Hon David Parker, Minister of Revenue

Information Release

Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2)

November 2022

Availability

This information release is available on Inland Revenue's tax policy website at https://taxpolicy.ird.govt.nz/publications/2022/2022-ir-perm2-bill

Documents in this information release

#	Reference	Type	Title	Date
1	IR2022/065	Tax policy report	Overseas donee Status: New additions for the next available taxation bill	17 February 2022
2	DEV-22-SUB-0050	Cabinet Paper	Overseas Donee Status: New Additions for the Next Omnibus Taxation Bill	30 March 2022
3	DEV-22-MIN-0050	Minute	Overseas Donee Status: Additions for the Next Omnibus Taxation Bill	30 March 2022
4	CAB-22-MIN-0105	Minute	Report of the Cabinet Economic Development Committee: Period Ended 1 April 2022	4 April 2022
5	IR2022/158	Tax policy report	Fringe benefit tax and public transport	7 April 2022
6	IR2022/191	Tax policy report	GST status of statutory and regulatory charges	28 April 2022
7	IR2022/079	Tax policy report	Remedials for foreign trusts: policy approval	5 May 2022
8	IR2022/255	Tax policy report	Non-fiscal remedial items for the August 2022 omnibus taxation bill	12 May 2022
9	IR2022/269	Tax policy report	GST apportionment simplification – policy decisions and Cabinet paper	26 May 2022
10	IR2022/275	Tax policy report	Cabinet paper – Omnibus policy measures for inclusion in the August 2022 taxation bill	26 May 2022
11	IR2022/248 MBIE2122-4074	Tax policy report	Priority accorded to KiwiSaver employer contributions	1 June 2022
12	IR2022/282	Tax policy report	Remedials with fiscals for inclusion in the August 2022 taxation bill	2 June 2022

#	Reference	Type	Title	Date
13.	IR2022/262	Tax policy report	Final policy decisions following public consultation on the taxation of the gig and sharing economy Note: The regulatory impact assessments and statements attached to the paper are publicly available	10 June 2022
14.	IR2022/293	Tax policy report	Housing remedials for August 2022 tax bill	10 June 2022
15.	IR2022/312	Tax policy report	Network expenditure tax treatment: Remedial recommendations	16 June 2022
16.	IR2022/315	Tax policy report	R&D Tax Incentive: Notification of changes in activities	16 June 2022
17.	IR2022/318	Tax policy report	Allocation of subdivided land and unit titles among co-owners under the bright-line test and land-sale rules	17 June 2022
18.	DEV-22-SUB-0132	Cabinet paper	Measures for Inclusion in the 2022 Omnibus Tax Bill Note: The regulatory impact assessments and statements attached to the paper are publicly available	22 June 2022
19.	DEV-22-MIN-0132	Minute	Measures for Inclusion in the 2022 Omnibus Tax Bill	22 June 2022
20.	DEV-22-SUB-0135	Cabinet paper	Simplifying GST Apportionment Rules Note: The regulatory impact assessments and statements attached to the paper are publicly available	22 June 2022
21.	DEV-22-MIN-0135	Minute	Simplifying GST Apportionment Rules	22 June 2022
22.	IR2022/221 BRF21/22051318	Tax policy report	Comparing options to support build-to-rent	23 June 2022
23.	CAB-22-MIN-0242	Minute	Report of the Cabinet Economic Development Committee: Period Ended 24 June 2022	27 June 2022
24.	BN2022/339	Briefing note	Trust resettlements and rollover relief for land transferred out of a trust to a settlor	28 June 2022
25.	CBC-22-SUB-0037	Cabinet paper	Final policy decisions on the role of digital platforms in the taxation of the gig and sharing economy Note: The regulatory impact assessments and statements attached to the paper are publicly available	4 July 2022
26.	CBC-22-MIN-0037	Minute	The Role of Digital Platforms in the Taxation of the Gig and Sharing Economy: Final Policy Decisions	4 July 2022

#	Reference	Type	Title	Date
27.	CAB-22-MIN-0266	Minute	Report of the Cabinet Business Committee: Period Ended 8 July 2022	25 July 2022
28.	DEV-22-SUB-0163	Cabinet paper	Exemption from Interest Limitation for Build-to-Rent Assets Note: The regulatory impact assessments and statements attached to the paper are publicly available	27 July 2022
29.	DEV-22-MIN-0163	Minute	Exemption from Interest Limitation for Build-to-Rent Assets	27 July 2022
30.	CAB-22-MIN-0280	Minute	Report of the Cabinet Economic Development Committee: Period Ended 29 July 2022	1 August 2022
31.	IR2022/354	Tax policy report	Draft Cabinet paper – Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for introduction	3 August 2022
32.	LEG-22-SUB-0139	Cabinet Paper	Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for Introduction	25 August 2022
33.	LEG-22-MIN-0139	Minute	Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for Introduction	25 August 2022
34.	CAB-22-MIN-0346	Minute	Report of the Cabinet Legislation Committee: Period Ended 26 August 2022	29 August 2022
35.	IR2022/414	Tax policy report	Introduction of the Taxation (Annual Rates for 2022-23, Platform Economy, and Remedial Matters) Bill (No 2)	1 September 2022
36.	CAB-22-SUB-0364	Cabinet paper	Introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)	5 September 2022
37.	CAB-22-MIN-0364	Minute	Introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)	5 September 2022

Additional information

The Cabinet paper *Overseas Donee Status: Additions for the Next Omnibus Taxation Bill* (DEV-22-SUB-0050) was considered by the Cabinet Economic Development Committee on 30 March 2022 and confirmed by Cabinet on 4 April 2022.

The Cabinet paper *Measures for Inclusion in the 2022 Omnibus Tax Bill* (DEV-22-SUB-0132) was considered by the Cabinet Economic Development Committee on 22 June 2022 and confirmed by Cabinet on 27 June 2022.

The Cabinet paper *Simplifying GST Apportionment Rules* (DEV-22-SUB-0135) was considered by the Cabinet Economic Development Committee on 22 June 2022 and confirmed by Cabinet on 27 June 2022.

The Cabinet paper *Final policy decisions on the role of digital platforms in the taxation of the gig and sharing economy (*CBC-22-SUB-0037) was considered by the Cabinet Business Committee on 4 July 2022 and confirmed by Cabinet on 25 July 2022.

The Cabinet paper *Exemption from Interest Limitation for Build-to-Rent Assets* (DEV-22-SUB-0163) was considered by the Cabinet Economic Development Committee on 27 July 2022 and confirmed by Cabinet on 1 August 2022.

The Cabinet paper *Introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* (CAB-22-SUB-0364) was considered by Cabinet on Monday 5 September 2022.

Seven attachments to Cabinet papers are not included in this information release as they are publicly available.

Regulatory impact assessments and statements:

1. Cross-border workers tax reform (25 May 2022)
2. Taxation of the gig and sharing economy: GST (25 May 2022)
3. Taxation of the gig and sharing economy: Information reporting an exchange (25 May 2022)
4. GST status of statutory and regulatory charges (26 May 2022)
5. GST apportionment and adjustment rules (26 May 2022)
6. Fringe benefit tax exemption for public transport (31 May 2022)
7. Comparing option to support build-to-rent (20 June 2022)

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the OIA). Where this is the case, the relevant sections of the OIA that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the OIA under which information was withheld:

9(2)(a)	to protect the privacy of natural persons, including deceased people
9(2)(ba)	to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment
9(2)(f)(iv)	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
9(2)(g)(i)	to maintain the effective conduct of public affairs through the free and frank expression of opinions

Not in scope

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Overseas donee status: New additions for the next available taxation bill**

Date:	17 February 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/065

Action sought

	Action sought	**Deadline**
Minister of Revenue	**Agree** to recommendations	28 February 2022

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
Brandon Sloan	Principal Policy Advisor	s 9(2)(a) [redacted]
Emily Scrimgeour	Policy Advisor	

17 February 2022

Minister of Revenue

Overseas donee status: New additions for the omnibus taxation bill

Executive summary

1. This report seeks approval to give overseas donee status to eight New Zealand charities whose purposes are directed at activities outside New Zealand. We recommend these entities be added to schedule 32 of the Income Tax Act 2007 in the next taxation bill scheduled for introduction in the second half of 2022. "Overseas donee status" is used to describe certain New Zealand charities with overseas purposes to which donors are eligible for tax benefits, including:

   1.1 the donation tax credit, and

   1.2 tax deductions if the monetary donation is from a company or Māori authority.

2. Overseas donee status is an exception to the policy framework that generally limits tax benefits for donations to charities with New Zealand purposes.

3. The charities we recommend be granted overseas donee status are:

   3.1 Cotton on Foundation Ltd

   3.2 Engineers Without Borders New Zealand

   3.3 Family for Every Child

   3.4 Forest for People

   3.5 Heilala Vanilla Foundation (*on a temporary basis*)

   3.6 Joyya Trust

   3.7 New Zealand for UNHCR (the United Nations High Commissioner for Refugees)

   3.8 Solomon Islands Medical Mission

4. Descriptions of the charities, their purposes and activities, are provided in paragraphs 25 to 37 of this report. Decisions to grant overseas donee status approvals are assessed against long-established Cabinet criteria (see paragraph 19).

5. The eight charities we recommend be given overseas donee status meet Cabinet's criteria and are largely involved in the relief of poverty, the relief of sickness, or improving education outcomes in developing countries. All are registered (or about to be) under the Charities Act 2005. They all have adequate procedures for the accountability of funds applied to projects outside New Zealand.

6. Except for Heilala Vanilla Foundation, which we recommend have overseas donee status from 15 January 2022 in response to the Tongan state of emergency that occurred on that date, the remaining charities should have overseas donee status from 1 April 2022.

7. We are also recommending that Heilala Vanilla Foundation's donee status be time limited and end on 31 March 2026 (about 4 years). While the Foundation is well

placed to support recovery efforts following the recent tsunami it may not have as strong a role to play in terms of Tonga's overall future economic development (explained on page 9). We want to review the Foundation's work post the immediate emergency situation, and therefore consider a finite period is appropriate initially.

Financial implications

8. The revenue effect of giving overseas donee status to the eight charities recommended in this report is estimated to be $4.989 million over the forecast period. The revenue effect is recognised as a forecasting change because it reflects an increase in the cost of the decision to allow donations to New Zealand-based charities with overseas purposes to be eligible for tax benefits. The recommendations in this report have no impact of the Tax Policy Scorecard.[1]

Consultation

9. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services were consulted as part of our analysis of the charities discussed in this report.

10. The Treasury has been consulted in preparing this report and agrees with its recommendations.

Next steps

11. If you agree to the recommendations in this report, we will prepare a paper to the Cabinet Economic Development Committee seeking its approval to the additions to the list of overseas donee organisations in the Income Tax Act for inclusion in the omnibus taxation bill schedule for introduction in the second half of 2022.

12. We will report again during the year with further additions and removals to the list of overseas donee organisations.

13. A copy of this report should be referred to the Minister of Finance for his information.

[1] The Tax Policy Scorecard is a memorandum account that records the fiscal effect of approved tax policy decisions that improve the tax system outside of the Budget process.

Recommended action

1. **Agree** that the following charities be added to the list of organisations with overseas donee status in the Income Tax Act 2007:

(i)	Cotton on Foundation Ltd	Agreed/ Not agreed
(ii)	Engineers Without Borders	Agreed/ Not agreed
(iii)	Family for Every Child	Agreed/ Not agreed
(iv)	Forest for People	Agreed/ Not agreed
(v)	Heilala Vanilla Foundation (*on a temporary basis*)	Agreed/ Not agreed
(vi)	Joyya Trust	Agreed/ Not agreed
(vii)	New Zealand for UNHCR	Agreed/ Not agreed
(viii)	Solomon Island Medical Mission Trust	Agreed/ Not agreed

2. **Agree** that the charities in recommendation that you have approved are given overseas donee status from the following dates;

(i)	Heilala Vanilla foundation from 15 January 2022 until 31 March 2026	Agreed/ Not agreed
(ii)	The rest from 1 April 2022.	Agreed/ Not agreed

3. **Agree** that the reference to "UNHCR" be removed from1 April 2023, if you agree to recommendation 1(vii).

   Agreed/Not agreed

4. **Note** that agreeing recommendations 1 and 2 will result in the following adjustments to revenue forecasts:

Vote Revenue **Minister of Revenue**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.028)	(0.967)	(1.156)	(1.324)	(1.514)

   Noted

5. **Agree** that amendments giving effect to recommendations 1 to 3 be included in the omnibus taxation bill scheduled for introduction in the second half of 2022.

   Agreed/ Not agreed

6. **Direct** officials to prepare a paper to Cabinet seeking its approval for the changes recommended in this report.

   Directed

7. **Refer** a copy of this report to the Minister of Finance for his information.

   Referred

s 9(2)(a)

[redacted]

Brandon Sloan
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

Purpose

14. This report seeks your approval to give overseas donee status to eight registered charities and include the required amendments in the omnibus taxation bill scheduled for introduction in the second half of 2022.

Background

15. Since 1962, the Income Tax Act has provided tax benefits for monetary donations to New Zealand charities (including benevolent, philanthropic, or cultural organisations) whose purposes are largely limited to New Zealand. The Income Tax Act imposes certain statutory limitations on the entity's purposes and its application of funds, which must relate "wholly or mainly" to purposes in New Zealand. At the time, three charities with overseas purposes were made specific exceptions to the rule. The government also acknowledged that charities could be added to the list of names from time to time as comparable cases arise. In 1978, Cabinet developed criteria to support consideration about future additions of New Zealand-based overseas aid organisations to the legislative list (see paragraph 19).

16. Supporting New Zealand charities through granting overseas donee status is intended to assist the New Zealand Government's overseas development efforts, where aid objectives are better achieved by charitable non-government organisations (NGOs). The assistance is open-ended and less discretionary than other forms of government assistance[2] because it is delivered through the tax system using the benefits attached to monetary donations made to the listed charities.

17. Broadly, governments may seek to promote charitable giving:

    17.1 to further social objectives – in this particular case, overseas development aid,

    17.2 for the wider benefits to society (externalities), which may be over and above the value of the benefit provided via the tax system, and

    17.3 because donations can be effective indicators of when extra goods and services should be provided in market conditions that might otherwise not exist – this is particularly the case in developing countries, or when assisting individuals suffering from the effects of poverty or sickness, or a natural disaster.

18. The trade-off for these benefits is the open-ended revenue cost that applies for as long as the charity is on the list of approved donee organisations.

Cabinet's consideration of requests for overseas donee status

19. Since 1978, Cabinet has applied the following criteria, to assess applications for overseas donee status

    The basic criteria for adding an organisation to the list of approved "overseas" charities:

    (i) the funds of the charity should be principally applied towards:

[2] For example, the Ministry of Foreign Affairs and Trade's New Zealand aid programmes: the New Zealand Partnerships for International Development Fund (Partnerships Fund), the Sustainable Development Fund, the New Zealand Disaster Response Partnership (NZDRP), and the Pacific Island Countries Participation Fund (PIC Fund).

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries; or*

raising the educational standards of a developing country;*

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

[CM 78/14/7 refers]

20. The eligible purposes set out in the criteria are aligned with the Government's overseas development objectives (disaster relief, provision of humanitarian aid, and assisting developing countries) and narrower than the common law meaning of "charitable purpose" and the legislative framework in the Charities Act. Determination of donee status, including overseas donee status, remains the responsibility of Inland Revenue because of the tax benefits that attach to monetary donations. The process does not overlap with the work of the Department of Internal Affairs – Charities Services.

21. Irrespective of whether a charity's founding documents and activities are charitable, approval for inclusion on Schedule 32 is not automatic, and requests are considered on a case-by-case basis.

22. An overarching consideration is that any charity approved for overseas donee status is credible, transparent, and accountable.[3] Fiscal impacts and the integrity of the tax system are also relevant considerations. Annex A sets out the factors that we consider and analyse in respect of each charity that seeks overseas donee status.

23. Overseas donee status is an exception to the policy that tax benefits for donations should be limited to charities with New Zealand purposes and requires amending the Income Tax Act. In 2016, the Legislation Design and Advisory Committee provided advice to Inland Revenue confirming that the use of legislation to grant overseas donee status is appropriate.

Charities recommended for overseas donee status

24. The eight charities discussed below have purposes that come within the criteria provided in paragraph 19, and we recommend that they be granted overseas donee status. They all have adequate procedures for the accountability of funds applied to projects and can demonstrate a track record of activity or are connected with well-established international-based charities. Apart from New Zealand for UNHCR, the charities discussed in this report are registered under the Charities Act and have a centre of management in New Zealand. New Zealand for UNHCR is in the process of obtaining charitable registration under the Charites Act.

Cotton On Foundation New Zealand Ltd

25. Cotton On Foundation is an Australian resident charity established by the Cotton On Group, which has a strong commercial presence in New Zealand. The Foundation's works are directed at the relief of poverty, with a worldwide focus on impoverished communities. It supports a number of projects directed at improving educational outcomes in Uganda, Thailand, and South Africa through developing new infrastructure, such as buildings, and providing educational resources.

[3] *Guidelines for using the Cabinet criteria for overseas donee status*, endorsed by Cabinet in 2009 – CBC Min (09) 12/2 refers.

Engineers Without Borders New Zealand

26. Engineers Without Borders New Zealand (EWBNZ) supports capability-building programmes for engineering service providers in developing countries in the Pacific. Working with in-country partners, EWBNZ puts programmes in place to support learning and development outcomes for engineers and technicians. Recent projects include providing learning support for projects in Vanuatu and Kiribati.

Family for Every Child

27. Family for Every Child provides a platform for civil society organisations to collaborate and supports the exchange of knowledge and practice around children's care by building skills in research, documentation, programme piloting, advocacy and technical assistance. It has headquarters in the United Kingdom and the United States, as well as New Zealand.

Forests for People

28. Forests for People Ltd supports development projects and programmes directed at enhancing the welfare of indigenous communities in sensitive ecosystems. The projects create sustainable economic systems in developing countries through improving education outcomes and contributing to local employment in environmentally sustainable industries.

Heilala Vanilla Foundation

29. The Heilala Vanilla Foundation was established in 2013 and is active in promoting agricultural economic development in Tonga, including improving education and health outcomes for farming communities.

30. The Heilala Vanilla Foundation is supported by Heilala Vanilla Ltd (a registered New Zealand company). Heilala Vanilla Limited donates funds each year to Tonga via the Foundation, primarily in the areas of disaster relief and education.

31. The volcanic eruption and subsequent tsunami on 15 January 2022 have resulted in serious food security problems for the worst affected islands. The Heilala Vanilla Foundation has provided immediate aid in the form of food staple packs sent in January 2022, along with safety equipment to assist with the remapping of the coastlines to allow boat landings to recommence on outlying islands.

Joyya Trust

32. Joyya Trust supports local capacity building in four communities known for extreme poverty and human trafficking in Kolkata and West Bengal, India. The Trust places special emphasis on education, local community initiatives and economic projects to alleviate urban poverty and empower women and girls into work to counteract human trafficking.

New Zealand for UNHCR

33. The office of UNHCR – the United Nations High Commissioner for Refugees -was established by the United Nations General Assembly in 1950 with a mandate to lead and coordinate international action to protect and assist refugees and other forcibly displaced people of concern to UNHCR. New Zealand has been an active member of UNHCR's Executive Committee since its establishment. There are currently 82.4 million people of concern to UNHCR. To meet their humanitarian needs, UNHCR, with the support of the Executive Committee, has sought to further expand its

fundraising base through government support and increasingly also from the private sector.

34. In the 2008-09 income year the New Zealand Government granted UNHCR overseas donee status but at the time UNHCR had limited capacity to undertake fundraising appeals within New Zealand, with New Zealand donors being directed to the UNHCR global website or the private sector partner in Australia. UNHCR has since reviewed its fundraising activities in Australasia and has decided to create a New Zealand charitable trust - "New Zealand for UNHCR" to further fundraising activities in New Zealand, such as the UNHCR COVID-19 appeal.

35. We support the restructure as it means that the UNHCR would have transparency and accountability obligations under New Zealand charities law.

36. To facilitate the restructure regarding New Zealand donor tax benefits for donations, officials recommend that the existing reference to UNHCR be removed and substituted with the reference to New Zealand for UNHCR. Cabinet approval for the legislative change to support this restructure is not needed, given its earlier approval from the 2008-09 income year.

Solomon Island Medical Mission Trust

37. Solomon Islands Medical Mission Trust's primary purpose is to raise funds for a rural health clinic in Fauabu, Province of Malaita, Solomon Islands, to progressively upgrade its original hospital status. Work currently funded by the Trust, to be completed in the next few months, includes expanding the ablutions block and installing water supply.

Specific comments about the recommended charities

38. As part of our analysis of the charities discussed in this report, we have not identified any significant risks or concerns with their activities and governance. The charities recommended in this report have adequate donor support to carry out their purposes. However, we note:

Two of the charities have a limited track record of activity	***Forest for People Ltd***: Last year, 2021, we reported to you about The Orangutan Project and recommended, consistent with earlier Cabinet decisions, that it should not be given overseas donee status. In that report we noted that trustees would, in response to an unfavourable decision, restructure the New Zealand company and refocus its activities and funding towards humanitarian aid projects in conservation sensitive areas in Indonesia. Forests for People Ltd is the result of that restructure. The purposes of the company, and the projects it supports, are consistent with Cabinet's approval criteria. Further, the purposes of the trust have an express prohibition on supporting animal welfare projects. The directors involved are experienced with overseeing international development projects. We do not have any reservations with the restructure and the company's new direction.

…con't	***Heilala Vanilla Foundation***: While the Foundation has existed since 2013, it has not operated on a continuous basis. s 18(c)(i) [redacted] The 15 January 2022 state of emergency in Tonga has been the catalyst to move the strategic plan for the Foundation forward. Our recommendation to grant the Foundation overseas donee status is based on the national state of emergency in Tonga and the fact that the Foundation, via the company, has strong connections to Tonga's rural communities and outlying islands to deliver needed relief to support the rebuild from the recent volcanic eruption and subsequent tsunami. Beyond the Foundation's immediate emergency response, we consider the charity's future plans in respect of economic development in Tonga are unclear and too uncertain. Given our comments above, we are recommending that Heilala Vanilla Foundation has overseas donee status on a finite basis until 31 March 2026. This would not prevent the Foundation seeking permanent overseas donee status, but we would want to reexamine the Foundation's activity before we make such a recommendation. Our review of the Foundation would be scheduled for 2024/25.
Two of the charities is motivated by religious purposes	**Solomon Island Medical Mission Trust:** The Trust exists to raise funds for a rural health clinic in Fauabu, Province of Malaita, Solomon Islands. The clinic is owned and run by the Anglican Diocese of Malaita. The Trust works mainly with the Anglican provincial headquarters in the Solomon Islands (Anglican Church of Melanesia known as 'ACOM') based in the capital, Honiara, who liaise with their Diocese of Malaita. ACOM works closely with the clinic to identify fundraising priorities. While Cabinet's approval criteria are very clear that charities with religious purposes cannot be approved, officials note that religious organizations that operate in developing countries are more trusted in those communities as they are more reliable and possess non-corrupt networks and infrastructure to carry out their works. For example, the Anglican Missions Board is actively working with the Anglican Diocese of Polynesia in coordinating on the ground efforts in Tonga in response to the 15 January 2022 volcanic eruption and subsequent tsunami. Officials are satisfied that the Trust's purposes are solely the relief of poverty, and the advancement of education and healthcare, and not religious proselytization. The Trust's constitution also imposes prohibitions from carrying out religious purposes outside of New Zealand. **Joyya Trust:** The Trust was established by members of South West Baptist Church in Christchurch and has relationships with non-governmental organizations including the humanitarian arm of the New Zealand Baptists Missionary Society. The Trust has independent trustees and has sufficient safeguards against religious proselytization and discrimination. Officials are satisfied that the Trust's purposes are humanitarian only.

Centre of governance is outside New Zealand	***Cotton On Foundation New Zealand Ltd:*** The Foundation is an Australian resident company. It has a strong connection with New Zealand, via Cotton On (a clothing and stationery retailer). The company is a registered charity under New Zealand's Charities Act. From discussions with officials, the Foundation has appointed a non-executive director in New Zealand to be responsible for its New Zealand administration. The Foundation, therefore, has enforceable financial transparency and compliance obligations under New Zealand law. Although the current list of donee organisations includes non-resident charities,[4] since 2009 we have been reluctant to recommend non-resident charities for overseas donee status unless the charity has public transparency obligations in New Zealand. This position was the result of work to develop a set of *guidelines*[5] to assist charities seeking overseas donee status and promote greater public transparency and accountability from those charities. If the charity was non-resident, it would not be able to register under the Charities Act, and not meet the transparency expectations in the *guidelines*. We consider that the Cotton On Foundation meets the expectations set out in the *guidelines* and should be given overseas donee status.

39. We have not identified any specific matters or concerns with Engineers Without Borders New Zealand, Family for Every Child, and New Zealand for UNHCR.

Charities still under consideration

40. Officials are still analysing requests from five other charities. We are waiting for additional information from the trustees and, subject to the timing of the omnibus taxation bill, will report to you later in 2022 with our recommendations for further additions and removals of listed charities that have ceased operations.

Legislative vehicle and application date

41. Amendments adding the eight organisations recommended in this report to the list of overseas donee organisations in the Income Tax Act 2007 should be included in the next omnibus taxation bill, scheduled for introduction in the second half of 2022. The amendments should apply from 1 April 2022, noting the variations for New Zealand for UNHCR, and Heilala Vanilla Foundation below. Monetary donations received from that date will be eligible for tax benefits. The recommended application date gives the charities certainty for marketing and fund-raising purposes.

42. Inland Revenue's systems can work with an application date of 1 April 2022, as individuals will be able to claim the donations tax credit for receipted monetary donations as part of Inland Revenue's 2022–23 return cycle, starting on 1 April 2023. Companies and Māori authorities will be allowed deductions for monetary donations made during the 2022–23 income year.

New Zealand for UNHCR

43. We have discussed application date implications with UNHCR, and to facilitate the restructure we recommend that New Zealand for UNHCR be inserted with effect from 1 April 2022, with the corresponding reference to UNHCR being removed from

[4] For example, the Commonwealth Foundation (United Kingdom based, and added in 1967), Alhay Buhay Foundation Trust (Philippines, added in 1987), The Serious Road Trip Charitable Trust (United Kingdom, added 1995, but is being removed as part of the current taxation bill before the Finance and Expenditure Committee), and UNHCR (Sydney based and added in 2008, and has now created a New Zealand trust – paragraphs 33 to 36).
[5] *Ibid footnote 3.*

1 April 2023. The one-year overlap is to allow existing donors to be shifted to the new New Zealand entity.

Heilala Vanilla Foundation

44. The Foundation has requested an earlier application date of 15 January 2022, the date of the state of national emergency in Tonga. We have considered the arguments in support of a retrospective application date. We have not in the past endorsed requests from charities for earlier application dates, however, in this instance we consider the Foundation makes a good case as it is responding to a natural disaster:

44.1 While business donors to the Foundation arguably receive a windfall, in terms of being able to recognise business tax deductions for the donations, the benefit is immaterial, and expected to be in the region of $28,000.

44.2 There are precedents for earlier application dates for additions to the overseas donee list in cases where the New Zealand Government is responding to emergency events affecting our Pacific Island nation neighbours.

44.3 The date of the state of emergency (15 January) provides a clear date for when donations are eligible for business tax deductions. As such, the compliance impact on business donors and the Foundation is minimal. The administrative implications for Inland Revenue are manageable given there are a handful of donors affected and the proximity of the date of the end of the 2021/22 income year.

44.4 While there are currently a number of public appeals for donations in response to the state of emergency in Tonga, the Foundation has been primarily focused on businesses that have strong connections to Tonga.

45. The Ministry for Foreign Affairs and Trade is supportive of an earlier application date, as it aligns with the New Zealand Government's use of International Development Cooperation funding in support of Tonga's response to the 15 January tsunami.

Financial implications

46. The estimated financial implications of adding the eight charities recommended in this report are shown in Annex B. Over the forecast period 2021-22 to 2025-26, the expected financial impact is $4.989 million. The financial implications will be treated as a forecasting change and reflect the increasing cost of the policy to allow tax benefits for donations to New Zealand-based overseas aid charitable organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period. There is no impact on the Tax Policy Scorecard.

47. The addition of New Zealand for UNHCR is already included in revenue baselines, as UNHCR was given overseas donee status from the 2008/09 income year.

	$m – increase/(decrease)				
Vote Revenue	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.028)	(0.967)	(1.156)	(1.323)	(1.512)
Total change in Revenue	**0.028**	**0.967**	**1.156**	**1.324**	**1.514**

Consultation

48. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services have been consulted in the preparation of this report. The New Zealand Police's vetting service was also used in connection with the trustees/officers of the charities recommended in this report.

49. The Treasury has also been consulted in preparing this report and agrees with its recommendations.

Next steps

50. If you agree to the recommendations in this report, we will prepare a paper to the Cabinet Economic Development Committee seeking its approval to the additions to the list of overseas donee organisations in the Income Tax Act for inclusion in the omnibus taxation bill scheduled for introduction in the second half of 2022.

51. We will report again during the year with further additions and removals to the list of overseas donee status organisations.

52. A copy of this report should be referred to the Minister of Finance for his information.

Annex A: Analysis of requests for overseas donee status

53. Officials look at a number of factors when considering a charity's request to be added to the list of donee organisations in the Income Tax Act. We look to establish whether the charity is capable of meeting its purposes and is accountable for the funds it collects by:

    53.1 reviewing the charity's governing document (constitution and trust deed) to ensure the activities and purposes are consistent with Cabinet's criteria;

    53.2 requiring the purposes stated in the charity's governing document to be entirely within the scope of paragraph (i) of the Cabinet criteria and that no personal pecuniary profit can be derived;

    53.3 looking at the clauses governing the nature and extent of the trustees' discretionary powers, the winding-up clause, and the trustees' ability to amend the governing document;

    53.4 looking at the charity's past, current, and proposed activities;

    53.5 requesting that the trustees provide us with the charity's financial statements;

    53.6 considering the trustees' degree of control over the application of the charity's funds overseas, and procedures in place to ensure accountability for funds;

    53.7 considering the planning, monitoring, and evaluation processes used by the trustees regarding the application of the charity's funds, including how recipients use the funds, as well as the processes used to select beneficiaries and/or projects to support;

    53.8 asking whether the charity has a legal presence in New Zealand and if it has registered under the Charities Act;

    53.9 considering each request on the basis of other generic tax policy objectives, such as fiscal implications (including risk to the New Zealand tax base), consistency with other current government policy objectives, and the precedent effect; and

    53.10 consulting with other government agencies such as the Ministry of Foreign Affairs and Trade, and the Department of Internal Affairs – Charities Services, to identify any concerns with the organisation or sensitivities with the countries in which the organisation operates. We also use the New Zealand Police's vetting service in connection with the charity's trustees or directors.

Annex B: Financial implications by charity

s 18(c)(i)

[redacted]

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

OVERSEAS DONEE STATUS: NEW ADDITIONS FOR THE NEXT OMNIBUS TAXATION BILL

Proposal

1. This paper seeks the agreement of the Cabinet Economic Development Committee to grant overseas donee status to seven New Zealand charities whose purposes further New Zealand's international development objectives. Monetary donations to overseas donee organisations are eligible for tax benefits, such as the donation tax credit.

Relation to Government Priorities

2. Decisions to grant overseas donee status complement the Government's overseas development strategy.

Executive Summary

3. I recommend that the seven New Zealand charities with overseas charitable purposes discussed in this paper be granted overseas donee status and listed in schedule 32 of the Income Tax Act 2007, with application from 1 April 2022, with the exception of one charity whose status should be backdated from 15 January 2022 in response to the Tongan state of emergency that occurred on that date.

4. The necessary amendments would be included in the next omnibus taxation bill, scheduled for introduction in August 2022. The charities are discussed in paragraphs 10 to 17. The purposes and activities carried out by the charities discussed below fall within Cabinet's approval criteria (CM 78/14/7) as described in paragraph 7 and are involved in the relief of poverty and sickness and delivering humanitarian aid and development.

Background

5. New Zealand charities that support activities overseas and want their donors to be eligible for tax benefits (such as the donation tax credit) must be approved for overseas donee status and listed in Schedule 32 of the Income Tax Act. Monetary donations to listed organisations entitle individual New Zealand taxpayers to a tax credit (donation tax credit of 33 ⅓% of the amount donated, up to the amount of their taxable income. Companies and Māori Authorities are eligible for tax deductions, up to the level of their net income, for monetary donations to the named charities.

6. Generally, the availability of tax benefits to donations is limited to charities with New Zealand purposes only. Overseas donee status is therefore an established exception

for a specific class of charity. Giving overseas donee status requires legislative change by adding the charity to the list of overseas donee organisations in Schedule 32 of the Income Tax Act. Advice from the Legislative Design and Advisory Committee in 2016 to the Inland Revenue Department has confirmed that the use of legislation to implement decisions to grant overseas donee status is appropriate. There are 157 organisations listed in schedule 32.[1]

7. Cabinet has established criteria for granting overseas donee status:

The basic criteria for adding an organisation to the list of approved "overseas" charities:

(i) the funds of the charity should be principally applied towards:

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries; or*

raising the educational standards of a developing country;*

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

** developing countries recognised by the United Nations.*

[CM 78/14/7 refers]

Charities to be granted overseas donee status

8. I recommend that the charities named in paragraphs 10 to 17 be granted overseas donee status. The purposes of the recommended charities come within the criteria in paragraph 7. All the charities recommended in this paper have adequate procedures for the accountability of funds applied to projects and can demonstrate a track record of activity. All are registered under the Charities Act 2005.

9. The recommended charities are seeking overseas donee status to grow their New Zealand donor bases and increase the scope and scale of their in-country activities.

Cotton on Foundation

10. Cotton On Foundation is an Australian resident charity established by the Cotton On Group, which has a strong commercial presence in New Zealand. The Foundation's works are directed at the relief of poverty, with a worldwide focus on impoverished communities. It supports a number of projects directed at improving educational outcomes in Uganda, Thailand, and South Africa through developing new infrastructure, such as buildings, and providing educational resources.

[1] The Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill proposes to add 11 charities and remove 9 bringing the total to 159.

Engineers Without Borders New Zealand

11. Engineers Without Borders New Zealand (EWBNZ) supports capability-building programmes for engineering service providers in developing countries in the Pacific. Working with in-country partners, EWBNZ puts programmes in place to support learning and development outcomes for engineers and technicians. Recent projects include providing learning support for projects in Vanuatu and Kiribati.

Family for Every Child

12. Family for Every Child provides a platform for civil society organisations to collaborate and supports the exchange of knowledge and practice around children's care by building skills in research, documentation, programme piloting, advocacy and technical assistance. It has headquarters in the United Kingdom and the United States, as well as New Zealand.

Forests for People

13. Forests for People Ltd supports development projects and programmes directed at enhancing the welfare of indigenous communities in sensitive ecosystems. The projects create sustainable economic systems in developing countries through improving education outcomes and contributing to local employment in environmentally sustainable industries.

Heilala Vanilla Foundation

14. In response to the state of emergency in Tonga following the volcanic eruption and subsequent tsunami on 15 January 2022, Heilala Vanilla Foundation has provided immediate aid in the form of food staple packs, along with safety equipment to assist with the remapping of the coastlines to allow boat landings to recommence on outlying islands. In recognition of this charity's disaster relief response for Tonga, I am recommending that Heilala Vanilla Foundation's overseas donee status should apply from an earlier date, 15 January 2022, and be for a time-limited period ending 31 March 2026.

15. My recommendation to give Heilala Vanilla Foundation temporary overseas donee status recognises that the Foundation's immediate focus is to support Tonga's disaster response. The Foundation's longer term plans in Tonga are still in development. My officials recommend that the Foundation's activities should be re-evaluated in 2024 to assess if they are meeting Tonga's economic development needs as the nation transitions from responding to the 15 January natural disaster to a broader and sustained economic recovery.

Joyya Trust

16. Joyya Trust supports local capacity building in four communities known for extreme poverty and human trafficking in Kolkata and West Bengal, India. The Trust places special emphasis on education, local community initiatives and economic projects to alleviate urban poverty and empower women and girls into work to counteract human trafficking.

Solomon Island Medical Mission Trust

17. Solomon Islands Medical Mission Trust's primary purpose is to raise funds for a rural health clinic in Malaita, and progressively upgrade its original hospital status. Work currently funded by the Trust, to be completed in the next few months, includes expanding the ablutions block and installing water supply.

Financial implications

18. The estimated financial implications of adding the seven charities recommended in this paper are shown in the table below. Over the forecast period (2021–22 to 2025–26) the expected financial impact is $4.989 million. The financial implications will be treated as a forecasting change and reflect the increasing cost of the policy to allow tax benefits for donations to New Zealand-based charitable overseas aid organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period.

Vote Revenue **Minister of Revenue**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.028)	(0.967)	(1.156)	(1.324)	(1.514)

Legislative Implications

19. Granting overseas donee status to the named charities will require changes to the Income Tax Act 2007. I recommend that the necessary amendments are included in the next omnibus taxation bill scheduled for introduction in August 2022. Apart from Heilala Vanilla Foundation, which I am recommending has overseas donee status from 15 January 2022, the other charities should have overseas donee status from 1 April 2022, the start of the 2022-23 income year.

Impact Analysis

Regulatory Impact Assessment

20. The Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in this paper are exempt from the requirement to provide a Regulatory Impact Assessment as they have no or minor impacts on businesses, individuals, or not-for-profit entities.

Climate Implications of Policy Assessment

21. In respect of the proposal to grant overseas donee status to seven new charities the Climate Implications of Policy Assessment (CIPA) team at the Ministry for the Environment has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

Population implications

22. New Zealand's strategy for overseas development is underpinned by four development principles: effectiveness, inclusiveness, resilience and sustainability. The charities I am recommending be given overseas donee status exhibit these principles by carrying out activities that directly respond to poverty, provide essential medical services to isolated or impoverished communities, and develop economic or educational capacity in developing countries.

23. Several of the charities specifically target women to ensure that communities have strong women leaders and health care practitioners. Some also prioritise women and children's health and wellbeing. This will have a positive impact for women in the communities where these charities operate.

24. There is also a focus on the Pacific and Micronesia to support health and education outcomes, including providing a relief response for Tonga. Strong relationships in the Pacific are an important aspect of New Zealand's diplomatic and development strategy.

Human Rights

25. The changes I am recommending in this paper do not have any implications in relation to the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

Consultation

26. The Treasury, Ministry of Foreign Affairs and Trade (Pacific and Development Group) and the Department of Internal Affairs – Charities Services were consulted as part of our analysis of the seven charities recommended in this paper.

Communications

27. Once Cabinet has made its decision on granting overseas donee status, officials will inform each organisation of the relevant decision. I will make an announcement about the seven charities when the relevant taxation bill is introduced. Inland Revenue will publish details of the new legislation in a Tax Information Bulletin once the tax bill containing the measure is enacted.

Proactive Release

28. I propose to delay the proactive release of this Cabinet paper, without redaction, and associated Cabinet minutes until the introduction of the proposed omnibus taxation bill which contains the necessary amendments to give effect to the proposal. The expected introduction date for this bill is August 2022.

Recommendations

The Minister of Revenue recommends that the Committee:

1. Agree that the following charities be given overseas donee status and listed in schedule 32 of the Income Tax Act 2007:

    1.1 Cotton on Foundation

    1.2 Engineers without Borders

    1.3 Family for Every Child

    1.4 Forest for People

    1.5 Heilala Foundation (on a temporary basis)

    1.6 Joyya Trust

    1.7 Solomon Island Medical Mission Trust

2. Agree that the charities in recommendation 1 be given overseas donee status from the following dates:

    2.1 Heilala Vanilla from 15 January 2022 until 31 March 2026,

    2.2 The rest from 1 April 2022.

3. Note that agreeing to recommendations 1 and 2 has the following estimated fiscal costs, which will be treated as a forecasting change on the operating balance.

Vote Revenue **Minister of Revenue**	**2021–22**	**2022–23**	**2023–24**	**2024–25**	**2025–26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.028)	(0.967)	(1.156)	(1.324)	(1.514)

4. Agree to include amendments giving effect to recommendation 1 and 2 in the next omnibus taxation bill scheduled for introduction in August 2022.

5. Note that Inland Revenue will inform the trustees once Cabinet has made a decision about the charities in recommendation 1.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Document 3

DEV-22-MIN-0050

Cabinet Economic Development Committee

Minute of Decision

Overseas Donee Status: Additions for the Next Omnibus Taxation Bill

Portfolio **Revenue**

On 30 March 2022, the Cabinet Economic Development Committee:

1 **agreed** that the following charities be given overseas donee status and listed in Schedule 32 of the Income Tax Act 2007:

1.1 Cotton On Foundation;

1.2 Engineers without Borders New Zealand;

1.3 Family for Every Child;

1.4 Forest for People;

1.5 Heilala Vanilla Foundation (on a temporary basis);

1.6 Joyya Trust;

1.7 Solomon Island Medical Mission Trust;

2 **agreed** that the charities listed above be given overseas donee status from the following dates:

2.1 Heilala Vanilla Foundation: from 15 January 2022 until 31 March 2026;

2.2 the other charities listed in paragraph 1 above: from 1 April 2022;

3 **noted** that paragraphs 1 and 2 above have the following estimated fiscal costs, which will be treated as a forecasting change on the operating balance:

Vote Revenue Minister of Revenue	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26 and outyears**
Crown Revenue and Receipts Tax Revenue	(0.028)	(0.967)	(1.156)	(1.324)	(1.514)

4 **agreed** to include the amendments giving effect to paragraphs 1 and 2 above in the next omnibus taxation bill, which is scheduled for introduction in August 2022.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon David Parker
Hon Poto Williams
Hon Damien O'Connor
Hon Stuart Nash
Hon Michael Wood
Hon Dr David Clark
Hon Meka Whaitiri
Hon Phil Twyford
Rino Tirikatene, MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Cabinet

Minute of Decision

Report of the Cabinet Economic Development Committee: Period Ended 1 April 2022

On 4 April 2022, Cabinet made the following decisions on the work of the Cabinet Economic Development Committee for the period ended 1 April 2022:

Not in scope

DEV-22-MIN-0050	**Overseas Donee Status: Additions for the Next Omnibus Taxation Bill** Portfolio: Revenue	CONFIRMED

Not in scope

I N C O N F I D E N C E

Not in scope

Michael Webster
Secretary of the Cabinet

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Fringe benefit tax and public transport

Date:	07 April 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/158

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	11 April 2022
Minister of Revenue	**Agree** to recommendations	11 April 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Young	Principal Policy Advisor	s 9(2)(a) [redacted]
Svenja Brandt	Senior Policy Advisor	

07 April 2022

Minister of Finance
Minister of Revenue

Fringe benefit tax and public transport

Executive summary

1. You have asked officials to progress policy work on whether there should be a fringe benefit tax (FBT) exemption when an employer subsidises an employee's use of public transport [IR2021/167 refers]. This report sets out our position on such an FBT exemption and updates you on discussions we have had with some public transport providers and employer representative groups. It also discusses design and fiscal costs of an exemption and how such a measure could be funded (depending on timing and application date).

2. FBT applies, above a de minimis, when an employer subsidises an employee's use of public transport (for example, through a voucher or pre-loaded electronic ticketing card), whereas many employer-provided carparks are not subject to FBT. This non-neutral treatment may encourage the use of cars over environmentally friendlier public transport as a mode of travel to and from work.

3. While an exemption for public transport could improve environmental neutrality compared with the FBT treatment of employer provided on-premises car parking, it would increase overall distortion of the FBT and tax systems, including relative to other modes of transport (such as cycling). It may also incentivise calls for other FBT concessions which would create further economic distortions.

4. We believe that an FBT exemption would result in limited behavioural change and therefore offers poor value for money. Its application would be limited to situations where such fringe benefits are relevant to employers' locations and where employers were prepared to offer them to their employees. Our survey responses did show that FBT was a barrier to take-up. However, the lack of availability of low compliance and administration cost solutions was also a major issue.

5. If the Government wishes to increase public transport use, our preference would be for a direct policy to achieve this outcome (for example extending the recently announced measure to temporarily halve the cost of public transport to help counter the rising cost of living) rather than indirectly through a tax concession. Our view therefore is that the status quo would be preferable to exempting public transport fringe benefits from FBT.

6. Should you wish to proceed with an FBT exemption, we suggest exempting employer-provided fringe benefits on public transport for between home and work travel such as passenger transport by bus, train, ferry and tram that is available to the public, that charges set fares and runs on fixed routes.

7. Given a lack of data, a high-level estimate of the fiscal cost of exempting public transport from FBT is around $10 million per year. Officials preferred funding option is through a Budget bid for Budget 2023, which would allow for inclusion in the 2023 omnibus taxation bill and an application date of 1 April 2024.

8. Should you prefer an earlier application date of 1 April 2023, there are two potential options:

- A Budget 2023 bid, inclusion in Budget night legislation, and retrospective application of the legislative change. Retrospective application may cause some additional compliance costs.

- A charge on the Tax Policy Scorecard and inclusion in the 2022 omnibus tax bill. It is arguable whether such an FBT exemption would meet the requirements of the scorecard.

9. As a next step we would provide you with a draft Cabinet paper reflecting your preferences.

Recommended action

We recommend that you:

10. **agree** to adopt one of these two options:

10.1 Option 1 – Status quo – no FBT exemption for public transport (Inland Revenue and the Treasury officials' preferred option);

OR

Agreed/Not agreed Agreed/Not agreed

10.2 Option 2 – Exempt employer-provided public transport fringe benefits for between home and work travel from fringe benefit tax (Ministry of Transport officials' preferred option);

Agreed/Not agreed Agreed/Not agreed

11. **if you agreed to adopt Option 2, agree** to one of these two application dates:

11.1 exempt public transport fringe benefits from fringe benefit tax from 1 April 2023;

OR

Agreed/Not agreed Agreed/Not agreed

11.2 exempt public transport fringe benefits from fringe benefit tax from 1 April 2024;

Agreed/Not agreed Agreed/Not agreed

12. **if you agreed to Option 2 *and* a 1 April 2023 application date, note** that the fiscal impact of these decisions is an estimated $10 million reduction in tax revenue per year, with a corresponding impact on the operating balance and net core Crown debt:

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	-	(2.500)	(10.000)	(10.000)	(10.000)
Total Operating	**-**	2.500	10.000	10.000	10.000

Noted Noted

13. **if you agreed to Option 2 *and* a 1 April 2024 application date, note** that the fiscal impact of these decisions is an estimated $10 million reduction in tax revenue per year, with a corresponding impact on the operating balance and net core Crown debt:

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	-	-	(2.500)	(10.000)	(10.000)
Total Operating	**-**	-	2.500	10.000	10.000

Noted Noted

14. **if you agreed to a 1 April 2023 application date, agree** to adopt one of the following two options**:**

    14.1 submit a Budget bid for Budget 2023 seeking a fringe benefit tax exemption for public transport (this could be included in Budget night legislation with retrospective effect). This is officials' preferred option if a 1 April 2023 application date is chosen;

    OR

Agreed/Not agreed Agreed/Not agreed

    14.2 charge the forecast period revenue (as shown in recommendation 12 above) impact against the Tax Policy Scorecard (legislation to give effect to the exemption would be included in the omnibus 2022 taxation bill);

Agreed/Not agreed Agreed/Not agreed

15. **if you agreed to a 1 April 2024 application date:**

agree to submit a Budget bid for Budget 2023 seeking a fringe benefit tax exemption for public transport (this could be included in the 2023 omnibus taxation bill with prospective application). This is officials' preferred funding and application date option for an exemption;

Agreed/Not agreed Agreed/Not agreed

16. **direct** officials to draft a Cabinet paper reflecting your decisions;

Directed Directed

17. **refer** a copy of this report to the Minister of Transport for their information.

Referred/Not referred Referred/Not referred s 9(2)(a)

Paul Young
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Background

18. You asked officials to progress policy work on whether to exempt employer-provided public transport from fringe benefit tax (FBT) following a report outlining three transport and FBT issues with an environmental lens, including public transport and car parking [IR2021/167 refers].

19. The Tax Working Group (TWG) in its final report[1] noted a range of areas where greater environmental taxation could be used to change behaviour and raise revenue, including recommending that the Government consider allowing employers to subsidise their employees' public transport use without incurring FBT, given the practical difficulties associated with applying FBT to a wider range of employer-provided on-premises car parks.

20. The issue of exempting public transport from FBT has been frequently discussed in the media and your office has received several Ministerials on the issue over the last couple of years from interested parties. In addition, Hon Julie Anne Genter has proposed the Income Tax (Clean Transport FBT Exclusions) Amendment Bill, published 24 February 2021 as a members' bill. This Bill proposes measures to encourage businesses to support clean modes of transport and includes an FBT exemption for public transport passes provided to staff as a part of their salary package. The Bill has not yet been drawn from the members' bill ballot.

Current law

21. New Zealand's tax system has traditionally been based around a broad-base framework. This means that taxes are applied neutrally with few exemptions and subsidies. As a result, substantial amounts of tax revenue are raised relative to the level of tax rates, with the added benefit of simpler administration and compliance. There is generally a high threshold to depart from this neutrality approach. FBT is part of this framework.

22. Conceptually, anything that an employer provides to an employee that is salary or wages, or is a substitute for salary or wages, should be taxed, subject to the practicality of doing so. To ensure this is the case, most non-cash benefits received as a result of employment are treated as fringe benefits and are subject to FBT. As with the taxation of salary and wages, FBT coverage is intended to be broad with exemptions from FBT being limited to situations where compliance costs make it impracticable to apply FBT.

23. Any contributions made to an employee's public transport costs, for example in the form of a voucher or a loaded electronic ticketing card, triggers FBT unless they fall below the standard de minimis[2]. Any cash contributions to an employee's public transport costs are taxed like salary and wages under the PAYE (pay-as-you-earn) regime and do not attract FBT.

24. In contrast, when an employer provides free car parking to an employee on the employer's premises, including when the car park is leased from a car park provider, this is not subject to FBT in many instances. If the car park is "on-premises", it is exempt under the general FBT exemption for benefits provided on the employer's premises. The purpose of the general on-premises exemption is for taxpayer compliance costs reasons.

25. FBT is calculated and paid by the employer. The tax revenue from FBT for the year to June 2021 was $608 million, which was around 0.6% of total tax revenue.

[1] Future of Tax: Final Report | The Tax Working Group

[2] Unclassified benefits are exempt from FBT where the taxable value of the benefit provided to each employee is $300 or less per quarter per employee and the total taxable value of all unclassified benefits provided by the employer over the past 4 quarters is $22,500 or less.

Although FBT does not raise much revenue, it plays a key role in preventing leakage from the income tax base.

Problem definition

26. FBT should, like other tax rules, be neutral in its application, including in relation to its impact on environmental outcomes. Tax settings should not encourage environmentally damaging behaviour. Where there is such a bias, there is a strong case for removing it.

27. FBT applies to contributions above a de minimis made to employees for the use of public transport. However, FBT does not apply to many employer-provided carparks. The on-premises car parking exemption can be a sizeable benefit ($2,500-$5,000 per annum) to employees where parking charges are material, such as in central Auckland and Wellington. This does not align with the general tax neutrality approach. It may also encourage the use of private cars for transport to workplaces with free car parking over the use of public transport. A more environmentally neutral treatment across transport options would be desirable.

28. Removing the on-premises parking exemption has proved to be contentious in New Zealand, partly because of valuation and compliance cost concerns. Following our 2021 FBT and transport issues report you have ruled out progressing any policy work on car parking at this stage. The Tax Working Group considered that a way around the current impasse would be to expand the FBT exemptions to include employer-provided subsidisation of public transport.

Data and targeted consultation

29. In 2015–18, 74 percent of all commuting time travelling to work was spent as the driver of a private motor vehicle, with a further 6 percent spent as a passenger in such vehicles. Only 7 percent of all commuting time was spent on public transport. There are substantial regional differences in the use of public transport.

30. In the last couple of years COVID 19 has had a profound impact on people's use of public transport mainly due to concerns about being exposed to Covid 19 on public transport and increased working from home. It is not clear yet how enduring the impact will be in relation to working from home (noting that this will also reduce the demand for the use of private cars to travel between home and work). For those travelling between home and work in urban areas rising fuel costs may also shift some employees from travelling by private car to public transport. Currently, the Government has temporarily halved public transport ticket prices. An FBT exemption may not be necessary if that scheme, or similar direct subsidy schemes, were extended.

31. Inland Revenue does not hold detailed information on public transport fringe benefits currently provided by employers and the amount of FBT paid on these benefits, as employers are only required to provide one aggregate amount of all taxable benefits provided to their employees in their FBT returns. There is some limited historical data collected by Inland Revenue up to 2001.[3]

32. To get a better understanding of the level of public transport fringe benefits currently provided by employers, we asked BusinessNZ and the Corporate Taxpayers Group (CTG), whether their members are providing or are considering providing subsidised public transport to their employees.

33. This type of benefit did not seem to be something that many BusinessNZ members provided or considered at the moment. Challenges noted were the different

[3] Up to 2001 Inland Revenue collected benefit category data, including goods, services and subsidised transport accounting for 13% of FBT revenue at the time. We expect that much of this category was subsidised goods.

circumstances of employees for which it may or may not be a useful benefit and whether other fringe benefits, such as health insurance, might be of equal or more relevance.

34. CTG members largely stated they would be in favour of an FBT exemption for public transport and it would make more employers likely to consider public transport fringe benefits as an option. Those members who have attempted providing public transport benefits in the past have encountered significant compliance costs. They stated that it will be critical to the success of any exemption for public transport providers to have some type of simple approach for employers to use. Many CTG members have remote work sites and a public transport FBT exemption would not be of much help for their employees.

35. CTG members also provided details of car parks they have available and stated that, as a generalisation, other than remote sites, the provision of car parks is often restricted to being available for employees who need to park work vehicles in them or need to have a vehicle available for work related travel.

36. We have also talked to Auckland Transport and the Greater Wellington Strategy Group involved in transport planning about previous and current initiatives and pilots run with employers to partially or fully subsidise employees' public transport. There do not seem to be any large-scale initiatives. However, Auckland Transport is running a pilot with a few employers partially subsidising staff travel on public transport, using employee's travel (HOP) cards. This pilot is not marketed at the moment as it is not ready to be scaled up. Interest in the pilot seems to have been mainly triggered by changes in the parking situation of the employers' premises, for example a move to a location with little or no carparking or a significant increase in the cost of carparking.

37. The Greater Wellington Strategy Group has in the past facilitated discussions between a few employers, who were interested in encouraging a shift to public transport, and Snapper Services[4]. The employers then purchased prepaid electronic ticketing cards directly from Snapper Services or topped up employees' existing cards.

38. Another theme, both in talking to employer representative groups and transport providers, was that employers are investigating or already providing wider or alternative benefits, such as e-bikes, bicycles, and electric vehicles or a wider wellbeing programme consisting of health as well as environmental (including public transport) aspects. Often existing programmes work outside the FBT rules in that they involve remuneration or direct subsidies which are, like salary and wages, taxed under the pay-as-you-earn (PAYE) system rather than under FBT.

Objective

39. Current FBT rules may incentivise employers and employees to use private motor vehicles to travel to and from work over other more environmentally friendly modes of transport. The overall objective is to improve wider tax neutrality.

40. Removing the on-premises carparking FBT exemption has proved contentious in the past and you have indicated in a previous briefing note that no further policy work is to be done on applying FBT to more car-parking at this point in time. As suggested by the Tax Working Group, a way around the current impasse would be to expand the FBT exemptions to include employer-provided subsidisation of public transport as a more environmentally friendly form of transport.

[4] Snapper Services provides a public transport ticketing service for Wellington public transport.

41. The following part of the report therefore considers the option of exempting public transport fringe benefits from FBT against the status quo.

Summary analysis of options

Option	Pros	Cons	Environmental impact
1 – Status quo	No legislative change. Maintains consistency between public transport and other fringe benefits.	Car parks are subsidised when provided by an employer – encourages salary substitution.	Carpark "subsidy" encourages travel to and from work in private vehicle rather than using public transport. Current negative environmental impact maintained.
2 – Remove FBT from public transport fringe benefits	More balanced treatment between private cars (car parking) and public transport. Removes FBT incentive to using private cars over public transport.	Does not remove overall tax distortion. Creates inconsistent treatment between public transport and other fringe benefits, including other more environmentally friendly modes of transport such as cycling. Could incentivise calls for other FBT concessions. Could result in some salary substitution (tax saving of approximately $1,000 p.a. per person) which would mean a decrease in PAYE. Administrative complexity for employers in providing vouchers/ topping up electronic tickets might limit uptake by employers. Less relevant for employers located outside urban areas with sufficient public transport infrastructure.	Some behavioural change towards using public transport between home and work, which should reduce overall emissions and traffic congestion.

Conclusion

42. Inland Revenue and the Treasury officials' view is that the status quo would be preferable to exempting public transport fringe benefits from FBT. An exemption would create an additional economic distortion relative to other fringe benefits, including other modes of travel. Officials believe that an exemption would result in limited behavioural change as its application would be limited to situations where such fringe benefits are relevant to employers' location and employers' preparedness to offer them to their employees.

43. While some employers have stated that an FBT exemption is relevant to whether they would consider offering public transport fringe benefits, the uptake also seems to be dependent on public transport providers offering low compliance and administration cost solutions, which was stated as an additional barrier. If the Government wishes to increase public transport use, our preference would be for a direct policy to achieve this outcome (for example extending the recently announced measure to temporarily halve the cost of public transport to help counter the rising cost of living) rather than an indirect subsidy achieved through a tax concession.

What an exemption could look like

44. Should you wish to proceed with an FBT exemption for employer-provided public transport fringe benefits, this section outlines what an exemption could look like.

Scope and definition of public transport

45. There are some considerations as to the scope and definition of public transport. The boundaries between public, private and shared transport have become increasingly blurred and this trend is likely to continue in the future. However, we suggest adopting a traditional "narrow" scope and definition of public transport. This would include passenger transport by bus, train, ferry and tram that is available to the public, with set fares and that is run on fixed routes[5]. This scope would exclude air transport, taxis, shuttles and also other services that people share access to that is provided by service providers with a physical and/or digital infrastructure network, such as bike-sharing, ridesharing, and e-scooter hire.

Between home and work travel

46. We recommend the exemption is limited to transport to and from work. As the objective is to improve tax neutrality between car-parking on the employer's premises and public transport, limiting the exemption to between home and work travel would best achieve this neutrality. However, we note there may be some challenges around administration and compliance of this requirement in some situations, for example where the employer provides a monthly train pass.

Urban transport systems

47. There is also the question of whether the exemption should be limited to scheduled urban services as opposed to intercity rail and coaches. It has become more common for employees to live further away from their urban workplace. A limit may, for example, exclude commuters who are travelling to work in Wellington from Palmerston North (Capital Connection train services) or to work in Auckland from Hamilton (Te Huia train service). We therefore do not recommend limiting the exemption to urban transport systems.

Reporting of public transport fringe benefits

48. As previously stated, there is currently no requirement for employers to provide detailed information on fringe benefits they provide. Reporting in relation to public transport would be an unwelcome compliance cost for employers for something that is exempt from FBT. Therefore, we do not recommend additional separate reporting requirements for employers on the provision of public transport fringe benefits. This would, however, impact on Inland Revenue's ability to report back to Cabinet on uptake and effectiveness of the policy change.

Financial implications

49. Inland Revenue does not hold information on public transport fringe benefits currently provided by employers, so it is not certain what proportion of FBT is currently related to public transport.

50. A high-level estimate has been made based on historic New Zealand data, Australian data and feedback from the Corporate Taxpayer Group and BusinessNZ on public

[5] This scope is consistent with the definition of *public transport service* in section 5 of the Land Transport Management Act 2013.

transport fringe benefits. We estimate the fiscal cost of exempting public transport from FBT to be around $10 million per year. This represents an estimate of the amount currently paid under the status quo rules that would potentially be forgone with an exemption. It does not attempt to model a behavioural shift in future. We note that some Councils are either considering or are actively trialling reduced fare or fare-free public transport and one Auckland mayoral candidate stated a push for fare-free public transport will be the first thing he wants to achieve if elected in October. These would significantly reduce the revenue cost of a public transport FBT exemption (and potentially reduce the need for one).

51. The revenue cost could be funded through a Budget bid for Budget 2023 and included in the 2023 omnibus taxation bill to give effect to the exemption from 1 April 2024. This is officials' preferred funding and application date option. This is because it would allow the costs and benefits of the policy to be traded-off against the Government's other priorities and would follow standard legislative process. A 1 April 2024 application date represents a fiscal cost of $22.5 million over the forecast period.

52. If this initiative is considered through the Budget 2023 process, it could seek funding from:

- The Budget 2023 allowance, or
- The Climate Emergency Response Fund (CERF).

53. Should you prefer an earlier application date of 1 April 2023, there are two options set out below. A 1 April 2023 application date gives rise to a fiscal cost of $32.5 million over the forecast period.

54. One option is to submit a Budget 2023 bid and include legislation to give effect to an exemption in Budget night legislation. This would mean the legislative change would apply retrospectively to 1 April 2023 which could impose additional compliance costs on payroll providers. This is not expected to be significant as the legislation would be likely to pass approximately 2 months before the first quarter FBT is due.

55. The second viable option is a charge against the Tax Policy Scorecard. This would allow for the legislative change to give effect to an exemption to be included in the 2022 omnibus taxation bill with prospective application from 1 April 2023.

56. It is arguable whether the revenue implications of these changes should be counted against the Tax Policy Scorecard. An FBT exemption for public transport may not fit within the requirement that changes must be "intended to improve the tax system itself" (IR2021/551 refers). However, because an exemption for public transport would partly remedy the distortionary effects of the existing FBT treatment of carparks, a case could be made for Scorecard funding. As at the current date the scorecard balance stands at approximately $180 million over the forecast period.

57. The Treasury has advised that this change does not meet the criteria for a pre-commitment against the Budget 2023 allowance, as it does not have to be progressed urgently. Likewise, the Treasury does not advice the use of the Between-Budget-Contingency for this initiative.

58. These considerations provide further justification for considering the initiative through the Budget 2023 process.

Administrative implications

59. Administrative implications are likely to be small and would largely depend on the final design of a potential exemption.

Consultation

60. As outlined earlier in this report officials have talked to Auckland Transport and the Greater Wellington Strategy Group about relevant schemes and pilots. Officials have also consulted the Corporate Taxpayers Group and BusinessNZ on public transport fringe benefits provided or their interest in providing them in future.

61. The Treasury was consulted on the content of this report and agrees with the advice and recommendations. We agree that there is a case to be made that this policy corrects the environmental non-neutrality in relation to the exemption from FBT for on-premises car parks. However, the Treasury's assessment is that the potential for emissions reductions is likely to be very limited. On balance, other policies to reduce transport emissions and encourage public transport use, such as those in the Emissions Reduction Plan, are likely to have better value for money. The Treasury also notes that the distributional impacts of the policy are likely to be skewed towards workers at large employers in major cities, as there is unlikely to be interest in offering a public transport fringe benefit among small and/or regional businesses.

62. The Ministry of Transport was consulted on this report and favours exempting employer-provided public transport from FBT. In their view such an exemption is needed to improve neutrality in the application of FBT, which currently encourages the use of motor vehicles. In their view neutrality is eroded not only by the exemption for employer-provided carparks noted in this paper, but also through the way FBT applies to work-related vehicles.

63. Further, the transport chapter of the Emissions Reduction Plan that has recently been approved by Cabinet includes the target to:

    "Reduce total vehicle kilometres travelled by the light vehicle fleet by 20 percent by 2035 through improved urban form and providing better travel options, particularly in our largest cities."

64. The Ministry of Transport's view is that an FBT exemption for public transport would usefully complement other initiatives in facilitating the mode shift needed to achieve this target.

65. We note that there is a separate policy project underway reviewing the FBT treatment of work-related vehicles.

Next steps

66. Depending on your preferred option, we would provide you with a draft Cabinet paper reflecting your decisions.

67. We recommend that a copy of this report is referred to the Minister of Transport.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: GST status of statutory and regulatory charges

Date:	28 April 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/191

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Refer** a copy of this report to the Minister of Finance	11 May 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Graeme Morrison	Policy Lead, Indirect Tax	s 9(2)(a) [redacted]
Ben Smith	Senior Policy Advisor	

28 April 2022

Minister of Revenue

GST status of statutory and regulatory charges

Executive summary

Purpose

1. This report seeks your agreement to a new rule in the Goods and Services Tax Act 1985 (the GST Act) to confirm the GST treatment of statutory and regulatory charges. The proposed rule would address the current inconsistent and incoherent approach to how GST applies to statutory and regulatory charges. It could be included in the omnibus tax bill scheduled for introduction in August 2022.

Context and background

2. In this report, the term "statutory and regulatory charges" refers to any amount payable under an enactment or a regulation. The term is intended to be wide ranging and applies to all circumstances where a person would be required under an enactment or a regulation to make a payment (whether to a government department or other entity). Examples include fees and charges paid to government agencies for goods and services (such as for licencing, permits, and registration), taxes paid to Inland Revenue and Customs, and various levies paid to fund the activities, goods (including club goods) and services performed by various bodies.

3. GST applies to the broadest possible range of goods and services supplied in New Zealand. This keeps the tax simple, fair, and efficient. Consistent with this principle, GST also applies to the activities of the Crown. This means that government departments account for GST on the funding received through appropriations (which represent consideration from the Crown for the supply of outputs from government departments). Government departments also charge GST on supplies of goods and services they make, which helps ensure pricing neutrality with the private sector. It also simplifies compliance by avoiding some of the complications seen in other countries where apportionment is needed between non-taxable non-commercial activities and commercial taxable activities.

Problem definition

4. For GST to apply, there must be a consideration, and that consideration must be "in respect of, in response to, or for the inducement of" an identifiable supply of goods and services. It does not matter if the consideration is voluntary or not. Because GST is deliberately broad based, it is usually assumed that GST applies to most supplies of goods and services in New Zealand.

5. For some statutory and regulatory charges, however, there is a high degree of uncertainty as to the correct GST treatment. These are statutory and regulatory charges, often referred to as "levies", that are used to fund particular government objectives or functions, including providing club goods and public goods.

6. Levies can be contrasted with general taxes (like income tax) because, unlike general taxes, they are generally earmarked for particular purposes (such as recovering the costs of performing particular statutory functions), and there is often no direct link between the levy and identifiable goods and services being supplied. The levy will usually be set on the basis that the levy payer is part of a club of beneficiaries or regulated parties in respect of the relevant regulatory system. The fact that there is no clear rule in the GST Act that applies to all statutory and regulatory charges results in a degree of interpretative uncertainty on how GST should apply to them, if at all, and creates potential inconsistencies and an associated fiscal risk.

7. This uncertainty arises because the law does not always produce outcomes consistent with what we consider desirable from a GST policy perspective. For example, without a specific rule in the GST Act for rates payable to local authorities, it is arguable whether, under the general rules, GST would apply. This is also the case for many other statutory and regulatory charges and, because of this, the GST Act also contains various other specific deeming rules intended to confirm that GST does apply to specifically named statutory and regulatory charges.

8. The approach taken by tax policy officials at Inland Revenue and the Treasury to date has been to engage with other government agencies during the policy development of new statutory and regulatory charges to make sure the GST implications are clear from the beginning. This approach often results in amendments being made to the GST Act to ensure the appropriate GST policy outcome applies. This piecemeal and reactive approach has always carried a risk that some statutory and regulatory charges will come into force without the GST implications being properly considered. This is undesirable because it can result in a non-deliberate inconsistent (and incoherent) application of GST to statutory and regulatory charges.

Proposed solution

9. In IR2021/060 where you agreed to the GST policy work programme, we noted that a solution to this problem was to introduce an amendment to the GST Act which contained a default rule for all statutory and regulatory charges. We noted that default rule could provide that:

   9.1 All levies, fees, and charges ("**charges**") that are payable under an enactment or a regulation represented consideration for a supply from the recipient of the charge.

   9.2 Exceptions would exist where the charges were in the nature of fines, penalties, interest, or general taxes. This is because these types of charges do not typically represent consideration for the supply of goods or services.[1]

   9.3 The GST Act could also include a schedule of non-taxable statutory and regulatory charges that could cater for circumstances where this default rule was not appropriate.

Outcome

10. This proposal would ensure a consistent approach in the future to GST on statutory and regulatory charges and that piecemeal changes to the GST Act would no longer be required whenever a new statutory or regulatory charge was introduced. It would also provide greater certainty for government agencies on the GST status of statutory and regulatory charges they have administrative responsibility for.

[1] Though in some circumstances, fines and penalties can be an increase of the consideration for the goods and services and in these situations GST should continue to apply.

11. The impact of the approach outlined in this report on taxpayers, government agencies, and Inland Revenue, is expected to be minimal. This is because for many statutory and regulatory charges that correspond clearly to a supply of goods or services, GST is already being collected. For example, local authority rates, road user charges, and fuel excise are currently subject to GST. If the proposal in this report resulted in the cost of specific statutory or regulatory charges increasing to account for GST, the cost of this would only be noticed by persons who are not registered for GST (as persons registered for GST will generally be able to claim a GST credit for expenses incurred in relation to their taxable activity).

12. To provide sufficient time for any necessary changes to be made by other government agencies, we recommend a phased implementation approach where any new (and renewed or amended) statutory and regulatory charges that came into force on and after 1 July 2023 would be subject to this new rule. All other charges would need to be compliant with the new rule by 1 July 2026.

13. If you agree with the approach outlined in this report, we recommend that taxpayers and the Commissioner of Inland Revenue be prevented from amending previous GST assessments in a way that would give effect to an assessment that is inconsistent with the approach outlined in this report. If this is not done, there is a risk that taxpayers could seek to claim GST refunds on statutory and regulatory charges where GST was collected in the past, which could pose a significant revenue risk to the Crown.

14. The proposal in this report will not come at a fiscal cost. There are also no direct financial implications arising from the approach outlined in this report. The proposal could increase tax revenues if it resulted in GST being collected on statutory and regulatory charges where no GST is currently being collected, but only to the extent that the persons paying those charges were not able to claim a GST credit for the expense (which they would be able to if the charges were paid by GST registered persons in relation to their taxable activities).

Consultation

15. We have had early discussions with several private sector GST experts on the proposal outlined in this report. Most considered the approach made sense in the context of New Zealand's GST system. One expert considered deeming rules should generally be avoided as a matter of principle, and therefore did not support our recommended approach.

16. We also consulted with the Ministry of Business, Innovation and Employment, the Ministry of Justice, the Ministry of Transport, the Ministry for Primary Industries, and the Department of Internal Affairs. These agencies have administrative responsibility for the most statutory and regulatory charges. No material issues were identified as part of this consultation.

17. The Treasury and the Parliamentary Counsel Office were also consulted and agree with the approach outlined in this report.

Next steps

18. Subject to your agreement, we can prepare material for inclusion in a draft Cabinet paper that will seek agreement from Cabinet on several tax policy issues to be included in the August 2022 omnibus tax bill.

Recommended action

We recommend that you:

(a) **agree** that GST should, by default, apply to all statutory and regulatory charges (being amounts payable under an enactment or a regulation) other than charges that are:

i. fines, penalties (unless they represent an increase in the consideration for goods and services), and interest

ii. general taxes (such as income tax), or

iii. specifically listed in a schedule of non-taxable statutory and regulatory charges to the Goods and Services Tax Act 1985.

Agreed/Not agreed

(b) **agree** that this default rule should apply to all new statutory and regulatory charges that come into force, or are renewed, on or after 1 July 2023.

Agreed/Not agreed

(c) **agree** that for all other statutory and regulatory charges, the new default rule should apply from 1 July 2026.

Agreed/Not agreed

(d) **agree** that neither taxpayers themselves, nor the Commissioner of Inland Revenue, should be able to amend GST assessments in a way that would be inconsistent with the outcomes outlined in this report.

Agreed/Not agreed

(e) **agree** to a transitional regulation making power that would expire on 30 June 2026, enabling an Order in Council on the recommendation of the Minister of Revenue to add specifically named charges to the list of non-taxable statutory and regulatory charges.

Agreed/Not agreed

(f) if you agree to the recommendations in paragraphs (a) to (e), **agree** that amendments giving effect to these decisions should be included in the August 2022 omnibus tax bill.

Agreed/Not agreed

(g) **note** that if you agree to the recommendations in paragraphs (a) to (e), we will include this proposal in a draft Cabinet paper that seeks agreement to minor tax policy issues to be included in the August 2022 omnibus tax bill.

Noted

(h) **note** that there are no direct fiscal implications as a result of the decisions taken in paragraphs (a) to (c).

Noted

(i) **note** that to the extent that the proposed approach resulted in statutory and regulatory charges increasing in cost to account for GST, and where those charges were not paid by persons registered for GST as part of their taxable activity, there would be an unquantifiable positive fiscal impact.

Noted

(j) **refer** a copy of this report to the Minister of Finance for his information.

Referred/Not referred

Graeme Morrison
Policy Lead, Indirect Tax
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

Background

19. New Zealand's broad-based GST system means that, in most circumstances, determining whether a supply of goods or services is subject to GST is clear. Consistent with the broad-based approach, it was a deliberate policy decision when GST was introduced that all activities undertaken by the government involving the supply of goods and services would also be subject to GST. This was to ensure price neutrality with the private sector, and to avoid complex boundary issues that arise where distinctions are drawn between commercial (taxable) activities and non-commercial (non-taxable) activities taken by the government.

20. There are, however, some situations where the answer is not always clear, or where the law does not align with outcomes considered desirable from a GST policy perspective. This is particularly evident where the statutory or regulatory charges resemble "levies", which are typically used to fund specific government objectives or purposes. For these cases, the high degree of uncertainty can result in inappropriate GST outcomes.

21. There are two main arguments advanced for why GST should not (or would not, under existing law) apply to statutory and regulatory charges. These arguments are:

    21.1 Firstly, that the payment is not "in respect of, in response to, or for the inducement of" any identifiable supply of goods or services. While the definition of "consideration" in the GST Act is expressed in the broadest possible terms, for GST to apply that consideration still needs to correspond to an identifiable supply of goods and services. Sometimes it is difficult to identify the supply, or it is argued that the payment is not *for* the supply because the thing that the payment is being used to fund would be provided whether payments are made or not.

    21.2 Secondly, that the absence of a specific legislative rule that would indicate Parliament had intended for GST to apply means that GST is not intended to apply. The GST Act has a broad definition of "supply", but there are also specific "deeming rules" that are enacted to ensure that GST applies to deemed supplies. An example of a deemed supply is the rule that provides that rates payable to local authorities are for a deemed supply of goods and services from the local authority. Other examples exist in the context of several statutory and regulatory charges (such as road user charges, fuel excise, and the waste minimisation levy). The absence of a specific rule therefore could imply that it is intended that GST does not apply to statutory and regulatory charges that would not be subject to GST without a provision deeming there to be a supply of goods or services for GST to attach to.

22. While these arguments can be successful from a legal perspective, we consider they result in inappropriate outcomes from a GST policy perspective. This is why it is not uncommon that when new statutory and regulatory charges are introduced, we recommend corresponding amendments are made to the GST Act to make the GST implications of these charges clear. Inland Revenue is not made aware of every new statutory or regulatory charge from the early stages of its policy development, and this can make it difficult to advise on the GST implications from a tax policy perspective.

23. The courts have not directly considered the GST treatment of statutory and regulatory charges. The courts have, however, considered whether certain payments have corresponded to a supply of goods and services (and would therefore be subject to GST). The approach taken by the courts in these cases has, at least in part, informed recommendations from tax policy officials that explicit deeming provisions be inserted in respect of specific statutory and regulatory charges.

Problem definition

24. Under current law the GST treatment of many statutory and regulatory charges is often unclear or does not align with intended GST policy outcomes. The problem arises because, for GST to apply, there needs to be an identifiable supply of goods or services, and that supply needs to arise from a consideration (for example, a payment) that was "in respect of, in response to, or for the inducement of" that supply. This is the general rule.

25. In some circumstances, unless the GST Act contains a specific provision that makes the GST treatment clear, the general rule can result in GST not applying to statutory and regulatory charges because there is either an insufficient connection between the payment and a supply of goods and services, or it is difficult to identify the specific supply of goods and services.

26. The approach taken to date has been for piecemeal amendments to be made to the GST Act to ensure appropriate GST policy outcomes for specific statutory and regulatory charges. For example, a specific deeming provision was added to ensure that GST applied to the levy payable under the Infrastructure Funding and Financing Act 2020 which is used to fund infrastructure for housing and urban development. This approach lacks transparency and has resulted in uncertainty and non-deliberate inconsistencies in how GST applies to statutory and regulatory charges.

27. This approach also means that there are various statutory and regulatory charges that have similar characteristics but with varying GST treatments. This is not intentional. It is likely that the reason the differences in treatment has not been questioned is because the persons that pay the charges are generally registered for GST and therefore remain indifferent as to the GST treatment (on the basis they can claim a credit of the GST they incur when they pay the charges).

Framework

28. We consider the case for GST applying to statutory and regulatory charges used to fund specific government objectives or purposes (including the activities of regulatory bodies) is principled from a GST policy perspective on several grounds.

29. Firstly, to maintain a broad-based GST system, it needs to apply to the broadest possible range of goods and services supplied in New Zealand. If there are certain situations where GST does not apply in relation to the supply of goods and services, this could undermine the broad-based nature of New Zealand's GST system. There is no doubt that the payment of statutory and regulatory charges (excluding fines, penalties, and interest) enables goods or services to be produced or performed.

30. For example, a number of regulatory bodies receive funding from statutory or regulatory charges and rely on that funding to perform their services for the benefit of the public or specific groups.[2] If that funding were unavailable, those services and functions would need funding from other sources, such as general taxes, or it would not be possible for them to operate. On this basis alone it seems clear that GST should apply to statutory and regulatory charges that are used to fund goods and services.

31. Secondly, we note that other funding sources (such as appropriations from the Crown, grants, and sales revenues) are in most cases subject to GST. If GST were not to apply to statutory and regulatory charges as a specific funding mechanism, this could create a tax bias towards using statutory and regulatory charges that are not subject to GST as funding schemes.

[2] Examples include the Financial Markets Authority and the many organisations that represent and provide education, training, market development, research and development services to commodity growers in New Zealand.

Proposed solution

32. We have considered various options to improve the coherence and consistency of how GST applies to statutory and regulatory charges. This includes whether we could raise awareness of the GST implications through broader cross-agency consultation and/or through making resources that could be made available alongside guidance from the Treasury, the Parliamentary Counsel Office, and the Department of the Prime Minister and Cabinet on the tax implications of new policy proposals that involve statutory and regulatory charges.

33. The issue with these approaches is that they do not directly address the problem that is caused by existing GST legislation, where, without new legislative provisions for specific statutory and regulatory charges, the law does not always produce outcomes consistent with what we consider appropriate from a GST policy perspective.

34. We therefore recommend the GST Act be amended to contain a default rule for statutory and regulatory charges. This would follow the approach taken to date in respect of statutory or regulatory charges which have been specifically added to the GST Act and would stop the need for piecemeal amendments in respect of new charges in the future.

35. The default position would provide that statutory and regulatory charges (excluding fines, penalties, interest, general taxes, and other amounts listed on a schedule of non-taxable statutory and regulatory charges in the GST Act) were deemed to be consideration for a supply of goods and services from the recipient of the charges.

36. This would resolve the current doubt that can arise when determining whether specific statutory and regulatory charges do give rise to a supply of goods and services in GST terms. This approach also ensures that the GST rules for determining whether a supply of goods and services is standard rated (most goods and services supplied in New Zealand), exempt (such as residential accommodation or financial services), or zero-rated (such as exports), would continue to apply.

37. The rationale for excluding charges in the nature of fines, penalties, and interest is because these amounts do not represent consideration – even in an indirect sense – for the supply of goods and services. Fines and penalties are generally forms of financial punishment imposed for carrying out some kind of prohibited activity. They do not relate to the supply of goods or services and therefore should not be subject to GST. Sometimes fines and penalties represent an increase in the consideration for the supply of goods and services and in these situations they should continue to be subject to GST. Interest is the cost of borrowing money and is treated as a supply of financial services, which is generally exempt from GST.

38. In theory GST could apply to income tax, taking the breadth of the GST system to its fullest extent. This is because the government uses revenue raised from income tax to fund goods and services like education, healthcare, and other social services. This point was acknowledged in the Report of the Advisory Panel on Goods and Services Tax to the Minister of Finance in June 1985. The report also noted that in practical terms it would be unnecessary for GST to apply to income tax because the government, with the support of the House of Representatives, could change income tax rates if it considered it necessary to do so.

Application date and phased implementation

39. We recommend that this default rule apply to all new statutory and regulatory charges (including those that are renewed or amended through new regulations) that come into force on or after 1 July 2023. This is at least three months after the expected enactment of the Bill that could contain the amendments.

40. For other statutory and regulatory charges that are not periodically renewed, we recommend that the default rule apply from 1 July 2026. This provides a three-year window for government agencies and Ministers to progress the necessary changes to the relevant Acts and regulations to ensure compliance with the new rule.

41. We note that a number of deeming provisions in the GST Act would no longer be required if this new default rule were enacted. These provisions should therefore be repealed from 1 July 2026. We would identify the provisions that could be repealed as part of the drafting of the bill.

Risks and mitigations

42. There are three main risks associated with the approach outlined in this report:

  42.1 The default rule applying to statutory and regulatory charges that should not be subject to the rule, but which are not charges in the nature of fines, penalties, interest, or general taxes.

  42.2 The compliance costs associated with updating statutory and regulatory charges to ensure they comply with the new rules.

  42.3 Taxpayers (or practitioners) seeking refunds of GST paid on historic statutory and regulatory charges.

The breadth of the proposed default rule

43. There may be circumstances where the default rule should not apply. To the extent they may not be known in advance, we expect these will be identified in the transitional period between the enactment of the bill that contains the default rule and the date that the default rule applies to all statutory and regulatory charges (which we propose is 1 July 2026).

44. To help mitigate this risk, we recommend that the GST Act include a new schedule of non-taxable statutory and regulatory charges which names specific charges to which the default rule would not apply. This schedule could be amended through primary legislation in the future if it were considered necessary to exclude new statutory or regulatory charges from the ambit of the default rule.

45. We also recommend that a transitional regulation making power is enacted to facilitate an orderly implementation of the new rule. The power would apply to statutory and regulatory charges established under empowering provisions enacted before the 1 July 2023 application date. In respect of these changes, an Order in Council may be made to update the schedule of non-taxable statutory and regulatory charges during the transitional period. The exact test will need to be further developed as part of drafting the bill, but the working approach is that the Minister of Revenue may recommend an addition to the schedule if satisfied that:

  45.1 the charges are in the nature of fines, penalties, interest, or general taxes; and

  45.2 the charges are not intended to fund the cost of providing specific government objectives or purposes.

46. We recommend that this transitional regulation making power expire on 30 June 2026 to coincide with the proposed default rule applying to all statutory and regulatory charges. After 30 June 2026, we note that the schedule of non-taxable statutory and regulatory charges could be updated through amendments contained in primary legislation if required. In these circumstances, the Minister of Revenue and tax policy officials would be able to consider whether it was appropriate that the schedule be amended or not.

Ensuring sufficient time to update charges

47. Another risk with the approach outlined in this report is that government agencies would need to update existing statutory and regulatory charges for which they have administrative responsibility where GST was not currently being collected, and where those charges did not fit within the exceptions framework proposed (that is, the charges were not in the nature of fines, penalties, interest, general taxes, or otherwise specifically excluded).

48. This process could take a significant amount of time because changes to statutory and regulatory charges would generally need to be made through Cabinet and, in the case of regulations, the Executive Council, or in the case of charges set in statute, through the House of Representatives. We acknowledge that these changes are not likely to be of a high priority.

49. The phased implementation approach outlined in paragraphs 39 to 41 should mitigate this risk. Our initial assessment of New Zealand Acts and regulations indicates that there would only be a small number of statutory and regulatory charges that would need to be updated to become compliant with the approach outlined in this report. There are more than 250 statutory and regulatory charges, however, and it has not been possible to review the GST treatment of every single one.

GST refund claims for historic assessments

50. There is also a risk that these amendments prompt taxpayers to reconsider the positions they have taken in earlier GST assessments, where they have collected and returned GST on statutory and regulatory charges that they could attempt to argue was not required under the law.

51. To prevent this risk from crystallising, and given the potential significant revenue risk, we recommend the GST Act be amended to prevent taxpayers and the Commissioner of Inland Revenue from amending historic GST assessments if the amendment would produce a result that is inconsistent with what is outlined in this report. This would, in effect, preserve the positions taken by taxpayers in GST assessments up until the date the amendments discussed in this report were enacted.

Impact analysis

Financial implications

52. The proposal in this report would see GST applying, as a default position, to newly created statutory and regulatory charges, including those that are renewed or amended (except those that resembled charges in the nature of fines, penalties, interest, and general taxes, or which were listed on the proposed schedule of non-taxable statutory and regulatory charges) on or after 1 July 2023.

53. The fiscal impact of the proposal is impossible to determine without knowing what new statutory or regulatory charges are currently being considered or developed, and whether the charges would be paid by GST registered persons as part of their taxable activity or not.

54. There may be financial implications for existing statutory and regulatory charges where there is currently no GST being collected. To the extent that these charges exist, and which would under the proposal now become liable for GST, there would likely be an increase in tax revenue where the charges were paid by persons who were not registered for GST.

55. For charges that are not new (or renewed, or amended), GST would apply from 1 July 2026, and so any fiscal impact as a result of GST now applying to them would be outside the forecast period.

56. Another possible impact is that it may be decided to exclude certain statutory or regulatory charges from GST by adding them to the proposed schedule of non-taxable statutory and regulatory charges. This would likely have a fiscal cost which would need to be recognised at the time these decisions were made.

57. As discussed in paragraphs 50 and 51, there is also a potential fiscal risk in relation to historic GST assessments, where taxpayers may seek GST refunds of GST charged on statutory and regulatory charges prior to the proposed default rule coming into force. It is for this reason that we recommend that neither taxpayers, nor the Commissioner of Inland Revenue, be able to amend previous GST assessments in such a way that would result in outcomes inconsistent with the proposed approach in this report.

Administrative implications

58. There are no material administrative implications of the proposal outlined in this report. Inland Revenue would communicate the changes and continue to support other government agencies understand the GST implications of new statutory and regulatory charges as and when required.

59. At the margins, the proposal should reduce administration costs for Inland Revenue and other government agencies because the GST status of new statutory and regulatory charges would be clear and understood from the early stages of policy development.

Compliance implications

60. The compliance implications of the approach outlined in this report are expected to be minimal.

61. Government agencies and others responsible for administering statutory and regulatory charges would need to start charging GST on amounts they collect to the extent GST was not already being charged. The three-year transitional period should provide sufficient time for those without the necessary systems in place to make the alterations to their systems to become compliant. For charges to be updated, as noted, either new Orders in Council will need to be submitted through the Executive Council, or primary legislation will need amending.

62. For payers of statutory and regulatory charges the compliance implications will depend on whether the payer is registered for GST or not (and, if they are, whether the charges being paid relate to their taxable activity). If the charges are paid by GST registered persons in relation to their taxable activity they will generally be able to claim a credit for the GST component of the charge, so there is no change in cost as a result of GST applying.

63. For payers who are not registered for GST, to the extent that the rule proposed in this report would require GST to be charged on statutory and regulatory charges where no GST is currently being collected, there would generally be an increase in costs. We have not identified any charges that are not currently subject to GST, and which are paid by a large group of persons. Common examples, such as local authority rates, road user charges, and fuel excise, are all currently subject to GST.

Consultation

64. We have had early discussions with GST experts from Deloitte, KPMG, and PwC. All but one stakeholder supported the approach outlined in this report. The stakeholder that did not support the approach disagreed with deeming rules in the GST Act more generally. For the reasons we have noted in this report, we consider the proposed approach is preferable to the status quo, where the same outcomes discussed in this report would generally be achieved through specific amendments to the GST Act each time a new statutory or regulatory charge is introduced.

65. We also consulted with the top five government agencies by volume of statutory and regulatory charges. The Ministry for Primary Industries has administrative responsibility for commodity levies, which represent a considerable proportion of regulatory charges. Commodity levies are generally expressed as being subject to GST currently and therefore the proposed approach in this report will have no impact on the Ministry for Primary Industries as it merely aligns the GST Act with existing practice.

66. The Ministry of Justice has administrative responsibility for the Sentencing Act 2002 which includes a statutory charge that would be affected by the proposed approach in this report. The specific charge is the Victim Offender Levy, which is $50, payable on conviction of a crime, imposed by a court, and used to fund victim support services. From a GST policy perspective, we consider this levy should be subject to GST, but collecting GST on the levy without adjusting the amount would affect the Ministry of Justice's funding. This is an example of why a phased implementation approach is preferable as it ensures there is appropriate time for these sorts of issues to be resolved.

67. The Ministry of Transport, the Ministry of Business, Innovation and Employment, and the Department of Internal Affairs raised no issues during consultation.

68. The Treasury and the Parliamentary Counsel Office (PCO) agree with the approach outlined in this report.

69. PCO agrees that the application of GST to government charges is currently unclear, and this lack of clarity regularly causes issues in drafting primary and secondary legislation. The introduction of a new default position will remove this uncertainty. It will also enable PCO to develop and use standard drafting for provisions relating to charges, as the underlying GST position will be clear. PCO also strongly supports removing the individual deeming provisions from the GST Act at the same time as the default rule is introduced: the retention of these artefacts would perpetuate residual uncertainty and inaccessibility in the law.

Next steps

70. If you agree to the approach outlined in this report, the next step would be to seek Cabinet approval to include amendments to the GST Act in the upcoming omnibus tax bill scheduled for introduction in August 2022.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Remedials for foreign trusts: policy approval

Date:	5 May 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/079

Action sought

	Action sought	Deadline
Minister of Revenue	**Endorse** the agreement of the Parliamentary Under-Secretary to the Minister of Revenue to the recommendations in this report **Agree** to include approved changes in upcoming Bill	18 May 2022
Parliamentary Under-Secretary to the Minister of Revenue	**Agree** to recommendations **Refer** this report to the Minister of Revenue	16 May 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Sam Rowe	Acting Policy Lead	s 9(2)(a)
s 9(2)(a)	Principal Policy Advisor	

5 May 2022

Minister of Revenue
Parliamentary Under-Secretary to the Minister of Revenue

Remedials for foreign trusts: policy approval

Executive summary

1. This report seeks your decisions on the remedial changes to the foreign trust disclosure rules we propose following recent external consultation. The proposed changes are remedial in nature and do not have any fiscal implications. None are material enough to require Cabinet approval.

2. The Treasury has been consulted on this report.

Proposed remedials

3. Foreign trusts are not subject to New Zealand income tax on foreign income. In 2017, the disclosure requirements for foreign trusts were substantially strengthened in response to concerns these trusts were being used to avoid foreign income tax. Foreign trusts with a New Zealand resident trustee were required to register with Inland Revenue and make certain disclosures if they wanted their foreign-sourced income to be exempt from New Zealand taxation.

4. On 22 February 2021, you approved the release of an external consultation letter on 10 proposed foreign trust remedials (IR2021/036 refers). Several of those remedials have minor fiscal implications and will be included in an omnibus report for approval by the Minister of Finance and Minister of Revenue.

5. The remaining remedials without fiscal implications are:

- **Issue 1**: Currently, some trusts that are not technically "foreign trusts" can use the tax exemption for foreign income without complying with the foreign-trust disclosure rules. This is due to an issue with the definition of a "foreign trust" and is contrary to the policy intent. We propose to align the disclosure requirements with the use of that tax exemption by enacting a new definition (such as "foreign disclosing trust") and making consequential changes.

- **Issue 2**: There is no explicit power to deregister foreign trusts. We propose to explicitly grant the Commissioner of Inland Revenue (*CIR*) the power to deregister a foreign trust on her own initiative or on application by the trustee.

- **Issue 3**: We propose to clarify that trustees will have to provide the same information and signed declaration for new settlors (settlors after the trust is registered) as that required for settlors existing at the time of registration.

- **Issue 4**: Final beneficiaries are beneficiaries that have a right to any remaining trust property when the trust is wound up. We propose to clarify that final beneficiaries should be treated like discretionary beneficiaries for the purposes of the disclosure rules. This will mean that they are subject to the lighter disclosure requirements that apply to discretionary beneficiaries, instead of the more detailed requirements that apply to fixed beneficiaries.

- **Issue 5**: We propose to require trustees to update information provided in an annual return when it changes (consistent with the requirement to update information provided on registration when it changes).

6. In addition to the above, we propose to fix some minor drafting and cross-referencing issues.

Next steps

7. We will include any approved remedials in the upcoming Taxation (Annual Rates for 2022-23, Integrity Measures, and Remedial Matters) Bill scheduled for introduction in August 2022 (*August Bill*).

Recommended action

We recommend that you:

Recommendations for the Parliamentary Under-Secretary to the Minister of Revenue

1. **agree** to align the foreign trust disclosure requirements with the use of the foreign-sourced income exemption

Agreed/Not agreed

2. **agree** to explicitly grant the CIR the power to deregister a foreign trust, either on her own initiative or on application by the contact trustee

Agreed/Not agreed

3. **agree** to clarify that trustees have to provide the same information and signed declaration for new settlors as for existing settlors

Agreed/Not agreed

4. **agree** that final beneficiaries should be subject to the lighter disclosure requirements that apply to discretionary beneficiaries, instead of the more detailed disclosures required for fixed beneficiaries

Agreed/Not agreed

5. **agree** to require trustees to update information provided in an annual return when it changes

Agreed/Not agreed

6. **agree** to minor drafting and cross-referencing changes, including:

- replacing references to a trustee "in the business of providing trustee services" with "professional trustee",
- replacing references to beneficiaries of "fixed trusts" and "discretionary trusts" with references to beneficiaries with a fixed or discretionary interest in a trust,
- including the foreign trust disclosure rules in the definition of "trust rules" in the Income Tax Act 2007,

- requiring disclosure of a minor beneficiary's "date of birth" instead of their "age",
- fixing cross-reference errors, and
- changing the term "resident foreign trustee" to "resident trustee".

Agreed/Not agreed

7. **refer** this report to the Minster of Revenue

Referred

Recommendations for the Minister of Revenue

8. **endorse** the agreement of the Parliamentary Under-Secretary to the Minister of Revenue to the recommendations made above.

Endorsed/Not endorsed

9. **agree** that the approved changes will be included in the Taxation (Annual Rates for 2022-23, Integrity Measures, and Remedial Matters) Bill scheduled for introduction in August 2022.

Agreed/Not agreed

s 9(2)(a)

s 9(2)(a)
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue

/ /2022

Dr Deborah Russell
Parliamentary Under-Secretary to the Minister of Revenue

/ /2022

Background

1. Since 1987, NZ has taxed trusts according to the settlor's tax residence. The worldwide income of a trust with an NZ resident settlor is therefore subject to NZ tax, even if the trustees are non-residents. Conversely, a trust that has never had an NZ resident settlor is only subject to NZ tax to the extent its income is NZ-sourced, even if its trustees are NZ residents.

2. In 2016, the leak of the Panama Papers led to concerns that foreigners were setting up trusts in NZ to avoid or evade foreign tax in their home jurisdictions. This was possible because, at the time, NZ's disclosure requirements for trusts were very light. A Government Inquiry led by John Shewan, which resulted in the Shewan Report, found that the existing foreign trust disclosure rules were inadequate and recommended changes to address the issues it identified.[1]

3. Following the Shewan Report, in 2017 changes were made to the Tax Administration Act 1994 (*TAA*) to increase the disclosures required of foreign trusts with NZ resident trustees (*the 2017 changes*). Since those changes have been applied, officials have identified remedial issues which require legislative amendments.

The proposed remedials

4. On 22 February 2021, you approved the release of an external consultation letter on 10 proposed foreign trust remedials (IR2021/036 refers). Several of those remedials had minor fiscal implications and will be included in an omnibus report for approval by the Minister of Finance and Minister of Revenue. The remaining remedials are included in this report and do not have fiscal implications. None of the remedials are material enough to require Cabinet approval.

5. The consultation letter was released in March 2021. Twelve submissions were received. This report summarises the results of that consultation and provides our recommended changes (if any) to the proposed remedials.

6. We recommend including any approved remedials in the Taxation (Annual Rates for 2022-23, Integrity Measures, and Remedial Matters) Bill scheduled for introduction in August 2022 (*August Bill*). We propose that all remedials should apply from the date of enactment of the August Bill.

Issue 1: Definition of "foreign trust" not aligned with foreign-sourced income exemption

7. As noted above, NZ taxes trusts based on the settlor's tax residence. This is done through a foreign-sourced income exemption in the Income Tax Act 2007 (*ITA*).

8. For a "foreign trust" to use the foreign-sourced income exemption, it has to comply with the foreign trust disclosure requirements. However, some trusts can use the foreign-sourced income exemption without technically being a "foreign trust" and therefore without complying with the foreign trust disclosure rules.

9. This is because the foreign-sourced income exemption works by exempting trusts that meet certain requirements (including not having an NZ resident settlor)[2] for a given *income year*. The exemption has always worked in this way as the ITA considers income on a yearly basis. It envisages that settlors may migrate to and from NZ, and taxes accordingly.

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[1] *Government Inquiry into Foreign Trust Disclosure Rules* (June 2016) <www.treasury.govt.nz> ('the Shewan Report').

[2] In some cases, a trust with an NZ resident settlor in the income year may still qualify for the foreign-sourced income exemption if the settlor was a transitional resident during that year.

10. In contrast, the definition of a "foreign trust" does not envisage settlors' circumstances changing. A trust will only be a foreign trust if it has not had an NZ resident settlor since 1987, when the current tax regime for trusts was introduced. As a result of this misalignment, some trusts can fall outside the definition of a "foreign trust" but still use the foreign-sourced income exemption.

11. A trust that has previously had a NZ resident settlor, but not one in the relevant income year, may qualify for the foreign-sourced income exemption. But such a trust will not technically be a "foreign trust". It will not have to, and indeed cannot, comply with the foreign trust disclosure rules, which only apply to "foreign trusts". (These trusts generally will not have to comply with the domestic trust disclosure rules introduced in 2020 either, if they do not have any NZ-sourced income.) This is contrary to the policy intent. The Shewan Report recommended that the foreign-sourced income exemption should only be available to "foreign trusts" that have registered and met their disclosure obligations.[3]

Consultation

12. To resolve this issue, the March consultation letter proposed to enact a new definition (such as "foreign disclosing trust"). We proposed that the new definition should include any trust qualifying for the foreign-sourced income exemption, and that these trusts must comply with the foreign trust disclosure rules in the TAA. The new definition would be separate from the definition of "foreign trust", which would continue to apply for ITA purposes.

13. With one exception, submitters supported the proposal or its general direction:

- Two submitters argued that some trusts may qualify for the foreign-sourced income exemption but not use it, so should not be covered by the new definition. One pointed out it was common for people to set up a NZ family trust to hold their family home or a rental property. If the settlors migrated to Australia, the trust could qualify for the foreign-sourced income exemption. However, if the trust only had NZ rental income, it will pay NZ tax and will not use the exemption.

- Submitters also argued the new definition should not include a trust that has elected to be a complying trust. Complying trusts must pay tax on their foreign income. The election regime allows trusts that were set up offshore to enter the NZ tax system and start paying tax here. For example, a family trust set up offshore may make this election if the family moves to NZ. The benefit of the election is that distributions from the trust will not be taxed, since full NZ tax will have already been paid when the income was derived.

- One submitter, the Auckland District Law Society (*ADLS*) Trust Law Committee opposed the proposed change. They argued that it was not a remedial as the Shewan Report had recommended that the enhanced registration and disclosure requirements should only apply to trusts that were classified "foreign trusts".

Officials' recommendation

14. We agree with submitters that the new definition should not include trusts that qualify for, but have not used, the foreign-sourced income exemption. In the example where a family trust holds NZ property but the family has left NZ, it is more appropriate for the trust to comply with the domestic trust disclosure rules (as under the current law). Moreover, the family may return to NZ after several years without ever having used the foreign-sourced income exemption. Requiring

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3 See paras [1.25] and [6.18] of the Shewan Report.

such a trust to move from the domestic trust disclosure regime to the foreign trust disclosure regime and back imposes unnecessary compliance and administration costs. The NZ tax consequences for such a trust are the same as for a purely domestic trust, so it is appropriate that the disclosure consequences are the same.

15. We also agree that the new definition should not include a trust that has elected to be a complying trust, even if it has previously used the foreign-sourced income exemption. Going forward, the NZ tax consequences for the trust are the same as for a purely domestic trust, so the disclosure consequences should also be the same.

16. However, we disagree with the ADLS Committee's objections to the proposed change. While it is true that the Shewan Report referred to "foreign trusts" instead of to "trusts using the foreign-sourced income exemption", we do not think this reflected a deliberate decision to exclude the latter from the disclosure requirements. We consider that the policy and reputational risks are the same. Foreigners could use a non-foreign trust with a NZ resident trustee in the same way that they could use a foreign trust — to avoid (and possibly evade) tax on foreign income in their home jurisdiction, while not being subject to NZ tax. It is therefore appropriate to subject these trusts to the same registration and disclosure requirements as foreign trusts.

17. In light of the above, we recommend modifying our initial proposal so that the new definition (e.g. "foreign disclosing trust") includes any trust that has previously *used* the foreign-sourced income exemption, unless it has elected to be a complying trust. The new definition should also include any trust that is currently a "foreign trust" so that trusts currently complying with the foreign trust disclosure rules will continue to do so.

Issue 2: No explicit power to deregister trusts

18. There is currently no explicit power to deregister trusts in the legislation, even though the ITA refers to deregistered trusts. To resolve this, the March consultation letter proposed to grant the Commissioner of Inland Revenue (*CIR*) the explicit power to deregister a foreign trust where she is satisfied the trust:

- is no longer a foreign trust,
- no longer has an NZ resident trustee, or
- did not meet the requirements for registration in the first place.

19. We proposed that the CIR could exercise this power on her own initiative or on application by a trust. A trust applying for deregistration would have to provide certain information such as the reasons for deregistration, supporting evidence, and final annual returns for the period up to its deregistration. We also proposed that the deregistration could be backdated to a point where the trust ceased to meet the statutory requirements.

20. Submitters generally supported the proposal. One asked for clarity on which persons could apply for deregistration of a trust. Another suggested a notice period of 30 or 60 days before deregistration is effective, to allow trustees the chance to object if they wanted to. A submitter also suggested allowing trusts the option to file a final set of full-year accounts that included the date of deregistration, rather than having to prepare part-year accounts for the period up to its deregistration.

Officials' recommendation

21. We recommend including the proposal as described in the March consultation letter in the August Bill with several minor changes in response to submitters' points.

22. The contact trustee is the contact point for the trust under the foreign trust disclosure rules, so we consider that only the contact trustee should be able to apply to deregister. In practice, since we are proposing that the CIR will be able to deregister a trust on her own initiative, this is unlikely to make much difference.

23. We agree with submitters' suggestions of a 30-day notice period, and to allow trusts to file a final set of accounts for the full year, including the date of deregistration.

Issue 3: Information required of new settlors

24. When applying for registration, the trustee is required to provide certain information, including a signed declaration, for any settlor of the trust. However, the legislation is not clear on whether this same information is required for *new* settlors (people who made settlements after the trust was registered).

25. In the March consultation letter, we proposed to require the same information and signed declaration for any new settlors at the time that the trustee files the annual return for the period in which the new settlement was made. Submitters supported or did not object to this proposed change.

Officials' recommendation

26. We recommend including the proposal as described in the March consultation letter in the August Bill.

Issue 4: Treatment of final beneficiaries

27. Final beneficiaries are beneficiaries that have a right to any remaining trust property when the trust is wound up. The current disclosure rules only mention fixed and discretionary beneficiaries, not final beneficiaries. It is therefore unclear whether final beneficiaries should comply with the disclosure requirements for fixed or discretionary beneficiaries.

28. The disclosures required for discretionary beneficiaries are lighter than those for fixed beneficiaries until a distribution is made. For a fixed beneficiary, on registration the trustee must provide their name, email, physical address, tax residence and taxpayer identification number.[4] In contrast, for a discretionary beneficiary, on registration the trustee only needs to provide enough details of each beneficiary *or class of beneficiary* sufficient for the CIR to determine if a person is a beneficiary when a distribution is made. Only if a distribution is made to a discretionary beneficiary are their personal details (name, email, address etc) required in the annual return.

29. The March consultation letter invited submissions on whether final beneficiaries should be subject to the requirements applying to fixed or discretionary beneficiaries. All submitters who commented thought that treating final beneficiaries like fixed beneficiaries would create excessive compliance costs. Submitters pointed out that, like discretionary beneficiaries, final beneficiaries are often an indeterminate class (e.g. descendants of the settlor) and may not receive any distributions from the trust.

30. The Office of the Privacy Commissioner (*OPC*) observed that we had not given any reason for knowing the identity of final beneficiaries before a distribution is made to them. Without a good reason, OPC thought that requiring the information would be an "overcollection" of personal information in breach of Information Privacy

[4] If the beneficiary is a minor, their age must be provided but their email, physical address and tax residence are not required.

Principle 1.[5] OPC did not think that collecting information about a final beneficiary before they receive a distribution seemed "sufficiently connected" to the purpose of implementing the Shewan Report recommendations.

Officials' recommendation

31. We agree that, since final beneficiaries may be part of a class, it would be excessive to require the same level of disclosure as for fixed beneficiaries. Accordingly, we recommend that final beneficiaries should be subject to the same disclosure requirements as discretionary beneficiaries. OPC has confirmed that it is comfortable with this proposal.

Issue 5: Require annual return information to be updated when it changes

32. Contact trustees are required to update information provided on registration when it changes. However, there is no corresponding requirement to update the information provided in an annual return if it changes. The March consultation letter proposed to require contact trustees to notify the CIR of changes to information in annual returns within 30 days after becoming aware of the change.

33. Submitters thought that instead of notifying the CIR of changes within 30 days, trustees should be allowed to notify of changes via the next annual return. This would reduce compliance costs, better align with other reporting obligations and be less likely to be overlooked.

Officials' recommendation

34. We agree that there would be compliance cost savings if trustees could notify the CIR of most changes in the next annual return. There is no particular benefit to the CIR receiving most information outside the annual return process.

35. An exception is any changes in trustees or trustee contact details. It is important for the CIR to know who the contact trustee is at any point. These changes will also be uncommon and are hard for the trustee to overlook.

36. We recommend that:

- trustees should continue to notify the CIR of changes to trustees or their contact details within 30 days of them becoming aware of it,
- other updates should be required in the next annual return at the latest, regardless of whether the original information was given on registration or in an annual return. (Trustees will still have the option to provide information earlier, outside the annual return cycle, if they want.)

Minor drafting issues

37. We have also identified a number of minor drafting issues. Except for the last issue, all of the following were contained in the March consultation letter and were supported by submitters:

[5] Privacy Act 2020, s 22. Information Privacy Principle 1 states that an agency must not collect personal information unless the information is collected for a lawful purpose connected with a function or an activity of the agency; and the collection of the information is necessary for that purpose. Moreover, if the lawful purpose for which information is collected does not require collecting an individual's identifying information, the agency may not require identifying information.

- The TAA currently refers to a trustee "in the business of providing trustee services", which is not a defined term. We propose to change this to "professional trustee", which is an existing defined term.
- The TAA currently refers to beneficiaries of a "fixed trust" or "discretionary trust". Some trust deeds provide for both fixed and discretionary beneficiaries. For clarity, we propose to amend the TAA to instead refer to beneficiaries with fixed or discretionary interests in a trust.
- The ITA's definition of "trust rules" does not refer to the foreign trust disclosure rules. The effect is that some provisions and definitions that should apply to the foreign trust disclosure rules do not. We propose to include the foreign trust disclosure rules in the definition of "trust rules".
- The TAA currently requires a trustee to disclose the "age" of any minor beneficiaries of a fixed trust. Technically this requires trustees to notify the CIR of the beneficiary's new age every year, which is impractical. We propose to change this to refer to a minor beneficiary's "date of birth" instead.
- There are minor cross-referencing errors in the TAA's penalties provisions.
- The TAA currently uses the term "resident foreign trustee". This term is confusing as it can imply that the trustee is foreign, even though it refers to an NZ resident trustee. We propose to change this to simply "resident trustee". Although we have not consulted on this issue, the change will not have any practical impact other than be clearer.

Consultation

38. The Treasury has been consulted on this report.

39. During public consultation, the Office of the Privacy Commissioner (OPC) made a submission on the treatment of final beneficiaries in Issue 4. It has confirmed that it is comfortable with our amended proposal above.

Next steps

40. We will include any approved changes in the Taxation (Annual Rates for 2022-23, Integrity Measures, and Remedial Matters) Bill scheduled for introduction in August 2022.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Non-fiscal remedial items for the August 2022 omnibus taxation bill

Date:	12 May 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/255

Action sought

	Action sought	Deadline
Minister of Revenue	**Endorse** the agreement of the Parliamentary Under-Secretary to the Minister of Revenue to the recommendations in this report.	26 May 2022
Parliamentary Under-Secretary to the Minister of Revenue	**Agree** to the recommendations. **Refer** this report to the Minister of Revenue	26 May 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Melissa Siegel	Bill Manager	s 9(2)(a)
Jason Batchelor	Policy Advisor	

12 May 2022

Minister of Revenue
Parliamentary Under-Secretary to the Minister of Revenue

Non-fiscal remedial items for the August 2022 omnibus taxation bill

Executive summary

1. This report seeks your agreement to make amendments to several Inland Revenue Acts[1] for inclusion in the tax bill scheduled for introduction in August 2022 ("the Bill").

2. The recommended changes in this report are remedial in nature and are intended to ensure the relevant tax law is consistent with the policy intent. The remedials seek to maintain the coherence and integrity of the tax system. The recommended changes do not give rise to any material:

   2.1 Revenue or other fiscal costs;
   2.2 Compliance or administrative costs; or
   2.3 Systems or technology implications.

3. While none of these amendments are material enough to require Cabinet approval, they require approval from the Parliamentary Under-Secretary to the Minister of Revenue and endorsement by the Minister of Revenue.

4. The Treasury has been consulted on this report and they agree with the recommendations.

Next steps

5. In preparation for the introduction of the Bill, officials will be reporting to the Minister of Finance and the Minister of Revenue on policy issues in late May and remedial items with fiscal implications early June.

[1] Income Tax Act 2007 ("ITA"), Tax Administration Act 1994 ("TAA"), and the Goods and Services Act 1985 ("GST Act").

Recommendations

7. We recommend that you:

Recommendations for the Parliamentary Under-Secretary to the Minister of Revenue

a. **Indicate** in the body of this report where you agree or do not agree with a recommendation.

Indicated

b. **Agree** that, except where specified, the approved recommendations outlined in this report will apply from the date of enactment.

Agreed/Not agreed

c. **Refer** this report to the Minister of Revenue**.**

Referred

Recommendations for the Minister of Revenue

d. **Endorse** the Parliamentary Under-Secretary to the Minister of Revenue's agreement to the recommendations made above.

Endorsed

e. **Agree** that the approved amendments will be included in the upcoming omnibus taxation bill scheduled for introduction in August 2022.

Agreed/Not agreed

s 9(2)(a)

Melissa Siegel
Bill Manager
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue

/ /2022

Dr. Deborah Russell
Parliamentary Under-Secretary to the Minister of Revenue

/ /2022

Background

8. This report seeks your agreement to remedial amendments to various Inland Revenue Acts to be included in the next omnibus taxation bill scheduled for introduction in August 2022 ("the Bill").

9. The recommended changes are designed to align the relevant legislation with the original policy intent or operational practice, and do not involve changes to existing policy settings. None of the changes recommended in this report have fiscal implications.

10. We do not consider that the recommended changes in this report require Cabinet approval.

11. Unless otherwise stated all recommendations should apply from the date of enactment of the Bill.

GST treatment of government grants paid to public authorities

12. Government grants and subsidies are generally subject to GST when received by GST registered persons. This ensures that GST registered recipients of government grants and subsidies receive the same economic benefit as unregistered persons who are unable to claim a GST refund in respect of GST incurred buying goods and services used in their taxable activity.

13. An exception to this rule exists for public authorities. The exception arose because, at the time the rule for government grants and subsidies was introduced in the 1990s, it was anticipated that public authorities that received government grants would have to return GST on them under the GST rules for public authorities (where funding received from the Crown is subject to GST). Recent legal analysis by Inland Revenue has concluded this assumption was incorrect.

14. We therefore recommend amending the GST Act to remove this exception for public authorities. This would mean that where a public authority receives a government grant or subsidy from another public authority, they would be required to return GST on the amount received.

15. Because the government grants are paid and received by GST registered public authorities, the GST nets out and there are no fiscal implications as a result of this proposal.

16. We recommend this proposal applies to government grants and subsidies paid on or after 1 April 2023.

Recommendations

Agree that government grants and subsidies paid to public authorities should be subject to GST.

Agreed/Not agreed

Agree that this should apply to government grants and subsidies paid to other public authorities on or after 1 April 2023.

Agreed/Not agreed

Clarification of the GST rules and voluntary administration

17. The GST Act includes certain rules when a taxpayer is placed into bankruptcy, liquidation or receivership ("the incapacitated person"). These rules ensure that where the Official Assignee, a liquidator or receiver is appointed ("the specified agent"), it is that specified agent who is required to pay any GST liabilities and not the financially distressed company (which is unlikely have the ability to pay).

18. Voluntary administration was introduced in 2007 to provide financially distressed companies with the opportunity to turn around their financial position before considering more permanent options, such as liquidation. However, a company under voluntary administration is not explicitly listed as an incapacitated person, and consequently there are differing views on whether the company or their specified agent is liable for the GST. Given the similar nature and purpose of voluntary administration compared to the insolvency processes already listed in the rules, we consider that GST should be returned by the specified agent on taxable supplies made during an administration period. We therefore propose to clarify that an incapacitated person includes voluntary administration.

Recommendation

Agree to clarify that an incapacitated person includes voluntary administration.

Agreed/Not agreed

Improvements to the GST place of supply rules

19. Inland Revenue recently publicly consulted on some GST residency public guidance items. This led to submissions from tax advisors suggesting several potential improvements to the GST place of supply rules which could reduce compliance costs for users of these rules and create consistency with similar rules currently used for remote services (such as digital or streaming products) and distantly taxable goods (imported goods purchased for less than $1,000 from offshore websites). The suggested improvements would not change the amount of GST collected on the relevant supplies so would have no fiscal implications.

20. We have considered these submissions and propose that the following amendments could be included in the Bill:

    20.1 Extending tax residency proxies used for imported remote services so they also apply to exported remote services. This would reduce compliance costs for New Zealand businesses selling digital or online services overseas.

    20.2 The rules currently allow a non-resident importer of goods and a GST registered purchaser to agree that the supply is in New Zealand and is subject to GST. These agreements allow the non-resident importer to charge 15% GST on their sales and claim back the input tax (such as GST collected by Customs) used to make such supplies. Tax advisors have noted that it is difficult to implement these agreements and a better option would be to allow the non-resident supplier to unilaterally treat the supply as being made in New Zealand.

    20.3 Tax advisors also suggested extending the application of some rules which allow suppliers to use commercial information to determine if they are supplying to a GST registered business. This would be consistent with similar rules already used for imported remote services and distantly taxable goods.

Recommendation

Agree to improve the place of supply rules in the GST for exported services and imported goods.

Agreed/Not agreed

Clarifications to the compulsory zero-rating of land rules

21. To address the risk of phoenix fraud and reduce compliance costs for GST registered persons, the sale of land between two GST registered persons must be zero-rated in certain circumstances. Various issues have been identified with these rules that require amendments to provide clarity and reduce compliance costs for taxpayers.

22. The first issue involves supplies of an interest in land where there is a mix of periodic payments and a large irregular payment. This often occurs with commercial leases, where a large irregular payment is made at the beginning of the lease and followed by regular rental payments.

23. Under current rules, an irregular payment of more than 25% of the total contract price must be zero-rated. This is because such a supply is akin to an economic transfer of title. However, the rules also provide that any periodic payments made after such a lump sum must also be zero rated.

24. Taxpayers have noted that the subsequent zero-rating of regular rental payments significantly increases their compliance costs, as it requires them to apply different GST and invoicing treatment to such rents, compared to other commercial rents.

25. We recommend amending the treatment of regular, periodic payments following an irregular payment so that they are standard-rated (15% GST) rather than zero-rated.

26. The second issue concerns the GST treatment of a lease granted as part of the sale of a business to the purchaser of business assets (for example, in respect of business premises). The sale of a business as a going concern is zero-rated, but this does not apply to leases granted as part of the sale. This creates unnecessary compliance costs for businesses as they must determine how much of the consideration paid is for the granting of the lease (as this supply is subject to 15% GST) and how much is for other aspects of the sale of the business. If the business premises had been sold instead of a new lease being granted, or if an existing lease had instead been assigned or surrendered, the entire transaction could be zero-rated.

27. We recommend an amendment that would require the granting of a lease as part of a sale of business assets to be zero-rated.

28. Because the two commercial lease issues involve supplies between registered persons, the same overall amount of net GST is collected regardless of whether these supplies are standard-rated or zero-rated, so both of the proposed amendments would have no fiscal implications.

29. We also recommend an amendment to clarify what happens when it is discovered that a supply of land was incorrectly zero-rated after the date on which the transaction was settled. When this occurs, a special rule requires the purchaser of the land to return 15% GST on the supply of the land, to ensure that the correct amount of GST is collected. However, submissions from tax advisors have noted that in certain circumstances, it can be unclear if the special rule applies or not, which increases the risks of errors, disputes and GST not being collected.

30. We recommend that the special rule be amended to clarify the circumstances in which it applies. The proposed clarifications would not have fiscal implications as they would align the application of the special rule with current taxpayer practice and in the absence of the special rule applying, the 15% GST liability would be imposed on the vendor rather than the purchaser of land.

Recommendations

Agree that regular periodic payments under an agreement for supplies of an interest in land that are made following an irregular payment of more than 25% of the consideration specified in the agreement be standard rated.

Agreed/Not agreed

Agree that the grant of a lease as part of a business asset sale must be zero-rated where the other requirements of zero-rating are met.

Agreed/Not agreed

Agree to amendments to clarify the application of an existing special rule which requires the purchaser of land to pay GST if the sale of the land was incorrectly treated as a zero-rated supply.

Agreed/Not agreed

Input tax deductions for goods and services not yet available for use at time GST return is filed

31. A GST registered person is entitled to an input tax deduction to the extent to which goods or services purchased by them are used for, or available for use in, making taxable supplies. There is a problem where goods or services are purchased on deferred terms, meaning that they are not yet 'available for use'. For example, if the registered purchaser has paid for or received an invoice for goods, but the goods have not yet been delivered to them, they may be unable to claim an input tax deduction under a strict reading of the provision, even though they have incurred the expense.

32. We understand that standard practice has been to claim an input tax deduction in relation to goods and services, even if they have not physically been received, provided they have been paid for or an invoice has been received.

33. We recommend amending the GST Act to clarify that a GST registered purchaser can claim an input tax deduction to the extent to which the goods or services purchased by them are expected to be used in making taxable supplies. This amendment would align the law with the policy intent and current practice.

34. We recommend retrospective application from 1 April 2011 (the date the relevant provision was first enacted) to align with existing practice.

Recommendations

Agree that a GST input tax deduction be allowed to the extent to which the goods or services are used for, expected to be used for, or available for use in, making taxable supplies.

Agreed/Not agreed

Agree that this amendment should apply retrospectively from 1 April 2011.

Agreed/Not agreed

Income tax treatment of grants paid by public purpose Crown-controlled companies

35. In 2015, Inland Revenue revised its interpretation of the definition of "public authority" for tax purposes, based on advice from Crown Law. This resulted in fewer entities qualifying as public authorities, including most of the Crown-controlled companies listed in schedule 4A of the Public Finance Act 1989. To effectively reinstate the tax outcome for these entities, a specific income tax exemption was created in 2019 for public purpose Crown-controlled companies (PPCCCs).

36. The tax treatment of grants and subsidies made by PPCCCs was not considered at the time. A grant or subsidy paid by a public authority to a business is treated as excluded income of the business, so is not taxable to the business. Deductions or depreciation losses for the corresponding expenditure are disallowed. This ensures a tax neutral outcome where a government grant funds particular business expenditure.

37. We recommend aligning the income tax treatment of grants and subsidies made by PPCCCs with that of grants and subsidies made by public authorities. Grants and subsidies made by PPCCCs would be excluded income of the recipient, and corresponding deductions and depreciation losses would be denied. The amendment would reduce compliance costs for recipients of grants from PPCCCs without reducing government revenue.

38. This change would have no fiscal impact for grants derived and corresponding expenditure incurred in the same year. To the extent that a grant and corresponding expenditure is not derived or incurred in the same year, there may be an unquantifiable fiscal impact in the short term. However, this impact would be short-lived due to grants and expenditure aligning over time.

39. We recommend that this change applies retrospectively from the date of enactment of the income tax exemption for PPCCCs (18 March 2019).

Recommendations

Agree that grants and subsidies made by public purpose Crown-controlled companies should be excluded income of the recipient, and that deductions or depreciation loss for expenditure that corresponds to the grant payment should be disallowed.

Agreed/Not agreed

Agree that this amendment should apply retrospectively from 18 March 2019.

Agreed/Not agreed

Financial arrangements – impaired credit adjustments

40. Gains or losses in the fair value of a financial asset are spread over the term of the arrangement. One exclusion to this approach is for "impaired credit adjustments". These are adjustments in the fair value of a financial asset due to a decline in the credit quality of the arrangement. These decreases are not tax deductible. This is the correct policy result as these adjustments are provisions for doubtful debts which are not tax deductible until they are written off as bad debts.

41. Reversals of some, or all, of a previously reported credit loss is taxable, even though the initial recognition was not deductible. Taxing the reversal of a non-deductible adjustment is not logical. In practice, Inland Revenue and taxpayers have been treating reversals of impaired credit adjustments under the fair value method as non-assessable. This approach has been accepted by taxpayers as logical and a matter of practice.

42. We recommend clarifying that reversals of impaired credit adjustments under the fair value method are not assessable. This proposal has no fiscal implications, and Inland Revenue would not be forgoing any collectable revenue, as it would align the law with existing practice. We recommend that this amendment applies retrospectively from 1 April 2007 in line with when IFRS was adopted for income tax purposes to legitimise tax positions taken by taxpayers.

Recommendations

Agree that reversals of impaired credit adjustments under the fair value method should not be assessable.

Agreed/Not agreed

Agree that this amendment should apply retrospectively from 1 April 2007.

Agreed/Not agreed

Meaning of Highly Effective Hedging Instrument

43. The comparative value (CV) method must be used to calculate foreign investment fund (FIF) income from all non-ordinary shares. Broadly speaking, non-ordinary shares are shares that are like New Zealand dollar denominated debt. Under the CV method, income is calculated based on total economic returns. This is similar to how income from New Zealand dollar denominated debt is calculated under the financial arrangements rules.

44. One of the requirements for a share to be a non-ordinary share under the current rules is that it must be hedged to New Zealand dollars by a hedging instrument that is highly effective under IFRS 9. The problem with this requirement is that IFRS 9 does not refer to or define what a highly effective hedge is, so it is not clear when the CV method must be used.

45. This problem is the result of an accounting standard change from IAS 39 to IFRS 9. Prior to this change, a non-ordinary share was required to be hedged to New Zealand dollars by a hedging instrument that was highly effective under IAS 39. IAS 39 defined a highly effective hedge as a hedging instrument that removes 80% to 125% of foreign currency risk for a hedged item. This was a simple bright-line test for taxpayers to apply.

46. To address this issue, we recommended that the reference to IFRS 9 be removed from the non-ordinary share requirements and the term 'highly effective' be defined

similarly to the bright-line test in IAS 39. This would align with the original policy intent and would provide certainty for taxpayers.

47. We recommend that this change applies from 26 June 2019. This is when the non-ordinary share requirements were updated to refer to IFRS 9. The recommended change would align the law with current taxpayer practice and therefore would have no fiscal cost.

Recommendations

Agree that the reference to IFRS 9 should be removed from the non-ordinary share requirements and the term 'highly effective' should be defined based on the bright-line test in IAS 39.

Agreed/Not agreed

Agree that this should apply from 26 June 2019.

Agreed/Not agreed

References to adoption

48. The Adoption Act 1955 provides that once an adoption order has been made, an adopted child is deemed to become the child of the adoptive parents for all purposes, civil, criminal, or otherwise. They are also deemed not to be the children of the birth parents.

49. Unless the purpose is to distinguish between adopted children and other children, it is therefore unnecessary for the ITA or the TAA to refer to adoption. Existing references to adoption that provide that adopted children are to be treated the same as children by birth (for example, in the associated persons rules) could create a negative inference for other sections that do not specify this treatment.

50. We recommend that such references to adoption should be repealed. While there would be no change in treatment, the repeal of these unnecessary provisions would provide certainty. As there would be no change in overall treatment, there is no associated fiscal cost.

Recommendation

Agree that provisions specifying adopted children are treated the same as other children should be repealed.

Agreed/Not agreed

Updating OECD Transfer Pricing Guidelines

51. The ITA contains transfer pricing rules, which apply to cross-border transactions between associated persons. The ITA provides that the rules are to be applied consistently with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD transfer pricing guidelines" or "the Guidelines"). The Guidelines are updated periodically and on 20 January 2022, the OECD published an updated version of the Guidelines ("the 2022 Guidelines").

52. The current definition of "OECD transfer pricing guidelines" refers to the 2017 version of the Guidelines. The 2022 Guidelines are consistent with our current transfer pricing practices and provide additional guidance on the transfer pricing aspects of financial transactions. The 2022 Guidelines are also already used in

interpreting our double tax agreements ("DTAs"), which are based on the OECD Model Tax Convention.

53. We therefore recommend that the definition of "OECD transfer pricing guidelines" be amended to refer to the 2022 Guidelines. This amendment would ensure that our domestic transfer pricing rules apply consistently with the current OECD guidelines and our DTAs.

54. We recommend a retrospective application date of 20 January 2022 to coincide with when the 2022 Guidelines were published. This would allow taxpayers who wish to rely on the 2022 Guidelines to do so immediately.

55. Stakeholders supported updating the definition but raised concerns over the retrospective application date. In practice, we do not expect much, if any, difference between applying the 2017 Guidelines and the 2022 Guidelines as the underlying principles are the same — the 2022 Guidelines just provide more guidance and examples. However, to address concerns raised by stakeholders, we also recommend a savings provision for taxpayers relying on the 2017 Guidelines for the 2022-23 income year and for those with existing binding rulings.

56. There are no fiscal implications associated with this remedial. Parts of the updated guidance are largely irrelevant to New Zealand for two reasons: they apply to a transfer pricing method that is rarely used here in practice, or they concern the valuation of hard-to-value intangibles, which are not generally taxed in New Zealand because we do not have a general capital gains tax. The remaining guidance largely clarifies and elaborates on existing guidance and is consistent with our current transfer pricing practices.

Recommendation

Agree to amend the definition of "OECD transfer pricing guidelines" to refer to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 and to update cross-references.

Agreed/Not agreed

Agree that this should apply from 20 January 2022, with a savings provision for the 2022–23 income year and for taxpayers with existing binding rulings.

Agreed/Not agreed

Income of deceased persons (estates returns de minimis)

57. Income earned by an individual before their death but not received until after must be filed as part of an estate return. This approach is not customer centric and can create unnecessary compliance costs, especially when the tax return that needs to be filed under the estate is a nil return.

58. We recommend that income earned before an individual's death but received within 28 days after their death can be filed under the individual's IRD number and not under an estate IRD number. This would make the filing of an individual's final income payment more customer centric as there would no longer be a requirement for an estate IRD number to be applied for and the final tax return to be filed under this estate IRD number.

59. This amendment has no fiscal cost as the change will alter which tax return is filed on behalf of the deceased person but won't ultimately change the amount of tax payable by that person.

Recommendations

Agree that income earned by an individual before their death and received within 28 days of the date of death should be filed under the individual's IRD number and not the estate's IRD number.

Agreed/Not agreed

Agree that this should apply for the 2022–23 and later income years.

Agreed/Not agreed

Non-active trusts: compliance costs for trusts

60. There is an issue when a small amount of money is left to a minor in a trust and they do not have access to the funds until they are older. The beneficiary may not benefit from their inheritance or gift because a portion or all of it has been used to pay administrative fees before the funds vest. These trusts may not fall within the definition of a non-active trust. When this is the case, compliance costs associated with filing tax returns can deplete the funds in the trust.

61. We recommend addressing this particular issue to ensure that such smaller trusts can be classed as non-active trusts to reduce compliance costs for beneficiaries of those trusts.

62. While this remedial amendment will result in fewer tax returns having to be filed it should not result in a loss of revenue as only those trusts that derive reportable income will be able to become non-filing. Reportable income had tax deducted at source so while a return is not filed, tax is still ultimately being accounted for on the income.

Recommendations

Agree for amendments to be made so small trusts with immaterial amounts of income can be classified as non-active trusts and no longer have to file a tax return.

Agreed/Not agreed

Agree that this should apply to small trusts with immaterial amounts of income from the 2021–22 and later income years.

Agreed/Not agreed

Petroleum decomissioning: refundable tax credit and exploratory wells

63. The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 narrowed the range of expenditure on abandoning exploratory wells which may be eligible for a refundable tax credit. This was to better align these credit rules with what was intended when the decommissioning rules were introduced in 2018.

64. Through consultation with industry, officials agree that, under the amended rules there are certain situations where part of a refundable credit may be unintentionally denied. This occurs when a miner does not incur expenditure on abandoning an exploratory well but is required to calculate a positive "exploration abandonment excess" amount that lowers the credit they are entitled to.

65. We therefore recommend amending the ITA to change the calculation of the exploration abandonment excess in certain situations so that petroleum miners are not denied part of a refundable credit that they should be entitled to.

66. This change should apply retrospectively to income years commencing on or after 30 March 2022. This is the date the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 came into force.

67. In addition, changes were made to the operation of the credit during the select committee stage of the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022. The decommisioning rules apply on an income year basis. However, the application date for the select committee changes is 30 March 2022, rather than income years commencing on or after 30 March 2022. We recommend that the application date for the changes to the petroleum decommissioning rules made in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 should be amended to refer to income years commencing on or after 30 March 2022.

68. This amendment does not result in a fiscal impact within the forecast period as we do not expect any eligible petroleum decommissioning within the scope of this change to take place within the next five years.

Recommendations

Agree to amend the calculation of "exploration abandonment excess" in the petroleum mining regime to ensure petroleum miners are not denied part of a refundable credit.

Agreed/Not agreed

Agree that this amendment should apply to income years commencing on or after 30 March 2022.

Agreed/Not agreed

Agree that the changes to the petroleum decommissioning rules in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 should apply to income years commencing on or after 30 March 2022.

Agreed/Not agreed

Repeal of redundant provisions relating to the co-existence of two software platforms

69. The TAA contains provisions to provide the Commissioner of Inland Revenue with the discretion to not impose penalties where it was necessary due to resource constraints imposed by the co-existence of two Inland Revenue software platforms. As new tax products were progressively introduced into Inland Revenue's new computer system, START, these provisions have been repealed.

70. Now that Business Transformation is complete, and Inland Revenue is only operating from the START platform, these transitionary provisions are redundant and can be repealed.

71. This change will not have a fiscal benefit because even though it would remove the discretion to not impose penalties, the initial benefit of the penalty was not recognised.

Recommendation

Agree to repeal redundant provisions relating to the Commissioner of Inland Revenue's discretion to not impose penalties where it was necessary due to resource constraints imposed by the co-existence of two Inland Revenue software platforms.

Agreed/Not agreed

Provisional tax & standard uplift calculation method of the second instalment

72. Wording in the ITA around amounts payable for provisional tax under the standard uplift is not clear and arguably does not support Inland Revenue's practice, policy intent, or the programming of START regarding which uplift method should be used by a customer when filing their provisional tax returns on or before the second instalment date.

73. The wording can be read to allow customers to use the 10% uplift option for their second instalment provided their previous year's return was not due or filed on or before their first instalment date. This is not consistent with Inland Revenue's long-standing practice of requiring the 5% method to be used if a return for the prior year has been filed on or before the second instalment date.

74. A further clarification is needed for how uplift is calculated when the instalment date falls on a weekend or public holiday.

75. Officials recommend the relevant wording be amended to provide clarity on which uplift amount should be used on the taxpayer's second instalment of provisional tax.

76. This amendment will not have a fiscal impact as these changes will only clarify the current legislation to ensure that taxpayers know the consequences for their provisional tax instalments when they file their return around the second instalment date.

Recommendations

Agree to clarify the wording as to which uplift amount should be used and how that applies when a payment day falls on a weekend or public holiday, so it aligns with Inland Revenue's long-standing practice regarding the second instalment of provisional tax.

Agreed/Not agreed

Agree that this should apply to customer's provisional tax instalments for the 2022–23 and later income years.

Agreed/Not agreed

Early payment discount and tax pooling

77. An amendment was made in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 to allow non-safe harbour taxpayers (those with residual income tax of more than $60,000) to use purchased tax pooling funds to mitigate use of money interest in their first year as a provisional taxpayer.

78. This amendment was made to remedy an unintended consequence of a previous change. That amendment applies from the 2019–20 and later income years, as that is when officials thought the unintendeted consequence began. However, officials have since discovered that the issue dates back to the 2017-18 income year. We therefore recommend the application date be brought back to align with when the unintended consequence began, the 2017–18 income year.

79. This amendment will not have a fiscal cost as is correcting an application date from a previous amendment, which also had no fiscal implications.

Recommendation

Agree to bring the application date of the early payment discoung and tax pooling remedial earlier, to the 2017–18 and later income years.

Agreed/Not agreed

Trusts: imputation credits and distributions

80. An imputation credit included in a dividend that is distributed to a beneficiary of a trust is limited under a formula set out in the ITA. The credits are limited to promote an even distribution among beneficiaries, rather than allowing dividends with credits attached to be paid only to beneficiaries who are best able to utilise them.

81. However, the limit placed on the credit does not flow through to similarly reduce the imputation credits included in the beneficiary's assessable income. This results in a taxpayer being taxed on an imputation credit they don't actually receive.

82. Previously, under the Income Tax Act 2004 (ITA 2004), the amount of the adjustment made under the formula was linked to the amount of imputation credits included in assessable income. This was not intended to change with the rewrite of the ITA.

83. Using the ITA 2004 as an interpretation guide, the correct interpretive position can be reached that the adjustment flows through to the imputation credit included in the taxpayer's assessable income.

84. We recommend that the legislation should be amended to expressly give effect to this interpretation. The amendment would not have a fiscal cost as it is aligning the legislation with current practice.

Recommendation

Agree that where a tax credit is adjusted for a beneficiary under the Income Tax Act 2007, this adjustment flows through to reduce the corresponding imputation credit included in a taxpayer's assessable income.

Agreed/Not agreed

Updating the insurance tax provisions following the adoption of NZ IFRS 17

85. Life and general insurers are able to use accounting standards when calculating their "outstanding claims reserve". Currently, the accounting standard that is used for insurance is NZ IFRS 4. This is referred to in the ITA along with terms and concepts used in that standard. A new standard, NZ IFRS 17, will replace NZ IFRS 4 from 1 January 2023. The introduction of the new standard requires amendments to the ITA to:

    85.1 *Update existing references for life and general insurance:* The current legislative references to NZ IFRS 4 will need to be updated to align with the introduction of NZ IFRS 17. This will allow insurers to continue to use accounting standards when calculating life and general insurers' outstanding claims reserves from 2023 (i.e., when IFRS 17 takes effect).

    85.2 *Grandparent existing spreading arrangements entered into under NZ IFRS 4 for life financial reinsurance:* Inland Revenue has agreements in place with taxpayers which govern the spreading method used for life financial reinsurance contracts. These were entered into under NZ IFRS 4. To preserve these existing agreements, we recommend introducing a grandparenting provision that allows agreements entered into under NZ IFRS 4 to remain in place after the introduction of NZ IFRS 17 in 2023.

86. We have undertaken informal, targeted engagement on these proposals through the Financial Services Council and the Insurance Council of New Zealand. Stakeholders were generally comfortable with these proposed remedial amendments, although some indicated that they would prefer policy changes to the taxation of general insurers so that fewer tax adjustments will be required once NZ IFRS 17 starts to apply. We will continue to engage with the industry on these matters.

87. These remedials do not carry fiscal or operational implications as they either update existing section references or preserve existing arrangements.

Recommendations

Agree to update existing legislative references to NZ IFRS 4 to align with NZ IFRS 17 so it is available for use from 2023.

Agreed/Not agreed

Agree to grandparent existing agreements between Inland Revenue and taxpayers over the spreading method used for life financial reinsurance contracts. This will allow these agreements to remain in place after the adoption of NZ IFRS 17.

Agreed/Not agreed

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: GST apportionment simplification - policy decisions and Cabinet paper

Date:	26 May 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/269

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	3 June 2022
Minister of Revenue	**Agree** to recommendations **Approve** and **lodge** the attached Cabinet paper with the Cabinet Office	3 June 2022 By 10:00 a.m., Thursday 16 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Gordon Witte	Principal Policy Advisor	s 9(2)(a)
Graeme Morrison	Policy Lead	

26 May 2022

Minister of Finance
Minister of Revenue

GST apportionment simplification - policy decisions and Cabinet paper

Purpose

1. This report recommends a package of tax policy changes to simplify the GST (Goods and Services Tax) apportionment and adjustment rules. It also provides a draft Cabinet paper which would seek Cabinet approval to the recommended changes.

Background

2. A GST-registered taxpayer can claim GST input tax deductions on purchases of assets (such as buildings and vehicles) that they intend to use in their business.

3. Where the asset is used both for business use and for private use (or making exempt supplies), then the taxpayer can only deduct a percentage of the total deduction, based on their estimate of the percentage of business use. This is known as apportionment.

4. Once the taxpayer has apportioned their input tax deduction based on their estimated business use, they are required to monitor their actual use of the asset over time and, if their estimate is inaccurate, then the taxpayer must account for this difference in their GST return, annually. This is known as an adjustment or change in use.

5. The current GST apportionment and adjustment rules are complex and have high compliance costs.

6. In March 2022, we published an officials' issues paper, *GST apportionment and adjustment rules* which sought submissions on a range of potential policy reforms for simplifying the rules, improving fairness, and reducing compliance costs.

Proposed reform package following public consultation

7. The package of proposed policy options has been refined and improved in response to submissions.[1] Submitters supported the main proposals outlined in the issues paper. They considered that the package of policy options that we recommend below, would be more effective at reducing business compliance costs and ensuring GST was collected on private consumption, than alternative policy options which were also consulted on in the issues paper.

8. We recommend you agree to include the following package of GST apportionment changes in the upcoming omnibus taxation bill:

    8.1 Allow GST-registered businesses to elect to treat certain assets such as dwellings, which have mainly private or exempt use, as if they only had

[1] Inland Revenue received and considered 11 submissions from: BDO, Cedar Pacific & McConnell Property (a property developer), Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, EY, KPMG, PwC (two submissions), the Retirement Villages Association, the Salvation Army and Steve Veale (an accountant).

private or exempt use. This proposal would align the GST rules with current GST practices for GST-registered persons who may have some minor business use of their private dwellings.

8.2 Introduce a simple principal purpose test for assets acquired for less than $10,000 (GST exclusive). If these assets are principally acquired for business purposes, the GST-registered business would claim a full GST input tax deduction (rather than applying the apportionment rules).

8.3 Introduce integrity measures to improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset. This is important for land where a large GST refund (or cost saving) may have been claimed on acquisition but there can be a failure to continue to use the land in a business activity or properly account for GST if the land is later sold.

8.4 Make several improvements to the current GST apportionment and adjustment rules. The proposed improvements would reduce business compliance costs and were strongly supported by submitters. They comprise:

a) Reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make GST adjustments (this ranges from no subsequent adjustments for low-value assets, to 10 years of adjustments for high-value assets and land).

b) Expanding the ability to use a wash-up rule which provides a final adjustment (rather than ongoing adjustments) when there has been permanent change of use. The proposal will allow this rule to be used for any permanent change in use (rather than just a change to fully business, or fully non-taxable use) and to be applied 12 months earlier.

c) Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply, and consequentially repealing some complex formulae in the legislation which apply to specific and uncommon scenarios.

Financial implications

9. The proposed reform package is estimated to decrease GST revenues, with a corresponding impact on the operating balance and net debt in the forecast period and outyears as per the following table:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	(0.600)	(4.000)	(4.000)	(4.000)	(4.000)
Total Operating	**0.600**	**4.000**	**4.000**	**4.000**	**4.000**

10. This cost is due to one part of the package which is a proposal to introduce a simple principal purpose test for assets purchased for less than $10,000 (GST exclusive). This proposal was strongly supported by submitters as an effective way to reduce compliance costs for businesses on purchases of low value assets such as work tools, computers, and smartphones.

11. Officials recommend that the fiscal implications of these changes be managed against the Tax Policy Scorecard. Funding the changes through the Scorecard would mean there is no impact on between-Budget contingency or Budget allowances.

12. Ministers have previously agreed that the Tax Policy Scorecard should be the default option for managing the fiscal impacts of tax policy changes, excluding "structural" changes, social policy, changes mainly intended to advance non-tax objectives, and departmental spending. Its balance cannot exceed $200 million over the forecast period nor fall below zero (T2021/1273 refers).

13. The Treasury has advised that this change is consistent with Ministers' criteria for Scorecard funding, and that taking this approach would not cause the Scorecard's balance to exceed its limits.

Administrative implications

14. The proposals would be administered by Inland Revenue. One of the proposed integrity measures would require Inland Revenue to implement a new information disclosure for GST-registered persons who claim a large GST deduction (or cost saving from zero-rating) for business use, at the time they acquire land, aircraft, or high-value boats. Similar information disclosures already apply to persons with interests in foreign companies for income tax purposes.

Next steps

15. We have attached a draft Cabinet paper and Regulatory Impact Statement that reflects the recommendations in this report.

16. If you agree to the recommendations the next step would be to lodge the attached Cabinet paper with the Cabinet Office by 10am Thursday 16 June, ahead of the Cabinet Economic Development Committee meeting on 22 June 2022.

17. If Cabinet approves the proposals, the necessary amendments could be included in the upcoming omnibus tax bill which is scheduled for introduction in August 2022.

Recommended action

We recommend that you:

a) **agree** to allow GST-registered businesses to elect to treat certain assets such as dwellings, with mainly private or exempt use, as if they only had private or exempt use.

Agreed/Not agreed Agreed/Not agreed

b) **agree** that recommendation (a) be applied on a retrospective basis to qualifying assets which were purchased and sold prior to the proposed new legislation being enacted, as this would align with the historical GST positions taken on the qualifying assets.

Agreed/Not agreed Agreed/Not agreed

c) **agree** to introduce a simpler rule for assets acquired for less than $10,000 (GST exclusive), that when such assets are principally acquired for business purposes, the business would claim a full GST input tax deduction.

Agreed/Not agreed Agreed/Not agreed

d) **agree** to introduce integrity measures that will improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset.

Agreed/Not agreed Agreed/Not agreed

e) **agree** to the following improvements to the current GST apportionment and adjustment rules to reduce compliance costs:

- Reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make GST adjustments;
- Allowing an adjustment for a permanent change in use in a wider range of circumstances and 12 months earlier than the current rules; and
- Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply and consequentially repealing some complex formula in the legislation which apply to specific and uncommon scenarios.

Agreed/Not agreed Agreed/Not agreed

f) **note** the package of proposed GST apportionment changes in recommendations (a) to (e) are estimated to decrease GST revenues, with a corresponding impact on the operating balance and net debt in the forecast period and outyears as per the following table:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	(0.600)	(4.000)	(4.000)	(4.000)	(4.000)
Total Operating	**0.600**	**4.000**	**4.000**	**4.000**	**4.000**

Noted Noted

g) **agree** that the fiscal implications of the proposed GST apportionment changes (noted in (f) above) be managed against the Tax Policy Scorecard.

Agreed/Not agreed Agreed/Not agreed

h) **agree** the legislative amendments to the Goods and Services Tax Act 1985 required to give effect to the recommended changes in this paper be included in the next omnibus tax bill currently scheduled for introduction in August 2022.

Agreed/Not agreed Agreed/Not agreed

i) **approve** and **lodge** the attached Cabinet paper with the Cabinet Office by 10am Thursday 16 June, for consideration by the Cabinet Economic Development Committee.

Agreed/Not agreed

s 9(2)(a)

Graeme Morrison
Policy Lead
Policy and Regulatory Stewardship
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Cabinet paper - Omnibus policy measures for inclusion in the August 2022 taxation bill

Date:	26 May 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/275

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	10am, Thursday 16 June 2022
Minister of Revenue	**Agree** to recommendations **Approve** and **lodge** the attached Cabinet paper with the Cabinet Office	10am, Thursday 16 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Peter Frawley	Policy Director (acting)	s 9(2)(a) [redacted]
Melissa Siegel	Senior Policy Advisor	

26 May 2022

Minister of Finance
Minister of Revenue

Cabinet paper - Omnibus policy measures for inclusion in the August 2022 taxation bill

Executive summary

1. This report seeks agreement to four policy items for inclusion in the upcoming taxation bill scheduled for introduction in August 2022 (the Bill). The policy initiatives are:

   1.1 Setting annual rates for 2022–23;

   1.2 Charities recommended for overseas donee status;

   1.3 Dual resident companies; and

   1.4 Cross-border workers.

2. There are two additional policy items that have already been considered by Ministers, but there are additional points of clarification needed before including them in a Cabinet paper. Both policy items are included in the attached draft Cabinet paper:

   2.1 The Minister of Revenue has previously agreed to introduce a new default rule for the GST treatment of statutory and regulatory charges in the Bill which will also require Cabinet approval (IR2022/191 refers). This report seeks agreement to a minor change to the proposed transitional regulation making power that the Minister of Revenue agreed in the previous policy report.

   2.2 The Minister of Finance and the Minister of Revenue have also previously agreed to exempt employer-provided public transport fringe benefits for between home and work travel from fringe benefit tax (IR2022/158 refers). How this initiative will be funded needs clarification.

3. These policy items require Cabinet approval. To ensure they can be included in the Bill at introduction, they would need to be considered by the Cabinet Economic Development Committee (DEV) at its meeting on 22 June and by Cabinet on 27 June.

4. If you agree to all the policy initiatives in this report, please refer the attached Cabinet paper to the Cabinet Office by 10:00am Thursday 16 June.

Recommended action

We recommend that you:

5. **approve** and **lodge** the attached Cabinet paper and regulatory impact assessments to the Cabinet Office by 10:00am Thursday, 16 June 2022 for the Cabinet Economic Development Committee to consider at its meeting on 22 June 2022;

   Agreed/Not agreed　　　　　　　　　　Agreed/Not agreed

6. **note** that where a policy item requires a regulatory impact assessment, this has been completed and is attached to the Cabinet paper;

   Noted　　　　　　　　　　Noted

7. **indicate** in the body of this report where you agree or do not agree with a recommendation;

Financial recommendations

8. **agree** that the fiscal costs associated with the policy changes recommended in this report should be managed against the Tax Policy Scorecard;

   Agreed/Not agreed　　　　　　　　　　Agreed/Not agreed

s 9(2)(a)

Peter Frawley
Policy Director (acting)
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Cabinet paper - Omnibus policy measures for inclusion in the August 2022 taxation bill

Background

9. This report seeks agreement to four policy items for inclusion in the upcoming taxation bill scheduled for introduction in August 2022 (the Bill). The policy initiatives are:

    9.1 Annual rates for the 2022–23 tax year;

    9.2 Charities recommended for overseas donee status;

    9.3 Dual resident companies; and

    9.4 Cross-border workers.

10. If you agree to all the policy initiatives in this report, please refer the attached Cabinet paper to the Cabinet Office by 10:00am Thursday 16 June so that it may be considered by Cabinet Economic Development Committee (DEV) at its meeting on 22 June.

Financial Implications

11. Several decisions in this paper have financial implications for the Crown, as they would produce relatively small changes to tax revenue. Officials recommend managing these changes through the Tax Policy Scorecard.

12. Setting the annual rates for 2022–23, introducing a new default rule for the GST treatment of statutory charges, and extending overseas donee status to two additional charities are consistent with existing policy decisions. Hence, there are no direct financial implications arising if you agree to the recommendations on these issues.

13. However, the changes relating to dual resident companies, cross-border workers, and fringe-benefit tax on public transport would have financial implications, as described in the body of the report.

14. Ministers have previously agreed that the Tax Policy Scorecard should be the default option for managing the fiscal impact of tax policy changes, excluding "structural" changes, social policy, departmental funding, and changes mainly intended to achieve non-tax objectives (T2021/1273 refers). The Scorecard allows the revenue-negative impacts of some tax changes to be offset against the revenue-positive impacts of other tax changes so as to better promote a timely and balanced programme of changes. In addition to these criteria for being managed through the Tax Policy Scorecard, the Scorecard's balance may not exceed $200 million over the forecast period, nor fall below zero.

15. The Treasury has advised that the changes proposed in this report are consistent with Ministers' criteria for the Scorecard. There is no risk that the Scorecard may exceed its limits as a result of these changes.

16. If you agree to the policy decisions in this report and to manage them against the Scorecard, there will be no impact on the Between-Budget Contingency (BBC) or future Budget allowances. However, there will be a small impact on the operating balance and net debt from each change.

GST treatment of statutory and regulatory charges *(Minister of Revenue only)*

17. The Minister of Revenue has previously agreed to introduce a new default rule for the GST treatment of statutory and regulatory charges in the Bill which will also require Cabinet approval (IR2022/191 refers).

18. In that report, the Minister of Revenue agreed to a transitional regulation making power that would enable the Minister of Revenue to recommend an Order in Council to add specifically named statutory or regulatory charges to the proposed schedule of non-taxable statutory and regulatory charges. We recommend a minor change so that this transitional regulation making power also enable the Minister of Revenue to recommend an Order in Council that could add a class of charges to the proposed schedule. This change has been reflected in the draft Cabinet paper.

Recommended action

19. **Note** that the Minister of Revenue has already agreed to introduce a default rule for the GST status of statutory and regulatory charges and the attached Cabinet paper includes material on this.

Noted

20. **Agree** that the transitional regulation making power that the Minister of Revenue agreed for the GST status of statutory and regulatory charges should also permit the Minister of Revenue to recommend an Order in Council to add a class of charges to the schedule of non-taxable statutory and regulatory charges, as opposed to only specifically named charges.

Agreed/Not agreed

Exempting employer subsidised public transport from fringe benefit tax

21. The Minister of Finance and the Minister of Revenue have previously agreed to exempt employer-provided public transport fringe benefits for between home and work travel from fringe benefit tax (IR2022/158 refers).

22. The previous report stated that this policy has a fiscal cost of $2.5m in the first year and $10m in subsequent years. Budget 2022 involved changes providing a 50 percent concession on public transport for Community Services Cardholders. Because of this, the fiscal cost has been adjusted down to $2.25m in the first year and $9m in subsequent years. Officials are seeking clarification that you agree to a 1 April 2023 application date and that you agree to this cost being accounted for on the Tax Policy Scorecard.

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	-	(2.250)	(9.000)	(9.000)	(9.000)

23. Officials are still finalising the regulatory impact assessment for this policy change, and will provide it to your offices as soon as practicable.

Recommended action

24. **Agree** to exempt employer-provided public fringe benefits from fringe benefit tax from 1 April 2023;

Agreed/Not agreed Agreed/Not agreed

25. **Agree** to charge the forecast period revenue (as shown above) impact against the Tax Policy Scorecard.

Agreed/Not agreed Agreed/Not agreed

Setting annual rates for 2022–23

26. The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act.

27. It is proposed that this Bill set the annual rates of income tax for the 2022–23 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007.

28. This will not have any fiscal or administrative implications.

Recommended action

29. **Agree** to set the annual rates of income tax for the 2022–23 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007.

Agreed/Not agreed Agreed/Not agreed

Charities recommended for overseas donee status *(Minister of Revenue only)*

30. Further to the charities you agreed to give overseas donee status to in report IR2022/065 and approved by Cabinet (CAB-22-MIN-0105 refers), we have been working with another two charities to progress their requests for legislative change.

31. "Overseas donee status" is used to describe certain New Zealand charities with overseas purposes to which donors are eligible for tax benefits, including:

    31.1 the donation tax credit, and

    31.2 tax deductions if the monetary donation is from a company or Māori authority.

32. Overseas donee status is an exception to the policy framework that generally limits tax benefits for donations to charities with New Zealand purposes.

33. Since 1978, Cabinet has applied the following criteria to assess applications for overseas donee status [CM 78/14/7 refers]:

The basic criteria for adding an organisation to the list of approved "overseas" charities:

(i) the funds of the charity should be principally applied towards:

the relief of poverty, hunger, sickness or the ravages of war or natural disaster; or

the economy of developing countries; or*

raising the educational standards of a developing country;*

(ii) charities formed for the principal purpose of fostering or administering any religion, cult or political creed should not qualify;

34. The eligible purposes set out in the criteria are aligned with the Government's overseas development objectives (disaster relief, provision of humanitarian aid, and assisting developing countries).

35. The two charities discussed below have purposes that come within the criteria in paragraph 33 and we recommend that they be granted overseas donee status. They all have adequate procedures for the accountability of funds applied to projects and can demonstrate a track record of activity or related to well-established international-based charities. Both of these charities are registered under the Charities Act 2005.

Anglican World Aid (AWA) Aotearoa

36. AWA Aotearoa Ltd has been set up as the humanitarian aid arm of the Anglican Missions Board of the Church in Aotearoa, New Zealand and Polynesia. Currently, the Missions Board is supporting aid and development projects and coordinating appeals for emergencies (primarily in neighbouring Pacific Island nations) and is heavily involved in the aid response in Tonga in response to the 15 January volcanic eruption and subsequent tsunami. It is active in supporting economic development projects in Kolkata, Fiji, and Tonga. Other objectives include providing relief from the effects of poverty in Mozambique, and supporting Al Ahli Hospital in Gaza. AWA Aotearoa will support the delivery of humanitarian aid projects coordinated by the Missions Board.

37. We are satisfied that the AWA Aotearoa's purposes are for the relief of poverty, and the advancement of education and healthcare. Its constitution imposes prohibitions from carrying out religious purposes outside of New Zealand and ensures its activities and works are free from discrimination.

Pacific Island Food Revolution

38. Pacific Island Food Revolution (PIFR) promotes local, healthy food in the Pacific to combat the non-communicable disease crisis through a multi-media communication programme that uses TV, social and traditional media and community partnerships.

39. PIFR's aim is to use local healthy food and knowledge to underpin economic development, tourism, health and wellbeing. This is in response to the health and development crisis declared by Pacific Island Governments in 2011 and its potential impact on national development.[1]

40. We recommend that PIFR is granted overseas donee status, subject to minor changes to its constitution. We are satisfied that PIFR's purposes fall within the Cabinet criteria of relief of sickness improving economic outcomes in developing countries. The charity also has robust governance and policies and is aligned with the Government's overseas development priorities and primary focus on the pacific region.

41. PIFR's application has the strong support of the Ministry of Foreign Affairs and Trade as it has previously been financially supported by grants from the Australian and New Zealand Governments. It is now transitioning into a private donations model.

42. Because PIFR has no proven record of donations we recommend that PIFR's overseas donee status be approved on a time limited basis, for five years, ending

[1] Tuitama L, Yong-soo S, Clark H, Tukuitonga C and Beaglehole R. (2014) Acting on the Pacific crisis in non-communicable diseases. *The Lancet*, *384*(9957) 1823-1824. https://doi.org/10.1016/S0140-6736(14)61824-9.

31 March 2027. This will allow us to assess its performance after having a chance to establish a donor base.

Financial implications

43. Over the forecast period 2021/22 to 2025/26, the estimated financial implications of adding the two charities recommended in this report is $0.667 million. Consistent with previous practice, the financial implications will be treated as a forecasting change to reflect the increasing cost of the policy to allow tax benefits for donations to New Zealand-based overseas aid charitable organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period. There is no impact on the Tax Policy Scorecard.

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue		(0.183)[2]	(0.117)	(0.167)	(0.200)

Legislative vehicle and application date

44. Amendments adding the two organisations recommended in this report to the list of overseas donee organisations in the Income Tax Act 2007 should be included in the next omnibus taxation bill. The amendments should apply from 1 April 2022 for the PIFR and from 11 April 2022 for AWA Aotearoa (the date the charity was created). The recommended application dates give the charities certainty for marketing and fundraising purposes.

45. Inland Revenue's systems can work these recommended application dates, as individuals would be able to claim the donations tax credit for receipted monetary donations as part of Inland Revenue's 2022–23 return cycle, starting on 1 April 2023. Companies and Māori authorities would be allowed deductions for monetary donations made during the 2022–23 income year.

Consultation

46. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services have been consulted in the preparation of this report. The New Zealand Police's vetting service was also used in connection with the trustees/officers of the charities recommended in this report.

[2] The reflects expected fundraising activity in response to the state of emergency in Tonga following the volcanic eruption and subsequent tsunami on 15 January 2022.

Recommended action

47. **Agree** that the following charities be added to the list of organisations with overseas donee status in the Income Tax Act 2007:

 47.1 Anglican World Aid Aotearoa

Agreed/Not agreed

 47.2 Pacific Island Food Revolution *(on a temporary basis until 31 March 2027)*

Agreed/Not agreed

48. **Agree** that the charities in recommendation 47 are given overseas donee status from the following dates:

 48.1 Anglican World Aid (Aotearoa) Ltd, 11 April 2022; and

 48.2 Pacific Island Food Revolution Ltd, 1 April 2022 for a time limited period until 31 March 2027.

Agreed/Not agreed

49. **Note** the following changes to tax revenue as a result of the decisions in recommendation 47 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Tax Revenue		(0.183)[3]	(0.117)	(0.167)	(0.200)

Noted

Dual resident companies

50. In April 2022, Inland Revenue began targeted consultation regarding proposed changes to certain rules that apply to 'dual resident' companies (that is, companies that are a tax resident in two jurisdictions) (IR2022/042 refers). The proposed changes seek to address concerns raised by stakeholders with changes to Australia's corporate tax residency rules, and improve the integrity of two specific measures.

Proposed rules in response to Australia's changes to its corporate residency rules

51. In 2019, in response to a recent Australian High Court judgment, the Australian Tax Office issued technical guidance that amended its approach to determining when companies are a tax resident in Australia under the central management and control (CMAC) test. The changes have adversely impacted some New Zealand companies that have Australian directors. The concern is that these companies may have inadvertently become an Australian resident under the new test, and so may have inadvertently lost access to several beneficial New Zealand tax regimes, including imputation credit account and the consolidation rules.

[3] The reflects expected fundraising activity in response to the state of emergency in Tonga following the volcanic eruption and subsequent tsunami on 15 January 2022.

52. While the Australian Government has announced that it intends to legislate changes to the CMAC test to effectively return to the original interpretation, we believe there continues to be benefit in progressing the proposed changes in this report. These changes would ensure New Zealand resident companies retain access to several beneficial tax regimes that they would otherwise lose access to, while maintaining the integrity of the underlying rules.

The loss grouping and consolidation rules

53. Dual resident companies are unable to access the loss grouping and consolidation rules (which allow losses incurred in one group company to be offset against profits in another group company) due to an integrity risk that they could claim a deduction for the same expenditure in more than one country (referred to as 'double dipping'). The opportunity for companies to 'double dip' was eliminated under the recently enacted hybrid and branch mismatching rules in 2018, thus removing the integrity risk. Therefore, dual resident companies no longer need to be excluded from the loss grouping and consolidation rules. Allowing such companies access to these rules would allow them to pay tax on the net income of the group as a whole, meaning that the level of taxation would better reflect the group's economic income.

54. We recommend amending the eligibility criteria for both the loss grouping and consolidation rules to ensure dual resident companies can access these rules. Stakeholders are supportive of this proposed change.

Imputation credit account rules

55. We also recommend changes to the imputation credit account rules (ICA) to allow a New Zealand resident company to automatically become an 'Australian ICA company' under the rules and maintain its ICA balance where its tax residency tie-breaks to Australia under the Australia-New Zealand double tax agreement (DTA). This change would mean an affected company would not forfeit its accumulated ICA balance in the event of a residency change to Australia. This change is important, as taxpayers can inadvertently lose tax residence, and losing imputation credits is a heavy penalty for this. As Australian companies are already allowed to maintain an ICA account (and attach imputation credits to dividends paid to New Zealand shareholders), allowing the credits to be maintained on a change in tax residency to Australia would remove the harsh penalty without involving a significant departure from current settings. We also consider it appropriate from a policy perspective for the credits to be retained, as the same shareholders would own the company before and after the residence change (meaning they bore the economic cost of the tax which generated the imputation credits).

56. Submitters are very supportive of this change. Several stakeholders suggested the proposed change should be extended to countries other than Australia, as the risk of non-payment of New Zealand income tax is non-existent given the imputation credits represent income tax paid at the company level. While the idea may have merit, it is outside the scope of the current work and would require considerably more policy analysis. This is because it would involve assessing whether companies in countries beyond Australia should be able to maintain a New Zealand imputation credit account. This would also have implications for companies changing corporate residence.

57. Accordingly, we recommend amending the election process for becoming an Australian ICA company and automatically transferring the ICA balance to the new account to ensure a company's ICA balance is retained if its residency tie-breaks to Australia. At this stage we do not recommend applying the proposed changes more generally to situations where a dual resident company tie-breaks to a jurisdiction other than Australia.

Retrospective application date

58. Given the changes to Australia's corporate residency rules came into effect from 15 March 2017, we recommend retrospectively applying the proposed changes relating to the loss grouping consolidation rules and imputation credit account rules from this date. This would ensure any New Zealand company affected by the change in the CMAC test is covered by the proposed changes in the unlikely event that Australia does not legislate changes to its CMAC test.

Integrity measures

59. As noted in our earlier report (IR2022/042 refers), we have identified potential issues regarding the domestic dividend exemption and the company migration rules. These involve situations where companies may in some instances extract income without the anticipated New Zealand taxation, simply by changing where it is tax resident for the purposes of a DTA. We believe there is merit in strengthening these rules to ensure they are robust while minimising potential overreach.

60. While stakeholders have generally agreed the problem should be resolved, they have raised concerns that the proposed changes may impose additional compliance costs and unintended consequences.

Domestic dividend exemption

61. New Zealand generally does not tax dividends paid within a corporate group. This domestic dividend exemption applies where the recipient of a dividend is a New Zealand resident, regardless of whether they are a dual resident or if their residency tie-breaks to another country under a DTA. Under a number of New Zealand's DTAs, a dividend subsequently paid by a dual resident is exempt from New Zealand taxation, if the payer is treated as resident in the other jurisdiction under the DTA.[4] The dividend is treated as paid between two non-New Zealand companies and so New Zealand does not have any taxing rights in respect of it.

62. We propose to remove the exemption for dividends paid to certain dual resident companies if the receiving company is treated as resident in another country under a DTA. The dividend would instead be subject to non-resident withholding tax (NRWT).

63. Stakeholders raised a number of concerns with this proposal, including difficulties in determining where a company's residence tie-breaks to, that residency changes can sometimes be temporary, and the impact of long ownership chains that could involve multiple dual-resident companies. We believe these concerns can largely be resolved by:

    63.1 Focussing the changes so they only apply to situations where the dividend would have been taxable had it been paid to a non-resident. The changes should only apply to unimputed dividends[5] and to situations where the dual resident recipient would not qualify for a 0% NRWT rate under a DTA.

    63.2 Deferring the liability to pay NRWT by up to two years to give time for taxpayers to determine their tax residency and revert it to New Zealand.

    63.3 During this two-year deferral, giving taxpayers the ability to remove the NRWT liability if the dual resident dividend recipient changes its tax residency

[4] Most DTAs contain a "tie-break" provision, to determine the residency of a taxpayer that is resident in both countries under their respective domestic tax laws. Under the tie break provision, a company is treated as resident in only one country for the purposes of a DTA. This means a company that is resident under our domestic tax rules may be treated as Australian resident under the NZ/Australia DTA (and vice versa).

[5] Imputed dividends paid by a resident company can qualify for a 0% NRWT rate.

back to New Zealand in a way that would ensure that if the recipient on-paid the dividend, New Zealand would be able to impose NRWT. This is provided the recipient does not on-pay a dividend received during the deferral period.

63.4 Ensuring that NRWT is only levied at one part of an ownership chain of dual resident companies.

63.5 Including a de minimis threshold (for example, dividends of $1 million or less paid during a 12-month period) to reduce the compliance costs for smaller companies.

Corporate migration rules

64. The corporate migration rules apply when a company ceases to be a New Zealand tax resident and result in a deemed liquidation, disposal of assets and distribution to shareholders. This can have significant income tax consequences. The purpose of the rules is to stop taxpayers from avoiding NRWT by migrating the paying company to another country before paying the dividend.

65. However, the rules do not apply when a New Zealand company is dual resident and its tax residency tie-breaks to another jurisdiction under a DTA. This can eliminate New Zealand's ability to subsequently tax the accumulated income and gains of the company, as such taxation is usually prevented under the DTA. We propose to amend the corporate migration rules so that they also apply in situations where a company's residency tie-breaks to another jurisdiction under a DTA.

66. Similar concerns were raised by stakeholders to those for the domestic dividend exemption proposal. Some of these concerns may be remedied by providing a two-year deferral to allow taxpayers to change the tax residency back to New Zealand. To ensure the proposed changes remain effective (that is, New Zealand retains appropriate taxing rights), this deferral period would cease immediately prior to the dual resident company paying a dividend or disposing of assets that would not be taxable if the company's residency tie-breaks to another country.

67. These refinements to the proposals for amending the domestic dividend exemption and corporate migration rules would appropriately ensure the targeting of high-risk arrangements that give rise to integrity concerns, while reducing the potential compliance costs and the consequences if taxpayers inadvertently trigger the rules.

Application date

68. We recommend the proposed changes to the dividend exemption rules and the corporate migration rules take effect from the date of introduction of the omnibus tax bill, to reduce the risk of tax planning before the proposed changes are enacted.

Fiscal and administration cost

Loss grouping, consolidation and imputation credit account rules

69. The fiscal impact of the proposed changes to the loss grouping, consolidation and imputation account rules are estimated to be neutral over time. This is because it is likely that Australia will enact retrospective legislation to resolve the issue in the CMAC test and in the interim, the Australian Tax Office is not applying any resource to this particular residency issue. Therefore, companies are continuing to apply the prior interpretation of the CMAC test, meaning that they are not currently dual resident. The loss grouping and consolidation rules also do not have a fiscal impact as existing hybrid and branch mismatching rules mean there is no effective change to the tax settings.

Domestic dividend exemption and corporate migration rules

70. The fiscal impact of the proposed integrity changes to the dividend exemption and corporate migration rules is estimated to be neutral to nominally fiscally positive, with expected revenue of $0.2 million per annum. However, there is limited information available to make an accurate forecast.

71. We recommend this be accounted for on the Tax Policy Scorecard as shown below:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	0.200	0.200	0.200	0.200	0.200

72. The administrative cost of the proposals is anticipated to be minimal.

Consultation

73. To understand the impact of the proposed changes, Inland Revenue officials consulted with KPMG, PwC, Chartered Accountants Australia and New Zealand, the New Zealand Law Society, and the Corporate Taxpayers Group. Stakeholders provided advice on the opportunities to tighten the application of the integrity measures to ensure the proposed rules fulfil the policy intent.

Recommended action

74. **Agree** to amend the loss grouping rules to enable access for dual resident companies.

Agreed/Not agreed Agreed/Not agreed

75. **Agree** to the recommendation above being retrospectively applied from 15 March 2017.

Agreed/Not agreed Agreed/Not agreed

76. **Agree** to amend the consolidation rules to enable access for dual resident companies.

Agreed/Not agreed Agreed/Not agreed

77. **Agree** to the recommendation above being retrospectively applied from 15 March 2017.

Agreed/Not agreed Agreed/Not agreed

78. **Agree** to amend the imputation credit account rules to enable New Zealand companies that become dual resident in Australia to automatically shift their imputation credit account into the trans-Tasman imputation credit account rules.

Agreed/Not agreed Agreed/Not agreed

79. **Agree** to the recommendation above being retrospectively applied from 15 March 2017.

Agreed/Not agreed Agreed/Not agreed

80. **Note** there are no fiscal impacts arising from the recommended changes to the loss grouping rules, consolidation rules and the imputation credit account rules.

Noted Noted

81. **Agree** to amend the domestic dividend exemption and corporate migration rules to resolve specific integrity risks.

Agreed/Not agreed Agreed/Not agreed

82. **Agree** to the recommendation above applying from the date of the introduction of the omnibus tax bill containing the recommended changes, scheduled for introduction in August 2022.

Agreed/Not agreed Agreed/Not agreed

83. **Note** the following changes to tax revenue as a result of the decision in recommendations 81 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	0.200	0.200	0.200	0.200	0.200

Noted Noted

84. **Agree** to include the legislative changes to give effect to the recommendations above in the next available omnibus tax bill, scheduled for introduction in August 2022.

Agreed/Not agreed Agreed/Not agreed

85. **Agree** to delay the proactive release of the report, the associated Cabinet paper, associated Cabinet minute until after the introduction of the omnibus tax bill.

Agreed/Not agreed Agreed/Not agreed

Cross-border workers

86. The Income Tax Act 2007 and the Tax Administration Act 1994 impose obligations on persons who make payments subject to pay as you earn (PAYE) withholding tax, fringe benefit tax (FBT), employer's superannuation contribution tax (ESCT) or non-resident contractors' tax (NRCT). Current policy settings do not adequately reflect the complexities of cross-border work. Concerns that the current rules are not sufficiently clear or flexible have been raised with Inland Revenue policy officials by businesses, employers and Inland Revenue operational staff.

87. This issue has been one of importance to employers and businesses for a number of years. New Zealand has a long-standing need to import specialist skills from abroad. The COVID-19 pandemic has emphasised the role of technology in enabling remote working (including across borders). Further to this, changes in the labour market, including the use of contracts for the supply of personal services, rather than traditional employment relationships, require recognition. Finally, addressing the issue also supports the Government's objectives of accelerating New Zealand's economic recovery and laying the foundations for a better future.

88. A review of the tax rules applying to cross-border workers was included on the Tax Policy Work Programme. An officials' issues paper was published in October 2021

(IR2021/299 refers). Following consultation, officials propose changes to the current tax rules. The changes do not extend to the tax treatment of recognised seasonal employees.

Problem definition

89. The obligation to comply with employment-related tax requirements falls on the employer or payer of the income. Employers are obliged to withhold tax under the PAYE system and pay FBT and ESCT, where applicable. Payers of non-resident contractors are obliged to withhold NRCT (via the PAYE system) from contract payments.

90. The collection of PAYE via withholding from employee's cash remuneration streamlines the collection of taxes on individuals' salaries or wages and ensures that the amount collected is broadly accurate. PAYE collection and reporting smooths the payment of tax for both the employee and the government and enables better administration of the tax and transfers system. Over time, to ensure all elements of remuneration are taxed on an equivalent basis, FBT and ESCT were introduced to tax non-cash benefits and employer superannuation contributions, respectively. New Zealand's PAYE, FBT and ESCT rules are strictly applied.

91. Where the payee is a non-resident contractor, the payer is required to withhold NRCT, a schedular tax, from the contract payment. NRCT is collected via the PAYE system. The purpose of NRCT is to manage 'flight risk', where non-resident contractors depart New Zealand having completed their work and collected payment without meeting their tax obligations.

92. Unless a contract payment is exempt, the payer is required to withhold NRCT, generally at 15%, from each contract payment. While NRCT is included in the PAYE system, it can apply to contracts where both payer and contractor are non-resident and only the activity takes place in New Zealand.

93. Employers and payers of non-resident contractors find the current tax rules to be cumbersome, costly, and ambiguous and difficult to apply in practice. They each face similar issues, including lack of communication concerning the employee's or non-resident contractor's presence and/or activities in New Zealand and unforeseen delays to projects.

94. The issues can be broken into three broad categories:

    94.1 PAYE, FBT and ESCT are inflexible withholding obligations and do not adequately cater for the complexities of cross-border employment arrangements. For example, where the employer or payer expected an employee or non-resident contractor to benefit from an exemption from New Zealand tax, for example under the terms of a double taxation agreement, a project delay may result in the need to pay New Zealand tax. Similarly, it is not always possible to gather and process compensation data from global sources in time to meet New Zealand's reporting and payment dates.

    94.2 PAYE, FBT and ESCT obligations have been interpreted differently by employers, tax advisors and Inland Revenue. A recent operational statement "Non-resident employers' obligations to deduct PAYE, FBT and ESCT in cross-border employment situations" has clarified that the obligations arise for an employer with a sufficient presence in New Zealand. Under the current rules, if there is no presence in New Zealand, an employee should pay PAYE directly to Inland Revenue. However, no equivalent rule exists for FBT and ESCT.

    94.3 NRCT withholding obligations are inflexible and require modernisation. In addition to the issues which arise for employers, specific issues exist for payers of non-resident contractors. These relate to exemption from the NRCT withholding obligation. Breaches of the thresholds and/or delays in the exemption process may result in a cost borne by New Zealand businesses.

95. Strictly, breaches of the rules require a voluntary disclosure to report underpaid tax to Inland Revenue and correct the tax position for each affected employer, payer and/or individual. Voluntary disclosures are time-consuming and costly to prepare and from an administrative perspective are time-consuming to process and resolve.

Policy intent and framework

96. In our view, the fundamental policy settings for taxing cross-border workers are sound. Therefore, we do not consider that structural reform is necessary. In particular, we do not propose changing the rate of tax payable by cross-border workers, or the circumstances in which tax is payable.

97. However, employees working in New Zealand for a non-resident employer (whether as a remote worker, a business traveller or on assignment to a New Zealand employer) and non-resident contractors who are working in New Zealand are in different compliance circumstances to local employees and contractors. These different circumstances may mean a different administrative approach is justified which responds to the problems raised with Inland Revenue officials and improves the certainty, and efficiency of the tax system and reduces the cost of compliance.

98. Both initial conversations and submissions indicate that current administrative policy settings are too narrow and precise and do not adequately reflect the complexities which arise in connection with cross-border working. There is an opportunity to modernise the rules to enable the flexibility sought by businesses and employees. Further, the rules would benefit from clarification and modernisation. The overall policy package aims to reduce the cost of complying with New Zealand's PAYE, FBT, ESCT and NRCT rules.

99. Measures to simplify tax rules often face a trade-off between the accuracy of the rules in question and reduced compliance costs. This review has focused on ensuring that tax compliance is supported by reducing the focus on the strict requirements of current tax administration. It is expected that this will reduce compliance costs with only timing impacts on the amount of tax collected.

100. In addition, the proposals entail systems changes which would improve Inland Revenue's understanding of the cross-border working landscape. Improved data would enable Inland Revenue to police the rules more effectively using the insights gained.

Proposed measures

PAYE, FBT and ESCT: flexibility

101. We see merit in establishing a more flexible framework for PAYE, FBT and ESCT in cross-border working arrangements. There should be an opportunity for tax to be captured via existing systems in the first instance - a voluntary disclosure should not be required in all circumstances.

102. Flexible arrangements should include the following features:

102.1 They should be available to employers of identified cross-border employees.

102.2 Where New Zealand tax has been underpaid, it should be possible to make a catch-up payment within 60 days of a breach of an exemption or knowledge of that breach. It should also apply to certain irregular remuneration items, for example bonuses paid after the employee has left New Zealand.

102.3 The PAYE bond should be repealed.

PAYE, FBT and ESCT: integrity

103. The application of the PAYE, FBT and ESCT rules lack clarity. Further, there is a need to ensure that non-cash benefits and employer's superannuation contributions are taxed via FBT and ESCT. We propose rules to clarify and support the integrity of the sufficient presence test as follows:

103.1 A safe harbour should be available where the non-resident employer has two or fewer employees present in New Zealand or pays $500,000 or less of gross-employment related taxes per tax year, and has either made alternative arrangements for PAYE, FBT and ESCT obligations to be met or communicated the obligations to the affected employee(s).

In such a case, an employer who has incorrectly determined that they do not have New Zealand PAYE, FBT and ESCT obligations on the basis that they do not have a sufficient presence in New Zealand will be protected from penalties on the unpaid tax.

103.2 The rule that where a non-resident employer does not have a PAYE obligation, the obligation to report and pay PAYE transfers to the employee should be clarified. A corresponding rule for FBT and ESCT should be introduced. This will ensure that employees are taxed equally on fringe benefits and superannuation contributions, regardless of their employer's New Zealand tax residence or presence.

103.3 A rule confirming that a related New Zealand entity may agree to assume responsibility for the non-resident employer's PAYE, FBT and ESCT obligations should be introduced. The local entity will have joint and several liability for the tax obligations.

NRCT

104. We favour providing greater flexibility and modernising existing NRCT settings. Flexibility recognises that the strict application of the rules is not always appropriate, particularly where businesses are trying to comply. Modernisation is needed to support a more flexible approach and assist in the reduction of compliance costs. We propose the following:

104.1 Amending the NRCT threshold rules so that the payer would be required to consider their contract with the non-resident contractor only in determining their withholding obligations. For this purpose, the 'single payer' would comprise the payer and related entities.

104.2 Introducing a non-resident reporting requirement. Reporting will assist in identifying the non-resident contractor and whether or not a payment is exempt from NRCT. This will enable Inland Revenue to monitor thresholds and exemptions and supports the introduction of a single payer approach.

104.3 Permitting greater flexibility in the NRCT system. This would allow:

104.3.1 A catch-up payment of NRCT to be made within 60 days. This will operate on a similar basis to PAYE, FBT and ESCT flexibility.

104.3.2 Certificates of exemption to be issued with a retroactive period of up to 92 days.

104.3.3 Certificates of exemption to be issued on a broad 'all activities' basis where the non-resident contractor is able to demonstrate they have a good compliance history.

104.3.4 Certificates issued on a good compliance history basis should last for a two-year period, although Inland Revenue could determine another period is appropriate.

104.3.5 A non-resident contractor should be able to rely on a previous exemption to establish they have a good compliance history.

104.4 The non-resident contractor's PAYE bond should be repealed.

Technical and remedial items

105. Three technical remedial amendments are proposed:

105.1 Employer contributions to foreign superannuation schemes should be made subject to PAYE (including ESCT), rather than FBT.

105.2 A clarification that FBT obligations which arise in connection with payments made after an employee has left New Zealand and ceased to be a New Zealand tax resident ("trailing payments") only apply to benefits relating to time in New Zealand.

105.3 A clarification that the non-resident contractor day-count and monetary thresholds do not apply to non-resident entertainers.

106. The specific proposals are outlined in more detail in the tables in Appendix 1, along with the feedback on those proposals from submitters. Submissions have been taken into account in determining the final policy design, as outlined. Submitters supported the majority of proposals. Where the proposal attracted mixed or little support, additional comments are provided in the table.

Application date

107. We recommend that proposals that support the integrity of the PAYE, FBT, and ESCT obligations apply from 1 April 2023. All other proposals should apply from 1 April 2024. The later date allows sufficient time for systems changes where required.

Fiscal and administration cost

108. The fiscal impact of the changes is a revenue small gain or loss as shown in the table below, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Tax Revenue	-	0.200	(1.000)	-	-

109. The recommended changes require systems changes and updated guidance both for Inland Revenue and external publication. Implementation and on-going administration costs will be met through baseline funding.

Recommended action

110. **Agree** to enable more flexible PAYE arrangements for employers of identified cross-border employees.

Agreed/Not agreed Agreed/Not agreed

111. **Agree** to repeal the employer PAYE bond provision.

Agreed/Not agreed Agreed/Not agreed

112. **Agree** to introduce a safe harbour for PAYE, FBT and ESCT obligations. This would apply to non-resident employers only.

Agreed/Not agreed Agreed/Not agreed

113. **Agree** to clarify employee responsibilities for discharging PAYE, FBT and ESCT obligations.

Agreed/Not agreed Agreed/Not agreed

114. **Agree** to allow the transfer of PAYE, FBT and ESCT obligations to a related New Zealand entity.

Agreed/Not agreed Agreed/Not agreed

115. **Agree** to change the day count and monetary NRCT withholding thresholds to a 'single payer' requirement.

Agreed/Not agreed Agreed/Not agreed

116. **Agree** to introduce a reporting requirement for payers of non-resident contractors.

Agreed/Not agreed Agreed/Not agreed

117. **Agree** to improve the flexibility of NRCT payments and exemptions.

Agreed/Not agreed Agreed/Not agreed

118. **Agree** to enable a 'nominated taxpayer' to establish a good compliance history basis for the NRCT exemption and discharge tax obligations.

Agreed/Not agreed Agreed/Not agreed

119. **Agree** to repeal the non-resident contractor PAYE bond provision.

Agreed/Not agreed Agreed/Not agreed

120. **Agree** to include minor, technical remedial issues being:

120.1 Make employer contributions to foreign superannuation schemes subject to PAYE (including ESCT) rather than FBT.

Agreed/Not agreed Agreed/Not agreed

120.2 Clarify FBT obligations which arise when trailing payments are received only applies to benefits relating to time in New Zealand.

Agreed/Not agreed Agreed/Not agreed

120.3 Clarify the non-resident contractor day-count and monetary thresholds do not apply to non-resident entertainers.

Agreed/Not agreed Agreed/Not agreed

121. **Note** the following changes in tax revenue as a result of the decision in recommendations 110, 113 and 117 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Tax Revenue	-	0.200	(1.000)	-	-

Noted Noted

122. **Agree** that recommendations 112 to 114 should apply from 1 April 2023.

Agreed/Not agreed Agreed/Not agreed

123. **Agree** that recommendations 110, 111, 115 to 120 should apply from 1 April 2024.

Agreed/Not agreed Agreed/Not agreed

Consultation

124. In addition to the consultation outlined for each policy initiative in this report, the Treasury was consulted on the content of this report and draft Cabinet paper. The Department of the Prime Minister and Cabinet was consulted on the draft Cabinet paper had no comment.

Next steps

125. If you agree to all the policy initiatives in this report, please refer the attached Cabinet paper to the Cabinet Office by 10:00am Thursday 16 June.

Appendix 1 – Cross-border workers proposal

PAYE, FBT and ESCT

Initial proposal	Description	Feedback	Final policy
Flexible PAYE, FBT and ESCT arrangements should be available to employees on a shadow payroll only.	As flexibility recognises the different circumstances which apply to cross-border employers and employees, it should be available to identifiable employers or employees only.	A number of submitters suggested that flexible arrangements should be made available to a wider class of cross-border workers.	Flexible PAYE arrangements will enable catch-up payments to be made in some circumstances (below). Flexible arrangements should be available to identified cross-border employees on a shadow or local payroll, or who administer their own PAYE, FBT and ESCT. This should include a discretion to enter into bespoke arrangement in some circumstances.
Where a cross-border employee has an outstanding New Zealand tax obligation, a catch-up payment of New Zealand tax should be made within 28 days.	A catch-up payment should be permitted where an employer reasonably believed an exemption was available, or compensation data was not available in time to meet New Zealand reporting and payment requirements, or where the employee receives trailing compensation such as a bonus.	Many submitters stated that the 28-day time period for making payments under a flexible PAYE system was too short.	The period for a catch-up payment should be 60 days from breach or knowledge of the breach. This period should also apply to irregular or trailing compensation (for example a bonus or employee share scheme income).
The PAYE bond should be repealed.	More flexible PAYE, FBT and ESCT rules should mean that the PAYE bond is no longer required. The bond provision was little used in practice.		The PAYE bond should be repealed.

Initial proposal	**Description**	**Feedback**	**Final policy**
Non-resident employers should be required to discharge their PAYE, FBT and ESCT obligations where they: (i) have a sufficient presence in New Zealand, or (ii) they do not have a sufficient presence in New Zealand but they have five or more employees present in New Zealand or pay $500,000 or more of gross employment-related taxes per year.	Concerns were raised that the current sufficient presence test was uncertain and difficult to apply. The threshold aimed to clarify where the application of the sufficient presence test did not result in a clear outcome, the obligation would arise where either of the threshold conditions were met.	A threshold to support the identification of when an employment-related tax obligation arose was not seen as helpful. Other approaches, including a safe harbour, were preferred.	The threshold should be replaced with a safe harbour. The safe harbour applies where the non-resident employer has: (i) two or fewer employees present in New Zealand; or (ii) pays $500,000 or less of gross employment-related taxes per tax year; and (iii) the employer has made alternative arrangements for the tax obligations to be met or communicated to the affected employee(s) that they have an obligation to report and pay these taxes directly to Inland Revenue.
A New Zealand entity may agree to assume responsibility for the non-resident employer's PAYE, FBT and ESCT obligations.	We understand that such arrangements are common. We agree that this is a practical solution and that a New Zealand entity should be able to act as the non-resident employer's agency. An entity which accepts the transfer of the obligations should notify Inland Revenue of their status as agent.	Some submitters raised concerns that, to the extent that formalising this practice results in joint and several liability being imposed, it may deter New Zealand companies from administering taxes for a non-resident company. Permitting the transfer of tax obligations would be voluntary. Where an agency relationship arises, joint and several liability is appropriate.	A New Zealand entity may agree to assume responsibility for the non-resident employer's PAYE, FBT and ESCT obligations.
Where a non-resident employer does not have a sufficient presence in New Zealand and does not make any other arrangement to discharge	Under existing rules, where the employer does not withhold PAYE, the PAYE obligation is transferred to the employee. The application of this	Some submitters were concerned that the proposal could disadvantage the employee if the employer does	An employee is required to report and pay PAYE, FBT and ESCT where a non-resident employer does not have a sufficient presence in New

Initial proposal	**Description**	**Feedback**	**Final policy**
PAYE, FBT and ESCT, the employee is required to report and pay those taxes.	rule to cross-border working arrangements requires clarification. A corresponding rule for FBT and ESCT should be introduced to ensure that employees are taxed equally on fringe benefits and superannuation contributions.	not make arrangements to fund the tax. We consider a rule for the transfer of FBT and ESCT to the employee to report and pay the taxes is necessary. The transfer rule operates as a backstop to the employer's options, ensuring fringe benefits and employer superannuation contributions are taxed regardless of the employer's presence in New Zealand. The policy does not preclude an employer from funding the tax for the employee to pay to Inland Revenue, using a PAYE intermediary to manage the employee's tax affairs, or registering with Inland Revenue and paying these taxes directly. The overall policy of flexibility allows such alternative arrangements.	Zealand and did not make any other arrangement to discharge those taxes (such as having another entity assume responsibility).

NRCT

Proposal	Description	Feedback	Final policy
Where a payer of a non-resident contractor assesses the NRCT thresholds, it is appropriate to view those thresholds from the payer's point of view only.	NRCT withholding is not required where: (i) the non-resident contractor is present in New Zealand for 92 days or fewer in a 12-month period and entitled to relief under a double taxation agreement, or (ii) total payments to the non-resident contractor are $15,000 or less in a 12-month period. The current rules require the payer to take a wide view of the non-resident contractor's circumstances and to take into account information that does not relate to their contract with the non-resident contractor. The payer may not have this information or be easily able to obtain it. It is more appropriate to require the payer to consider their contract with the non-contractor only; i.e. a single payer view.	Submitters broadly agreed with the single payer approach to the thresholds, but some favoured a wider reform, or increase, of the thresholds.	Where a payer of a non-resident contractor assesses the NRCT thresholds, the 'single payer' view should apply. That is the payer should apply the thresholds as if it was the only person paying the non-resident contractor. For this purpose the 'single payer' will comprise the payer and related entities.
Introduce a requirement for payers to report details of payments made to non-resident contractors.	Current settings require the payer to ensure thresholds and exemptions are available. Reporting enables Inland Revenue to monitor the thresholds. Reporting would be regular, and largely based on information available to the payer, such as the non-resident contractor's	NRCT payment reporting was felt by many submitters to impose an unnecessary compliance cost. However, others felt that, provided care was taken to minimise compliance costs and the information sought was broadly that already obtained by payers or line with	A requirement for payers to report details of payments made to non-resident contractors should be introduced.

Proposal	**Description**	**Feedback**	**Final policy**
	name, address and tax identification number.	existing reporting, the proposal was acceptable. Reporting enables Inland Revenue to monitor the thresholds and exemptions and supports the single payer approach. However, we note the concerns raised about the information required. These points will be taken into account in finalising the design of the reporting requirement.	
Improve the flexibility of NRCT by enabling: (i) Where a payer has an outstanding NRCT obligation, a catch up payment of New Zealand tax may be made within 28 days (so a voluntary declaration does not have to be made). (ii) Certificates of exemption to be issued with retroactive period of up to 92 days. (iii) Enabling certificates of exemption to be issued for all New Zealand contract activities where the non-resident contractor is able to demonstrate they have a good compliance history. These certificates should last for a two year period.	Concerns were raised that the existing certificate of exemption process is slow and cumbersome. It is not always possible to have a certificate in place prior to the contract activity beginning, particularly if work is urgent. Certificates often need to be renewed annually, and apply only to a specific project.	Many submitters stated that the 28-day time period for making payments under a flexible NRCT system was too short. With respect to certificates of exemption, some submitters sought greater flexibility, particularly the length and breadth of the certificates. Officials think that flexibility should be balanced against the integrity of New Zealand's tax system – which is the underlying purpose of NRCT.	Amendments should be made to allow: (i) A catch-up payment of NRCT to be made within 60 days. (ii) Certificates of exemption to be issued with retroactive period of up to 92 days. (iii) Enabling certificates of exemption to be issued on a broad 'all activities' basis where the non-resident contractor is able to demonstrate they have a good compliance history. (iv) Certificates issued on a good compliance history basis should last for a two year period, although Inland Revenue may determine another period is appropriate. (v) A non-resident contractor should be able to rely on a previous

Proposal	Description	Feedback	Final policy
			exemption to establish they have a good compliance history.
Enable a 'nominated taxpayer' to establish a good compliance history basis for the NRCT exemption and discharge tax obligations for related non-resident contractors. The nominated taxpayer and the non-resident contractors would have joint and several liability.	A New Zealand resident entity could: (i) demonstrate a good compliance history for the purpose of obtaining exemption certificates for related non-resident contractors, and (ii) act as agent for the discharge of New Zealand tax obligations.	Some submitters raised concerns that where joint and several liability is imposed it may deter New Zealand companies from administering taxes for a related non-resident company. In addition, there are concerns that joint and several liability could leave the New Zealand company with a tax debt. We acknowledge these points. However, joint and several liability applies to other taxes. It provides Inland Revenue with an ability to enforce a tax debt. Warranties and indemnities for debt may form part of a commercial negotiation. On that basis, we think joint and several liability is an appropriate feature of the policy.	A 'nominated taxpayer' should be permitted to establish a good compliance history basis for the NRCT exemption and discharge tax obligations for related non-resident contractors. Liability should be joint and several.
Establish a register of exempt non-resident contractors with a good compliance history.	A register would enable a payer to know whether a non-resident contractor had a valid exemption from NRCT in relation to certificates issued on the basis of good compliance history. However, most certificates are issued on the basis of relief under a double taxation agreement, which requires an analysis of the particular contract	This proposal attracted mixed feedback – some submitters felt it would bring a welcome transparency and reduce compliance costs. Others felt that it might be impractical and raised commercial sensitivity or privacy concerns. We do not propose proceeding with this at present. Whilst the proposal attracted some support, the benefits of a register do not justify the costs	This proposal will not proceed.

Proposal	Description	Feedback	Final policy
	activity. This limits the usefulness of a register.	of creating and maintaining the register.	
Repeal the non-resident contractor PAYE bond provision.	Flexible NRCT arrangements and the change to a single payer approach to the thresholds should mean that the NRCT bond is no longer required. The bond provision was little used in practice.		The NRCT bond should be repealed.

Technical and remedial items

Proposal	Description	Feedback	Final policy
Make employer contributions to foreign superannuation schemes subject to PAYE (including ESCT) rather than FBT.	Currently, FBT applies where an employer makes a contribution to a non-New Zealand superannuation scheme which resembles a New Zealand scheme. However, this treatment causes compliance costs in filing FBT returns that might not otherwise be required. It also causes complexity as many other systems tax superannuation contributions under PAYE-equivalent systems. This proposal would simplify the treatment of employer contributions to foreign superannuation schemes and reduce the cost of compliance with FBT obligations.	Similar to the discussion in the first table about the transfer of FBT obligations to employees, concerns were raised about the potential cashflow disadvantage for employees where an employer does not make an arrangement to directly or indirectly pay or fund the tax. We have concluded that allowing employer contributions to foreign superannuation schemes to be subject to PAYE or ESCT, rather than FBT, is appropriate. Overall, it will simplify tax compliance for many businesses and reduce compliance costs.	Employer contributions to foreign superannuation schemes should be subject to PAYE (including ESCT) rather than FBT.
Clarify that where a payment is received after an employee has broken New Zealand tax residence (‘trailing payments’), FBT only applies to benefits relating to time in New Zealand.	New Zealand rules charge FBT on benefits provided to an employee in any quarter or income year in which the employee receives a PAYE income payment liable to income tax. This includes ‘trailing’ payments such as bonuses paid after the employee has ceased New Zealand tax residence. The rule requires clarification to ensure that while the trailing payment is subject to PAYE, the receipt of the trailing payment should not trigger a liability to FBT		Clarify FBT on trailing payments only applies to benefits relating to time in New Zealand.

	except to the extent the benefits relate to the time spent working in New Zealand.		
Amend the shadow payroll rule so that income is recognised when paid (to align with ordinary PAYE rules).	Payday filing rules include a specific rule for persons whose income is reported on shadow payrolls for New Zealand tax purposes. It deems the employee's PAYE income payment to be recognised for both tax and reporting purposes on the 20th day following payment. Recognising the income for tax purposes when it is paid will align the rules with the ordinary rules for taxing PAYE income payments. Employment income information reporting requirements and withholding tax payment dates would not change.	Whilst possible to make to recognise pay at the date of payment, ordinary PAYE rules require filing within two days (for digital filers). It is possible to achieve the objective of the proposal, however this would have significant system impacts for all employers.	This proposal will not proceed.
Clarify the non-resident contractor day-count and monetary thresholds do not apply to non-resident entertainers.	Interpretation Statement IS 10/04 *Non-resident contractor schedular payments* outlines that, while the term "non-resident contractor" is broad enough to include a "non-resident entertainer", these two categories should be considered separately. The proposal will make this distinction clear in legislation.		Clarify the non-resident contractor day-count and monetary thresholds do not apply to non-resident entertainers.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Priority accorded to KiwiSaver employer contributions

Date:	01 June 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/248 MBIE 2122-4074

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	14 June 2022
Minister of Revenue	**Agree** to recommendations	14 June 2022
Minister of Commerce and Consumer Affairs	**Agree** to recommendations	14 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Carolyn Elliott	Policy Lead Policy and Regulatory Stewardship Inland Revenue	s 9(2)(a) [redacted]
Dominic Kebbell	Manager Corporate Governance and Intellectual Property Policy Ministry of Business, Innovation and Employment	
Bary Hollow	Principal Policy Advisor Inland Revenue	
Robert Clarke	Senior Policy Advisor Ministry of Business, Innovation and Employment	

01 June 2022

Minister of Finance
Minister of Revenue
Minister of Commerce and Consumer Affairs

Priority accorded to KiwiSaver employer contributions

Executive summary

1. Though KiwiSaver employer contributions are preferential debt when a person is made bankrupt it is not clear whether they are preferential debt when a company or association is liquidated.

2. This is causing confusion among insolvency practitioners and other government agencies when applying the legislation.

3. To make it clear that KiwiSaver employer contributions have the same preferential debt status whether the employer is a natural person or a company or association, we recommend amendments to the Tax Administration Act 1994 (Tax Administration Act)[1].

4. As a consequence of those amendments it will also be necessary to amend schedule 7 of the Companies Act 1993 (Companies Act) and section 274 of the Insolvency Act 2006 (Insolvency Act).

5. In officials' view, these amendments are remedial and will not require Cabinet approval. They do, however, have a fiscal benefit of approximately $56,000 per year.

KiwiSaver employer contributions

6. Under the KiwiSaver Act 2006, there are two main categories of contribution to a KiwiSaver member's KiwiSaver account. These are:

   - *Employee contributions:* An employee who is a KiwiSaver member may choose to contribute at least 3% of their salary or wages to their KiwiSaver account.

   - *Employer contributions:* Where an employee is a contributing member of KiwiSaver, an employer must generally contribute the equivalent of 3% of an employee's gross salary or wages to the employee's KiwiSaver account. An employer may also make voluntary employer contributions above the minimum 3%[2].

7. Since 1 April 2020, KiwiSaver employer contributions, both voluntary and compulsory, have been subject to a Crown guarantee. This means employer contributions are paid to employees' KiwiSaver accounts based on employment income information employers provide to the Commissioner of Inland Revenue (the Commissioner), in advance of the employer contributions having been received by the Commissioner.

[1] The amendments are in section 4A(3)(bc) which extends certain PAYE rules in the Tax Administration Act to KiwiSaver employer contributions and section 167 which provides priority in insolvency.
[2] From 1 April 2021, unpaid employer contributions whether compulsory or voluntary are treated the same in terms of the penalties, recovery and use of money interest regimes in the Tax Administration Act.

8. This aligned the treatment of employer contributions with employee contributions.

Preferential debt status of KiwiSaver employer contributions

9. Where an employer is a natural person who has been bankrupted, unpaid KiwiSaver employer contributions are treated as preferential debt under section 167(2)(a) of the Tax Administration Act.

10. Where an employer is a company or an association that is being liquidated, section 167(2)(b) of the Tax Administration Act provides that KiwiSaver employer contributions have the ranking provided for in schedule 7 of the Companies Act.

11. However, in schedule 7, KiwiSaver employer contributions are not separately identified. This is creating confusion regarding whether they are preferential debt because in all other cases taxes with preferential status are separately identified in schedule 7[3].

12. As noted above, under the Tax Administration Act, KiwiSaver employer contributions are preferential debt when the employer is a natural person. In our view, there is no reason they should have a different status where the employer is a company or association.

13. The fact that s 167(2)(b) of the Tax Administration Act states that in liquidation KiwiSaver employer contributions have the ranking in schedule 7 of the Companies Act suggests it was always intended that employer contributions would have a ranking in schedule 7 of the Companies Act (i.e. be preferential debt).

14. To make it clear that KiwiSaver employer contributions are preferential debt regardless of whether the employer is a natural person or a company or association, the provisions in the Tax Administration Act and Companies Act need to be integrated better. In particular, where s 167(2)(b) of the Tax Administration Act refers to a ranking on liquidation being provided for in schedule 7 of the Companies Act, the ranking should also be provided for in schedule 7[4].

Proposed amendments

15. Addressing the issues raised above will require an amendment to sections 4A(3)[5] and 167 of the Tax Administration Act. As a consequence of these amendments, it will be necessary to amend schedule 7 of the Companies Act and section 274 of the Insolvency Act.

16. The amendments will specifically identify unpaid KiwiSaver employer contributions as having the same preferential debt status as KiwiSaver employee contributions.

17. Section 274 of the Insolvency Act, which concerns individuals, is the mirror provision of schedule 7 of the Companies Act which concerns companies and associations.

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[3] In liquidation unpaid tax with very few exceptions (for example income tax) is preferential debt. This includes KiwiSaver employee deductions, Payroll taxes, Goods and Services Tax, and Withholding Taxes. The legal foundation for this debt having preferential status is established in schedule 7 of the Companies Act 1993 and s 274 of the Insolvency Act 2006.

[4] Another example of this lack of integration is that at present though s 167(2)(a) of the Tax Administration Act provides a priority over KiwiSaver employer contributions on bankruptcy, s 274 of the Insolvency Act which lists the priority of payments on bankruptcy does not specifically list KiwiSaver employer contributions though s 274 does specifically list KiwiSaver employee contributions.

[5] This section extends certain PAYE rules in the Tax Administration Act to KiwiSaver employer contributions.

18. Accordingly, when schedule 7 is amended to include KiwiSaver employer contributions, section 274 should also be amended at the same time so there is symmetry in the two provisions.

19. These amendments will make it clear that the Commissioner's priority is the same whether the employer is an individual or a company or association[6].

20. As the Companies Act and the Insolvency Act fall within the Commerce and Consumer Affairs portfolio, these amendments will need to be managed jointly by Inland Revenue and the Ministry of Business, Innovation and Employment.

21. The proposed amendments are remedial in nature and do not require Cabinet approval.

Financial implications

22. The proposed change increases the chance of debt recovery for outstanding KiwiSaver contributions that would otherwise have been written off. Consequently, there will be a small fiscal saving from reduced impairment in the year that the debt is incurred. Ultimately, this becomes reduced write-offs (with an impairment reversal offset) in later years. Debt impairments and write-offs are both managed under the same appropriation.

23. The estimated fiscal saving is based on an assumed 2% increase in the recovery rate on the debt affected by the policy change. This 2% assumption is inferred from published liquidation statistics from the official assignee[7]. The debt affected by the policy change is based on 2021 data on KiwiSaver write-offs, allowing for the likelihood (39%) that this was due to a liquidation, and scaling up for an anticipated increase in the volume of liquidations post COVID-19. This leads to an estimated fiscal saving of 2% of $2.8 million, or $56,000 per annum.

24. If you agree to the change, there will be a corresponding impact on the operating balance and net debt. However, because of the small size of this change relative to the appropriation ($841 million in 2022/23), the Treasury and Inland Revenue advise that the appropriation limit should not be modified. Likewise, because the change is small and fiscally positive, officials consider that fiscal impact should be permitted to 'flow through' (i.e. it should not be reflected in allowances).

25. The default option for managing the fiscal impacts of tax policy changes is the Tax Policy Scorecard. However, Ministers have previously agreed that social policy changes should be excluded from the Tax Policy Scorecard (T2021/1273 refers). Officials propose that a future report on the Scorecard's balance will also discuss whether small KiwiSaver changes, like this one, should continue to be excluded.

Consultation

26. The Treasury has been consulted on these proposed amendments and concurs with the proposed amendments.

Next Steps

27. The amendments referred to above will be included in the next available tax bill.

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[6] As noted above at present the Commissioner is provided with priority over unpaid KiwiSaver employer contributions under the Tax Administration Act when the employer is a natural person. Section 274 of the Insolvency Act does not specifically identify unpaid KiwiSaver employer contributions as being preferential debt. If only schedule 7 of the Companies Act was amended given section 274 of the Insolvency Act is its mirror provision in the Insolvency Act this may lead to suggestion that priority differs when the employer is an individual as opposed to a company or association.

[7] New Zealand insolvency and trustee service.

Recommended action

28. We recommend that you:

Recommendations	Minister of Finance	Minister of Revenue	Minister of Commerce and Consumer Affairs
a. **Agree** to amend the Tax Administration Act 1994 to ensure consistency in the priority of KiwiSaver employer contributions between employers who are natural persons and non-natural persons (i.e., companies and associations).	Agreed Not agreed	Agreed Not agreed	
b. **Agree** to amend schedule 7 of the Companies Act 1993 and section 274 of the Insolvency Act 2006 to include KiwiSaver employer contributions as having the same preferential debt status as KiwiSaver employee contributions.	Agreed Not agreed		Agreed Not agreed
c. **Agree** to include the amendments referred to above in the next available tax bill.	Agreed Not agreed	Agreed Not agreed	
d. **Note** that the approximate fiscal impact of the changes in recommendations a-c above is a reduction in impairment expenses of approximately $56,000 per annum.	Noted	Noted	Noted
e. **Agree** not to recognise any change to appropriations or allowances as a result of this decision, because of the small size of the change.	Agreed Not agreed		

s 9(2)(a) [redacted]

Carolyn Elliott
Policy Lead
Policy and Regulatory Stewardship
Inland Revenue

s 9(2)(a) [redacted]

Dominic Kebbell
Manager
Corporate Governance and
Intellectual Property Policy
Ministry of Business, Innovation and
Employment

Hon Grant Robertson
Minister of Finance

/ /2022

Hon David Parker
Minister of Revenue

/ /2022

Hon Dr David Clark
Minister of Commerce and
Consumer
Affairs

/ /2022

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Remedials with fiscals for inclusion in the August 2022 taxation bill

Date:	2 June 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/282

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations **Note** the contents of this report	23 June 2022
Minister of Revenue	**Agree** to recommendations **Note** the contents of this report	23 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Melissa Siegel	Bill Manager	s 9(2)(a)
Jason Batchelor	Policy Advisor	

2 June 2022

Minister of Finance
Minister of Revenue

Remedials with fiscals for inclusion in the August 2022 taxation bill

Executive summary

1. This report seeks your agreement to make amendments to several Inland Revenue Acts for inclusion in the next omnibus tax bill scheduled for introduction in August 2022.

2. The recommended changes in this report are remedial in nature and are intended to ensure the relevant tax law is consistent with the policy intent. The remedials seek to maintain the coherence and integrity of the tax system. Most of the recommended changes do have fiscal costs associated with them.

3. All but one of the initiatives that have fiscal implications will be funded through the Tax Policy Scorecard. The remaining item would be funded through a pre-commitment against the Budget 2023 allowance, subject to your approval. We are not seeking Cabinet's agreement to any spending.

Recommended action

We recommend that you:

4. **indicate** in the body of this report where you agree or do not agree with a recommendation;

Indicated Indicated

5. **indicate** in the body of this report where you agree with the fiscal implications resulting from the recommended change;

Indicated Indicated

6. **agree** that, except for one remedial seeking pre-commitment against the Budget 2023 allowance, the fiscal implications resulting from all these changes will be managed through the Tax Policy Scorecard;

Agreed/Not agreed Agreed/Not agreed

7. **note** the net fiscal impact of all the proposed changes on the Tax Policy Scorecard is as follows:

	$m – increase/(decrease)				
	2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Impact on Tax Policy Scorecard	(0.159)	(1.285)	(1.285)	(1.285)	(1.285)

Noted Noted

8. **agree** that, except where specified, the approved amendments outlined in this report will apply from the date of enactment;

Agreed/Not agreed Agreed/Not agreed

9. **agree** that approved amendments will be included in the next omnibus tax bill scheduled for introduction in August 2022.

Agreed/Not agreed Agreed/Not agreed

s 9(2)(a)

Melissa Siegel
Bill Manager
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Background

10. This report seeks your agreement to remedial amendments to various Inland Revenue Acts to be included in the next omnibus tax bill scheduled for introduction in August 2022, tax bill ("the Bill"). In this report, the Income Tax Act 2007 is referred to as the "ITA", the Tax Administration Act 1994 as the "TAA", and the Goods and Services Tax Act 1985 as the "GST Act". The Commissioner of Inland Revenue is referred to as the "CIR".

11. The recommended changes are designed to align the relevant legislation with the original policy intent or operational practice and do not involve changes to existing policy settings. Most of the changes recommended in this report have fiscal implications.

12. We do not consider that the recommended changes in this report require Cabinet approval. Most of the changes recommended in this report have fiscal implications. All but one would be managed through the Tax Policy Scorecard. The remaining item would be funded through a pre-commitment against the Budget 2023 allowance.

13. Unless otherwise stated all recommendations should apply from the date of enactment of the Bill.

Financial Implications

14. Ministers have previously agreed (T2021/1273 refers) that the Tax Policy Scorecard should be the default option for managing the fiscal impact of tax policy changes, excluding "structural" changes, social policy, departmental funding, and changes mainly intended to achieve non-tax objectives. The Scorecard allows the revenue-negative impacts of some tax changes to be offset against the revenue-positive impacts of other tax changes so as to better promote a timely and balanced programme of changes. In addition to these criteria, the Scorecard's balance may not exceed $200 million over the forecast period, nor fall below zero.

15. The Treasury has been consulted on this report, and agrees that the changes proposed in this report are consistent with Ministers' criteria for the Scorecard. There is no risk that the Scorecard may exceed its limits as a result of these changes.

16. If you agree to the policy decisions in this report and to manage them against the Scorecard, there will be no impact on the Between-Budget Contingency (BBC) or future Budget allowances. However, there will be a small impact on the operating balance and net debt from each change.

17. The Treasury and Inland Revenue are planning to report to Ministers on the Scorecard's balance, past and future prioritisation efforts, and other fiscal management issues (including the forecast period that applies to Scorecard items decided from May to October each year).

GST – Associating members of joint ventures with the joint venture

18. For GST purposes, a joint venture is treated as a registered person in its own right, separate from its members. This is consistent with other unincorporated bodies such as partnerships and trusts. In the case of partnerships and trusts, the associated persons rules deem partners and trustees to be associated with the relevant partnership or trust. The associated persons rules are intended to prevent the same economic group from obtaining a larger GST credit than is intended as a result of transferring goods between related entities.

19. However, there is no equivalent associated person rule for joint ventures (associating members of a joint venture with the joint venture). We are aware that the lack of an associated persons rule for joint ventures has created problems in relation to the purchase of secondhand goods.

Example

A GST registered unincorporated joint venture (the JV) was established between three individuals. The individuals were also beneficiaries of a trust that is not registered for GST (the Trust).

The JV purchased land from the Trust. If the JV were a partnership, there would be a limit on the secondhand goods input tax credit that the partnership could claim, because the Trust and partnership could be said to be associated under the tripartite association rule. This is because the partnership and the Trust become associated where they are both individually associated with a common person (in this case, individuals who are both partners of the partnership and beneficiaries of the Trust).

However, because the GST Act does not associate a joint venture with its members, the rule is not engaged here, and the value of the secondhand goods credit is not limited.

20. We recommend the GST Act be amended to include a rule that associates members of an unincorporated joint venture with the joint venture itself. This amendment would ensure that joint ventures face the same GST treatment as other unincorporated bodies such as partnerships and trusts.

21. We recommend that this amendment apply to tax positions taken on or after the date of introduction of this Bill. This is necessary to prevent taxpayers from taking advantage of the current gap, which enables them to claim greater second-hand goods input tax credits than intended.

Financial implications

22. The proposed amendment does not have a material fiscal cost. It may have a positive fiscal impact, but the extent to which this can be determined depends on understanding the effect of the proposal on future taxpayer behaviour, which cannot be known. For this reason, we have identified a nominal revenue gain of $0.2 million a year, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	0.200	0.200	0.200

Recommendations

Agree that, for GST purposes, members of joint ventures should be associated with the joint venture itself.

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment apply to tax positions taken on or after the date of introduction of this Bill.

Agreed/Not agreed Agreed/Not agreed

Agree to treat the fiscal impact of this change as a nominal increase in tax revenue of $0.2m per year, with a corresponding impact on the operating balance and net debt.

Agreed/Not agreed Agreed/Not agreed

Financial arrangement rules for debt-equity swaps

23. Under general tax principles, the forgiveness of a debt is considered income because the debtor is in a better economic position than they were prior to the debt being forgiven. Debt forgiveness income is taxable under the ITA.

24. If the debtor is a company, the lender may agree to treat its debt as being wholly or partly repaid in exchange for shares in the debtor or another group company. Where a debtor issuing shares is insolvent, the value of the debt is clearly more than the market value of the shares. This means the debtor is better off because they receive the full economic benefit of the debt forgiveness for a consideration of much lesser value.

25. Under the current rules, tax consequences follow the form of the arrangement which means that forgiven debts are not always taxed as income. If the shares are issued directly in exchange for a reduction in the debt, the debtor is taxed on their debt forgiveness income (because the shares are worth less than the debt forgiven). However, if the arrangement is an issue of shares for cash and the debtor then uses that cash to repay the debt, the shares can in effect be treated as worth the same as the debt. This creates an integrity risk in the debt forgiveness rules because this sort of arrangement can be used by a debtor to inappropriately avoid deriving debt forgiveness income.

26. In this situation, the debtor will often be in tax loss (hence the insolvency). It is inappropriate for this tax loss not to be offset against any economic income from the debt forgiveness. In other cases, the debtor will not be in tax loss, for example if the insolvency is due to capital asset losing value, or the loss has been used to offset another company's income in an earlier year.

27. We recommend an amendment to ensure that taxpayers cannot avoid deriving debt- forgiveness income by using a two – step process. Arrangements for a debtor to issue shares for consideration (usually cash), on the basis that all or part of the consideration for the shares is used to repay a debt owed to the person subscribing for the shares, should be treated in the same way as a direct issue of shares in repayment of debt. Under this approach, the issue of the shares will be treated as a payment under the financial arrangement, where the amount of the payment will be the market value of the shares.

28. This approach would have no significant effect on the ability of the lender to claim a deduction for the bad debt.

Financial Implications

29. The financial implication of this change is a revenue gain of approximately $0.2 million per year, with a corresponding impact on operating balance. This figure represents a nominal gain because in most but not all circumstances the increased tax liability will be offset the tax losses of an insolvent company.

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	0.200	0.200	0.200

Recommendations

Agree that all arrangements for a debtor to issue shares, on the basis that all or part of the consideration for the shares is used to repay debt owed to the person subscribing for the shares, are treated in the same way as a direct issue of shares for debt under the financial arrangement rules

Agreed/Not agreed Agreed/Not agreed

Agree to treat the fiscal impact of this change as a nominal increase in tax revenue of $0.2m per year, with a corresponding impact on the operating balance and net debt.

Agreed/Not agreed Agreed/Not agreed

Investment into Australian unit trusts: application of the controlled foreign company and foreign investment fund rules

30. The foreign investment fund (FIF) rules tax investments held by New Zealand residents in a range of foreign funds, including foreign unit trusts. The FIF rules apply to portfolio interests (less than 10%) and, in some situations, to non-portfolio interests. The investor is taxed on their income from the investment on accrual. The investor can use one of several methods under the FIF rules to calculate their attributable FIF income. Resulting distributions are generally not taxed to ensure there is no double taxation. The intent of the FIF rules is to ensure that New Zealand residents do not escape New Zealand income tax on their foreign investments.

31. The controlled foreign company (CFC) rules generally apply to interests held by New Zealand residents in foreign companies where five or fewer New Zealand residents hold 50% of the shareholding. The CFC rules intend to tax mobile passive income as it accrues so that New Zealand income tax cannot be avoided by sheltering foreign income offshore.

Inability to use FDR method

32. Under the FIF rules, the fair dividend rate (FDR) method deems 5% of the opening value of a person’s investment to be taxable income. The FDR method is the standard method for calculating attributable FIF income.

33. New Zealand resident investors who hold 10% or more of the interests in an Australian unit trust (AUT) are currently unable to use the fair dividend rate (FDR) method for calculating their attributable FIF income.

34. Prior to 2014, interests of 10% or more in AUTs were exempt from the New Zealand FIF and CFC rules. In 2014, the FIF exemption for most AUTs was removed. However, certain corresponding changes to the FIF rules were not made. In particular, the definition of ‘opening value’ in the FDR method calculation rules was not amended to accommodate AUTs, which means that calculating FIF income under the FDR method is not possible. This omission inadvertently limits the options available for a New Zealand resident investor to calculate their FIF income from AUTs.

35. We recommend the FDR method be amended to ensure that New Zealand resident investors in AUTs can use the FDR method to calculate their FIF income in relevant situations. This change should apply retrospectively to income years commencing on or after 1 July 2014 to preserve the position of taxpayers that may have calculated attributable FIF income using the FDR method since that date.

Double taxation of FIF income from certain indirect AUT interests

36. Where a New Zealand tax resident holds a direct interest in a FIF and certain FIF methods are used to calculate income, the rules ensure that no further taxation arises from that FIF interest to ensure there is no double taxation. This in part is done by treating distributions from certain attributing interests in a FIF as excluded income. A taxpayer must also return attributed income from an indirect interest in a FIF in certain circumstances. However, there is no corresponding exclusion of distributions from indirect FIF interests.

37. This means if a New Zealand resident holds their FIF investment through an overseas subsidiary, rather than directly, a distribution from that indirect FIF interest can be taxable. An example of this is where an AUT that is a CFC holds the FIF interest. Distributions from an AUT generally do not qualify for the foreign dividend exemption and are taxed in New Zealand. This can result in double taxation of a New Zealand investor on the same economic income – once as attributed FIF income, and again as the distribution from the AUT.

38. We recommend extending the dividend exclusion and excluded income treatment to a distribution paid by an AUT from funds sourced from an attributing interest in a FIF. This would help to ensure that the economic income of the relevant FIF is only taxed once.

Over taxation of AUT CFC income

39. Where a New Zealand investor owns an AUT CFC that holds an interest in an AUT FIF, a distribution from the AUT FIF to the CFC is passive income for the CFC. The CFC rules provide a deduction for distributions by an AUT CFC in certain circumstances, but this is limited to a proportion based on the CFC's passive income earning assets relative to its total assets. While an AUT CFC must return the entire distribution from the AUT FIF as income, only a portion of that distribution is deductible when the AUT CFC passes that distribution on. Double economic taxation can arise because the New Zealand investor returns income under the FIF rules on its indirect investment in the AUT FIF and a portion of this is also returned by the taxpayer as income from its direct interest in the AUT CFC under the CFC rules.

40. We recommend amending the CFC rules to exclude amounts received by an AUT CFC from an attributing interest in an AUT FIF, where that FIF income or loss will separately be attributed to a NZ taxpayer. This would help ensure that the economic income of the relevant FIF will only be taxed once to the New Zealand investor. A corresponding change would be required to ensure that a deduction is not available under the CFC rules to the extent the AUT CFC on-pays the FIF distribution to its investor(s).

Financial implications

41. The proposed changes to make the FDR method available for AUT FIF investments will have no fiscal impact because over the long-term FDR generally returns similar levels of FIF income as other available methods. There is also no expected fiscal cost from a retrospective change, as we understand that given the policy intent for the FDR method and existing legal uncertainty about the availability of the FDR

method to AUT FIF interests, no reassessments of prior periods would be undertaken.

42. The fiscal impact of proposed changes relating to double taxation of indirect FIF interests is estimated to be a revenue loss of approximately $1.100 million a year, with a corresponding impact on the operating balance:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(1.100)	(1.100)	(1.100)	(1.100)

43. s 9(2)(g)(i) [redacted] we have estimated a nominal revenue loss of approximately $0.2 million a year, with a corresponding impact on the operating balance:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(0.200)	(0.200)	(0.200)	(0.200)

Recommendations

Inability to use the FDR method

Agree that the FDR method should be available for calculating the FIF income of AUT FIFs.

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment should apply for income years beginning on or after 1 July 2014.

Agreed/Not agreed Agreed/Not agreed

Note that this amendment does not have a fiscal impact.

Noted Noted

Double taxation of FIF income from certain indirect AUT interests

Agree that a New Zealand resident investor should not be taxable on distributions from an AUT CFC to the extent the distribution is funded from a FIF that has been subject to FIF taxation in New Zealand**.**

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment apply to income years commencing on or after 1 April 2023.

Agreed/Not agreed Agreed/Not agreed

Note the following changes to tax revenue a result of the policy decisions above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(1.100)	(1.100)	(1.100)	(1.100)

Noted Noted

Over taxation of AUT CFC income

Agree that the CFC income of an AUT CFC should not include a distribution from a FIF to the extent the FIF has been subject to FIF taxation in New Zealand.

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment apply to income years commencing on or after 1 April 2023.

Agreed/Not agreed Agreed/Not agreed

Note the following changes to tax revenue a result of the policy decisions above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(0.200)	(0.200)	(0.200)	(0.200)

Noted Noted

Foreign trust disclosure rules

44. New Zealand has a settlor-based trust regime, which means that trusts are taxed depending on the settlors' tax residence, rather than the trustees.' Broadly, a trust with no New Zealand resident settlors is a "foreign trust" (even if it has New Zealand resident trustees). Like foreign individuals, foreign trusts are generally only subject to New Zealand tax on New Zealand sourced income. Foreign trusts can qualify for a foreign-sourced income exemption subject to meeting certain conditions, including disclosure requirements.

45. In 2017, the disclosure requirements for foreign trusts were strengthened in response to concerns they were being used by non-residents to avoid foreign income tax. Foreign trusts with a New Zealand resident trustee are now required to

register with Inland Revenue and make certain disclosures to qualify for the foreign-sourced income exemption.

46. In March 2021, we released an external consultation letter on 10 proposed remedials relating to those amended disclosure rules. Most of those remedials do not have fiscal implications and were approved by the Parliamentary Under-secretary to the Minister of Revenue and endorsed by the Minister of Revenue (IR2022/079 refers). However, three of the remedials have fiscal implications and are outlined below.

Issue 1: Testamentary trusts

47. For a foreign trust to qualify for the foreign-sourced income exemption, it must have a trust deed. However, testamentary trusts are created by wills and do not have trust deeds (wills are not legally trust deeds). It is not intended that a foreign trust created under a will be treated any differently from a trust created by a living settlor under a trust deed.

48. We recommend that wills should be treated as trust deeds for purposes of the foreign-sourced income exemption. We also recommend making this change retrospective to 21 February 2017, which aligns with the commencement of the amended disclosure rules. All submitters supported this proposal.

Issue 2: CIR discretion to backdate a registration

49. Another requirement to qualify for the foreign-sourced income exemption is that the trust must be registered both at the time the foreign-sourced amount is derived and at the beginning of the income year in question.

50. The CIR has a discretion to allow the foreign-sourced income exemption to apply for most minor failures to comply with the disclosure rules, but not where a foreign trust is not registered in time. In some cases, this may be excessively harsh.

51. We recommend that where a trustee has made reasonable efforts to be registered in time, the CIR should have a discretion to backdate a registration. Submitters supported this proposal.

Issue 3: More flexible approach to non-compliance

52. When the disclosure rules were strengthened in 2017, the relevant penalties were not updated. The current penalties that apply are the general criminal penalties in the TAA (for example, failure to provide information when required). A criminal penalty is difficult to apply in practice because they require a criminal conviction.

53. The main consequence for a foreign trust that does not comply with the disclosure requirements in an income year is that it cannot use the foreign-sourced income exemption that year. This can be too harsh if the non-compliance is relatively minor. The CIR has a discretion to allow the foreign-sourced income exemption, but only if a trustee has *corrected* a failure to comply with the disclosure rules. However, some failures cannot in fact be corrected – for example, the age of the trust or prior mismanagement may result in the loss of historical information on settlors or settlements. At the other end of the spectrum, the removal of the foreign-sourced income exemption for non-compliance is too light if the trust has no foreign-sourced income because there is no incentive for the trustees to comply with the rules.

54. We recommend two changes that would allow for a more flexible and proportionate response to non-compliance:

54.1 enacting a new civil penalty of up to $1,000 for failures to comply with the disclosure rules, and

54.2 giving the CIR a discretion to allow trusts to use the foreign-sourced income exemption where they have made reasonable efforts comply with the requirements and to correct any failures to comply, even if the failure could not in fact be corrected.

55. The Ministry of Justice has confirmed that it is comfortable with our proposal to introduce a civil penalty.

Financial implications

56. For the three proposed remedials we have identified a revenue loss of approximately $388,700 in the first year followed by an ongoing annual cost of $385,000, with a corresponding impact on the operating balance:

	$m – increase / (decrease)			
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue				
(Issue 1)	(0.009)	(0.005)	(0.005)	(0.005)
(Issue 2)	(0.200)	(0.200)	(0.200)	(0.200)
(Issue 3)	(0.180)	(0.180)	(0.180)	(0.180)
Total change in Tax Revenue	**(0.389)**	**(0.385)**	**(0.385)**	**(0.385)**

57. The figures above are underpinned by several assumptions. For Issue 1, very few trusts will be affected by the retrospective application date. The ongoing cost ($5,000 per year) is based roughly on the one-off cost ($8,700) of allowing the exemption to apply retrospectively, but it is possible that more testamentary trusts will attempt to register with Inland Revenue if the remedial is enacted.

58. The fiscal impact of Issue 2 ($200,000 per year) is estimated based on the average number of foreign trust applications per year and the average income of a random sample of 100 foreign trusts (excluding outliers). Assumptions have been made on the number of late registrations that would be affected.

59. Issue 3 relates to compliance activity ($180,000 per year). The $20,000 annual revenue gain is based on historical levels of non-compliance and factors in a reduction of that assuming that the civil penalty increases compliance. That revenue gain partially offsets the estimated ($200,000) annual revenue loss from expanding the CIR’s discretion to allow the foreign-sourced income exemption. The estimated revenue loss is based on the average income of a random sample of 100 foreign trusts.

Recommendations

Agree to allow a will to be treated as a trust deed for purposes of the foreign-sourced income exemption.

Agreed/Not agreed Agreed/Not agreed

Agree that the change in the recommendation above should have retrospective effect from 21 February 2017, when the disclosure rules were introduced.

Agreed/Not agreed Agreed/Not agreed

Agree to extend the CIR's discretion to allow the foreign-sourced income exemption to situations where a trust is not registered in time but has made reasonable efforts to do so.

Agreed/Not agreed Agreed/Not agreed

Agree to enact a new civil penalty of up to $1,000 for failures to comply with the disclosure rules.

Agreed/Not agreed Agreed/Not agreed

Agree to extend the CIR's discretion to allow the foreign-sourced income exemption to situations where a trustee has made reasonable efforts to comply with the requirements of the exemption and made reasonable efforts to correct any failures to comply, even if the failure could not in fact be corrected.

Agreed/Not agreed Agreed/Not agreed

Note the following changes as a result of the decisions above, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)			
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue				
(Issue 1)	(0.009)	(0.005)	(0.005)	(0.005)
(Issue 2)	(0.200)	(0.200)	(0.200)	(0.200)
(Issue 3)	(0.180)	(0.180)	(0.180)	(0.180)
Total Operating	**(0.389)**	**(0.385)**	**(0.385)**	**(0.385)**

Noted Noted

Residential rental loss ring-fencing rules

60. The residential rental loss ring-fencing rules have been in place since the 2019–20 income year. These rules prevent rental losses from being offset against other income such as salary and wages. Ring-fenced losses can be offset against either:

    60.1 future rental income from that residential property,

    60.2 rental income from the taxpayer's other residential properties in their portfolio, or

    60.3 taxable income derived from the sale of residential property.

61. In limited circumstances when a residential property is sold, unused ring-fenced losses can be released and offset against other income types.

62. The TAA provides the CIR with the ability to write off tax debts. However, to ensure that the taxpayer does not receive an undue advantage, any accrued tax losses are also extinguished.

63. An issue arises because ring-fenced losses are not defined as being a tax loss. This means that under current law, a residential property investor with ring-fenced losses could have a tax debt written off by the CIR but would still be able to benefit from their ring-fenced losses. This double-dipping does not align with the policy intent of either the debt write-off or residential rental loss ring-fencing rules.

64. We recommend that a 'tax loss' for the purpose of the tax debt write-off rules should include ring-fenced losses arising under the residential rental loss ring-fencing rules. We recommend that this should apply in relation to tax debts written off on or after 1 April 2023.

Financial implications

65. As described above, the law currently does not provide for ring-fenced rental losses to be extinguished when a tax debt is written off. However, this is not yet reflected in tax forecasts. Officials therefore recommend that you note the reduction in tax revenue and then agree to a remedial change that would resolve the issue, restoring tax forecasts to their present track, but for a one-off $200,000 cost in 2022/23. This is because the forecast change applies immediately, but the recommended amendment would only take effect for tax debts written off on or after 1 April 2023.

66. The likely extent of the issue is hard to quantify. Based on previous years' data, we recommend adjusting tax revenue forecasts downwards from 2022/23 onwards by $200,000 per year, and likewise treating the proposed amendment as resulting in $200,000 of additional tax revenue per year.

67. The Treasury has advised that the fiscal impact of the proposed amendment, but not the forecasting change, should be managed against an allowance

Recommendations

Note that, at present, ring-fenced rental losses cannot be extinguished when a taxpayer's tax debt is written off.

Noted Noted

Note the following forecast adjustment for tax revenue, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Crown Revenue and Receipts: Tax Revenue	(0.200)	(0.200)	(0.200)	(0.200)	(0.200)

Noted Noted

Agree that a tax loss should include ring-fenced losses arising under the residential rental loss ring-fencing rules for the purposes of the debt write-off rules.

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment should apply to tax debts written off on or after 1 April 2023.

Agreed/Not agreed Agreed/Not agreed

Note the following changes to tax revenue a result of the policy decisions above, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	0.200	0.200	0.200

Noted Noted

Student loan time bar

68. The TAA imposes a four-year time bar on the amendment of tax assessments. The time bar means that, once four years have passed, an assessment for income tax, KiwiSaver deductions or ACC earner's levy deductions generally cannot be amended. The four-year time bar does not currently apply to student loan repayment obligations from salary and wage income. The consequence of not having a time bar for student loans is that it creates uncertainty for borrowers because an employer can amend an employment schedule at any time. These amendments can flow through and impact on borrowers' loan balances. The worst-case scenario is where an employer makes an amendment which results in a

previously closed student loan having to be re-opened. The lack of a time bar imposes an additional administrative burden on Inland Revenue, as Inland Revenue needs to explain to the individual that their student loan balance has been affected by their employer correcting a past error.

69. We recommend an amendment to provide that student loan scheme repayment obligations for salary and wage income cannot be altered after a period of four years. This change could affect approximately 100 student loan customers per year.

70. We recommend that this change applies from 1 April 2023.

Financial implications

71. If you agree to this change, there will be a small cost to the Government. This is because changes to student loan scheme repayment obligations after four years tend to increase student loan deductions. Had this policy been in place for the 2020–21 tax year, student loan receipts would have been $5,000 lower. For the 2021–22 tax year, student loan receipts would have been approximately $7,000 lower. Erring on the side of caution, officials recommend recognising a cost of $10,000 each fiscal year. There will also be a small, unquantifiable administrative cost saving to Inland Revenue if these corrections no longer have to be processed.

72. The Treasury has advised that this change cannot be managed though the Tax Policy Scorecard, the scope of which excludes social policy changes, including schemes administered by Inland Revenue (T2021/1273 refers). Instead, officials advise that the cost of the change – should you agree to it – should be managed as a pre-commitment against the Budget 2023 allowance.

Recommendations

Agree that student loan scheme obligations for salary and wage income be subject to the four-year time bar.

Agreed/Not agreed Agreed/Not agreed

Agree that this change should apply from 1 April 2023.

Agreed/Not agreed Agreed/Not agreed

Note the following changes to student loan receipts as a result of the policy recommendation above, with a corresponding impact on net debt:

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Student Loans - Receipts	(0.025)	(0.010)	(0.010)	(0.010)

Noted Noted

Agree to manage the fiscal impact of the above change as a pre-commitment against the Budget 2023 allowance.

Agreed/Not agreed Agreed/Not agreed

Business Continuity Test (BCT) Remedial *(Minister of Revenue only)*

73. The BCT, which was enacted in the *Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021*, allows companies to carry forward tax losses to future years if they have a change in ownership, so long as there is no major change in the nature of the business activities of the company.

74. There were several areas where the enacted legislation did not fully match the policy intent of the rules. A number of these were corrected in the *Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022.* However, one remedial which had been approved by the Minister of Revenue and Parliamentary Under-Secretary to the Minister of Revenue (IR 2022/017 refers) was not included in the final Act due to time pressures.

75. This remedial would modify the way in which an ownership change is measured for the purposes of the BCT to ensure that small changes in shareholding do not result in a reset of the business continuity period.

76. If you agree to the remedial, it would be included in the Bill. This amendment has no fiscal cost and should be backdated to the original application date of the BCT rules, the 2020–21 and later income years.

Recommendations

Agree to include a remedial amendment to the BCT rules to modify the way in which an ownership change is measured for companies under the BCT to ensure small changes in shareholding do not result in a reset of the business continuity period.

Agreed/Not agreed

Note that there are no fiscal impacts arising from this change.

Noted

Updating the insurance tax provisions following the adoption of NZ IFRS 17 *(Minister of Revenue only)*

77. From 1 January 2023, IFRS 17 will replace IFRS 4 as the accounting standard by which insurers and general insurers are able to calculate an aspect of their tax calculation known as the outstanding claims reserve. A remedial item was included in a recent report to update certain existing references in the ITA from IFRS 4 to IFRS 17 (IR2022/255 refers).

78. We have since become aware of the possibility that some insurers could choose to adopt IFRS 17 *before* 1 January 2023. We therefore recommend that a transitional provision be included to enable insurers to adopt IFRS 17 early.

79. This transitional provision is intended to act as a safeguard for taxpayers who may wish to adopt IFRS 17 early. This addition is not expected to be widely used and does not have any fiscal implications.

Recommendations

Agree to include a transitional provision to cover insurers who apply IFRS 17 prior to 1 January 2023.

Agreed/Not agreed

Note that there are no fiscal impacts arising from this change.

Noted

Tax treatment of interest rate swaps held by multi-rate PIEs *(Minister of Revenue only)*

80. The portfolio investment entity (PIE) rules contain a timing rule that requires a multi-rate PIE to allocate income and deductions:

    80.1 as reflected in the PIE's valuation of investor interests (for example, unit pricing), if such valuations are made, or

    80.2 as shown in the PIE's financial statements, if it does not value investor interests.

81. This rule overrides other timing rules, including the spreading methods in the financial arrangements rules. The intention is to tax income as it accrues to an investor rather than at a later time when the investor may have already exited the PIE.

82. Interest rate swaps, which change in value as interest rates change, are usually taxed under the financial arrangements rules. The CIR has a determination detailing the spreading methods for these swaps in the financial arrangements rules. One method effectively ignores unrealised fair value gains or losses on interest rate swaps for tax purposes, meaning only the interest rate swap cash flows are taxed. This reduces volatility and is appropriate when a swap is held as a hedge because the fair value movements net to zero over its life.

83. Multi-rate PIEs cannot use this determination method because of the timing rule in the PIE rules. This results in volatility because fair value gains or losses are included in the taxable income of a multi-rate PIE.

84. To address this volatility, we recommend that multi-rate PIEs which otherwise satisfy the criteria for using the determination method but for the PIE timing rule, be allowed to choose to use this determination method to spread income and deductions from interest rate swaps.

85. We recommend that this change applies from 1 April 2023.

86. This remedial will have no fiscal cost because it will not change the total amount of income or deductions over the life of an interest rate swap, only the spread of income or deductions.

Recommendations

Agree that multi-rate PIEs be allowed to choose to use Method C in Determination G27 to spread income and deductions from interest rate swaps, provided other requirements for using that determination method are met.

Agreed/Not Agreed

Agree that this should apply from 1 April 2023.

Agreed/Not Agreed

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Final policy decisions following public consultation on the taxation of the gig and sharing economy**

Date:	10 June 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/262

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	15 June 2022
Minister of Revenue	**Agree** to recommendations	15 June 2022
	Authorise lodgement of the attached Cabinet paper with the Cabinet Office	By 10:00 a.m., Thursday 23 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Graeme Morrison	Policy Lead	s 9(2)(a)
Ben Smith	Senior Policy Advisor	

10 June 2022

Minister of Finance
Minister of Revenue

Final policy decisions following public consultation on the taxation of the gig and sharing economy

Executive summary

Purpose

1. This report summarises the feedback received on the discussion document *The role of digital platforms in the taxation of the gig and sharing economy* which closed for public consultation in late April 2022. It also makes final policy recommendations following the period of public consultation.

2. If you agree to the recommendations in this report, the next step would be to seek Cabinet approval for changes to tax laws to be included in the upcoming omnibus tax bill which is scheduled for introduction in August 2022.

The discussion document

3. The gig and sharing economy refers to economic activity facilitated by digital platforms (commonly referred to as "apps") which connect buyers with those who share their assets, skills, and labour. Common examples include short stay accommodation, ridesharing, and food and beverage delivery services.

4. The discussion document included proposals in three areas: information reporting and exchange, GST, and other measures to reduce compliance costs for sellers on digital platforms in the gig and sharing economy. There were 12 submitters on the discussion document. These submissions came from a mix of digital platforms (domestic and multinational) and accounting and law firms. The discussion document asked:

    4.1 Whether Inland Revenue should receive information about income earned on digital platforms in the gig and sharing economy (and whether New Zealand should implement its own rules, or rules designed by the Organisation for Economic Co-operation and Development (the OECD)) to address this current gap.

    4.2 How GST should apply to activities in the gig and sharing economy and whether the GST registration threshold should be lowered for those providing taxable accommodation and personal services through digital platforms, or whether the digital platforms should be required to collect and return GST on these supplies to Inland Revenue.

    4.3 If there were other changes that could be made to New Zealand's tax system to reduce compliance costs for sellers in the gig and sharing economy, such as standard cost deductions for income tax purposes, and opportunities to avoid GST apportionment rules for capital assets.

Information reporting and exchange

5. All submitters understood that Inland Revenue would benefit from receiving income information from digital platforms about the income earned by sellers in the gig and sharing economy. Submitters supported New Zealand implementing the OECD's information reporting and exchange framework rather than designing bespoke rules for a New Zealand context.

6. We support implementation of the OECD's rules in New Zealand. These rules would require New Zealand digital platforms to provide information annually to Inland Revenue about non-resident sellers of accommodation, personal services, vehicle rentals, and the sale of goods operating on their platform. Inland Revenue would then share this information under an information exchange framework with foreign tax authorities. Inland Revenue would also receive information about New Zealand sellers from foreign tax authorities, where foreign digital platforms had reported that information to them.

7. We recommend these rules be implemented in New Zealand with effect from 1 January 2024. This would ensure there is sufficient time for digital platforms to meet the requirements of the OECD rules, and that Inland Revenue has sufficient time to implement the required system changes for the processing of information (which it would receive from New Zealand digital platforms) and the exchange of that information. This would mean New Zealand tax resident digital platforms would need to provide information about income earned by foreign sellers, which Inland Revenue could then exchange with other OECD countries, in 2025.

8. The OECD's rules mirror rules designed by the European Commission which will apply in Europe from 2023. Tax authorities in Europe will only be able to share information with other countries which have rules of equivalence. We consider it important that New Zealand has rules that are equivalent to those in Europe because many digital platforms are based there. We therefore recommend, if you agree to New Zealand implementing the OECD's rules, that:

    8.1 The optional modification to the OECD's rules that would exempt small New Zealand digital platforms from the reporting requirements is not implemented. This exemption does not exist in the European rules.

    8.2 New civil penalties are introduced to the Tax Administration Act 1994 which could be used in cases of non-compliance with the OECD's rules by sellers and New Zealand tax resident digital platforms. These penalties should be based on the penalties that were implemented alongside the Common Reporting Standard – another OECD information exchange which relates to financial account information.

How GST should apply

9. The discussion document noted that many supplies of services through digital platforms in the gig and sharing economy were not subject to GST from the consumers of those services. This is because many who operate through digital platforms are below the GST registration threshold of $60,000 in a 12-month period. This could create a tax bias towards using services provided through digital platforms relative to other options which would ordinarily be subject to GST (for example, accommodation in hotels and motels is subject to GST but renting a room through a digital platform is generally not). The discussion document also noted that this distortion reduces the efficiency of GST and does not support the long-term sustainability of the GST system overall.

10. To address these issues, the discussion document noted that the GST registration threshold could be lowered for those sellers operating through digital platforms in the gig and sharing economy. An alternative solution was implementing marketplace rules (which currently require electronic marketplaces to collect and return GST on imported digital services – for example, purchases through mobile phone app stores – and low value imported goods) which would require digital platforms in the gig and sharing economy to collect and return GST on behalf of the underlying sellers that provide certain services such as accommodation and transportation.

11. Submitters opposed making changes to the GST system noting that changes would result in increased compliance costs, and that it would be desirable to look at whether GST changes were appropriate once more was known about the size of the gig and sharing economy in New Zealand. It was noted that the OECD's information exchange would help in determining the size.

12. There is a trade-off between competing policy objectives here – that is, maintaining a broad-based and sustainable GST system against minimising compliance and administration costs. Implementing marketplace rules would improve the efficiency of the GST system by ensuring supplies of services which are substantively the same or similar have the same tax treatment. It would also promote the long-term sustainability of the GST base. Marketplace rules would, however, impose compliance costs on digital platforms, which would need to upgrade their systems and provide support to their users, to ensure that GST was being collected and returned to Inland Revenue. There are also compliance costs for sellers who would choose to be registered for GST so that they could recover GST on their costs.

13. On balance, we recommend implementing extended electronic marketplace rules that would require digital platforms to collect GST on supplies of taxable accommodation and transportation services (which includes ridesharing and food and beverage delivery). These industries were noted by the OECD as the most significant in the gig and sharing economy currently.

14. We do not consider it necessary to wait for more information on the size of the gig and sharing economy in New Zealand before implementing these changes. This is because we do not expect this information would enable any clearer decisions on policy direction to be made. Based on analysis done by Inland Revenue, we estimate there to already be tens of thousands of taxpayers operating in the gig and sharing economy. This currently represents a considerable proportion of economic activity which is largely outside the GST base, and which is only expected to grow.

15. If marketplace rules were implemented, a simplified method of enabling sellers to recover GST on their costs would be needed to ensure sellers were not materially over-taxed. One option included in the discussion document was a flat rate scheme, where digital platforms had to charge GST at the full rate, but they could return GST at a reduced rate to Inland Revenue, passing on the difference between the standard rate and the flat rate to sellers as recognition of the unrecoverable GST on their costs. Sellers can also register for GST if they choose to (this is the status quo).

16. The effect of a decision to implement extended electronic marketplace rules in this way would result in compliance costs for digital platforms, and sellers on those platforms (to the extent that they did not want to use the proposed flat rate scheme). It would also likely increase the cost of services provided through digital platforms by approximately 15%.

Other compliance cost reduction measures

17. Submitters were supportive of efforts to reduce compliance costs for sellers on digital platforms in the gig and sharing economy but no recommendations beyond what was included in the discussion document were identified. The discussion document noted that standard cost deductions for income tax purposes could reduce compliance costs for sellers in the gig and sharing economy – particularly where there were mixed-use assets (for example, motor vehicles and land that are used partly for income-earning purposes and partly for private purposes). Inland Revenue can currently issue standard cost determinations which could be used by sellers in the gig and sharing economy, and no changes to these rules are proposed as part of this report.

18. We have reported to you separately on GST apportionment issues, including the ability for taxpayers to elect to opt significant assets (for example, land) out of the GST base, which was supported by submitters on this discussion document (IR2022/269 refers).

Financial implications

19. The financial implications arising from these proposals present choices for Ministers. Broadly, both policy proposals are expected to raise revenue: the information reporting and exchange framework is likely to raise an additional $11 million each year, while the proposal to implement extended electronic marketplace rules for GST and digital platforms in the gig and sharing economy will likely raise $47 million each year. There are, however, up-front build costs (particularly for the information reporting and exchange framework, which may cost up to $13.7 million to introduce), as well as the associated depreciation and capital charge, and ongoing administration costs. All these estimates are subject to some uncertainty.

20. **Treatment of additional revenue:** Your options for both changes are to add the revenue to the Tax Policy Scorecard, to manage the impact through allowances, or allow the revenue to "flow through" for now, and consider the revenue as part of setting Budget allowances later this year for the Budget Policy Statement. The Treasury recommends you:

    20.1 allow the revenue from implementing extended electronic marketplace rules for GST to "flow through". This is because adding this revenue to the Scorecard would take it over its cap (T2021/1273 refers); and

    20.2 manage the revenue from the information reporting and exchange framework through the Scorecard, as is the default, although there is a case for allowing it to flow through to offset the substantial one-off build costs.

21. **Ongoing departmental costs:** The costs associated with these changes for Inland Revenue are significant. For the extension to the electronic marketplace rules, the most significant costs are ongoing: less than $1.02 million would need to be appropriated in the first year, but over five years, the cost is likely to be up to $2.1 million. If you wished to defer consideration of the ongoing costs for this proposal, we recommend proceeding to include this change in the upcoming omnibus tax bill, and appropriating only $1.02 million now.

22. **Up-front build costs**: By contrast, for the information reporting and exchange proposal, the largest cost is the up-front capital expenditure (which could be up to $13.7 million). The Treasury recommends that this funding should be appropriated when the change is legislated, as it is non-discretionary spend associated with the policy change rather than departmental costs that could be met from re-prioritisation. If you do not wish to appropriate additional funding for this now, Treasury officials recommend that the policy change should *not* be included in the upcoming omnibus tax bill.

Consultation

23. The proposals in this report follow public consultation and consideration of submissions from Airbnb, the Asia Internet Coalition, Baker McKenzie, Booking.com, Delivereasy, Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, EY, KPMG, the New Zealand Law Society, PwC, Trade Me, and Uber NZ.

24. The Treasury and the Ministry of Business, Innovation and Employment were consulted on the recommendations in this report. The Ministry of Business, Innovation and Employment noted that the proposals in this report do not affect the work they are doing on the gig economy. The Ministry of Justice were consulted on the penalty implications and no issues were identified during this consultation.

Treasury comment

25. The Treasury supports Inland Revenue's policy recommendations to implement extended electronic marketplace rules to digital platforms that provide accommodation and transportation services. We recommend Ministers agree to include these changes in the upcoming omnibus tax bill.

26. We also recommend letting the additional tax revenue "flow through" to tax forecasts, and we will provide further advice on what impact – if any – this and other tax policy changes should have on Budget allowances when these are set through the Budget Policy Statement later this year.

27. The administration funding impacts for this change should be considered through the Budget process. Accordingly, we recommend appropriating only an additional $1.02 million at this point, deferring the decision as to whether additional funding is required or whether the departmental costs could be met by reprioritising existing resources.

28. For the OECD's information reporting and exchange framework, the Treasury considers that, ideally, enactment of this proposal would be deferred until the build costs have been secured through the Budget process.

29. This would delay implementation of the framework, potentially having some adverse impact on stakeholders and New Zealand's perception as committed to international information-sharing agreements. However, it would avoid a scenario in which legislation passed through the omnibus tax bill must then be undone by a subsequent enactment for want of funding through the Budget. Moreover, it is not self-evident that the change is sufficiently worthwhile to warrant out-of-cycle funding, given the substantial costs to implement. Ministers should carefully consider whether the additional revenue over the longer term and the non-financial benefits outweigh the up-front costs.

30. If you choose to proceed with this change now, the Treasury recommends any additional administrative funding (other than the up-front build costs) through the Budget process.

31. The Treasury notes that future information sharing changes (such as an OECD proposal on cryptocurrency and international tax proposals) could have similar up-front and ongoing costs. The results may be reflected in further costings presented to Ministers before Budget 2023, and you will face similar trade-offs between funding out-of-cycle or deferring to the Budget. Further work on the potential level of costs following the completion of its Business Transformation programme is being undertaken by Inland Revenue. The Treasury recommends that Ministers seek further reporting from Inland Revenue on the build costs associated with measures such as these.

Next steps

32. A draft Cabinet paper that reflects the recommendations in this paper has been appended to this report. This paper can be updated depending on Ministers' final decisions. If Ministers agree to the recommendations the next step would be to lodge the attached Cabinet paper with the Cabinet Office ahead of the Cabinet Economic Development Committee meeting on 29 June 2022.

33. If Cabinet agree to the changes, amendments could be included in the upcoming omnibus tax bill which is scheduled for introduction in August 2022.

Recommended action

We recommend that you:

Key recommendations

a) **agree** to implement the OECD's "Model Rules for Reporting by Platform Operators with respect to Sellers in the Gig and Sharing Economy".

Agreed/Not agreed Agreed/Not agreed

b) **agree** to extend the current electronic marketplace rules for GST to also apply to:

i. taxable accommodation being all accommodation other than exempt residential accommodation

ii. transportation services which include ridesharing and food and beverage delivery, and

iii. other services closely connected with these services if paid for through a digital platform.

Agreed/Not agreed Agreed/Not agreed

c) **note** that to give effect to recommendations (a) and (b), amendments will be required to the Tax Administration Act 1994 and the Goods and Services Tax Act 1985.

Noted Noted

d) if you agree with recommendations (a) and (b), **agree** to:

EITHER

i. include the necessary amendments in the upcoming omnibus tax bill that would give effect to the OECD's information reporting and exchange framework from 1 January 2024, and the extended electronic marketplace rules from 1 April 2024 (Inland Revenue's preferred option).

Agreed/Not agreed Agreed/Not agreed

OR

ii. include the necessary amendments in the upcoming omnibus tax bill that would give effect to the extended electronic marketplace rules from 1 April 2024, but defer decisions on the OECD's information reporting and exchange framework until a later date (The Treasury's preferred option).

Agreed/Not agreed Agreed/Not agreed

Information reporting and exchange: further policy recommendations

e) **note** that for New Zealand to receive information from European member states, New Zealand needs to have rules of equivalence with the European Union.

Noted Noted

f) **note** that the OECD designed an optional extension to the rules referred to in recommendation (a) which covers the sale of goods and vehicle rentals to ensure the OECD's rules are equivalent to the European rules.

Noted Noted

g) **agree** that New Zealand implement the optional extension to the OECD's Model Rules that includes the sale of goods and vehicle rental, to ensure New Zealand has rules of equivalence with the European Union.

Agreed/Not agreed Agreed/Not agreed

h) **agree** not to implement the modification to the OECD's rules that would exempt small (below EUR 1 million per year) New Zealand tax resident digital platforms from the reporting requirements, to ensure New Zealand has rules of equivalence with the European Union.

Agreed/Not agreed Agreed/Not agreed

i) **note** that Inland Revenue do not intend to use the information collected under the information exchange to pre-populate sellers' income tax returns in the first three years of operation.

Noted Noted

Information reporting and exchange: penalties

j) **agree** to introduce a penalty of $300 per failure, up to $10,000 per year (the reportable period) that would apply to New Zealand tax resident digital platforms that failed to comply with their obligations under the OECD's rules.

Agreed/Not agreed Agreed/Not agreed

k) **agree** to introduce penalties that could apply to New Zealand tax resident digital platforms that fail to take reasonable care in complying with their obligations under the OECD's rules of:

i. $20,000 for the first offence, and

ii. $40,000 for subsequent offences, capped at $100,000 per reportable period.

Agreed/Not agreed Agreed/Not agreed

l) **agree** to introduce of a penalty of $1,000 in circumstances where sellers on digital platforms fail to provide the digital platform with the information required under the OECD's rules.

Agreed/Not agreed Agreed/Not agreed

m) **note** that the penalties referred to in recommendations (j) to (l) are consistent with penalties introduced to the Tax Administration Act 1994 for financial institutions required to provide information under the Common Reporting Standard (an OECD information exchange about financial account information).

Noted Noted

n) **note** that in the first years of the OECD's rules being operational in New Zealand, the Commissioner of Inland Revenue would focus on promoting compliance with the rules and would apply discretion in imposing penalties.

Noted Noted

How GST applies – extending electronic marketplace rules: further policy recommendations

o) **note** that as the gig and sharing economy continues to grow, further activities may be identified for inclusion in extended electronic marketplace rules in the future.

Noted Noted

p) **agree** that large commercial operators in the accommodation sector (which have more than 500 listings per year) should be allowed to agree with the digital platforms to continue being responsible for their own GST obligations.

Agreed/Not agreed Agreed/Not agreed

q) **agree** to implement a flat rate scheme that would require digital platforms to return GST to Inland Revenue at a reduced rate where the underlying seller of the accommodation or transportation services is not registered for GST, of 6.5%.

Agreed/Not agreed Agreed/Not agreed

r) **note** that this flat rate scheme would ensure sellers who were not registered (or required to be registered) for GST would receive 8.5% of the total sales from digital platforms in recognition of the otherwise unrecoverable GST on their costs.

Noted Noted

s) **note** that the flat rate was determined based on analysis of GST return information in the transportation and accommodation sectors, and that officials will continue to monitor the flat rate scheme over time to ensure it is achieving its policy objective.

Noted Noted

t) **agree** that the current shortfall penalties in the Tax Administration Act 1994 should apply in circumstances where sellers misrepresent their GST registration status to digital platforms to obtain a greater than intended monetary payment from the digital platforms under the flat rate scheme.

Agreed/Not agreed Agreed/Not agreed

Financial implications

u) **note** that the decisions above will:

i. increase tax revenue (see recommendation (x) below), and

ii. create up-front costs and ongoing costs for Inland Revenue, including build costs, depreciation, capital charge, compliance, and administration (see recommendation (y) below).

Noted Noted

v) **note** that the recommendations below also seek decisions:

i. on whether to appropriate additional funding to meet the ongoing and up-front costs arising from these decisions, or only the up-front costs, and

ii. on what allowance impact, if any, should be recognised arising from the additional revenue and departmental costs.

Noted Noted

w) **note** that, assuming you agree to proceed with:

i. the OECD's information reporting and exchange framework, and appropriate additional funding to meet all the expected costs arising from this, the total fiscal impact is as shown below:

	$ m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Operating Balance and Net Debt Impact	-	(1.400)	(6.700)	(6.800)
Operating Balance Only Impact	-	-	-	-
Net Debt Only Impact	-	13.700	-	-
Total	**-**	**12.300**	**(6.700)**	**(6.800)**

Noted Noted

ii. the extension to the electronic marketplace changes and appropriate additional funding to meet all the expected costs arising from this, the total fiscal impact is as shown below:

	$ m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Operating Balance and Net Debt Impact	-	(11.030)	(46.460)	(46.460)
Operating Balance Only Impact	-	-	-	-
Net Debt Only Impact	-	0.300	-	-
Total	**-**	**(10.730)**	**(46.460)**	**(46.460)**

Noted Noted

Tax revenue impacts

x) **note** the following changes to tax revenue, with a corresponding impact on the operating balance and net debt:

i. if you agreed to introduce the OECD's information reporting and exchange framework at recommendation (d)(i):

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	-	5.500	11.000	11.000
Total Operating	**-**	**(5.500)**	**(11.000)**	**(11.000)**

Noted Noted

ii. if you agreed to implement extended electronic marketplace rules at recommendations (d)(i) or (d)(ii):

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax Revenue	-	11.750	47.000	47.000
Total Operating	**-**	**(11.750)**	**(47.000)**	**(47.000)**

Noted Noted

Appropriation impacts

y) **agree** to the following changes to appropriations to give effect to the decisions at recommendations (d)(i) or (d)(ii) above:

i. if you agreed to implement the OECD's information reporting and exchange framework at recommendation (d)(i):

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Multi-Category Expenses and Capital Expenditure (MCA): *Services to customers*				
Services to Ministers and to inform the public…	-	0.300	0.390	0.400
Services to process obligations and entitlements	-	3.400	3.270	3.140
Management of debt and outstanding returns	-	0.200	0.320	0.320
Investigations	-	0.200	0.320	0.340
Total Multi-Category Expenses and Capital Expenditure	-	4.100	4.300	4.200
Total Operating	**-**	**4.100**	**4.300**	**4.200**
Inland Revenue Department – Capital Expenditure PLA	-	13.700	-	-
Total Capital	**-**	**13.700**	**-**	**-**

Agreed/Not agreed Agreed/Not agreed

ii. if you agreed to implement the extended electronic marketplace rules at recommendation (d)(i) or (d)(ii):

EITHER

A. **agree** to appropriate additional funding to meet the up-front and ongoing costs (Inland Revenue's preferred option):

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Multi-Category Expenses and Capital Expenditure (MCA): *Services to customers*				
Services to Ministers and to inform the public…	-	0.050	0.020	0.020
Services to process obligations and entitlements	-	0.210	0.120	0.120
Management of debt and outstanding returns	-	0.250	0.200	0.220
Investigations	-	0.210	0.200	0.180
Total Multi-Category Expenses and Capital Expenditure	-	0.720	0.540	0.540
Total Operating	**-**	**0.720**	**0.540**	**0.540**
Inland Revenue Department – Capital Expenditure PLA	-	0.300	-	-
Total Capital	**-**	**0.300**	**-**	**-**

Agreed/Not agreed Agreed/Not agreed

OR

B. **agree** to appropriate additional funding to meet the up-front costs only (The Treasury's preferred option):

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Multi-Category Expenses and Capital Expenditure (MCA): *Services to customers*				
Services to Ministers and to inform the public…	-	0.050	-	-
Services to process obligations and entitlements	-	0.210	-	-
Management of debt and outstanding returns	-	0.250	-	-
Investigations	-	0.210	-	-
Total Multi-Category Expenses and Capital Expenditure	-	0.720	-	-
Total Operating	**-**	**0.720**	**-**	**-**
Inland Revenue Department – Capital Expenditure PLA	-	0.300	-	-
Total Capital	**-**	**0.300**	**-**	**-**

Agreed/Not agreed Agreed/Not agreed

Allowance and other impacts

z) **agree** to manage the additional revenue noted above at recommendation (x):

i. if you agreed to implement the OECD's information reporting and exchange framework at recommendation (d)(i):

EITHER

A. against the Tax Policy Scorecard (Inland Revenue and the Treasury's preferred option)

Agreed/Not agreed Agreed/Not agreed

OR

B. as agreed below, at recommendation (z)(ii).

ii. if you agreed to implement the extended electronic marketplace rules in recommendations (d)(i) or (d)(ii):

EITHER

A. allow the revenue to "flow through" in the expectation that officials will advise later on what impact, if any, this, and other tax policy changes should have on future Budget allowances (The Treasury's preferred option).

Agreed/Not agreed Agreed/Not agreed

OR

B. pre-commit the additional revenue against the Budget 2023 allowance.

Agreed/Not agreed Agreed/Not agreed

aa) **agree** to manage the additional departmental costs agreed at recommendation (y) as a pre-commitment against the Budget 2023 allowance.

Agreed/Not agreed Agreed/Not agreed

Lodgement of the Cabinet paper

bb) **authorise** lodgement of the attached Cabinet paper with the Cabinet Office before 10:00 a.m. on Thursday, 23 June 2022 for consideration by the Cabinet Economic Development Committee on Wednesday 29 June 2022.

Authorised/Not authorised

s 9(2)(a)

Graeme Morrison
Policy Lead
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Information reporting and exchange

Problem definition

34. The discussion document noted that Inland Revenue does not currently receive regular income information about sellers' incomes earned on digital platforms in the gig and sharing economy. This means that sellers themselves need to report this information to Inland Revenue when completing their end of year income tax return. This increases the risk that sellers will not declare their income, or will under-report their income, which requires investigative resource to address.

35. In contrast, Inland Revenue does receive regular income information from other third parties and intermediaries in the tax system. For example, employers and banks are required to provide Inland Revenue with regular employment and investment income information. That information is then used by Inland Revenue to pre-populate income tax returns which reduces opportunities for taxpayers to be non-compliant by not declaring or under-reporting income from these sources.

36. This problem is common among countries where the gig and sharing economy is popular. Some countries have implemented (or are in the process of implementing) bespoke information reporting requirements (such as Australia) where foreign digital platforms are required to provide information to tax authorities where that information relates to tax residents of that country. If each country implemented bespoke reporting requirements, this would significantly increase compliance costs on multinational digital platforms that have a presence in a number of countries across the globe.

Proposed solution

37. It is against this background that the OECD developed Model Rules for Platform Operators with Respect to Sellers in the Gig and Sharing Economy. These rules would require New Zealand tax resident digital platforms to provide Inland Revenue with information about sellers' incomes earned through that platform for personal services, accommodation rental, and, under the extended module, information about vehicle rentals and the sale of goods. This extended module aims to match rules developed by the European Commission which will apply to members in the European Union from 2023. The purpose of the OECD's rules is to create a standardised reporting framework which, relative to countries implementing bespoke reporting requirements, results in reduced compliance costs for multinational digital platforms.

38. Under the OECD's rules, multinational digital platforms have a reporting obligation to one tax authority. The digital platform must provide information, in a standardised OECD format, to the tax authority in which it is a tax resident. The information required to be provided enables the receiving tax authority to share information with other tax authorities, to the extent that the information is relevant to them. For example, if New Zealand implemented the OECD's rules, Inland Revenue would receive information about New Zealand tax resident sellers on multinational digital platforms from other OECD jurisdictions and European countries.

39. For New Zealand tax resident digital platforms, and to ensure equivalence with rules designed by the European Commission, information will need to be reported to Inland Revenue about non-residents' sales of accommodation, personal services, vehicle rentals, and goods.

40. We do not propose that New Zealand tax resident digital platforms be required to provide Inland Revenue information about the sale of goods or vehicle rentals under the OECD's optional module for New Zealand tax resident sellers. This is because the sale of goods will not always give rise to income for income tax purposes, and implementing the OECD's rules in respect of New Zealand tax resident sellers for this information will impose considerable and unjustified compliance costs. Inland Revenue could also, if needed, use its existing information demand powers to obtain information about the sale of goods through New Zealand tax resident digital platforms.

41. The first calendar year of operation for the OECD's rules (and the European rules) is 2023. Because changes to New Zealand's laws are required to give legislative effect to the OECD's rules, and the earliest possible bill that could incorporate these amendments is expected to pass in March 2023, we recommend that New Zealand implement the OECD's rules with effect from 1 January 2024. This is consistent with the implementation timeline for the United Kingdom s 9(2)(ba) .

42. The cost of this application date means that Inland Revenue will not receive information about New Zealand tax resident sellers on digital platforms for the 2023 calendar year. We do not support implementing the rules for the 2023 calendar year because this would require retrospective legislation and would likely impose significant compliance costs on digital platforms in New Zealand without sufficient time for them to make the necessary changes to their systems.

Optional exemption for small digital platforms in New Zealand

43. The OECD's rules allow countries to implement an optional modification to exempt small digital platforms from the reporting requirements. Submissions from digital platforms generally did not support this exemption, noting it would be contrary to the policy objective of improving Inland Revenue's visibility of sellers' incomes earned across all digital platforms. Other submitters supported the exemption because of the compliance cost savings on small digital platforms.

44. We acknowledge the exemption would have compliance cost benefits for smaller digital platforms, however, the disadvantages of implementing this exemption is that Inland Revenue would have reduced visibility of income earned from sellers on these platforms unless a different reporting mechanism was designed, and implementation of this exemption could mean that New Zealand did not have rules of equivalence with Europe. For these reasons we do not recommend implementing the exemption in New Zealand.

Using information to pre-populate sellers' income tax returns

45. The discussion document also asked submitters whether the information received from the OECD's information reporting and exchange framework should be used to pre-populate sellers' income tax returns. It noted that the data related to a calendar year, and not the New Zealand tax year, which made pre-population impractical. Various methods to overcome this timing mismatch were included in the discussion document – such as partial pre-population for nine out of 12 months of the tax year, or an attribution method where calendar year income would be attributed to the New Zealand tax year.

46. Submitters had mixed views on which method would be preferable. Submitters also noted that pre-population would only marginally reduce compliance costs relative to the status quo, where sellers will be aware of the income they earned from the digital platforms because they will receive confirmation of this information themselves.

47. We note that there are often data integrity concerns with OECD information exchanges in the first few years of operation. For this reason, we recommend that further thought is given to how the information received under this information exchange is used in pre-populating sellers' income tax returns, and that we report back in the future on the preferred approach after several years of the information exchange having run.

Penalties supporting the OECD's rules

48. We recommend introducing new civil penalties to the Tax Administration Act 1994 that the Commissioner of Inland Revenue (the Commissioner) could impose in circumstances where sellers, and New Zealand tax resident digital platforms, fail to comply with their obligations under the OECD's rules. This includes, for example, situations where information is not provided to Inland Revenue on time or is otherwise incomplete or incorrect.

49. In circumstances where New Zealand tax resident digital platforms failed to comply with their obligations under the OECD's rules, we recommend introducing a penalty of $300 per failure, and capped at $10,000 per reportable period, which is one year.

50. If New Zealand tax resident digital platforms failed to take reasonable care in complying with their obligations under the OECD's rules, we recommend the Commissioner be able to impose a penalty of up to $20,000 for the first offence, and $40,000 for subsequent offending, capped at $100,000 per reportable period.

51. For sellers that fail to provide the correct information to New Zealand tax resident digital platforms, we recommend the Commissioner can impose a penalty of $1,000.

52. These penalties are consistent with penalties introduced when the Common Reporting Standard – another OECD information reporting and exchange framework relating to financial account information – was implemented in New Zealand. These penalties will also help ensure that New Zealand's implementation of the OECD's rules have equivalence to the rules developed by the European Commission.

How GST should apply

Problem definition

53. The discussion document noted that activities performed by sellers in the gig and sharing economy should be subject to GST, as this would ensure that there was a similar GST treatment between supplies of things which were substantially the same or similar. For example, short stay accommodation through a digital platform should have a similar GST treatment to short stay accommodation provided through hotels and motels, where GST currently applies. Further, as the gig and sharing economy is expected to continue growing (given its popularity), there is currently a significant proportion of economic activity which is not subject to GST, which is inconsistent with New Zealand's broad based GST framework.

54. To address this, the discussion document noted that the current GST registration threshold of $60,000 of sales per 12-month period could be reduced for sellers in the gig and sharing economy. In the alternative, the current electronic marketplace rules which apply to sales of "remote services" and low value imported goods could be extended to also apply to supplies of taxable (short stay) accommodation in New Zealand, and other personal services. The electronic marketplace rules were originally introduced in 2016 for remote services and extended to apply to low value goods in 2019. We consider these rules have been successful.

Stakeholder views

55. Submitters on the discussion document opposed the GST proposals. The reasons for this were because submitters considered the proposals would introduce additional complexity to New Zealand's GST system resulting in increased compliance costs for sellers and digital platforms, and because there was a lack of evidence to suggest that GST not applying to most activities in the gig and sharing economy is causing distortions.

56. It was suggested that New Zealand should focus on implementing the OECD's information reporting and exchange framework, so it could build an evidence base on the size of the gig and sharing economy in New Zealand and consider GST proposals in the future. It was also noted that implementing changes to the GST system would impose compliance costs on the digital platforms, which are currently focused on making changes to their systems to comply with the OECD's information reporting and exchange framework.

57. Technical issues with the proposals were also identified, such as the need for it to be clear when the digital platform would be deemed to be the supplier of the services that were made by someone else; and that New Zealand currently received GST on many "personal services" which are provided through non-resident digital platforms under the remote services rules.

58. Submitters also noted that unlike the electronic marketplace rules for remote services and low value goods, where the underlying suppliers would be unlikely to have incurred New Zealand GST on their costs, most sellers in the gig and sharing economy are based in New Zealand and would be incurring New Zealand GST on their costs. The methods to enable recovery of GST on expenditure were complex and would result in increased compliance costs for sellers on digital platforms, who were generally unsophisticated taxpayers.

The case for GST applying

59. The decision to implement changes to the GST system that would require digital platforms in the gig and sharing economy to be responsible for collecting and returning GST to Inland Revenue depends on competing policy objectives. There are trade-offs between maintaining an efficient GST system with a broad base and reducing compliance and administration costs.

60. On balance, we consider there are strong arguments for proceeding with introducing extended electronic marketplace rules in New Zealand. These are:

    60.1 Doing so would improve the efficiency and fairness of New Zealand's GST system by ensuring that supplies of services that are substantively the same, or similar in nature, have the same GST treatment.

    60.2 It is expected that the gig and sharing economy will continue to grow over time. Unless changes to New Zealand's GST system are made, this could result in a considerable proportion of economic activity which is not subject to GST. This would be inconsistent with New Zealand's broad-based GST framework.

61. Under extended electronic marketplace rules, all the existing rules that apply to electronic marketplaces for the purposes of the remote services rules and low value imported goods rules would be extended to apply to additional services which were added. This should go some ways towards addressing issues identified in submissions on the discussion document that it may be confusing to determine when the digital platform is deemed to be the supplier of the underlying services performed by the sellers. This is because the rules for electronic marketplaces have been in place for several years and are generally well understood.

62. In recognition of the technical complexities raised with "personal services",[1] we recommend that GST is instead applied to taxable accommodation (and services closely connected with taxable accommodation, and which is paid for through the digital platform, such as cleaning) and transportation services (which includes ridesharing and food and beverage delivery services).

63. Accommodation and transportation services were identified by the OECD as the sectors that created the most urgent pressures from a GST perspective in the gig and sharing economy. This is consistent with our analysis of tax return information for both income tax and GST for these sectors. GST applies to accommodation services in similar circumstances in other OECD countries, to varying degrees, such as Canada, India, and Mexico. For transportation services, Australia and Canada require GST registration for taxi and ridesharing providers. Further activities or sectors (such as personal and professional services to the extent not currently subject to GST) could be added over time, in response to new and emerging business models in the gig and sharing economy.

64. We recommend that the digital platforms would be deemed the supplier of the accommodation and transportation services where the digital platform: authorised the charge for the services, and/or directly or indirectly set a term or condition in relation to the supply. These are the same rules that apply for remote services and low value imported goods. We recommend that there are exceptions for large commercial operators, such as hotels, where they can enter into agreements with digital platforms, enabling them to remain responsible for their own GST obligations.

65. For digital platforms that do not process the payments from buyers themselves, we recommend the existing bad debt deduction rule be extended to apply in these circumstances.[2]

66. We note that implementing extended electronic marketplace rules would impose compliance costs on digital platforms which would become liable for returning GST on behalf of sellers who operate on them. We note that these sellers, in many circumstances, are not required to be registered for GST because they operate below the GST registration threshold. The policy rationale for the GST registration threshold is to recognise that there are trade-offs between maintaining a broad GST base that reduces distortions against the compliance and administration costs associated with GST registration.

67. With extended electronic marketplace rules, the registration threshold is effectively applied to the digital platform (and not the underlying sellers on the digital platforms themselves). The digital platform would become responsible for collecting and returning GST to Inland Revenue on a regular basis. To maintain the principle that GST is not a cost on businesses but is instead a tax on final/private consumption, if extended electronic marketplace rules were implemented, sellers would need a method to recover GST on their costs. This is discussed further from paragraph 71.

68. It is expected that the cost of services provided through digital platforms in the gig and sharing economy will increase by approximately 15% if extended electronic marketplace rules are implemented. There is also a risk that digital platforms may leave the New Zealand market. This risk was identified with the earlier remote services and low value imported goods rules but did not eventuate in either of those cases.

[1] GST currently applies to many personal services where they are "remote services" under current GST law. A personal service is a remote service if there is no necessary connection between the place where the services are physically performed and the recipient of the service, provided that the service is arranged through an electronic marketplace.

[2] This rule allows electronic marketplaces to claim a bad debt deduction for the GST that they would be liable for in relation to the supply of services made through the platform. To the extent that the digital platform recovers the payment for these services from the underlying seller, this bad debt deduction is reversed. We understand this rule works well in practice for electronic marketplaces that facilitate the supply of low value imported goods.

The effect on large commercial operators which are currently returning GST

69. Some submitters were concerned that implementing extended electronic marketplace rules may result in double taxation of the same services. This could apply where, for example, hotels advertised taxable accommodation on digital platforms. These hotels are already returning GST on these supplies of short stay accommodation, and if platforms were deemed the supplier, there is a risk of GST being charged twice on the same supply.

70. To mitigate this risk, we recommend that large commercial operators in the accommodation sector be able to enter into agreements with digital platforms that would allow GST to continue being the responsibility of the large commercial operator and not the digital platforms. In defining a large commercial operator, we recommend a service provider of taxable accommodation that has at least 500 listings per year.

GST on sellers' costs

71. The discussion document noted three different methods for enabling sellers to recover GST on their costs. These methods were: standard GST registration (which is the status quo), a flat rate scheme (which would require digital platforms to collect GST at the standard rate, and return a reduced rate to Inland Revenue, with the difference being passed on to the sellers by the digital platform as an approximation of the GST on the costs incurred by the sellers), and a method that involved integrating GST concepts into the income tax return.

72. Submitters noted that all these options would result in increased compliance costs for sellers, and/or the digital platforms (in the case of the flat rate scheme). We note that there are competing policy objectives here. If the primary policy objective is to ensure that sellers in the gig and sharing economy, who would be subject to GST under extended electronic marketplace rules, are no better (or worse) off than under a standard GST registration, then sellers should be required to register for GST and comply with the rules in the usual way. On the other hand, if the primary policy objective were to reduce compliance costs for sellers, a flat rate scheme approach could be implemented.

73. We therefore recommend a hybrid approach under which sellers on digital platforms could choose to be registered for GST if they wanted to, and this would ensure the highest degree of accuracy in terms of GST recovery on their costs; but for sellers that were below the GST registration threshold, they could choose the flat rate scheme. This has implications for the digital platforms who would need to differentiate between sellers that purported to be registered for GST and sellers that purported not to be registered for GST.

The flat rate scheme

74. The flat rate scheme is intended to discourage GST registration by ensuring that sellers' GST costs are recognised in an approximate way through payment from the digital platforms. The way it achieves this is:

    74.1 Digital platforms would charge and collect GST at the standard GST rate on the supplies that are made through the platform. The digital platforms would return to Inland Revenue a reduced amount as GST.

    74.2 The difference between the standard rate of GST and this reduced amount would be passed on to the sellers by the digital platforms. Where this applied, sellers would not be able to register for GST and recover GST on their costs like they would with a standard GST registration.

75. Determining an appropriate flat rate that achieves this objective, and which is representative of the actual amount of GST that a seller would be expected to be able to recover under a standard GST registration, has been difficult.

76. We have relied on information included in GST returns for short stay accommodation providers and taxi drivers. We have identified these taxpayers using Business Industry Classification (BIC) codes which are disclosed by taxpayers. These returns show a range of expense to sales ratios which we have used to determine the flat rate that would be appropriate for both short stay accommodation and transportation.

77. Because GST returns do not distinguish between expenditure for capital assets (such as land and motor vehicles) and operating expenditure (such as rates, insurance, vehicle registration, fuel, etc) we have excluded those with expenses greater than sales to arrive at the rate. It would be inappropriate for the flat rate scheme to recognise GST on capital assets, as unlike an ordinary GST registration, where the flat rate is used, there will be no corresponding GST liability on assets retained when the seller stops providing their services through a digital platform.

78. Based on this analysis, we recommend a flat rate scheme of 6.5% (which would be the percentage of GST that will be paid to Inland Revenue by the digital platforms) and 8.5% which would be the amount passed on to sellers, in recognition of the otherwise unrecoverable GST on their costs, by the digital platforms.

79. The flat rate scheme should only be available to sellers who are not required to be registered for GST under the current rules. For sellers that choose to be registered, or who are required to be registered, the flat rate scheme should not be available. This is because one of the main policy objectives of the flat rate scheme is to reduce compliance costs for sellers by discouraging voluntary GST registrations.

80. We recommend that the rate be monitored over time to ensure that it is meeting its policy objectives.

Facilitation services

81. Digital platforms charge sellers for the service of connecting sellers with buyers. The fee for these services is generally subject to GST under the remote services rules but whether it is subject to GST at 15% or zero-rated depends on the sellers' GST registration status. If the seller is registered for GST, the facilitation services are either zero-rated or not subject to GST. This is on the basis that the seller, being a registered person, would be able to recover the GST component of any facilitation services through the GST return process. If the seller is not registered for GST, the facilitation services are subject to GST at 15%.

82. The discussion document asked whether, if extended electronic marketplace rules were implemented, facilitation services should continue being subject to zero-rating when supplied to registered persons, or whether they should instead always be standard rated. Standard rating facilitation services could result in compliance cost reductions for digital platforms which would not need to apply different GST treatments to the same services depending on the GST registration status of the recipient.

83. Submissions on whether facilitation services should be standard rated or zero-rated in the context of extended electronic marketplace rules were mixed. Some submitters supported zero-rating of facilitation services on the grounds it would reduce compliance costs for digital platforms as it would save them from having to apply different GST treatments to the services based on the GST registration status of the recipient of the services (the sellers). Others considered all facilitation services should be standard rated for the same reason.

84. Under the proposed flat rate scheme, digital platforms will be required to ask sellers for their GST registration status (and sellers will need to be able to update their GST registration status if their circumstances change) so the digital platform can apply the flat rate to sales on behalf of unregistered sellers (as opposed to the standard GST rate for GST registered sellers). As the digital platforms will be required to know the GST registration status of the underlying sellers, and this can be used to determine the GST treatment of facilitation services, we recommend no changes to the current GST rules for facilitation services.

Penalties supporting the GST proposals

85. The Tax Administration Act 1994 includes a range of civil and criminal penalties. Civil penalties apply to the late filing of returns and the late payment of tax. Civil penalties also apply to tax shortfalls (being the difference in the amount of tax assessed by a taxpayer, and the amount actually payable by the taxpayer). Criminal penalties can apply in cases involving evasion and fraud.

86. Implementing extended electronic marketplace rules as described in this report would not require the creation of new civil or criminal penalties. The existing penalties for the late filing of GST returns and the late payment of GST in the Tax Administration Act 1994 would be appropriate. We recommend clarifying that shortfall penalties can apply in circumstances where sellers misrepresent their GST registration status to digital platforms to obtain a greater monetary advantage. This would mean that sellers could, depending on the circumstances, be liable for penalties between 20% and 150% of the tax shortfall caused as a result of their failure to notify the digital platform of their correct GST registration status.

Impact analysis

87. The proposal to introduce extended electronic marketplace rules for platforms that enable taxable accommodation and transportation services has economic implications and compliance and administration cost implications.

88. If GST applied to these services when provided through digital platforms, it is expected that the price of these services would increase by 15%. Submitters suggested that implementing these changes may encourage consumers to purchase these services directly from sellers instead of through digital platforms. We acknowledge the proposal could increase the incentive for this at the margins in the accommodation sector, where hosts may rely on digital platforms to connect them with guests who they then develop a direct relationship with for the future. We do not consider this a material risk for transportation services, however, and note that substitutable services (such as taxi drivers, or restaurants that provide food delivery services themselves) are generally subject to GST anyway.

89. There would be up-front and ongoing compliance costs for digital platforms, which would need to adapt their systems to be compliant with the new rules, and would need to ensure that they remained compliant, and provided support to their users in the event of queries. These compliance costs were referred to in submissions on the discussion document made by digital platforms. These factors could also result in additional increases in the cost of the services provided through these digital platforms to consumers.

90. Sellers on these platforms would also incur compliance costs to the extent that they decided to register for GST. The flat rate scheme, as an option, should mitigate this impact on sellers who will not be required to register for GST unless they exceed the GST registration threshold.

91. Inland Revenue would need to ensure that these rules were communicated and understood. There would also be associated ongoing monitoring of compliance with the new rules required, as with any changes to tax laws.

Application date

92. Digital platforms have indicated that, as a general rule, a period of at least 12 months following enactment of the relevant legislation, alongside clear published guidance on the new rules, is required to make the necessary system changes.

93. If you agree to implementing extended electronic marketplace rules, we therefore recommend an application date of 1 April 2024. If the legislative changes are included in the August 2022 omnibus tax bill, which is expected to pass by 31 March next year, this would ensure 12 months' time for implementation is available for digital platforms.

Other measures to reduce compliance costs

94. The discussion document also sought feedback on other measures that could be implemented that would reduce compliance costs for sellers in the gig and sharing economy. Examples included in the discussion document were:

    94.1 Ensuring that the standard cost income tax deductions for mixed-use assets (such as homes and motor vehicles) would be available for sellers in the gig and sharing economy. These deductions are based on average costs, and for sellers that choose to use them, reduce compliance costs associated with record keeping and calculating deductions that are available based on actual use.

    94.2 Changes to the GST system to allow capital assets to be opted-out of the GST base. Sellers in the gig and sharing economy may purchase an asset which they use to make taxable supplies, and they are therefore entitled to claim a credit for any GST they incur. When the sellers' taxable activity stops, or the asset is otherwise disposed of, there will be a corresponding GST liability. There are also apportionment and adjustment rules which apply to assets which can be complex to apply.

95. No further suggestions on other measures to reduce sellers' compliance costs were included in submissions. No changes are needed to New Zealand's tax laws to enable standard cost income tax deductions for mixed-use assets. Changes to the GST system to allow capital assets to be opted-out of the GST base will be progressed in a separate tax policy report on GST apportionment issues (IR2022/269 refers).

Financial implications

96. The financial implications arising from these proposals present choices for Ministers. Broadly, both policy proposals are expected to raise revenue: the OECD's information reporting and exchange framework is likely to raise an additional $11 million each year, while the proposal to implement extended electronic marketplace rules where GST would apply to accommodation and transportation services provided through digital platforms will likely raise $47 million each year. There are, however, up-front build costs (particularly for the OECD's information reporting and exchange framework, which may cost up to $13.7 million to introduce), as well as the associated depreciation and capital charge, and ongoing administration costs. All these estimates are subject to some uncertainty.

97. **Treatment of additional revenue:** Your options for both changes are to add the revenue to the Tax Policy Scorecard, to manage the impact through allowances, or allow the revenue to "flow through" for now, and consider the revenue as part of setting Budget allowances later this year for the Budget Policy Statement. The Treasury recommends you:

97.1 allow the revenue from implementing extended electronic marketplace rules for GST to "flow through". This is because adding this revenue to the Scorecard would take it over its cap (T2021/1273 refers); and

97.2 manage the revenue from the OECD's information reporting and exchange framework through the Scorecard, as is the default, although there is a case for allowing it to flow through to offset the substantial one-off build costs.

98. **Ongoing departmental costs:** The costs associated with these changes for Inland Revenue are significant. For implementation of extended electronic marketplace rules, the most significant costs are ongoing: less than $1.02 million would need to be appropriated in the first year, but over five years, the cost is likely to be just over $2.1 million. If you wished to defer consideration of the ongoing costs for this proposal, Treasury officials recommend proceeding to include this change in the upcoming omnibus tax bill, and appropriating only $1.02 million now. Inland Revenue recommend appropriating the full $2.1 million now.

99. **Up-front build costs**: By contrast, for the OECD's information reporting and exchange proposal, the largest cost is the up-front capital expenditure (which could be up to $13.7 million). We recommend that this funding should be appropriated when the change is legislated, as it is non-discretionary spend associated with the policy change rather than departmental costs that could be met from re-prioritisation. If you do not wish to appropriate additional funding for this now, Treasury officials recommend that the policy change should *not* be included in the upcoming omnibus tax bill.

100. Given this, Ministers could consider implementing the extended electronic marketplace rules in the upcoming omnibus tax bill and not the OECD's information reporting and exchange framework. Inland Revenue does not recommend this option for four reasons:

100.1 First, there will be an expectation that the OECD's rules are implemented in New Zealand at some point. Deferring the decision not only results in foregone tax revenue of $11 million per year, but could also signal that New Zealand is not supportive of the OECD's rules, which are also being implemented in other OECD countries such as s 9(2)(ba) the United Kingdom on the same timeline as is proposed for New Zealand (the 2024 calendar year).

100.2 Second, the OECD's rules have a significant amount of support from tax authorities and multinational digital platforms. The OECD's rules are the product of extensive consultation between the OECD, tax authorities, and multinational digital platforms. The support that New Zealand implement these rules was evident in submissions on the discussion document, where all submitters agreed with it being the preferred option to address the information gap for Inland Revenue in respect of sellers on digital platforms in the gig and sharing economy.

100.3 Third, a decision to defer implementing the OECD's information reporting and exchange framework in New Zealand could result in adverse compliance costs for New Zealand digital platforms with non-resident sellers. This is because New Zealand digital platforms could have reporting obligations to multiple foreign tax authorities (because New Zealand digital platforms would be expected to provide information to foreign tax authorities about non-resident sellers operating on their platforms). Under the OECD's rules, New Zealand digital platforms would only be required to provide information to Inland Revenue, and Inland Revenue would then exchange that information with other OECD members. This results in a substantial compliance cost reduction for New Zealand based digital platforms by there being only one reporting obligation.

100.4 Fourth, there is a risk that a decision to implement the OECD's information reporting and exchange framework in the future may coincide with other OECD information exchange proposals which are currently being developed (such as for cryptocurrency and international tax proposals). If these proposals all coincided at the same time, Inland Revenue could face significant challenges making the necessary changes to its START system to give effect to them all on the same timeline.

Administrative implications

101. The proposals outlined in this report will have up-front and ongoing administration costs for Inland Revenue.

101.1 For the OECD's information reporting and exchange framework: the estimated costs are up to $26.3 million, which includes $13.7 million for the capital system building, $5.6 million for administration costs, and $7 million for depreciation and capital charge.

101.2 For the extended electronic marketplace proposals: the estimated costs are up to $2.1 million, which includes $0.3 million for the capital system building, $1.7 million for the administration costs, and $0.1 million for depreciation and capital charge.

102. There are different options for managing these costs. One option would be for Ministers to agree to all the additional funding up-front (which would include build costs, depreciation, capital charge and ongoing administration). That would allow both proposals to be included in the upcoming omnibus tax bill. This is Inland Revenue's preferred option. The Treasury recommends that, if you wish to proceed with this option, you should manage the cost as a pre-commitment against the Budget 2023 allowance.

103. Another option would be to defer agreeing to some or all the additional departmental funding. If you were concerned about the ongoing administration costs, you could agree to fund only the up-front costs ($1.02 million) now, and direct Inland Revenue to seek the remaining amount (approximately $1.08 million) through the Budget process. The Treasury, but not Inland Revenue, recommends this option.

104. If you were concerned about the up-front build costs associated with the information reporting and exchange proposal, you could choose to defer enactment of the proposal and direct Inland Revenue to submit a Budget bid for the funding necessary for the change to progress. This would delay implementation by at least a year, costing either $11 million in foregone revenue (if the extension to the electronic marketplace rules were unaffected, as the Treasury would recommend) or $47 million (if Ministers agreed to also delay the extension to the electronic marketplace rules, noting Inland Revenue's preference is to keep the two proposals on the same timeline).

105. Note that, if you wish to enact these changes into law through the upcoming omnibus tax bill, the Bill will need to be passed before Budget decisions are published. If Inland Revenue's Budget bid(s) for costs associated with these changes were unsuccessful, Ministers would then face a choice between amending the legislation, requiring Inland Revenue to reprioritise its existing resources, or risk the changes being unimplemented. Digital platforms may have invested their own resources in preparation of the changes by this point. We consider that this is a scenario that should be avoided.

Next steps

106. If you agree with the proposals in this report, the necessary legislative amendments could be included in the upcoming omnibus tax bill which is scheduled for introduction in August 2022.

107. To meet timeframes for the upcoming omnibus tax bill, Cabinet approval will be required by early July. We have prepared a draft Cabinet paper for you to take to the Cabinet Economic Development Committee on 29 June 2022. We will amend this paper if necessary to reflect the decisions taken by Ministers in this report. We have also provided copies of the Regulatory Impact Statements for the proposals.

108. The appended draft Cabinet paper will need to be lodged with the Cabinet Office by 10:00 a.m. on Thursday, 23 June 2022. We will work with your office to coordinate comments and feedback on the Cabinet paper ahead of its lodgement.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Housing remedials for August 2022 tax bill

Date:	10 June 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/293

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	24 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Chris Gillion	Policy Lead	s 9(2)(a)
Melissa Siegel	Senior Policy Advisor	

10 June 2022

Minister of Revenue

Housing remedials for August 2022 tax bill

Executive summary

Purpose

1. This report seeks your agreement on potential remedial amendments relating to the taxation of residential property that could be included in the next omnibus tax bill scheduled for introduction in August 2022.

2. The issues and recommendations outlined in this report are remedial in nature and do not require Cabinet approval. They are intended to ensure the relevant tax law is consistent with the policy intent. The remedials seek to maintain the coherence and integrity of the tax system. There are no fiscal implications associated with any of the changes recommended in this report.

Background

3. There has been significant reform of the taxation of residential property in recent years, including:

    3.1 The introduction of interest limitation rules to deny interest deductions in relation to residential property (enacted in March 2022);

    3.2 The extension of the bright-line test, which taxes disposals of residential property made within a certain period, from five to 10 years (enacted in March 2021);

    3.3 Further changes to bright-line test settings, including: a shorter five-year test for new builds; rollover relief for certain common land transactions, most commonly those where there is a change in legal ownership but not economic ownership; and changes to the main home exclusion (enacted in March 2022); and

    3.4 The introduction of residential rental loss ring-fencing rules to prevent rental losses being offset against other income such as salary and wages (enacted in 2019).

4. As part of the bedding-in process of any new regime, issues are identified where the legislation does not achieve the policy intent, or where there are unintended consequences. Fixing these remedials is an important part of the tax policy process to ensure the rules operate efficiently and correctly.

Consultation

5. Treasury has been consulted on the contents of this report.

6. We undertook limited consultation with private sector stakeholders on the issues and recommended changes outlined in this report.

Next steps

7. Subject to your approval, we will prepare draft legislation for inclusion in the next omnibus tax bill scheduled for introduction in August 2022.

Recommended action

We recommend that you:

8. **indicate** in the body of this report where you agree or do not agree with a recommended amendment;

   Indicated

9. **agree** that approved amendments will be included in the next omnibus tax bill scheduled for introduction in August 2022.

   Agreed/Not agreed

s 9(2)(a)

[redacted]

Chris Gillion
Policy Lead
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

Background

10. There has been significant reform of the taxation of residential property in recent years, including:

    10.1 The introduction of interest limitation rules to deny interest deductions in relation to residential property (enacted in March 2022);

    10.2 The extension of the bright-line test from five to 10 years (enacted in March 2021);

    10.3 Further changes to bright-line test settings, including: a shorter five-year test for new builds; rollover relief for certain common land transactions, most commonly those where there is a change in legal ownership but not economic ownership; and changes to the main home exclusion (enacted in March 2022); and

    10.4 The introduction of residential rental ring-fencing rules to prevent rental losses being offset against other income such as salary and wages (enacted in 2019).

11. The bright-line test taxes the disposal of residential land made within a certain period. The length of the bright-line period is dependent on when the person acquired the residential land:

    11.1 A two-year test applies to residential land acquired on or after 1 October 2015 and before 29 March 2018.

    11.2 A five-year test applies to residential land acquired on or after 29 March 2018 and before 27 March 2021.

    11.3 A 10-year test applies to residential land acquired on or after 27 March 2021.

12. As part of the bedding-in process of any new regime, issues are identified where the legislation does not achieve the policy intent, or where there are unintended consequences. Remedying these issues is an important part of the tax policy process to maintain the integrity of the tax system and to ensure the tax system operates correctly and efficiently.

13. If you agree to provide a legislation solution to the issues outlined in this report, these amendments could be included in the next omnibus tax bill scheduled for introduction in August 2022.

14. All of these issues are remedial in nature and do not require Cabinet approval. There are no fiscal implications associated with our recommendations. The recommended changes are covered by approved funding which would cover any associated administrative costs and systems or technology implications.

15. In this report, the Income Tax Act 2007 is referred to as "the ITA" and the Tax Administration Act 1994 as "the TAA".

Rollover relief: bright-line test and interest limitation

16. Rollover relief under the bright-line test ensures that certain transfers of residential land are not taxed at the time of the transfer, but instead, the recipient takes on the original owner's acquisition cost and date. When the recipient disposes of the residential land, this cost and acquisition date will determine whether the disposal is taxed under the bright-line test.

17. In the context of interest limitation, interest deductions for residential property will be gradually phased out between 1 October 2021 and 31 March 2025 for properties

acquired before 27 March 2021. For properties acquired on or after 27 March 2021, interest deductions have been denied since 1 October 2021. Rollover relief ensures that certain legal restructures do not kick someone out of this phasing-out period and into full denial before 31 March 2025.

18. The bright-line test as introduced in 2015 included limited relief for certain transfers: relationship property, inherited property, and company amalgamations. The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 introduced additional rollover relief rules for certain legal transfers of residential land when there is no underlying change in economic ownership. The changes extended coverage of rollover relief to the following legal structures from 1 April 2022, provided certain conditions are met:

    18.1 Family trusts: standard trusts and Māori authority trusts,

    18.2 Look-through companies,

    18.3 Partnerships,

    18.4 Treaty of Waitangi settlements, and

    18.5 Transfers within wholly-owned groups of companies.

19. The extent of relief under the bright-line test for these new categories generally depends on the amount of consideration paid for the transfer:

    19.1 If the transfer occurs at or below the original owner's acquisition cost (i.e. the person has not realised a gain), no tax consequences arise for the original owner if the transfer is made within the relevant bright-line period. The recipient then takes on the original owner's bright-line start date and cost base.

    19.2 If the transfer occurs for more than the original owner's cost (i.e. they have realised a profit), then that gain is taxed if within the relevant bright-line period. A rule that deems bright-line disposals to be made at market value is switched off to ensure the 'paper profit' is not taxed. The recipient then takes on the original owner's bright-line start date but with an updated cost base of the amount for the transfer.

20. Rollover relief for interest limitation purposes is provided in the same situations as the bright-line test, but with no requirement regarding consideration.

21. The recommendations in this section of the report should apply for both interest limitation and bright-line test purposes unless otherwise specified. For interest limitation, the recommended amendments should have a commencement date of 27 March 2021 and be effective from 1 October 2021, and for the bright-line test, the amendments should apply from 1 April 2022.

Māori family trusts: Māori authority trustees

22. Rollover relief is available for transfers of land subject to Te Ture Whenua Māori Act 1993 to a trust that is either a Māori authority or eligible to be a Māori authority, where all beneficiaries are members of the same iwi or hapū or are descendants of the same tīpuna. This is intended to mirror the family trust rule while recognising that Māori family trusts may be structured differently.

23. The intent is that rollover relief should be available regardless of the reason why the trustee is a Māori authority or eligible to be one. The current legislation inadvertently restricts the provision to situations where the trustee is (or is eligible to be) a Māori authority who, on behalf of Māori claimants, receives and manages assets that are transferred by the Crown as part of a settlement of a claim under

the Treaty of Waitangi. This restriction is not necessary because another section provides rollover relief for Treaty of Waitangi settlements.

Recommendation
Agree that rollover relief should be available for Māori family trusts where the trustee is a Māori authority, or is eligible to be one, regardless of the reason for its eligibity.
Agreed/not agreed

Transfers involving multiple legal structures

24. Rollover relief is provided for transfers of residential land to trusts, partnerships and look-through companies, as well as transfers out of these structures to the land's original owner. For example, rollover relief is provided for the transfer of residential land held on family trust back to the original settlor. Rollover relief is also provided if that person then decides to transfer the land to a look-through company of which they are the sole shareholder. For efficiency, it makes sense to provide rollover relief where the same result is achieved in one transaction, rather than two.

25. The rules provide rollover relief where the original owner receives the residential land from the legal structure but in a different capacity, for example, if the settlor of a family trust receives the land from the trust in their capacity as a shareholder of a look-through company. However, the wording of the relevant provisions is not clear, which has led to queries from private sector advisors. We recommend that the sections be redrafted to provide certainty to taxpayers and their advisors that rollover relief is provided in these scenarios.

Recommendation
Agree that the legislation relating to rollover relief involving transfers between multiple legal structures should be clarified.
Agreed/not agreed

Resettlements of trusts

26. The officials' report on the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill recommended that rollover relief be available when an eligible trust is resettled, but this was not reflected in the drafting. The recommendation was on the basis that rollover relief would be available if land was transferred out of an eligible trust and then subsequently transferred to a new eligible trust. Providing rollover relief for a trust resettlement ensures that taxpayers can qualify for rollover relief with one transaction, rather than requiring them to undertake two separate transactions. The current legislation does not achieve this.

Recommendation
Agree that the legislation should be clarified to ensure that resettlements of eligible trusts should qualify for rollover relief.
Agreed/not agreed

Transfers to settlors who originally made cash settlements on family trust

27. Provided certain conditions are met, rollover relief is provided for transfers of residential property from family trusts back to the settlors of the trust. However, this only applies in situations where the settlor originally transferred the property to the trust, or in other words, they were the original owner of the property. Rollover relief does not apply for transfers of residential property from the trust to the settlor where instead the settlor made cash settlements on the trust (or guaranteed the obligations of the trust) to enable the trust to acquire the property. We recommend that rollover relief also apply in these situations.

Recommendation

Agree that the legislation should be clarified to ensure that rollover relief applies to a transfer of residential property from an eligible family trust to a settlor of the trust in the situation where the settlor made cash settlements on the trust or guaranteed its obligations to enable it to acquire the property.

Agreed/not agreed

Inherited property

28. There are two different sections in the ITA that cover the treatment of inherited property under the bright-line test. Substantively, both sections provide the same result and it is unclear why both sections are needed. To improve clarity and reduce uncertainty, we recommend that the two sections be consolidated.

Recommendation

Agree that the two provisions dealing with inherited property under the bright-line test should be consolidated.

Agreed/not agreed

Relevant bright-line period

29. When a transfer of residential land is eligible for bright-line test rollover relief, the intent is that the bright-line period does not reset. This includes both the start date of the bright-line period and which bright-line test applies.[1] The start date of the bright-line period is determined by the date on which legal title was transferred, whereas the date of acquisition (generally when a person enters into the agreement to purchase a property) determines which bright-line test applies (IR2022/012 refers).

30. The current wording of the legislation provides that the recipient only takes on the original owner's bright-line start date, but not the underlying acquisition date. This means that while the start date does not reset, the recipient becomes subject to a 10-year bright-line period if the transfer is made on or after 27 March 2021. For example, a property acquired in 2016 was subject to the two-year test and could have been disposed of without tax under the bright-line test in 2018 onwards. If a transfer eligible for rollover relief occurs in 2022, the recipient would need to retain the property until 2026.

[1] Refer paragraph 11 for further information.

31. This is not the policy intent, and the legislation should be clarified to ensure that the recipient also takes on the relevant bright-line test period and associated settings (including where no bright-line test applies because the land was originally acquired before 1 October 2015).

Recommendation

Agree that when rollover relief is provided under the bright-line test, the recipient should take on both the original owner's bright-line start date as well as the relevant bright-line test settings.

Agreed/not agreed

Bright-line test for residential land

Acquiring or disposing of a part share of residential land

32. When a share in residential land is disposed of, the disposal of that share may be subject to tax under the bright-line test. The bright-line period should reset only for the ownership share that has changed hands. A provision intended to clarify this was included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022, following a draft interpretation statement by Inland Revenue's Tax Counsel Office (TCO) which stated that someone's bright-line period would reset for the share that does not change hands (IR2022/012 refers).

33. For example, if co-ownership shares held by two people change from 50:50 to 25:75, the bright-line clock should reset only for the 25% share transferred. This could arise in the context of parents helping their children onto the property ladder by initially being co-owners of the property before selling their share to the child.

Drafting issues

34. The intention is that this clarification should align with the start of the bright-line test, 1 October 2015, to ensure taxpayers are not adversely impacted by TCO's view. However, the clarification inadvertently only applies from 27 March 2021. We recommend an amendment to ensure that the bright-line clock does not reset for part-shares transferred before 27 March 2021.

35. The current wording of the provision also erroneously refers to a "transfer by a person", when it should refer to a "transfer to a person". We recommend that this be corrected to ensure the provision operates correctly.

Transitional issues relating to 10-year bright-line test

36. There is a transitional issue relating to which bright-line test applies and whether this changes for the original portion. The application provisions for the earlier two-year and five-year tests provide that they apply when someone *first* acquires an interest in residential land on or after 1 October 2015 and 29 March 2018 respectively.

37. The application provision for the 10-year test omits the word "first". The intent behind this is that if, for example, someone purchased a property in 2005, sold it in 2007, but then repurchased it in 2022, the 2022 purchase should be subject to the 10-year bright-line test. There was a concern that the word "first" could have kept them outside the scope of the bright-line test for the 2022 purchase.

38. The omission of the word "first" in the 10-year test raises concerns when someone purchases a part-share of a piece of residential land and then subsequently acquires

an additional share. This specific scenario was not contemplated at the time the 10-year test was enacted.

39. Consider an example where someone starts with a 50% share in a property in 2017 and they then acquire an additional 25% share in 2022. Although the bright-line clock would not restart for the original 50% share, the current law provides that the original 50% share would become subject to a 10-year test (when it was previously subject to a two-year test). This means that the bright-line clock for the 50% share starts "ticking" in 2017, but instead of being able to dispose of it from 2019 onwards without being taxed under the bright-line test, they now need to hold it until 2027.

40. This is not the policy intent as it would retroactively bring residential land acquired before 27 March 2021 within scope of the 10-year bright-line test.

41. We recommend the legislation be clarified to ensure that when someone acquired part of a residential property before 27 March 2021 and then subsequently acquires an additional share in the same land on or after 27 March 2021, the relevant original bright-line test length and associated settings should continue to apply to the part acquired before 27 March 2021. In the example above, this would be the two-year bright-line test that applied to property acquired between 1 October 2015 and 28 March 2018.

42. If you agree to this proposed amendment, there is a consequential issue regarding the treatment of the subsequent 25% share acquired in 2022 in the example above. There is a concern that two different bright-line tests (and their associated settings) could apply to one piece of land.

43. This would increase compliance costs and complexity for taxpayers because they would need to consider two sets of rules. In the example in paragraph 39, this means the two-year test for the 50% portion acquired in 2017 and the 10-year test for the 25% share acquired in 2022. We recommend a taxpayer friendly approach whereby the relevant pre-27 March 2021 settings would also apply to the subsequently acquired share of the same land. This result would align with the previous application settings for the two-year and five-year tests.

44. Even though this approach is taxpayer friendly, we are satisfied the integrity risk is low as it is a transitional issue and requires the person to have acquired a partial share in the land before the 10-year bright-line test was introduced.

45. Note that the issue is more likely to arise in the parent/child co-ownership scenario, where the child gradually acquires the parents' share of the land. In this case, the eventual disposal of the property by the child is likely to be excluded from the bright-line test due to the main home exclusion. However, having two different bright-line tests apply, including two sets of main home exclusion rules to work through, could create undue complexity for taxpayers.

Recommendations

Drafting issues

Agree that the provision dealing with the reset of a person's bright-line clock following an acquisition or disposal of a part share in land should be redrafted to refer to transfers to a person rather than by a person.

Agreed/not agreed

Agree that the provision dealing with the reset of a person's bright-line clock following an acquisition or disposal of a part share in land should be redrafted to ensure that it also applies to transfers before 27 March 2021.

Agreed/not agreed

Transitional issues relating to 10-year bright-line test

Agree that when someone owns a portion of residential land that was acquired before 27 March 2021 and subsequently acquires another portion of that land on or after 27 March 2021, the relevant bright-line test and associated settings for the original share should continue to apply for the original share.

Agreed/not agreed

Agree that that when someone owns a portion of residential land that was acquired before 27 March 2021 and subsequently acquires another portion of that land on or after 27 March 2021, the relevant bright-line test and associated settings for the original share should also apply for the post 27-March 2021 share.

Agreed/not agreed

Interest limitation rules

46. The interest limitation rules have a commencement date of 27 March 2021 and took effect on 1 October 2021. Unless otherwise stated, recommended amendments in this section should be retrospective to these dates to ensure alignment with the introduction of the interest limitation rules.

Definition of business premises

47. The interest limitation rules do not apply to a property to the extent it is used as business premises. 'Business premises' is defined in the ITA, but the specific definition says it only applies for the purposes of the entertainment expenditure rules and the land sale rules. The interest limitation rules are not part of the land sale rules. This means there is ambiguity as to whether the definition of business premises applies for the purposes of interest limitation or whether there is an intended different meaning.

48. We recommend amending the definition of business premises to ensure that it applies for the purposes of interest limitation.

Recommendation

Agree that the definition of business premises in the ITA should apply for the purposes of interest limitation.

Agreed/not agreed

Interposed entities: property subject to an exemption

49. The interposed entity rules support the integrity of the interest limitation rules by ensuring that a person cannot circumvent the rules by borrowing indirectly through an interposed company or trust. The rules work by denying interest deductions based on an entity's interposed residential property percentage (IRP percentage), which looks an entity's disallowed residential property (DRP) (that is, property subject to interest limitation).

50. In broad terms, an entity's IRP percentage depends on the value of its "disqualified assets" as a percentage of its total assets. Disqualified assets generally consist of disallowed residential property (DRP), other than new builds or property subject to a land business or development exemption.

51. However, some DRP subject to an exemption (for example, council or social housing) is still treated as a "disqualified asset" in the current legislation. The effect is that taxpayers borrowing indirectly to acquire an exempt property will be denied deductions on that borrowing. This is unintended.

52. The legislation should be clarified to ensure that DRP subject to an exemption is not treated as a "disqualified asset".

Recommendation

Agree that disallowed residential property subject to an exemption should not be treated as a "disqualified asset" under the interposed entity rules.

Agreed/not agreed

Interposed entities: when DRP is a mixed-use asset

53. As noted in paragraph 49, the interposed entity rules are an anti-avoidance measure and deny interest deductions for taxpayers who indirectly hold DRP through interposed entities (such as close companies) and borrow money to acquire ownership interests in the entities. They work by denying interest deductions based on an entity's IRP percentage. Without interposed entity rules, such taxpayers would be allowed interest deductions that are economically incurred for DRP.

54. The mixed-use asset (MuA) rules deal with the deductibility and apportionment of expenditure incurred in relation to specified types of assets that are used partly for income-earning purposes, partly for private purposes, and are not in use for at least 62 days in an income year. This means that DRP, such as a holiday home, can be a MuA.

55. Currently, the formula used to calculate the IRP percentage for close companies excludes DRP that is subject to the MuA rules. The effect of this exclusion is that a close company that holds DRP that is a MuA may not be an interposed entity. This would occur if, for example, a close company only holds a holiday home that is used private purposes and to earn income. In such a case, the MuA rules allow an apportioned interest deduction for the time that the holiday home is used to earn income, when the policy intent is that the interest deduction should be fully denied. This can give rise to an integrity risk as taxpayers could circumvent the interest limitation rules by borrowing to purchase shares in a close company that holds a MuA DRP. Additionally, there might be an incentive to ensure that a holiday home rental property held in a close company qualifies as a MuA.

56. We recommend that the interposed entity rules be clarified to ensure they apply in situations where DRP that is a MuA is held through a close company. This proposed change is intended to act as an anti-avoidance rule to deter taxpayers from using such a structure. As such, there are no financial implications associated with this proposed amendment.

Recommendation

Agree that the interest limitation interposed entity rules should apply to taxpayers who indirectly hold DRP that is a mixed-use asset through close companies.

Agreed / not agreed

Full denial of deductions on foreign currency loans

57. The intent is that foreign currency loans used to fund residential property in New Zealand should be immediately subject to interest denial from 1 October 2021 without access to the transitional phasing-out period available to New Zealand dollar denominated loans.

58. To enable this, the ITA currently overrides two other provisions to deny all interest deductions for foreign currency loans. However, the overrides do not achieve the policy intent and the drafting should be corrected.

59. The first provision overridden does not actually relate to foreign currency loans and is therefore unnecessary. The second provision overridden incorrectly applies more broadly than intended, as it could deny interest deductions incurred in relation to non-residential property.

Recommendations

Agree that the overriding section in relation to the treatment of foreign currency loans under the new interest limitation rules should be repealed.

Agreed/not agreed

Mixed-use asset rules

60. Under the mixed-use asset (MuA) rules, interest incurred by a person that is not a company is apportioned between income earning use, private use, and no use under a specified formula. Interest incurred by a close company is apportioned under a separate formula.

61. Under the interest limitation rules, the policy intent is that the apportionment of interest incurred by a close company for disallowed residential property (DRP) that is a MuA should follow the same formula as a non-company. The intent is that interest apportioned under the MuA rules to income earning use is then subject to denial under the interest limitation rules.

62. The current drafting does not achieve this intent as it provides that interest incurred by a close company for DRP (that is a MuA) is no longer subject to the MuA rules. This is because the interest limitation rules removed interest incurred by a close company for DRP (that is a MuA) from the formula that applied to close companies but did not include a corresponding provision that such interest should instead be apportioned using the formula that applies to a non-company.

63. We recommend that the interest incurred by a close company for DRP (that is a MuA) should be apportioned using the same formula in the MuA rules that applies to a person who is not a company.

Recommendations

Agree that interest incurred by a close company for DRP should be included in the same formula in the MuA rules that applies to a person who is not a company.

Agreed/not agreed

Agree that this amendment should apply to interest incurred on or after 1 October 2021, to align with the introduction of the interest limitation rules.

Agreed/not agreed

Other residential property issues

Acquisition date of property when company elects to become LTC

64. When a company makes an election to become a look-through company (LTC), it is effectively deemed to have been "replaced" by the LTC. The policy intent is that the LTC steps into the shoes of the superseded company and must use the tax book values of the company's assets and liabilities at the time of the LTC election, and has the same acquisition date, status, intention or purpose in relation to the assets.

65. The problem is that the legislation does not currently refer to the LTC having the same acquisition date for the assets as the superseded company, even though it is clear that the policy intention is that the LTC steps into the shoes of the company on election for all purposes under the LTC rules. This issue is most relevant in the context of the bright-line test, which considers when land was acquired to determine which (or whether the) bright-line test applies, but it could also be relevant for other regimes that may apply to the LTC's assets.

66. It appears from the officials' report on the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill that there was an intention to redraft the relevant provision to clarify that the LTC has the same acquisition date for the assets, but this amendment was never made. We recommend that this amendment be made to clarify the policy intention.

Recommendations

Agree that a clarification be made that an LTC has the same acquisition date for assets it held prior to electing to become an LTC as the superseded company.

Agreed/not agreed

Agree that this amendment should apply for the 2017–18 and later income years, when the corresponding changes to the LTC regime were made in the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

Agreed/not agreed

Definitions of "settlement" and "principal settlor"

67. The term "principal settlor" was first used for the purposes of the main home exclusion in the bright-line test and prior to the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 was defined within the bright-line rules. A principal settlor is someone whose settlements for the trust are the greatest or greatest equal by market value, with an amended definition of "settlement" applying to excludes some services provided below market value. This is intended to provide greater certainty about what counts as "property" when determining whether someone is a principal settlor of the trust.

68. The term "principal settlor" is now used for other aspects of the bright-line test as well as the residential rental loss ring-fencing rules and the interest limitation rules.

The Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 moved and updated the definition of "principal settlor" to reflect its broader application, but no corresponding amendment was made to the definition of "settlement".

69. We recommended that the definition of "settlement" be updated to reflect the changes to the definition of "principal settlor" and its broader application to other rules relating to residential property.

Recommendations

Agree that the definition of settlement be clarified so that the exclusion of below market value services also applies for other aspects of the bright-line test, the residential rental loss ring-fencing rules and the interest limitation rules.

Agreed/not agreed

Agree that this change should apply from 27 March 2021, to align with when the definition of "principal settlor" was updated.

Agreed/not agreed

Minor maintenance items

70. There are a number of references that need to be updated to ensure they refer to the correct sections and actual terminology used in the legislation. These will be included in the next omnibus tax bill.

Administrative implications

71. The recommended changes in this report are covered by approved funding which would cover any associated administrative costs and systems or technology implications.

Consultation

72. Treasury was consulted on the contents of this report.

73. We undertook limited consultation with private sector stakeholders on the issues and recommended changes in this report.

Next step

74. If you agree to provide a legislative solution to the issues outlined in this report, we recommend that these changes be included in the next omnibus tax bill, scheduled for introduction in August 2022.

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Network expenditure tax treatment: Remedial recommendations**

Date:	16 June 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/312

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	30 June 2022
Minister of Revenue	**Agree** to recommendations **Refer** a copy of this report to the Minister of Energy and Resources	30 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Fulton	Principal Policy Advisor	s 9(2)(a) [redacted]
Casey Plunket	Special Policy Advisor	

16 June 2022

Minister of Finance
Minister of Revenue

Network expenditure tax treatment: Remedial recommendations

Summary

Purpose

1. This report seeks your agreement to remedial changes to the tax treatment of expenditure on distribution networks. These changes are broadly consistent with the *Tax treatment of expenditure on distribution networks* consultation document you previously approved for release [IR2022/159 refers].

Background

2. Distribution networks convey electricity, gas, water, and telecommunications. An example is the electricity distribution network of an electricity lines company. Its components include poles, cables, transformers, and switches.

3. Deductions for expenditure on depreciable property are spread over the economic life of the property. Deductions for expenditure on repairs and maintenance is allowed in the year the expenditure is incurred.

4. An issue in relation to distribution networks is whether the asset (for both depreciation and for repairs and maintenance purposes) is the network or its component items. If the asset is the network, expenditure to acquire or build the network will usually be depreciable over the life of the network and expenditure to replace its component items will likely be immediately deductible repairs and maintenance. If the assets are the component items, expenditure to acquire or replace a component item will usually be capitalised and depreciated over the life of the component (which is shorter than the life of the network).

5. Network owners have, in nearly all instances, been depreciating component items of networks in accordance with the Commissioner's depreciation schedule and treating component items as the relevant item of property for repairs and maintenance purposes since the depreciation rules were introduced on 1 April 1993 (component items approach). Currently there is a high degree of uniformity for financial reporting purposes, Commerce Commission regulatory purposes and tax in distinguishing capital expenditure from revenue expenditure. The depreciation schedule has never included a depreciation rate for a distribution network.

6. In July 2021 the Tax Counsel Office of Inland Revenue ("TCO"), concluded its view on whether the component items approach is in accordance with case law. It concluded that for the purposes of the depreciation rules and for determining whether expenditure on repairs and maintenance is deductible, a network, and not its component items, is the relevant asset (network approach). The network approach by extension applies to all distribution networks. The network approach does not affect how the law applies to non-network assets, such as how depreciation applies to distinct chattels within residential property.

7. Officials consider the component items approach remains the appropriate setting for distribution networks and consulted on proposals to realign the law with the long-standing practice.

Response to consultation

8. 11 submissions were received from affected network operators and their advisors. Submitters were supportive of legislative change to maintain the component items approach currently applied by nearly all network operators. They were concerned of unintended consequences which officials are managing in the design of the drafting. Submitters were strongly opposed to retrospectively requiring networks that are already applying the network approach to apply a component items approach. Our recommendations no longer include this retrospective feature. Further detail is included in Appendix 1 of this report.

Recommended remedial change

9. Officials recommend remedial changes to ensure distribution networks apply the component items approach for all tax purposes including depreciation and repairs and maintenance; this is consistent with the policy intent. We do not consider that the recommended changes in this report require Cabinet Approval.

10. The recommended changes are:

 10.1 Inserting a definition of a distribution network into the Income Tax Act 2007. This definition should cover electricity, telecommunications, water, and gas networks with the definition of each of these referencing to existing definitions within their relevant regulatory Acts.

 10.2 Confirming that, for a distribution network, depreciable property is the items set in the depreciation schedule and not the network itself.

 10.3 Confirming that, for a person who owns a distribution network, expenditure to acquire depreciable property that is not part of other depreciable property is only deductible as a depreciation loss.

 10.4 Providing the Commissioner with discretion not to add a distribution network to the depreciation schedule.

11. For divisible items, such as electrical cables, the recommended remedial changes are not intended impact how this division is made. For example, a network operator will still be able to determine, on the facts, the appropriate portion of cable (such as covering a street, subdivision or a suburb) to record as a separate asset it just won't be able to classify that cable as part of a larger network asset.

12. This recommended remedial change is also not intended to change how taxpayers classify smaller items (for which no depreciation rate has been set). For example, a possum guard on a power pole can be included as part of the value of that power pole rather than being required to be separately identified under the default depreciation category.

Application date

13. As noted above, nearly all distribution networks owners currently apply a component items approach. For these taxpayers the recommended changes should apply for all periods starting on or after 1 April 1993 that are consistent with the recommendations. This will ensure they do not have to change the treatment applied for previous or future periods and was supported by submitters.

Networks not currently applying the component items approach

14. A small number of distribution networks have been applying a network approach. As there is no network depreciation rate, they have been applying a hybrid approach where they identify a different asset for depreciation purposes (the component items of a network), than for repairs and maintenance purposes (the network itself). This hybrid approach maximises tax deductions and is not consistent with the intended policy or the TCO interpretation (which requires a consistent asset identification notwithstanding the lack of a network depreciation rate) but each limb of the hybrid approach can, in isolation, be justified.

15. We recommend that taxpayers applying a network approach in a return filed before 31 March 2022, or with a binding ruling confirming a network approach, be required to apply the component items approach for years starting on or after 1 April 2024. This date will provide time to manage system changes and cashflow impacts of this change and was supported by submitters.

Discretion to add assets to the depreciation schedule

16. As noted above, a distribution network has never been listed on the depreciation schedule. Officials want to maintain the ability for the depreciation schedule to be updated over time. Currently the Commissioner has a limited ability to decline adding an item to the depreciation schedule, particularly where case law supports identification of that asset. To prevent a taxpayer subverting the intent of the recommended remedial changes in this report the Commissioner should be provided discretion to not add a network to the schedule of depreciable property.

17. While the network approach is recommended to be available until 2024 for taxpayers already applying this approach, the Commissioner should be able to decline a request to add a network from 31 March 2022.

Recommended bill

18. We recommend these changes are included in the next available omnibus tax bill, planned for introduction in August 2021.

Consultation

19. Treasury has been consulted and agrees with the recommendations.

20. A consultation document *Tax treatment of expenditure on distribution networks* was released on 12 April 2022. 11 submissions were received and have been incorporated into the recommendations in this report. A summary of these submissions and our response is included as Appendix 1.

Administrative impact

21. These changes are not expected to have a significant administrative impact and can be managed within existing baselines.

Fiscal impact

22. Current fiscal forecasts do not incorporate the expected change in revenue that would result if the relevant taxpayers consistently applied the network approach (as they are now required to, in light of the TCO interpretation). The change is the combined effect of two changes which partially offset each other. Moving to a network approach increases deductions for repairs and maintenance but also

reduces depreciation from an average of around 9% on component items to a network rate assumed to be 4%[1]. As an example, for electricity distribution networks for the year ended March 2023 the increase in repairs and maintenance would be $118m and the decrease in depreciation would be $91m for an increase in expenditure of $27m and a reduction in tax of $7.5m.

23. There is considerable uncertainty about the net fiscal effect of applying the TCO interpretation, but the table below provides officials' best estimate. It is based on two critical assumptions:

23.1 A network depreciation rate for electricity networks of 4%. This is an increase from 2% used in the previous report. 4% more closely matches the 2021 regulatory[2] average rate of 3.86% and is below the historical globo rate of 5%. The correct rate may be above or below 4% but would require significant analysis that will become redundant if the recommendations in this report are agreed to. At lower depreciation rates the TCO interpretation will increase tax revenue and at higher rates tax revenue would decrease.

23.2 We have assumed that the impact on other networks is twice the size of electricity networks. Copies of the calculations to justify this assumption can be supplied if required.

24. Officials estimate of the impact on forecasts, and the consequential impact on the operating balance and net debt, is:

	$ m – increase / (decrease)				
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Electricity networks	0.000	(52.000)	(7.000)	1.000	7.000
Other[3] networks	0.000	(104.000)	(14.000)	2.000	14.000
Impact on Tax Revenue	**0.000**	**(156.000)**	**(21.000)**	**3.000**	**21.000**

25. If the law is not changed, this would be the total fiscal impact[4]. However, if you decide (as recommended) to reverse the effect of the TCO interpretation, this would mean that a second change to tax forecasts would be required, substantially offsetting the first and restoring the forecasts to their current track. In other words, for nearly all affected taxpayers, this would mean no change to their tax obligations relative to current practice.

26. The changes recommended above will also mean the small number of network operators who are currently applying a network (hybrid) approach would need to transition to the component items approach from 1 April 2024. For those taxpayers, this will result in less expenditure being deductible in the year it is incurred, but an increase in assets and therefore higher depreciation deductions over time.

27. Hence, the combined effect of the policy decision to maintain the component items approach currently used by nearly all networks and move the small number of taxpayers currently applying the network (hybrid) approach to a component items approach would be as shown in the table below.

[1] These are the rates for electricity distribution networks. The rates for other networks can be higher but this is factored into the fiscal estimates in this report.
[2] The Commerce Commission's regulation of electricity lines services and is not directly related to tax depreciation.
[3] This includes the national grid, gas, water and telecommunication industries with similar network characteristics
[4] Tax revenue is estimated to increase in years beyond the forecast period and is approximately neutral overall by the end of the 2028/29 year.

	$ m – increase / (decrease)				
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Keeping networks on a component basis	0.000	156.000	21.000	(3.000)	(21.000)
Moving networks applying the hybrid approach to a component basis	0.000	(0.400)	(7.600)	6.700	10.800
Impact on Tax Revenue	**0.000**	**155.600**	**13.400**	**3.700**	**(10.200)**

28. The ordinary practice for decisions of this kind would be for their fiscal impact to be managed through the Tax Policy Scorecard (T2021/1273 refers). However, you have also agreed that the Scorecard's balance should not fall below zero nor exceed $200 million over the forecast period. To manage the fiscal impacts of this change through the Scorecard, the total effect on its balance would be the combined impact of the table below paragraph 27, (i.e. $162.5 million over the forecast period). Inland Revenue and the Treasury advise against this option, as it would cause the Scorecard's balance to exceed its agreed $200 million limit.

29. Officials instead recommend that the fiscal impacts of the forecasting change should be allowed to 'flow through' for the moment (i.e. be reflected in forecasts but not directly in allowances). The Treasury proposes to provide further advice on what impact, if any, various recent non-Scorecard tax change should have on Budget allowances when these are considered again through the development of the Budget Policy Statement (BPS).

Recommended action

We recommend that you:

a. **agree** to insert a definition of a distribution network into the Income Tax Act 2007

Agreed/Not agreed Agreed/Not agreed

b. **agree** that the assets of a distribution network, for the purposes of the Income Tax Act 2007, should be its component items rather than the entire network (the component items approach).

Agreed/Not agreed Agreed/Not agreed

c. **agree** that recommendations a. and b. should apply to all periods commencing on or after 1 April 2024 for a distribution network that either has not applied the component items approach in those periods, or has a binding ruling allowing the network approach for those periods.

Agreed/Not agreed Agreed/Not agreed

d. **agree** that recommendations a. and b. should apply to all periods commencing on or after 1 April 1993 for a distribution network that has applied the component items approach in those periods except where recommendation c. applies.

Agreed/Not agreed Agreed/Not agreed

e. **agree** that the Commissioner should be provided discretion to not add a distribution network to the depreciation schedule.

Agreed/Not agreed Agreed/Not agreed

f. **agree** that recommendation e. should apply to requests made after 31 March 2022.

Agreed/Not agreed Agreed/Not agreed

g. **note** the following forecast change to tax revenue as a result of the Tax Counsel Office's interpretation, with a corresponding impact on the operating balance and net debt:

	$ m – increase / (decrease)				
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Electricity networks	0.000	(52.000)	(7.000)	1.000	7.000
Other networks	0.000	(104.000)	(14.000)	2.000	14.000
Impact on Tax Revenue	**0.000**	**(156.000)**	**(21.000)**	**3.000**	**21.000**

noted noted

h. **note** the following change to tax revenue, with a corresponding impact on the operating balance and net debt, as a result of the decisions above, at recommendations a. to f.:

	$ m – increase / (decrease)				
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Keeping networks on a component basis	0.000	156.000	21.000	(3.000)	(21.000)
Moving network electricity networks to a component basis	0.000	(0.400)	(7.600)	6.700	10.800
Impact on Tax Revenue	**0.000**	**155.600**	**13.400**	**3.700**	**(10.200)**

noted noted

i. **agree** to allow the fiscal impacts of the decisions shown above, to be reflected in forecasts but not to recognise any immediate impact on allowances (i.e. to 'flow through').

Agreed/Not agreed Agreed/Not agreed

j. **refer** a copy of this report to the Minister of Energy and Resources for her information.

Referred/Not referred

Paul Fulton
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Appendix 1 – Response to submissions

1. This appendix summarises the themes of the 11 submissions received and officials response. Submissions were received on behalf of:

- Corporate Taxpayers Group
- Eastland Network
- Electra Limited
- Electricity Network Association
- EY Limited
- Orion New Zealand Ltd
- PowerCo Limited
- Powernet
- PwC New Zealand
- Spark
- Vector Limited

Support for proposals

2. Submitters were supportive of the proposed changes for network operators who apply the component approach. They noted this would retain the long-standing industry practice which has been for the most part, consistently applied across the electricity and other network industries. We welcome this support.

Detail of component approach

3. Submitters were concerned of the unintended consequences which could disrupt the existing practice of network operators who already applied the component approach. For example, they wanted to maintain discretion around classifying smaller items that are part of or attached to an item on the depreciation schedule. Officials agree that a network operator that was applying a reasonable interpretation of the component approach in prior periods should be able to maintain this approach following the recommended law change. Officials are working with submitters to develop appropriate drafting to achieve this.

Retrospective changes for operators applying the network approach

4. Submitters were universally opposed to a retrospective application of a component items approach for operators. Officials original position was on the basis that it is impossible to apply the TCO interpretation due to the absence of a network rate and we did not want to validate an approach that had always required non-compliance with the existing rules. However, as noted above, applying the network approach to repairs and maintenance is consistent with the TCO interpretation and applying a component items approach to depreciation is consistent with the depreciation schedule issued by the Commissioner. By applying the proposed amendments prospectively to operators that have

Effect of moving from the component approach to the network approach

5. Some submitters noted that moving from a network approach to a component approach would bring forward tax payments which would impact cashflow available for network maintenance and upgrades. Officials acknowledge that this will be the impact for some networks; however, officials do not consider the purpose of the tax treatment of distribution networks is to provide an effective tax subsidy to those networks. Nor should that subsidy provide a benefit compared with the majority of network operators that have always applied the component approach and want to continue to do so. If the government wanted to provide additional cashflow to network operators this would be better achieved by changes to the Commerce Commission requirements or other non-tax measures.

Choice between network and component approaches

6. Some submitters suggested that distribution network operators should have the choice whether to apply a network or component approach. Officials disagree as we do not support a network approach from a policy perspective. Furthermore, allowing a choice of assets is not an approach taken for other industries and would increase compliance costs as networks could calculate both options then choose the one that provided the greatest expected tax benefit.

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: R&D Tax Incentive: Notification of changes in activities

Date:	16 June 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/315

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Refer** a copy of this report to the Minister of Research, Science and Innovation	30 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Graham Tubb	Principal Policy Advisor	s 9(2)(a)
David Cuellar	Senior Policy Advisor	

16 June 2022

Minister of Revenue

R&D Tax Incentive: Notification of changes in activities

Purpose

1. This report seeks your agreement to make a remedial amendment to the R&D Tax Incentive (RDTI) legislation for inclusion in the upcoming omnibus tax Bill.

2. The recommended amendment would remove the existing requirement for businesses that have RDTI general approval for multiple years to notify Inland Revenue and confirm that there have been no material changes for their business. It would be replaced with a requirement to notify Inland Revenue if there have been changes in their R&D activities.

3. This report also seeks your agreement to make an Order in Council that would extend the due date for the current notification requirement for the 2021–22 income year. Your authorisation is sought for Inland Revenue to issue a drafting instruction to the Parliamentary Counsel Office (PCO) to draft an Order in Council accordingly.

Background

4. The RDTI operates as a 15% tax credit for eligible R&D expenditure on eligible R&D activities.

5. For an R&D activity to be eligible for the RDTI, a business must include it in a general approval (GA) application[1] and the Commissioner of Inland Revenue must then approve that application. A business cannot claim the RDTI for expenditure on any activities not approved by the Commissioner.

6. A GA can cover activities in a single year and up to two further income years. For multi-year GAs, a business is required to notify in each subsequent year that there have been no material changes for their business for the relevant income year. This rule was designed to ensure businesses consider the accuracy and validity of their GAs in each year after it has been approved.

7. This notification requirement creates compliance costs for businesses as it requires them to proactively contact Inland Revenue to confirm that their already-approved GA is still valid. It is an administratively intensive requirement for Inland Revenue to enforce as it requires manual checking of web messages by staff.

8. The GA application process shares its deadline with this notification requirement for multi-year GAs, which is the seventh day of the second month after the end of a business' income year. For example, a standard balance date (March) taxpayer's due date for a GA and for making the requisite notification for a multi-year GA is 7 May each year.

9. The RDTI was introduced in the 2019–20 income year, though GAs were not required until the 2020–21 income year. Businesses did not have to notify Inland Revenue of no material changes for their business if they had a multi-year GA in 2020–21 because the requirement only applies to the second and third year of a

[1] Approval can also be sought through a criteria and methodologies application, but this is restricted to larger R&D performers and is not relevant for the purpose of this report.

multi-year GA. This means the first year that this requirement applies for is the 2021–22 income year.

10. For some businesses, it is no fault of their own that they missed the due date for this notification requirement. This is because some businesses had submitted GA applications on time but they had not been approved by the time their notification deadline passed.[2] This effectively made it impossible for those businesses to make the required notification.

11. The total number of taxpayers required to make this notification for the 2021–22 year (that had a multi-year GA in the 2020–21 income year) is 532 businesses. Of that group, 26 have made the required notification. The 506 businesses that have not comprise 42% of the 1191 active businesses enrolled in the RDTI.

Proposed amendment

12. We recommend replacing the requirement to notify of no material changes for a business with a requirement to notify if there are material changes in a business' R&D activities. This would decrease compliance costs for businesses, and it would confirm the administrative approach that Inland Revenue has taken in practice.

13. Businesses will still be required to consider whether their GA is valid for later income years under a multi-year GA as there would still be a requirement to notify Inland Revenue if there is a change in a business' R&D activities.

14. We recommend that this amendment applies retrospectively from the 2020–21 income year, which was the first year of the GA process for RDTI applications. This would remove legal uncertainty concerning the validity of affected GAs.

Transitional Order in Council

15. Despite the proposed amendment, there would still be a group of taxpayers that are at risk of experiencing a significant delay in receiving an R&D credit.[3] This group comprises businesses that received a multi-year GA in the 2020–21 income year and have an early or standard balance date (as the notification deadline has passed for this group of businesses for the 2021–22 income year). Late balance date businesses are also affected if they are still waiting for their 2020–21 GA application to be approved when their notification deadline passes.

16. For affected taxpayers with multi-year GAs and early/standard balance dates, they would have been required to notify of no material changes for their business as recently as 7 May 2022. However, many affected businesses did not make that notification due to lack of knowledge that the requirement existed.

17. The Tax Administration Act 1994 includes a broad power to extend the time for doing something under the Act. This would include extending the deadline for businesses to notify Inland Revenue that there have been no material changes for their business for the relevant income year.

18. We recommend that you make an Order in Council extending the time for making this notification for the 2021–22 income year from the ordinary due date (being the seventh day of the second months after the end of the 2021–22 income year) to 30 April 2023. This allows for businesses to make the requisite notification if they have previously missed it for the 2021–22 income year. This extended date gives Inland

[2] Most delays arose because the Commissioner was not able to grant approval for some applications until 30 March 2022 when the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 came into force.

[3] A delay is the consequence assuming the passing of the legislative amendment; if the amendment is not passed, there is a more severe risk of R&D credits not being paid out at all to affected businesses.

Revenue time to contact affected businesses and make them aware of the requirement and extension. It would be applicable for all RDTI-enrolled businesses.

19. A longer extended due date also guards against the risk of Inland Revenue not approving the relevant GAs before the extended due date lapses. Otherwise, Inland Revenue may have to deny a taxpayer an R&D credit but subsequently reassess the business and allow them the credit from March 2023 if the recommended legislative amendment proceeds. This would create significant administrative costs, and we consider it is better to avoid this by extending the notification due date past the expected date of the recommended legislative amendment coming into force.

20. The consequences of not making this Order in Council will be that businesses that have filed their 2021–22 income tax return (including their RDTI supplementary return) before March 2023 will experience a delay in receiving their credit. If the legislative amendment is not made as well, then affected businesses would miss out on R&D credits entirely for the 2021–22 income year despite being compliant with all other requirements of the RDTI regime. We consider that denying or delaying R&D credits due to businesses not telling Inland Revenue that there have been no material changes for their business is harsh and counter to the intent of the RDTI.

21. As described at paragraph 10, it was not possible for businesses to make the required notification by the original due date if they did not have a GA approved at the time the notification was due. This was the case even if they submitted a GA application on time, knew of the requirement, and were willing to make the notification. An extension of the due date is a fair way to ensure this group are still able to receive their tax credits in a timely manner.

Financial implications

22. The proposed legislative amendment would not have a fiscal impact as the notification requirement does not change the amount of R&D tax credits paid out to businesses. The requirement exists for compliance reasons, but it is not intended to exclude businesses from being eligible for the RDTI.

23. If the legislative amendment is passed, then the Order in Council extending the due date would not have a fiscal impact as it brings forward the disbursement of some R&D tax credits within the same financial year. It would not lead to more or less credits being paid out overall.

Consultation

24. The Treasury, the Ministry of Business, Innovation and Employment, and Callaghan Innovation were consulted on this proposed amendment and the Order in Council.

Next steps

25. Subject to your agreement, we will prepare the amendment for inclusion at the introduction stage of the next omnibus taxation Bill.

26. If authorised, we will also issue a drafting instruction to PCO to draft an Order in Council giving effect to an extension of the notification deadline for the 2021–22 income year. We will report to you again with the draft Order and Cabinet paper.

27. Subject to your agreement, we will communicate to RDTI stakeholders that a legislative amendment will be introduced in the next Bill addressing the notification requirement, and that an Order in Council will be recommended to remedy the notification issue for the 2021–22 income year.

28. A copy of this report should be referred to the Minister of Research, Science and Innovation for their information.

Recommended action

We recommend that you:

1. **agree** to replace the existing R&D Tax Incentive requirement for multi-year general approvals so businesses are only required to notify if there is a material change in their business;

   Agreed/Not agreed

2. **agree** that this amendment should apply retrospectively from the 2020–21 income year;

   Agreed/Not agreed

3. **agree** that this amendment be included in the upcoming omnibus taxation Bill scheduled for introduction in August 2022;

   Agreed/Not agreed

4. **agree** to the making of an Order in Council that extends the timeframe for businesses to notify Inland Revenue that there have been no material changes for their business for the 2021–22 income year;

   Agreed/Not agreed

5. **authorise** Inland Revenue to issue a drafting instruction to the Parliamentary Counsel Office to draft an Order in Council that gives effect to this extension;

   Authorised/Not authorised

6. **agree** that agencies be able to communicate the above decisions to stakeholders;

   Agreed/Not agreed

7. **refer** a copy of this report to the Minister of Research, Science and Innovation for their information.

   Referred/Not referred

s 9(2)(a)

[redacted]

Graham Tubb
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Allocation of subdivided land and unit titles among co-owners under the bright-line test and land-sale rules**

Date:	17 June 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/318

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Refer** a copy of this report to the Minister of Housing	1 July 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Chris Gillion	Policy Lead	s 9(2)(a)
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17 June 2022

Minister of Revenue

Allocation of subdivided land and unit titles among co-owners under the bright-line test and land-sale rules

Purpose

1. This report seeks your decision on an issue relating to the bright-line test and land-sale rules that commonly occurs during the development process whereby multiple investors in the original parcel of land are then individually allocated the resulting subdivided or unit-titled parcels.

2. If you agree to provide a legislative solution, the proposed amendment could be included in the next omnibus tax bill scheduled for introduction in August 2022.

Context and background

3. We have become aware of an issue as part of a private ruling application through Inland Revenue's Tax Counsel Office (TCO). It has arisen in the build-to-rent context but is also relevant to smaller subdivisions. The current law has the potential to disincentivise certain housing developments involving multiple investors where one or more of the developers do not immediately sell the completed units.

4. In 2021, TCO consulted on a draft Interpretation Statement clarifying the application of the bright-line test and land-sale rules when co-owners subdivide land and partition the resulting titles to each of the co-owners.[1] Effectively under current law, partitioning of land among the co-owners can result in a tax liability even if there is no effective economic change in ownership.

5. For example, if two people co-own land 50:50 and subsequently subdivide it with each getting a title for 50% of the original land, they will each have disposed of their 50% interest in the land the other gets on the subdivision. If the land has increased in value between when it was acquired and when it is subdivided, there will be a tax impost even though what they each have after the subdivision is essentially economically equivalent to what they had before. This tax liability arises even if the person would not otherwise be taxed under the bright-line test or other land-sale rules if they eventually sold their title, for example, because it is their main home.

6. This interpretation was not expected by tax practitioners, and we understand it was one of the main issues raised by submitters on the TCO draft Interpretation Statement.

7. The specific issue raised with us primarily concerns the construction of an apartment block or other housing development where unit titles are issued. Unlike standard subdivisions where the subdivision can occur at the start of the process, unit titles under the Unit Titles Act 2010 can only be issued once construction is complete, therefore magnifying tax consequences. However, the current law is also an issue for fee simple subdivisions (as noted in the example in paragraph 5).

[1] PUB00411 *Income tax – Application of the land sale rules to changes to co-ownership, subdivisions, and changes of trustees*. The draft has now been finalised as IS 22/03 *Income Tax – Application of the land sale rules to co-ownership changes and changes of trustees*. The finalised Interpretation Statement does not cover subdivisions, given the issue discussed in this report, for which we are recommending a legislative amendment.

Issue

8. Large-scale development projects may involve a consortium of investors working together through a joint venture (JV) or other tax-transparent structure, often seen in the build-to-rent market. The parcel of land is owned by the JV and the members of the JV contribute to development costs based on their interests in the JV. Once construction is complete and titles for the apartments or units are issued, the properties are then individually allocated to the members of the JV, based on their overall JV interest and the market value of the apartments.

> **Example**
>
> A 10-apartment development project is a 60:40 JV between two investors. Investor A holds a 60% stake in the JV and Investor B holds a 40% stake. Investor A is a landlord and will rent out their allocated apartments, while Investor B will sell their allocated apartments. During the development process, Investor A and Investor B contribute costs based on their respective stakes in the JV.
>
> Titles for the apartments are issued under the Unit Titles Act 2010 upon completion. Six apartments are transferred to Investor A and the remaining four apartments are transferred to Investor B based on the market value of the apartments. If the market value allocation does not exactly correspond with their stakes in the JV, there will be a wash-up payment between the two investors to ensure that neither investor ends up better off relative to their contribution to the development.

9. The main concern arises for Investor A. Investor A does not sell their allocated apartments. They individually rent their apartments on the open market and become a landlord. This means they generally hold their investments on capital account and would only pay income tax on the sale of their apartments, if they sell within the bright-line period.

10. However, under the current law they are taxed under the bright-line test at the time the apartment units are allocated among the JV members.

11. This is because Investor A and Investor B hold the equivalent of their JV interest in the original parcel of land and once the unit titles are issued, they then legally hold the equivalent interest in the 10 apartments (refer step 2 in the example diagram on the next page). When individual apartments are allocated to each of the JV members under the JV agreement (so that each apartment only has one owner), this is considered a disposal of the share in the apartments that are not part of an investor's apartment allocation (refer step 3 in the example diagram on the next page).

12. These disposals are deemed to occur at market value. This means that while an investor gets a deduction for their share of the costs, the tax implications can be significant if the titling occurs upon completion. This is necessarily the case for apartments or other housing developments where titles are issued under the Unit Titles Act 2010, because unit titles can only be issued upon completion.

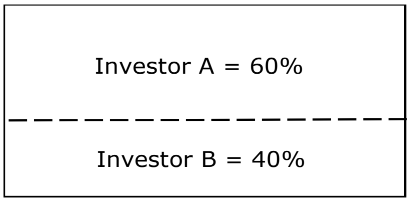
13. The issue can also arise for standard subdivisions but can often be managed, because the subdivision can occur at the start of the process. If the subdivision is completed at the beginning of the development, any change in market value is more readily manageable from a tax perspective. However, there are still compliance costs incurred in complying with the resulting tax obligation.

14. Note that a similar issue arises for Investor B, but it does not necessarily result in over taxation. They hold the land on revenue account and under current law both the allocation process and final sale would be subject to tax. Since the allocation of the apartments between A and B is deemed to have occurred at market value, this provides an uplift in the Investor B's cost base and there should be no double

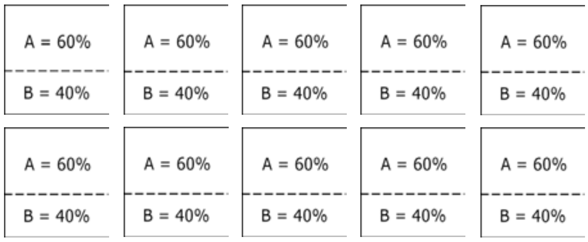
taxation. However, there are concerns regarding the timing of, and compliance costs associated with, this two-step process.

Example

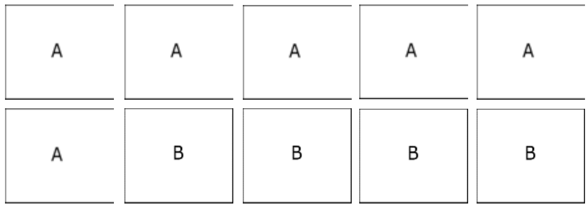
Step 1
During development, Investor A holds 60% of the original parcel of land and investor B holds 40% through their respective interests in the JV.



Step 2
When the titles for the 10 apartments are issued upon completion, Investor A legally owns 60% in each of those 10 apartments and Investor B legally own 40% through their interests in the JV.



Step 3
Under the JV agreement, six apartments are transferred to Investor A and four to Investor B.



What is taxed?
A tax liability is triggered at step 3, because Investor A has legally disposed of its 60% share in B's four apartments and Investor B has legally disposed of its 40% share in A's six apartments. For Investor A, this liability arises under the bright-line test, and for Investor B, this could be under the other land-sale rules. These disposals are deemed to occur at market value.

Subsequent sales
Investor B, who holds their apartments on revenue account, will be taxed on their sales of the apartments to the final purchasers. If Investor A sells any of their six apartments within the bright-line period these sales will also be taxed. However, the disposals at step 3 being deemed to occur at market value creates an uplifted cost base for each investor, which ensures there is no double taxation.

Policy intent

15. Conceptually, Investor A has not realised a profit because they own 60% of the underlying land, contribute 60% of the development costs and end up with 60% of the assets by market value at the end of the project.

16. Even though Investor A does not hold the land on revenue account, if they do sell any of the apartments within the new build bright-line period, those sales would correctly be taxed.

17. However, it was not intended that the bright-line test would apply when the units are allocated amongst the JV members. We consider this to be an unintended consequence of how the bright-line rules work in the context of the development process.

18. If a single investor undertook the development on their own and retained ownership of the apartments following completion, they would not be taxed under the bright-

line test. Alternatively, if instead of being involved in the development process directly, an investor purchased an apartment off the plan from the development JV, the allocation of the apartment to that investor would not trigger the bright-line test for that investor.

19. For Investor B who is taxed on both the unit allocation and the final sale, the current law provides an uplift for their cost base to mitigate the risk of double taxation. However, this two-stage process of taxation increases compliance costs and could create timing issues (in terms of there being realised profits from which to pay tax) if the two stages occur in different income years.

Other considerations

20. The current law may act as a barrier to the Government's housing objectives of increasing quality housing supply in urban centres and improving outcomes for tenants. It could disincentivise large-scale housing developments where economies of scale are dependent on institutional investors working together.

21. We do not have data on how many subdivisions or unit-title developments have been impacted by the current law or whether taxpayers have historically complied with the law, given uncertainty prior to the TCO draft Interpretation Statement. Submissions received by TCO suggest that the current law is not an outcome that had been considered by tax practitioners. We expect that non-compliance is high but inadvertent.

22. Since the release of the TCO draft Interpretation Statement, we are aware of at least one instance where this issue may prevent a planned development from being undertaken, should no solution be found.

Officials' recommended option

23. We recommend an amendment to the bright-line test and land-sale rules so that the partitioning of divided or unit-titled land among the co-owners of the original parcel is not considered a disposal between the co-owners.

24. This would ensure that where a housing development involves multiple investors working together, the allocation of individual properties to each of the investors in line with their share in the investment does not trigger the bright-line test. In the case of revenue-account investors where both the allocation and subsequent sale would be subject to tax, the proposed change would ensure they only pay tax at one stage, thereby reducing compliance costs and timing issues.

25. We recommend this proposed change should apply to unit-title developments, as well as fee simple subdivisions or partitions among the co-owners of the original parcel of land.

26. To mitigate any potential risk for gaming, this should only be to the extent that the allocation of properties by market value is proportional to the person's interest in the underlying land and contributions to the development before the division and allocation. If there are adjustments throughout the development process to the amount of land to be allocated to each investor (and changes to contribution levels and wash-up payments between the co-owners to reflect this), these would continue to be subject to tax.

27. We consider the proposed amendment to be remedial in nature and would therefore not require Cabinet approval. The current law is an unintended outcome that is not in line with the policy intent. Therefore, our recommended approach would ensure that the relevant tax law is in line with the policy intent and would maintain the

coherence and integrity of the tax system. It would also assist in supporting the Government's housing objectives.

28. Our recommendation does not apply to opaque structures such as companies and trusts, where subdivided land is then allocated to individual shareholders. This would require further analysis and consideration as it would not be a remedial change.

29. We recommend an application date of 27 March 2021, to align with the introduction of the 10-year bright-line test and rewrite of the bright-line rules. Note that the current law would still apply to transactions before 27 March 2021. However, the Commissioner of Inland Revenue is charged with the care and management of the tax system. This involves the appropriate prioritisation of resources. Given that the incorrect application of the current law is likely to be widespread but inadvertent, Inland Revenue will not apply resources to investigate these cases.

Financial implications

30. Our proposal has no fiscal implications.

31. The current law as expressed in the draft Interpretation Statement is not in line with the policy intent of the bright-line test. As noted in paragraph 29, as part of the Commissioner of Inland Revenue's care and management of the tax system, any incorrect application of the current law will not be investigated and pursued. Because of this, the proposed amendment would not impact tax revenue under the bright-line test.

32. Regarding investors who hold land on revenue account and might otherwise be required to pay income tax on the two disposals (the allocation and the subsequent sale), the quantum of tax paid would not change. The proposal would allow them to account for tax on only one transaction, thereby reducing compliance costs and potential timing issues.

Consultation

33. The Treasury and Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD) were consulted on the contents of this report. HUD supports Inland Revenue's recommendations.

Next steps

34. We recommend that a copy of this report is referred to the Minister of Housing for her information.

35. If you decide to provide a legislative solution, we will draft the proposed amendment for inclusion in the next omnibus tax bill scheduled for introduction in August 2022.

36. If you receive correspondence on the issue and you agree to resolve the issue, you may wish to provide certainty by stating your intention to propose a legislative solution. We can work with your Office on a response.

Recommended action

We recommend that you:

37. **note** that in the development of a single parcel of land involving multiple investors as co-owners where that parcel is subsequently divided and individually allocated

among the investors, under current law each investor is regarded as having disposed of their share in the units not allocated to them, thereby triggering the bright-line test or other land-sale rules;

Noted

38. **note** that this primarily impacts investors who do not hold land on revenue account because rather than selling the properties in the development, they rent them out to members of the public, for example, build-to-rent;

Noted

39. **agree** that the partition of land (including subdivided or unit-titled land) among co-owners should not be a disposal for the bright-line test or other land-sale rules, to the extent the market value of the land parcels a co-owner is allocated is proportional to their share in the original parcel of land and development costs prior to the partition;

Agreed/Not agreed

40. **agree** that the proposed amendment should apply to partitions on or after 27 March 2021;

Agreed/Not agreed

41. **note** that Inland Revenue will not apply resources to investigate any incorrect application of the current law in relation to partitions before 27 March 2021;

Noted

42. **agree** to include any proposed amendments in the next omnibus tax bill scheduled for introduction in August 2022;

Agreed/Not agreed

43. **note** that there are no fiscal implications associated with these recommendations;

Noted

44. **refer** a copy of this report to the Minister of Housing for her information.

Referred/Not referred

s 9(2)(a)

[redacted]

Chris Gillion
Policy Lead
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

MEASURES FOR INCLUSION IN THE 2022 OMNIBUS TAX BILL

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to six general policy measures that require changes to tax legislation.

2. If approved, I propose including the necessary legislative amendments in the next omnibus tax bill, scheduled for introduction in August 2022.

Relation to Government Priorities

3. The measures in this paper promote Government priorities by maintaining the integrity of the tax system and making it easier for taxpayers to meet their obligations.

Executive Summary

4. This paper has been prepared to obtain approval to include six policy matters in the 2022 omnibus tax bill.

5. I recommend amendments to the Income Tax Act 2007, Tax Administration Act 1994, and the Goods and Services Act 1985, relating to the following initiatives:

   5.1 Setting annual rates for the 2022–23 tax year.

   5.2 Charities recommended for overseas donee status.

   5.3 Amendments to the treatment of dual resident companies.

   5.4 Improvements to the taxation of cross-border workers.

   5.5 The GST treatment of statutory and regulatory charges.

   5.6 Exempting employer subsidised public transport from fringe benefit tax.

6. These issues have been covered in the same paper for efficiency.

7. All of the initiatives proposed are funded through either a forecasting adjustment or through the Tax Policy Scorecard mechanism ("the Scorecard"). Therefore, I am not seeking Cabinet's agreement to any spending.

8. The Scorecard is a memorandum account that allows the fiscal impacts of tax policy changes to be offset against one another, rather than being managed through Budget

allowances or the between-Budget contingency. Use of the Scorecard requires joint Minster of Finance and Minister of Revenue agreement. The initiatives in this paper have been jointly agreed to by me and the Minister of Finance.

Setting annual rates for 2022-23

9. The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act.

10. I propose that an omnibus tax bill set the annual rates of income tax for the 2022–23 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007. To ensure that the bill can be enacted by 31 March 2023, the bill would need to be introduced in August 2022.

11. This will not have any fiscal or administrative implications.

Charities recommended for overseas donee status

Background

12. New Zealand charities that support activities overseas and want their donors to be eligible for tax benefits (such as the donation tax credit) must be approved for overseas donee status and listed in Schedule 32 of the Income Tax Act 2007. Monetary donations to listed organisations entitle individual New Zealand taxpayers to a tax credit of 33 ⅓% of the amount donated, up to the amount of their taxable income. Companies and Māori Authorities are eligible for tax deductions, up to the level of their net income, for monetary donations to the listed charities.

13. Generally, the availability of tax benefits to donations is limited to charities with New Zealand purposes only. Overseas donee status is an established exception for a specific class of charity. Giving overseas donee status requires legislative change by adding the charity to the list of overseas donee organisations in Schedule 32 of the Income Tax Act 2007. Advice from the Legislative Design and Advisory Committee in 2016 to the Inland Revenue Department has confirmed that the use of legislation to implement decisions to grant overseas donee status is appropriate. There are 159 organisations listed in schedule 32.

14. Cabinet has established criteria for granting overseas donee status:

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

** developing countries recognised by the United Nations.*[1]

Charities to be granted overseas donee status

15. In addition to the seven charities approved in March 2022 (CAB-22-MIN-0105 refers), I recommend the following charities be given overseas donee status.

AWA Aotearoa

16. AWA Aotearoa Ltd has been set up as the humanitarian aid arm of the Anglican Missions Board of the Church in Aotearoa, New Zealand and Polynesia ("the Missions Board"). The Missions Board supports aid and development projects and coordinates appeals for emergencies (primarily in neighbouring Pacific Island nations) and is heavily involved in the aid response in Tonga in response to the 15 January volcanic eruption and subsequent tsunami. It is active in supporting economic development projects in Kolkata, Fiji, and Tonga. Other objectives include providing relief from the effects of poverty in Mozambique and supporting Al Ahli Hospital in Gaza. AWA Aotearoa will support the delivery of humanitarian aid projects coordinated by the Missions Board.

Pacific Island Food Revolution

17. Pacific Island Food Revolution (PIFR) promotes local, healthy food in the Pacific to combat the non-communicable disease crisis through a multi-media communication programme that uses TV, social and traditional media and community partnerships.

18. PIFR's aim~~s~~ is to use local healthy food and knowledge to underpin economic development, tourism, health and wellbeing. This is in response to the health and development crisis declared by Pacific Island Governments in 2011 and its potential impact on national development.

19. I recommend that PIFR overseas done status be time limited until 31 March 2027. This is because PIFR has no proven record of donations, having previously been financially supported by grants from the Australian and New Zealand Governments. It is now transitioning into a private donations model. This will allow Inland Revenue to review PIFR's activities once it has had a chance to establish a donor base.

Application date

20. I recommend the Anglican World Aid (Aotearoa) Ltd be given overseas donee status from 11 April 2022 (the date the charity was created), and the Pacific Island Food Revolution Ltd from 1 April 2022 for a time limited period until 31 March 2027.

Dual resident companies

Background

21. In 2019, in response to an Australian High Court judgment, the Australian Tax Office (ATO) issued new technical guidance on Australia's corporate tax residency rules that effectively changed its approach to when companies are tax resident in Australia under the central management and control (CMAC) test. Several stakeholders have raised

[1] CM 78/14/7 refers.

concerns about the impact of this change on some New Zealand companies that have Australian directors, as these New Zealand companies would be deemed to be tax resident in both New Zealand and Australia.

22. Other integrity issues have been identified regarding the treatment of dual resident companies under the domestic dividend exemption and the corporate migration rules. I believe there is merit in strengthening these rules to ensure they are robust while not resulting in overreach.

Problem Definition

Changes to Australia's corporate residency rules

23. The main concern with the change to Australia's CMAC test is that it could result in more New Zealand resident companies being deemed to be dual resident with Australia and consequently, losing access to some beneficial tax regimes in New Zealand which ordinarily do not apply to dual resident companies.

24. While the Australian Government has announced that it intends to enact retrospective legislation to the CMAC test to effectively return to the original interpretation, there are benefits to progressing changes to our domestic rules now. These changes would ensure New Zealand resident companies retain access to several beneficial New Zealand tax regimes that they may otherwise lose access to, while maintaining the integrity of the underlying rules.

Integrity issues

25. Issues have been identified regarding the domestic dividend exemption and the company migration rules not applying in certain situations.

26. Normally, a dividend paid between members of a wholly owned group of New Zealand resident companies is exempt from income tax (known as the domestic dividend exemption). This exemption does not apply to dividends paid to a foreign company, which are instead subject to non-resident withholding tax (NRWT). However, a double tax agreement (DTA) may prevent the application of NRWT if it is paid to a foreign company by a dual resident New Zealand company whose residency tie-breaks to another country under that DTA (as the dividend is treated as paid between two non-New Zealand residents).

27. The combination of the domestic dividend exemption with the DTA restriction creates the opportunity for unimputed dividends to be paid offshore through a dual resident company, without being subject to any New Zealand tax.

Proposed Solution

Changes to Australia's corporate residency rules

28. Three tax regimes (loss grouping, consolidation and imputation credit account) have been identified where changes could address stakeholder concerns with Australia's corporate residency rules while maintaining the integrity of the underlying rules.

29. The purpose of the loss grouping rules is to allow a company to offset its losses against the profits of another company in the same group. The consolidation rules have a

similar outcome, as members of a consolidated group are treated as one economic entity for income tax purposes. Dual resident companies are unable to access these two regimes due to an integrity risk that they could claim a deduction for the same expenditure in more than one country (referred to as 'double dipping'). This risk has been eliminated with the introduction of the hybrid and branch mismatching rules in 2018, and so the eligibility requirements can be relaxed without creating additional risk.

30. Given the protection to the tax base from existing hybrid and branch mismatch rules, I propose to amend the loss grouping and consolidation rules to remove the residency restrictions in these rules.

31. The imputation credit account (ICA) rules allow a company to attach a credit for income tax paid by a company to a dividend paid to its shareholders. This is to prevent income tax from being paid twice on the same economic income – once on the company profits and again when those profits are distributed to shareholders. Where a New Zealand company becomes a dual resident and its residency tie-breaks to another country, the company loses its accumulated ICA balance.

32. Under certain circumstances, an Australian company can elect to be an 'Australian ICA company' and maintain an ICA. The rules do not currently allow a New Zealand company to retain any imputation credits after it becomes an Australian resident company and elects to be an Australian ICA company. This can be particularly unfair when there is an inadvertent change in tax residency (for example, due to a retrospective change in the tax residency rules in Australia).

33. I propose to amend the ICA rules to allow a New Zealand resident company to automatically become an Australian ICA company and maintain its ICA balance in the event its tax residency tie-breaks to Australia. This will ensure New Zealand dual resident companies do not forfeit their accumulated imputation credits in the event of a residency change to Australia.

34. Stakeholders were supportive of the recommended changes to the three tax regimes, with several supporting the idea that the ICA changes could be further extended to companies that are dual resident with countries other than Australia. However only Australian companies can maintain an ICA, so I do not propose extending the amendment to non-Australian companies.

Integrity issues

35. Issues have been identified regarding the domestic dividend exemption and the company migration rules. These involve situations where certain groups of companies may extract income without the anticipated New Zealand taxation, simply by changing a company's tax residency. There is merit in strengthening these rules to ensure they are robust while not resulting in overreach.

36. While stakeholders have generally agreed the problems should be resolved, they are concerned the proposed changes may impose additional compliance costs and could have unintended consequences. As a result of stakeholder feedback, refinements have been made to the proposals (refer below) to limit the changes to specific arrangements that give rise to concerns and to provide taxpayers a period to remedy their tax residency before a tax obligation is imposed.

Domestic dividend exemption

37. The domestic dividend exemption applies where the recipient of a dividend is a New Zealand resident, regardless of whether they are a dual resident or if their residency tie-breaks to another country under a DTA. Under a number of our DTAs, a dividend paid by a dual resident may be exempt from New Zealand taxation. This means that distributions from New Zealand resident companies can sometimes avoid taxation under the NRWT rules.

38. I propose removing the exemption for dividends paid to certain dual resident companies where the tax residence tie-breaks to another country under a DTA. The dividend would instead be subject to NRWT.

39. Stakeholders have raised concerns with the proposal due to difficulties in determining where a company's residence tie-breaks to, temporary changes in residence, and the impact of long ownership chains involving multiple dual resident companies. I propose to resolve these concerns by:

    39.1 Focussing the changes so they only apply if the dividend paid to the dual resident company would not be subject to NRWT if that company was non-resident under our domestic rules. The changes would therefore only apply to unimputed dividends[2] and in situations where the recipient would not qualify for a 0% NRWT rate under a DTA.

    39.2 Deferring the liability to pay NRWT by up two years to give taxpayers time to determine tax residency.

    39.3 During this two-year deferral, providing taxpayers the ability to remove the NRWT liability if the dividend recipient changes its tax residency back to New Zealand in a way that would ensure that if the recipient itself paid a dividend it would be subject to NRWT. This would only be available if the recipient has not already on-paid the dividend.

Corporate migration rules

40. The corporate migration rules apply when a company ceases being New Zealand tax resident and result in a deemed liquidation, disposal of assets and distribution to shareholders. This can have significant income tax consequences.

41. However, the rules do not apply when a New Zealand company is dual resident and its tax residency tie-breaks to another jurisdiction under a DTA. This is not desirable, as such a company could distribute all of its assets to foreign shareholders without any New Zealand taxation consequences. To remedy this issue, I propose that the corporate migration rules would apply where a New Zealand resident company's tax residency tie-breaks to another jurisdiction under a DTA.

42. Similar concerns were raised by stakeholders to those for the domestic dividend exemption. I propose to remedy these by providing a two-year deferral to allow taxpayers to change the tax residency back to New Zealand. To ensure the proposed changes remain effective (that is, New Zealand retains appropriate taxing rights), this

[2] Imputed dividends paid by a resident company can qualify for a 0% NRWT rate.

deferral period would cease immediately prior to the dual resident company paying a dividend or disposing of assets that would not be taxable if the company's residency tie-breaks to another country.

43. The refinements to address stakeholder concerns for both the domestic dividend exemption and corporate migration rules would ensure that high-risk arrangements that give rise to integrity concerns would be targeted, while limiting potential overreach and compliance costs.

Application dates

44. I recommend the changes to the eligibility rules for the loss grouping, consolidation and imputation credit regimes be retrospectively applied from 15 March 2017, to ensure New Zealand companies affected by the change to Australia's corporate residency rules have continued access to these regimes.

45. I recommend the changes to the domestic dividend exemption and the corporate migration rules take effect from the date of introduction of the omnibus tax bill, in order to reduce the risk of tax planning before the proposed changes are enacted.

Cross-border workers

Background

46. The obligation to comply with employment-related tax requirements falls on the employer or payer of the income. Employers are obliged to withhold tax under the pay as you earn (PAYE) system and pay fringe benefit tax (FBT) and employer's superannuation contribution tax (ESCT), where applicable. Payers of non-resident contractors are obliged to withhold non-resident contractor's tax (NRCT) from contract payments.

47. Concerns were raised with Inland Revenue that these rules are not sufficiently clear or flexible when applied to cross-border work arrangements. A review of these rules was included on the Tax Policy Work Programme and public consultation was undertaken following the release of an officials' issues paper by Inland Revenue in October 2021.

Problem Definition

48. The problems can be broken into three broad categories of issues:

    48.1 PAYE, FBT and ESCT do not adequately cater for the complexities of cross-border employment arrangements. The employer may expect an exemption to be available, for example under a double taxation agreement, but project delays may mean that the conditions of the exemption cannot be met. In addition, remuneration for cross-border employees may be paid by different parts of a worldwide corporate group, which can make it difficult to gather and process compensation data to meet New Zealand's reporting and payment dates.

    48.2 PAYE, FBT and ESCT obligations have been differently interpreted by employers, tax advisors and Inland Revenue. A recent operational statement clarified that the obligations arise for an employer with a sufficient presence in

New Zealand. Under the PAYE rules, if there is no presence in New Zealand, an employee should pay PAYE directly to Inland Revenue. However, no equivalent rule exists for FBT and ESCT.

48.3 NRCT withholding obligations are inflexible and require modernisation. In addition to the issues which arise for employers, specific issues exist for payers of non-resident contractors. Breaches of the thresholds and/or a failure to obtain an exemption prior to the first contract payment may result in a cost borne by New Zealand businesses.

49. Breaches of the rules require a voluntary disclosure to report the underpaid tax to Inland Revenue and correct the tax position for each affected employer, payer and/or individual. Voluntary disclosures are time consuming and costly to prepare and from an administrative perspective are time consuming to process and resolve.

Proposed Solution

50. The fundamental policy settings for taxing cross-border workers are sound, and therefore structural reform is not necessary. However, the administrative aspects of the rules should be clarified and modernised. This will reduce the cost of complying with New Zealand's PAYE, FBT, ESCT and NRCT rules.

PAYE, FBT and ESCT flexibility

51. I propose the establishment of a broad framework for PAYE, FBT and ESCT to apply to cross-border working arrangements. This framework would include more flexible PAYE, FBT and ESCT arrangements that apply to identified cross-border employees.

52. I anticipate that these more flexible PAYE, FBT and ESCT arrangements will reduce the need for employers to make voluntary disclosures of underpaid tax in cross-border situations and reduce the cost of complying with these rules.

PAYE, FBT and ESCT integrity

53. An employer has an obligation to comply with the PAYE, FBT and ESCT rules if they have a sufficient presence in New Zealand. It can be difficult for businesses to determine the threshold for a sufficient presence.

54. There is also a need to ensure that non-cash benefits and employer superannuation contributions are taxed via FBT and ESCT where the employer does not have an obligation to comply with New Zealand's tax rules.

55. I propose the following changes to clarify and support the integrity of the sufficient presence test:

55.1 A safe harbour should be available where the non-resident employer has no more than two employees present in New Zealand, or pays $500,000 or less of gross-employment related taxes per year, and has either made alternative arrangements for PAYE, FBT and ESCT obligations to be met or communicated the obligations to the affected employees. The safe harbour will clarify when a PAYE, FBT and ESCT obligation arises for a non-resident employer and will protect the non-resident employer from penalties for non-compliance if they are within it.

55.2 The current rule which transfers the obligation to report and pay PAYE to an employee where a non-resident employer does not have a PAYE obligation should be clarified. A corresponding rule for FBT and ESCT should be introduced. This will ensure that employees are taxed equally on fringe benefits and superannuation contributions, regardless of their employer's New Zealand tax residence or presence.

55.3 A rule confirming that a related New Zealand entity may agree to assume responsibility for the non-resident employer's PAYE, FBT and ESCT obligations should be introduced. The local entity will have joint and several liability for the tax obligations. This proposal also supports PAYE flexibility.

NRCT

56. Similar to PAYE, FBT and ESCT, there is a need to modernise, and provide greater flexibility in, the NRCT rules. Flexibility recognises that the strict application of the rules is not always appropriate, particularly where businesses are trying to comply. Modernisation is needed to support a more flexible approach and assists reduction of compliance costs. I propose:

56.1 Amending the NRCT threshold rules so that the payer is required to consider only their contract with the non-resident contractor. For this purpose, the 'single payer' will comprise the payer and related entities. At present, the test requires the payer to obtain information directly from the non-resident contractor about other activities in New Zealand in the previous 12 months, including time spent on holiday. The payer can rely on information that is incorrect or incomplete but, depending on the circumstances, may also bear the tax cost of that inaccuracy. This proposal will also make the application of the thresholds to contract payments more certain.

56.2 Introducing a requirement for payers of non-resident contractors to report details of the non-resident contractor to Inland Revenue to assist in identifying the non-resident contractor and whether or not a payment is exempt from NRCT. This will enable Inland Revenue to monitor thresholds and exemptions and supports the introduction of a single payer approach.

56.3 Changes to allow greater flexibility in the NRCT system, which will allow:

56.3.1 A catch-up payment of NRCT to be made within 60 days. This will operate on a similar basis to the PAYE, FBT and ESCT flexibility measure.

56.3.2 Certificates of exemption to be issued with a retroactive period of up to 92 days.

56.3.3 Certificates of exemption to be issued on a broad 'all activities' basis where the non-resident contractor is able to demonstrate they have a good compliance history.

56.3.4 Certificates issued on a good compliance history basis to last for a two-year period, although Inland Revenue may determine another period is appropriate.

56.3.5 A non-resident contractor to rely on a previous exemption to establish they have a good compliance history.

57. Like flexible PAYE, FBT and ESCT arrangements, flexible NRCT arrangements aim to reduce the need for employers to make voluntary disclosures of underpaid tax to correct any errors. Flexibility recognises that it is not always possible to complete the certificate of exemption process before the work starts, particularly when the work is urgent.

58. These amendments also recognise that the exemptions are given on the basis that either no New Zealand tax is ultimately due from the non-resident contractor or that Inland Revenue is confident the non-resident contractor will comply if tax is due. The proposals broaden the ambit of certificates of exemption granted on the basis of good compliance and simplify the basis for future applications.

59. In addition, the non-resident contractor's PAYE bond should be repealed. The introduction of flexible NRCT should mean that the bond is no longer required. It is rarely used in practice.

Further technical amendments

60. I propose a further technical amendment:

60.1 Employer contributions to foreign superannuation schemes should be made subject to PAYE (including ESCT), rather than FBT. This proposal will simplify tax compliance for many businesses and reduce compliance costs.

Application dates

61. I propose the PAYE, FBT and ESCT integrity measures apply from 1 April 2023. All other changes should apply from 1 April 2024.

GST treatment of statutory and regulatory charges

62. The GST treatment of statutory and regulatory charges – being amounts that are paid under Acts or regulations – can be unclear. The lack of a general rule that applies to statutory and regulatory charges has resulted in an inconsistent and incoherent approach as to how GST applies to such charges, which is undesirable.

63. To improve coherence and provide greater certainty about the GST status of statutory and regulatory charges, I recommend the Goods and Services Tax Act 1985 be amended to contain a new default rule for statutory and regulatory charges. The proposed rule would clarify that any amount payable under an enactment or a regulation is deemed to be consideration for the supply of goods and services from the recipient of the charge, unless the amount payable is in the nature of fines, penalties, interest, or a general tax payable to the Crown (such as income tax).

64. This is consistent with the broad-based nature of New Zealand's GST, where GST applies to the broadest possible range of goods and services supplied in New Zealand, which helps to keep GST simple and efficient.

65. It may be identified in the future that there are good tax policy reasons why certain statutory and regulatory charges should not be subject to this new treatment. To address this, I propose a new schedule to the GST Act which would list non-taxable statutory and regulatory charges.

66. The effect of this change on taxpayers is expected to be minimal. Most statutory and regulatory charges paid by taxpayers (such as local authority rates, fuel excise, and road user charges) are currently subject to GST. If this proposal results in GST now applying to charges where it did not previously, the effect of this on persons will depend on whether they are registered for GST (and, if they are, whether the charges relate to their taxable activity).

67. To ensure there is sufficient time for government agencies to make the necessary changes to ensure compliance with this proposed default rule, I recommend a three-year transitional approach to implementation.

68. I propose that the default rule should apply from 1 July 2023 for any new (including those that are renewed through updated regulations or amended empowering provisions) statutory and regulatory charges. For existing statutory and regulatory charges that are not updated during the three-year transitional period, the default rule would apply from 1 July 2026.

69. To prevent the risk of historic GST refund claims, I also recommend that taxpayers, and the Commissioner of Inland Revenue, be prevented from amending historic GST assessments where those amendments would result in an outcome inconsistent with what is proposed in this paper. This is because of the potentially significant fiscal risk that historic refunds may pose.

70. To facilitate an orderly implementation of the changes, and in the event that the proposal would result in GST applying to charges where it should not apply, I recommend a transitional regulation making power that would enable the Minister of Revenue to recommend an Order in Council to update the proposed schedule of non-taxable statutory and regulatory charges in the GST Act. This regulation making power should expire on 30 June 2026 which is the end of the transitional period.

71. This approach is supported by officials at Inland Revenue, the Treasury, and the Parliamentary Counsel Office. Several GST experts in the private sector were also consulted and support the proposal.

Application date

72. I propose that the default rule should apply from 1 July 2023 for any new (including those that are renewed through updated regulations or amended empowering provisions) statutory and regulatory charges. For existing statutory and regulatory charges that are not updated during the three-year transitional period, the default rule would apply from 1 July 2026.

Exempting employer subsidised public transport from fringe benefit tax

Background

73. Conceptually, anything that an employer provides to an employee either in the form of salary or wages or as a substitute for salary or wages should be taxed. To ensure this is the case, most non-cash employment benefits are treated as fringe benefits and are subject to fringe benefit tax (FBT) on a broadly comparable basis to salary and wages. Exemptions from FBT are generally limited to situations when compliance costs make it impracticable to apply FBT.

Problem Definition

74. Generally, contributions by an employer to their employees' public transport costs, for example in the form of a voucher or a loaded electronic ticketing card, is subject to FBT unless they fall below the standard de minimis[3].

75. In contrast, when an employer provides free car parking to an employee on the employer's premises FBT does not apply in many instances. This extends to car parks leased from a car park provider. This exemption is part of a general FBT exemption for benefits provided "on-premises", to reduce taxpayer compliance costs.

76. The car park exemption can be a sizeable benefit to employees ($2,500-$6,000 per annum) where parking charges are material, such as in central Auckland and Wellington. This does not align with the general approach that tax should be applied neutrally to avoid distorting decision-making. It can encourage the provision of car parking in lieu of a portion of taxable salary and wages. It may also encourage people to commute using private cars rather than public transport, which can have a negative environmental impact.

Proposed Solution

77. FBT should, like other tax rules, be neutral in its application, including its impact on environmental outcomes. Tax settings should not encourage environmentally damaging behaviour.

78. Applying FBT to more on-premises car parking has been attempted on several occasions, notably in 2012. However, this proved to be contentious in New Zealand, partly because of valuation and compliance cost concerns, and therefore did not proceed.

79. To improve tax and environmental neutrality in this area, I therefore propose to expand the FBT exemptions to include public transport fringe benefits as a more environmentally friendly mode of transport compared with private cars. This means when an employer subsidises an employee's use of public transport primarily for the

[3] Miscellaneous benefits are exempt from FBT when the taxable value provided to each employee is $300 or less per quarter and the total taxable value of all unclassified benefits provided by the employer to all employees over the past four quarters is $22,500 or less. There is also a longstanding concessional FBT treatment when an employer that is in the business of providing public transport allows an employee to travel on that transport for less than fares charged to the public, but this covers relatively few employees.

purposes of travel between home and work, for example via a voucher or a loaded electronic ticketing card, FBT would not apply.

80. Our proposal is consistent with the Tax Working Group recommendation in its 2018 final report that the Government consider allowing employers to subsidise their employees' public transport use without incurring FBT given the practical difficulties associated with applying FBT to a wider range of car parks.

Application date

81. I propose this exemption apply from 1 April 2023.

Financial Implications

82. All of the initiatives proposed in this paper will be funded through either a forecasting adjustment or through the Tax Policy Scorecard mechanism ("the Scorecard"). Therefore, I am not seeking Cabinet's agreement to any spending.

83. The Scorecard is a memorandum account that allows the fiscal impacts of tax policy changes to be offset against one another, rather than being managed through Budget allowances or the between-Budget contingency. The use of the Scorecard requires joint Minster of Finance and Minister of Revenue agreement. The initiatives in this paper have been jointly agreed to by us.

Charities recommended for overseas donee status

84. The estimated financial implications of adding the two charities recommended in this paper are shown in the table below. Over the forecast period (2021/22 to 2025/26) the expected fiscal cost is $0.667 million. Consistent with previous practice, the financial implications will be treated as a forecasting change to reflect the increasing cost of the policy to allow tax benefits for donations to New Zealand-based charitable overseas aid organisations. The revenue estimates are based on projections made by the charities about the monetary donations they expect to receive for the forecast period.

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(0.183)	(0.117)	(0.167)	(0.200)

Dual resident companies

85. The fiscal impact of the changes to the loss grouping, consolidation and imputation account rules are estimated to be neutral over time. This is because it is likely that Australia will enact retrospective legislation to resolve the issue in the CMAC test and in the interim the Australian Tax Office is not applying any resource to this particular issue. Therefore, companies are continuing to apply the previous interpretation of the CMAC test, meaning that they are not currently dual resident. The loss grouping and consolidation rules do not have a fiscal impact as existing hybrid and branch mismatching rules mean there is no effective change to the tax settings.

86. The fiscal impact of the integrity changes is estimated to be neutral to nominally fiscally positive, with expected revenue of $0.2 million per annum. However, there is limited information available to make an accurate forecast.

87. This policy will have the following changes to tax revenue, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	0.200	0.200	0.200

Cross-border workers

88. Most changes in the package are administrative and have no fiscal implications. The introduction of catch-up payments will result in a timing change, which will result in a negative impact in the year of introduction, estimated to be approximately $1 million. The FBT and ESCT integrity proposal will be fiscally positive, while the NRCT threshold change is expected to be fiscally negative. In the year of introduction, the integrity proposal is expected to result in a small revenue increase of $0.2 million. In subsequent years this increase will be balanced by the fiscal negative expected to result from the NRCT threshold change.

89. This policy will have the following changes to tax revenue, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	(1.000)	-	-

GST treatment of statutory and regulatory charges

90. The proposal to introduce a new default rule for GST and statutory and regulatory charges has no direct financial implications. Decisions made to exclude certain charges in the future (through adding them to the proposed schedule of non-taxable statutory and regulatory charges) may have a fiscal cost that will need to be recognised at the time decisions to do this are taken.

Exempting employer subsidised public transport from fringe benefit tax

91. The fiscal impact of the proposed fringe benefit tax exemption for public transport is an estimated $9 million reduction in tax revenue per year, with a corresponding impact on the operating balance and net Crown core debt:

	$m – increase / (decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(2.250)	(9.000)	(9.000)	(9.000)

Legislative Implications

92. Implementing these proposals requires changes to the Income Tax Act 2007, Tax Administration Act 1994, and the Goods and Services Tax Act 1985.

93. If approved, I propose including the legislative changes resulting from these recommendations in the next omnibus taxation bill, scheduled for introduction in August 2022.

Impact Analysis

Regulatory Impact Assessment

94. For both *charities recommended for overseas donee status* and *dual resident companies*: The Regulatory Quality Team at the Treasury has determined that the regulatory decisions sought in this paper are exempt from the requirement to provide a Regulatory Impact Assessment as they have no or minor impacts on businesses, individuals, or not-for-profit entities.

95. The Inland Revenue Quality Assurance Panel has reviewed the following Regulatory Impact Assessment and consider that the information and analysis summarised in each meets the quality assurance criteria.

    95.1 GST status of statutory and regulatory charges.

    95.2 Cross-border workers tax reform.

    95.3 Fringe benefit tax exemption for public transport.

Climate Implications of Policy Assessment

96. For the *charities recommended for overseas donee status*, *dual-resident companies, cross-border workers*, and *GST treatment of statutory and regulatory charges,* the Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to these proposals as the threshold for significance is not met.

97. For *exempting employer subsidised public transport from fringe benefit tax,* the CIPA team has been consulted and confirms that the CIPA requirement does not apply to this proposal as the threshold for significance is not met. This proposal has the potential to result in a small reduction in emissions as compared to the current rules, the new rules would effectively provide more incentive for employees to use public transport over private motor vehicles to travel to and from work. This impact is likely to be relatively small and is not an impact that can be accurately quantified with ease.

Population Implications

98. The recommended changes in this paper are not expected to have any undue implications for specific demographics in New Zealand.

Charities recommended for overseas donee status

99. New Zealand's strategy for overseas development is underpinned by four development principles: effectiveness, inclusiveness, resilience and sustainability. The charities I am recommending be given overseas donee status exhibit these principles by carrying out activities that directly respond to poverty, provide essential medical services to isolated or impoverished communities, and develop economic or educational capacity in developing countries.

100. There is a focus on the Pacific and Micronesia to support health and education outcomes, including providing a relief response for Tonga. Strong relationships in the Pacific are an important aspect of New Zealand's diplomatic and development strategy.

Human Rights

101. There are no human rights implications associated with the recommended changes in this paper.

Consultation

102. In addition to the specific consultation undertaken for each of the policy initiatives as outlined below, the Treasury and Department of the Prime Minister and Cabinet were consulted on the contents of this Cabinet paper.

Charities recommended for overseas donee status

103. The Ministry of Foreign Affairs and Trade (Partnerships, Humanitarian and Multilateral Division) and the Department of Internal Affairs – Charities Services were consulted as part of our analysis of the two charities recommended in this paper. The New Zealand Police's vetting service was also used in connection with the trustees/officers of the charities recommended in this paper.

Dual resident companies

104. To understand the impact of the proposed changes, Inland Revenue officials consulted with KMPG, PwC, Chartered Accountants Australia and New Zealand, the New Zealand Law Society and the Corporate Taxpayers Group. Stakeholders provided advice on the opportunities to tighten the application of the integrity measures to ensure the proposed rules fulfil the policy intent.

Cross-border workers

105. An officials' issues paper was released by Inland Revenue in October 2021. Ten submissions were received from tax advisors and representative bodies such as the Corporate Taxpayers Group. Meetings were held to discuss submissions and obtain further understanding of the impact of the proposals. The proposals were broadly

supported. Where the proposals attracted mixed or little support, changes were made to the proposals to address stakeholder concerns, where justified.

GST treatment of statutory and regulatory charges

106. Inland Revenue officials consulted with the Treasury and the Parliamentary Counsel Office, and GST experts at Deloitte, KPMG, and PwC on the proposed approach. To understand the impact of the proposal on existing statutory and regulatory charges, Inland Revenue officials consulted with the Ministry for Primary Industries, the Ministry of Business, Innovation and Employment, the Ministry of Transport, the Ministry of Justice, and the Department of Internal Affairs. No material issues were identified during this consultation.

Exempting employer subsidised public transport from fringe benefit tax

107. Inland Revenue officials consulted with the Treasury, the Ministry of Transport, Auckland Transport, the Greater Wellington Strategy Group, the Corporate Taxpayers Group and BusinessNZ. Stakeholders largely supported an FBT exemption for employer subsidised public transport. Some stated that it will be critical to the success of the exemption for public transport providers to have a simple approach solution for employers to use.

Communications

108. I will make an announcement regarding the proposals in this paper, when the omnibus tax bill containing the proposals is introduced (currently scheduled for August 2022). A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

Proactive Release

109. I propose to delay the proactive release of this Cabinet paper, associated minutes, and key advice papers until after the introduction of the omnibus taxation bill containing these proposals. The expected introduction date for this bill is August 2022.

110. Drawing the public attention to the dual resident company integrity issues before legislation is introduced may create a fiscal risk.

Recommendations

The Minister of Revenue recommends that the Committee:

Annual Rates for 2022–23

1. Agree to set the annual rates of income tax for the 2022–23 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007.

Charities recommended for overseas donee status

2. Agree that the following charities be given overseas donee status and listed in schedule 32 of the Income Tax Act 2007:

2.1 Anglican World Aid (Aotearoa) Ltd; and

2.2 Pacific Island Food Revolution Ltd.

3. Agree that the charities in recommendation 2 be given overseas donee status from the following dates:

   3.1 Anglican World Aid (Aotearoa) Ltd, 11 April 2022; and

   3.2 Pacific Island Food Revolution Ltd, 1 April 2022 for time limited period until 31 March 2027.

4. Note the following changes to tax revenue as a result of recommendations 2 and 3, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.00)	(0.183)	(0.117)	(0.167)	(0.200)

Dual resident companies

5. Agree to amend the loss grouping rules to enable access for dual resident companies.

6. Agree to amend the consolidation rules to enable access for dual resident companies.

7. Agree to amend the imputation credit account rules to enable New Zealand companies that become dual resident with Australia to retain their accumulated imputation credits.

8. Agree to recommendations 5 to 7 being retrospectively applied from 15 March 2017.

9. Note there are no fiscal impacts arising from recommendations 5 to 7.

10. Agree to amend the domestic dividend exemption and corporate migration rules to address specific integrity risks relating to dual-resident companies and the avoidance of New Zealand tax.

11. Agree to recommendation 10 applying from the date of the introduction of the omnibus tax bill containing the recommended changes.

12. Note the following changes to tax revenue as a result of the decisions in recommendations 10, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	**-**	0.200	0.200	0.200	0.200

Cross-border workers

13. Agree to changes to pay as you earn (PAYE), fringe benefit tax (FBT) and employer's superannuation contribution tax (ESCT) as follows:

    13.1 enable more flexible PAYE arrangements for employers of identified cross-border employees;

    13.2 repeal the employer PAYE bond provision;

    13.3 introduce a safe harbour for PAYE, FBT and ESCT obligations. This will apply to non-resident employers only;

    13.4 Clarify employee responsibilities for discharging PAYE, FBT and ESCT obligations;

    13.5 Allow the transfer of PAYE, FBT and ESCT obligations to a related New Zealand entity.

14. Agree to changes to non-resident contractor's tax (NRCT) as follows:

    14.1 Change the day count and monetary NRCT withholding thresholds to a 'single payer' test;

    14.2 Introduce an NRCT reporting requirement;

    14.3 Improve the flexibility of NRCT payments and exemptions;

    14.4 Enable a 'nominated taxpayer' to establish a good compliance history basis for the NRCT exemption and discharge tax obligations;

    14.5 Repeal the non-resident contractor PAYE bond provision.

15. Agree to a technical change as follows:

    15.1 Make employer contributions to foreign superannuation schemes subject to PAYE (including ESCT) rather than FBT.

16. Agree that the recommendations 13.3 to 13.5 apply from 1 April 2023 and that other recommendations apply from 1 April 2024.

17. Note the following changes in tax revenue as a result of the decision in recommendations 13.1, 13.2, 14, 15, and 16 above, with a corresponding impact on the operating balance and net debt.

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	(1.000)	-	-

GST treatment of statutory and regulatory charges

18. Agree that any amounts payable under an enactment or a regulation (excluding amounts in the nature of fines, penalties, interest, and general taxes such as income tax) are deemed to be consideration for a supply of goods and services (the **default rule**);

19. Agree to a new schedule to the Goods and Services Tax Act 1985 of non-taxable statutory and regulatory charges (**charges**) that can include a class of charges or specific charges that the default rule does not apply to;

20. Agree that the default rule referred to in recommendation 18 applies:

    20.1 to all new statutory and regulatory charges that come into force, or are amended, on or after 1 July 2023;

    20.2 to all other statutory and regulatory charges that are not on the schedule of non-taxable statutory and regulatory charges referred to in recommendation 19, by 1 July 2026;

21. Agree to a transitional regulation making power that will enable the Minister of Revenue to recommend an Order in Council to add either a class of statutory or regulatory charges, or specific statutory and regulatory charges, to the proposed schedule of non-taxable statutory and regulatory charges;

22. Agree that this transitional regulation making power applies from the enactment of the legislation containing the default rule, and would expire on 30 June 2026.

23. Note that recommendations 18 to 22 have no direct fiscal impact.

24. Note that future decisions to add specific statutory or regulatory charges to the proposed schedule of non-taxable charges may have a fiscal cost that will need to be recognised by Cabinet when decisions are taken to do this in the future.

25. Agree that neither taxpayers, nor the Commissioner of Inland Revenue, should be able to amend historic GST assessments in a way that would be inconsistent with the default rule to prevent a potentially significant fiscal risk from materialising.

Exempting employer subsidised public transport from fringe benefit tax

26. Agree to exempt employer-subsidised public transport fringe benefits primarily for travel between home and work from fringe benefit tax from 1 April 2023.

27. Note the following changes in tax revenue as a result of the decision in recommendation 26 above, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)				
Vote Revenue **Minister of Revenue**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**

Crown Revenue and Receipts: Tax Revenue	-	(2.250)	(9.000)	(9.000)	(9.000)

Next steps

28. Agree that the above recommendations be included in the tax bill scheduled to be introduced in August 2022.

29. Agree to delegate authority to the Minister of Revenue to make minor technical changes to the policies included in this paper before introduction of the omnibus tax bill.

30. Note that, to prevent creating a fiscal risk by drawing the public's attention to integrity issues relating to dual-resident companies, the proactive release of this Cabinet paper, the associated Cabinet minute, and key advice papers will be delayed until after the introduction of the omnibus taxation bill containing the changes recommended in this paper.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Cabinet Economic Development Committee

Minute of Decision

Measures for Inclusion in the 2022 Omnibus Tax Bill

Portfolio **Revenue**

On 22 June 2022, the Cabinet Economic Development Committee:

Annual rates for 2022–23

1 **agreed** to set the annual rates of income tax for the 2022–23 tax year at the same rates currently specified in Schedule 1 of the Income Tax Act 2007;

Charities recommended for overseas donee status

2 **agreed** that the following charities be given overseas donee status and listed in schedule 32 of the Income Tax Act 2007:

2.1 Anglican World Aid (Aotearoa) Ltd;

2.2 Pacific Island Food Revolution Ltd;

3 **agreed** that the charities referred to in paragraph 2 above be given overseas donee status from the following dates:

3.1 Anglican World Aid (Aotearoa) Ltd: 11 April 2022;

3.2 Pacific Island Food Revolution Ltd: 1 April 2022 for a time-limited period until 31 March 2027;

4 **noted** the following changes to tax revenue as a result of paragraphs 2 and 3 above, with a corresponding impact on the operating balance and net debt:

$m – increase/(decrease)					
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	(0.00)	(0.183)	(0.117)	(0.167)	(0.200)

Dual resident companies

5 **agreed** to amend the loss grouping rules to enable access for dual resident companies;

6 **agreed** to amend the consolidation rules to enable access for dual resident companies;

7 **agreed** to amend the imputation credit account rules to enable New Zealand companies that become dual resident with Australia to retain their accumulated imputation credits;

8 **agreed** that the decisions in paragraphs 5 to 7 above be retrospectively applied from 15 March 2017;

9 **noted** there are no fiscal impacts arising from paragraphs 5 to 7 above;

10 **agreed** to amend the domestic dividend exemption and corporate migration rules to address specific integrity risks relating to dual-resident companies and the avoidance of New Zealand tax;

11 **agreed** that the decision in paragraph 10 above apply from the date of the introduction of the omnibus tax bill containing the recommended changes;

12 **noted** the following changes to tax revenue as a result of paragraph 10 above, with a corresponding impact on the operating balance and net debt:

$m – increase/(decrease)					
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.200	0.200	0.200	0.200

Cross-border workers

13 **agreed** to changes to pay as you earn (PAYE), fringe benefit tax (FBT) and employer's superannuation contribution tax (ESCT), as follows:

13.1 enable more flexible PAYE arrangements for employers of identified cross-border employees;

13.2 repeal the employer PAYE bond provision;

13.3 introduce a safe harbour for PAYE, FBT and ESCT obligations (this will apply to non-resident employers only);

13.4 clarify employee responsibilities for discharging PAYE, FBT and ESCT obligations;

13.5 allow the transfer of PAYE, FBT and ESCT obligations to a related New Zealand entity;

14 **agreed** to changes to non-resident contractor's tax (NRCT), as follows:

14.1 change the day count and monetary NRCT withholding thresholds to a 'single payer' test;

14.2 introduce an NRCT reporting requirement;

14.3 improve the flexibility of NRCT payments and exemptions;

14.4 enable a 'nominated taxpayer' to establish a good compliance history basis for the NRCT exemption and discharge tax obligations;

14.5 repeal the non-resident contractor PAYE bond provision;

15 **agreed** to a technical change, namely to make employer contributions to foreign superannuation schemes subject to PAYE (including ESCT) rather than FBT;

16 **agreed** that:

16.1 the decisions in paragraphs 13.3 – 13.5 above apply from 1 April 2023;

16.2 the other decisions referred to in paragraphs 13-15 above apply from 1 April 2024;

17 **noted** the following changes in tax revenue as a result of the decision in paragraphs 13.1, 13.2, 14, 15, and 16 above, with a corresponding impact on the operating balance and net debt.

$m – increase/(decrease)					
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	0.2000	(1.000)	-	-

GST treatment of statutory and regulatory charges

18 **agreed** that any amounts payable under an enactment or a regulation (excluding amounts in the nature of fines, penalties, interest, and general taxes such as income tax) are deemed to be consideration for a supply of goods and services (the default rule);

19 **agreed** to a new schedule to the Goods and Services Tax Act 1985 of non-taxable statutory and regulatory charges (charges) that can include a class of charges or specific charges that the default rule does not apply to;

20 **agreed** that the default rule referred to in paragraph 18 applies:

20.1 to all new statutory and regulatory charges that come into force, or are amended, on or after 1 July 2023;

20.2 to all other statutory and regulatory charges that are not on the schedule of non-taxable statutory and regulatory charges referred to in paragraph 19 above, by 1 July 2026;

21 **agreed** to a transitional regulation-making power that will enable the Minister of Revenue to recommend an Order in Council to add either a class of statutory or regulatory charges, or specific statutory and regulatory charges, to the proposed schedule of non-taxable statutory and regulatory charges;

22 **agreed** that this transitional regulation-making power will apply from the enactment of the legislation containing the default rule, and would expire on 30 June 2026;

23 **noted** that paragraphs 18 to 22 above have no direct fiscal impact;

24 **noted** that future decisions to add specific statutory or regulatory charges to the proposed schedule of non-taxable charges may have a fiscal cost that will need to be recognised by Cabinet when decisions are taken to do this in the future;

25 **agreed** that neither taxpayers, nor the Commissioner of Inland Revenue, should be able to amend historic GST assessments in a way that would be inconsistent with the default rule to prevent a potentially significant fiscal risk from materialising;

Exempting employer subsidised public transport from fringe benefit tax

26 **agreed** to exempt employer-subsidised public transport fringe benefits primarily for travel between home and work from fringe benefit tax, from 1 April 2023;

27 **noted** the following changes in tax revenue as a result of the decision in paragraph 26 above, with a corresponding impact on the operating balance and net debt:

$m – increase/(decrease)					
Vote Revenue Minister of Revenue	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	(2.250)	(9.000)	(9.000)	(9.000)

Next steps

28 **agreed** that the above proposals be included in the tax bill scheduled to be introduced in August 2022;

29 **authorised** the Minister of Revenue to make minor technical changes to the decisions referred to above before the introduction of the omnibus tax bill.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon David Parker
Hon Poto Williams
Hon Damien O’Connor
Hon Stuart Nash
Hon Michael Wood
Hon Meka Whaitiri
Hon Kieran McAnulty
Rino Tirikatene, MP
Dr Deborah Russell, MP

Officials present from:
Office of the Prime Minister
DPMC

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

SIMPLIFYING GST APPORTIONMENT RULES

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to a package of tax policy changes to simplify the GST (Goods and Services Tax) apportionment and adjustment rules.

2. If approved, I propose including the necessary legislative amendments in the next omnibus tax bill, scheduled for introduction in August 2022.

Relation to Government Priorities

3. This proposal supports the Government's Fiscal Strategy and the following workstream in the Government's 2021–22 tax policy work programme: Maintaining the tax system. Tax legislation needs to be regularly maintained and updated in response to changing technology and business practices. It is also important that tax legislation reflects the principles of fairness and certainty.

4. The proposals in this paper support this workstream as the proposed policy options seek to update the existing GST rules to improve fairness, reduce compliance costs, and better reflect commercial practices.

Executive Summary

5. Goods and Services Tax (GST) is a 15% tax on goods and services that are supplied to consumers in New Zealand by GST-registered persons (such as businesses). A GST-registered person can deduct GST paid on purchases of assets (such as buildings and vehicles) that they use in their business.

6. Where the asset is used both for business use and for private use (or making exempt supplies), then the GST-registered person can only deduct a percentage of the total deduction, based on their estimate of the percentage of business use. This is known as apportionment.

7. Once a business has apportioned a GST deduction based on their estimated business use, they are required to monitor their actual use of the asset over time, and if their estimate is inaccurate, account for this difference in their GST return, annually. This is known as an adjustment or change in use.

8. The current GST apportionment and adjustment rules are complex and have high compliance costs.

9. In March 2022, my officials published an officials' issues paper, *GST apportionment and adjustment rules* which sought submissions on a range of potential policy reforms for simplifying the rules, improving fairness, and reducing compliance costs. Submitters supported the main proposals which have been refined and improved in response to the submissions.

10. The revised proposals which I recommend Cabinet agree to and include in the next omnibus tax bill are to:

    10.1 Allow GST-registered businesses to elect to treat certain assets such as dwellings, which have mainly private or exempt use, as if they only had private or exempt use.

    10.2 Introduce a simple principal purpose test for assets acquired for $10,000 or less (GST exclusive). If these assets are principally acquired for business purposes, the GST-registered business would claim a full GST input tax deduction (rather than applying the apportionment rules).

    10.3 Introduce new integrity measures to improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset. This is important for land where a large GST refund (or cost saving) may have been claimed on acquisition but there can be a failure to continue to use the land in a business activity or properly account for GST if the land is later sold.

    10.4 Make improvements to the current GST apportionment and adjustment rules to reduce compliance costs. These include:

    - Reducing the number of years taxpayers need to monitor their actual business use of assets and make GST adjustments;

    - Allowing taxpayers to make an adjustment for a permanent change in use in a wider range of circumstances and 12 months earlier than the current rules; and

    - Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for taxpayers to apply, and consequentially repealing some complex formula in the legislation which apply to specific and uncommon scenarios.

11. The estimated fiscal cost of this reform package is $4m per annum. I propose that the fiscal cost should be managed against the Tax Policy Scorecard and therefore not impact the between-Budget contingency or Budget allowances.

Background

12. Goods and Services Tax is a 15% consumption tax on most goods and services supplied to New Zealand consumers by registered persons (such as businesses). To ensure GST is not a cost on business production, businesses can claim back GST input tax deductions on purchases of goods and services they use in their business.

13. However, where the asset is used both for business use, such as a van delivering packages during the week, and for private use, such as recreational use of the van in the weekend (or making exempt supplies), then the taxpayer can only deduct a percentage of the total GST deduction, based on their estimate of the percentage of business use. This is known as apportionment. Apportionment ensures GST is collected on the asset's private use.

14. Once a business has claimed a GST deduction based on their estimated business use, they are required to monitor their actual use of the asset over time and, if their estimate is inaccurate, then they must account for this difference in their GST return, at the end of each year. This is known as an adjustment or change in use.

15. In March 2022, my officials published an officials' issues paper, *GST apportionment and adjustment rules* which sought submissions on a range of potential policy reforms for simplifying the rules, improving fairness, and reducing business compliance costs.

16. The 11 submissions received on the issues paper noted that the current rules are complex and impose unreasonable compliance costs.

17. Submitters supported the main reform options that are proposed in this Cabinet paper and noted that they would be more effective at reducing business compliance costs, and ensuring GST was collected on private consumption, than alternative policy options which were also consulted on in the issues paper.

Proposed package of GST apportionment changes

18. A proposed package of legislative amendments to the GST apportionment and adjustment rules has been developed and refined in response to submissions on the March 2022 issues paper and from further policy advice from Inland Revenue. The main elements of this package are explained below.

Allow mainly private assets with minor business use to be treated as wholly private

19. The United Kingdom and Singapore's GST rules allow taxpayers to exclude assets from being subject to the apportionment rules, and GST on sale, by choosing not to claim an input tax deduction at the time of purchase.

20. I propose a similar provision be added to New Zealand's GST Act. This would allow GST-registered businesses to elect to treat certain assets, with mainly private or exempt use, as if they only had private or exempt use. This would ensure GST-registered sole traders are not disadvantaged compared to other types of ownership structures where private assets are usually held by a different person to the entity which is GST-registered.

21. Submissions supported the proposal and noted that most of the affected taxpayers have historically not claimed input tax deductions (or zero-rating) when acquiring assets that have a mainly private use (e.g., a family home with a home office). To align with these existing practices, it is proposed that the election method should be applied on a retrospective basis to qualifying assets which were purchased and sold prior to the new legislation.

22. In addition, to ensure taxpayers which purchased assets prior to the reform are not disadvantaged, a transitional rule is proposed which would allow taxpayers to choose to repay GST deductions (or zero-rating) that they have previously claimed on a mostly private asset within 24 months of the reforms taking effect and, in return, this asset would not be subject to GST on sale in the future.

Introduce a principal purpose test for assets acquired for $10,000 or less

23. I also propose to introduce a simple principal purpose test for assets acquired for $10,000 or less (GST exclusive). If these assets are principally acquired for business purposes, the GST-registered business would claim a full GST input tax deduction (rather than applying the apportionment rules).

24. This test would reduce compliance costs for taxpayers by reducing the number of assets subject to the apportionment and adjustment rules.

25. As with the election method, submissions considered this proposal would be a practical way to reduce compliance costs and better align the GST rules with existing commercial practices for low-value assets with minor or incidental private use.

Integrity measures

26. In addition to reducing compliance costs for the affected businesses, the proposed reform package would include several new integrity measures. These measures would improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset.

27. The issues paper consulted on a potential new requirement for certain GST-registered businesses to provide basic information to Inland Revenue about land, aircraft, and high-value boats that they have purchased and intend to use in their business activity. The proposal would be more targeted than Australia's GST rules which require all capital expenses to be reported on a businesses' GST return.

28. This information will help Inland Revenue identify and improve tax compliance in situations where a large GST refund (or cost saving from acquiring zero-rated land) was originally claimed on acquisition of the asset, but there has been a failure to continue to use the asset in a business activity or properly account for GST if the asset is later sold (e.g., because the business never commences trading or has closed down).

29. A new deeming rule is also proposed to clarify that in these situations (business use claimed on acquisition), GST is properly accounted for if the asset is sold, even though the person's business activity may have since ceased. Other proposed integrity measures ensure that a wash-up calculation that applies when there has been a permanent change to the percentage of business or private use, cannot be unintentionally exploited to avoid tax.

Simplifying existing apportionment and adjustment rules

30. Finally, I propose several improvements to the existing apportionment and adjustment rules that would reduce compliance costs for the affected GST-registered businesses. These improvements were strongly supported by submitters and include:

    30.1 Reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make annual GST adjustments (this ranges from no subsequent adjustments for low-value assets, to 10 years of adjustments for high-value assets and land);

    30.2 Expanding the ability to use a wash-up rule which provides a final adjustment (rather than ongoing adjustments) when there has been permanent change of use. The proposal will allow this rule to be used for any permanent change in use (rather than just a change to fully business, or fully non-taxable use) and to be applied 12 months earlier; and

    30.3 Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply and consequentially repealing some complex formula in the legislation which apply to specific and uncommon scenarios.

Financial Implications

31. The proposed reform package is estimated to decrease GST revenues, with a corresponding impact on the operating balance and net debt in the forecast period and outyears as per the following table:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	(0.600)	(4.000)	(4.000)	(4.000)	(4.000)
Total Operating	**0.600**	**4.000**	**4.000**	**4.000**	**4.000**

32. I propose that the fiscal implications of these changes be managed against the Tax Policy Scorecard. There will therefore be no impact on the between-Budget contingency or Budget allowances. The Tax Policy Scorecard is a longstanding mechanism that allows most fiscal impacts of items on the Tax Policy Work Programme to be aggregated, with any revenue gains being offset against future revenue-negative policy changes.

Legislative Implications

33. Implementing these proposals requires changes to the Goods and Services Tax Act 1985.

34. If approved, I propose including the legislative changes resulting from these recommendations in the upcoming omnibus taxation bill, scheduled for introduction in August 2022.

Impact Analysis

Regulatory Impact Assessment

35. The Quality Assurance reviewer at Inland Revenue has reviewed the regulatory impact assessment prepared by Inland Revenue. The reviewer considers that the information and analysis summarised in the regulatory impact statement meets the quality assurance criteria.

Climate Implications of Policy Assessment

36. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

37. There are no population implications arising from these proposals.

Human Rights

38. The proposals do not give rise to any human rights implications.

Consultation

39. The Treasury was consulted and support the proposed changes.

Communications

40. I will make an announcement on the contents of the omnibus taxation bill, including this proposal, when the bill is introduced. Inland Revenue will also publish bill commentary items explaining the proposed legislative changes at this time.

Proactive Release

41. I propose to delay the proactive release of this Cabinet paper, associated minutes, and key advice papers with appropriate redactions until the introduction of the bill which would contain these proposals. The expected introduction date for this bill is August 2022.

Recommendations

The Minister of Revenue recommends that the Committee:

1. **note** that in March 2022 my officials published an officials' issues paper, *GST apportionment and adjustment rules* which publicly consulted on a range of policy reforms for simplifying these rules, improving fairness, and reducing compliance costs.

2. **note** that submissions on the issues paper supported the proposals and identified ways they could be refined and improved which has culminated in the following recommended reform package.

3. **agree** to allow GST-registered businesses to elect to treat certain assets, with mainly private or exempt use, as if they only had private or exempt use.

4. **agree** that recommendation 3 be applied on a retrospective basis to qualifying assets which were purchased and sold prior to the proposed new legislation being enacted, as this would align with the historical GST positions taken on the qualifying assets.

5. **agree** to introduce a simpler rule for assets acquired for $10,000 or less (GST exclusive), that when such assets are principally acquired for business purposes, the business would claim a full GST input tax deduction.

6. **agree** to introduce integrity measures that will improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset.

7. **agree** to make the following improvements to the current GST apportionment and adjustment rules to reduce compliance costs:

   7.1 Reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make GST adjustments;

   7.2 Expanding the ability to use a wash-up rule which provides a final adjustment (rather than ongoing adjustments) when there has been permanent change of use; and

   7.3 Allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply, and consequentially repealing some complex formula in the legislation which apply to specific and uncommon scenarios.

8. **note** the package of proposed GST apportionment changes in recommendations 3 to 7 are estimated to decrease GST revenues, with a corresponding impact on the operating balance and net debt in the forecast period and outyears as per the following table:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	(0.600)	(4.000)	(4.000)	(4.000)	(4.000)
Total Operating	**0.600**	**4.000**	**4.000**	**4.000**	**4.000**

9. **agree** to manage the fiscal impacts of the decisions at recommendations 3 to 7 above against the Tax Policy Scorecard.

10. **agree** the legislative amendments to the Goods and Services Tax Act 1985 required to give effect to the recommended changes in this paper be included in the next omnibus tax bill currently scheduled for introduction in August 2022.

11. **authorise** the Minister of Revenue, in consultation with the Minister of Finance, to make final policy decisions, in line with these recommendations.

Authorised for lodgement

Hon David Parker
Minister of Revenue

DEV-22-MIN-0135

Cabinet Economic Development Committee

Minute of Decision

Simplifying GST Apportionment Rules

Portfolio **Revenue**

On 22 June 2022, the Cabinet Economic Development Committee (DEV):

1 **noted** that on 2 March 2022, DEV agreed to the release of an officials' issues paper, *GST apportionment and adjustment rules,* which publicly consulted on a range of policy reforms for simplifying these rules, improving fairness, and reducing compliance costs [DEV-22-MIN-0017];

2 **noted** that submissions on the issues paper supported the proposals and identified ways they could be refined and improved, which has culminated in a reform package outlined in the paragraphs below;

3 **agreed** to allow GST-registered businesses to elect to treat certain assets, with mainly private or exempt use, as if they only had private or exempt use;

4 **agreed** that the proposal in paragraph 3 above be applied on a retrospective basis to qualifying assets that were purchased and sold prior to the proposed new legislation being enacted, as this would align with the historical GST positions taken on the qualifying assets;

5 **agreed** to introduce a simpler rule for assets acquired for $10,000 or less (GST exclusive), namely that when such assets are principally acquired for business purposes, the business would claim a full GST input tax deduction;

6 **agreed** to introduce integrity measures that will improve Inland Revenue's ability to collect GST owing on the sale of assets by a GST-registered business that claimed business use of the asset when they originally acquired the asset;

7 **agreed** to make the following improvements to the current GST apportionment and adjustment rules to reduce compliance costs:

7.1 reducing the number of years GST-registered businesses need to monitor their actual business use of assets and make GST adjustments;

7.2 expanding the ability to use a wash-up rule that provides a final adjustment (rather than ongoing adjustments) when there has been permanent change of use;

7.3 allowing Inland Revenue to approve a wider range of apportionment methods that are more practical for GST-registered businesses to apply, and consequentially repealing some complex formula in the legislation that apply to specific and uncommon scenarios;

8 **noted** that the package of proposed GST apportionment changes referred to in paragraphs 3 to 7 above are estimated to decrease GST revenues, with a corresponding impact on the operating balance and net debt in the forecast period and outyears, as per the following table:

$m – increase/(decrease)					
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 & Outyears**
Tax Revenue	(0.600)	(4.000)	(4.000)	(4.000)	(4.000)
Total Operating	0.600	4.000	4.000	4.000	4.000

9 **agreed** to manage the fiscal impacts of proposals in paragraphs 3 to 7 above against the Tax Policy Scorecard;

10 **agreed** that the legislative amendments to the Goods and Services Tax Act 1985 required to give effect to the above paragraphs be included in the next omnibus tax bill, currently scheduled for introduction in August 2022;

11 **authorised** the Minister of Revenue, in consultation with the Minister of Finance, to make final policy decisions, in line with the above paragraphs.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon David Parker
Hon Poto Williams
Hon Damien O’Connor
Hon Stuart Nash
Hon Michael Wood
Hon Meka Whaitiri
Hon Kieran McAnulty
Rino Tirikatene, MP
Dr Deborah Russell, MP

Officials present from:
Office of the Prime Minister
DPMC

Inland Revenue
Te Tari Taake

Te Tūāpapa Kura Kāinga
Ministry of Housing and Urban Development

Tax policy report: Comparing options to support build-to-rent

Date:	23 June 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/221 BRF21/22051318

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations	28 June 2022
Minister of Housing	**Agree** to recommendations	28 June 2022
Minister of Revenue	**Agree** to recommendations	28 June 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Paul Bruere	Principal Policy Advisor, Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development	s 9(2)(a) [redacted]
Chris Gillion	Policy Lead, Inland Revenue	

13 June 2022

Minister of Finance
Minister of Housing
Minister of Revenue

Comparing options to support build-to-rent

Executive summary

Purpose

1. This report responds to requests Ministers made on previous advice (BRF21/22011217 refers). The report seeks decisions from you on whether to introduce support for the build-to-rent (BTR) sector through the tax system, and if so, what support should be provided.

2. In addition, this report seeks a decision from you on how to define BTR as an asset class, should you decide to proceed with options 1 or 2. As requested by Ministers, this report provides further advice on potentially including a minimum tenure requirement of between three and 10 years, and seeks a decision on what minimum tenure requirement should apply.

The options

3. This report seeks decisions from Ministers on the following three options:

   - Option 1: introduce an exemption from interest limitation for BTR assets, which would apply in-perpetuity ***(Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development's recommended option; Inland Revenue and Treasury's second preferred option)***
   - s 9(2)(f)(iv)
   - Option 3: retain the status quo ***(Inland Revenue and Treasury's recommended option)***

4. If Ministers choose either option 1 or 2, Officials recommend that this applies from 1 April 2022 at the earliest.

Defining BTR as an asset class

5. Officials recommend the following definition for BTR as an asset class[1]:

   (a) at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels;

   (b) the dwellings and any common land or facilities for those dwellings have a single owner;

   (c) dwellings can be held in one or more titles;

[1] Note that the exact wording used in any legislation may differ from the wording used in this report, however the legislation would achieve the policy intent.

(d) the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor);

(e) the dwellings are used or available for rent under the Residential Tenancies Act 1986;

(f) explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986;

(g) the dwellings must have continuously been used as build-to-rent dwellings since they were constructed

6. Te Tūāpapa Kura Kāinga recommends that BTR developments must also offer a minimum tenancy of three years and enable tenants accepting this offer to terminate the tenancy as though it were a periodic tenancy. Te Tūāpapa Kura Kāinga recommends a three-year minimum tenure requirement because it is:

- about 50 percent longer than the average tenancy in the general market (~22 months) and more than double the median tenancy (~16 months)
- in Te Tūāpapa Kura Kāinga's view, in proportion to the financial value of perpetual interest deductibility
- in line with requirements for build-to-rent in the UK and Australia, as well as other international regimes.

7. Te Tūāpapa Kura Kāinga does not support a 10-year minimum requirement but notes that a five-year minimum tenure requirement is a viable option if Ministers prefer (see Appendix 1 for full analysis).

8. Treasury recommends the longer 5- or 10-year options because longer minimum tenure lengths:

- are likely to provide wellbeing benefits to tenants by promoting independence and stability, which can provide the basis for community participation, continuity of schooling for children, continuity of healthcare and increased social cohesion
- should provide better financial security for BTR investors, and may provide a positive signal to the wider rental market.

Application to new or existing BTR assets

9. Officials recommend the asset class only applies to new BTR assets (that receive a code compliance certificate on or after 27 March 2020). This could disadvantage existing BTR asset owners, as their assets will not qualify for any interest deductibility. However, the purpose of providing support is to encourage the development of new BTR. If the asset class is applied to existing BTR assets, we would need a transitional process for existing asset owners to comply with the asset class requirements.

Financial Implications

10. The financial implications of applying options 1 and 2 to new or existing BTR assets are set out below. New BTR developments are already able to apply the new build exemption from interest limitation, so there would be no additional cost over the forecast period if option 1 were to apply to new BTR only.

			$m - increase/(decrease)			
Vote Revenue		**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Option 1 interest limitation exemption	New BTR	0.0	0.0	0.0	0.0	0.0
	Existing BTR	0.0	0.0	(0.5)	(0.6)	(1.0)
	TOTAL	**0.0**	**0.0**	**(0.5)**	**(0.6)**	**(1.0)**
s 9(2)(f)(iv) [redacted]						

Next steps

11. If Ministers decide to proceed with options 1 or 2, officials will provide you with a Cabinet paper. The Cabinet paper will need to be lodged by 23 June 2022 if Ministers want legislative changes to be included in the August 2022 Omnibus Tax Bill. The Cabinet paper would then need to be considered by DEV on 29 June 2022 and by Cabinet on 4 July 2022.

Recommended action

We recommend that you:

12. **agree** to adopt one of these 3 options:

- Option 1 – introduce an exemption from interest limitation for build-to-rent assets *(Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development preferred option; Inland Revenue and Treasury's second preferred option)*; OR

Agreed/Not agreed   Agreed/Not agreed   Agreed/Not agreed

s 9(2)(f)(iv) [redacted]

- Option 3 – retain the status quo (*Inland Revenue and Treasury's preferred option)*;

Agreed/Not agreed   Agreed/Not agreed   Agreed/Not agreed

13. if you agree to adopt option 1 or option 2 chosen in [12] above, **agree** that the option adopted would apply from 1 April 2022 (the 2022/23 tax year);

Agreed/Not agreed   Agreed/Not agreed   Agreed/Not agreed

14. if you agree to adopt option 1 or option 2 chosen in [12] above, **agree** to the following definition of build-to-rent as an asset class:

(a) at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels

(b) the dwellings and any common land or facilities for those dwellings have a single owner

(c) dwellings can be held in one or more titles

(d) the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor)

(e) the dwellings are used or available for rent under the Residential Tenancies Act 1986

(f) explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986

(g) the dwellings must have continuously been used as build-to-rent dwellings since they were constructed

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

15. if you agree to adopt option 1 or option 2 chosen in [12] above, **agree** to include one of the following minimum tenure length requirements in the definition of a build-to-rent asset class:

- Option 1 - build-to-rent developments must offer a minimum tenancy of three years and enable tenants accepting this offer to terminate the tenancy as though it were a periodic tenancy *(Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development preferred option);*

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

- Option 2 - build-to-rent developments must offer a minimum tenancy of five years and enable tenants accepting this offer to terminate the tenancy with 56 days' notice (equal to twice the notice period of a periodic tenancy);

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

- Option 3 - build-to-rent developments must offer a minimum tenancy of ten years and enable tenants accepting this offer to terminate the tenancy with 56 days' notice (equal to twice the notice period of a periodic tenancy);

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

16. if you agree to adopt option 1 or option 2 chosen in [12] above, **agree** to adopt one of these two options:

- Option 1 – only include new build-to-rent assets, which received their code compliance certificate(s) on or after 27 March 2020, in the definition referred to in [12] above (preferred option); OR

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

- Option 2 – include both existing and new build-to-rent assets in the definition referred to in [12] above;

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

17. if you agree to adopt option 1 or option 2 chosen in [10] above, **agree** to include the legislative changes required to give effect to your decisions above in the 2022 August Omnibus Tax Bill;

Agreed/Not agreed Agreed/Not agreed Agreed/Not agreed

18. **refer** a copy of this report to the Minister of Finance for their information.

Referred/Not referred Referred/Not referred s 9(2)(a) [redacted]

s 9(2)(a) [redacted]

Jeremy Steele
General Manager
Policy and Legislation Design
Te Tūāpapa Kura Kāinga –
Ministry of Housing and
Urban Development

Chris Gillion
Policy Lead
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon Megan Woods
Minister of Housing
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Background

19. Build-to-rent (BTR) is a category of residential dwelling dedicated to providing medium to high-density long-term rentals. Increasing BTR supply could contribute to housing outcomes by increasing the long-term proportion of housing available as rentals and increasing the diversity of general rental supply, especially more affordable 1- and 2-bedroom typologies. BTR also may provide a significant tool to grow the stock of modern residential dwellings with lower environmental impacts, for instance, near significant public infrastructure such as the Auckland rail projects.

20. Cabinet agreed in December 2021 for work to continue on the design of a possible exemption from interest limitation for BTR assets (SWC-21-MIN-0228 and BRF21/22011217 refers). You have asked us to specifically compare two options for using the tax system to support BTR assets:

- providing BTR assets with an in-perpetuity exemption from interest limitation; or
- s 9(2)(f)(iv) [redacted]

21. In previous advice, both Inland Revenue and the Treasury have recommended against a specific exemption from interest limitation for BTR assets (IR2021/325 refers). s 9(2)(f)(iv) [redacted]

22. Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development supports introducing an asset class exemption from interest limitation for BTR assets. s 9(2)(f)(iv) [redacted]

23. This report also provides further advice on the definition of BTR as an asset class, in particular advice Ministers requested on including a minimum tenure requirement of between three and 10 years.

Problem definition

24. BTR does not currently have any specific exemption from the interest limitation rules, but a 20-year exemption for new builds applies for new BTR assets. s 9(2)(f)(iv) [redacted]

25. BTR stakeholders have advised that the status quo limits the potential for the sector, and could risk reducing delivery of warm and safe rental supply in New Zealand. We understand that some stakeholders have chosen to invest elsewhere (including overseas) as a result of the introduction of interest limitation rules, while only developments that do not need interest-bearing capital to deliver are still going ahead.

Options to address the problem

26. This report compares the support the tax system could provide the BTR sector. It considers two options and compares them against the status quo (no specific tax support for the BTR sector).

- **Option 1: Providing an asset class exemption from interest limitation for BTR assets, which would apply in-perpetuity.** The interest limitation rules apply from 1 October 2021 to limit the ability for residential property investors to deduct interest on loans relating to residential property. This option would provide an in-perpetuity exemption from interest limitation for BTR assets. The exemption would allow interest incurred in relation to BTR assets to continue to be deducted indefinitely.

- s 9(2)(f)(iv) [redacted]
- **Option 3: Retain the status quo.** s 9(2)(f)(iv) [redacted] Interest deductions are also currently being phased out over approximately four years for existing BTR assets, and interest will eventually be completely subject to the interest limitation rules. BTR assets that receive their code compliance certificates on or after 27 March 2020 will be considered new builds, and would qualify for the new build exemption for 20 years from the date they receive their code compliance certificate(s).

27. If you select options 1 or 2, you will need to decide whether support should only be available to new BTR assets, or if it should also be available for existing BTR assets. You will also need to decide how the BTR asset class should be defined. This is covered in more detail after the options analysis section below.

Options analysis

Objective of supporting the BTR sector

28. The overall net present value (NPV) tax benefit of providing an exemption from interest limitation for BTR assets s 9(2)(f)(iv) [redacted] This is illustrated in the following example, which is based on the following assumptions:

- the investor has a new BTR asset which is initially worth $15m
- the investor holds the BTR asset for 50 years
- all future deductions are discounted at a rate of 5%
- the investor borrows 50% of the cost of the BTR asset
- the investor pays interest of 6% per annum.

29. The NPV tax benefit for each option is as follows:

30. **Option 1:** the existing new build exemption provides the investor with a NPV tax benefit of $1,570,239, which corresponds to the investor's initial 20 years of interest deductions. Option 1 would enable the investor to continue to deduct interest for another 30 years after the new build exemption expires. The NPV tax benefit of those extra interest deductions would be **$730,008.** The size of the NPV tax benefit of option 1, relative to the initial value of the BTR in this example, is 4.87%.

31. s 9(2)(f)(iv) [redacted]

32. **Option 3** provides no new support to the BTR sector, noting that even if Ministers were to select this option the new build exemption would still apply for the first 20-years for new BTR assets.

33. The above analysis assumes a debt level of 50%. The NPV analysis for both options is sensitive to changes in the debt ratio. s 9(2)(f)(iv) [redacted]

The impact of inflation

34. Because our tax system is not indexed for inflation, deductions for interest expenses are made up of two components:

- The real component, which is, effectively, the interest rate that the borrower would be charged in the absence of inflation; and

- The inflation component.

35. Together they make up the nominal interest rate.

36. Allowing deductions for the nominal interest rate is in part allowing a deduction for inflation as well as the real cost of borrowing.

37. Investors in new build-to-rent properties will be able to deduct expenses for the nominal interest rate for the first 20 years under the current settings of the interest limitation rules.

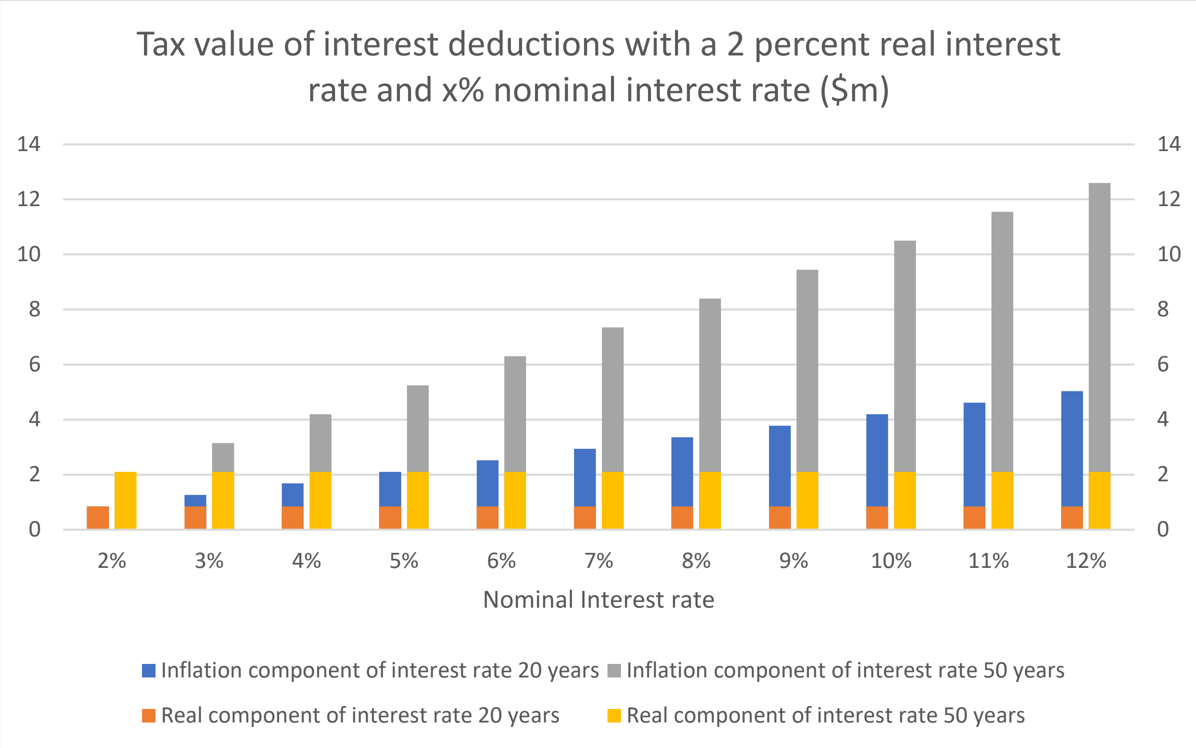
38. If an in-perpetuity exemption was introduced for BTR assets, these investors would be able to deduct the nominal interest rate for the life of their investment. We have assumed a 50 year time horizon as a proxy for in-perpetuity.

39. In periods of high inflation, and if the real component of the nominal interest rate is constant, the deductions for the inflation component will be greater relative to the real component.

40. This is illustrated in figure 1 below. [2]

[2] Figure 1 assumes the value of the BTR asset is $15 million, the asset is 50% debt funded (making total borrowings $7.5m) and the tax rate of the investor is 28% (corporate tax rate).

Figure 1



41. The vertical axis shows the value of the tax deductions to the build-to-rent investor.

42. The horizontal axis shows the nominal interest rate. For example, assume the nominal interest rate is 7% in figure 1. In this analysis we have assumed the real component of interest is constant at 2% over time. The inflation component is therefore 5%.

43. The vertical bars reflect the total value of the tax deduction separated into the real component and the inflation component for two scenarios: where nominal interest is deductible for the first 20 years (blue/orange) and where the nominal interest is deductible for 50 years (grey/yellow). 50 years has been taken as a proxy for allowing interest deductions in perpetuity.

44. In the example where the nominal interest rate is 7%:

- The value of the tax deductions for interest for a **20-year** period is $2.94 million. This is made up of real interest deductions of $840,000 and deductions for the inflation component of $2.1 million.

- The value of the tax deductions for interest for a **50-year** period is $7.35 million. This is made up of real interest deductions of $2.1 million and deductions for the inflation component of $5.25 million.

45. The key points from this analysis are that:

- Under the current settings of the interest limitation rules, BTR investors will be able to deduct their nominal interest expenses for 20 years for new builds.

- Allowing interest deductions for 50 years (which we have used as a proxy for in-perpetuity) increases the value of the deductions for any given rate of inflation.

- As inflation rises, deductions for the inflation component also rise relative to the real interest component under both the 20-year and 50-year exemptions.

- A longer exemption means a greater proportion of the deductions for nominal interest is made up of the inflation component rather than the real interest component.

46. Investors who hold BTR assets will also be subject to the relevant bright-line test. If investors sell within their bright-line period they will be taxed on any gains made. If sold outside the bright-line period any capital gains will not be taxed. A portion of these gains will be due to inflation.

Officials' recommended option for providing support for BTR

Te Tūāpapa Kura Kāinga recommendation

47. Te Tūāpapa Kura Kāinga recommends option 1, noting that until recently Ministers indicated a preference for an asset class that was shaped to work with interest deductibility. The current 20-year limit for new builds reduces the long-term cashflow for BTR assets, affecting development decisions and leading to less upfront investment in new BTR. Extending interest deductibility for BTR assets addresses the pain point for initial investment in BTR assets, by matching New Zealand's interest deductibility to the same setting as for BTR investment opportunities overseas.

48. Option 1 would provide the greatest number of rental dwellings of any option and would be more likely to supply long-term rental inventories of smaller and more affordable 1-and 2-bedroom typologies (which are heavily needed). If applied to new build BTR, Option 1 costs nothing in the short term.

49. s 9(2)(f)(iv) [redacted]

Inland Revenue recommendation

Recommended option – the status quo (option 3)

50. Inland Revenue recommends option 3, which would be to retain the status quo. This is because Inland Revenue considers that there is no inherent difference between BTR assets and regular residential property, apart from scale. To provide BTR investors with concessionary treatment would be inequitable if the same concessions are not also provided to individual 'mum and dad' investors.

51. s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

52. If Ministers would like to support the BTR sector, Inland Revenue would recommend using measures that sit outside the tax system.

Second preference – an exemption from interest limitation (option 1)

53. If Ministers decide to provide support to the BTR sector through the tax system, then Inland Revenue recommends option 1, which would involve introducing an in-perpetuity exemption from interest limitation for BTR assets. Inland Revenue prefers option 1 as it provides a similar benefit to BTR assets as option 2, but is simpler from both a compliance and administrative perspective.

Treasury recommendation

54. The Treasury agrees with Inland Revenue's recommendation and reasoning in favour of option 3, which would be to retain the status quo. The Treasury does not see a compelling reason to provide BTR investors with tax concessions. The problem definition in this report does not justify why BTR investors require support in addition to the existing new build exemption, especially given the likelihood that the BTR industry will focus on new build developments. Both options 1 and 2 would increase the complexity of the tax system and are unlikely to improve efficiency or fairness.

55. If Ministers decide to support the BTR sector then we agree with Inland Revenue's and Te Tūāpapa Kura Kāinga's preference for option 1 over option 2.

56. s 9(2)(f)(iv) [redacted]

Application date and timing

57. If you decide to proceed with providing support to the BTR sector through the tax system, officials recommend that any legislation giving effect to this support take effect from 1 April 2022 at the earliest, which is the 2022/23 tax year.

58. Depending on the option selected, Inland Revenue may need to make changes to tax returns, and we would not be able to make these changes retrospectively to the tax returns issued for a previous year. Any legislative changes would also ideally take effect from the beginning of an income year, rather than from a date that is part way through an income year, to reduce administrative and compliance costs.

Defining BTR as an asset class

59. As mentioned above, if Ministers decide to proceed with options 1 or 2 (introducing an exemption from interest limitation for BTR assets or reintroducing development for BTR buildings), you will need to decide how to define BTR as an asset class.

Previously agreed definition

60. On 1 March 2022, the Ministers of Housing, Finance and Revenue received a report (BRF21/22011217 refers) seeking agreement to progress design work on a BTR asset class exemption from interest deductibility. This March report outlined a potential asset class definition, which included potentially requiring BTR operators to offer minimum tenancies of three years.

61. Ministers agreed to the definition in principle but requested further advice on the length of a minimum tenure requirement. Specifically, Ministers sought advice on options between three and 10 years. This report provides advice on minimum tenure requirement periods of **three years**, **five years**, and **10 years**.

Minimum tenure length requirement

62. Te Tūāpapa Kura Kāinga analysed tenure length options (summarised in table 2) considering:

- how the length would compare to the median length of tenancies (16 months)
- how proportionate the length is to the additional value of interest deductibility from year 21 onwards
- comparison to overseas BTR norms for tenure length (e.g., United Kingdom planning rules require three-year tenancies)
- whether Residential Tenancies Act 1986 (the RTA) amendment may be needed to address complications of long tenures for landlords.

63. Te Tūāpapa Kura Kāinga also considered the termination and notice rights that tenants may need to have to ensure they are not locked in to inflexible fixed-term tenancies. It considers that without better termination rights for tenants, tenants will opt-out of the long-term options and this requirement for the asset class will have little effect.

64. The analysis in the main body of this report focusses on a three-year minimum tenure requirement (Te Tūāpapa Kura Kāinga's recommended option). For more information on five- and ten-year tenure lengths refer to **appendix one**.

Table 2: summary of minimum tenure requirement options

Criteria	**Three years (recommended)**	**Five years (alternative recommendation)**	**10 years (not recommended)**
Value to tenants (vs market median of 16 months)	2.25 times longer	3.75 times longer	7.5 times longer
Proportionate to the financial value of interest deductibility	Yes	Less but still reasonable	No
In line with overseas BTR	Same	Longer than overseas settings	Far longer than overseas settings
Recommended tenants notice period	28 days	56 days	56 days
Residential Tenancies Act change required for BTR assets	No	Possibly	Probably

Te Tūāpapa Kura Kāinga's recommendation

65. Te Tūāpapa Kura Kāinga continues to recommend a three-year minimum tenure requirement because it is:

- about 50 percent longer than the average tenancy in the general market (~22 months) and more than double the median tenancy (~16 months)
- in proportion to the financial value of perpetual interest deductibility
- in line with requirements for BTR in the UK and Australia, as well as other international regimes.

66. Te Tūāpapa Kura Kāinga notes that five-year minimum tenure requirement is a viable option, however it considers there may not be much need or value in legislating a minimum tenure requirement beyond three years. This is because:

- BTR tenants will be afforded long-term tenancies (and associated wellbeing benefits) by default through the model as it aims to provide long-term rental housing
- some common reasons for termination (e.g., landlord/their family moves in, selling the dwelling, changing the use) conflict with the other requirements of the proposed BTR asset class definition
- the recommended requirement for asset class qualification is for a three-year *minimum* tenure to be *offered* to tenants **–** the RTA enables fixed-term tenancies to be agreed that provide more rights for tenants, and existing BTR operators are already providing tenancies using this feature of the RTA.

Treasury's recommendation

67. The Treasury would support the longer 5- or 10-year tenure options. Reference to the existing median tenancy should not anchor the minimum applicable to the BTR sector, especially if they are to be supported through the tax system. Legislative change will be required to allow tenancy terminations regardless of which minimum tenure length is selected.

68. Longer minimum tenure lengths are likely to provide wellbeing benefits to tenants that should also be considered when making this decision. For example, longer tenures promotes independence and stability, which can provide the basis for community participation, continuity of schooling for children, continuity of healthcare and increased social cohesion. Further, a longer minimum tenure length should provide better financial security for BTR investors, and may provide a positive signal to the wider rental market.

Tenancy termination

69. Should Ministers agree to a three-year minimum tenure requirement, officials recommend the asset class definition is written to require BTR operators to grant BTR tenants the right to terminate the minimum length tenancy as if it were a periodic tenancy (i.e., 28 days' notice). This will ensure BTR tenants have long-term housing security but still have options and can exit for lifestyle and preference options (e.g., affordability, home purchase, family or labour mobility). If Ministers prefer a five-year minimum tenure requirement, we recommend tenants are granted the right to terminate the minimum length tenancy with 56 days' notice (i.e., twice the notice period of section 51(2B) of the RTA).

70. Some BTR operators already offer fixed-term tenancies with bespoke notice terms for tenants pre-agreed (e.g., 90 days). We consider a 28-day notice period is likely to be accepted by the sector with a three-year minimum requirement.

Additional requirement: continued use as BTR asset

71. An additional requirement was accidentally omitted from the definition previously agreed to by Ministers, which officials consider an important part of the BTR asset class definition. The requirement is that the dwellings must have continuously been used as BTR dwellings since they were constructed.

Officials' recommended option for defining BTR as an asset class

72. Officials recommend the following definition for BTR as an asset class:[3]

(a) at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels;

(b) the dwellings and any common land or facilities for those dwellings have a single owner;

(c) dwellings can be held in one or more titles;

(d) the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor);

(e) the dwellings are used or available for rent under the Residential Tenancies Act 1986;

(f) explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986;

(g) the dwellings must have continuously been used as build-to-rent dwellings since they were constructed.

Te Tuāpapa Kura Kāinga recommendation

73. Te Tūāpapa Kura Kāinga recommends that BTR developments must also offer a minimum tenancy of three years and enable tenants accepting this offer to terminate the tenancy as though it were a periodic tenancy.

74. Te Tūāpapa Kura Kāinga does not support a 10-year minimum requirement but notes that a five-year minimum tenure requirement is a viable option if Ministers prefer.

Treasury recommendation

75. The Treasury recommends that BTR developments must also offer a minimum of 5-tenure option.

Application to new or existing BTR assets

76. Ministers will also need to decide whether any support provided to BTR assets should specifically be limited only to *new* BTR developments, or if it should also apply to

[3] Note that the exact wording used in any legislation may differ from the wording used in this report, however the legislation would achieve the policy intent.

existing BTR developments. If you decide just to provide support to new BTR developments, officials recommend tying this to criteria already used in the new build exemption, so that any BTR asset that receives its code compliance certificate on or after 27 March 2020 would be considered 'new'. This requirement would need to be satisfied as part of the process of determining which taxpayers are eligible for the BTR asset class definition.

Option 1: BTR exemption from interest limitation

77. If Ministers were to proceed with support for new BTR assets only, this would be consistent with the current exemption from interest limitation for new builds. New build BTR developments already qualify for the new build exemption, so providing an asset class exemption for new BTRs would have no additional fiscal cost over the forecast period. There would only be an additional fiscal cost once the new build exemption expires, which would be 20 years after a BTR development receives it code compliance certificate(s).

78. However, allowing existing BTR developments to qualify would reduce the likelihood of these BTR assets being sold off, which would in turn reduce the likelihood of existing tenants being displaced. In addition, if BTR investors decide to retain their existing BTR developments because an exemption applies, these investors may be able to use their existing BTR developments to raise funds to invest in new BTR developments. There would be a fiscal cost of up to $2.1m over the forecast period if an exemption from interest limitation were to apply to existing BTRs, as these properties are currently subject to interest limitation.

s 9(2)(f)(iv)

[redacted]

Officials' recommendation regarding application to new or existing BTR assets

80. Officials recommend the asset class only apply to new BTR assets with code compliance certificates dated on or after 27 March 2020.

Revenue implications

Financial implications

81. This report describes two options for supporting the BTR sector through the tax system. However, these options should be traded-off against other opportunities to improve housing outcomes and the Government's wider wellbeing, economic and fiscal objectives. The usual mechanism for doing so is to defer decisions with fiscal implications to the Budget process.

82. Additionally, Ministers have agreed that the default mechanism for managing the fiscal implications of tax policy changes should be the Scorecard (T2021/1273 refers). But Ministers also confirmed that the Scorecard should not be used to fund changes that mainly advance non-tax objectives. The Treasury advises that, for this reason, the financial implications of the decisions in this report should be managed

through future Budget allowances or the between-Budget contingency (BBC). Officials will report back to you with more detailed advice on managing these financial impacts, alongside a draft Cabinet paper, should you decide to progress any of these proposals.

Fiscal impact of options 1 and 2

83. The fiscal impact of applying options 1 and 2 to new or existing BTR assets is set out below. New BTR developments are already able to apply the new build exemption from interest limitation, so there would be no additional cost over the forecast period if option 1 were to apply to new BTR only.

			$m - increase/(decrease)			
Vote Revenue		**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**
Option 1 interest limitation exemption	New BTR[4]	0.0	0.0	0.0	0.0	0.0
	Existing BTR	0.0	0.0	(0.5)	(0.6)	(1.0)
	TOTAL	**0.0**	**0.0**	**(0.5)**	**(0.6)**	**(1.0)**
s 9(2)(f)(iv)						

Option 3 – the status quo

84. Retaining the status quo would have no financial implications.

Administrative implications

85. Inland Revenue and Te Tūāpapa Kura Kāinga will continue work on who would be responsible for determining whether a taxpayer satisfies the BTR definition, and who would maintain a register of these taxpayers on an ongoing basis. This register will need to be accessible by Inland Revenue each tax year, so that Inland Revenue is aware of which taxpayers can be claiming interest s 9(2)(f)(iv) for BTR assets, when these taxpayers first satisfied the criteria, and if these taxpayers cease to meet the criteria.

86. As the 20-year limit on interest deductibility for new residential builds applies to new BTR assets, it may be difficult to impose minimum tenure offer requirements (requirement 'h' in the asset class definition) until after the 20-year limit for each individual BTR asset. We are unclear how likely this this may be but we will need to allow some pragmatism in complying with the tenure requirement, as the requirement would be for the minimum tenure **to be offered** to tenants, not that all tenancies must be the minimum length.

Consultation

87. Some submissions to the Finance and Expenditure Committee on the interest limitation proposals were in favour of a specific exemption for BTR assets. Submitters argued that when compared with regular residential rental accommodation, BTR assets provide greater tenure security to tenants, do not

[4] New build-to-rent developments are already able to apply the new build exemption from interest limitation, so there would be no additional cost over the forecast period.

compete with first home buyers and are more comparable to commercial assets (such as student accommodation or retirement villages). Additionally, they stressed that the industry will not grow without an in-perpetuity exemption from interest limitation.

88. Te Tūāpapa Kura Kāinga convened a BTR reference group throughout 2021. This group provided input into the asset class policy and extending the exemption from interest deductibility:

- s 9(2)(f)(iv)

- interest deductibility removal and limits was characterised as a barrier to BTR development. BTR stakeholders have also been consulted in one-to-one discussions about the key barriers. Feedback from some institutional investors was that interest deductibility effectively determines whether investing in domestic BTR is viable, compared to international opportunities.

89. Te Tūāpapa has not consulted on minimum tenure requirements, but notes this could be done prior to introduction or while legislation for the asset class is progressing through House.

Next steps

90. Once Ministers have made decisions, officials will provide you with a Cabinet paper, which will need to be lodged by 23 June 2022. In order to meet the timelines for the August 2022 Omnibus Tax Bill, the Cabinet paper would need to be considered by DEV on 29 June 2022 and by Cabinet on 4 July 2022.

Appendix 1 – Te Tūāpapa Kura Kāinga comment on alternative minimum tenures

Five-year tenures are a feasible but less proportionate requirement; 10-year tenure is not recommended as the tenure requirement.

91. Although less proportionate to the financial value of perpetual interest deductibility than three-years, a five-year minimum tenure requirement is feasible. It is nearly four times as long as the median tenancy in the general market and maybe accepted by the build-to-rent sector as five-year tenancies are already offered by some build-to-rent landlords in Aotearoa.

92. We consider five years to be the maximum length possible before changes to the RTA are likely to be required (reasons for this are outlined at paragraph 81). For landlords that need to terminate tenancies, they would still have the option to either come to agreement with tenants or to apply to the Tenancy Tribunal (under section 66 of the RTA).

93. Around two percent of tenancies terminated in 2021 were 10 years or longer.[1] Any period above five years is much longer than rental market medians and averages and is disproportionate to the financial value of perpetual interest deductibility.

94. Additionally, a 10-year minimum tenure requirement may create operational challenges for landlords that require amendment to the RTA. For example, new termination grounds within fixed-term tenancies to enable a build-to-rent operator to redevelop buildings or remediate faulty or substandard buildings.[2] Section 51 (2F) of the RTA provides landlords with the ability to terminate a periodic tenancy (with at least 90 days' notice) to complete extensive alterations, refurbishment, repairs or redevelopment of the premises (provided it would not be reasonably practicable for the tenant to remain in the unit). Build-to-rent operators would need RTA amendment to use the above ground for termination.

95. A 10-year minimum tenure requirement is much more onerous on a build-to-rent landlord than the sector may be willing to accept. This could dampen interest – and ability – from the private rental market to deliver much needed rental housing supply. It is also unlikely to be necessary to ensure long-term tenure and security for build-to-rent tenants (given the long-term focus of build-to-rent, and which can be achieved by a three-year minimum requirement).

Tenancy termination

96. Should Ministers agree to a five or 10-year minimum tenure requirement, we recommend the asset class definition is written to grant build-to-rent tenants the right to terminate the minimum length tenancy with 56 days' notice (i.e., twice the notice period of section 51(2B) of the RTA). This balances the need to ensure proportionality between the minimum tenure requirement and termination notice periods with flexibility for tenants. We have not engaged with the build-to-rent sector on a termination notice period specifically, however, we think, based on previous engagement that the sector is likely to accept the argument that tenants need more flexible notice terms for lengthy fixed-term tenancies.

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[1] This includes tenancies 10-30 years long.

[2] We are not sure how the RTA might apply to multiple tenancies across connected dwellings in a single asset. For example, the RTA provides rights to terminate for emergencies, however there are situations where BTR operators would need tenants at any length of tenancy to vacate dwellings that are habitable to enable repairs to other dwellings, with greater effects when tenancies are longer than 5 years. Reflecting the nature of BTR assets as dwellings within one asset rather than unit titles, there may need to be some rights for landlords at the asset level rather than the dwelling level to consider in future.

Cabinet

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Report of the Cabinet Economic Development Committee: Period Ended 24 June 2022

On 27 June 2022, Cabinet made the following decisions on the work of the Cabinet Economic Development Committee for the period ended 24 June 2022:

Not in scope

DEV-22-MIN-0132	**Measures for Inclusion in the 2022 Omnibus Tax Bill** Portfolio: Revenue	CONFIRMED
DEV-22-MIN-0134	**GST on Fees Charged to Managed Funds** Portfolio: Revenue	CONFIRMED
DEV-22-MIN-0135	**Simplifying GST Apportionment Rules** Portfolio: Revenue	CONFIRMED

Not in scope

Not in scope

[redacted]

Michael Webster
Secretary of the Cabinet

Inland Revenue
Te Tari Taake

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Briefing note

Reference:	BN2022/339
Date:	28 June 2022
To:	Revenue Advisor, Minister of Revenue – Matthew Atherton Private Secretary, Minister of Revenue – Nikki Chamberlain Revenue Advisor, Parliamentary Under-Secretary to the Minister of Revenue – Ruairi Cahill-Fleury
From:	Melissa Siegel
Subject:	**Trust resettlements and rollover relief for land transferred out of a trust to a settlor**

Purpose

1. This note provides further information requested by the Minister of Revenue on trust matters as they pertain to rollover relief for the purposes of the bright-line test and the new interest limitation rules.

2. A recent policy report to the Minister of Revenue dated 10 June 2022 (IR2022/293 refers) recommended that the legislation be clarified to ensure that:

   - Resettlements of eligible trusts qualify for rollover relief.
   - Rollover relief applies to a transfer from an eligible family trust to a settlor of the trust in the situation where the settlor made cash settlements on the trust or guaranteed its obligations to enable it to acquire the property.

Context – Existing rules and policy rationale

3. Following the extension of the bright-line test from five to 10 years, the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 extended the rollover relief available under the bright-line test to cover a wider range of scenarios where there is a legal transfer of residential land, but no overall change in economic ownership. These include:

   - Partnerships
   - Look through companies
   - Transfers within wholly owned groups of companies
   - Certain family trusts.

4. The expanded rollover relief provisions are not exhaustive and only apply in some relatively simple and common scenarios where the economic ownership of the residential land has not changed (or, in the case of a transfer to a family trust, economic ownership of the land has not materially changed as the trust is

substantially controlled by the land's original owner), and no gain on the transfer of the land has been realised.[1]

5. Rollover relief under the bright-line test essentially disregards an intervening disposal by treating the transfer as a disposal and acquisition for an amount that equals the total cost of the residential land to the transferor. The recipient is deemed to take on the transferor's original date of acquisition along with the transferor's cost base. This ensures the recipient can benefit from the original owner's years of ownership of the residential land to determine whether their disposal of the land is inside or outside the bright-line period.

6. Rollover relief is also provided under the interest limitation rules in the same types of common scenarios where legal ownership is restructured but economic ownership remains unchanged. This is to ensure that, for a person with a pre-27 March 2021 loan for residential property who restructures the legal ownership of the property and the accompanying loan on or after 27 March 2021, the loan continues to be grandparented under the transitional rules.

Family trusts

7. The new rules provide rollover relief for transfers of residential land to or from family trusts provided certain requirements are met, including that:

   - each transferor (in the case of a transfer by a settlor to a trust) or each recipient (in the case of a transfer from a trust back to a settlor) of the land is also a beneficiary of the trust
   - at least one of those transferors or recipients of the land is also a principal settlor[2] of the trust
   - all natural person beneficiaries are either principal settlors or are related[3] to a principal settlor – and if there is more than one principal settlor, all principal settlors are related to each other.

8. These requirements ensure that rollover relief is only available for family trusts and not all trusts.

9. In addition, no relief is available for distributions to the beneficiaries of the trust who are not settlors. Such distributions continue to be subject to the bright-line test where applicable. This ensures that the application of the bright-line test cannot be circumvented by transferring residential land into a trust and then distributing the property to a beneficiary.

10. For symmetry, rollover relief is available where residential land held in a family trust is transferred back to the original owner (that is, the settlor who had originally settled it on the trust – referred to as an "original settlor"). The legislation provides

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[1] Where a gain has been realised, partial relief may apply to ensure that the transferor is not taxed on the market value of the land but the amount it was actually sold for (that is, they do not pay tax on the "paper profit" but the actual gain realised), and that the recipient has a cost base that is equivalent to the amount they paid for the land. The recipient is also deemed to take on the transferor's acquisition date so that they benefit from the transferor's years of ownership.

[2] A "principal settlor" is a settlor who made the greatest or greatest-equal settlement on the trust.

[3] Two people are "related" if they are within four degrees of blood relationship, are married or are in a civil union or de facto relationship, or one person is within four degrees of blood relationship with the other person's spouse, civil union partner or de facto partner.

that the residential land transferred to the original settlor by the trustees of the trust must either be:

- the same land they originally transferred to the trust, and all other original settlors also get their land back, or
- *in part* the same land they originally transferred to the trust, if that part and all other transfers back to other original settlors are in the same proportions as in the original settlement on the trust.

11. In other words, rollover relief is only available in this situation where the land is transferred back to the original owner (or owners) in the same proportions they had before. This prevents rollover relief from applying when a change in economic ownership occurs, for example, where Settlor A and Settlor B originally co-owned land in 50:50 proportions, settled it on their family trust, and then later received it back from the trust in 25:75 shares.

Trust resettlements

12. A resettlement of a trust is when all or some of the property of the trust is resettled onto a different trust. In addition to a formal resettlement where all or some of the trust property is transferred to the trustees of another trust pursuant to a deed of resettlement, a resettlement can occur when a trust is varied to such an extent that the original trust no longer exists.

13. The tax consequences of a trust resettlement are those that arise on the transfer of property or following a loss of continuity. When property is resettled onto another trust, no consideration is paid by the recipient trustees. However, for tax purposes (including for the bright-line test), the property transferred is valued at market value. The same value is used by both the resettling and recipient trustees.

14. Submitters on the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill (the Bill) noted that the legislation as it was drafted did not cover trust resettlements. They stated that resettlements should qualify for rollover relief in some circumstances, such as where the beneficiaries of each trust are identical or where each beneficiary of the recipient trust meets the definition of a "close family beneficiary" in relation to a principal settlor of the original trust.

15. Following the changes introduced in the Trusts Act 2019, submitters note that a lot of discretionary family trusts that hold residential land are being reviewed, with some finding that the trust deeds are no longer fit for purpose under the new Act. They have said that in some cases, it is more efficient to resettle the property onto a new family trust with a trust deed that does comply with the requirements of the new Act.

16. As was outlined in our comments in the officials' report on the Bill, we agreed with the submissions. We noted in the officials' report that a single resettlement transaction (that is, where the resettling trustees transfer the land directly to the trustees of the recipient trust) is economically equivalent to carrying out two separate transactions that both qualify for rollover relief (that is, where the trustees of the original trust transfer the property back to the settlor who originally settled it on the trust, and the settlor then transfers it to the trustees of the recipient trust). On this basis, an economically equivalent resettlement transaction should qualify for rollover relief.

17. Although the Finance and Expenditure Committee (the FEC) accepted our recommendation that rollover relief apply to certain trust resettlements, we ran out of time to include an amendment providing for this outcome in both the revision-tracked Bill and the Minister of Revenue's Supplementary Order Paper that was introduced at the Bill's Committee of the whole House stage. Given the FEC's decision to accept the submission and the level of interest still being expressed by

the private sector on this issue, we recommended in the 10 June policy report that such an amendment be included in the August Bill.

Transfers to settlors who originally made cash settlements on family trust

18. As outlined above, rollover relief is provided for transfers of residential land from family trusts to the settlors of the trust provided certain conditions are met, including that at least one of the settlors receiving the land is a principal settlor, and the land is transferred back to the settlors in the same proportions as they had before the original settlement on the trust. The issue is that rollover relief clearly only applies in situations where the settlor was the original owner of the land before it was transferred to the trust. For instance, rollover relief does not apply to a transfer of residential land from a qualifying family trust to a settlor in the circumstance where the settlor instead made *cash* settlements on the trust or guaranteed its obligations to enable it to purchase the land.

19. Following consultation on this matter with private sector stakeholders, we recommended in the 10 June policy report that rollover relief apply to a transfer from an eligible family trust to a settlor of the trust in the situation described above.

20. Our thinking is that, as an alternative to the existing requirements, rollover relief should also apply when land is transferred from a qualifying family trust to a settlor who was not the original owner of the land given certain conditions are met. These conditions are that the settlor:

    - was a principal settlor of the trust at the time the land was acquired by the trustee, and
    - is still a principal settlor when the trustee transfers the land to them.

21. In line with the principle that rollover relief should not apply when there is a change in economic ownership, we do not think rollover relief should apply to transfers to settlors who are not principal settlors of the trust either at the time the land was acquired by the trustee or when the trustee transfers the land. This timing requirement is mainly to ensure that a beneficiary (such as an adult child of the original principal settlor) cannot become a principal settlor later just to receive the land without bright-line test tax implications. It would also ensure that a person who is no longer a principal settlor is not eligible for rollover relief, unless they originally transferred the land or part of the land to the trust and receive it back from the trust in the same proportion as they originally held it.

Consultation with Treasury

22. Treasury was informed about this briefing note.

Melissa Siegel
Senior Policy Advisor
s 9(2)(a)

In Confidence

Office of the Minister of Revenue

Cabinet Business Committee

FINAL POLICY DECISIONS ON THE ROLE OF DIGITAL PLATFORMS IN THE TAXATION OF THE GIG AND SHARING ECONOMY

Proposal

1 This paper seeks the Cabinet Business Committee's agreement to include amendments in the upcoming omnibus taxation bill that will:

1.1 give legislative effect to the Organisation for Economic Co-operation and Development's (the OECD's) Model Rules for Reporting by Platform Operators with respect to Sellers in the Gig and Sharing Economy, including the optional extension, and

1.2 introduce rules to New Zealand's GST legislation that would require digital platforms to collect and return GST to Inland Revenue on supplies of accommodation and transportation services (including ridesharing and food and beverage delivery services).

Relation to Government Priorities

2 The Government's current tax policy work programme includes an item on the taxation of the gig and sharing economy. This follows consideration by the OECD of tax administration and policy issues arising from the growth and popularity of the gig and sharing economy internationally.

3 In March 2022, a discussion document, *The role of digital platforms in the taxation of the gig and sharing economy*, was published with Cabinet's agreement. The proposals in the discussion document focused on information reporting and exchange, GST, and other compliance cost reduction measures for sellers. Submitters on the discussion document included multinational and New Zealand based digital platforms, and accounting and law firms specialising in taxation. Public consultation closed in late April 2022.

Tax changes to support the gig and sharing economy

4 The gig and sharing economy refers to economic activity which is facilitated by digital platforms – commonly referred to as "apps" – that connect buyers with sellers who share their skills, assets, and labour. Common examples of activities in the gig and sharing economy include the provision of short-stay accommodation, transportation services (including ridesharing and food and beverage delivery), and other personal and professional services.

5 The size of the gig and sharing economy in New Zealand is currently unknown. Inland Revenue expects that there are tens of thousands of taxpayers who provide services through digital platforms in the gig and sharing economy based on data it holds.

6 There are no special tax rules for those who operate in the gig and sharing economy ("sellers"). Sellers are treated as self-employed for tax purposes, and have corresponding tax obligations such as record keeping of income and expenses, providing tax returns, and registering for GST provided they are over the GST registration threshold of $60,000 per 12-month period.

7 The proposals in the discussion document included implementing:

7.1 An information reporting and exchange framework that has been developed by the OECD. This would improve Inland Revenue's visibility of income earned by New Zealand tax residents on multinational digital platforms in the gig and sharing economy.

7.2 Changes requiring digital platforms to collect and return GST on behalf of sellers who provide short stay accommodation and personal services through digital platforms. This would support the long-term sustainability of the GST base and improve the efficiency of GST by ensuring GST applied equally to these services, whether provided through digital platforms or other business models.

8 These proposals, the feedback from public consultation, and recommended next steps are discussed further below.

9 Other measures to reduce compliance costs for sellers included the availability of standard cost deductions for income tax purposes, and allowing significant assets (such as land and motor vehicles) to be opted out of the GST base. This paper is not seeking Cabinet decisions on these items.

Information reporting and exchange

10 Digital platforms have significant volumes of information which is useful for tax authorities. This includes information about the sales and income of those who operate on these platforms.

11 Building on work that has been done for financial account information, the OECD developed an information reporting and exchange framework for digital platforms in the gig and sharing economy. The purpose of the information reporting and exchange framework is to ensure a standardised approach to information reporting for multinational digital platforms which operate in multiple jurisdictions.

12 If implemented, the OECD’s information reporting and exchange framework requires digital platforms to provide information annually to the tax authority in which they are a tax resident. This information includes the sales and income earned by sellers of accommodation and personal services and identifying information about the sellers, such as their name, address, country of tax residence, and tax file number. This information is then shared by the tax authority with other tax authorities, to the extent that the information relates to sellers who are tax resident in their jurisdiction. The OECD developed an extended module to the rules which requires information on the sale of goods and vehicle rentals. This was to match rules designed by the European Commission and which will be applied in Europe from 2023.

13 If New Zealand implemented the OECD’s information reporting and exchange framework, Inland Revenue would receive information about New Zealand tax resident sellers on digital platforms that are based offshore. Inland Revenue could use this information to support sellers comply with their tax obligations.

14 New Zealand tax resident digital platforms would also need to provide Inland Revenue with information that Inland Revenue would then exchange with other tax authorities.

15 The OECD’s rules have been designed to be equivalent to rules designed by the European Commission and which will be in force in Europe from the 2023 calendar year. It is important that New Zealand’s rules are equivalent to the rules in Europe, as without rules of equivalence, New Zealand would not receive information from the many digital platforms that will report to European tax authorities.

16 All submitters on the discussion document supported implementation of the OECD’s rules in New Zealand. This is because the rules reduce compliance costs relative to bespoke rules by providing a standardised format (and single reporting point) for information to be disclosed and exchanged.

17 It would not be practical to implement the OECD’s information reporting and exchange framework in New Zealand for the 2023 calendar year. This is because digital platforms in New Zealand will need time to ensure their systems are compliant with the information collection and reporting requirements, and because Inland Revenue would need sufficient time to make changes to its START system to enable it to receive the information.

18 I therefore recommend that the OECD’s information reporting and exchange framework is incorporated into New Zealand’s domestic law and would apply for the 2024 and later calendar years. This would mean the first information exchange would occur in early 2025. This implementation timeline is aligned with what has been signalled by the United Kingdom s 9(2)(ba) [redacted]

19 Implementing these rules will ensure that Inland Revenue gets access to information from a broad range of multinational digital platforms in the gig and sharing economy through various tax authorities. Inland Revenue will use this information in its compliance and enforcement functions, and through using this information to promote tax compliance, it is expected to generate additional tax revenue of $11 million per year.

20 To support the OECD's rules, I also propose introducing new civil penalties to the Tax Administration Act 1994. These penalties could apply to New Zealand tax resident digital platforms, and sellers on those platforms, where they fail to comply with the information reporting requirements under the OECD's rules. I recommend these penalties are based on penalties that were included in the Tax Administration Act 1994 following implementation of the Common Reporting Standard in New Zealand, which is another OECD information exchange that relates to financial account information.

21 In the future, Inland Revenue may be able to use the information from other tax authorities to pre-populate sellers' income tax returns. Information is provided on a calendar year basis as opposed to the New Zealand tax year which ends 31 March, and further legislative changes would be required in the future to enable pre-population. Inland Revenue officials will provide further advice on pre-population in the future, following the first few years of the information exchange.

22 Based on Inland Revenue's experience with the Common Reporting Standard, it is anticipated that there may be integrity issues with the information exchanged between tax authorities in the first few years of operation. For pre-population to be possible, Inland Revenue will need to be sure that the information it receives about sellers matches the correct taxpayers in Inland Revenue's START system.

Applying GST to accommodation and transportation services

23 GST applies to a broad range of goods and services supplied in New Zealand. This keeps the tax simple, fair, and efficient. The discussion document noted that because many sellers on digital platforms in the gig and sharing economy operate below the GST registration threshold of $60,000, many services provided through digital platforms in the gig and sharing economy are not currently subject to GST by final consumers.

24 To address this, it was noted that the GST registration threshold could be lowered for sellers on digital platforms in the gig and sharing economy, or changes requiring digital platforms to collect and return GST on behalf of sellers could be implemented in New Zealand.

25 Submitters on the discussion document were generally opposed to any proposals to make changes to New Zealand's GST system in light of the growth and popularity of the gig and sharing economy. It was considered further economic modelling and analysis would be desirable to show the size and effect of any proposed changes, and noted that changes to the GST system would increase compliance costs on digital platforms and sellers who would not otherwise need to consider the implications of being registered for GST because they operated below the GST registration threshold.

26 Despite these submissions, I consider there are strong arguments for requiring digital platforms to collect and return GST on behalf of sellers in specific industries. This improves the efficiency of GST by reducing distortions (ensuring supplies of services that are the same or similar are subject to the same tax treatment) and supports the long-term sustainability of the GST system.

27 This approach is also consistent with the approach that New Zealand has taken in 2016, when rules requiring electronic marketplaces to collect and return GST on supplies of imported digital services (for example, app store sales) were implemented and in 2019, when rules requiring electronic marketplaces to collect and return GST on supplies of low value imported goods were implemented.

28 This approach is also preferable to the other options noted in the discussion document. Under the status quo with a $60,000 GST registration threshold, Inland Revenue officials expect there to be a sizeable proportion of economic activity which is not currently subject to GST by consumers. If the gig and sharing economy continues to grow as is expected this could undermine the GST base over time. I also do not recommend a general lowering of the GST registration threshold because of the associated compliance and administration costs this would impose across the board, and a targeted lowering of the GST registration threshold for sellers in the gig and sharing economy would, when compared with implementing extended electronic marketplace rules, significantly increase compliance costs for sellers and administration costs for Inland Revenue.

29 I therefore propose that the current rules in the Goods and Services Tax Act 1985 that require electronic marketplaces to collect and return GST on behalf of those selling digital services, and low value imported goods, be extended to also apply in circumstances where electronic marketplaces are enabling sellers of:

29.1 accommodation, being any accommodation that is taxable (excluding residential accommodation) in New Zealand, and

29.2 transportation services, which includes ridesharing and food and beverage delivery, and

29.3 services that are closely connected with these services (for example, cleaning) and which are paid for through the digital platforms.

30 These industries were identified by the OECD as the most significant in the gig and sharing economy currently. As the gig and sharing economy continues to evolve, and new business models and industries emerge, it is possible that this list be expanded in several years' time once further information on emerging activities became available through the OECD's information reporting and exchange framework.

31 The discussion document proposed GST applying to all "personal services". GST currently applies to many personal services where they are provided through electronic marketplaces under New Zealand's GST rules for imported digital services and extending these rules further would require complex changes to these rules, which would require further consultation.

32 These changes are targeted at sellers that operate below New Zealand's GST registration threshold. For large commercial operators, GST is currently being collected on the services referred to in paragraph 29. To ensure these changes do not impose significant compliance costs associated with changing accounting systems on large commercial operators such as hotels who may advertise their rooms on digital platforms, I recommend that large commercial operators in the accommodation sector (being those with more than 500 listings per year) be able to enter into agreements with digital platforms to ensure that they remain responsible for their own GST obligations.

33 The effect of the GST proposals on consumers is an anticipated increase in the cost of these services by approximately 15 percent. Digital platforms that enable these services will also incur compliance costs in adapting their systems to be compliant with the new requirements. Sellers on these digital platforms may incur additional compliance costs to the extent that they choose to register for GST rather than use the flat rate scheme which is proposed below. Platforms and sellers may pass these costs on to consumers. There are also administrative implications for Inland Revenue as resources will be required for the ongoing administration of the proposal.

34 This proposal supports the efficiency and fairness of the GST system. It is also consistent with our broad-based GST framework. The proposal does increase compliance costs for digital platforms. These digital platforms are currently registered for GST in New Zealand because they supply imported digital services which are subject to GST. The existing rules for electronic marketplaces in the Goods and Services Tax Act 1985 and the Tax Administration Act 1994 that apply to electronic marketplaces will continue to apply.

Implementation of a flat rate scheme

35 If digital platforms were responsible for collecting and returning GST to Inland Revenue on these supplies on behalf of sellers, to maintain the principle that GST is not a cost on production, the underlying sellers of these services would need a method to recover GST on their costs.

36 Sellers could register for GST themselves and claim GST credits on their costs in the usual way, however this results in compliance costs. To mitigate these compliance costs, an alternative option – a flat rate scheme – was proposed in the discussion document. Under the flat rate scheme, digital platforms would collect GST at the standard rate of 15 percent but return a proportion of this to Inland Revenue as GST, with the remaining proportion being passed on to the sellers in recognition of the otherwise unrecoverable GST on costs they will have incurred.

37 For sellers who are not registered for GST, including those sellers who are not required to be registered for GST, and to mitigate the compliance and administration costs associated with GST registration for these sellers, I recommend that an optional flat rate scheme be available. This scheme will apply where sellers notify the digital platform that they are not registered for GST, and will require digital platforms to return a lower rate of GST to Inland Revenue, with the difference between the standard rate and this lower being passed on to the seller.

38 Based on GST return information from those in the short-stay accommodation and transportation sectors, Inland Revenue officials have identified the median expenditure incurred by sellers who are currently registered for GST. This median ignores those with greater expenses than sales in both sectors. This analysis suggests a flat rate scheme that results in GST of 6.5 percent being returned to Inland Revenue with the remaining 8.5 percent being passed on to sellers in recognition of the otherwise unrecoverable GST on their costs is appropriate. Inland Revenue officials will monitor the flat rate scheme to ensure it remains appropriate over time.

39 For sellers who prefer a greater degree of accuracy they will retain the ability to register for GST on a voluntary basis.

40 In circumstances where sellers that misrepresent their GST registration status to the digital platforms to obtain greater monetary benefits, I recommend clarifying that the existing penalties framework in the Tax Administration Act 1994 apply. In addition to reversing the benefit of the flat rate scheme for these sellers, the current shortfall penalties should be available.

Financial Implications

41 The estimated revenue implications of implementing the OECD's information reporting and exchange framework are shown in the table below. Over the next four years (2022/23 to 2025/26), it is expected the proposal will increase tax revenue by $27.5 million, with a corresponding impact on the operating balance and net debt:

	$ m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	5.500	11.000	11.000
Total Operating	**-**	**(5.500)**	**(11.000)**	**(11.000)**

42 Requiring digital platforms to collect and return GST on behalf of sellers of taxable accommodation, transportation services, and closely connected services is also expected to be fiscally positive. Over the next four years (2022/23 to 2025/26), it is expected the proposal will increase tax revenue by $105.75 million, with a corresponding impact on the operating balance and net debt:

	$ m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	11.750	47.000	47.000
Total Operating	**-**	**(11.750)**	**(47.000)**	**(47.000)**

43 The estimated cost to Inland Revenue arising from both of these proposals over the next four years is $28.4 million. Implementing the OECD's information reporting and exchange framework is estimated to cost $12.6 million (operating) and $13.7 million (capital), whereas requiring digital platforms to return GST on behalf of sellers would cost $1.8 million (operating) and $0.3 (capital). There would also be ongoing costs to Inland Revenue from both proposals, amounting to approximately $5 million each year.

44 This may require an increase to Inland Revenue's departmental appropriations, which could be managed as a pre-commitment against the 2023 Budget allowance. However, some uncertainty remains as to these costings and the extent to which they can be met from Inland Revenue's baselines. I therefore seek a delegation that would allow myself and the Minister of Finance to jointly agree to pre-commit up to $28.4 million from the 2023 Budget allowance to bring these changes into effect, pending further advice from Inland Revenue and the Treasury.

45 I further recommend that officials report back, as part of the preparation of the Budget Policy Statement, on what impact – if any – the additional revenue from the extension of the electronic marketplace rules to digital platforms should have on Budget allowances. I also propose that the fiscal management of any additional revenue from implementing the OECD's information reporting and exchange framework should be considered by the Ministers of Finance and Revenue at a later date, again pending further advice from officials.

Legislative Implications

46 The proposals in this paper would require amendments to the Tax Administration Act 1994 and the Goods and Services Tax Act 1985.

47 I recommend these amendments be included in the upcoming omnibus taxation bill which is expected to be introduced in August.

Impact Analysis

Regulatory Impact Statement

48 Inland Revenue officials prepared two Regulatory Impact Statements "Information reporting and exchange proposals for the taxation of the gig and sharing economy" and "GST proposals for the taxation of the gig and sharing economy". The Quality Assurance reviewer at Inland Revenue has reviewed both these Regulatory Impact Statements and considers that the information and analysis summarised in the statements meets the quality assurance criteria.

Climate Implications of Policy Assessment

49 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

50 The proposals in this paper are not expected to have any undue implications for specific demographics in New Zealand.

Human Rights

51 There are no human rights implications associated with the proposals in this paper.

Consultation

52 The Government consulted on these proposals in the discussion document *The role of digital platforms in the taxation of the gig and sharing economy* which was released for public consultation in March 2022. The proposals in the discussion document were consistent with work done by the OECD on both information reporting and exchange and GST issues which included consultation with multinational digital platforms.

53 The discussion document prompted submissions from Airbnb, the Asia Internet Coalition, Baker McKenzie, Booking.com, Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, Delivereasy, EY, KPMG, the New Zealand Law Society, Trade Me, PwC, and Uber NZ.

54 In preparing this Cabinet paper, Inland Revenue officials consulted with the Treasury and the Ministry of Business, Innovation and Employment. The Ministry of Justice was consulted on the penalty implications and had no concerns with the approach proposed in this paper. The Ministry of Business, Innovation and Employment noted that the proposals in this paper did not affect the work being done on the definition of "employee".

55 The Treasury supports the implementation of the electronic marketplace rules to digital platforms, as outlined in this paper. However, given the significant costs associated with the implementation of the OECD's information reporting and exchange framework, the Treasury recommends deferring enactment of this change, so that the departmental funding can be considered through the Budget process.

Communications

56 I will make an announcement regarding the proposals in this paper when the omnibus taxation bill that contains these proposals is introduced. This is expected to be in August 2022.

57 Tax policy officials will also prepare a *Commentary* to the Bill which will be published on the Bill's introduction. This will explain the detail of the proposals.

58 Inland Revenue also include details of any new tax legislation in the *Tax Information Bulletin* shortly after enactment.

Proactive Release

59 I propose to delay the proactive release of this Cabinet paper, associated minutes, and key advice papers until after the introduction of the omnibus taxation bill containing these proposals. The expected introduction date for the bill is August 2022.

Recommendations

The Minister of Revenue recommends that the Committee:

1 note that the taxation of the gig and sharing economy is an item on the Government's current tax policy work programme.

2 note that the Government released a discussion document *The role of digital platforms in the taxation of the gig and sharing economy* for public consultation between March 2022 and April 2022.

Information reporting and exchange

3 note that the Organisation for Economic Co-operation and Development (the OECD) designed an information reporting and exchange framework for digital platforms to provide tax authorities with information about sellers in the gig and sharing economy.

4 note that implementing the OECD's model rules will ensure New Zealand has rules equivalent to those developed by the European Commission for use by members of the European Union.

5 note that if New Zealand did not have rules of equivalence with the European Union, Inland Revenue would not receive information about New Zealand tax residents on digital platforms that were tax resident in Europe, where many large digital platforms are based.

6 agree to give legislative effect to the OECD's "Model Rules for Reporting by Platform Operators with respect to Sellers in the Gig and Sharing Economy" and the optional module that includes the sale of goods (together, "the OECD's rules").

7 agree that New Zealand tax resident digital platforms below EUR 1 million will be required to comply with the OECD's rules to ensure that New Zealand's implementation of the rules are equivalent to those developed by the European Commission which does not have an optional exemption for small digital platforms.

8 agree that the OECD's rules should be implemented for the 2024 calendar year, with the first information exchange occurring in 2025.

9 agree to implement penalties that apply to New Zealand tax resident digital platforms that fail to comply with their obligations under the OECD's rules of:

9.1 $300 per instance, up to $10,000, per reporting period (1-year), and

9.2 $20,000 for the first offence, and $40,000 for subsequent offences, up to $100,000 per reporting period, in circumstances where the digital platform fails to take reasonable care in complying with their obligations under the OECD's model rules.

10 agree that the Commissioner of Inland Revenue (the Commissioner) can impose the penalties referred to in recommendation 9.

11 agree to implement a penalty of $1,000 that the Commissioner could impose on sellers who fail to provide digital platforms with the information required under the OECD's rules about their identity.

12 note that the penalties referred to in recommendations 9 to 11 are consistent with penalties that were introduced when New Zealand implemented the Common Reporting Standard which is an OECD information exchange relating to financial account information.

13 note that the Commissioner will focus on supporting New Zealand tax resident digital platforms and sellers to comply with their obligations under the OECD's rules and would apply discretion in imposing these penalties.

14 agree to include amendments to the Tax Administration Act 1994 that give effect to recommendations 6 to 11 in the upcoming omnibus taxation bill.

Applying GST to accommodation and transportation services

15 note that the OECD identified the accommodation and transportation sectors as the largest sectors of the gig and sharing economy globally currently.

16 note that many sellers on digital platforms who provide these services are below the GST registration threshold, which means these services are often not subject to GST by consumers, where GST is generally paid on these services when provided through other means.

17 agree to extend the rules that currently require electronic marketplaces to collect and return GST on behalf of suppliers of imported digital services and low value imported goods to also apply to supplies of:

17.1 taxable accommodation (which includes all accommodation other than residential accommodation)

17.2 transportation services (which includes ridesharing and food and beverage delivery services, but does not include package delivery services), and

17.3 services that are closely connected with the services referred to above (such as cleaning) when paid for through a digital platform that facilitates these services.

18 note that as the gig and sharing economy continues to grow, further activities may be identified for inclusion in extended electronic marketplace rules in the future.

19 agree that all the rules the currently apply to electronic marketplaces that provide imported digital services and low value imported goods should, with any necessary modifications, also apply to digital platforms that enable the supplies referred to in recommendation 16.

20 agree to implement a flat rate scheme that requires digital platforms to charge GST at 15 percent, returning to Inland Revenue GST at a discounted rate of 6.5 percent, and paying 8.5 percent to sellers that are not registered for GST.

21 note that the flat rate scheme has been determined based on analysis of GST return information for those in the taxi driving and holiday home sectors.

22 note that Inland Revenue officials will monitor the flat rate scheme over time to ensure it achieves the policy objective.

23 agree that sellers who misrepresent themselves as not being registered for GST to digital platforms to receive greater payments from digital platforms could be liable for penalties on the tax shortfalls created.

24 agree that large commercial operators in the accommodation sector (being those with more than 500 listings a year) should be able to agree with digital platforms that they will remain responsible for their own GST obligations.

25 agree that the changes in referred to in recommendations 17 to 24 apply from 1 April 2024.

26 agree to include amendments that give effect to recommendations 17 to 25 in the upcoming omnibus taxation bill.

Financial implications

27 note the following changes to tax revenue resulting from the decisions at recommendations 3 – 14 to implement the OECD's model rules for information reporting and exchange, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	5.500	11.000	11.000
Total Operating	**-**	**(5.500)**	**(11.000)**	**(11.000)**

28 note the following changes to tax revenue resulting from the decisions at recommendations 15 – 26 to extend the electronic marketplace rules for GST to digital platforms, with a corresponding impact on the operating balance and net debt:

	$ m – increase / (decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	11.750	47.000	47.000
Total Operating	**-**	**(11.750)**	**(47.000)**	**(47.000)**

29 delegate to the Minister of Revenue and Minister of Finance:

29.1 the authority to agree to up to $28.400 million of additional departmental funding to Vote Revenue to meet the up-front and/or ongoing costs arising as a result of these changes; and

29.2 the authority to agree how to manage the fiscal impacts of the decisions at recommendations 3 – 14 (to implement the OECD's model rules for information reporting and exchange).

30 agree to manage the fiscal impacts of:

30.1 the decisions at recommendations 15 – 26 (to extend the electronic marketplace rules for GST to digital platforms) in a manner to be confirmed at a later date, as part of developing the Budget Policy Statement; and

30.2 the decision at recommendation 29 (to delegate authority to the Minister of Revenue and Minister of Finance to agree additional departmental funding to meet the cost of these changes), as a pre-commitment against the Budget 2023 allowance.

31 delegate the Minister of Revenue, in consultation with the Minister of Finance, the ability to make technical decisions necessary to give effect to the policy proposals agreed in this paper, ahead of inclusion in the upcoming omnibus taxation bill.

Hon David Parker
Minister of Revenue

CBC-22-MIN-0037

Cabinet Business Committee

Minute of Decision

The Role of Digital Platforms in the Taxation of the Gig and Sharing Economy: Final Policy Decisions

Portfolio **Revenue**

On 4 July 2022, the Cabinet Business Committee:

Background

1 **noted** that the taxation of the gig and sharing economy is an item on the government's current tax policy work programme;

2 **noted** that the government released the discussion document *The role of digital platforms in the taxation of the gig and sharing economy* for public consultation between March and April 2022;

Information reporting and exchange

3 **noted** that the Organisation for Economic Co-operation and Development (OECD) designed an information reporting and exchange framework for digital platforms to provide tax authorities with information about sellers in the gig and sharing economy;

4 **noted** that implementing the OECD's model rules will ensure New Zealand has rules equivalent to those developed by the European Commission for use by members of the European Union;

5 **noted** that if New Zealand did not have rules of equivalence with the European Union, Inland Revenue would not receive information about New Zealand tax residents on digital platforms that were tax resident in Europe, where many large digital platforms are based;

6 **agreed** to give legislative effect to the OECD's "Model Rules for Reporting by Platform Operators with respect to Sellers in the Gig and Sharing Economy" and the optional module that includes the sale of goods (together, "the OECD's rules");

7 **agreed** that New Zealand tax resident digital platforms below EUR 1 million will be required to comply with the OECD's rules to ensure that New Zealand's implementation of the rules are equivalent to those developed by the European Commission which does not have an optional exemption for small digital platforms;

8 **agreed** that the OECD's rules should be implemented for the 2024 calendar year, with the first information exchange occurring in 2025;

9 **agreed** to implement penalties that apply to New Zealand tax resident digital platforms that fail to comply with their obligations under the OECD's rules of:

9.1 $300 per instance, up to $10,000, per reporting period (1-year);

9.2 $20,000 for the first offence and $40,000 for subsequent offences, up to $100,000 per reporting period, in circumstances where the digital platform fails to take reasonable care in complying with their obligations under the OECD's model rules;

10 **agreed** that the Commissioner of Inland Revenue (the Commissioner) can impose the penalties referred to in paragraph 9;

11 **agreed** to implement a penalty of $1,000 that the Commissioner could impose on sellers who fail to provide digital platforms with the information required under the OECD's rules about their identity;

12 **noted** that the penalties referred to in paragraphs 9 to 11 are consistent with penalties that were introduced when New Zealand implemented the Common Reporting Standard which is an OECD information exchange relating to financial account information;

13 **noted** that the Commissioner will focus on supporting New Zealand tax resident digital platforms and sellers to comply with their obligations under the OECD's rules and would apply discretion in imposing these penalties;

14 **agreed** to include amendments to the Tax Administration Act 1994 that give effect to the decisions in paragraphs 6 to 11 in the upcoming omnibus taxation bill;

Applying GST to accommodation and transportation services

15 **noted** that the OECD identified the accommodation and transportation sectors as the largest sectors of the gig and sharing economy globally currently;

16 **noted** that many sellers on digital platforms who provide these services are below the GST registration threshold, which means these services are often not subject to GST by consumers, where GST is generally paid on these services when provided through other means;

17 **agreed** to extend the rules that currently require electronic marketplaces to collect and return GST on behalf of suppliers of imported digital services and low value imported goods to also apply to supplies of:

17.1 taxable accommodation (which includes all accommodation other than residential accommodation);

17.2 transportation services (which includes ridesharing and food and beverage delivery services, but does not include package delivery services);

17.3 services that are closely connected with the services referred to above (such as cleaning) when paid for through a digital platform that facilitates these services;

18 **noted** that as the gig and sharing economy continues to grow, further activities may be identified for inclusion in extended electronic marketplace rules in the future;

19 **agreed** that all the rules the currently apply to electronic marketplaces that provide imported digital services and low value imported goods should, with any necessary modifications, also apply to digital platforms that enable the supplies referred to in paragraph 16;

20 **agreed** to implement a flat rate scheme that requires digital platforms to charge GST at 15 percent, returning to Inland Revenue GST at a discounted rate of 6.5 percent, and paying 8.5 percent to sellers that are not registered for GST;

21 **noted** that the flat rate scheme has been determined based on analysis of GST return information for those in the taxi driving and holiday home sectors;

22 **noted** that Inland Revenue officials will monitor the flat rate scheme over time to ensure it achieves the policy objective;

23 **agreed** that sellers who misrepresent themselves as not being registered for GST to digital platforms to receive greater payments from digital platforms could be liable for penalties on the tax shortfalls created;

24 **agreed** that large commercial operators in the accommodation sector (being those with more than 500 listings a year) should be able to agree with digital platforms that they will remain responsible for their own GST obligations;

25 **agreed** that the changes in paragraphs 17 to 24 apply from 1 April 2024;

26 **agreed** to include amendments that give effect to the decisions in paragraphs 17 to 25 in the upcoming omnibus taxation bill;

27 **noted** the following changes to tax revenue resulting from the decisions in paragraphs 3 – 14 to implement the OECD's model rules for information reporting and exchange, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)			
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	5.500	11.000	11.000
Total Operating	**-**	**(5.500)**	**(11.000)**	**(11.000)**

28 **noted** the following changes to tax revenue resulting from the decisions in paragraphs 15 to 26 to extend the electronic marketplace rules for GST to digital platforms, with a corresponding impact on the operating balance and net debt:

	$ m – increase / (decrease)			
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26 & outyears**
Crown Revenue and Receipts: Tax Revenue	-	11.750	47.000	47.000
Total Operating	**-**	**(11.750)**	**(47.000)**	**(47.000)**

29 **authorised** the Minister of Finance and Minister of Revenue to agree:

29.1 up to $28.400 million of additional departmental funding to Vote Revenue to meet the up-front and/or ongoing costs arising as a result of the above changes;

29.2 how to manage the fiscal impacts of the decisions in paragraphs 3 to 14 (to implement the OECD's model rules for information reporting and exchange);

30 **agreed** to manage the fiscal impacts of:

30.1 the decisions in paragraphs 15 to 26 (to extend the electronic marketplace rules for GST to digital platforms) in a manner to be confirmed at a later date, as part of developing the Budget Policy Statement;

30.2 the decision at paragraph 29 (to authorise the Minister of Revenue and Minister of Finance to agree additional departmental funding to meet the cost of these changes), as a pre-commitment against the Budget 2023 allowance;

31 **authorised** the Minister of Revenue, in consultation with the Minister of Finance, to make technical decisions necessary to give effect to the policy decisions above ahead of inclusion in the upcoming omnibus taxation bill.

Rachel Clarke
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Kelvin Davis
Hon Dr Megan Woods
Hon Chris Hipkins
Hon Carmel Sepuloni
Hon Andrew Little
Hon Nanaia Mahuta
Hon Kiri Allan
Hon Michael Wood
Hon Dr David Clark

Officials present from:
Office of the Prime Minister
Department of the Prime Minister and Cabinet

Document 27

CAB-22-MIN-0266

Cabinet

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Report of the Cabinet Business Committee: Period Ended 8 July 2022

On 25 July 2022, Cabinet made the following decisions on the work of the Cabinet Business Committee for the period ended 8 July 2022:

Not in scope

CBC-22-MIN-0037	**The Role of Digital Platforms in the Taxation of the Gig and Sharing Economy: Final Policy Decisions** Portfolio: Revenue	CONFIRMED

Not in scope

Rachel Hayward
Acting Secretary of the Cabinet

In Confidence

Office of the Minister of Housing

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

EXEMPTION FROM INTEREST LIMITATION FOR BUILD-TO-RENT ASSETS

Proposal

1. This paper seeks agreement to define a build-to-rent asset class and provide an in-perpetuity exemption from interest limitation for that asset class.

Relation to Government Priorities

2. Our Government has three overarching objectives: to keep New Zealanders safe from COVID-19, to accelerate our recovery and to lay the foundations for a better future through reducing inequality and addressing child poverty, reducing carbon emissions and improving housing affordability [CAB-20-MIN-0525 refers].

3. Supporting the build-to-rent sector in Aotearoa New Zealand will enable the Government to deliver on its priority to improve housing affordability and to deliver on its housing policy objective that every New Zealander has a safe, warm, dry, and affordable home to call their own, whether they rent or own [CAB-21-MIN-0018 refers]. This will be achieved by increasing the supply, density, and diversity of rentals in the general rental market, producing more affordable rental supply and improving rental security for tenants.

Executive Summary

4. Aotearoa New Zealand is not building enough houses where they are needed and at price points that low- to moderate-income households can afford. The lack of new supply, coupled with increased demand, has increased prices and rents for existing homes, resulting in adverse wellbeing outcomes for many.

5. The Government has a broad work programme in place to increase housing supply. This support is primarily focused on increasing the supply of public housing and supporting the development of housing for first home buyers (including the initial changes to interest limitation). Action is needed by Government to increase the supply of quality rental housing, thereby improving the lives of New Zealanders experiencing rental stress.

6. This paper proposes exempting build-to-rent developments in-perpetuity from the interest limitation rules, which deny investors the ability to deduct interest on loans relating to residential investment property. This provides an extension for build-to-rent

developments beyond the 20-year new build exemption, which is provided to ensure continued delivery of new housing supply.

7. Build-to-rent is a different model of residential housing to that commonly seen in Aotearoa New Zealand's current private rental market, where individual or a small number of dwellings are owned by small-scale investors. It could play a major role in continuing the current momentum of new supply in coming years. Build-to-rent will improve the quality of rental housing in Aotearoa New Zealand and relieve capacity and financial pressure on solutions elsewhere in the market, including public housing and rental subsidy through the Accommodation Supplement.

8. The long-term time horizons (50+ years) associated with build-to-rent mean the 20-year new build exemption from the interest limitation rules is not sufficient to ensure viability of a build-to-rent project. In particular, build-to-rent is impacted by the interest limitation rules in two ways:

   8.1 the rules increase taxation and reduce cashflow from rentals – this is partially solved for new build-to-rent developments by the 20-year new build exemption from interest limitation.

   8.2 the rules affect future sales – because interest deductions are limited, if a build-to-rent asset needs to be sold, the lack of interest deductions affects asset value in the build-to-rent asset market. This impact has two potential outcomes:

      8.2.1 investors and developers will see development in build-to-rent as riskier than investment in other opportunities, including those overseas (having a negative impact on supply), or

      8.2.2 build-to-rent developments are progressed but after 20 years each asset is split up and sold in the general housing market as apartments. This increases supply but risks displacing tenants.

9. Exempting build-to-rent developments from the interest limitation rules will help to enable the full potential of the sector, therefore increasing its ability to contribute to the delivery of quality rental supply in Aotearoa New Zealand. In addition to the aforementioned benefits, build-to-rent can also play an important counter-cyclical role in supporting housing construction at times when securing buyers and development finance for build to sell developments is more challenging, as it is now [CPC-22-MIN-0017 refers].

10. The cost of this policy in foregone revenue is $2.1 million over the forecast period.

Background

11. In March 2021, Cabinet considered a suite of measures to increase housing supply and improve affordability for first home buyers [CAB-21-SUB-0045 and CAB-21-MIN-0070 refers]. One of the measures was a change to tax settings that prevents property investors from deducting interest costs against the income they make from a property, with a 20-year exemption for new builds. It was intended that this change would support more sustainable house prices and improve affordability for first home buyers.

12. Following consideration of these proposals, Cabinet invited me to report back on how Government can further support increased delivery of high-quality rentals at both market and subsidised rent [CAB-21-MIN-0061 refers]. The report back, considered by Cabinet in December 2021, provided an overview of the Government's support, and obtained Cabinet agreement to:

    12.1 continue further work on designing an in-perpetuity exemption to the interest limitation rules (which came into effect 1 October 2021) for build-to-rent developments

    12.2 design settings for the Affordable Housing Fund [SWC-21-MIN-0228 refers]. The $350 million Fund will support the development of new, affordable homes for low- to-moderate income earners in locations facing the biggest housing supply and affordability challenges.

Increasing rental supply

13. As outlined in the previous report back on increasing rental supply, Aotearoa New Zealand is not building enough houses where they are needed and at price points that low- to moderate-income households can afford. The lack of new supply, coupled with increased demand, has increased prices and rents for existing homes, resulting in adverse wellbeing outcomes for many.

14. The Government has a broad work programme in place to increase housing supply. This includes the Housing Acceleration Fund, the Kāinga Ora Land Programme, the Land for Housing Programme, the Māori Infrastructure Fund and Whai Kāinga Whai Oranga, and the Resource Management (Enabling Housing Supply and Other Matters) Amendment Bill. These interventions are in place to deliver a range of housing types to meet diverse housing needs.

15. This support, however, is primarily focused on increasing the supply of public housing and supporting the development of housing for first home buyers. The Government Policy Statement on Housing and Urban Development makes clear that increased supply of rental housing needs to be part of our solution to the housing crisis, however there is a visible gap in support for rental supply. Like many other jurisdictions, the Government needs to play a more active role in the private rental market – and across all price points – to improve rental supply and the lives of New Zealanders experiencing rental stress.

16. Increasing the supply of new-build housing in the right places will have an impact on affordability. The Affordable Housing Fund, launching in August this year, will provide much-needed support to increase the supply of affordable rentals. Further support is required, however, to sustain and grow the supply of new rental housing, and to ensure that more of this supply is affordable for low- and moderate-income households which cannot afford a market rent.

The role of build-to-rent

17. Build-to-rent is a category of medium to high-density residential dwelling, expressly built to provide long-term rental housing to tenants. The term "build-to-rent" encompasses the development and long-term professional management of a multi-

unit rental property by institutional investors and developers, often financed by institutional capital over a 50-year timeframe. Build-to-rent is a different model to that commonly seen in Aotearoa New Zealand's current private rental market, where individual or a small number of dwellings are owned by small-scale investors.

18. Build-to-rent offers a range of benefits, including:

    18.1 enabling significant dedicated rental supply, including the most needed rental typologies (i.e., one- and two-bedroom units), and in areas of high demand. Build-to-rent developers could contribute to urban regeneration, particularly around the Auckland rail corridors[1] and central Wellington

    18.2 enabling affordability due to its long-term investment horizon which is critical to providing new general and market affordable supply. It can also complement community affordable developments by bringing the scale needed to make the community affordable portion financially viable[2]

    18.3 providing the opportunity for Government rental supply support to have impact at scale, which is necessary to have a material impact on the market and potentially dampen rent increases

    18.4 providing better tenant experiences as it typically offers long-term rental tenure and stability and improved rental housing (which generally comes with new build housing) and is often in central locations, close to employment and amenities.

19. A small number of build-to-rent developments exist in Aotearoa New Zealand, primarily in Auckland. Developers and housing providers are interested in delivering build-to-rent, including at more affordable price points but will be influenced by the settings Government puts in place. We note there are some risks with the model, as many tenants are affected by actions of one common landlord in each build-to-rent development. To mitigate this risk, we can set expectations upfront and monitor any problems as they arise.

20. We believe build-to-rent could play a major role in continuing the current momentum of new supply in coming years, and in improving the quality of rental housing in Aotearoa New Zealand. In addition to the above benefits, build-to-rent can play an important counter-cyclical role in supporting housing construction at times when securing finance for build to sell developments is more challenging, as it is now. For example, developers are currently reporting increased difficulty securing pre-sales in build to sell developments due to a combination of higher interest rates, tighter lending criteria and declining house price expectations. Rents are still increasing, however, and the build-to-rent sector can attract different forms of stable, long-term investment (e.g., from iwi or local superannuation funds).

21. We are more likely to successfully address the housing crisis if we address it from all possible angles. Increasing rental supply, including supply offered at general market

[1] The build-to-rent sector claims as many as 6500 additional rental dwellings could be delivered by 2030, with modelling that over 12,000 rental dwellings could be supplied in Central Auckland associated with infrastructure developments there.

[2] Community affordable rental housing is housing that is affordable for lower income households which cannot afford a market rent, even for a modest home. They are usually delivered by community housing providers, iwi, Māori land trusts and non-profit entities and rely on local and central government subsidies and/or philanthropic funding.

and market affordable rents, will relieve capacity and financial pressure on solutions elsewhere in the market, including public housing and rental subsidy through the Accommodation supplement.

22. To help provide the certainty needed for small and large-scale investment in build-to-rent, the Overseas Investment Office issued guidance in March this year regarding the Overseas Investment Act 2005 (the Act) and application of the Act for build-to-rent developments. Increasing clarity and confidence regarding the application of the Act will increase liquidity (vital for build-to-rent due to its long-term time horizons) and support greater appetite for international capital investment for build-to-rent. Additional certainty is necessary, however, to encourage the investment (both nationally and offshore) needed to deliver new rental supply.

Effect of the current interest limitation rules on build-to-rent assets and supply

23. In March 2021, the Government announced that from 1 October 2021 investors would not be able to deduct interest costs against the income they make from a property. To ensure continued delivery of new housing supply, the interest limitation legislation includes a 20-year exemption for new build developments which allows investors to continue to deduct interest costs during that period.

24. Following the announcement, build-to-rent stakeholders raised concerns that without an extended exemption, the rules would seriously harm the feasibility of commercially delivered build-to-rent developments. Stakeholders have indicated that they are investing elsewhere (including overseas) because of the introduction of interest limitation rules.

25. The change to interest limitation creates two challenges for build-to-rent development:

    25.1 **it increases taxation and reduces cashflow from rentals** – this is partially solved for new build-to-rent by the 20-year interest limitation exemption

    25.2 **it affects future sale** – because interest deductions are limited, if a build-to-rent asset needs to be sold, the lack of interest deductions affects asset value in the build-to-rent asset market. This has two potential outcomes:

        25.2.1 build-to-rent developers and investors will see development as riskier than build-to-rent opportunities overseas or developments exempt from the interest limitation rules such as retirement villages, so only a small number of build-to-rent developments may go ahead. This negatively affects supply.

        25.2.2 build-to-rent developments are progressed, but after 20 years each asset is split up and sold in the general housing market as apartments. This increases supply but risks displacing tenants.

Proposal to extend exemption of build-to-rent assets from interest limitation limits

26. The current interest limitation rules are shaped around tilting the balance in residential property in favour of owner-occupiers over property investors. While we want to curb investors' appetite for existing residential properties, we also want to stimulate investment in new housing. We recognised at the time the interest limitation rules were

announced that build-to-rent developments could meet gaps in our rental market. Encouraging build-to-rent developments would provide more options for density and diversity in rental supply, but it needs policy settings that enable it to grow. By providing a tax benefit, we can also set some expectations for build-to-rent developments to benefit tenants.

27. We believe it is critical to encourage further development of rental supply and to use all levers available to do this. As such, we propose that build-to-rent assets qualify for extended exemption from the interest limitation rules, in line with other exemptions in the Income Tax Act 2007 (such as those for retirement villages and student accommodation). We propose an asset class definition to determine what a qualifying build-to-rent asset is.

28. We have added an additional condition to the definition of a build-to-rent asset to the proposal outlined in the previous report back on increasing rental supply. We propose that build-to-rent asset owners are required to offer a 10-year fixed-term tenancy option to tenants, and to permit any tenant accepting that offer to terminate the tenancy with 56 days' notice.

29. We propose that new and existing build-to-rent assets qualify for the extended exemption, to ensure that the small number of existing build-to-rent dwellings, owners and their tenants are not unfairly disadvantaged by this rule change (existing build-to-rent developments are not eligible for the 20-year new build exemption).

Defining build-to-rent as an asset class

Definition used to extend the exemption in the Income Tax Act[3]

30. The Social Wellbeing Committee previously agreed to a build-to-rent asset class definition. This is outlined in Appendix A. In addition to the previously agreed requirements, we propose the following are included in the build-to-rent definition:

    30.1 explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986

    30.2 tenants must be offered a fixed-term tenancy of at least ten years with the ability to give 56 days' notice of termination, but they may agree to or request other tenancy offers.

31. The definition is based on international examples but reflects the different context for opportunities in Aotearoa New Zealand:

    31.1 setting the size at 20 dwellings means, subject to other development costs, build-to-rent developments will be more viable in regional centres

    31.2 including commercial premises within build-to-rent developments enables community amenities to be provided and alternative revenue streams for the development. Including other dwellings supports developments that want to mix

[3] The specific definition may be set in a regulatory instrument outside the Act, to enable future changes.

tenure types, and which is likely needed to make development viable in regional centres

31.3 requiring explicit personalisation policies (requirement 30.1 above) makes lifestyle issues like pets and home-making more transparent to prospective tenants, without requiring all build-to-rent providers to offer personalisation options that may not be appropriate to every development (e.g., not all build-to-rent locations and typologies will be suitable for pets, and some build-to-rent providers may wish to promote exclusion of pets as a point of difference to benefit some tenants)

31.4 requiring continuous use as a build-to-rent dwelling prevents developers converting existing buildings to attempt to access a tax benefit.

Tenure length requirements (requirement 30.2 above)

32. Secure tenure improves wellbeing outcomes for tenants through:

32.1 enabling people to settle and personalise their homes

32.2 reducing how frequently they must find new accommodation

32.3 enabling them to build and maintain connection to their community.

33. For families with school-aged children that are renting, secure tenure means learning and socialisation are less disrupted. For renters with health and disability issues, secure tenure enables enduring connections to support networks and health providers and means they can make long-term adaptations to their accommodation that enable a higher quality of life.

34. In the private rental market, median tenure is only 16 months, and the most common tenancy is for one year. By comparison, some of the existing build-to-rent providers in Aotearoa New Zealand offer three or five year fixed-term tenancies with generous notice terms for tenants. This is done using the provisions of the Residential Tenancies Act 1986 that enable landlords to voluntarily provide more flexibility in tenancy agreements.[4]

35. We believe that security of tenure is critical. If there is Government support for build-to-rent, we want to ensure that providers entering the build-to-rent sector in Aotearoa New Zealand commit to providing secure tenancies for individuals and whānau.

36. We therefore propose to include a requirement in the asset class definition for build-to-rent providers to offer a 10-year fixed term tenancy, with tenants allowed to give 56 days' (8 weeks') notice of termination. We considered a range of minimum tenure options, including options between three and 10 years, but consider 10 years to be a suitable minimum period as it reflects the length of periods in a person's life where stability is particularly key, e.g., the length of time a child attends early childhood education, kōhanga reo or primary school. This length is more than three times the

[4] Subsection 11 (2) of the Residential Tenancies Act 1986

length of minimum tenure requirements in international regimes (including Australia and the United Kingdom).

37. Build-to-rent providers and tenants would be able to agree to other tenancy options but having this requirement provides a legislated standard that reflects the value of the tax benefit granted to owners of these assets. The notice period for tenants provides the ability to end tenancies for changes in employment or lifestyle, while providing time for the build-to-rent provider to schedule refits[5] and source new tenants.

Affordability requirements were assessed but not recommended

38. We carefully considered whether specific requirements around affordability should be included in the asset class definition. Subsidised affordable rentals are not viable without a system that continuously provides rent subsidies, and we do not recommend creating a subsidy programme for the build-to-rent sector. The Affordable Housing Fund will deliver affordable rentals in targeted regions and trial different approaches to how they are financed.

39. Build-to-rent can improve general market rental affordability by supplying higher rental density, particularly one-and-two-bedroom dwellings that are more efficiently supplied at a larger scale. However, using a tax limitation benefit on a variable cost like interest is not sufficient or consistent enough to incentivise affordable rentals. Other build-to-rent systems use tax credits, inclusionary planning requirements and tax discounts available under their more complex taxation regimes.

40. s 9(2)(f)(iv) [redacted]

Application to new or existing build-to-rent assets

41. We propose the extended exemption applies to existing build-to-rent assets (which do not currently quality for the 20-year new build exemption). Given the definition of a build-to-rent asset has both size and continuous use requirements, there would be few existing providers that qualify. Including them in the exemption ensures the personalisation and tenure requirements are consistent for all build-to-rent operators and tenants.

42. To be pragmatic for the sake of compliance, we would expect the tenant focussed requirements to apply to existing build-to-rent assets from one year after the asset class is implemented, and all other requirements of the asset class to already be in place.

Start date for in-perpetuity exemption from interest limitation

43. The interest limitation rules apply from 1 October 2021 to limit the ability for residential property investors to deduct interest on loans relating to residential property. An in-perpetuity exemption would allow interest incurred in relation to build-to-rent assets to

[5] Build-to-rent dwellings are commonly renovated between tenants, including customisation for new tenants in some cases.

continue to be deducted indefinitely. Residential property that was built and received a code compliance certificate on or after 27 March 2020 is exempt from the interest limitation rules for 20 years to mitigate the impact of the rules on new build housing supply.

44. We recommend that an exemption from the interest limitation rules applies from 1 October 2021. This means that taxpayers who hold existing build-to-rent assets are not subject to the rules for the short period of 1 October 2021 to 31 March 2022, before then being exempt from them. This retrospective application would result in lost revenue of only $100,000, which is low due to the few assets that are likely to meet the build-to-rent asset definition (representing approximately 500 dwellings) and the fact that interest deductions are only partially denied for the period in question.

Examples of the value of interest limitation to the build-to-rent sector

45. The overall net present value (NPV) tax benefit of providing an exemption from interest limitation rules for build-to-rent assets is illustrated in the following example. The example assumes the investor has a new build-to-rent asset which is initially worth $15 million, and they borrow 50 percent of the cost of the asset.[6]

    45.1 The **new build exemption** from interest limitation already provides the investor with a NPV tax benefit of $1,570,239, which corresponds to the investor's initial 20 years of interest deductions.

    45.2 Providing an **in-perpetuity exemption** for build-to-rent assets would enable the investor to continue to deduct interest for another 30 years after the new build exemption expires. The NPV tax benefit of those extra interest deductions would be an additional **$730,008**, which is 4.87 percent of the value of the build-to-rent asset.

46. For freehold developments, the perpetual exemption does not provide a financial benefit. However, if such a development is sold to a new owner that used interest-bearing finance, they would have to assure themselves and Inland Revenue that the build-to-rent asset met all the requirements of the asset class definition to qualify for the tax benefit.

The impact of inflation

47. Because our tax system is not indexed for inflation, deductions for interest expenses are made up of two components: the real component, which is, effectively, the interest rate that the borrower would be charged in the absence of inflation, and the inflation component. Together these components make up the nominal interest rate.

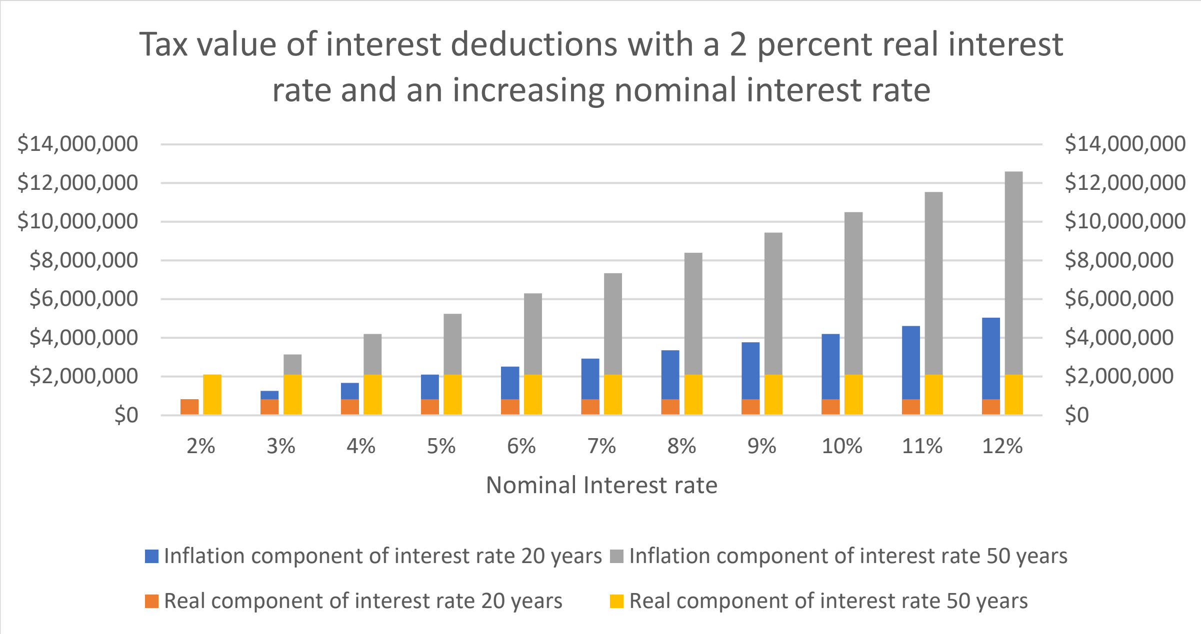
48. Allowing deductions for the nominal interest rate is in part allowing a deduction for inflation as well as the real cost of borrowing. Investors in new build-to-rent properties will be able to deduct expenses for the nominal interest rate for the first 20 years under the current settings of the interest limitation rules.

[6] The example also assumes that the asset will be held by the investor for 50 years.

49. If an in-perpetuity exemption is introduced for build-to-rent assets, these investors would be able to deduct the nominal interest rate for the life of their investment. A 50-year time horizon is assumed as a proxy for in-perpetuity.

50. In periods of high inflation, and if the real component of the nominal interest rate is constant, the deductions for the inflation component on any asset that grows in value will be greater relative to the real component. This is illustrated in figure 1 below.[7]

Figure 1



51. The vertical axis shows the value of the tax deductions to the build-to-rent investor. The horizontal axis shows the nominal interest rate. For example, assume the nominal interest rate is 7 percent in figure 1. In this analysis, the real component of interest is assumed to be constant at 2 percent over time. The inflation component is therefore 5 percent.

52. The vertical bars reflect the total value of the tax deductions separated into the real component and the inflation component for two scenarios: where nominal interest is deductible for the first 20 years (blue/orange) and where the nominal interest is deductible for 50 years (grey/yellow). 50 years has been taken as a proxy for interest deductions in-perpetuity.

53. In the example where the nominal interest rate is 7 percent:

53.1 the value of the tax deductions for interest for a **20-year period** is $2.94 million. This is made up of real interest deductions of $840,000 and deductions for the inflation component of $2.1 million

[7] Figure 1 assumes the value of the build-to-rent asset is $15 million, the asset rate is 50 percent debt funded (making total borrowings $7.5 million) and the tax rate of the investor is 28 percent (corporate tax rate).

53.2 the value of the tax deductions for interest for a **50-year period** is $7.35 million. This is made up of real interest deductions of $2.1 million and deductions for the inflation component of $5.25 million.

54. The key points from this analysis are that:

54.1 under the current settings for the interest limitation rules, build-to-rent investors will be able to deduct their nominal interest expenses for 20 years for new builds

54.2 allowing interest deductions for 50 years (which is used as a proxy for in-perpetuity) increases the value of the deductions for any given rate of inflation

54.3 as inflation rises, deductions for the inflation component also rise relative to the real interest component under both the 20-year and 50-year exemptions

54.4 a longer exemption means a greater proportion of the deductions for nominal interest is made up of the inflation component rather than the real interest component.

55. Investors who hold build-to-rent assets will also be subject to the relevant bright-line test. If investors sell within their bright-line period, they will be taxed on any gains made. If sold outside the bright-line period any capital gains will not be taxed. A portion of these gains will be due to inflation.

Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development comment

56. Te Tūāpapa Kura Kāinga **recommends** an exemption for build-to-rent assets. The current 20-year limit for new builds reduces the long-term cashflow for build-to-rent assets, affecting development decisions and leading to less upfront investment in new build-to-rent. Extending interest limitation for build-to-rent assets addresses the pain point for initial investment in build-to-rent assets by matching Aotearoa New Zealand's interest limitation to the same setting as for build-to-rent investment opportunities overseas. Exempting build-to-rent assets from the interest limitation rules remains consistent with the policy intent of the initial change to interest limitation which was to reduce speculation on existing housing and incentivise investment in new housing.

57. Te Tūāpapa Kura Kāinga notes the effects of inflation on interest limitation apply to all assets which appreciate in value, including commercial and government assets. Te Tūāpapa Kura Kāinga also notes that changes to the Residential Tenancies Act are not required at this stage, but 10-year tenures may require build-to-rent-specific legislation once the in-perpetuity exemption is operational and tenancy issues emerge.

58. A longer tenure requirement (i.e., longer than three years) may impact negatively on uptake of the exemption and therefore on delivery of build-to-rent as the additional costs of longer tenures may outweigh the benefit of the exemption for build-to-rent providers.

Inland Revenue comment

59. Inland Revenue does **not** recommend an exemption for build-to-rent assets. A key purpose of the interest limitation rules is to discourage investment in existing residential rental property. Inland Revenue considers that there is no inherent

difference between investors in build-to-rent assets and smaller residential investors apart from scale. Therefore, concessionary treatment for large scale investors would be inequitable. Further, new build-to-rent assets already benefit from a 20-year exemption from the interest limitation rules.

The Treasury comment

60. The Treasury does **not** recommend an exemption for build-to-rent assets. The sector will largely be comprised of new build developments that will already receive a 20-year exemption, and there is little evidence that the sector requires additional financial support via the tax system. The sector continues to expand in full knowledge of the tax changes, and several public funding-streams are available to directly support its continued development without the complexity outlined in this paper.

Implementation

61. Providing an exemption from the interest limitation rules would require a schedule of build-to-rent assets that meet the prescribed definition. This schedule would need to be monitored on an ongoing basis. It would need to be accessible by Inland Revenue each tax year, so that Inland Revenue is aware of which taxpayers can claim interest deductions for build-to-rent assets, when these taxpayers first satisfied the criteria, and if these taxpayers cease to meet the criteria.

62. Te Tūāpapa Kura Kāinga and Inland Revenue will assess options for a regulator.

Financial Implications

63. The fiscal impact of applying an exemption from interest limitation to new or existing build-to-rent assets is set out in the table below. New build-to-rent developments are already within the scope of the new build exemption from the recently introduced interest limitation rules, so there would be no additional cost over the forecast period if the exemption were to apply to new build-to-rent developments only.

64. However, if existing build-to-rent developments were also exempted from the interest limitation rules from 1 October 2021, there would be a reduction in tax revenue, with a corresponding impact on the operating balance and net debt. The reduction in tax revenue does not materialise until 2022/23 because their tax returns for 2021/22 are not filed until 2022/23. This would represent a pre-commitment of the operating allowance for Budget 2023 and will require a budget bid.

Exemption for new and existing build-to-rent assets:

	$m - increase/(decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax revenue	(0.000)	(0.500)	(0.600)	(1.000)
Total Operating	**0.000**	**0.500**	**0.600**	**1.000**

Legislative Implications

65. Implementing these proposals requires changes to the Income Tax Act 2007.

66. If approved, we propose including the legislative changes resulting from these recommendations in the August Omnibus Tax Bill, scheduled for introduction in August 2022.

Impact Analysis

Regulatory Impact Assessment

67. The Quality Assurance panel at Inland Revenue has reviewed the *Comparing Options to Support Build-to-Rent* Regulatory Impact Assessment prepared by Inland Revenue and considers that the information and analysis summarised in the Regulatory Impact Assessment **meets** the quality assurance criteria.

Climate Implications of Policy Assessment

68. Encouraging build-to-rent has general climate policy implications:

    68.1 construction in general produces emissions, and build-to-rent construction will likely emit more carbon due to the amount of concrete and steel required in higher-density developments

    68.2 build-to-rent assets are likely to support lower emission lifestyles for residents, due to favourable factors like links to public transport and cycleways, fewer carparks, and less reliance on cars/roading in developments and being developed to up-to-date energy and emissions efficiency standards.

69. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

70. The proposal does not impact negatively on any population groups; however parts of the proposal take into consideration the housing context of relevant population groups.

71. The size of build-to-rent assets (20 dwellings) reduces the barrier to development in smaller regional centres. While this does not directly address rental supply in rural areas, it enables build-to-rent developments at a smaller scale than is typical overseas (which tend towards requiring 50 or 100 dwellings). This means rural or smaller communities –including iwi Māori – are not excluded from this housing product.

72. Children and people with disabilities have been considered in the design of the minimum tenure requirement, as low tenure security heavily affects outcomes for these population groups. However, we note it will be decades before enough build-to-rent dwellings are supplied to effect population-level outcomes.

73. Māori, Pacific peoples, and ethnic communities are considered by enabling build-to-rent flexibility to provide different housing typologies. Although we expect the build-to-rent sector to focus on supplying more one- and two-bedroom dwellings, there are opportunities for development of larger dwellings that aim to provide housing to multigenerational whānau and family units of other ethnicities.

74. Women (especially women who experience multiple and intersecting forms of disadvantage, including wāhine Māori, Pacific women, Asian women, and disabled women) rate lower across most wellbeing measures, including housing, and are likely to benefit from an increased investment in rental supply. Rental models such as build-to-rent have features which are likely to better support women, as well as their whānau. This includes security of tenure, quality, affordability, and accessibility.

Human Rights

75. There are no inconsistencies between this proposal and the Human Rights Act 1993.

Consultation

76. Some submissions to the Finance and Expenditure Committee on the interest limitation proposals were in favour of a specific exemption for build-to-rent assets. Submitters argued that when compared with regular residential rental accommodation, build-to-rent assets provide greater tenure security to tenants, do not compete with first home buyers and are more comparable to commercial assets (such as student accommodation or retirement villages). Additionally, they stressed that the industry will not grow without an in-perpetuity exemption from interest limitation.

77. Te Tūāpapa Kura Kāinga convened a build-to-rent reference group throughout 2021. This group provided input into the asset class policy and extending the exemption from interest limitation. Interest limitation removal and limits were characterised as a barrier to build-to-rent development. Build-to-rent stakeholders have also been consulted in one-to-one discussions about the key barriers. Feedback from some institutional investors was that interest limitation effectively determines whether investing in domestic build-to-rent is viable compared to international opportunities.

78. The following agencies were consulted in the development of the proposal in this paper: The Treasury, Ministry of Social Development, Te Puni Kōkiri, Kāinga Ora – Homes and Communities, Toitū Te Whenua Land Information New Zealand, Manatū Wāhine – Ministry for Women, Ministry for Pacific Peoples, Te Arawhiti and

Department of Internal Affairs. Department of the Prime Minister and Cabinet was informed.

Communications

79. We will make an announcement on the contents of the August Omnibus Tax Bill, including this proposal, when the Bill is introduced. A commentary on the Bill will also be released at this time on the Inland Revenue website.

Proactive Release

80. We propose to proactively release this Cabinet paper and associated minutes with appropriate redactions with the introduction of the August Omnibus Tax Bill. Key advice will be released within 30 working days of Cabinet making final decisions.

Recommendations

The Ministers of Housing and Revenue recommend that the Committee:

1. **agree** to introduce an in-perpetuity exemption from interest limitation for build-to-rent assets

2. **agree** that the exemption applies from 1 October 2021 to align with the introduction of the interest limitation rules

3. **agree** that the proposals are included in the August Omnibus Tax Bill, scheduled for introduction in August 2022

4. **note** that Ministers have already agreed to a build-to-rent asset class definition [SWC-21-MIN-0228 refers]:

    4.1 at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels

    4.2 the dwellings and any common land or facilities for those dwellings have a single owner

    4.3 dwellings can be held in one or more titles

    4.4 the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor)

    4.5 the dwellings are used or available for rent under the Residential Tenancies Act 1986

    4.6 the dwellings must have continuously been used as build-to-rent dwellings since they were constructed

5. **agree** to include a personalisation policies requirement in the definition of a build-to-rent asset class

5.1 explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986

6. **agree** to include a minimum tenure length requirement in the definition of a build-to-rent asset class

   6.1 tenants of a build-to-rent dwelling must be offered a fixed-term tenancy of at least 10 years with the ability to give 56 days' notice of termination, but may agree to or request other tenancy offers

7. **note** affordability requirements are not included in the asset class definition as the extended exemption past year 20 is not a sufficient or effective incentive

8. **agree** to include both existing and new build-to-rent developments in the in-perpetuity exemption from interest limitation

9. **note** the following changes because of the decision at recommendation 8 to exempt new and existing build-to-rent assets from the interest limitation rules, with a corresponding impact on the operating balance and net debt:

	$m - increase/(decrease)			
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax revenue	(0.000)	(0.500)	(0.600)	(1.000)
Total Operating	**(0.000)**	**0.500**	**0.600**	**1.000**

10. **agree** to manage the fiscal impact of the decision at recommendation 8 above as a pre-commitment against the Budget 2023 allowance

11. **agree** to delegate to the Minister of Housing and the Minister of Revenue the authority to make technical design decisions on the administration of the in-perpetuity exemption from interest limitation

Authorised for lodgement

Hon Dr Megan Woods
Minister of Housing

Hon David Parker
Minister of Revenue

Appendix A – previously agreed build-to-rent asset class definition

81. The Social Wellbeing Committee previously agreed to a build-to-rent asset class definition [SWC-21-MIN-0228 refers]. It included the following requirements:

    81.1 at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels

    81.2 the dwellings and any common land or facilities for those dwellings have a single owner

    81.3 dwellings can be held in one or more titles

    81.4 the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor)

    81.5 the dwellings are used or available for rent under the Residential Tenancies Act 1986

82. This paper seeks agreement to this above definition and including the following requirements:

    82.1 explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986

    82.2 tenants must be offered a fixed-term tenancy of at least 10 years with the ability to give 56 days' notice of termination, but they may agree to or request other tenancy offers.

DEV-22-MIN-0163

Cabinet Economic Development Committee

Minute of Decision

Exemption from Interest Limitation for Build-to-Rent Assets

Portfolios **Housing / Revenue**

On 27 July 2022, the Cabinet Economic Development Committee:

1 **agreed** to introduce an in-perpetuity exemption from interest limitation for build-to-rent assets;

2 **agreed** that the exemption apply from 1 October 2021 to align with the introduction of the interest limitation rules;

3 **agreed** that the above proposals be included in the next Omnibus Tax Bill, which is scheduled for introduction in August 2022;

4 **noted** that on 15 December 2021, the Cabinet Social Wellbeing Committee agreed to the following components that could be included in the build-to-rent asset class definition:

4.1 at least 20 dwellings in one or more buildings that comprise a single development, on either a single parcel of land or multiple contiguous parcels;

4.2 the dwellings and any common land or facilities for those dwellings have a single owner;

4.3 dwellings can be held in one or more titles;

4.4 the building that a build-to-rent dwelling is in can include other dwellings or commercial premises that do not form part of the build-to-rent development (for example, an apartment block that has shops on the ground floor);

4.5 the dwellings are used or are available for rent under the Residential Tenancies Act 1986;

4.6 the dwellings must have continuously been used as build-to-rent dwellings since they were constructed;

[SWC-21-MIN-0228]

5 **agreed** to include a personalisation policies requirement in the definition of a build-to-rent asset class, namely that explicit personalisation policies must be offered, over and above the Residential Tenancies Act 1986;

6 **agreed** to include a minimum tenure length requirement in the definition of a build-to-rent asset class, namely that tenants of a build-to-rent dwelling must be offered a fixed-term tenancy of at least 10 years with the ability to give 56 days' notice of termination, but may agree to, or request, other tenancy offers;

7 **noted** that affordability requirements are not included in the asset class definition as the extended exemption past year 20 is not a sufficient or effective incentive;

8 **agreed** to include both existing and new build-to-rent developments in the in-perpetuity exemption from interest limitation;

9 **authorised** the Minister of Housing and the Minister of Revenue to make technical design decisions on the administration of the in-perpetuity exemption from interest limitation;

Financial implications

10 **noted** the following changes, as a consequence of paragraph 8 above to exempt new and existing build-to-rent assets from the interest limitation rules, with a corresponding impact on the operating balance and net debt:

	$m - increase/(decrease)			
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Tax revenue	(0.000)	(0.500)	(0.600)	(1.000)
Total operating	**(0.000)**	**0.500**	**0.600**	**1.000**

11 **agreed** to manage the fiscal impact of the decision in paragraph 8 above as a pre-commitment against the Budget 2023 allowance.

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Dr Megan Woods
Hon David Parker
Hon Willie Jackson
Hon Michael Wood
Hon Kiri Allan
Hon Dr David Clark
Hon Dr Ayesha Verrall
Hon Priyanca Radhakrishnan
Hon Meka Whaitiri
Hon Phil Twyford
Hon Kieran McAnulty
Rino Tirikatene, MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV

Document 30

CAB-22-MIN-0280

Cabinet

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Report of the Cabinet Economic Development Committee: Period Ended 29 July 2022

On 1 August 2022, Cabinet made the following decisions on the work of the Cabinet Economic Development Committee for the period ended 29 July 2022:

Not in scope

DEV-22-MIN-0163	**Exemption from Interest Limitation for Build-to-Rent Assets** Portfolios: Housing / Revenue	CONFIRMED

Not in scope

Rachel Hayward
Acting Secretary of the Cabinet

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Draft Cabinet paper – Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for introduction**

Date:	3 August 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/354

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations **Authorise** the lodgement of the attached Cabinet paper	10am Thursday 18 August 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Melissa Siegel	Bill manager	s 9(2)(a) [redacted]
Jason Batchelor	Policy Advisor	

3 August 2022

Minister of Revenue

Draft Cabinet paper – Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for introduction

Summary

1. This report asks you to authorise for lodgement the attached Cabinet paper, and accompanying draft Bill and departmental disclosure statement with the Cabinet Office by 10am Thursday 18 August 2022 for consideration at the Cabinet Legislation Committee meeting on Thursday 25 August 2022.

2. The Cabinet paper seeks approval to introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill ("the Bill") on 30 August 2022 and recommends that at its First Reading, the Bill is referred to the Finance and Expenditure Select Committee.

3. This report seeks your agreement regarding changes to two proposed remedial amendments as well as amendments to the Platform Economy proposals, for which Cabinet delegated authority to you in consultation with the Minister of Finance to make technical decisions.

4. We have drafted the Cabinet paper and the Bill on the basis you agree to the recommendations in this report. Please advise if there are any changes to the Cabinet paper that you would like to make.

5. The Bill is currently with the Ministry of Justice for its Bill of Rights Act vetting. We will advise if any issues arise from this process.

6. The Bill contains the items listed below.

Policy items approved by Cabinet

7. The Bill contains amendments on the following matters, as previously agreed by Cabinet:

    7.1 Setting of annual rates of income tax for the 2022–23 tax year [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

    7.2 Taxation of the Platform Economy [CBC-22-MIN-0037 (4 July 2022) and CAB-22-MIN-0266 (25 July 2022)].

    7.3 GST on management services supplied to managed funds [DEV-22-MIN-0134 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

    7.4 GST apportionment and adjustment rules [DEV-22-MIN-0135 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

    7.5 GST status of legislative charges [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

    7.6 Cross-border workers reform [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

7.7 Dual resident companies [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

7.8 Granting nine charities overseas donee status year [DEV-22-MIN-0050 (30 March 2022) and CAB-22MIN-0105 (4 April 2022), and DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

7.9 Fringe benefit tax exemption for public transport [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

7.10 Build-to-rent exemption from interest limitation [DEV-22-MIN-0163 (27 July 2022) and CAB-22-MIN-0280 (1 August 2022)].

Remedial items approved by Minister of Revenue

8. The Bill contains a number of remedial amendments you have previously agreed to in the following reports:

8.1 Remedials for foreign trusts (5 May 2022, IR2022/079).

8.2 Non-fiscal remedial items for the August 2022 omnibus taxation bill (12 May 2022, IR2022/255).

8.3 Priority accorded to KiwiSaver employer contributions (1 June 2022, IR2022/248).

8.4 Remedials with fiscals for inclusion in the August 2022 taxation bill (2 June 2022, IR2022/282).

8.5 Housing remedials for August 2022 tax bill (10 June 2022, IR2022/293).

8.6 Network expenditure tax treatment (16 June 2022, IR2022/312).

8.7 R&D Tax Incentive: Notification of changes in activities (16 June 2022, IR2022/315).

8.8 Allocation of subdivided land and unit titles among co-owners under the bright-line test and land-sale rules (17 June 2022, IR2022/318).

Further approvals sought

Technical changes to the Platform Economy proposals

9. Cabinet delegated authority to the Minister of Revenue, in consultation with the Minister of Finance, to make technical decisions to give effect to the Platform Economy proposals [CBC-22-MIN-0037 (4 July 2022) and CAB-22-MIN-0266 (25 July 2022)]. We seek your agreement on three issues using this delegated authority.

Threshold for opt-out agreements for large commercial enterprises supplying accommodation

10. The Bill includes amendments to require the operator of an electronic marketplace to collect GST on taxable accommodation provided through the electronic marketplace (for example, electronic accommodation marketplaces, such as Booking.com, would need to collect GST on behalf of hotels that listed rooms through them).

11. Cabinet agreed that large commercial providers of accommodation, defined as a provider that offered more than 500 listings per year on an electronic marketplace, could enter into agreements with the operator of the marketplace that enabled them to continue returning GST themselves (an "opt-out agreement"). This is intended to reduce the compliance costs associated with having to change accounting systems and practices for large commercial providers of accommodation who will already be returning GST on the accommodation they provide through electronic marketplaces.

12. In drafting the amendments for the Bill, it became evident that this threshold may not be appropriate in all circumstances. For example, a person who provides short-stay accommodation through an electronic marketplace could satisfy this requirement with only two units available for rent. This would result in them meeting the criteria to enter into an opt-out agreement which is not intended.

13. To ensure the proposed amendments achieve the policy objective for large commercial accommodation providers and do not inadvertently enable smaller accommodation providers to enter into opt-out agreements, we recommend that a person who provides more than 2,000 nights of accommodation[1] through an electronic marketplace be able to enter into an opt-out agreement with the operator of the electronic marketplace.

14. There may be some motels, for example, that do not meet this threshold. We therefore also recommend that the Commissioner of Inland Revenue be able to determine other circumstances in which a provider of accommodation meets the criteria to enter into an opt-out agreement. In determining the circumstances, the Commissioner would be required to consider the compliance costs that would be imposed on taxpayers who would need to make changes to their accounting systems and practices, and the size and scale of the accommodation providers' activities. The determination could be made following a period of public consultation.

Enabling the Commissioner to disclose a person's GST registration status for the effective operation of the proposed flat-rate scheme

15. Cabinet also agreed to a flat-rate scheme which would require operators of electronic marketplaces to pass on a flat-rate credit to the underlying suppliers of taxable accommodation and transportation services in recognition of the unrecoverable GST on those suppliers' costs in circumstances where those suppliers are not registered for GST. To address the risk that a person may misrepresent their GST registration status to the operator of an electronic marketplace to obtain the flat-rate credit, we recommend the Commissioner be able to disclose a person's GST registration status to the operator of an electronic marketplace and that the that the confidentiality rules be amended to allow the Commissioner to disclose this information.

Remedial and maintenance amendments

16. We seek your agreement for the following remedial items:

    16.1 You previously agreed to a remedial amendment relating to the look-through company rules to clarify that a look-through company (LTC) has the same acquisition date for its assets as the superseded company (IR2022/293 refers). The proposed application date was the 2017–18 and later income years to align with other changes to the LTC regime. However, the proposed

[1] This threshold is used in the Organisation for Economic Co-operation and Development's reporting standards for digital platforms in defining a large provider of commercial accommodation for income tax reporting purposes.

amendment should apply from 1 April 2011, being the original application date of the relevant provision.

16.2 A remedial amendment was previously approved (by the Parliamentary Under-Secretary to the Minister of Revenue) to clarify that, for the Research & Development Tax Incentive (RDTI), notifications must be provided if there is a material change in a business' activities from what had originally been approved (IR2022/315 refers). This clarification was to be made for general approvals of R&D activities. The proposed amendment should also apply for criteria and methodologies approvals as well. This would have no practical effect on how the RDTI is administered but ensures that the draft legislation is consistent for all types of applications to avoid any confusion.

17. A number of minor maintenance items that have arisen during the Bill's compilation (for example, correcting minor faults of expression, reader's aids, incorrect cross-references, and repealing redundant provisions). We recommend that these be included in the Bill.

Item not included in the Bill

18. One remedial item that was previously approved by the Parliamentary Under-Secretary to the Minister of Revenue and endorsed by yourself has not been included in the Bill.

19. The application date for the petroleum decommissioning changes in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 has not been amended from the date of enactment (30 March 2022) to income years commencing on or after 30 March 2022 (IR2022/255 refers). As these changes did not include an application date provision this could only be achieved by repealing all of the changes and reintroducing them with the correct application date. As noted in IR2022/255, it is not expected any petroleum miners will use these provisions for the 2021–22 income year.

Departmental disclosure statement

20. A draft departmental disclosure statement is attached to accompany the Cabinet paper in accordance with Cabinet guidelines. The draft departmental disclosure statement is referred to Cabinet along with the Cabinet paper.

21. The departmental disclosure statement must be finalised by Inland Revenue and sent to the Parliamentary Counsel Office two working days before the introduction of the Bill. It will be made publicly available when the Bill is introduced.

New Zealand Bill of Rights Act 1990

22. We believe the provisions in the Bill are consistent with the rights and freedoms affirmed by the New Zealand Bill of Rights Act 1990 (BORA). The Ministry of Justice is currently undertaking the required BORA vetting. Although not expected, we will advise if any issues arise from this process.

Caucus consultation

23. We recommend that the Bill is introduced in the House shortly after Cabinet approves it for introduction. To achieve this, caucus consultation will need to occur in advance of Cabinet's final decision.

24. We can provide you with additional information on the contents of the Bill to support your office's caucus consultation in relation to the introduction of the Bill.

Proactive release

25. We propose to proactively release the Cabinet paper, Cabinet minutes and key advice papers after the Bill is introduced.

Next steps

26. We have drafted the attached Cabinet paper and associated documents on the basis that you agree to the recommendations in this report. Please advise if there are any changes to the paper that you wish to make.

27. To be considered at the Cabinet Legislation Committee meeting on Thursday 25 August 2022, the Cabinet paper needs to be lodged with the Cabinet Office by 10am on Thursday 18 August 2022.

28. We will liaise with your office to arrange appropriate publicity for the introduction of the Bill.

Treasury consultation

29. Treasury were informed about this report.

Recommended action

We recommend that you:

1. **Note** the contents of this report, attached draft Cabinet paper, draft *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill* ("the Bill"), and draft departmental disclosure statement.

   Noted

Platform Economy changes

2. **agree** that a person that provides more than 2,000 nights of accommodation through an electronic marketplace can enter into an agreement with the operator of the marketplace enabling them to remain responsible for their own GST obligations (rather than the operator of the marketplace).

   Agreed/Not agreed

3. **agree** that the Commissioner of Inland Revenue be able to determine the other circumstances in which a person may meet the criteria to enter into an opt-out agreement with the operator of an electronic marketplace.

   Agreed/Not agreed

4. **agree** that the Commissioner of Inland Revenue can disclose a person's GST registration status to the operator of an electronic marketplace to ensure the effective operation of the proposed flat-rate scheme.

   Agreed/Not agreed

Further remedial and maintenance amendments

5. **Agree** that the proposed amendment to the look-through company (LTC) rules clarifying that a LTC has the same acquisition date for its assets as the superseded company should apply from 1 April 2011.

   Agreed/Not agreed

6. **Agree** that the proposed changes to the notification requirement for general approvals in the Research and Development Tax Incentive should also apply to criteria and methodologies approvals.

   Agreed/Not agreed

7. **Note** that a proposed amendment relating to the application date for the petroleum decommissioning changes previously agreed to by you and the Parliamentary Under-Secretary to the Minister of Revenue has not been included in the Bill.

   Noted

8. **Agree** that a number of minor maintenance items that have arisen during the Bill's compilation (for example, correcting minor faults of expression, reader's aids, incorrect cross-references, and repealing redundant provisions) be included in the Bill.

   Agreed/Not agreed

Next steps

9. **Agree** to the proactive release of the Cabinet paper, Cabinet minutes and key advice papers after the Bill is introduced.

   Agree/Not agreed

10. **Authorise** the lodgement of the attached Cabinet paper and associated documents with the Cabinet Office by 10am Thursday 18 August 2022.

    Authorised/Not authorised

s 9(2)(a)

Melissa Siegel
Bill Manager
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

In Confidence

Office of the Minister of Revenue

Chair, Cabinet Legislation Committee

TAXATION (ANNUAL RATES FOR 2022–23, PLATFORM ECONOMY, AND REMEDIAL MATTERS) BILL: APPROVAL FOR INTRODUCTION

Proposal

1. This paper seeks Cabinet Legislation Committee agreement to introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill on 30 August 2022. The Bill introduces amendments to the:

    1.1 Income Tax Act 2007;

    1.2 Income Tax Act 2004;

    1.3 Tax Administration Act 1994;

    1.4 Goods and Services Act 1985;

    1.5 Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022;

    1.6 Companies Act 1993;

    1.7 Insolvency Act 2006.

2. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill holds a category 4 priority on the 2022 Legislative Programme (to be referred to a select committee in the year).

Policy

3. The Bill implements the policy items listed below. A Bill is necessary as amendments to existing legislation are required to implement the proposed policy changes.

Policy items with Cabinet approval

Setting of annual rates of income tax for the 2022–23 tax year [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

4. The Income Tax Act 2007 requires the rates of income tax to be set each tax year by an annual taxing Act.

5. The Bill proposes that the annual rates of income tax for the 2022–23 tax year be set at the rates currently specified in schedule 1, part A of the Income Tax Act 2007.

Taxation of the platform economy [CBC-22-MIN-0037 (4 July 2022) and CAB-22-MIN-0266 (25 July 2022)]

6. The Bill implements rules designed by the Organisation for Economic Co-operation and Development (OECD) that were developed in response to the rapid growth of the digital economy and calls for a global reporting framework in respect of activities being facilitated by digital platforms in the gig and sharing economy (also known as the "platform economy").

7. It implements an international information reporting and exchange framework designed by the Organisation for Economic Co-operation and Development. This will improve Inland Revenue's access to information from digital platforms about income earned by sellers in the sharing and gig economy (in relation to accommodation rentals, personal services, vehicle rentals, and the sale of goods). This would apply for the 2024 calendar year, with the first exchange occurring in 2025.

8. It will require operators of electronic marketplaces to collect and return GST on supplies of taxable (short-stay) accommodation, and certain transportation services (ride-sharing and beverage and food delivery services) from 1 April 2024. These rules include:

   8.1 Opt-out agreements that enable large commercial enterprises that supply taxable accommodation through electronic marketplaces to enter into agreements with marketplace operators that they remain responsible for collecting and returning GST on the accommodation they provide.

   8.2 A flat-rate scheme that requires marketplace operators to pass on a flat-rate credit of 8.5% of the consideration for the services supplied through an electronic marketplace to the underlying supplier, where the underlying supplier is not registered for GST. This is to recognise the otherwise unrecoverable GST on the costs these underlying suppliers will have incurred in making these supplies through the marketplace.

GST status of legislative charges [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

9. The Bill proposes amendments to clarify the GST treatment of charges paid under New Zealand Acts and regulations ("legislative charges"). The proposed amendments are intended to reflect that under New Zealand's broad-based GST framework, GST applies to the broadest possible range of goods and services supplied in New Zealand.

10. The Bill proposes to amend the Goods and Services Tax Act 1985 to introduce a rule that would treat all legislative charges as consideration for a supply of goods and services. This is to remove the doubt that can exist in determining whether legislative charges are "in respect of, in response to, or for the inducement of" a supply of goods and services. This would apply to legislative charges that come into force after 1 July 2023, and all other legislative charges on 1 July 2026.

11. The Bill also proposes a schedule of non-taxable legislative charges which could be amended in the future to include a reference to specific charges, or classes of charges, that should not be subject to the proposed rule. A transitional regulation-making power is proposed that would enable an Order in Council to be made on the recommendation

of the Minister of Revenue to add specific charges, or classes of charges, to this proposed schedule until 30 June 2026.

GST on management services supplied to managed funds [DEV-22-MIN-0134 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

12. The Bill proposes that services supplied by managers and investment managers to managed funds and retirement schemes would be subject to 15% GST. These amendments include repealing the existing exemption for management services supplied to retirement schemes, and would ensure consistent GST treatment for management services supplied to both managed funds and retirement schemes.

13. These amendments would apply from 1 April 2026; however, managers and investment managers that supply services to managed funds would have discretion to continue with their existing GST treatment until 1 April 2026, as well as the option to transition to the new rules before 1 April 2026.

GST apportionment and adjustment rules [DEV-22-MIN-0135 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

14. The Bill includes a proposed reform of GST apportionment and adjustment rules which is designed to reduce compliance costs, improve fairness in tax outcomes between different types of ownership structures and arrangements, and better align the rules with current taxpayer practices.

Cross border worker reform [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

15. This Bill proposes to modernise and clarify the application of the pay-as-you-earn (PAYE) withholding tax, fringe benefit tax (FBT), employer's superannuation contribution tax (ESCT) and non-resident contractors' tax (NRCT) rules to employers and payers of cross-border workers. The overall policy package aims to reduce the cost of compliance and to enable greater flexibility in the rules.

Dual resident companies [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

16. The Bill proposes amendments relating to companies that are both tax resident in New Zealand and another jurisdiction ("dual resident companies").

17. The first series of amendments seeks to resolve uncertainty created by Australia's recent changes to the application of its corporate residency tax rules, which may result in more New Zealand companies being tax resident in Australia. The proposed amendments would ensure affected New Zealand companies have uninterrupted access to New Zealand's loss grouping, consolidation and imputation credit regimes.

18. The second series of amendments seek to resolve integrity issues with the application of the domestic dividend exemption and corporate migration rules to dual resident companies. The amendments to the domestic dividend exemption and the corporate migration rules are targeted at arrangements which have a tax integrity risk, while limiting potential overreach and compliance costs.

Granting nine charities overseas donee status year [DEV-22-MIN-0050 (30 March 2022) and CAB-22MIN-0105 (4 April 2022)] and [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

19. The Bill proposes nine New Zealand charities with overseas charitable purposes be granted overseas donee status and listed in schedule 32 of the Income Tax Act 2007. The status would mostly have effect from 1 April 2022, with a few exceptions where it proposes charities be given an earlier application date in response to their fundraising for disaster relief in Tonga, and the humanitarian crisis in Ukraine.

20. The Bill also proposes to change the name of an already listed charity as the result of a restructure.

Fringe benefit tax exemption for public transport [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

21. The Bill proposes a fringe benefit tax exemption for public transport. The exemption would cover fares on bus, train, ferry, tram, or cable car services subsidised by an employer mainly for the purpose of their employee travelling between their home and place of work.

Build-to-rent exemption from interest limitation [DEV-22-MIN-0163 (27 July 2022) and CAB-22-MIN-0280 (1 August 2022)]

22. The Bill proposes that build-to-rent (BTR) assets be exempt in-perpetuity from the interest limitation rules. This would allow investors to continue to deduct interest on loans relating to BTR assets for as long as they meet the asset class definition. This exemption would ensure the interest limitation rules do not disincentivise investment in BTR developments, increasing their ability to contribute to quality rental supply in Aotearoa New Zealand.

Items not requiring Cabinet approval

23. The Bill also includes a range of remedial amendments that I recommend be included in the Bill. These cover a range of tax issues and typically ensure that the relevant tax laws are consistent with their policy intent. The amendments do not involve any significant policy change and do not require Cabinet approval. The amendments do not have any material revenue or other fiscal effects.

Minor remedial and maintenance items

24. The Bill also contains a number of minor remedial and maintenance items. These correct minor faults of expression, reader's aids, and incorrect cross-references.

Impact Analysis

25. Regulatory impact statements (RISs) were prepared, where required, for the policy items in the Bill. These were submitted at the time that Cabinet approval for the policy items was sought. These RISs are:

    25.1 *Taxation of the gig and sharing economy: GST*, Inland Revenue, 25 May 2022;

    25.2 *Taxation of the gig and sharing economy: Information reporting and exchange*, Inland Revenue, 25 May 2022;

25.3 *GST status of statutory and regulatory charges*, Inland Revenue, 2 June 2022;

25.4 *GST on management services supplied to managed funds*, Inland Revenue, 25 May 2022;

25.5 *GST apportionment and adjustment rules*, Inland Revenue, 26 May 2022;

25.6 *Comparing options to support build-to-rent*, Inland Revenue, 29 June 2022;

25.7 *Cross-border workers tax reform*, Inland Revenue, 25 May 2022; and

25.8 *Fringe benefit tax exemption for public transport*, Inland Revenue, 31 May 2022.

Compliance

26. The Bill complies with:

26.1 the principles of the Treaty of Waitangi;

26.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

26.3 the disclosure statement requirements (the draft disclosure statement is attached);

26.4 the principles and guidelines set out in the Privacy Act 1993;

26.5 relevant international standards and obligations;

26.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

27. The main policy measures within this Bill have been developed in accordance with the Generic Tax Policy Process (GTPP). It is a very open and interactive engagement process between the public and private sectors. This process helps to ensure that tax and social policy changes are well thought through. The GTPP is designed to ensure better, more effective policy development through the early consideration of all aspects, and likely impacts, of proposals. The GTPP increases opportunities for public consultation.

28. The GTPP means that major tax initiatives are normally subject to public scrutiny at all stages of their development. As a result, Inland Revenue and Treasury officials have the opportunity to develop more practical options for reform by drawing on information provided by the private sector and the people who will be affected.

Relevant Government Departments or Other Public Bodies

29. The Treasury was consulted on the development of many of the proposals in the Bill. Other government departments and public bodies were also consulted on relevant aspects of the proposals where appropriate, including the Ministry of Business, Innovation and Development, the Department of Internal Affairs, and the Ministry of

Justice. Feedback from government departments and public bodies was used to develop and refine these proposals.

Relevant Private Sector Organisations and Public Consultation Processes

30. A number of the proposals in the Bill were subject to public consultation, which was undertaken in various forms. In addition, private sector organisations were consulted on specific matters of relevance to them. The feedback provided by these stakeholders was taken into account when finalising policy proposals. The attached draft disclosure statement provides further information on the various parties consulted and the form in which consultation was undertaken for the policy items in the Bill.

The Government Caucus and Other Parties Represented in Parliament

31. The Government caucus will be consulted on this Bill before its proposed introduction.

Binding on the Crown

32. A number of Inland Revenue Acts currently bind the Crown (including the Income Tax Act 2007). This amending Bill does not alter the status quo in this respect – the amendments follow the position of the principal Acts.

Allocation of Decision Making Powers

33. The Bill proposes to introduce a transitional regulation-making power that would enable the Governor-General, on the recommendation of the Minister of Revenue, to add specific charges (or a class of charges) to the proposed schedule of non-taxable legislative charges. This transitional regulation making power was considered desirable to facilitate an orderly transition to the proposed new rules, which would ensure GST applied consistently to all legislative charges in New Zealand (except those that resembled fines, penalties, interest, and taxes themselves). It is possible that charges are identified during the transitional period (which ends on 30 June 2026) where there may be good tax policy reasons why the charge should not be subject to the proposed new rules. The Bill proposes that this transitional regulation-making power will expire on 30 June 2026.

34. The Bill also proposes to implement an OECD information reporting and exchange framework in relation to digital platforms and sellers in the gig and sharing economy. This information reporting and exchange framework may be amended from time to time. The Bill includes a regulation-making power that would enable the Governor-General to make an Order in Council to incorporate future changes made by the OECD to the information reporting and exchange framework. This is consistent with the approach taken for other OECD information reporting and exchange frameworks (for example, the Common Reporting Standard which relates to financial account information).

Associated Regulations

35. No regulations are required to bring the proposed Bill into operation.

Definition of Minister/Department

36. The Bill does not contain a definition of Minister, department, or chief executive.

Commencement of Legislation

37. Each provision of the Bill comes into force on the date specified in the Bill for that provision.

Parliamentary Stages

38. The Bill should be introduced on 30 August 2022, referred to the Finance and Expenditure Select Committee and reported back to the House by early March 2023.

39. As the Bill sets the annual income tax rates for the 2022–23 tax year, and because a number of the proposals in the Bill have an application date of 1 April 2023, the Bill should be enacted by the end of March 2023.

Communications

40. I will make an announcement about the proposals in the Bill when it is introduced. A commentary on the Bill will also be released at this time. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

Proactive Release

41. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Committee:

1. note that the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill holds a category 4 priority on the 2022 Legislative Programme (to be referred to a select committee in the year);

2. note that the Bill sets the annual income tax rates for the 2022–23 tax year;

3. note that the Bill makes substantive, remedial, and technical amendments to the:

    3.1 Income Tax Act 2007;

    3.2 Income Tax Act 2004;

    3.3 Tax Administration Act 1994;

    3.4 Goods and Services Act 1985;

    3.5 Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022;

    3.6 Companies Act 1993;

3.7 Insolvency Act 2006.

4. approve the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;

5. agree that the Bill be introduced on 30 August 2022;

6. agree that the Government propose that the Bill be:

   6.1 referred to the Finance and Expenditure Committee for consideration;

   6.1 reported back to the House by early March 2023;

   6.2 enacted by 31 March 2022.

Authorised for lodgement

Hon David Parker
Minister of Revenue

LEG-22-MIN-0139

Cabinet Legislation Committee

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for Introduction

Portfolio **Revenue**

On 25 August 2022, the Cabinet Legislation Committee:

1 **noted** that the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (the Bill) holds a category four priority on the 2022 Legislative Programme (to be referred to a select committee in the year);

2 **noted** that the Bill sets the annual income tax rates for the 2022–23 tax year;

3 **noted** that the Bill makes substantive, remedial, and technical amendments to the:

3.1 Income Tax Act 2007;

3.2 Income Tax Act 2004;

3.3 Tax Administration Act 1994;

3.4 Goods and Services Act 1985;

3.5 Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022;

3.6 Companies Act 1993;

3.7 Insolvency Act 2006.

4 **approved** the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill [IRD 23489/3.0] for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;

5 **agreed** that the Bill be introduced on 30 August 2022;

6 **agreed** that the government propose that the Bill be:

6.1 referred to the Finance and Expenditure Committee for consideration;

6.2 reported back to the House by early March 2023;

6.3 enacted by 31 March 2022.

Rebecca Davies
Committee Secretary

Present:
Hon Andrew Little
Hon David Parker
Hon Stuart Nash
Hon Michael Wood (Chair)
Dr Duncan Webb, MP (Senior Government Whip)

Officials present from:
Office of the Prime Minister
Officials Committee for LEG

Cabinet

Minute of Decision

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Report of the Cabinet Legislation Committee: Period Ended 26 August 2022

On 29 August 2022, Cabinet made the following decisions on the work of the Cabinet Legislation Committee for the period ended 26 August 2022:

Not in scope

LEG-22-MIN-0139	**Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill: Approval for Introduction** Portfolio: Revenue	CONFIRMED

Not in scope

Not in scope

Rachel Hayward
Acting Secretary of the Cabinet

Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Draft Cabinet paper – Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)**

Date:	1 September 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/414

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations **Note** the contents of this report	10am Friday 2 September 2022
Minister of Revenue	**Agree** to recommendations **Note** the contents of this report **Authorise** the lodgement of the attached Cabinet paper by 10am Friday 2 September	10am Friday 2 September 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Peter Frawley	Policy Lead	s 9(2)(a)
Melissa Siegel	Bill Manager	

1 September 2022

Minister of Finance
Minister of Revenue

Draft Cabinet paper – Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)

Purpose

1. This report seeks your approval to lodge the attached Cabinet paper, which seeks Cabinet approval to:

    1.1 reverse a previous Cabinet decision to apply 15% GST to management services supplied to managed funds; and

    1.2 authorise the Minister of Revenue, in consultation with the Leader of the House, to introduce the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* as soon as practicable.

2. The *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* will be substantively the same as the now withdrawn *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill*, but would exclude the amendments relating to GST on management services supplied to managed funds.

Context and background

3. The Minister of Revenue has requested that the previous policy measure agreed to by Cabinet on GST on management services supplied to managed funds (CAB-22-MIN-0242; DEV-22-MIN-0134 refers) be removed from the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill* (the Bill).

4. Cabinet previously agreed that services supplied by managers and investment managers to managed funds and retirement schemes would be subject to 15% GST. This decision was taken on the basis that the current rules relating to the GST treatment of fund manager and investment manager fees are creating complexity and inconsistency across the managed funds industry.

5. The *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill* was introduced on 30 August 2022.

6. On 31 August 2022, the Minister of Revenue announced that this policy measure will no longer be included in the Bill and withdrew the Bill from the House.

7. Rather than reintroducing the same bill without the amendments relating to GST on management services supplied to managed funds, procedurally, a new bill needs to be introduced. The *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* would be substantively the same as its predecessor but would not include the amendments relating to GST on management services supplied to managed funds.

Financial implications

8. The proposal to not proceed with applying 15% GST on management services supplied to managed funds would have the following estimated fiscal impact, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Tax Revenue	-	-	-	(37.0)	(247.0)
Total operating	-	-	-	37.0	247.0

9. However, Cabinet previously agreed not to directly recognise any impact on the Budget 2023 operating allowance at the time of the previous decision, so reversing that decision has no impact on that allowance.

Consultation

10. The Treasury and Department of the Prime Minister and Cabinet were consulted on this report and the attached draft Cabinet paper.

Next steps

11. Attached to this report is a proposed paper to be taken direct to Cabinet on Monday 5 September. It seeks Cabinet's agreement to reverse its decision to apply 15% GST to management services supplied to managed funds and to authorise the Minister of Revenue, in consultation with the Leader of the House, to introduce the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* as soon as practicable.

12. This paper must be lodged by 10am Friday 2 September, so that Cabinet can consider it at its meeting on Monday 5 September.

13. We will provide the Minister of Revenue with a new draft Bill for introduction and accompanying draft disclosure statement as soon as possible. To ensure that the new Bill can have its first reading on Thursday 15 September, it should be introduced by Friday 9 September.

Recommended action

We recommend that you:

14. **Note** that Cabinet previously agreed that services supplied by managers and investment managers to managed funds and retirement schemes would be subject to 15% GST (CAB-22-MIN-0242; DEV-22-MIN-0134 refers).

Noted | Noted

15. **Agree** that this proposal should not proceed.

Agreed/Not agreed | Agreed/Not agreed

16. **Note** the following changes as a result of the decision in recommendation 15 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Tax Revenue	-	-	-	(37.0)	(247.0)
Total operating	-	-	-	37.0	247.0

Noted | Noted

17. **Note** that when Cabinet previously agreed to apply GST to management services supplied to managed funds, it deferred the recognition of any impact on the Budget 2023 operating allowance so reversing the policy decision has no impact on that allowance;

Noted | Noted

Next steps (Minister of Revenue only)

18. **Note** that the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill* introduced on 30 August 2022 was discharged on 31 August 2022.

Noted

19. **Agree** to take the attached paper direct to Cabinet on 5 September 2022 seeking Cabinet's agreement to the changes and to delegate authority to the Minister of Revenue, in consultation with the Leader of the House, to introduce the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)* ("the new Bill").

Agreed/Not agreed

20. **Authorise** the attached Cabinet paper for lodgement by 10am Friday 2 September.

Authorised/Not authorised

21. **Note** that the new Bill will be substantively the same as the *Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill*, but will not include the GST on fund manager and investment manager fees policy.

Noted

22. **Note** that we will provide you with a draft version of the new Bill and departmental disclosure statement as soon as possible.

Noted

23. **Agree**, subject to Cabinet approval, to introduce the new Bill as soon as practicable, in consultation with the Leader of the House.

Agreed/Not agreed

s 9(2)(a)

[redacted]

Peter Frawley
Policy Lead
Policy and Regulatory
Stewardship

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

In Confidence

Office of the Minister of Revenue

Chair, Cabinet

INTRODUCTION OF THE TAXATION (ANNUAL RATES FOR 2022–23, PLATFORM ECONOMY, AND REMEDIAL MATTERS) BILL (NO 2)

Proposal

1. This paper seeks Cabinet's agreement to not proceed with policy decisions previously taken by Cabinet on applying GST to management services supplied to managed funds [DEV-22-MIN-0134 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

2. I discharged the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill on 31 August 2022, which contained amendments relating to GST on management services supplied to managed funds.

3. This paper also seeks Cabinet's agreement to delegate authority to me to introduce a new bill, titled the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2), in consultation with the Leader of the House, as soon as practicable.

Executive Summary

4. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill was introduced on 30 August 2022. One of the policy measures proposed in that Bill was that services supplied by managers and investment managers to managed funds and retirement schemes would be subject to 15% GST [DEV-22-MIN-0134 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)].

5. Since the introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill, there has been strong public debate about the impact of the GST changes on the fees charged by managed funds and retirement scheme savings, such as KiwiSaver.

6. It is clear from the public's reaction to this proposal that it has caused concern for New Zealanders, which risked undermining confidence in KiwiSaver.

7. I have listened to these concerns, and I am recommending these proposals no longer proceed. I have announced that this policy item will not progress, and I am seeking Cabinet agreement to reverse its previous decision.

8. On 31 August 2022, I discharged the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill, and a new bill should be introduced in its place.

9. I propose that Cabinet delegate to me the authority to introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) ("the new Bill") as soon as practicable, in consultation with the Leader of the House.

Policy

GST on management services to managed funds

10. Cabinet agreed that management services supplied to managed funds should be subject to 15% GST on the basis that the current rules relating to the GST treatment of fund manager and investment manager fees are creating complexity and inconsistency across the managed funds industry. The amendments would have applied from 1 April 2026. Managers and investment managers that supply services to managed funds would have had the discretion to continue with their existing GST treatment until 1 April 2026, or the option to transition to the new rules before 1 April 2026. [DEV-22-MIN-0134 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]

11. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill included amendments that would subject services supplied by managers and investment managers to managed funds and retirement schemes to 15% GST. These amendments included repealing the existing exemption for management services supplied to retirement schemes, and would ensure consistent GST treatment for management services supplied to both managed funds and retirement schemes.

12. Following the introduction of the bill on 30 August 2022, there has been strong public debate about the impact of the GST changes on New Zealanders' retirement savings, in particular, KiwiSaver balances.

13. On 31 August 2022, I announced that this change will no longer proceed and the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill has been discharged.

14. As this was a policy previously agreed to by Cabinet, I seek Cabinet's agreement to reverse its previous decision.

Introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)

15. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) ("the new Bill") should be introduced as soon as practicable. The new Bill will be substantively the same as the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill, but will not contain the GST on management services to managed funds policy.

16. The new Bill holds a category 4 priority on the 2022 Legislative Programme (to be referred to a select committee in the year). The new Bill will set the annual rates of income tax for the 2022–23 tax year and should be enacted by the end of March 2023 [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]. I anticipate that the new Bill would be introduced by 9 September 2022, referred to the Finance and Expenditure Committee and reported back to the House by early March 2023.

17. In addition to setting the annual rates of income tax for 2022–23, the new Bill will implement the following policy items:

    17.1 Taxation of the platform economy [CBC-22-MIN-0037 (4 July 2022) and CAB-22-MIN-0266 (25 July 2022)];

    17.2 GST status of legislative charges [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)];

    17.3 GST apportionment and adjustment rules [DEV-22-MIN-0135 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)];

    17.4 Cross-border worker reform [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)];

    17.5 Dual resident companies [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)];

    17.6 Granting nine charities overseas donee status year [DEV-22-MIN-0050 (30 March 2022) and CAB-22MIN-0105 (4 April 2022)] and [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)];

    17.7 Fringe benefit tax exemption for public transport [DEV-22-MIN-0132 (22 June 2022) and CAB-22-MIN-0242 (27 June 2022)]; and

    17.8 Build-to-rent exemption from the interest limitation rules [DEV-22-MIN-0163 (27 July 2022) and CAB-22-MIN-0280 (1 August 2022)].

18. The new Bill will also include a range of remedial amendments that cover a range of tax issues and typically ensure that the relevant tax laws are consistent with their policy intent. The amendments do not involve any significant policy change and do not require Cabinet approval. The amendments do not have any material revenue or other fiscal effects.

19. In order to expedite the process, I seek Cabinet's agreement to delegate authority to me, in consultation with the Leader of the House, to introduce the new Bill as soon as practicable. I seek this delegated authority on the basis that the new Bill will be substantially the same as the Bill previously agreed to by Cabinet for introduction [LEG-22-MIN-0139 (25 August 2022) and CAB-22-MIN-0346 (29 August 2022)], but will not include the amendments relating to GST on management services supplied to managed funds.

Financial Implications

20. The proposal to not proceed with applying 15% GST on management services supplied to managed funds has the following estimated fiscal impact, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Tax Revenue	-	-	-	(37.0)	(247.0)
Total operating	-	-	-	37.0	247.0

21. However, Cabinet previously agreed not to directly recognise any impact on the Budget 2023 operating allowance at the time of the previous decision, so reversing that decision has no impact on that allowance.

Legislative Implications

22. If approved, I propose, in consultation with the Leader of the House, to introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) as soon as practicable.

23. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) holds a category 4 priority on the 2022 Legislative Programme (to be referred to a select committee in the year). It sets the annual income tax rates for the 2022–23 tax year and should be enacted by 31 March 2023.

Impact Analysis

Regulatory Impact Assessment

24. Regulatory impact statements (RISs) were prepared, where required, for the policy items in the Bill. These were submitted at the time that Cabinet approval for the policy items was sought. These RISs are:

    24.1 *Taxation of the gig and sharing economy: GST*, Inland Revenue, 25 May 2022;

    24.2 *Taxation of the gig and sharing economy: Information reporting and exchange*, Inland Revenue, 25 May 2022;

    24.3 *GST status of statutory and regulatory charges*, Inland Revenue, 2 June 2022;

    24.4 *GST apportionment and adjustment rules*, Inland Revenue, 26 May 2022;

    24.5 *Comparing options to support build-to-rent*, Inland Revenue, 29 June 2022;

    24.6 *Cross-border workers tax reform*, Inland Revenue, 25 May 2022; and

    24.7 *Fringe benefit tax exemption for public transport*, Inland Revenue, 31 May 2022.

Compliance

25. The Bill will comply with:

    25.1 the principles of the Treaty of Waitangi;

    25.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

    25.3 the disclosure statement requirements;

    25.4 the principles and guidelines set out in the Privacy Act 1993;

    25.5 relevant international standards and obligations;

    25.6 the *Legislation Guidelines* (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Population Implications

26. The recommended changes in this paper are not expected to have any undue implications for specific demographics in New Zealand.

Human Rights

27. There are no human rights implications associated with the recommended changes in this paper.

Consultation

28. The Treasury and Department of the Prime Minister and Cabinet were consulted on the contents of this Cabinet paper.

Communications

29. I will make an announcement on this decision and introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) as soon as practicable.

Proactive Release

30. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that Cabinet:

1. agree that the changes previously agreed to by Cabinet (DEV-22-MIN-0134 and CAB-22-MIN-0242 refers), that services supplied by managers and investment managers to managed funds and retirement schemes would be subject to 15% GST, should not proceed;

2. note the following changes as a result of the decision in recommendation 1 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Tax Revenue	-	-	-	(37.0)	(247.0)
Total operating	-	-	-	37.0	247.0

3. note that when Cabinet previously agreed to apply GST to management services supplied to managed funds, it deferred the recognition of any impact on the Budget 2023 operating allowance so reversing the policy decision has no impact on that allowance;

4. authorise the Minister of Revenue, in consultation with the Leader of the House, to introduce the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) ("the Bill") as soon as practicable;

5. note that the Bill will be substantively the same as the previously introduced and now discharged Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill, but will not include the amendments relating to GST on management services supplied to managed funds.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Cabinet

Minute of Decision

Introduction of the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)

Portfolio **Revenue**

On 5 September 2022, Cabinet:

1 **noted** that in June 2022, the Cabinet Economic Development Committee (DEV):

1.1 noted that the current rules relating to the GST treatment of fund manager and investment manager fees were creating complexity and inconsistency across the managed funds industry;

1.2 agreed to provide consistency by requiring fund manager and investment manager fees to be subject to 15 percent GST;

[DEV-22-MIN-0134];

2 **rescinded** the decision in paragraph 1 above;

3 **noted** the following changes as a result of the decision in paragraph 2 above, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Revenue **Minister of Revenue**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Tax Revenue	-	-	-	(37.0)	(247.0)
Total operating	-	-	-	37.0	247.0

4 **noted** that when Cabinet previously agreed to apply GST to management services supplied to managed funds, it deferred the recognition of any impact on the Budget 2023 operating allowance, so reversing the policy decision has no impact on that allowance;

5 **authorised** the Minister of Revenue, in consultation with the Leader of the House, to approve the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) (the Bill) for introduction as soon as practicable;

6 **noted** that the Bill will be substantively the same as the previously introduced and now discharged Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill, but will not include the amendments relating to GST on management services supplied to managed funds.

Rachel Hayward
Acting Secretary of the Cabinet