preventing the offset of losses from the property against such income.

Comment

Officials do not consider that the proposed carve-out for revenue account property would require taxpayers to provide or retain substantial information.

Most investors do not hold their rental properties on revenue account. But for those that do (for example, properties acquired with the intention of disposal), for the exclusion to apply the taxpayer would have to:

- notify the Commissioner that the property will be taxed on sale; and
- be able to identify the expenses that relate to that particular property, unless all of their properties are on revenue account.

It is not considered that this is overly onerous, given that most investors hold their properties on capital account, and in light of the above recommendation that the notification requirement not apply to dealers, developers etc.

It was also submitted that it would be unfair for the exclusion not to apply to property that *may* be taxed on sale (for example, under the bright-line, or under one of the other land sale provisions that may apply depending on events that transpire). It is noted that all residential land within the scope of the proposed ring-fencing rules falls into this category, as if sold within the bright-line period (either two or five years) it would be taxed on sale. If the rules did not apply to any residential land that *may* be taxed on sale, they would not apply to any land for the first two to five years of ownership. The carve out is intended to cover only land that it is *known* will be taxed on sale. This is because one of the rationales for the proposed rules is that not all of the economic income will be taxed, and that that rationale is not relevant in respect of properties that will be taxed on sale regardless of when that occurs.

It is noted that if a property *ends up* being taxed on sale (for example, because it is sold within the bright-line period), any excess deductions, not absorbed by rental income and profit on the sale, can then be released (if the requirements for this are met).

Recommendation

That the submission be declined.

Issue: Revenue account land – requirements for exclusion unclear

Submission
(Deloitte)

The submitted stated that they were unable to understand the requirements in paragraph (b)(ii) of this provision (proposed section DB 18AF).

Comment

Proposed section DB 18AF(b)(ii) in the Bill provides that the exclusion for revenue account property can apply if a taxpayer is applying the rules on a portfolio basis, provided that all of the properties in the portfolio are on revenue account.

This has been clarified in the redrafted provisions.

Recommendation

That the submission be accepted.

Issue: Main home exclusion – where mixed-use land

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that there should be clarification on when the "main home" exemption would apply to mixed use land.

Comment

The proposed main home exclusion is based on the existing main home exclusion from the bright-line test, under which residential land may be taxed if disposed of with either two or five years of being acquired (depending on when the land was acquired).

Under the proposed exclusion, the land would need to have been used predominantly, for most of the income year, for a dwelling that was the taxpayer's main home.

There is some Inland Revenue guidance, in the context of the bright-line main home exclusion, on what it means for land to have been used predominantly for a main home. It is clear from the guidance that this test requires consideration of the proportion of the physical area of the land that is used for the dwelling, and it is noted that in this context "predominantly' means more than 50 percent. As noted in the guidance, in situations where land is used for more than one purpose, a taxpayer would need to determine the area of land used for their private residential purposes and the area of land used for other purposes.

The guidance Inland Revenue has provided in respect of the bright-line main home exclusion will be relevant in relation to the proposed main home exclusion from the ring-fencing rules, to the extent the exclusions are the same. The difference between the two is for the bright-line exclusion, the land has to have been used predominantly for the main home *for most of the time it is owned*, whereas in the context of the proposed ring-fencing rules the test is whether it has been predominantly used as the main home *for most of the income year*. The guidance around what "predominantly" means, which is relevant to land used for more than one purpose, is equally relevant to the main home exclusion from the proposed ring-fencing rules.

Recommendation

That the submission be declined.

Issue: Main home exclusion – trust property

Submission
(Baucher Consulting Limited, Deloitte)

It was submitted that the main home exclusion in relation to property held in a trust is unnecessarily restrictive. In particular, it was considered that the requirement that a principal settlor of the trust does not have a main home, or if they do it is the property in question, should be removed. It was considered that this definition is unnecessarily restrictive and excludes several legitimate "main home" situations that use a trust structure. For example, it was noted that a settlor may establish several trusts for differing asset protection reasons, or a single trust may hold several properties occupied by beneficiaries.

It was submitted that the test for the exemption should be that contained in section CB 16A(1)(b)(ii) of the Income Tax Act 2007 (the residential exclusion from many of the land sale rules), and that a remedial amendment should also be made to section CB 16A (the main home exclusion from the bright-line test) in this regard.

It was also noted that the wording in paragraph (b)(ii) is confusing.

Comment

The proposed rules are intended to apply to any rental property, including where a beneficiary of a trust rents trust property. If a beneficiary lives in trust property rent-free, the property-related expenses would not be deductible to the trustees, so the proposed rules would not be relevant.

In terms of the submission that the proposed exclusion should be the same as the bright-line main home exclusion in section CB 16A, it is noted that this is the case in terms of property held in trust. As noted above, the difference between the two exclusions is the period over which the use of the property is looked at (being the whole period of ownership for the purposes of the bright-line test, and the income year for the purposes of the proposed ring-fencing rules).

Recommendation

That the submissions be declined.

Issue: Main home exclusion – should extend to the home of a taxpayer who is temporarily overseas

Submission
(KPMG)

It was submitted that the main home exclusion should extend to cover the home of a taxpayer who is temporarily overseas. In this situation, the home would be the taxpayer's main home if they were living in New Zealand, and the home could still be considered their permanent place of abode for tax residence purposes. It was submitted that the main home exclusion should be available for a taxpayer's New Zealand residential property that was, or could reasonably be, their main home, where the taxpayer continues to retain their New Zealand tax residence.

Comment

The proposed main home exclusion is intended to apply based on the home being used by the taxpayer as their main home, for most of the income year. Officials do not consider that the fact that a property was the person's main home, or could be if they lived in New Zealand, would justify excess deductions being able to be used against other income, if the property is being used as a rental property for the time being.

While the property may still be regarded as a permanent place of abode of the taxpayer's for tax residence purposes, the permanent place of abode test expressly contemplates that a person may have more than one permanent place of abode, and is about the parameters within which a person should still be tax resident in New Zealand (though the allocation of taxing rights may be impacted by the application of tax treaties). The proposed ring-fencing rules are aimed at ensuring deductions in respect of loss-making properties cannot be used against income from other sources, with the capital gains not being taxed. This rationale is applicable to properties that are temporarily rented out just as it is to other rental properties. The proposed exclusion being limited to the one property that is actually used as the taxpayer's "main home" is consistent with the bright-line main home exclusion, which allows a taxpayer to have only one main home at a time.

Recommendation

That the submission be declined.

Issue: Main home exclusion – unclear why needed

Submission
(Deloitte)

The submitter considered it to be unclear why the provision was needed given that there is no need to ring-fence any property used personally by the owners due to the "private limitation" denying the ability to claim deductions in the first instance.

Comment

A property that is a person's main home may also be partly used for income earning purposes (for example, all or part of the property may sometimes be rented out). In this situation, expenses relating to the property would be partly deductible. While in many situations, the apportionment of expenses between the private use and the income-earning use of the property would mean that the activity is not loss-making, this would not necessarily be the case. The proposed rules are aimed at loss-making investment properties, rather than any incidental income-earning use of a taxpayer's main home.

Recommendation

That the submission be noted.

Issue: Employee accommodation – support for exclusion

Submission
(Chartered Accountants Australia and New Zealand, Deloitte)

The submitters supported the exclusion for employer-provided accommodation – it was considered sensible and logical.

Recommendation

That the submission be noted.

Issue: Employee accommodation – the exclusion should apply to all employee accommodation

Submission
(Corporate Taxpayers Group)

Submitters felt that more consideration should be given to ensuring the rules do no unnecessarily impose compliance costs on businesses that hold residential property in their business, as there is not the same mischief present. In particular, it was submitted that the rules should not apply to *any* employee accommodation. Submitters thought it was unclear why the current limitations for employee accommodation being carved out were considered necessary.

Comment

It is accepted that is most situations where employee accommodation is provided, the mischief the proposed rules are aimed at is not present. It is also accepted that this may include situations outside the scope of the exclusion proposed in the Bill. Given that the mischief is really only likely to be present in situations where the employer and employee are associated, officials are recommending limiting the restrictions currently proposed for employee accommodation to situations involving employee accommodation provided to associated persons. Officials are recommending that other employee accommodation be excluded from the rules without those restrictions.

Recommendation

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

Issue: Employee accommodation – the exclusion should extend to accommodation owned by a related entity

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that the exclusion for employee accommodation should include accommodation owned by a related entity.

Comment

If the Committee agrees with the above recommendation that the restrictions currently proposed for employee accommodation only apply to situations involving employee accommodation provided to associated persons, officials do not consider that there is any need for expanding the exclusion to cover property owned by related entities.

Recommendation

That the submission be declined.

Issue: Employee accommodation – IR guidance

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that Inland Revenue should provide guidance on the extent of the exclusion for employee accommodation.

Comment

If the Committee agrees with the above recommendation that the restrictions currently proposed for employee accommodation apply only to situations involving employee accommodation provided to associated persons, officials do not consider that it is necessary to provide detailed guidance on the scope of the restrictions. However, officials propose to include some brief comment on the restrictions for employee accommodation provided to associated persons in the *Tax Information Bulletin* item covering the proposed rules.

Recommendation

That the submission be declined.

Issue: Widely-held companies – support for exclusion

Submission
(Corporate Taxpayers Group, Deloitte)

The submitters supported the exclusion of property owned by widely-held companies.

Recommendation

That the submission be noted.

Issue: Widely-held companies – the exclusion should extend to Government and Government owned enterprises

Submission
(Corporate Taxpayers Group, Deloitte)

One submitter commented that a number of large businesses that do not meet the definition of "widely-held company" would still be caught by the rules. It was considered that more consideration should be given to ensuring the rules do no unnecessarily impose compliance costs on such businesses that hold residential property in their business, as there is not the same mischief present. In particular, it was considered that the rules should not apply to Government and Government owned enterprises. It was suggested that this could be done by excluding the entities listed in schedule 36 of the Income Tax Act 2007.

Comment

Officials agree that the mischief the proposed rules are aimed at is not present in respect of the Government enterprises listed in schedule 36 of the Income Tax Act 2007 (which, in particular, includes Housing New Zealand Corporation and Housing New Zealand Limited).

Recommendation

That the submission be accepted.

Issue: All non-land-rich companies should be excluded

Submission
(Deloitte)

The submitter considered that all non-land-rich companies should be excluded, as the widely-held company exclusion would not cover large family-owned businesses or other private non-land-rich businesses – putting these entities at a potential competitive disadvantage and subjecting them to higher compliance costs.

Comment

Officials agree that in terms of companies, the mischief the proposed rules are aimed at is really only present in respect of close companies (in general terms, companies with five or fewer natural persons whose total voting interests are more than 50 percent – with associated persons being treated as one person). As such, officials consider that it would be appropriate for the proposed rules to not apply to companies other than close companies.

Recommendation

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

PORTFOLIO OR PROPERTY-BY-PROPERTY APPLICATION OF THE RULES

Clauses 49 and 65

Issue: Support for default portfolio approach

Submission
(New Zealand Property Investors Federation, Real Estate Institute of New Zealand)

The submitters supported the rules applying on a portfolio basis by default. This was considered very sensible, as it would go some way towards minimising the reduction in supply of rental property, and also because it would be highly complex for owners with multiple properties to report properties on an individual basis.

Recommendation

That the submission be noted.

Issue: Support for ability to elect property-by-property approach

Submission
(Chartered Accountants Australia and New Zealand, Real Estate Institute of New Zealand)

The submitters supported taxpayers having the ability to apply the rules on a property-by-property basis.

Recommendation

That the submission be noted.

Issue: Property-by-property approach should be allowed on change of use

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that there should be the ability for taxpayers to apply the rules on a property-by-property basis on a change of use that brings the property into the scope of the rules (for example, if a property that that had been used as commercial property or a main home became a residential rental property).

Comment

Officials agree that this is appropriate.

Recommendation

That the submission be accepted.

Issue: The election to take a property-by-property approach

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that the election to apply the rules on a property-by-property basis should be made by taking a position on that basis in the tax return.

Comment

Officials agree that this is appropriate.

Recommendation

That the submission be accepted.

Issue: Different approaches for different properties

Submission
(New Zealand Law Society)

It was submitted that the proposed legislation was not clear whether different approaches (portfolio or property-by-property) could be taken for different properties. It was submitted that this should be allowed.

In particular, it was noted that some provisions suggest that a taxpayer may take a portfolio approach to some properties and a property-by-property approach to other property owned at the same time (for example, the meaning of "residential rental property" for proposed section DB 18AC, which excludes properties the taxpayer has elected to take a property-by-property approach to). However, it was considered that proposed section DB 18AD(1) seems inconsistent with that notion, with its requirement that the person owns no land that was residential rental property in the divestment year.

Comment

It is intended that the rules allow taxpayers to take different approaches for different properties. This may have been unclear from proposed section DB 18AD(1) in the Bill, because of the definition of "residential rental property" for the purposes of that propose section being at the end of the provision. This has been clarified in the redrafted provisions.

Recommendation

That the submission be accepted.

Issue: Different approaches taken by look-through company shareholders or partners in a partnership

Submission
(nsaTax Ltd)

The submitter commented that the legislation appears to allow shareholders in a look-through company, or partners in a partnership, to take different approach to applying the rules (that is, portfolio or property-by-property). It was unclear whether this is an intended outcome.

Comment

It is not intended that shareholders in look-through companies, or partners in partnerships, can take different approaches to applying the rules (that is, whether they apply the rules on a portfolio or property-by-property basis). Whatever approach the entity has taken flows through to the partners or shareholders in these transparent entities. Officials will clarify this in the *Tax Information Bulletin* item covering the proposed rules.

Recommendation

That the submission be declined.

USE OF RING-FENCED AMOUNTS

Clauses 49 and 65

Issue: Use of deductions against income from residential land that is outside the scope of the rules

Submission
(nsaTax Ltd)

The submitter commented that the draft legislation only allows ring-fenced deductions to be offset against residential property income, which does not include income from residential land excluded from the scope of the rules (for example, land acquired for the purpose or intention of disposal, or land in a land development business). This seems contrary to the clear policy intent.

Comment

Officials agree that it is appropriate for ring-fenced deductions to be able to be used against income from residential land that is outside the scope of the rules because it is on revenue account (the examples given above), as all of the economic income from such land will be taxed. However, officials do not consider that ring-fenced deductions should be able to be used against income from other residential land that is outside the scope of the rules but will not be taxed on sale – for example, a mixed-use asset or main home.

Recommendation

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

Issue: Carried forward deductions from other properties

Submission
(Deloitte)

The submitter commented that the definition of "net disposal income" in proposed section DB 18AC(3)(b) was hard to understand. It seems to suggest that if a taxpayer has excess ring-fenced deductions that it carries forward from divested properties, those deductions will act prohibitively to stop taxpayers from deducting property related expenditures to cover net income from the divestment of properties in the current year. The submitter noted that they were unable to identify the underlying policy considerations that would justify this approach.

Comment

Excess deductions may effectively be "transferred" from a property that was not taxed on sale (or a portfolio that was not fully-taxed on sale) to another property or another portfolio in the future. It is intended that these transferred deductions be able to be used against rental income or land sale income from the property or portfolio, but for those transferred amounts not to be released if the property or portfolio they have been transferred to is fully-taxed on disposal.

The provisions in the Bill may not achieve what is intended in this regard, and this has been provided for in the redrafted provisions.

Recommendation

That the submission be accepted.

Issue: Unfencing on divestment – rules unclear

Submission
(Deloitte, New Zealand Law Society)

One submitter commented that the rules for the "unfencing" of losses in proposed section DB 18AC(5) to (7) were difficult to understand. In particular, it was noted that subsection (5)(c) uses very complex language, and that as a result, a simple interpretation might suggest that all ring-fenced deductions are released when a portfolio is totally divested and no notification is made to carry forward deductions. It was observed that this outcome is contrary to the Bill *Commentary*.

Another submitter thought that proposed section DB 18AC(5)(d) contains a precondition for the release of ring-fenced deductions from a portfolio, being that the person has not treated any excess deductions as deductions that relate to residential rental property under proposed sections DB 18AD to DB 18AH. It was considered unclear how proposed sections DB 18AD or DB 18AH could apply, since proposed section DB 18AC(5) applies only to *taxable* disposals, whereas proposed sections DB 18AD and DB 18AH apply to excess deductions where there have been one or more *non-taxable* disposals of land in the portfolio. It was submitted that proposed section DB 18AC(5)(d) should be deleted, or, if there is a reason to retain it, it should be redrafted so that the purpose of the provision is clearer.

Comment

It is acknowledged that these provisions in the Bill may be difficult to understand. The intention of the provisions is that if an amount of excess deductions from another property that was not taxed on sale has been transferred to another property or portfolio, no excess deductions can be released after the taxable sale of that property or the taxable divestment of that portfolio. Essentially, this would mean that the excess deductions relating to a non-taxable property would "taint" the property or portfolio the deductions were transferred to.

However, officials now recommend that rather than "taint" the property or portfolio to which the excess deductions are transferred, the amount otherwise available for release instead be reduced by the transferred amount. This is considered a more appropriate outcome.

Recommendation

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

Issue: Release in year of taxable divestment

Submission
(New Zealand Law Society)

It was noted that the intention is to remove the ring-fencing of deductions in respect of a portfolio if all the property has been disposed of and each disposal gave rise to income. However, it was submitted that proposed section DB 18AC(5)(c) is difficult to interpret and appears to require the last disposal to occur before the start of the year in which the deduction is released. It was submitted that if that is the intended meaning, the preferable approach would be for the deduction to be released in the income year of the final taxable disposal.

Comment

This is how the rules were intended to operate, and has been provided for in the redrafted provisions.

Recommendation

That the submission be accepted.

Issue: Order in which different classes of losses to be used

Submission
(Chartered Accountants Australia and New Zealand, nsaTax Ltd)

It was submitted that the proposed legislation should specify the order in which ring-fenced deductions are utilised (for example, on a "first in, first out" basis). It was noted that the Bill implies a "first in, first out" basis for a wholly-owned group company, by virtue of the reference to continuity for companies and section IA 5 and IP 3 of the Act. However, there is no indication as to the order losses should be utilised for individuals, look-through companies, partnerships or trusts.

It was submitted that the proposed legislation should clarify whether different classes of losses are to be used in a certain order. For example, a taxpayer may have an overall loss in the current year but have made a profit on the residential rental activity. Is the taxpayer able to utilise or re-characterise a portion of the quarantined brought forward losses against the residential rental profit?

Comment

If a taxpayer has made an overall loss in a particular income year but has made a profit on the residential rental activity, any ring-fenced residential property deductions they have from prior years would be able to be used against those profits, as they can be used against rental income, not overall net income. This will have the effect of decreasing the amount of the ring-fenced deductions. Officials will clarify this in the *Tax Information Bulletin* item covering the proposed rules.

Recommendation

That the submission be declined.

Issue: Support for release of ring-fenced deductions on taxable sale

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that the proposed rule to release ring-fenced losses in some circumstances is fair. Officials were thanked for responding to feedback.

Recommendation

That the submission be noted.

Issue: Ring-fenced deductions should be released on sale, whether taxable or not

Submission
(New Zealand Property Investors Federation)

Under the proposal, losses could only be offset against residential rental income from future years or taxable income on sale. As there is no capital gains tax in New Zealand, there is no tax payable when a rental property is sold. This means that losses could only be offset against rental income from future years. This introduces risk for rental property owners, as if they have to sell the property before it becomes income producing they completely lose the benefit of the losses. This is completely unfair given that the rule will not apply to other asset classes. This risk further reduces the incentive to buy and provide rental property. It was submitted that if the proposal is introduced, losses should be released if a property is sold, whether or not the sale is taxed.

Comment

One of the rationales for the proposed rules is that not all of the economic income from an investment property is taxed, so to the extent deductions exceed rental income in the long-term, they in substance relate to the untaxed capital gain and should not be allowed. If excess deductions were released on any sale, whether taxable or not, this would undermine one of the key rationales for the proposed rules.

While there is no capital gains tax in New Zealand, there are some circumstances in which sales of residential land will be taxable (for example, under the bright-line test). If that is the case, ring-fenced deductions could be used against that (net) income.

Recommendation

That the submission be declined.

Issue: Transfer of ring-fenced amounts within a "group of companies"

Submission
(Chartered Accountants Australia and New Zealand, nsaTax Ltd)

It was submitted that the rules should allow ring-fenced deductions to be transferred within a "group of companies", as other losses can be, not just within a wholly-owned group. It was considered that there is no mischief in allowing ring-fenced deductions to be transferred between ordinary group companies, so the 66 percent commonality requirement that applies for all other losses should be used here too.

Comment

Losses can be transferred under the loss grouping rules where the companies have at least 66 percent common ownership (in addition to other requirements being satisfied).

Officials consider that ring-fenced losses should be able to be transferred between companies, but that this should be limited to companies in the same wholly-owned group, as the economic ownership is the same in that situation.

This restriction to wholly-owned groups is consistent with the approach taken to the grouping of most other tax attributes, for example, the inter-corporate dividend exemption, intra-group transfers of trading stock, consolidated group rules, imputation group rules, use of attributed CFC net losses or FIF net losses by group companies, use of CFC foreign tax credits by group companies, and use of credits for supplementary dividends by group companies.

Recommendation

That the submission be declined.

Issue: Ring-fenced amounts should not be subject to the shareholder continuity rules

Submission
(PwC, Real Estate Institute of New Zealand)

It was submitted that there should be more flexibility for companies to carry forward unused losses. Companies are subject to the 49 percent shareholder continuity rules for carrying forward income tax losses. It was submitted that it would further significantly limit the ability for companies to use losses from residential investment properties if the ring-fenced losses are also subject to the shareholder continuity rules.

Comment

As noted above, officials are now recommending that the proposed rules not apply to companies other than close companies. Officials do not consider that there is any strong basis to not apply the general shareholder continuity rules in relation to excess deductions for the companies the rules will apply to.

Recommendation

That the submission be declined.

Issue: There should be a mechanism for subvention payments to be allowed

Submission
(Chartered Accountants Australia and New Zealand, nsaTax Ltd)

It was submitted that the rules should allow for companies to pay for losses transferred to them. The transfer or offset of ring-fenced deductions will create unimputed retained earnings for the recipient company, which in turn creates an uncrystallised tax liability on the ultimate distribution of retained earnings. To avoid this, subvention payments should be allowed for – this could be done by way of reference to the existing loss offset rules in subpart IC, which allow for the making of a subvention payment.

Comment

Officials are now recommending that the proposed rules not apply to companies other than close companies. If this recommendation is accepted, officials do not consider that it is necessary to provide for subvention payments in relation to excess deductions.

Recommendation

That the submission be declined.

Issue: Treatment of ring-fenced deductions for consolidated group companies and amalgamated companies

Submission
(nsaTax Ltd)

There should be rules to deal with the treatment of ring-fenced deductions for consolidated group companies and amalgamated companies. The proposed rules do not deal with this, which is inconsistent with the rest of the Income Tax Act 2007.

Comment

As noted above, officials are now recommending that the proposed rules not apply to companies other than close companies. If this recommendation is accepted, officials do not consider it necessary to specifically provide for the treatment of ring-fenced deductions for consolidated groups or amalgamated companies.

Recommendation

That the submission be declined.

Issue: Treatment of ring-fenced deductions on change of use

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that the legislation should clarify the status of accumulated ring-fenced deductions when land has had a change of use, or partial change of use (for example, from residential rental to commercial rental or main home). Where a residential rental with ring-fenced excess deductions is converted to a commercial use, there appears to be no ability to offset any accumulated deductions against the future income from that property. It was submitted that these ring-fenced deductions should be available to be used against the property while it remains within the definition of residential property (that is, where it has been used as a residential rental for more than half the time). However, it was noted that this will cause complexity as the taxpayer is required to keep applying the test to determine the point at which it becomes predominantly commercial – as such it was suggested that the better answer may be to apply the test annually rather than over the life of the property.

Comment

Where there has been a change of use of residential land (for example from residential rental to commercial rental), ring-fenced deductions would be able to be used against income from the property while it remains within the definition of "residential rental property". Officials consider that if a property has been "residential land" at any time in an income year it should "residential rental property" for that year. This would mean that in a change of use year, where the property has been a "residential rental property" in the year, any ring-fenced deductions in relation to the property could be used against any other income from the property (for example, commercial rent).

It is noted that the definition of "residential rental property" excludes the main home. To be the "main home" the property has to have been used as the main home for *most of the income year*. Because of this, if the change of use has been from residential rental to the taxpayer's "main home", the ring-fencing rules would not apply in relation to the rental deductions for that year.

Recommendation

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

Issue: Transferred excess deductions should not "taint" other deductions

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that excess deductions on sale should not "taint" deductions that relate to another property or portfolio. Only the excess that relates to the non-taxable property should remain ring-fenced – any excess deductions that relate to a property taxed on sale should be released.

Comment

Officials now recommend that rather than “taint” the property or portfolio to which the excess deductions are transferred, the amount otherwise available for release instead be reduced by the transferred amount. This is considered a more appropriate outcome.

Recommendation

That the submission be accepted.

Issue: Use of ring-fenced deductions against depreciation recovery income

Submission
(Capital Accounting Associates Limited (oral submission), nsaTax Ltd)

The proposed rules may result in a taxpayer being taxed on depreciation recovery income, despite the underlying depreciation deductions being denied. It is conceivable that depreciation recovery income will arise for residential rental property (for example, chattels, or historical depreciation on buildings). The legislation does not allow current year or carried forward ring-fenced deductions to be offset against depreciation recovery income – which arises from the disposal of chattels which are not residential rental income, and it arises under subpart EE not sections CC 1 to CC 2. It was submitted that ring-fenced deductions should be claimable against such depreciation recovery income.

Comment

Residential rental chattels are unlikely to be sold for above tax book value, giving rise to depreciation recovery income. However, some properties investors may have depreciation recovery income arising on the sale of their properties because of historic building depreciation claimed. Officials agree it is appropriate that any excess deductions be able to be offset against any depreciation recovery income. The redrafted Bill allows for this.

Recommendation

That the submission be accepted.

Issue: Use of ring-fenced deductions against financial arrangement income

Submission
(nsaTax Ltd)

It was submitted that ring-fenced deductions should be claimable against financial arrangement income arising from debt related to the residential rental property. It was noted that it is likely that offshore residential rental property will be funded by foreign denominated currency, and movements in the exchange rate may give rise to gains under the financial arrangements rules.

Comment

There is currently a project on the tax policy work programme looking at issues in respect of the financial arrangements rules and foreign mortgages. Officials consider that the issue in relation to foreign exchange losses that submitters have raised should be considered as part of that project, so there is a coherent and consistent approach.

Recommendation

That the submission be declined.

Issue: Use of ring-fenced deductions arising from the interposed entity rules

Submission
(Chartered Accountants Australia and New Zealand, KPMG)

It was submitted that the legislation should specify how ring-fenced deductions arising from the interposed entity rules can be used. In particular, the taxpayer may not receive "residential rental property income" (for example, from another property, held directly), but may receive dividends from the company. Otherwise, the only corresponding "income" will be a gain on sale of the shares in the company, which may be held on capital account. It was submitted that ring-fenced deductions should be able to be used against dividends from the residential land-rich company (or the portion that relates to residential rental property), or against distributions from a residential land-rich trust.

It was also submitted that the interposed entity rules should be modified so that an interposed entity can offset ring-fenced losses if they derive income that is related to residential property income. The submitter commented that the interposed entity is unlikely to receive "residential rental property income" as that term is defined in the Bill.

Comment

Officials agree that ring-fenced deductions arising from the application of the interposed entity rules should be able to be used against distributions from the entity, to the extent those distributions relate to residential property income. This has been clarified in the redrafted provisions.

Recommendation

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

THE INTERPOSED ENTITY RULES

Clauses 49 and 65

Issue: When "applied capital percentage" should be determined

Submission
(New Zealand Law Society, nsaTax Ltd)

It was submitted that the interposed entity rules should specify the applicable point in time for determining the "applied capital percentage".

One submitter commented that presumably the intention is that this is determined at the end of each income year.

Another submitter suggested that the rules should cater for changes in the applied capital percentage throughout the year. The example given was:

- At the start of the income year, $600,000 was borrowed and used to subscribe for shares in the residential land-rich company, with the funds being used to buy a residential rental property.
- On 31 March, $400,000 was borrowed and used to subscribe for further shares, with the funds being used to buy a share portfolio.

It was noted that in this scenario, the "applied capital percentage" at the start of the year would be 100 percent. At the end of the income year it would be 60 percent. And the weighted average applied capital percentage calculated on a daily basis would be 99.9 percent. The legislation does not indicate when the applied capital percentage should be measured, so it could be any of these. This should be clarified.

Comment

The provisions as currently drafted do not clarify when the "applied capital percentage" is to be determined. For the sake of simplicity, officials recommend that this be as at the end of the income year. The redrafted provisions provide for this.

Recommendation

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

Issue: The rules require tracing the use of funds

Submission
(nsaTax Ltd)

The submitter noted that there are no interest allocation rules, because it was considered that these would introduce substantial complexity (as discussed in the Regulatory Impact Statement). However, it was submitted that the rules dealing with interest deductibility require tracing of the use of funds – for example, the definition of "applied capital percentage" in proposed section DB 18AJ(4).

Comment

Officials do not consider that the definition of "applied capital percentage" requires tracing of the use of funds. Rather, the definition simply requires identification of the percentage of the entity's existing capital that represents the cost of any residential rental property the entity owns.

Recommendation

That the submission be declined.

Issue: Absurd outcomes from "applied capital percentage" rule

Submission
(nsaTax Ltd)

It was submitted that the "applied capital percentage" rule will result in absurd outcomes. The example given was:

- A look-through company owns the shareholders' private residence, the purchase price of which was funded through share capital funded from the shareholders' cash.
- The shareholders also borrowed to subscribe for further share capital, which is in turn used to acquire a residential rental property.

It was submitted that in this scenario, only part of the interest deductions would be subject to ring-fencing, which is an absurd outcome as clearly the borrowed funds were used to acquire the residential rental property.

Comment

The "applied capital percentage", for the purposes of the interposed entity rules, is the percentage of the entity's capital that has been used to acquire residential rental property. The rule has the effect of essentially regarding all of the capital (both debt and equity) as split on a pro rata basis between the different investments the capital has funded. This is intended to be easier to apply than a rule requiring taxpayers to trace the use of specific funds. Officials consider this to be the most appropriate approach on the basis of its relative simplicity.

Recommendation

That the submission be declined.

Issue: Different classes of shares

Submission
(nsaTax Ltd)

It was submitted that the interest limitation rules should provide for situations where there are different classes of shares. Otherwise, it was considered that there could be unfair results (for example, in a situation where some shares carry voting rights and other shares carry rights to participate in distributions).

Comment

One of the elements in the interposed entity "share of profits" formula is the person's interest, which for a company is their voting interest in the company.

The provision in the Income Tax Act 2007 that defines "voting interest" deals with situations where shareholder decision-making rights vary.

Officials do not consider that there is any need to provide for the potential for different share classes with some shares carrying voting rights and others carrying rights to participate in distributions. The interposed entity rules are intended to prevent the ring-fencing rules being circumvented through a taxpayer borrowing to invest in an entity which invests in residential property. The proposed rules would limit the person's interest deductions in this situation, based on the person's interest in the entity (for companies) and the level of capital applied to acquiring residential property. If a person chooses to invest in residential property through an entity rather than directly, they could ensure they have voting interests so they could deduct some of their interest in the current year.

Recommendation

That the submission be declined.

Issue: Clarification on trust rule

Submission
(Chartered Accountants Australia and New Zealand, nsaTax Ltd)

One submitter considered that the proposed interposed entity rule applicable to trusts was unworkable, as it is not possible to acquire an interest in a trust, so this is unworkable.

Another submitter considered that the commentary should be expanded to clarify that the interposed entity rule for trusts is intended to apply to the beneficiary of a fixed trust that is not a unit trust, where the beneficiary borrows to acquire the interest in the trust. It was suggested that the commentary should also note that this situation is not likely to occur often.

Comment

As noted by one of the submitters, the interposed entity rule for trusts is intended to apply in relation to fixed trusts that are not unit trusts. While this may not arise often in practice, the interposed entity rules are aimed at preventing circumvention of the ring-fencing rules, so officials consider that the legislation should cover this possibility. Officials will clarify this in the *Tax Information Bulletin* item covering the proposed rules.

Recommendation

That the submissions be noted.

Issue: Reference to trusts "with" property

Submission
(nsaTax Ltd)

It was submitted that the definition of a "residential land-rich entity" is confusing in relation to trusts, as it refers to a trust "with" residential rental property. The submitters commented that it is unclear why the definition does not refer to the trustees "owning" the property. It was submitted that if it is intended to include a trust that has the use of a residential rental property that it does not own, this should be specified, and also presumably this would be the case for companies, partnerships and look-through companies too.

Comment

The definition of "residential land-rich entity" in the Bill, as it relates to trusts, refers to a trust "with residential rental property as trust property". Officials consider this to be clear, as trust property is property owned by the trustees. The definition in the redrafted provisions differs slightly, and refers to "a trustee of a trust *whose property* includes residential rental property". Officials think it is clear this refers to property owned by the trustee. Similarly, the definition in the redrafted provisions refers to a company, partnership, or look-through company if more than 50 percent of "its assets" are residential land.

It is noted that the provisions cover leasehold estates not just estates in fee simple (see submission titled *Issue: Leased land*).

Recommendation

That the submission be declined.

Issue: The interposed entity rule should not apply to look-through companies

Submission
(Chartered Accountants Australia and New Zealand)

It was submitted that the interposed entity rules should not apply to look through companies. As look-through companies are transparent, any excess deduction in a look-through company should belong to the shareholder and be available to put into a "portfolio" owned by the shareholder and used to offset any rental profits of the shareholder has.

The submitter noted that the extent to which a look-through company is transparent has been raised with the Committee and with officials, but that this issue has never been resolved. The submitter considered that the inclusion of look-through companies as interposed entities suggests that a look through company is not fully transparent. The submitter considered that clarity in this area is needed and should be a priority.

Comment

Any excess deduction a look-through company has would belong to the shareholder, and would be able to be used by the shareholder against income from other residential property the shareholder may own. This would make those properties a portfolio for the shareholder.

However, if the interposed entity rules did not apply to look-through companies, the shareholder's interest in respect of the borrowings used to invest in the entity would be fully deductible for the income year, even if the residential property was not profitable. The interposed entity rules are aimed at restricting the interest deduction that can be allocated to income year. These rules are necessary even for transparent entities because otherwise the ring-fencing rules would not apply to the shareholder's (or partner's, in the case of a partnership) interest deduction, as that expenditure would not be incurred in relation to the property, but in relation to the investment in the entity.

Recommendation

That the submission be declined.

Issue: Absurd outcomes if residential rental property sold

Submission
(nsaTax Ltd)

It was submitted that the land-rich entity rules could result in absurd outcomes if a residential rental property is subsequently sold by the entity, but the entity remains land-rich because the shareholders' private residence is in the entity. The example given was:

- A look-through company owns the shareholders' main home, which cost $600,000 and was funded through share capital funded by the shareholders' cash.
- The shareholders borrow $400,000 which they use to subscribe for further share capital, which is used to acquire a residential rental property.
- Subsequently, the look-through company sells the rental property for $400,000 and applies the sale proceeds to acquire a managed share portfolio.
- The look-through company remains a land-rich entity, and the "applied capital percentage" remains at 40 percent (total share capital of $1m, with $400,000 applied to acquire the residential rental property).
- Interest incurred by the shareholders will be ring-fenced to the extent of 40 percent, even though the look-through company no longer holds the rental property.
- No deduction is claimable by the shareholders as they have no rental income attributed to them by the look-through company.

It was submitted that this is an absurd outcome.

Comment

If a residential land-rich entity sells property and residential land no longer makes up over 50 percent of its assets, the entity will no longer be a “residential land rich entity” as defined. The interest incurred by the shareholders from that time would not be ring-fenced.

Recommendation

That the submission be declined.

Issue: Unlikely to be fully effective

Submission
(EY)

The submitter agreed that a “land-rich entity” rule is required to give the rules any chance of success. However, they cautioned that the rule is unlikely to be fully effective. It was noted that well-funded investors may ensure their land-rich entity is not debt-funded, organising their finances to deduct debt elsewhere. Further, investors with residential property and other significant assets would be able to ensure the 50 percent threshold is not reached.

Comment

It is acknowledged that well-funded investors would be able to debt fund investments other than their residential properties. This is the case whether the investor holds their residential properties in an entity or directly; it is not an issue specific to the proposed land-rich entity rules, but the ring-fencing rules more generally.

Recommendation

That the submission be noted.

MISCELLANEOUS INTERPRETIVE ISSUES

Clauses 49 and 65

Issue: "Unless the context otherwise requires"

Submission
(Deloitte)

It was submitted that the phrase "unless the context requires otherwise" in proposed section DB 18AD(6) (which defines "residential rental property" for the purposes of that section) leaves the provision open to abstract interpretation. It is unclear what the "context" could be that could result in "residential rental property" for the purposes of that section being other than as defined in subsection (6).

Comment

Officials agree that this "unless the context otherwise requires" is unnecessary in this definition. The redrafted provisions are structured differently, and the issue does not arise in the redraft.

Recommendation

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

Issue: "Pieces" of residential rental property

Submission
(Deloitte)

It was submitted that the phrase "pieces of residential rental property" is odd, as it connotes a portion of a whole (for example, part of a property).

Comment

Officials agree that the phrase "pieces of residential rental property" is confusing. The redrafted provisions do not use this term when referring to property to which the rules are being applied on a property-by-property basis.

Recommendation

That the submission be accepted.

Issue: Does the default portfolio approach apply to a single property?

Submission
(Deloitte)

It was submitted that there should be clarification of the treatment of a taxpayer's single rental property, as this cannot be a "portfolio" under the common meaning of that term, but the "piece of property" rules only apply by election.

Comment

It was intended that the default "portfolio" approach could be used for a single property, despite the common meaning of the term "portfolio".

However, as noted in relation to the submission titled *Issue: The election to take a property-by-property approach*, officials are recommending that the election to apply the rules on a property-by-property basis should be made by taking a position on that basis in the tax return. The effect of this would be that if a taxpayer has only one rental property, the rules would be applied on the property-by-property basis. If they subsequently acquire another property, they could apply the rules on the portfolio basis.

Recommendation

That the submission be noted.

Issue: Land that was residential rental property "at some time" owned

Submission
(New Zealand Law Society)

Proposed section DB 18AC(4) uses the phrase "at some time when they owned the land". It was submitted that the natural meaning of the phrase is that the person no longer owns the land, however, subsection (4) is clearly intended to apply when the land is still owned, although it is no longer residential rental property. It was suggested that the subsection would be clearer if it was rephrased as: "the person owns residential rental property or land that was, in a previous income year, residential rental property of the person".

Comment

This has been clarified in the redrafted provisions.

Recommendation

That the submission be accepted.

Issue: Lack of clarity about portfolio and property-by-property basis

Submission
(*Anne Shotbolt, David Phipps, Kevin Cox, Leonie Jamieson*)

Two submitters stated that the rules should apply on a portfolio basis. One submitter asked not to remove the ability to offset losses within a portfolio. One submitter commented that applying the rules on a property-by-property basis is undesirable as losses should be transferrable between properties.

Comment

The proposed rules would apply on a portfolio basis by default, with taxpayers having the option to choose to apply them on a property-by-property basis for a particular property.

Recommendation

That the submissions be noted.

Issue: Allocating ring-fenced deductions to another property on non-taxable disposal or divestment

Submission
(Matter raised by officials)

Ring-fenced deductions remaining on the sale of a property or the divestment of a portfolio can be treated as relating to another property. However, as currently drafted, these provisions limit the ability to do this to a *later income year* (proposed sections DB 18AD(1)(f) and DB 18AH(1)(d)). The ability to treat these excess deductions as relating to another property should be available for the income year in question (the sale or divestment year) or a later income year.

Recommendation

That the submission be accepted.

Clauses 49 and 65

Issue: Restructuring should not result in adverse tax consequences

Submission
(PwC, Real Estate Institute of New Zealand)

It was submitted that there should be transitional rules to ensure there are no adverse tax consequences for taxpayers who wish to restructure their investments in light of the proposed rules. For example, it was noted that investors may want to split out their rental properties and hold them in a separate vehicle. It was submitted that if there is no change in the economic ownership, such transfers should not result in taxable income (for example, under the bright-line or other land sale rules).

Comment

Officials do not consider there to be a strong basis for transitional rules if taxpayers choose to restructure their investments, and consider that the general rules should apply.

Recommendation

That the submission be declined.

Issue: Increased compliance costs and IR education programme

Submission
(Accountants + Tax Agents Institute of New Zealand, Baucher Consulting Limited, Generate Accounting Group Limited)

It was submitted that the proposed rules will result in significant additional compliance costs for taxpayers and their advisors, and that these costs will be magnified by the hurried introduction of the rules. It was noted that many residential property investors hold only one or two properties and may not have easy access to the necessary level of advice required to comply. As such, it was recommended that Inland Revenue run an appropriate educational programme to ensure all residential property advisors are made aware of the changes and their potential impact.

Comment

Inland Revenue will produce guidance to assist taxpayers and advisors in complying with the rules.

Recommendation

That the submission be noted.

Care and management of tax system

OVERVIEW

Seven submissions were made on the proposal to extend the Commissioner's care and management role. Most submitters supported the proposal. Submissions focused largely on further technical refinements to the legislative drafting of the proposal.

The Commissioner's care and management role was considered as part of a wider review of the Tax Administration Act in the 2015 Government discussion document *Towards a New Tax Administration Act*. At the time, it was noted that a key aspect of the Commissioner's care and management role is explaining the law to taxpayers. It was also noted that generally tax law could be interpreted consistently with the policy intent, but that in some circumstances the interpretation of the law when applying ordinary statutory interpretation principles may not accord with the policy intent. When this happens, it can tie the Commissioner's and the taxpayer's resources up in outcomes that are inconsistent with both parties' practice and/or expectations.

A proposal was developed to extend the Commissioner's care and management role to provide her with more flexibility to address issues with tax law that produced outcomes that were inconsistent with policy intent. The proposal was originally included in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill which was introduced to Parliament in June 2018. The proposal was removed from that Bill at the recommendation of the Finance and Expenditure Committee for further work to take place with the Legislation Design and Advisory Committee and affected parties.

The revised proposal includes a regulation-making power and an administrative power of exemption. The regulation-making power permits the Governor General to make an Order in Council on the recommendation of the Minister of Revenue and this is referred to as a "modification". The administrative power of exemption is for the Commissioner of Inland Revenue and this is referred to as an "exemption".

Broadly, the powers can be used where there is an issue with tax legislation that produces an outcome that is inconsistent with intended policy outcomes (for example, there is a drafting error or inconsistency in the legislation). Modifications and exemptions are subject to several safeguards, including optional application for affected taxpayers, automatic expiration within three years, and a period of public consultation before a modification or exemption comes into force.

The revised legislative drafting in the Supplementary Order Paper reflects work between Inland Revenue officials, the Legislation Design and Advisory Committee, and submitters.

All references to legislation in this section are to the Tax Administration Act 1994 and the provisions proposed to be inserted to the Tax Administration Act 1994 as contained in the Supplementary Order Paper.

EXTENDING THE COMMISSIONER'S CARE AND MANAGEMENT ROLE

Clause 67E

Issue: Support for the proposal

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, New Zealand Law Society, New Zealand Super Fund, Russell McVeagh)

Six submitters supported the proposal in the Supplementary Order Paper which provides alternative options to resolve issues with tax legislation that produce results which are inconsistent with the policy intent.

The submitters agreed that the overall proposal would give more flexibility to tax administration. The redrafted power allows for modifications and exemptions from the Inland Revenue Acts in certain circumstances and for a limited time. *(Chartered Accountants Australia and New Zealand)*

The proposed power will provide greater certainty to taxpayers seeking to apply tax legislation containing drafting errors, ambiguities and inconsistencies. *(Corporate Taxpayers Group, New Zealand Super Fund)*

Given the challenges inherent in developing, administering and maintaining tax legislation during a time of major law and systems change, we accept there is a case for remedial powers. The way in which the remedial powers are delineated so that the Commissioner may grant an exemption from a provision of the Inland Revenue Acts, with modifications being reserved for the Governor General by way of Order in Council, is also reasonable. *(EY)*

The Law Society submits that the redrafted provisions will achieve their intended purpose and have enough taxpayer protections to ameliorate many of the rule of law concerns previously raised in its submission on the proposal as drafted in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill. *(New Zealand Law Society)*

A submitter supports the proposed powers to create modifications or exemptions to temporarily remedy or mitigate the effect of drafting errors and other anomalies in tax legislation. The proposed powers will provide a more principled, consistent and transparent framework for addressing drafting errors and other anomalies in tax legislation than is currently available. *(Russell McVeagh)*

Recommendation

That the submissions be noted.

Issue: Proposed safeguards are appropriate

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, New Zealand Law Society, New Zealand Super Fund)

Although we have always supported the extension of the power, we believed it was important that appropriate safeguards were put in place. This proposed legislation includes several. *(Chartered Accountants Australia and New Zealand)*

It will be apparent that the limitations constrain the content of any modification or exemption (such that it must not be inconsistent with the intended purpose or object of the law enacted by Parliament) as well as requiring a high level of transparency and procedural scrutiny. The proposed adjustments would provide a consistent, principled and transparent framework for addressing drafting errors. The proposed power is to address drafting errors in the legislation itself rather than errors made by a taxpayer. *(Corporate Taxpayers Group)*

The safeguards for taxpayers included in the Supplementary Order Paper covering these concerns are generally well considered. All taxpayers should be entitled to depend on the law as it has been passed by Parliament where this is to their advantage. The ability for the taxpayer to opt-in (or opt-out as applicable) to the modification or exemption is the most crucial counterweight to the powers to override primary legislation. *(EY)*

We consider the proposed powers are more principled and transparent than the status quo provided by Inland Revenue's care and management power, which requires Inland Revenue to address legislative anomalies by declining to enforce the provisions that result in the anomaly; and for these reasons, strengthen the rule of law and are (given the various proposed safeguards the proposed powers incorporate) a pragmatic way of addressing anomalies given the limits on Parliament's time, while respecting Parliament's sovereignty to make laws. *(Russell McVeagh)*

The redrafted provisions will achieve their intended purpose and have sufficient taxpayer protections to ameliorate many of the rule of law concerns previously raised. *(New Zealand Law Society)*

Comment

Officials worked with the Legislation Design and Advisory Committee to ensure that concerns with the rule of law were mitigated as best as possible. Officials note the proposal includes the following safeguards:

- *Optional application.* Modifications and exemptions must always be optional for taxpayers to apply. If taxpayers choose not to apply the modification or the exemption, the law applies to the person as if the modification or exemption did not exist.
- *General application to a class of taxpayers.* Modifications and exemptions will not be able to change the application of a tax law for a particular taxpayer, but will be limited to groups or classes or taxpayers (or circumstances) to ensure it is only used to remedy objectively determined issues with tax laws.
- *Changes must not be inconsistent with the intended policy.* Modifications and exemptions must not be inconsistent with intended policy outcomes, and cannot be broader than is reasonably necessary to give effect to intended policy outcomes.

- *Three-year time limit.* Modifications and exemptions will expire within three years of coming into force. This should provide sufficient time for amendments to primary legislation to be considered.
- *Public consultation.* Before a modification or exemption is made, there must generally be a period of six weeks for public consultation, unless a case of urgency exists.
- *Disallowable instruments.* Modifications and exemptions are disallowable instruments. Both will be subject to review by the Regulations Review Committee and can be disallowed by the House of Representatives. In addition, modifications will be reviewed by Cabinet.

As the proposed powers are significant officials acknowledge the need for appropriate safeguards to ensure the powers cannot be used to weaken the rule of law or disadvantage taxpayers. Officials consider the draft legislation in the Supplementary Order Paper achieves this.

Recommendation

That the submissions be noted.

Issue: Opposition to the proposal

Submission
(Alison Pavlovich)

The submitter opposes the proposal because they consider it undermines the segregation of powers required for a stable and effective democracy. The submitter notes that the limitation on the power of the executive branch of government to administrative functions is vital to ensure the law is executed fairly across all taxpayers, as legislated by Parliament. This extension of power would allow the Commissioner (and others) to exempt some taxpayers from the law.

The submitter considers the provision will benefit only those taxpayers who can afford representation to lobby the Commissioner to utilise the power, resulting in a power that cannot be enjoyed by the wider populous (and instead only those who can afford to pay for it) which has the effect of undermining of democracy.

The submitter provides an example of how the power might operate, noting that under the proposal the Commissioner does not have to apply the law strictly due to the perceived unfairness of the outcome.

The submitter notes the proposal will circumvent the process required for tax law change, including public consultation, scrutiny by the Finance and Expenditure Committee, independent advice and parliamentary scrutiny. In addition, the submitter considers that a power provided to an unelected member of the executive should not be legitimised.

The submitter also notes that compliant taxpayers would be penalised if they pay tax according to the law when non-compliant taxpayers are excused under the proposed powers. The potential to treat some taxpayers differently to others undermines the voluntary compliance model as perceived unfairness and reduces a taxpayer’s willingness to comply.

The submitter also points out that this proposal has been introduced to the Bill by way of a Supplementary Order Paper, which manages to escape some of the scrutiny the Bill has already been under.

Comment

The proposal does provide the Commissioner with the ability to exempt taxpayers from the provisions within the Inland Revenue Acts in limited circumstances where the law cannot be interpreted in a manner consistent with its policy intent. It should be noted that the Commissioner's power of exemption is intended to only be used for minor or administrative matters where there are no, or negligible fiscal implications. For other issues that are not better resolved through waiting for amendments to primary legislation, the modification by Order in Council would be used.

Inland Revenue officials have worked closely with the Legislation Design and Advisory Committee to mitigate concerns with the rule of law. This is reflected in the numerous safeguards contained in the legislative drafting, as outlined in the response to the submission on the existence of appropriate safeguards above.

Officials do not agree that the proposal will benefit only those taxpayers who can afford representation to lobby the Commissioner to utilise the power. This is because, in implementing the proposal, Inland Revenue will create a channel for taxpayers to raise issues that they believe should be considered in the context of these powers. Further, as modifications and exemptions have general application, they must be available for all taxpayers who are affected by the issue to apply.

In addition, officials do not agree that the power could be used in the manner described in the submitter's example. The proposed power cannot be used to address circumstances where a person makes a mistake in taking a tax position (such as the case in the submitter's example) but is instead limited to situations where the legislation is inconsistent with (or cannot be interpreted in a manner that is consistent with) the clear and understood policy intent. Further, as noted, a modification or an exemption made under the proposed powers would have general application to taxpayers (or a class of persons or circumstances) so the chances of the power being used to the benefit of only one taxpayer would be very low.

A key objective of the proposal is to provide a temporary "bridge" for taxpayers who, despite knowing what the intended outcomes are, are unable to achieve those outcomes based on the wording of the legislation. Officials agree that the best means of achieving this would be through amendments to primary legislation, but also note that this cannot always be achieved quickly. This prolongs uncertainty for taxpayers who may be required to provide Inland Revenue with numerous tax returns during the period new legislation is being contemplated and enacted. Without a temporary solution, taxpayers may be unsure about what tax positions to take in filing their returns.

Officials also do not agree that taxpayers can be penalised under the proposal. This is because, as noted above, a modification or an exemption has general application to all taxpayers affected by the issue the modification or the exemption is seeking to resolve, and taxpayers can choose whether they apply a modification or an exemption to their circumstances. A person will always have the option to continue to apply the law as if the modification or the exemption did not exist, and the Commissioner must apply the law in relation to the person as if the modification or the exemption did not exist in these circumstances. In addition, in circumstances where a modification applies to earlier periods and taxpayers have already taken tax positions, taxpayers will be able to ask the Commissioner to amend their returns to align the tax positions in those returns with the modification.

As also noted, the proposal was originally included in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Bill which was introduced to Parliament in June 2018. The proposal was removed pending further work between Inland Revenue officials and the Legislation Design and Advisory Committee. The draft legislation in the Supplementary Order Paper reflects that work as well as input from private sector submitters. The truncated process was signalled in the officials' report to the Finance and Expenditure Committee on submissions to that bill. Officials also note that the proposal has been the subject of significant and ongoing consultation since its inclusion in the 2015 Government discussion document, *Towards a New Tax Administration Act*.

Recommendation

That the submission be declined.

Issue: Operationalisation of the proposed powers

Submission

(Chartered Accountants Australia and New Zealand)

The success of the new power will depend on how it is put into practice. We acknowledge that the proposed power is intended to be wider than the current power and to allow the Commissioner or the Minister to give primacy to the policy intent of the legislation. It will be important that the new power is used in a targeted way, in situations when it is needed and to the extent intended. Given the importance of the Government policy to the exercise of the power, it will be important the policy officials are involved in decisions on its exercise. If these things are not done, there is a risk that the power will not be effective. *(Chartered Accountants Australia and New Zealand)*

Comment

Inland Revenue is currently in the process of preparing interpretation guidelines for the proposed new provisions. These guidelines would be used by Inland Revenue in applying the proposed new provisions. This will ensure that any interpretative issues that arise during the implementation process will be subject to consultation and further discussion. It is expected that these guidelines will be subject to both internal and external consultation.

In addition to the guidelines, clear processes are being developed, and will be made publicly available, to allow taxpayers to request the use of the power through Inland Revenue's website.

Further information will also be provided in the *Tax Information Bulletin* covering changes on the Bill.

Recommendation

That the submission be noted.

Issue: Clarification that costs of compliance can be considered

Submission

(Corporate Taxpayers Group, New Zealand Super Fund, Russell McVeagh)

The submitters propose the powers should be able to be used in circumstances where it is reasonably necessary to provide an alternative means of complying with provisions that are difficult to comply with. In these circumstances, a modification or an exemption should be available to provide an alternative means of complying, provided the modification or exemption is consistent with the intent of the legislation to which the modification or exemption would apply. The other protections and limitations included in the proposed powers would also apply.

It is also submitted that this could be achieved by amending proposed sections 6D(5)(a)(ii) and 6E(1)(c) by adding the underlined text:

> to give effect to the intended purpose or object of a provision of the Inland Revenue Acts, or to resolve ambiguity<u>, including by providing an alternative means of complying with a provision of the Inland Revenue Acts:</u>

This clarification is appropriate because one of the circumstances in which legislative drafting results in difficulties for taxpayers and does not achieve the intended purpose or object of the legislation is where the drafting specifies a means of compliance that is not workable in practice.

An example would be a rule requiring market value to be determined in a certain way (for example, by using a certain index or database) in circumstances where it is not practicable to use that method, and/or the method would not in fact result in a reasonable assessment of market value. This sort of drafting error may impose financial costs, as well as additional uncertainty and stress for taxpayers seeking to comply with their obligations. The exercise of the power to address such a situation would result in the law as drafted better reflecting Parliament's intent, and would enhance the integrity of the tax system.

Comment

Officials consider the proposed wording of the draft legislation in the Supplementary Order Paper could cater for the circumstances described by the submitters.

Proposed sections 6D(5) and 6E(2) outline the circumstances in which a modification or an exemption may be made. That is, where the Minister of Revenue or the Commissioner considers it is reasonably necessary to do one or more of the following:

- to remedy or mitigate the effect of an "obvious error" (as defined in proposed section 6G) in a provision of the Inland Revenue Acts;
- to give effect to the intended purpose or object of a provision of the Inland Revenue Acts, or to resolve ambiguity;
- to reconcile an inconsistency between certain provisions of the Inland Revenue Acts, or between the relevant provision and an administrative practice of the Commissioner.

Officials consider that the wording that permits a modification or an exemption where it is reasonably necessary to "give effect to the intended purpose or object of a provision of the Inland Revenue Acts" would, when combined with the ability for a modification to state "an alternative means of complying with the provision" (as permitted by proposed section 6D(2)(d)(i)), be able to deal with the compliance cost matters raised by the submitters. An exemption could also provide an alternative means of complying through the use of terms and conditions, which are permitted under proposed section 6E(3)(c)(i). For example, an exemption could be conditional on taxpayers treating the provision subject to the exemption in another way.

Officials will consider whether this result needs to be made more certain by adopting the amendment proposed by submitters for the revision-tracked version of the Bill.

Recommendation

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

Issue: Definition of "obvious error"

Submission
(Russell McVeagh)

Proposed section 6G(c) should be omitted, as it is unnecessary in view of section 6G(a). If the intended purpose or object is clear (proposed section 6G(a)), and that intended purpose or object cannot be carried into effect (proposed section 6G(b)), then that in itself is evidence that there is an obvious error: the intended purpose or object is clear and yet cannot be given effect under the provisions in question. An Order in Council or exemption made under proposed section 6D or 6E must comply with the limitations and protections in those provisions, and will not necessarily involve second-guessing and seeking to replicate the form of the provision that Parliament would have made had the error been known to Parliament.

Comment

The definition of "obvious error" in proposed section 6G reflects the test used by the courts in *Inco Europe Ltd v First Choice Distribution Ltd* [2000] 2 All ER 109 (HL).

The proposed powers provide the Minister of Revenue or the Commissioner with the ability to resolve an "obvious error" as defined in proposed section 6G. This requires the Minister of Revenue or the Commissioner to be satisfied that there is an error that arises only in the circumstances where:

- the intended purpose or object of the relevant provision is clear (proposed paragraph (a));
- the intended purpose or object cannot be carried into effect by the relevant provision (proposed paragraph(b)); and
- the substance of the provision that Parliament would have made, had the error become known, or had the circumstances been allowed for, is clear (proposed paragraph (c)).

As the proposal already allows the Governor General on the recommendation of the Minster of Revenue to make a modification or the Commissioner make an exemption to "give effect to the intended purpose or object of a provision" in situations where there is an obvious error, removing proposed paragraph (c) would remove the need for a separate definition of "obvious error".

Proposed paragraph (c) would allow for errors within the Inland Revenue Acts to be corrected by way of a modification or an exemption where it was clear that the law as drafted would have been different, had Parliament known of the circumstances in question and taken them into account when drafting the law.

Recommendation

That the submission be declined.

Issue: Repetition in proposed section 6D(1)

Submission
(Russell McVeagh)

Proposed section 6D(1) should be simplified. Proposed section 6D(1)(b) ("granting an exemption from a provision of the Inland Revenue Acts") is unnecessary given proposed section 6D(1)(a) allows the exercise of the power "providing that a provision of the Inland Revenue Acts does not apply". Accordingly, proposed section 6D(1)(b) should be removed.

Comment

Officials agree that "granting an exemption from a provision of the Inland Revenue Acts" and "providing that a provision of the Inland Revenue Acts does not apply" are doing the same thing. Proposed section 6D(1) should be amended to remove the unnecessary duplication.

Recommendation

That the submission be accepted.

Issue: Opt-in and opt-out process

Submission
(New Zealand Law Society)

As modifications and exemptions can be opt-in or opt-out, it is not clear how taxpayers will be able to choose to apply a modification or an exemption in the circumstances. It would be onerous if taxpayers were required to write a separate letter at the time of filing their returns. This might impose the modification or exemption on the taxpayer. We presume a taxpayer could make this choice by filing their tax return taking a tax position incorporating or giving effect to that modification or exemption.

Comment

Proposed sections 6D(4) for modifications and 6E(5) for exemptions provide that a modification or an exemption will either be opt-in or opt-out. The proposed legislation (in sections 6D(2)(b) and 6E(3)(b)) provides that the means for taxpayers to opt to apply (or opt not to apply) a modification or an exemption will be specified in the modification or the exemption itself.

Where a modification or an exemption is opt-in, taxpayers will be required to do something in order to give effect to the modification or the exemption before it applies. Where a modification or an exemption is opt-out, taxpayers will be required to do something in order to not apply it. Further, in cases where the modification or exemption is opt-out, taxpayers must be provided with a reasonable opportunity to not apply the modification or exemption before it would take effect.

Whether a modification or exemption will be opt-in or opt-out will depend on the circumstances. Officials expect that a modification or exemption would be opt-out in situations where a significant number of taxpayers are affected, and the modification or exemption provides taxpayers with a more workable outcome than the status quo. In other situations, it may be more appropriate for the modification or the exemption to be opt-in, such as where taxpayers could use a valuation option given by the Commissioner when filing their tax return and taking a tax position.

The method for opting in and opting out, as well as whether a modification or an exemption applies on an opt-in or opt-out basis, would both be subject to public consultation.

Recommendation

That the submission be noted.

Issue: Available period of retrospective application for exemptions

Submission
(Chartered Accountants Australia and New Zealand)

The submitter considers it important that modifications and exemptions can apply to years that are not subject to the time bar, otherwise taxpayers will face further uncertainty over whether prior years will be subject to a different tax treatment.

The submitter notes it is not clear why a modification can have retrospective application of up to four years before it comes into force, but the extent of retrospective application for exemptions is limited to the beginning of the tax year in which the exemption is made. The submitter considers the extent of retrospective application should be four years for both modifications and exemptions.

Comment

Under the proposed draft legislation, the provision that empowers the regulations by Order in Council will allow for retrospective application of up to four income years before the year in which the Order in Council comes into force. The extent of retrospective application available for exemptions made by the Commissioner is intended to be more limited, and is only available as far back as the beginning of the income year in which the exemption is made. Both modifications and exemptions would expire automatically at the end of the third income year corresponding to the tax year in which the modification or the exemption is made.

The Commissioner's exemption-making power is intended largely for administrative matters, where there are no, or negligible, fiscal implications. It is not clear what benefit retrospective application would have in these circumstances. In addition, officials note that if a greater degree of retrospective application is required, rather than resolve the issue using an exemption, a modification, which is intended to be used for issues that are more sensitive or that have fiscal implications, could be used (provided it is not more appropriate to wait for an amendment to primary legislation).

Recommendation

That the submission be declined.

Issue: Clarifying the extent of retrospective application for modifications

Submission
(Matter raised by officials)

Proposed section 6D(3)(b) provides that a modification can apply for up to four income years before the income year corresponding to the tax year in which the modification comes into force. A minor amendment is necessary to clarify that the period of retrospective application aligns with the time bar for amending assessments.

Comment

The time bar in section 108 prevents the Commissioner from increasing the amount of tax assessed (or decreasing the amount of a net loss) if more than four tax years have passed since the end of the tax year in which the taxpayer makes their assessment. The Commissioner is also unable to issue a refund in respect of an amended assessment unless the Commissioner receives notice or is satisfied that the person is entitled to the refund within the time bar period.

The current proposed wording of section 6D(3)(b) which specifies the period of retrospective application available for a modification would not allow taxpayers to apply a modification in respect of all tax returns that are not subject to the time bar period.

For example, if a modification was made during the 2021 tax year which applied to that year and four previous income years, taxpayers would be able to apply it to their income tax returns for the 2016–17 and later years. However, because the time bar applies four years after the end of the tax year in which the income tax return was filed, the time bar could apply to income tax returns filed for the 2015–16 income year. This is because income tax returns for the 2015–16 income year would generally be filed during the 2016–17 tax year.

The intent is that taxpayers be able to apply a modification to all tax returns that are not subject to the time bar.

Recommendation

That the submission be accepted.

Issue: Applying modifications to returns that have already been filed

Submission
(EY, New Zealand Law Society)

Two submitters queried how taxpayers could apply modifications that had retrospective effect to tax returns that had already been filed. Both submitters noted that taxpayers would have to apply to the Commissioner for an amendment to their assessment under section 113.

Submitters considered there should be a simple and straightforward method for taxpayers to use to apply modifications to previous tax returns.

Both submitters also noted that the Commissioner's power to amend assessments under section 113 is discretionary and submitted that the Commissioner should be required to amend an assessment in tax returns already filed to give effect to a modification.

Comment

Section 113 enables the Commissioner to amend an assessment to ensure its correctness. The Commissioner has published guidance on her approach to applications from taxpayers who request amendments to their assessments under section 113 in *Standard Practice Statement 16/01 – Requests to amend assessments*. The Commissioner's practice, as outlined in the statement, is that she will use section 113 to amend an assessment to correct a tax position which is clearly incorrect.

The criteria applied in determining whether to exercise section 113 are based on the existing care and management principles in sections 6 and 6A, which require the Commissioner to use her best endeavours to protect the integrity of the tax system, while acknowledging the Commissioner has limited resources and must be able to make resourcing decisions.

Submitters suggested the Commissioner should be required to amend an assessment to give effect to a modification in situations where tax returns have already been filed. Officials consider that this approach could be inconsistent with the Commissioner's care and management duty and therefore consider a better approach would be to outline how taxpayers can apply a modification to past assessments within the modification itself. This would ensure the issue was a matter for public consultation. The method for applying a modification to past returns would be part of the transitional matters relating to the modification which are permitted under proposed section 6D(2)(c)(iii) and section 6E(3)(iii).

Recommendation

That the submission be declined.

Issue: Effect of retrospective application on returns already filed

Submission
(Russell McVeagh)

The submitter recommends an amendment be made to proposed sections 6D(4) and 6E(5) to make it clear that where a modification has retrospective application, and operates on an opt-out (instead of opt-in) basis that taxpayers should not need to do anything to preserve the tax position(s) taken in prior returns. In these circumstances taxpayers should be able to rely on the law without the effect of the modification.

Comment

Officials consider the submitter's concerns can be addressed through the use of savings provisions, which modifications and exemptions can both provide under proposed sections 6D(2)(c)(iii) and 6E(3)(c)(iii) respectively.

For example, if a modification came into force and had retrospective application covering a period where tax returns had already been filed, and the positions taken in those returns were correct under the law (without the effect of the modification), those positions could be preserved.

Officials also note that in the case of an exemption, the extent of retrospective application is limited to the beginning of the income year that corresponds to the tax year in which it comes into force. This means that there will only be limited situations where exemption will affect an income tax return which has already been filed.

Recommendation

That the submission be declined.

Issue: Ability to dispense with or shorten the period of public consultation in cases of urgency

Submission
(EY, New Zealand Law Society)

We recognise that there may be unforeseen circumstances justifying urgency and accept that a case of urgency could exist in some exceptional circumstances. We consider that the meaning of a "case of urgency" is clarified, either through a statutory definition, published guidance from the Commissioner, or both. *(EY)*

The consultation requirement is a crucial taxpayer protection that also reduces the rule of law concerns. Consultation should only be reduced or dispensed with in very narrow, prescribed situations, being "exceptional circumstances". The "exceptional circumstances" test is applied elsewhere in the Act and has been interpreted by the courts, so will provide guidance to the Minister of Revenue and the Commissioner over when consultation is not required to take place. The submitter also considers that the urgency carve-out should apply to the Minister of Revenue only, and not the Commissioner, so that there will at least be internal consultation between the Minister of Revenue and the Commissioner for exemptions. In addition, if the consultation period is shortened or dispensed with the reasons for this should be published. *(New Zealand Law Society)*

Comment

Proposed section 6F(3) allows the Minister of Revenue or the Commissioner to shorten, or dispense with, the period of public consultation required. Officials expect in most cases before a modification or an exemption is made it will be subject to a period of six weeks of public consultation. Further, proposed section 6F(1) requires that the Minister of Revenue or the Commissioner undertake a consultative process that includes providing the proposed modification or exemption (alongside an explanation of how the modification or exemption meets the relevant criteria) to persons and representatives that it is reasonable to consult with. This would include the likes of Chartered Accountants Australia and New Zealand and the New Zealand Law Society.

Proposed section 6F(3) would only be used to shorten or reduce the period of public consultation where there were exceptional circumstances, such as a natural disaster or the issue having major systems implications in administering the tax system, and where the issue the modification or the exemption was seeking to resolve was clear and not contentious. Officials therefore agree that the period of public consultation should only be reduced or dispensed with in such "exceptional circumstances", as this is consistent with the intended purpose of the provision.

Officials note the definition of "exceptional circumstances" in the Tax Administration Act 1994 currently applies in the context of several provisions that relate to the formal disputes process. It applies when a taxpayer (or the Commissioner) is unable to meet statutory timeframes within the disputes process because of events or circumstances that are beyond their control. As noted above, officials consider the period of consultation would be expected to be shortened or dispensed with in limited situations such as a natural disaster or a major issue with an Inland Revenue computer system. As such, the current definition of "exceptional circumstances", which generally considers a taxpayer's particular circumstances, cannot easily be used as a reference point for proposed section 6F(3).

Officials also do not agree that the ability to shorten or dispense with the consultation requirement should be limited to the Minister of Revenue in the case of modifications only as this could (in exceptional cases) remove the ability to pragmatically address administrative issues that could have major systems implications for Inland Revenue but very limited impact on taxpayers.

Officials expect that if the period of public consultation is shortened or dispensed with the reasons would generally be publicised. Officials do not consider it necessary to amend the legislation to require this.

Recommendation

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

Issue: Determining the "intended purpose or object of the provision" and establishing a remedial panel

Submission
(EY, New Zealand Law Society)

Two submitters suggested the Minister of Revenue or the Commissioner may want to consider the establishment of a panel, similar to the Rewrite Advisory Panel which operated from 1995 to 2014, for the purposes of consultation before a modification or an exemption is made.

The panel could both recommend a modification or exemption to the Minister of Revenue or the Commissioner and ensure that wider consultation occurred within the tax profession if necessary. It may be that a body of tax specialists would be better placed to provide advance comment as to whether the requirements listed in proposed sections 6D(5) and 6E(2) are met. The panel's recommendations could be published alongside the Minister of Revenue or the Commissioner's modification. *(EY)*

The Law Society consider that because a modification or exemption is based on "the intended purpose or object of the provision", the Minister of Revenue or the Commissioner should at least consult with an advisory committee or panel over what this means. This limited form of consultation should be mandatory when the normal consultation process is to be shortened or dispensed with. The Law Society sees an advisory committee or panel to be helpful to the Commissioner in terms of providing a measure of objectivity to the process, and in terms of taxpayer perceptions of the integrity of the tax system. *(New Zealand Law Society)*

Comment

Officials consider the consultation requirement in proposed section 6F will ensure there is opportunity for engagement between tax practitioners and Inland Revenue on proposed modifications and exemptions. Proposed section 6F requires the Minister or the Commissioner to undertake a consultative process "that includes the distribution, to persons or representatives or persons that it is considered reasonable to consult with" which would include Chartered Accountants Australia and New Zealand and the New Zealand Law Society.

Officials also note that, if needed, a panel could be established without enabling legislation. However, officials consider the current consultation requirements to be sufficient for ensuring that it is only objectively determined issues with the Inland Revenue Acts that are the subject of a modification or an exemption.

Establishing a panel and imposing requirements on the Minister of Revenue and the Commissioner to consult with that panel before a modification or an exemption is made will add an additional process and potentially prolong the period of uncertainty for taxpayers.

Recommendation

That the submission be declined.

Issue: Audits and disputes

Submission

(New Zealand Law Society)

The submitter considers it would be inappropriate to continue to audit or dispute a matter that has been raised as an issue to be considered for a modification or an exemption until a decision has been made about whether a modification or exemption should apply to resolve the issue.

The submitter also considers that if a modification or exemption is made, and it addresses an issue under dispute, taxpayers should be provided with additional time to make a choice whether to apply it.

It is also submitted that any audit or dispute over an issue should only recommence once a modification or exemption becomes law, and that taxpayers who are part way through a dispute with Inland Revenue should be able to apply a modification or exemption if that resolves the issue at dispute and the Commissioner should be bound by the taxpayer's decision.

Comment

Officials note that in respect of audits, the existing powers in sections 6 and 6A enable the Commissioner to make decisions not to allocate resources to areas (including the continuation of a dispute) where a modification or an exemption is being contemplated.

Officials have considered whether it would be appropriate to introduce a "stop the clock" rule for the disputes process of Part 4A of the Tax Administration Act 1994, and do not recommend making changes to these rules as suggested by the submitter. If a "stop the clock" rule was introduced, it could encourage taxpayers to raise, as an issue to be considered for a modification or an exemption, a matter that is better resolved through the statutory disputes process.

Officials note, in any case, that if a modification is made that has retrospective effect, taxpayers can ask the Commissioner to amend their assessment to give effect to the modification. Specifically, if a modification or an exemption is issued part-way through a dispute, if the taxpayer chooses to apply it, the Commissioner would in practice withdraw her proposed adjustments and apply the modification in relation to the taxpayer.

The proposed legislation deals with this by allowing taxpayers to apply modifications and exemptions optionally. If taxpayers do not wish to apply a modification or exemption, in accordance with proposed section 6C(5), the law applies in relation to the person as if the modification or the exemption did not exist. The Commissioner would be required to apply the law with the effect of the modification or the exemption in relation to the taxpayer in these circumstances.

Recommendation

That the submission be declined.

Issue: Renewing of modifications and exemptions and requirement to review a modification or exemption during the period it is in force

Submission

(New Zealand Law Society)

The submitter considers it should be clearer that the Commissioner is not able to reissue an exemption after it expires. The submitter notes that the issue could presumably be included within the tax policy work programme within the two-year period when it is in force. An extra subsection could be added to proposed section 6C, which outlines the purpose of the remedial powers, to state that the purpose is to provide relief pending legislative amendment.

The proposed legislation does not stipulate that the Commissioner must attempt to address issues with tax legislation that are being resolved through a modification or an exemption in a tax amendment bill put before Parliament at any time during the period that the modification or exemption applies.

The requirement that the Commissioner review the modification or exemption during the period it is in force (which was included in the draft legislation for this proposal in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Bill) should also be re-introduced.

Comment

The proposed legislation requires that a modification or an exemption cannot be in force for a prospective period longer than three complete income years – the income year corresponding to the tax year in which it comes into force and the next two income years. This is made clear by proposed sections 6D(3) and 6E(4). It is not intended to enable a modification or exemption to be reissued after it expires. For a modification or exemption to have ongoing effect after it has expired, an amendment must be made to primary legislation. Officials agree that it should be made explicit in the legislation that a modification or exemption cannot be reissued after it has expired.

The draft legislation in the Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters Bill required the Commissioner to review a modification before the end of the three years during which it was in force to "determine if the modification should be included in an amendment to the relevant provisions". This requirement is not replicated in the new draft legislation.

As noted, for a modification or exemption to have ongoing effect after it has expired, an amendment must be made to primary legislation. Therefore, officials do not consider it necessary to include the same wording in the new draft legislation.

Further, in some circumstances it may not be necessary to make amendments to primary legislation, such as where the legislation subject to the modification or exemption is only in place for a limited period of time.

Recommendation

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

Issue: Sunset clause and requirement for review

Submission
(New Zealand Law Society – oral submission)

The proposed powers should come with a sunset clause and/or subject to a review after five years.

Comment

A sunset clause would repeal the proposed powers after a defined period of time. For the powers to continue to be used, new legislation would need to be passed which either prevented the repeal of the powers, or reinstated them.

Officials consider the built-in safeguards on the proposed powers, including the fact that modifications and exemptions will be reviewed by both the Regulations Review Committee, and Inland Revenue within three years (as would be required for circumstances where it was necessary for a modification or exemption to have ongoing effect) are sufficient protections against the power being used inappropriately.

Officials also note that legislative changes are, as a matter of course, reviewed over time as part of the Generic Tax Policy Process and this will also be the case for this proposal if any significant issues arise.

Recommendation

That the submission be declined.

Other policy matters

ANNUAL RATES OF INCOME TAX

Clause 3

Submission
(Gina Gao, Kate Kate, Ray Craig, Wendy Feng, Zarir Chhor)

The Government should commission a working group to see where Government savings can be made and then reduce corporate rates and personal thresholds and rates. *(Kate Kate)*

No more tax. *(Gina Gao)*

Do some real work to help the country and stop take from hard workers. *(Wendy Feng)*

Flat tax of 25% on all incomes. *(Zarir Chhor)*

The annual rates of income tax should not be rolled over without some adjustment. The first, say, $19,000 of income per annum per person should be untaxed and taxation rates for income over that amount should be readjusted to maintain total annual revenue currently received for income tax. *(Ray Craig)*

Comment

The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act. The Bill proposes to set the annual rates of income tax for the 2019–20 tax year at the same rates as the preceding year.

Officials note that submitters have suggested lower tax rates, a flat tax or a tax-free threshold.

Officials also note that the Tax Working Groups' final report included some recommendations on personal income tax which the Government is currently considering.

Recommendation

That the submissions be declined.

Issue: Support to reinstate the tiebreaker provision

Clauses 84 and 85

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to reinstate the tiebreaker provision.

Recommendation

That the submission be noted.

Issue: Day count test amended

Clauses 84 and 85

Submission
(Matter raised by officials)

Clause 84 amends section 22 of the Student Loan Scheme Act 2011. This section outlines the tests for a borrower becoming New Zealand-based, and thereby receiving an interest free loan and having income-based repayment obligations.

Officials propose that section 22(1)(b) read "the borrower is treated as being physically in New Zealand <u>for a period of 183 consecutive days</u> because". This would improve the clarity of the legislation by specifying that the test for becoming New Zealand-based under section 22(1)(b) is a 183-day test.

Similarly, clause 85 amends section 23 of the Student Loan Scheme Act 2011. This section includes tests for a borrower becoming overseas-based.

Officials propose that section 23(1)(c) read "a New Zealand-based borrower who is treated as physically absent from New Zealand <u>for a period of 184 consecutive days</u> because". This would also improve the clarity of the legislation by specifying that the test for becoming overseas-based is a 184-day test.

Recommendation

That the submission be accepted.

Issue: Definition of income for student loans and Working for Families

Clauses 57 and 93

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to improve the alignment of the definitions of income for student loans and Working for Families purposes.

Recommendation

That the submission be noted.

SECURITISED PRE-1990 FOREST LAND EMISSION UNITS

Clauses 44, 45, 47 48, 52 and 53

Issue: Support for the proposed amendments

Submission
(Chartered Accountants Australia and New Zealand, CNI Iwi Land Management Ltd, Corporate Taxpayers Group, Deloitte, Matariki Forests)

The submitters support the amendments changing the tax treatment of transactions involving the lease and buy-back of pre-1990 forest land emission units.

Comment

The Bill contains amendments to change the tax treatment of securitised transactions involving pre-1990 forest land emissions units. A securitisation transaction typically involves the sale and compulsory buy-back of pre-1990 forest land emission units. Under current tax law, securitisation transactions would be treated as a sale and purchase. The amendments in this Bill treat the transaction as a loan for income tax purposes and reflect the underlying economic reality of the transaction.

A unique tax feature of pre-1990 forest land emission units is that a one-off tax-free status applies to transactions by the first (and only) owner of the unit. Subsequent transactions are taxable. The tax-free status exists as a transitional measure as part of the introduction of New Zealand's emissions trading scheme.

The amendment responds to concerns that the current tax law did not reflect the economic substance of the transaction and created an impediment for holders of pre-1990 forest land emission units that wanted to realise the value of those units but not lose the tax-free status of those units. The amendments therefore provide that the sale of the emissions units and the return of the equivalent units would be ignored for both parties. Instead, for tax purposes there would be a loan between the two parties. The interest flows earned/paid by both parties on the borrowed/lent funds would be taxable/deductible.

If the acquirer of the units may wish to on-sell them, any gain or loss on selling the units to a third party would be taxable or deductible according to the ordinary rules that apply to the sales of forest land emissions units.

Importantly, ignoring the sale transaction in this instance means that pre-1990 emissions units retain their one-off tax-free status if and when they are disposed of.

Recommendation

That the submissions be noted.

Issue: Scope of the proposed amendments should be extended to include post-1989 forest land emission units

Submission

(Corporate Taxpayers Group, Matariki Forests)

The submitters assert that the proposed amendments changing the tax treatment of transactions involving the lease and buy-back of pre-1990 forest land emission units should, on the ground of fairness, equally apply to post-1989 New Zealand emission units.

Comment

The proposed amendments are directed at the treatment of pre-1990 forest land emission units given their unique tax transitional treatment.

Post-1989 New Zealand emission units are treated as revenue account property and transactions involving the sale and compulsory buy-back are taxable in the year of sale and deductible in the year of repurchase, as noted in Matariki Forests' submission at 2.3. As such, the tax disincentives for these transactions is not as marked, unlike the loss of tax-free status for pre-1990 forest land emission units under similar transactions.

Officials agree that there is a technical fairness issue, as acknowledged in Inland Revenue's impact statement at page 7. For post-1989 forest land emissions units, because the sale and repurchase legs of the transaction are recognised separately, the associated income and deduction can arise in different years, which may have some cashflow impact. This will not be an issue for a securitised transaction involving a pre-1990 forest land emissions unit because the proposed legislation focuses only on the net cash flows from the transaction. There is a case for consistent treatment of pre-1990 and post-1989 emission units. However, there are several factors against using this Bill to create this consistency:

- The tax treatment of post-1989 emission units outlined in the submission from Matariki Forests is consistent with the tax treatment of revenue account property generally. This is not the case for pre-1990 forest emission units because of their unique tax treatment.
- There is a need for fuller engagement with holders of post-1989 emission units to ensure no unintended consequences, including overall consistency with the objectives of the review of the emission trading scheme that is currently underway.
- The issue that tax law should reflect the economic substance of sale and compulsory buy-back transactions is relevant for a wide range of assets and is better explored using the generic tax policy process, subject to resourcing and other commitments on the Government's tax policy work programme.

Recommendation

That the submissions be declined.

Issue: Drafting matters

Submission
(Chartered Accountants Australia New Zealand))

The submitter makes two editorial comments regarding the drafting of clauses 44 and 47.

Comment

Officials have reviewed the drafting of these clauses and confirm they accord with standard drafting convention and are correct.

Recommendation

That the submission be declined.

KEEPING TAX RECORDS IN TE REO MĀORI

Clauses 38(1), (3) to (5) and 68 to 71

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the change but cautions that non-te reo Māori speaking taxpayers could be disadvantaged or required to incur additional compliance costs if they receive a tax record in te reo Māori.

Comment

The proposed amendments allow taxpayers to hold tax records in te reo Māori as a matter of right, but subject to the requirement that documents to third-party taxpayers should be in English as required by the GST Act and Tax Administration Act.

The proposed amendments recognise in the Inland Revenue Acts that te reo Māori is an official language of New Zealand and codifies Inland Revenue's current operational practice, which has been in effect for over 20 years, to allow taxpayers to hold their tax records in te reo Māori. Inland Revenue is already resourced to work with tax records held in te reo Māori.

In response to the concern raised by the submitter, officials note that clause 38(5) in the Bill requires taxpayers that are registered for GST to use the English phrases required by the Goods and Services Tax Act 1985 – for example, "tax invoice", "buyer created tax invoice – IRD approved", "modified tax invoice – IRD approved", "copy only", and "debit/credit" note. Officials note that the current disclosure requirements in the Goods and Services Tax Act do not prevent additional information being provided on tax invoices that could be in another language, nor otherwise prohibit the use of bi-lingual documents.

The Bill also does not change the current requirement in the Tax Administration Act 1994 (section 32) that donee organisations produce donation receipts in English (unless otherwise permitted to do so in another language).

The reasons for retaining the English disclosure requirements in the Goods and Services Tax Act and the Tax Administration Act is that taxpayers rely on the documents required by those Acts to support tax positions, such as entitlements to GST input tax deductions and tax benefits for monetary gifts to donee organisations, such as charities. These documents need to be accessible and understood by a wide section of the community.

Anecdotal comments received by officials from tax practitioners suggest that the majority of Māori sector clients (including taxpaying Māori authorities and tax-exempt registered charities) keep their records in English. Organisations that are most likely to keep their records in te reo Māori are te kohanga reo, marae, kura kaupapa, and Māori social-service groups. Records that are typically kept in te reo Māori by these organisations consist of constitutional documents, cash books, cheque books, wage books and records, minutes of meetings and receipt books. Financial statements and accounting records prepared for third-parties (such as invoices and receipts) are typically prepared in English.

Recommendation

That the submission be declined.

Clause 61

Issue: General support

Submission
(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, PwC)

That the proposed amendment is supported as it overcomes accounting consequences and will help minimise compliance and administration costs. *(Chartered Accountants Australia and New Zealand)*

That the proposed amendment is supported as it gives employers the flexibility to address undesirable financial reporting consequences. *(Corporate Taxpayers Group, Deloitte, PwC)*

Recommendation

That the submissions be noted.

Issue: Form of legislation

Submission
(Corporate Taxpayers Group, Deloitte, PwC)

The form of the legislation be agreed with a professional accountancy body to ensure that the legislation is sufficient to provide the desired outcome.

Comment

Officials agree with the suggestion to obtain consensus with a professional accounting body on ensuring the wording meets the policy objective.

Recommendation

That the submission be accepted.

Issue: Ability for amendments to apply to current schemes

Submission
(Corporate Taxpayers Group)

Proposed section RD 7B does not seem to apply to benefits that have already been offered under existing employee share schemes (“ESS”), only to benefits offered or provided going forward.

The amendment states that an employer has irrevocably chosen to withhold and pay tax for a benefit for an employee if, at the time the benefit is offered or provided, it is a term of the offer of the benefit, or of the scheme under which the benefit is provided, the employer must withhold and pay tax under this section. Current schemes that have already offered benefits to their employees cannot fulfil this requirement, since they have already offered the benefit at some time in the past, and did not make the irrevocable election to withhold at that time. Therefore, they appear unable to get the benefit of this amendment.

Corporate Taxpayers Group submits that the proposed amendment should be extended to cover benefits offered under existing ESS.

Comment

Officials agree that the proposed amendment should be extended to cover benefits that have already been offered under existing ESS, provided that making provision for this possibility does not prevent the proposed amendment from achieving the desired accounting outcome.

Providing this additional flexibility will allow more employers to pay PAYE on behalf of employees, which was the policy intent of introducing the provision originally.

Recommendation

That the submission be accepted.

Issue: Use of term "benefit"

Submission
(Corporate Taxpayers Group)

The submitter queries whether the use of the term "benefit" in the proposed section RD 7B is appropriate, as the term is not defined and at the time of offer/grant, no actual "benefit" exists to an employee.

Comment

Officials acknowledge that no crystallised benefit exists to an employee at the time of the offer. However, officials do not consider it problematic that the word "benefit" refers to a contingent benefit, especially as the proposed provisions refer to the offer of a benefit, which inherently includes situations where the benefit has not yet crystallised and is still contingent.

Accordingly, officials do not think it necessary to replace the widely-understood term "benefit" or further define it.

Recommendation

That the submission be noted.

Issue: Possibility for employers to cancel irrevocable election to withhold

Submission

(PwC)

Under the currently proposed wording of amended section RD 7B, employers could still, after making an offer to employees which includes withholding as a term of the offer, simply cancel the offer and make a fresh offer which includes no such term. If this is the case, it could be argued that in substance, the employer still has "choice" in relation to its obligation to withhold. And if the employer has this choice, then any election to withhold is not truly irrevocable, and equity settled accounting treatment is therefore not available to the employer (for the tax/cash component of the benefit granted).

The submitter suggests the following wording to resolve this issue:

> **Irrevocable obligation**
> (2) An employer who has made an irrevocable election described in subsections (1)(a) and (3) must comply with subsection (4)(a) to (c) for both the relevant benefit and employee under the scheme, and for any benefit offered or provided to that employee in replacement of the relevant benefit where such relevant benefit offered or provided to that employee has been withdrawn or otherwise varied with the purpose or effect of avoiding the operation of this section.

Comment

Officials can see the argument that if it is possible for an employer to cancel a scheme that has withholding as a term of the offer, and replace it with a scheme that has no such term, then indeed an irrevocable election to withhold is not truly irrevocable, and therefore equity settled accounting treatment will not be available. If this is the case, then there is a risk that the proposed amendment will not achieve the intended policy outcome.

Officials agree that to prevent this, the irrevocable obligation to withhold should also apply to replacement schemes.

Recommendation

That the submission be accepted.

BENEFICIARIES AS SETTLORS

Clause 56

Issue: Support for the proposal

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal.

Recommendation

That the submission be noted.

Issue: Importance of correctly identifying settlors

Submission
(New Zealand Law Society)

The submitter stated that correctly identifying the settlors of a trust underpins a number of income tax and tax administration provisions, including:

- determining whether the trustees are liable to New Zealand income tax on their worldwide income;
- the income tax treatment of distributions made by the trustees;
- who is liable to meet the trustees' income tax liabilities;
- whether the trustees are required to register the trust as a New Zealand foreign trust;
- calculating "family scheme income" for the Working for Families entitlements; and
- "adjusted net income" for student loan purposes.

In some instances, correctly identifying the settlors of a trust in a particular income year is critical (for example, in calculating Working for Families entitlements), but in other instances it is critical to identify who have been the settlors of a trust since the trust was first settled (for example, in determining whether the trust is a foreign trust). For the above reasons, the submitter considers that it is essential that the definition of settlor is clear and unequivocal.

Comment

Officials agree with the submitter. Officials consider that the amendment results in a clear definition of "settlor".

Recommendation

That the submission be noted.

Issue: Previous position of Inland Revenue

Submission
(New Zealand Law Society)

The submitter said that in draft public ruling PUB0209[a], which was issued in December 2014, Inland Revenue concluded that a beneficiary of a trust would not be treated as a settlor of the trust just because they had a credit balance in their beneficiary current account and no interest was paid on that credit balance (or interest was paid at a rate less than the market rate). The commentary to the draft ruling includes comprehensive analysis that explains why a beneficiary would not be treated as a settlor in this situation. In essence, this is because the beneficiary does not cause a settlement to be made, as it is the trustee, not the beneficiary, who decides to make the distribution and whether the distribution is actually paid out or credited to account. Further, the beneficiary does not have legal ownership of the money, and so cannot provide money to the trust or provide financial assistance. PUB0209[a] was never finalised, but was widely recognised as reflecting Inland Revenue's considered view on this issue.

The submitter said that *Commentary* to the Bill on this issue states a view contrary to that expressed in PUB0209[a], and is also arguably contrary to the analysis set out in IS 18/01, *Taxation of Trusts – Income Tax* (28 June 2018).

Comment

As a draft, PUB0209[a] does not represent the Commissioner's final view on the matter, and is therefore not binding on Inland Revenue. As a result of submissions received on the draft the Commissioner further considered the issue and came to a different conclusion, which has resulted, and is reflected, in the proposal.

Officials disagree that the proposal is arguably contrary to the analysis set out in IS 18/01 – on the contrary, the analysis in IS 18/01 is consistent with the proposal. The analysis in IS 18/01 refers to the definition of "settlor" being purposefully wide, and discusses that those who transfer value to the trust are settlors.

Recommendation

That the submission be noted.

Issue: Savings provision

Submission
(Chartered Accountants Australia and New Zealand, New Zealand Law Society)

One submitter suggested that the amendment should include a savings provision, so that taxpayers who have adopted a different tax position are protected. *(Chartered Accountants Australia and New Zealand)*

The submitter noted that the amendment would not reflect the long-standing approach held by many practitioners. The submitter remarked that the policy intent is contrary to that approach. The submitter argued that this policy intent was not made clear when the trust rules were amended in the 1980s, and the accompanying comprehensive *Tax Information Bulletin* makes no mention of this. The submitter continued that such a clearly intended effect should have been identified. *(Chartered Accountants Australia and New Zealand)*

Another submitter noted that because of the importance of correctly identifying the settlors of a trust, it is essential that any uncertainties or overreach in that definition are resolved with retrospective effect. *(New Zealand Law Society)*

The submitter stated that it is clear who becomes a settlor following the amendment, but only from the date the Bill is enacted. The submitter said that it is still not clear whether a beneficiary with a credit current account balance would be treated as a settlor of the trust prior to the date of enactment. The submitter said that an alternative to making the proposed amendment retrospective is to allow a beneficiary to choose whether or not they are treated as a settlor of the trust where the trustee of the trust owes an amount to them before the date the Bill is enacted. However, taxpayers who have taken a tax position which turns on whether such a beneficiary is a settlor of the trust prior to the date the Bill is enacted are prevented from changing that tax position. *(New Zealand Law Society)*

Comment

Officials agree with the submissions and recommend changing the application date from the date of the enactment, as currently proposed, to 1 April 2020 to enable trustees of trusts with beneficiaries with current account credits to evaluate and address their position. The Commissioner will consider how to respond operationally in respect of tax positions taken for periods before 1 April 2020.

Recommendation

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

Issue: Wrong result for foreign trusts

Submission
(New Zealand Law Society)

The submitter stated that the uncertainty as to whether a beneficiary with a credit current account balance would be treated as a settlor of the trust prior to the date of enactment could lead to absurd and unintended results. For example, a beneficiary of a foreign trust who migrates to New Zealand and receives a small distribution from the trust which has been credited to their current account, will be treated as a settlor of the trust. This will cause the trust to cease being a foreign trust and make it liable for income tax on its worldwide income (for each income year that the beneficiary remains New Zealand tax resident). The beneficiary may be liable, as agent of the trustees, to meet the trustees' New Zealand income tax liability. The submitter does not consider this to be an intended policy outcome.

Comment

Officials consider that all beneficiaries with any current account balances retained with the trust are settlors where no market interest has been paid, because there is a transfer of value from the beneficiary to the trust. It is also consistent with the policy intent that beneficiaries with relatively modest current account balances are not treated as settlors.

This equally applies to beneficiaries of foreign trusts. In the absence of the proposed amendment, all beneficiaries of foreign trusts who have migrated to New Zealand, with any amounts retained in their current accounts, would have caused the trust to lose its foreign trust status. The amendment however clarifies that beneficiaries with account balances under $25,000, or with balances over $25,000 in relation to which a current rate of interest has been paid to the beneficiaries, are not settlors.

Recommendation

That the submission be noted.

Issue: The $25,000 threshold is arbitrary

Submission
(New Zealand Law Society)

The submitter stated that limiting the threshold change to beneficiaries who are owed no more than $25,000 at the end of the income year is arbitrary and could be ineffective. The trustees could manipulate beneficiary current account balances at the end of each income year to fall below the $25,000 threshold. The submitter noted that there is no clear rationale for why a beneficiary that is owed less than $25,000 at the end of an income year would not be treated as a settlor, whereas a beneficiary with $25,000 or more would be (unless the interest is charged on the balance at a rate not less than the prescribed rate of interest). The submitter noted that the analysis set out in PUB0209[a] applies irrespective of the beneficiary's current account balance.

The submitter recommended that the proposal is amended so that a beneficiary does not become a settlor of a trust solely because a trustee of the trust owes an amount to the beneficiary, irrespective of the amount.

Comment

Officials consider that beneficiaries transfer value to the trust by leaving any money in their current accounts with the trust, at no or below a market rate of interest. It is consistent with the policy intent that beneficiaries with relatively modest current account balances are not treated as settlors; the Bill sets a $25,000 threshold for this purpose. It is also consistent with the policy intent that those who leave significant amounts (above $25,000) in their current accounts with the trust at no or below market rate of interest should be settlors.

It is quite common in tax legislation to exclude a nominated amount from the application of a particular rule, for example, to ease compliance. Other examples in the Income Tax Act include section CQ 5(1)(d) (*When FIF income arises*, with a $50,000 cost *de minimis*), section HC 35 (*Beneficiary income of minors*, with a $1,000 *de minimis*), and section MB 13 (*Family scheme income from other payments*, with a $5,000 threshold).

Recommendation

That the submission be declined.

Issue: The proposed amendment affects Working for Families entitlements

Submission

(McIntyre Dick)

The submitter stated that the proposal dilutes the family scheme income of existing (formal) settlors, and increases family scheme income for beneficiaries that are also settlors. The latter are sometimes unaware of the distribution that makes them settlors, and may not report the additional income to Inland Revenue.

The submitter has also stated that once a settlor has been deemed a settlor for tax purposes, they are always a settlor. The proposed amendment may cause beneficiaries who received an allocation of income in one year only, to be the settlor for the rest of the trust's existence even though they may never receive income from the trust again. The submitter considered it to be an unfair overreach of the Working for Families rules.

The submitter proposed to amend the drafting, by also excluding beneficiaries who are not trustees or persons with the power of appointment or removal of trustees, from the scope of the definition of "settlor".

Comment

Officials consider that all beneficiaries with any current account balances retained with the trust are settlors where no market interest has been paid, because there is a transfer of value from the beneficiary to the trust. It is consistent with the policy intent that beneficiaries with relatively modest current account balances should be treated as settlors (whereas beneficiaries with significant balances should be treated as settlors). The proposal therefore introduces a "safe harbour" for beneficiaries with modest balances (below $25,000).

In accordance with section MB 1 of the Income Tax Act 2007, beneficiary income received by the person is included in their family scheme income. From 2011, section MB 7 (*Family scheme income of settlor of trust*) of the Income Tax Act 2007 also included the net income of a trust (less beneficiary income) in a person's family scheme income if they are a settlor of the trust. For this purpose, the trust's income was equally divided by the number of settlors, to be then added for the purposes of each settlor's Working for Families tax credits entitlements (if any). This was done so that the amount of undistributed trustee income is included in family scheme income because it is available to meet a family's living expenses. The effect of the 2011 amendment to section MB 7 of the Income Tax Act was that the family would receive their correct Working for Families tax credits entitlement.

A beneficiary will not be a settlor, if the trustees distribute to the beneficiary any funds above $25,000 on which market rate of interest has not been paid before the end of the trust's income year. Officials agree that once a settlor has been deemed a settlor for tax purposes, they always remain a settlor. This is an existing position however and is not affected by the proposal.

Recommendation

That the submission be declined.

CO-OPERATIVE COMPANIES: NON-DEDUCTIBLE CASH DISTRIBUTIONS

Clauses 51 and 58 to 60

Submission
(Chartered Accountants Australia and New Zealand, Deloitte)

Chartered Accountants Australia and New Zealand and Deloitte support the proposed amendment.

Chartered Accountants Australia and New Zealand notes that the proposed amendment will have the intended effect if tax on pool profits is always borne by members of the pool.

Recommendation

That the submissions be noted.

TAXATION OF LIFE INSURANCE: REMEDIAL CHANGES TO THE TAX TRANSITIONAL RULES

Clause 54

Issue: Threshold should be increased from 3 percent to 5 percent

Submission
(Financial Services Council, Sovereign Assurance Company Ltd)

The threshold in the proposed clause should replace the reference to 3 percent with 5 percent. (*All*)

The proposed 3 percent threshold is not supported because it does not reflect CPI movements for relevant periods and does not reflect commercial reality. (*Sovereign*)

Comment

In 2010 the taxation rules for life insurance business were substantially reformed and included rules that provided transitional relief for life policies sold before the commencement of the reforms (1 July 2010). The previous tax rules for life insurance business were broken and did not correctly tax the profits life insurers earned from selling life-risk insurance policies.

The transitional rules give life insurers a deduction (calculated by reference to the formula in section EY 30(7)) and have the effect of preserving the application of the previous tax rules to life insurance policies sold before 1 July 2010. The intent of the transitional rules was not, however, to provide comprehensive or full grandparenting for the entire lifetime of life insurance policies sold before the start of the reforms.

The proposed amendment in the Bill responds to a request for legislative change from the Financial Services Council concerning the availability of transitional relief for life insurance policies that were sold as "level premium", when those policies offered policyholders the option to increase the amount of life cover. Level premium life insurance policies are policies whose premiums do not change for the duration of the contractually agreed continuous period, that is, the period by which the premium would remain level.

The rules for "level premium" provide life insurers with an extended period of transitional relief (more than 5 years which applied to rate for age – also known as annual renewable term – life policies) on the basis that the life insurer has sold a policy for a premium that does not change over the policy's lifetime. The policies would have been priced using certain assumptions, including the tax rules at that time, and generally provided limited ability for the life insurer to adjust premiums even though the cost of insurance risk increases due to the increasing policyholder mortality risk.

Level premium policies can be sold with an additional benefit that allows policyholders to annually increase the amount of life cover to keep pace with inflation, as measured by percentage movements in the consumer price index ("CPI"). In 2010 the tax transitional rules were modified so that such annual adjustments did not disqualify level premium policies from transitional relief on the condition that the increase in life cover was "directly linked" to percentage movements in CPI and that any increases were contractually provided for in the life policy before 1 July 2010.

The proposed amendment in this Bill responds to a practical problem arising from the low-inflation environment that has existed in New Zealand since 2010, apart from the calendar quarters affected by the increase in the rate of GST in 2010.

Officials understand from consultation with the Financial Services Council that many of the increases in life cover under a level premium policy were subject to a minimum increase to ensure that the administration costs of providing an annual CPI benefit did not exceed the profit element priced into that benefit. For example, the administration costs of managing a 0.8% inflation increase in the sum assured would exceed the profit to the life insurer for providing that benefit. As noted in the submissions from AMP and Asteron a minimum increase of 3 percent was applied. Officials note that 3 percent aligns with the upper range of the Reserve Bank's inflation target since the mid-1990s.

From information provided to officials by the Financial Services Council, the proposed amendment's 3 percent threshold would preserve life insurer transitional relief for 10,000 life insurance policies. These life insurance policies are expected to have a remaining life of 5 years.

Sovereign argues that a 5 percent minimum cap should apply. Sovereign's concern is that a 3 percent threshold puts at risk about 900 life policies it asserts should receive risk grandparenting relief. These 900 policies offered policyholders growth life cover benefits of above 3 percent.

The matters raised by submissions go to the core objective of providing transitional relief. The transitional rules provided life insurers around 5 years of meaningful tax relief with the expectation that the relief would sharply decline in the 2016–17 income year to reflect transitional relief for life insurance policies sold as level premium or single premium. The rules have been successful in this outcome. The issue raised by submissions is to what extent on-going transitional relief should continue to be given to a small and declining segment of the life insurance market.

Officials consider that offering annual increases in life cover of 5 percent (when movements in CPI have not been continuously at such levels since the early 1990s) is on the high side of inflation expectations. As such, the policy benefit arguably provides the policyholder with more than protecting the real value of the initial amount of life cover and is adjusting for changes in lifestyle and income (life events). The additional benefit also makes the level premium policy an effective substitute for rate for age policies, most of which generally received a maximum transitional period of 5 years.

The solution sought by submitters is, in officials' view, beyond the scope of the proposed amendment. It is a moot point whether the current law supports annual increases in life cover of 5 percent and officials are aware of at least one instance where Inland Revenue has disallowed transitional relief for such increases.

Officials do not support the threshold in the proposed amendment being changed to 5 percent. There is a risk that such an increase could have unintended consequences, with an accompanying fiscal cost, and retrospectively alter existing life insurer tax positions and expectations.

Officials recognise, however, that the application date of the proposed amendment – income years that include 1 July 2010 and later – could affect tax positions taken by life insurers for earlier periods. The proposed amendment could be taken as retrospectively overriding tax positions where life insurers have claimed transitional relief for level premium policies that provide increases in life benefits of more than 3 percent. Taxpayers in this situation may choose to argue those tax positions under the current law.

Officials recommend that the application date should be changed and provide a savings provision allowing taxpayers to take a tax position on the basis of the current law, provided that tax position is taken before the date of Royal assent.

Recommendation

That the submission be declined, subject to officials' comment regarding the application date of the proposed amendment.

Issue: Nexus with inflation

Submission
(Sovereign Assurance Company Ltd)

The clause should amend section EY 30(5)(b) and remove the requirement that increases in premium be "directly linked" to the percentage change in CPI.

Comment

The current nexus test with percentage changes in CPI is intended to ensure that changes in the amount of life cover under the life policy have a connection with preserving the real value of the life cover and not permit increases that are intended to provide options to grow the life cover under the life policy. Officials consider the current test is appropriate.

Recommendation

That the submission be declined.

Issue: Drafting matters

Submission
(AMP Financial Services, Asteron Life Limited, Chartered Accountants Australia New Zealand, Deloitte, Financial Services Council, Sovereign Assurance Company Ltd)

The proposed amendment does not achieve the intended outcome.

Comment

Submitters consider that the amendment does not achieve its intended outcome of providing transitional relief for level premium life policies that provide the option to annually increase the sum assured, capped by the greater of 3 percent or percentage changes in the CPI. Submitters make a range of suggestions, including substituting the term "continuous rate period" for "cover review period". The concern is that the increase in the sum assured should be measured on an annual basis instead of over the entire term of the life insurance policy.

Officials agree that the amendment does not achieve the intended outcome as the proposed clause does not directly refer to policy benefits that give the option for policyholders to annually increase the amount of life cover but disagree with submitters' suggestions. Officials consider substituting the term "continuous rate period" for "cover review period" would be ineffective and propose an alternative change to ensure the amendment has its intended effect as set out in the recommendation.

Recommendation

That the submissions be accepted, subject to officials' comments. Officials recommend that clause 54 be amended to provide that:

- section EY 30(5)(b) applies to life insurance policies where the premium charged does not change during the continuous rate period, ignoring additions to the premium charged for annual increases in the sum assured under s EY 30(5BA); and
- section EY 30(5BA)) has effect if an annual increase in the sum assured is caused by a policy benefit, that exists before 1 July 2010, that permits increases in the sum assured provided that increase does not exceed the greater of 3 percent and the percentage change in the CPI.

CAPITAL RAISING COSTS – REQUIREMENT FOR REGISTERED PERSON TO "PRINCIPALLY" MAKE TAXABLE SUPPLIES

Clause 21(1)

Issue: Support for the proposed amendment

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendment.

Recommendation

That the submission be noted.

Issue: Test should be broadened

Submission
(KPMG)

The rules allowing registered persons to make input tax deductions in respect of capital raising costs in section 20H of the GST Act require that the registered person principally makes taxable supplies.

The drafting of the section should be changed so that in establishing whether the registered person is "principally" making taxable supplies, the exempt supplies arising from the capital raising itself are excluded. The test should also be broadened to include registered persons who intend to principally make taxable supplies.

Comment

As the submitter has identified, the requirement for the registered person to principally make taxable supplies would mean that GST-registered businesses would not be entitled to make input tax deductions for capital raising costs in the following situations:

- The business intends to make taxable supplies but is not currently making any taxable supplies. This could include start-ups that raise capital in advance of making any taxable supplies.
- An established business makes taxable supplies but raises capital in excess of the value of those taxable supplies (meaning that it would not meet the "principally" test).

Officials agree that these outcomes are contrary to the policy intention behind the GST rules allowing deductions for capital raising costs and that the drafting of section 20H(1) should be revised further to rectify these unintended outcomes.

Recommendation

That the submission be accepted.

CLARIFICATION OF THE APPLICATION OF THE COMMON REPORTING STANDARD

Clauses 73 and 74

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendment.

Recommendation

That the submission be noted.

LOSS OF EARNINGS INSURANCE

Clause 42

Submission
(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendment.

Recommendation

That the submission be noted.

New matters raised at Select Committee

MATTERS RAISED BY SUBMITTERS

Issue: General opposition to the Bill

Submission
(Amanda Bonham, David Hammond, Dipak Patel, Edwin Khoo, Florence Lim, Gloria Guo, Jack Bao, Jun Yan, Kening Zhou, Keyul Sharma, Lidia Real, Limin Li, Matthew Bonham, Naiyuan Sang, Nicky Rhodes, Pavel Brukvin, Wendy Feng)

Seventeen submitters expressed general opposition to the Bill (without identifying any particular measures) or suggested that the Bill should not proceed.

Comment

It is important to maintain the tax system and ensure that it continues to be fit for purpose. Changes in the economic environment, business practice, or interpretation of the law can mean that the tax system becomes unfair, inefficient, complex, or uncertain. The amendments in this Bill aim to address these concerns and improve current tax settings.

Recommendation

That the submissions be declined.

Issue: Foreign Account Tax Compliance Act ("FATCA")

Submission
(Garret Huelson)

The submission raises a general tax issue unrelated to any specific bill proposal. It pertains to the current requirement for information on the activities and financial holdings of "Kiwi-Americans" to be reported to the United States ("US") Internal Revenue Service, under that country's Foreign Account Tax Compliance Act ("FATCAC) legislation. The submission recommends that additional wording be introduced into this taxation Bill and that the "tax treaty" be amended to prevent such reporting.

The submission notes that there are thousands of "US persons" currently residing as citizens of New Zealand that are adversely affected by this law. It allows the United States to enforce double taxation and its own reporting codes on residents and citizens of New Zealand. It can jeopardise the ability of Kiwi-Americans to open accounts with New Zealand financial institutions and imposes tax reporting costs and other impediments on small businesses operating in New Zealand.

More generally, FATCA "siphons profits generated in NZ to fill government coffers in the USA", and "impedes on NZ's sovereign nation status by letting the US politicians regulate NZ financial institutions". The submission states that it is imperative that New Zealand takes steps to protect profits earned in New Zealand and adopts a territorial-based taxation approach.

Comment

The US FATCA legislation applies directly to all financial institutions worldwide. Penalties apply for non-compliance, including a US 30% withholding tax on US sourced payments. It would not be practical for New Zealand to pass legislation blocking FATCA reporting as such action would merely trigger the imposition of US penalties.

The FATCA reporting regime is also very similar to the global reporting of financial account information that has since been established under the G20/OECD *Automatic Exchange of Financial Account Information for Tax Purposes* ("AEOI") initiative. The US did not join the AEOI initiative as it already has FATCA and FATCA is specifically tailored for the US tax system which operates on a different basis than most other countries.

The "tax treaty" referred to in the submission is likely the FATCA intergovernmental agreement ("IGA") that New Zealand concluded with the US. This requires reporting to go through the local tax authority rather than direct to the US, thereby removing privacy concerns and other legal obstacles that would have arisen for financial institutions from direct reporting. It also establishes reciprocity, so that the US must also provide information to New Zealand on financial accounts held in the US by New Zealand residents. This should provide New Zealand with the same result as it would have if the US had implemented AEOI. These benefits would be lost if New Zealand terminated the IGA.

The recommendation in the submission for New Zealand to adopt a territorial based taxation approach would be a fundamental change that cannot be considered in the context of a submission on a bill.

Recommendation

That the submission be declined.

Issue: Tax on charities

Submission
(Zarir Chhor)

There should be no special tax treatment for charities.

Comment

Policy changes to the tax treatment of charities would require prioritising and resourcing as part of the Government's tax policy work programme.

Officials note that the Tax Working Group's final report included recommendations relating to the tax treatment of charities and that the Government is currently consulting on a review of the Charities Act 2005.

Recommendation

That the submission be declined.

Issue: Capital gains tax

Submission
(Bruce Wallis, CK Yan, Hongtao Du, Justin Rose, Phil Penney, Tania Tang)

Six submitters opposed a capital gains tax.

A capital gains tax will increase costs on landlords and reduce the incentives to work hard to earn wealth. *(CK Yan)*

Implementing a CGT would increase rents and reduce rental supply. *(Justin Rose, Phil Penney)*

I've paid for new carpet and vinyl for a rental property out of my salary income which has already been taxed. These costs can't be deducted against rental income. I would be taxed again under a capital gains tax. *(Tania Tang)*

A capital gains tax should apply progressively: exempt owner occupied and first rental property, apply loss ring-fencing and tax a second rental property; ring-fence and a higher tax on third rental properties and so on. *(Tania Tang)*

Comment

The Bill does not include a capital gains tax. Furthermore, the Government has announced it will not be introducing a capital gains tax.

Officials note that the existing tax rules allow the cost of new chattels such as carpet to be depreciated over several tax years. For details see the Inland Revenue publication, *General Depreciation Determination DEP 80: Residential Rental Property Chattels*.

Recommendation

That the submissions be noted.

Issue: Tax debt write-offs and refunds

Submission
(Gary Wills)

All monies owed by individuals, businesses, trusts or by Inland Revenue should be paid, regardless of how much is outstanding.

Comment

Inland Revenue actively seeks to collect debts that it is owed but there are some situations where debts cannot be collected. The tax laws include rules allowing for the write off of some debts in cases of hardship or where it would be uneconomical to collect a debt.

The individuals' income tax year end processes enacted in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 will help Inland Revenue to pay out refunds of tax by enabling the auto-calculation of approximately 2.5 million taxpayers' tax positions and the payment of refunds without the need for the taxpayer to interact with Inland Revenue where they have only earnt wages and salary and investment income.

Recommendation

That the submission be declined.

Issue: Certain income limits should increase with an increased minimum wage

Submission
(Connie Winslow)

The income limits for secondary tax and the community services card need lifting due to minimum wage increases.

Superannuation recipients who continue to work part time may lose their eligibility for a community services card because of the higher minimum wage, unless they reduce their hours of work.

Comment

Secondary tax codes help ensure that taxpayers with a second job have the correct amount of tax deducted from their pay cheques. This reduces the need to make adjustments (additional tax or refunds) at the end of the tax year. As there is no income threshold for using a secondary tax code, there is no need to adjust a threshold in response to a higher minimum wage.

The income thresholds for eligibility for a community services card are administered by the Ministry of Health and are outside the scope of a taxation bill.

The community services card income thresholds are periodically reviewed and adjusted upwards. The latest increases apply from 1 April 2019 – see Health Entitlement Cards Amendment Regulations 2019. Officials have referred this submission to the Ministry of Health to consider when they next review those thresholds.

Recommendation

That the submission be declined.

Issue: Secondary tax codes

Submission
(Gary Wills)

Secondary tax should be abolished and that all income should be taxed at the main rate.

Comment

New Zealand has a progressive tax system and secondary tax codes are necessary to help ensure that taxpayers with a second job have enough tax deducted from their pay cheques. This reduces the need to make adjustments (additional tax or refunds) at the end of the tax year. In some circumstances secondary tax can result in taxpayers paying too much tax and the Government has passed measures to deal with this problem in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019.

Recommendation

That the submission be declined.

Issue: GST Act rewrite

Submission
(Chartered Accountants Australia and New Zealand)

The proposed GST on low-value imported goods legislation has been drafted to fit into the existing structure of the Goods and Services Tax Act 1985 (GST Act). The GST Act is nearly 35 years old. There have been many changes in GST during those years and this is now evident when reading and interpreting GST legislation. The section structure has become more uneven as different regimes have been incorporated into the Act.

The Government should consider a rewrite of the Act.

Comment

A rewrite of the GST Act would require prioritising and resourcing as part of the Government's tax policy work programme. In particular, it would require a significant commitment of drafting resource and input from stakeholders such as tax practitioners.

Officials note that the tax policy work programme is full and consider that a rewrite of the GST Act would, at this time, be a lower priority than other uses of these resources such as policy items and remedial amendments.

Recommendation

That the submission be declined.

Issue: Associated persons definition – interaction of tripartite test with partnership and associate of partner test

Submission
(Polson Higgs)

The submitter has identified an unintended consequence of the tripartite test of association in section 2A(1)(i) of the GST Act 1985 – in particular its interaction with the partnership and associate of partner test in section 2A(1)(e).

To address this issue, the submitter has suggested that the limitation to the tripartite test in section 2A(8) be amended to read: "Subsection (1)(i) does not apply if two persons (persons A and B) are both associated with a third person (person C) under subsection (1)(c) either directly or indirectly through the application of subsection (1)(c) in any paragraph of subsection (1)."

Comment

The limitation to the universal tripartite test in section 2A(8) was inserted to prevent the tripartite test unintentionally increasing association for GST purposes past two degrees of blood relationship by chaining together associated relatives. For example, in the absence of the limitation in section 2A(8), an uncle and a nephew would be associated for GST purposes through their common association to the brother/father. The limitation prevents the uncle and nephew from being associated under the tripartite test only as a result of their blood relationship with the brother/father.

However, it is possible that such distant blood relations can be associated through the universal tripartite test indirectly as a consequence of the various aggregation rules for specific entity types. The submitter has provided a specific example of where the interaction of the partnership and associate of a partner test with the universal tripartite test produces an outcome that constitutes an overreach.

Given the existence of the universal tripartite test, the partnership and associate of partner test is not necessary. The specific example raised by the submitter can therefore be remedied by repealing the partnership and associate of partner test. Officials consider this amendment is preferable to the amendment suggested by the submitter as it is more certain. It would also be consistent with the associated persons definition in the Income Tax Act 2007.

Officials acknowledge there may be other examples of potential overreach under the tripartite test. This broader issue would however require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

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

Issue: Extension to non-resident oil rig exemption

Submission

(Petroleum Exploration and Production Association of New Zealand)

It is submitted that section CW 57 of the Income Tax Act 2007, which will otherwise expire on 31 December 2019, be renewed. Section CW 57 provides an exemption for income derived by a non-resident company from exploration and development activities in an offshore permit area.

Prior to section CW 57 being enacted some 15 years ago, drilling and seismic ships were in some cases incentivised to inefficiently leave New Zealand (with a new rig being mobilized to complete the exploration programme) before triggering a day count threshold in New Zealand's double tax agreements. The day count threshold (presence in New Zealand for 183 days, or sometimes a shorter period, in a 12-month period) is relevant to whether the owner would be subject to New Zealand tax and so can create an artificial incentive for swapping out one ship/rig before the period has elapsed for another.

The submitter considers section CW 57 to be important for the following reasons:

- It removes the incentive for the inefficient "rig churn" described above and thereby minimises unnecessary costs.
- It supports the delivery of current work programmes for petroleum exploration permits. All exploration permits in New Zealand have "drill-or-drop" commitments in the coming months and several years, which means that regulatory settings (including section CW 57) within this time must be certain and conducive to drilling taking place.
- It is critical to maintaining investor confidence in New Zealand. This is especially important in the current context of significant sovereign risk and policy uncertainty facing the petroleum sector in New Zealand following the unexpected ban on new petroleum exploration permits outside of onshore Taranaki.
- The Government has previously stated that it will honour existing permit holders' rights and we consider that maintaining long-standing exploration rules (including section CW 57) is an important part of that. Section CW 57 has been in place for almost 15 years and although it has a sunset period it has been renewed by successive Labour-led and National-led Governments. Businesses have inferred from this support that the exemption was a relatively stable aspect of New Zealand's tax policy settings.

The submitter understands that this Bill is likely to be the last tax bill to be enacted this year. Given that the exemption expires on 31 December 2019 it is critical that Parliament uses this Bill to amend section CW 57 accordingly.

Comment

This provision was originally introduced in 2004 for a five-year period ending on 31 December 2009. It has subsequently been extended twice more with expiry dates of 31 December 2014 and 31 December 2019 respectively.

However, the current policy position, which is reflected in the Income Tax Act, is that it will expire on 31 December 2019. Extending the provision beyond this date would be a policy change which requires a decision by Cabinet which has not been made.

Officials note a decision on section CW 57 is independent of the Government's decision not to grant new offshore petroleum exploration permits as the rigs and seismic vessels covered by this exemption will be used within existing permit areas.

Recommendation

That the submission be declined.

Issue: Tax treatment of transitional support payments made under the Oranga Tamariki Act 1989

Submission

(Matter raised by officials)

Section 386AAG and section 386B of the Oranga Tamariki Act 1989 come into force from 1 July 2019 and will enable two new payments to be made by the Chief Executive of Oranga Tamariki to young people or their caregivers. These payments extend support for young people leaving care by allowing them to:

- remain with or return to a caregiver until the age of 21 (section 386AAG); and
- receive financial assistance until the age of 25 (section 386B).

These payments are equivalent to other forms of financial assistance that are exempt from income tax, such as Foster Care Allowance payments made under section 363 of the Oranga Tamariki Act. Changes have already been progressed to exempt these payments from being considered income under the Social Security Act 2018. These payments are not intended to take on the nature of income or effect entitlements for various social policies. Legal advice has indicated that these payments may be taxable under the Income Tax Act 2007 and may be considered income for Working for Families, student loan repayments and child support purposes.

Comment

Officials recommend that amendments be made to sections CW33 and MB13 of the Income Tax Act 2007 to exempt payments made under sections 386AAG and 386B of the Oranga Tamariki Act 1989. The application date should be 1 July 2019.

Recommendation

That the submission be accepted.

Issue: Binding rulings on the test of principal purpose of making taxable supplies

Submission

(Matter raised by officials)

Officials recommend an amendment to section 91CB of the Tax Administration Act 1994 to remove the reference to the test of principal purpose of making taxable supplies in respect of matters that the Commissioner can issue binding rulings on. This is because the test no longer exists.

Comment

Changes made under the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 (the amendment Act) enable the Commissioner to issue binding rulings in relation to a person's purpose under certain provisions of the Income Tax Act 2007 and the Goods and Services Tax Act 1985. This included the ability for the Commissioner to issue binding rulings on the test of principal purpose of making taxable supplies under certain provisions of the Goods and Services Tax Act 1985. This test was removed from the Goods and Services Tax Act 1985 by the amendment Act. Section 91CB(3) of the Tax Administration Act 1994 should be amended to remove paragraph (c) with effect from 18 March 2019 (the date the amendment Act received the Royal assent) to ensure there is no confusion.

Recommendation

That the submission be accepted.

Issue: Removal of requirement for an "arrangement" in binding ruling

Submission
(Matter raised by officials)

Section 91EB(2)(a), which provides that a ruling does not apply in certain circumstances, is limited to where an "arrangement" is materially different from that ruled on. However, the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 has expanded the scope of matters that can be ruled on without the need for an "arrangement". This includes new section 91CB which allows rulings to be made on matters such as a person's status, whether an item is "trading stock" or "revenue account property" as defined under the Income Tax Act 2007, and the application of the intention tests in relation to the disposal of personal property and under certain land sales provisions.

It is submitted that section 91EB(2) be extended to also include a person's circumstances being materially different from the circumstances in relation to which a ruling is made under section 91CB.

Comment

The purpose of section 91EB(2) is to protect the revenue base from binding rulings given when there has been a material omission or representation in the application for the ruling or when the ruling could be applied in circumstances that are materially different from those outlined in the application. Paragraph (a) deals with the second situation but is limited to an arrangement that is materially different to that in the ruling.

Officials recommend that section 91EB(2) be amended as submitted to extend to when a person's circumstances are materially different to the circumstances in relation to which a ruling is made under section 91CB.

Recommendation

That the submission be accepted.

Issue: GST exemption for residential property that is sold after being sub-let for five or more years

Submission
(Matter raised by officials)

Most sales of residential land are not subject to GST as they are either not sold by GST-registered persons, or are not part of the GST-registered person's taxable activity. However, if a GST-registered person is regularly selling residential land, then they may have a taxable activity of selling property and so they may have to apply GST when they sell residential land.

An exception to this is when the land has been exclusively used for residential accommodation for at least the last five years, the sale of the land will be exempt from GST under section 14(1)(d) of the GST Act.

However, the current exemption requires the land-owner to have rented the dwelling to the ultimate tenant. It does not apply to sub-letting arrangements where a GST-registered land-owner has let the property to a housing provider who has sub-let it to tenants for five or more years. This means that such sub-letting arrangements can be disadvantaged relative to similar arrangements where the property owner had let the property directly to the tenant. These type of sub-letting arrangements are becoming increasingly common, particularly for social housing providers.

Section 14(1)(d) of the GST Act should be amended so it also exempts the sale of the residential property where the property has been sub-let to tenants for five or more years.

Recommendation

That the submission be accepted.

Issue: ACC attendant care payments

Submission
(Matter raised by officials)

An amendment has been made to the Income Tax Act 2007 to exempt backdated ACC payments that reimburse ACC beneficiaries for care they have paid for. An unintended consequence of this amendment is that the tax credit for the tax withheld by ACC is passed through to the carer where it should be assigned to the claimant. The Income Tax Act 2007 requires further amendment to rectify this issue.

Comment

ACC make payments to a number of ACC claimants who do not have full capacity and are unable to look after themselves ("ACC attendant care payments"). Attendant care payments are treated as schedular payments and ACC withhold tax at a rate of 10.5%. The ACC claimants who receive these payments can then on-pay this income to carers who provide services to the ACC claimants. These payments are exempt income to a claimant if they are on-paid to a carer, and the carer receives a tax credit for the amount withheld by ACC. Where the claimant passes on part of the payment to the carer, the claimant can claim a deduction for the amount passed on and the tax credit will be shared pro-rata between the claimant and carer.

Example: Current year entitlement passed on fully by the claimant to the carer.

Adam is a quadriplegic and Ben is his carer. ACC have assessed Adam's entitlement to care at $10,000 per year*.

ACC pays Adam $10,000 less the tax withheld ($1,050). Adam passes on the full amount to Ben. Adam is assessed on the gross amount of $10,000 but this income is exempt to Adam. Ben is taxable on this income of $10,000. Ben claims a credit of $1,050 for the tax already paid by ACC.

Example: Current year entitlement passed on partially by the claimant to the carer.

ACC pays Adam $10,000 less the tax withheld ($1,050). Adam pays Ben $5,000 gross to care for him. Adam receives a deduction for this amount. Ben is taxable on the amount paid to him. The tax credit of $1,050 is split equally between Adam and Ben.

* Note that entitlements are often paid on a weekly basis but a yearly payment has been chosen for the sake of simplicity.

Amendments made in ARMTARM

Although this scheme of levying withholding tax on ACC attendant care payments and not taxing the claimant on payments on-paid to the carer achieves its intended outcome where ACC provides the payments in the same year as the care is provided, it failed to do so in respect of back year payments. Where an ACC claimant was paid a back-year attendant care payment ("reimbursement payment"), the payment was effectively double taxed (taxed in both the hands of the claimant when received from ACC, and in the hands of the carer who paid tax on that income when the income was earned by the carer). This is because the law did not allow a reimbursement payment to be treated as exempt income or allow a deduction.

An amendment has been made in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 ("ARMTARM") to rectify this double taxation.

Issue requiring further amendment

The amendment in ARMTARM eliminated the double taxation by applying the relevant provisions to reimbursement payments. However, because the ARMTARM amendments followed the payment structure that applied to ACC attendant care payments that were made in the current year for the purposes of determining the allocation of tax withheld by ACC, it failed to take into account that where a reimbursement payment is made the claimant has previously paid the carer a "gross" amount and the carer would have paid tax on this amount. As applied, the amendments would deny the claimant a tax credit, and would allow the carer to claim a tax credit to which they were not entitled.

Example: Lumpsum backyear entitlement that reimburses the claimant for payments made to the carer

Adam receives a reimbursement payment from ACC of $40,000 which covers attendant care payments he has made to Ben over the past four years ($10,000 per year) out of his own pocket. ACC withholds tax on the $40,000 payment in the year it is paid ($4,200).

Ben has paid tax on the attendant care payments received over the last four years.

To ensure that Adam is reimbursed for the $40,000 he has paid, the tax credit should be attributed to Adam.

Tax treatment		**Cash flow**	
Gross income	$40,000	ACC payment	$35,800
Exempt income	($40,000)	Tax refund	$4,200
Taxable income	Nil		$40,000
Tax credit	$4,200	Payments to Ben	($40,000)
(Refund)	______		

Officials agree that the relevant provisions in the Income Tax Act 2007 should be further amended to ensure that where a reimbursement payment is made, the tax credit for the tax withheld by ACC is attributed to the claimant. Officials also consider that the proposed amendment should apply from the 2018–19 year to coincide with the application date of the amendments in the ARMTARM Act.

Recommendation

That the submission be accepted.

Issue: Time barred refunds in respect of ACC reimbursement payments

Submission

(Matter raised by officials)

An amendment has been made in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act (“ARMTARM”) to the ACC attendant care payment rules to eliminate the double taxation that occurs when a reimbursement payment is paid to a claimant. The amendment achieves this outcome by legislating that, where certain requirements are met, the reimbursement payment is exempt to the claimant.

Where an ACC claimant has returned that income in a prior year, they must request that the Commissioner amends their assessment under section 113 of the Tax Administration Act 1994. This will allow them to treat the payment as exempt income and therefore claim a tax refund.

The issue that arises under current law is that section RM 2 of the Income Tax Act 2007 acts as an impediment to the issuance of the refund due to the application of the timebar to amended assessments.

Example

Mary was involved in a car accident in 2006 which reduces her ability to care for herself. Mary pays Mandy $10,000 pa to care for her out of her own pocket.

2006–07 tax year: Mary pays Mandy $10,000. Mandy pays tax on this at her marginal rate.
2007–08 tax year: Same as above.
2008–09 tax year: Same as above.
2009–10 tax year: Same as above.

For the 2010–11 tax year, ACC accept that Mary is entitled to ongoing care. Along with paying Mary an entitlement for the 2010–11 tax year, ACC also pay Mary a lumpsum of $40,000 (less $4,200 withholding tax) as compensation for the previous 4 tax years. Mary files a tax return and also pays additional tax on this amount at her marginal tax rate.

Treatment of the $40,000 reimbursement payment (post ARMTARM amendments)

Under section CZ 35 of the Income Tax Act 2007, the lumpsum reimbursement payment that Mary received during the 2010–11 tax year will be treated as tax exempt income to Mary in the year in which it was received where the Commissioner is satisfied that the tax obligations relating to the payment have been met. Assuming that the Commissioner was satisfied that the tax obligations in relation to the payment had been met by the carer, this means that Mary could, under section 113 of the Tax Administration Act 1994, request that the Commissioner amend her assessment. The Commissioner would accept this request which would result in Mary being owed a substantial tax refund, as she has paid tax on income that is now determined to be exempt.

The way that section RM 2 of the Income Tax Act 2007 applies is to limit a taxpayer's ability to claim a refund from an amended assessment to the timebar period, being four years from the end of the tax year in which the taxpayer provides the return. This achieves the desired policy intent in most instances, but means that, in Mary's situation, she would be timebarred from claiming a refund. This is because more than four years have passed from the end of the tax year (2010–11) in which Mary provided the return.

Comment

Officials propose that an amendment is made to the refund provisions to include an exception that allows a taxpayer to claim a refund from an amended assessment outside the timebar period where the refund arises due to a reimbursement ACC attendant care payment.

Recommendation

That the submission be accepted.

Issue: Breach of confidentiality

Clause 72B

Submission

(Matter raised by officials)

Officials recommend a minor amendment to clarify what is covered by the offence for revenue officers who breach confidentiality.

Comment

The Taxation (Annual Rates, Modernising Tax Administration and Remedial Matters) Act 2019 contained provisions that modernise Inland Revenue's confidentiality rules. This included narrowing the coverage of the rule to focus specifically on information about taxpayers, rather than "all matters" relating to the Inland Revenue Acts as under the previous law. The new rules also contain a protection for information that, while not about taxpayers, is also highly sensitive as it could either prejudice the maintenance of the law or the integrity of the tax system. Examples of such information might include investigative techniques, audit strategies and so on.

The Tax Administration Act 1994 contains offences and penalties for those who breach the confidentiality rules. These provisions have been amended to take account of the new confidentiality rules. However, in the case of the provision that relates to Inland Revenue staff ("revenue officers") it is considered that a further minor amendment is required to clarify that it remains an offence to knowingly disclose information that would prejudice the maintenance of the law or the integrity of the tax system. The offence provision currently contains a cross-reference to section 18(3), the substantive provision that protects such information from disclosure. However, a more explicit reference to the type of disclosure this covers would improve the clarity of the offence provision.

Recommendation

That the submission be accepted.

Issue: Pre-consolidation imputation credits – correction of legislative error

Submission

(Matter raised by officials)

Incorrect date references in section 186(4) of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters Act 2019 (the "ARMTARM Act") (the transitional provision) should be corrected to ensure the provision works as intended for tax positions taken by a consolidated imputation group for the transfer of pre-consolidation imputation credits to the group's imputation credit account ("ICA") for periods beginning before 1 April 2021.

Comment

A consolidated imputation group may transfer a pre-consolidation imputation credit (section OP 22 refers) from a member company's ICA to the group ICA if:

- at any time, a debit entry is made to the group ICA (for example, by attaching imputation credits to a dividend);
- the debit entry results in a debit balance in the group ICA;
- at the time of the debit balance, a member company of the group has a pre-consolidation credit balance in its ICA;

- the amount transferred from the member company's ICA to the group ICA does not exceed the debit balance in the group ICA; and
- shareholder continuity requirements are met.

Submissions have been made requesting a review of the policy for section OP 22. Section 186(3) of the ARMTARM Act provided a savings provision to allow the Government time to consider the relative priority of this review in terms of the tax policy work programme. The savings provision protects a tax position taken for a period beginning on or after 1 April 2008 and before 1 April 2021 if the amount of a pre-consolidation credit transferred to the group ICA:

- exceeds the amount allowed to be transferred under section OP 22; and
- does not exceed the debit balance that has arisen in the ICA of the consolidated imputation group.

Officials are aware that some consolidated groups have taken tax positions that transfer pre-consolidation credits in excess of the amount allowed under the savings provision. These excess amounts have resulted in over-distributions of imputation credits, and therefore a liability for further income tax arises (which, when paid, is treated as tax paid by the consolidated imputation group).

As these excess distributions would have resulted in past years' ICA returns being required to be refiled, a transitional provision was also enacted in section 186(4) of the ARMTARM Act to minimise compliance and administration obligations for these returns. The transitional provision removes the need to refile past year ICA returns and is intended to require the payment of further imputation tax and the adjustments to the ICA for the overdistributions of imputation credits to be made in the same tax year.

However, this provision contains incorrect date references, which mean that there would be a timing misalignment between the adjustments to the ICA for overdistributions of imputation credits (which would be taken into account in ICA for the tax year ending 31 March 2021), and the due date for payment being in the tax year ending 31 March 2020.

In addition, the transitional provision is not clear that, for the 2019–20 and later tax years, it is no longer possible to have adopt a tax position to transfer an amount of pre-consolidation imputation credit that is more than the amount allowed under the savings provision. As this Bill will not be enacted until the latter part of 2019, officials recommend that:

- the transitional provision in section 186(4) of the ARMTARM Act be amended to ensure that it works as intended; and
- the due date for payment of further income tax be extended to fall after the enactment date of this Bill.

The following example illustrates how the transitional provision should apply when a consolidated imputation group has transferred pre-consolidation imputation credits in any period beginning on or after 1 April 2008 and before 1 April 2019.

Example: Adjustment for transfer of excess pre-consolidation imputation credit

This example is based on the following assumed facts:

- Company A in a consolidated group pays a dividend on 30 September 2016 with $60,000 imputation credits attached.
- Prior to paying the dividend, the consolidated group's ICA credit balance was $1,000.
- Company B, another company in the consolidated group, has a pre-consolidation ICA credit balance of $100,000.
- No other transactions occur in the group ICA during the year to 31 March 2017.
- The group transfers the entire amount of the pre-consolidation credit to the Group ICA on the payment of the dividend.

Assume the group also pays:

- $50,000 of income tax in April 2017;
- a dividend with $90,000 imputation credits attached in September 2017;
- $60,000 of income tax in April 2018;
- a dividend with $75,000 imputation credits attached in September 2018;
- $60,000 of income tax in April 2018; and
- a dividend with $58,000 imputation credits attached in September 2018.

Date	Group ICA As returned	Group ICA adjusted	Company B ICA As returned	Company B ICA adjusted
1 April 2016	1,000	1,000	100,000	100,000
30 September 2016 (dividend paid by Coy A)	(60,000)	(60,000)		
30 September 2016 (transfer from Coy B)	100,000	100,000	(100,000)	
30 September 2016 retrospective adjustment		(40,000)		40,000
31 March 2017 /1 April 2017 (balance)	41,000	(39,000)	0	40,000
Further income tax liability		*39,000*		
7 April 2017 tax paid	50,000	50,000		
30 September 2017 dividend paid by group company	(90,000)	(90,000)		
31 March 2018/1 April 2018	1,000	(79,000)		40,000
Further income tax liability		*40,000*		
7 April 2018 tax paid	60,000	60,000		
30 September 2018 dividend paid by group company	(58,000)	(58,000)		
31 March 2019 / 1 April 3019	(3,000)	(37,000)		40,000
Further income tax liability		*0*		
Aggregate further income tax liability		*79,000*		

This example illustrates that the consolidated group has overdistributed $79,000 of imputation credits during the two years to 31 March 2018. Shareholders will have received credit for this over-distributed amount in aggregate over the same years.

Therefore, the consolidated group is required to include the aggregate adjustments in its ICA return for the 2019–20 tax year and to pay further income tax of $79,000 by the due date during the 2019–20 tax year. As section 186(4) contains an incorrect reference to the 2020–21 tax year, a clarifying amendment will be made at the earliest opportunity.

No imputation penalty tax or imputation additional tax is payable on this aggregate amount of further income tax.

The pre-consolidation credits can be used in future periods provided the transfer is consistent with section OP 22, or until the 2020–21 tax year consistent with section 186(3) of the ARMTARM Act.

Recommendation

That the submission be accepted and the incorrect date references in the savings provision be corrected.

Issue: Tax Administration Act remedial

Submission
(Matter raised by officials)

The drafting of section 17(1CB) of the Tax Administration Act 1994 erroneously includes a reference to "sections 143 and 143A" which refers to some provisions involving criminal penalties. These references to criminal penalties should be removed.

The policy intent was that criminal penalties would not apply when the Commissioner was using the new information power for large multinational groups under section 17(1CB). Instead, the Commissioner would apply the new civil penalty in section 139AB that applies to large multinational groups that fail to provide the information.

Recommendation

That the submission be accepted.

Issue: Associated persons definition – omitted cross-reference in tripartite test

Submission
(Matter raised by officials)

The universal tripartite test in section 2A(1)(i) of the GST Act 1985 generally associates two persons, A and B, if person A is associated with a third person (person C) under any one of paragraphs (a) to (h), and person B is also associated with person C under any one of paragraphs (a) to (h).

A remedial amendment in the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 inserted new paragraph (hb) to associate a trustee of a trust with a person who has a power of appointment or removal of the trustee. As a result of a legislative oversight, the tripartite test was not updated to include a cross-reference to new paragraph (hb).

Consistent with the policy intention, officials recommend that a cross-reference to paragraph (hb) be inserted into the tripartite test, with application from the date of enactment of the Bill.

Recommendation

That the submission be accepted.

Issue: Clarifying the periods in sections 23C(4) and 23F(3) of the Tax Administration Act 1994

Submission
(Matter raised by officials)

New employment income reporting rules came into force on 1 April 2019. Section 23C(4) of the Tax Administration Act 1994 defines twice monthly reporting and section 23F(3) provides the option of twice monthly reporting for employers who file on paper. It is not clear when certain periods start and end, due to the way they are described in these provisions.

Sections 23C(4) and 23F(3) should be amended to clarify when the periods referred to in these sections start and end.

Recommendation

That the submission be accepted.

Issue: Correcting outdated reference in section 48B of the Tax Administration Act 1994

Submission
(Matter raised by officials)

Section 48B of the Tax Administration Act 1994 requires a retirement scheme contributor or a retirement savings scheme to provide the Commissioner with a reconciliation statement containing certain information. The information requirement in section 48B(2)(m) to provide a person's tax file number refers to the default retirement scheme prescribed rate. However, this reference was not updated when the prescribed rates changed. Section 48B(2)(m) should be updated to refer to the current default prescribed rate of 33%.

The amendment should apply retrospectively from 1 October 2010, which is the date the current prescribed rates applied from.

Recommendation

That the submission be accepted.

Issue: Definition of hire purchase agreement

Submission
(Matter raised by officials)

The definition of "hire purchase agreement" in section YA1 of the Income Tax Act 2007 contains an exclusion for agreements under which property in the goods passes absolutely. However, a drafting error means that these agreements are not excluded if they meet the general criteria under the definition. It is therefore submitted that paragraph (d) of the definition be amended to remove the error.

Comment

The definition of "hire purchase agreement" is used both in the income tax and GST legislation with timing implications that differ from other financial instruments.

It is recommended that paragraph (d) of the definition of "hire purchase agreement" in section YA1 of the Income Tax Act 2007 be amended by removing the conditional wording in the provision "unless the agreement is of a kind described [in the general criteria]" and instead ensuring that the provision is an exclusion to the general criteria.

Recommendation

That the submission be accepted.

Appendices

APPENDIX I: RING-FENCING – INDIVIDUAL SUBMITTERS' NAMES

Issue	Number of submitters	Names of submitters
All individual submitters	260	Aaron Burrett, Abhi Padalakar, Adrienne O'Sullivan, Akshay Triverdi, Alan Brown, Alan Gregory, Alan Kemp, Alan Willoughby, Alice Verheijen, Alice Zhu, Alan Lind, Amanda Lowe, Andrea Thompson, Andrew Butler, Andrew Clist, Andrew Conlon, Andrew Hart, Angela Shan Qi, Anil Anna, Anil Sharma, Ann Mackenzie, Anne Shotbolt, Anne Tseng, Annelies Guyan, Anthony Whitehouse, Anura Widana, APIA, Arthur Shew, Barry Saxon, BC Tee, Beatrice Ezpeleta, Beau Webster, Ben Keng, Bert Verdonk, Bill Stark, Brenda Ni, Brendan Doherty, Brendan Podayko, Brent Heslop, Brian Basco, Brian Mason, Bruce Wallis, Cameron Hadfield, Catherine Woodley, Cherian Thomas, Chooi Tai, Chris Binning, Chris Mercer, Chris Perera, Chris Scullin, Christine Wu, Claire Robinson, Cliff Ah Kit, Clinton Stokes, Colin Comber, Cosmos Misquita, Daniel Simperingham, David and Vikki Bacon, David Glen, David Green, David Phipps, David Rowell, Debbie Roberts, Deidre Mellamphy, Delpreet Singh, Di Yu, Diana West, Dilipchandra Balachandran, Eddie de Heer, Eduarda Abissamra, Eira Kuttner, Ela Purnell, Eleanor Sayer, Ethan Jia, Fadia Mudafar, Fiona Roberts-Cox, Florence Dong, Frank McCulloch, Frank Wang, Gavin Longstaffe, Georgina Witehira, Graeme Moore, Grant Beesley, Grant Dickson, Gregg Kerr, Gurpreet Gill, Hannah Jin, Hannah McQuikan, Haraish Rajpal, Harish Reddy, Harjiv Arora, Heather Pattison, Heidi Alter, Helen Joe, Ian Muir, Ignatius Fernandes, Ilya Zharenikov, Irene Leonard, Jacky Cheung, James Stevenson, Jasmine Chen, Jason Tan, Jeff Wang, Jeffrey Cate, Jeremy Nunis, Jerry Wang, Ji Zhang, Joanne Walker, Jodie Welsh, Joel D'Cruz, John Mavronicolas, John Paynter, John Roberts, John Wong, Joseph John, Joshua Jones, Juanling Nian, Judith Archibald, Julie Gordon, Justin Harness, Karen Anderson, Karl Hazewinkel, Kathy Fray, Keith Dunne, Kellys Osorio, Ken Landeman, Kent Dalziel, Kevin Cox, Keys Kerdemelidis-Kiesanowski, Kieran Searle, Kim Meichtry, Kiri Barfoot, Kiri Speirs, Klodia Kamberi, Ko Vasan, Kurt Story, Kyron Gosse, Leanne Powell, Leon Smith, Leon Wiliams, Leonie Jamieson, Leroy O'Donnell, Lesley Quirk, Lindsay Richards, Lois Goodman, Lorika van de Venter, Lotte Bayly, Luan You, Lydia Luo, Lynette Zander, Lynley Dodge, M Patel, Maggie Rebello, Maggie Sun, Marcus Bosch, Marcus Winders, Maria Shella Tabaco, Mark Garner, Mark Holliday, Mark McGoldrick, Martin Braunton, Matt Buckeridge, Matthew Dawe, Matthew Thomson, Megan Graham, Melanie Kilfoyle, Mervyn Rebello, Michael Steeneveld, Michael Stubbs, Michelle Abley, Michelle Christie, Michelle McFarlane, Mike Croft, Mingzhu Wu, Monique Oosterbaan, Narisa Morrissey, Natalie Perzylo, Nick Chan, Oleksiy Blazhevskyiy, Owen Moffitt, Paul Alexander, Paul Averes, Paul Roberts, Paul and Coleen Shipley, Paul Stone, Pearl van Blerck, Peter Bull, Peter Close, Peter Lewis, Peter Little, Peter Tarr, Peter Till, Peter van Kuyk, Philip Beech, Philip Clark, Philip Stewart Guyan, Philippa Binning, Phillip Hart, Pieter Oosterbaan, PJ Cohen, Rajen Kapadia, Rama Ramachandran, Raquel Withers, Ravi Chigurupati, Ravi Rama, Rebecca Bartlett, Reece Chamberlain, Richard Gruiters, Richard Watson, Rick Bardsley, Rob Brawn, Rob Rimmer, Robert Moore, Robert Vahry, Rodney Pomfrett, Roger Matheson, Rosemarie Gough, Ruth Davidson, Ryan K, Sally Rae, Sandra Dong, Sarah Wilson, Scott Highet, Sean Zhang, Sherry Dou, Shuang Yang, Simon Ayris, Simon Northey, Simone O'Meara, Sophia Vahry, Stanley Bu, Stephen Cruttwell, Stephen Lovelock, Steve Chew, Steve Lind, Steven Law, Susan Harrison, Tania Tang, Terance Greer, Teresa Elder, Thomas Dorman, Tim Goodwin, Tina Tong, Tracey Swift, Trent Archer, Troy Ross, Tuan Anh Nguyen, Vicki Haylock, Virendra Gupta, Wei Tian, Wensi Lu, Wilhelmina Staheli, Xiuyin Chen, Yi Gang Lu, Yohanes Santoso, Yolanda He, Yvonne Grant-Martens, Zahrir Chhor, Zhen Liu, Zikon Leung
Objection to the proposal to ring-fence residential rental property losses	252	Aaron Burrett, Abhi Padalakar, Adrienne O'Sullivan, Akshay Triverdi, Alan Brown, Alan Gregory, Alan Kemp, Alan Willoughby, Alice Verheijen, Alice Zhu, Alan Lind, Amanda Lowe, Andrea Thompson, Andrew Butler, Andrew Clist, Andrew Conlon, Andrew Hart, Angela Shan Qi, Anil Anna, Anil Sharma, Ann Mackenzie, Anne Shotbolt, Anne Tseng, Annelies Guyan, Anthony Whitehouse, Anura Widana, APIA, Arthur Shew, Barry Saxon, BC Tee, Beatrice Ezpeleta, Beau Webster, Ben Keng, Bert Verdonk, Bill Stark, Brenda Ni, Brendan Doherty, Brendan Podayko, Brent Heslop, Brian Basco, Brian Mason, Bruce Wallis, Cameron Hadfield, Catherine Woodley, Cherian Thomas, Chooi Tai, Chris Binning, Chris Mercer, Chris Scullin, Christine Wu, Claire Robinson, Cliff Ah Kit, Clinton Stokes, Colin Comber, Cosmos Misquita, Daniel Simperingham, David and Vikki Bacon, David

		Glen, David Green, David Phipps, David Rowell, Debbie Roberts, Deidre Mellamphy, Delpreet Singh, Di Yu, Diana West, Dilipchandra Balachandran, Eddie de Heer, Eduarda Abissamra, Eira Kuttner, Ela Purnell, Eleanor Sayer, Ethan Jia, Fadia Mudafar, Fiona Roberts-Cox, Florence Dong, Frank Wang, Gavin Longstaffe, Georgina Witehira, Graeme Moore, Grant Beesley, Grant Dickson, Gregg Kerr, Gurpreet Gill, Hannah Jin, Hannah McQuikan, Haraish Rajpal, Harish Reddy, Harjiv Arora, Heather Pattison, Heidi Alter, Helen Joe, Ian Muir, Ignatius Fernandes, Ilya Zharenikov, Irene Leonard Jacky Cheung, James Stevenson, Jasmine Chen, Jason Tan, Jeff Wang, Jeremy Nunis, Jerry Wang, Ji Zhang, Joanne Walker, Jodie Welsh, Joel D'Cruz, John Mavronicolas, John Paynter, John Roberts, John Wong, Joseph John, Joshua Jones, Juanling Nian, Judith Archibald, Julie Gordon, Karen Anderson, Karl Hazewinkel, Kathy Fray, Keith Dunne, Kellys Osorio, Ken Landeman, Kent Dalziel, Kevin Cox, Keys Kerdemelidis-Kiesanowski, Kieran Searle, Kim Meichtry, Kiri Barfoot, Kiri Speirs, Klodia Kamberi, Ko Vasan, Kurt Story, Kyron Gosse, Leanne Powell, Leon Smith, Leon Wiliams, Leonie Jamieson, Leroy O'Donnell, Lesley Quirk, Lindsay Richards, Lois Goodman, Lorika van de Venter, Lotte Bayly, Luan You, Lydia Luo, Lynette Zander, Lynley Dodge, M Patel, Maggie Rebello, Maggie Sun, Marcus Bosch, Marcus Winders, Maria Shella Tabaco, Mark Garner, Mark Holliday, Mark McGoldrick, Martin Braunton, Matt Buckeridge, Matthew Dawe, Matthew Thomson, Megan Graham, Mervyn Rebello, Michael Steeneveld, Michael Stubbs, Michelle Abley, Michelle Christie, Michelle McFarlane, Mike Croft, Mingzhu Wu, Monique Oosterbaan, Narisa Morrissey, Natalie Perzylo, Nick Chan, Oleksiy Blazhevskyiy, Owen Moffitt, Paul Alexander, Paul Averes, Paul Roberts, Paul and Coleen Shipley, Paul Stone, Pearl van Blerck, Peter Bull, Peter Close, Peter Lewis, Peter Little, Peter Tarr, Peter Till, Peter van Kuyk, Phil Penney, Philip Beech, Philip Clark, Philip Stewart Guyan, Philippa Binning, Phillip Hart, Pieter Oosterbaan, PJ Cohen, Rajen Kapadia, Rama Ramachandran, Raquel Withers, Ravi Chigurupati, Ravi Rama, Rebecca Bartlett, Reece Chamberlain, Richard Gruiters, Richard Watson, Rob Brawn, Rob Rimmer, Robert Moore, Robert Vahry, Rodney Pomfrett, Roger Matheson, Rosemarie Gough, Ruth Davidson, Ryan K, Sally Rae, Sandra Dong, Sarah Wilson, Scott Highet, Sean Zhang, Sherry Dou, Shuang Yang, Simon Ayris, Simon Northey, Simone O'Meara, Sophia Vahry, Stanley Bu, Stephen Cruttwell, Stephen Lovelock, Steve Chew, Steve Lind, Steven Law, Susan Harrison, Terance Greer, Teresa Elder, Thomas Dorman, Tim Goodwin, Tina Tong, Tracey Swift, Trent Archer, Troy Ross, Tuan Anh Nguyen, Vicki Haylock, Virendra Gupta, Wei Tian, Wensi Lu, Wilhelmina Staheli, Xiuyin Chen, Yi Gang Lu, Yohanes Santoso, Yolanda He, Yvonne Grant-Martens, Zahrir Chhor, Zhen Liu, Zikon Leung
Investors do not disadvantage first home buyers	15	Anne Shotbolt, Ben Keng, Cherian Thomas, Chris Binning, Delpreet Singh, Joanne Walker, Joseph John, Lindsay Richards, Marcus Bosch, Monique Oosterbaan, Peter Bull, PJ Cohen, Stephen Cruttwell, Thomas Dorman, Zikon Leung
Unfair (investment properties are treated differently to other properties)	91	Aaron Burrett, Adrienne O'Sullivan, Alan Willoughby, Alice Zhu, Andrew Butler, Andrew Conlon, Andrew Hart, Anil Anna, Ann Mackenzie, Anne Shotbolt, Anthony Whitehouse, Barry Saxon, BC Tee, Ben Keng, Brendan Doherty, Brendan Podayko, Brian Mason, Cameron Hadfield, Chooi Tai, Christine Wu, Claire Robinson, Cliff Ah Kit, Clinton Stokes, David Glen, David Green, Deidre Mellamphy, Eira Kuttner, Fadia Mudafar, Fiona Roberts-Cox, Florence Dong, Graeme Moore, Ian Muir, Irene Leonard, Jacky Cheung, Jerry Wang, Jodie Welsh, Joseph John, Juanling Nian, Karl Hazewinkel, Kathy Fray, Ken Landeman, Keys Kerdemelidis-Kiesanowski, Klodia Kamberi, Leonie Jamieson, Lorika van de Venter, Lydia Luo, Lynley Dodge, Marcus Bosch, Megan Graham, Mervyn Rebello, Michael Stubbs, Michelle Christie, Michelle McFarlane, Mike Croft, Mingzhu Wu, Monique Oosterbaan, Paul Alexander, Peter Bull, Peter Tarr, Peter Till, Peter van Kuyk, Philip Clark, Philip Stewart Guyan, Phillip Hart, Pieter Oosterbaan, Ravi Rama, Rebecca Bartlett, Reece Chamberlain, Rob Brawn, Robert Moore, Robert Vahry, Roger Matheson, Sally Rae, Sandra Dong, Scott Highet, Sean Zhang, Sherry Dou, Simon Northey, Stephen Cruttwell, Stephen Lovelock, Steve Chew, Steve Lind, Steven Law, Terance Greer, Tina Tong, Tracey Swift, Troy Ross, Vicki Haylock, Yohanes Santoso, Yvonne Grant-Martens, Zahrir Chhor,
Rents will increase and there will be a shortage of rental housing	178	Adrienne O'Sullivan, Akshay Triverdi, Alan Brown, Alan Gregory, Alan Kemp, Alan Willoughby, Alice Verheijen, Alice Zhu, Alan Lind, Amanda Lowe, Andrea Thompson, Andrew Butler, Andrew Clist, Andrew Hart, Anil Anna, Ann Mackenzie, Anne Shotbolt, Anne Tseng, Anthony Whitehouse, Anura Widana, Arthur Shew, Barry Saxon, BC Tee, Beau Webster, Ben Keng, Bert Verdonk, Bill Stark, Brenda Ni, Brendan Doherty, Brendan Podayko, Brian Basco, Brian Mason, Bruce Wallis, Cameron Hadfield, Catherine Woodley, Cherian Thomas, Chooi Tai, Chris Binning, Chris Mercer, Chris Perera, Chris Scullin, Christine Wu, Claire

		Robinson, Cliff Ah Kit, Clinton Stokes, Colin Comber, Daniel Simperingham, David and Vikki Bacon, David Rowell, Debbie Roberts, Deidre Mellamphy, Di Yu, Diana West, Dilipchandra Balachandran, Eleanor Sayer, Fadia Mudafar, Fiona Roberts-Cox, Frank Wang, Georgina Witehira, Graeme Moore, Grant Beesley, Grant Dickson, Gregg Kerr, Harish Reddy, Harjiv Arora, Heather Pattison, Heidi Alter, Helen Joe, Ian Muir, Ignatius Fernandes, Ilya Zharenikov, Irene Leonard, Jacky Cheung, James Stevenson, Jasmine Chen, Jason Tan, Jeff Wang, Jeffrey Cate, Jeremy Nunis, Jerry Wang, Ji Zhang, Joanne Walker, Jodie Welsh, Joel D'Cruz, John Mavronicolas, John Paynter, John Roberts, John Wong, Joseph John, Joshua Jones, Juanling Nian, Judith Archibald, Julie Gordon, Karl Hazewinkel, Kathy Fray, Kellys Osorio, Ken Landeman, Kent Dalziel, Kieran Searle, Kim Meichtry, Kurt Story, Kyron Gosse, Leanne Powell, Leroy O'Donnell, Lesley Quirk, Lindsay Richards, Lois Goodman, Lorika van de Venter, Luan You, Lynette Zander, Lynley Dodge, M Patel, Maggie Rebello, Maggie Sun, Maria Shella Tabaco, Mark Garner, Mark Holliday, Mark McGoldrick, Martin Braunton, Matthew Dawe, Megan Graham, Michael Steeneveld, Michael Stubbs, Michelle Abley, Michelle Christie, Michelle McFarlane, Mike Croft, Mingzhu Wu, Monique Oosterbaan, Narisa Morrissey, Owen Moffitt, Paul Alexander, Paul Roberts, Pearl van Blerck, Peter Bull, Peter Lewis, Peter Little, Peter Till, Peter van Kuyk, Phil Penny, Philip Beech, Philip Stewart Guyan, Phillip Hart, Pieter Oosterbaan, PJ Cohen, Rama Ramachandran, Raquel Withers, Rebecca Bartlett, Reece Chamberlain, Richard Gruiters, Richard Watson, Rob Brawn, Rodney Pomfrett, Roger Matheson, Rosemarie Gough, Ruth Davidson, Sally Rae, Sandra Dong, Sarah Wilson, Simon Northey, Sophia Vahry, Stanley Bu, Stephen Cruttwell, Stephen Lovelock, Steve Lind, Steven Law, Susan Harrison, Tania Tang, Thomas Dorman, Tracey Swift, Trent Archer, Troy Ross, Vicki Haylock, Wilhelmina Staheli, Yohanes Santoso, Yolanda He, Yvonne Grant-Martens, Zikon Leung
Other negative impacts on tenants	74	Alan Kemp, Alan Willoughby, Alice Verheijden, Allan Lind, Anil Anna, Anne Shotbolt, Anthony Whitehouse, Arthur Shew, BC Tee, Beau Webster, Bert Verdonk, Brenda Ni, Brendan Doherty, Brian Basco, Chris Binning, Chris Mercer, Chris Perera, Clinton Stokes, Colin Comber, Dilipchandra Balachandran, Fadia Mudafar, Georgina Witehira, Grant Beesley, Grant Dickson, Helen Joe, Ignatius Fernandes, Irene Leonard, Jerry Wang, Joanne Walker, John Mavronicolas, John Roberts, Joseph John, Joshua Jones, Julie Gordon, Ken Landeman, Kent Dalziel, Kieran Searle, Kim Meichtry, Kiri Barfoot, Kyron Gosse, Leanne Powell, Lesley Quirk, M Patel, Mark Garner, Mark Holliday, Matthew Dawe, Megan Graham, Michael Steeneveld, Michelle Abley, Michelle Christie, Monique Oosterbaan, Narissa Morrissey, Nick Chan, Pearl van Blerk, Peter Bull, Peter Till, Peter van Kuyk, Philip Clark, Philip Stewart Guyan, Pieter Oosterbaan, Rama Ramachandran, Richard Gruitters, Richard Watson, Ruth Davidson, Sally Rae, Sarah Wilson, Sophia Vahry, Stephen Cruttwell, Steven Law, Troy Ross, Vicki Haylock, Yohanes Santose, Yolanda He, Zikon Leung
Impacts on first home buyers	48	Anne Shotbolt, Anne Tseng, Arthur Shew, BC Tee, Ben Keng, Bill Stark, Brendan Doherty, Cherian Thomas, Chooi Tai, Chris Binning, Chris Mercer, David Rowell, Deidre Mellamphy, Delpreet Singh, Gregg Kerr, Ilya Zharenikov, Irene Leonard, Joanne Walker, John Wong, Joseph John, Julie Gordon, Kent Dalziel, Kim Meichry, Kiri Barfoot, Kyron Gosse, Luan You, Marcus Bosch, Marcus Winders, Marin Braunton, Megan Graham, Mervyn Rebello, Michelle Christie, Monique Oosterbaan, Peter Bull, Peter Lewis, Peter Little, Peter van Kuyk, Philip Stewart Guyan, Phillippa Binning, PJ Cohen, Sarah Wilson, Simon Northey, Sophia Vahry, Stephen Cruttwell, Stephen Lovelock, Thomas Dorman, Vicki Haylock, Zikon Leung
Impacts on investors	222	Abhi Padalakar, Adrienne O'Sullivan, Akshay Triverdi, Alan Brown, Alan Gregory, Alan Kemp, Alan Willoughby, Alice Verheijen, Alice Zhu, Alan Lind, Amanda Lowe, Andrea Thompson, Andrew Butler, Andrew Clist, Andrew Conlon, Andrew Hart, Anil Anna, Ann Mackenzie, Anne Shotbolt, Anne Tseng, Anthony Whitehouse, Anura Widana, Arthur Shew, Barry Saxon, BC Tee, Beau Webster, Ben Keng, Bert Verdonk, Bill Stark, Brenda Ni, Brendan Doherty, Brendan Podayko, Brent Heslop, Brian Basco, Bruce Wallis, Cameron Hadfield, Catherine Woodley, Cherian Thomas, Chooi Tai, Chris Binning, Chris Mercer, Chris Perera, Chris Scullin, Christine Wu, Claire Robinson, Cliff Ah Kit, Clinton Stokes, Colin Comber, Daniel Simperingham, David and Vikki Bacon, David Phipps, David Rowell, Debbie Roberts, Deidre Mellamphy, Delpreet Singh, Di Yu, Diana West, Eduarda Abissamra, Ela Purnell, Eleanor Sayer, Ethan Jia, Fadia Mudafar, Fiona Roberts-Cox, Frank McCulloch, Georgina Witehira, Graeme Moore, Grant Beesley, Grant Dickson, Gregg Kerr, Hannah McQuikan, Haraish Rajpal, Harjiv Arora, Heather Pattison, Heidi Alter, Helen Joe, Ian Muir, Ignatius Fernandes, Ilya

		Zharenikov, Irene Leonard, Jacky Cheung, James Stevenson, Jason Tan, Jeff Wang, Jeremy Nunis, Jerry Wang, Ji Zhang, Joanne Walker, Joel D'Cruz, John Mavronicolas, John Paynter, John Roberts, Joseph John, Joshua Jones, Juanling Nian, Judith Archibald, Julie Gordon, Justin Harness, Karen Anderson, Karl Hazewinkel, Kathy Fray, Keith Dunne, Kellys Osorio, Ken Landeman, Kent Dalziel, Kevin Cox, Keys Kerdemelidis-Kiesanowski, Kieran Searle, Kim Meichtry, Kiri Barfoot, Kiri Speirs, Ko Vasan, Kurt Story, Kyron Gosse, Leanne Powell, Leon Smith, Leonie Jamieson, Leroy O'Donnell, Lesley Quirk, Lindsay Richards, Lois Goodman, Lorika van de Venter, Lotte Bayly, Luan You, Lydia Luo, Lynette Zander, Lynley Dodge, M Patel, Maggie Rebello, Maggie Sun, Marcus Bosch, Marcus Winders, Maria Shella Tabaco, Mark Garner, Mark Holliday, Mark McGoldrick, Martin Braunton, Matt Buckeridge, Matthew Dawe, Matthew Thomson, Megan Graham, Melanie Kilfoyle, Mervyn Rebello, Michael Steeneveld, Michael Stubbs, Michelle Abley, Michelle Christie, Michelle McFarlane, Mike Croft, Mingzhu Wu, Monique Oosterbaan, Narisa Morrissey, Natalie Perzylo, Nick Chan, Oleksiy Blazhevskyiy, Owen Moffitt, Paul Alexander, Paul Roberts, Paul and Coleen Shipley, Paul Stone, Pearl van Blerck, Peter Bull, Peter Close, Peter Lewis, Peter Little, Peter Tarr, Peter Till, Peter van Kuyk, Philip Beech, Philip Clark, Philip Stewart Guyan, Philippa Binning, Phillip Hart, Pieter Oosterbaan, PJ Cohen, Rajen Kapadia, Rama Ramachandran, Raquel Withers, Ravi Chigurupati, Ravi Rama, Rebecca Bartlett, Reece Chamberlain, Richard Gruiters, Richard Watson, Rob Brawn, Rob Rimmer, Robert Moore, Robert Vahry, Rodney Pomfrett, Roger Matheson, Rosemarie Gough, Ruth Davidson, Sally Rae, Sandra Dong, Sarah Wilson, Scott Highet, Sean Zhang, Sherry Dou, Simon Ayris, Simon Northey, Simone O'Meara, Sophia Vahry, Stanley Bu, Stephen Cruttwell, Stephen Lovelock, Steve Chew, Steve Lind, Susan Harrison, Terance Greer, Teresa Elder, Thomas Dorman, Tim Goodwin, Tina Tong, Tracey Swift, Troy Ross, Vicki Haylock, Virendra Gupta, Wilhelmina Staheli, Yohanes Santoso, Yvonne Grant-Martens, Zahrir Chhor, Zhen Liu, Zikon Leung

APPENDIX II: SUMMARY OF RECOMMENDATIONS

GST on low-value imported goods

Rec #	Recommendation description	Raised by	Page #
1.	Offshore suppliers of remote services and goods can have a six-month taxable period for first six months of new rules if liable to register only as a consequence of the new rules for goods	Officials	10
2.	Transitional rules for certain fixed-term contracts	Officials	11
3.	Changes to Section 12(1) be redrafted for clarity	3 submitters	23
4.	Section 12(1) be amended so Customs can collect GST on tariff duty where a consignment of low-value goods is valued over $1,000	Officials	25
5.	Alternative information requirements for Customs, to prevent double taxation	3 submitters	26
6.	Registered person to take reasonable steps to ensure its name is included in Customs documents	Officials	29
7.	Allowing suppliers to agree with Commissioner on alternative information to be included in a receipt	KPMG	30
8.	Clarify drafting of valuation provision for where an electronic marketplace offers a discount for goods	3 submitters	41
9.	Clarify drafting of safe harbour rules	4 submitters	42
10.	Clarify calculation of “entry value” where goods are already in New Zealand	EY	48
11.	The term “entry value” be replaced by “customs value”	Officials	49
12.	Clarification that suppliers can issue a document that can double as a tax invoice and GST receipt	Deloitte	50
13.	Add omitted cross-reference to validate treatment of supply	Officials	52
14.	Allowing offshore suppliers to claim GST on their New Zealand expenses back	Officials	53
15.	Threshold for self-assessment test be changed from 95% to 75%	EY	54
16.	Clarify that proposals do not apply to alcohol or tobacco	Officials	59
17.	Amend section 5(27) so that it applies in more circumstances where a consumer provides deliberately false information	Officials	59

Ring-fencing residential property deductions

Rec #	Recommendation description	Raised by	Page #
18.	Improve, clarify and simplify drafting of legislation	8 submitters	83
19.	Clarify when rules would apply to mixed use land	2 submitters	86
20.	Remove notification requirement of revenue account land	nsaTAX	86
21.	Clarify exclusion requirements for revenue account land	Deloitte	89
22.	Exclude all employee accommodation	CTG	92
23.	Exclude Government entities	2 submitters	94

Rec #	Recommendation description	Raised by	Page #
24.	Exclude all non-land-rich companies	Deloitte	94
25.	Allow property-by-property approach for change of use	CAANZ	95
26.	Make property-by-property election by taking a tax position in the return	CAANZ	96
27.	Clarify whether different approaches (portfolio / property-by-property) can be taken for different properties	NZLS	96
28.	Use of deductions against residential land outside the rules	nsaTax	98
29.	Clarify that transferred excess deductions from properties after untaxed sales will not prevent deductions against future land sale income	Deloitte	98
30.	Clarify rules for unfencing on taxable divestment of portfolio	2 submitters	99
31.	Clarify rules so deduction can be released in income year of final disposal rather than the following year	NZLS	100
32.	Clarify status of deductions following a change of use	CAANZ	104
33.	Transferred excess deductions should not taint other deductions	CAANZ	104
34.	Specify how ring-fenced deductions arising from interposed entities can be used	2 submitters	106
35.	Interposed entity rules should specify the point in time for determining the 'applied capital percentage'	2 submitters	107
36.	Remove "unless the context requires otherwise" from section DB 18AD(6)	Deloitte	113
37.	Clarify that reference to land that was residential rental property "at some time … owned" includes land that is still owned but no longer residential rental property	NZLS	114
38.	Ensure excess deductions on untaxed sale of property can be transferred for the income year of sale rather than only for a later year	Officials	115

SOP 193 – Care and management of the tax system

Rec #	Recommendation description	Raised by	Page #
39.	Clarification that compliance costs can be considered	3 submitters	125
40.	Deal with repetition in section 6D(1)(b)	Russell McVeagh	127
41.	Clarify extent of retrospective application for modifications	Officials	129
42.	Ability to dispense with or shorten period of public consultation in cases of urgency	2 submitters	131
43.	Clarify that Commissioner cannot reissue exemption after expiry	NZLS	135

Other policy matters

Rec #	Recommendation description	Raised by	Page #
44.	Improve wording Student Loan Scheme Act section 22(1)b relating to Day count test method	Officials	140
45.	Get consensus from accounting profession on form of PAYE and Employee Share Scheme legislation	3 submitters	146
46.	Amendment to employee share scheme rules apply to benefits offered under existing ESS	CTG	146
47.	Improve wording to section RD 7B relating to possibility for employers to cancel irrevocable election to withhold	PwC	148
48.	Change application date for savings provision relating to beneficiaries as settlors to 1 April 2020	2 submitters	150
49.	Improve drafting for remedial changes to the tax transitional rules relating to life insurance	6 submitters	158
50.	Capital raising costs – Clarify that the rules apply to suppliers that intend to principally make taxable supplies and amend the ”principally” test to exclude exempt supplies from the capital raising itself	KPMG	160

New matters raised by submitters

Rec #	Recommendation description	Raised by	Page #
51.	Associated persons definition – repeal the partnership and associate of partner test	Polson Higgs	170

New matters raised by officials

Rec #	Recommendation description	Raised by	Page #
52.	Exempt transitional support payments made under Oranga Tamariki Act	Officials	173
53.	Remove reference to test of principal purpose in section 92CB of TAA relating to binding rulings	Officials	173
54.	Remove requirement for an “arrangement” in binding ruling	Officials	174
55.	Amend GST Act so sale of sub-let residential property rented for five or more years is GST exempt	Officials	175
56.	Attribute tax credit for tax withheld by ACC to claimant instead of the carer	Officials	175
57.	Allow taxpayers to claim refund from an amended assessment outside time bar period, arising from ACC attendant care reimbursement	Officials	177
58.	Clarify scope of offence for revenue officers who breach confidentiality	Officials	178
59.	Correct date references in ITA relating to pre-consolidation imputation credits	Officials	179
60.	Remove references to criminal penalties in section 17(1CB) of the Tax Administration Act	Officials	182
61.	Associated persons definition - insert cross-reference to tripartite test	Officials	182

Rec #	Recommendation description	Raised by	Page #
62.	Clarifying the periods in sections 23C(4) and 23F(3) of the Tax Administration Act 1994	Officials	183
63.	Correcting outdated reference in section 48B of the Tax Administration Act 1994	Officials	183
64.	Amend definition of “hire purchase agreement” in the Income Tax Act	Officials	183