

Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill

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

February 2022

Prepared by Policy and Regulatory Stewardship, Inland Revenue

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GST policy items

TAX TREATMENT OF CRYPTOASSETS

Issue: Create a token classification framework

Submission

(Chartered Accountants Australia and New Zealand)

We believe there should be a framework that deems cryptoassets to be taxed in accordance with current tax rules depending on their characteristics. Accordingly, coins in the nature of equity should be treated as equity, while those in the nature of debt should be treated as debt instruments. The changes proposed in this Bill will allow the law to take a step in that direction.

Comment

Officials note that they have worked closely with the submitter throughout development of these proposals, and we are aware their ultimate preference would be for a token classification framework such as they have described.

Officials consider that adopting a comprehensive framework, such as the token classification framework suggested by the submitter, would be too complex and instead prefer the approach taken by the proposals in this Bill. This approach is to identify the most obvious areas that create unintended policy outcomes or uncertainty for taxpayers in the taxation of cryptoassets (GST and the financial arrangements rules) and provide clarity in those areas.

Officials consider the token classification framework approach to be too complex for the following reasons:

- **Compliance costs:** There are over 15,000 cryptoassets and for taxpayers to work out which category applied to each individual asset and treat it accordingly would result in considerable compliance costs. The investor profile of a typical cryptoasset holder is a taxpayer who is often less sophisticated in tax matters and operates on a small scale with holdings that are usually quite small. It follows that working out the classification for each individual cryptoasset would impose undue and significant compliance costs on such taxpayers.
- **Nature of cryptoassets:** Cryptoassets do not fit neatly into existing categories of law. For example, a cryptoasset may be deemed to be a share. However, if, unlike a typical share, it does not provide an interest in a foreign company, it would be taxed very differently to other foreign equity investments (which would often be subject to the foreign investment fund rules). Cryptoassets can also change categories over time, or a cryptoasset could be a hybrid between multiple categories. These things would make it harder to apply a classification approach.

Recommendation

That the submission be declined.

Issue: Introduce simplified method for returning taxable income

Submission

(Chartered Accountants Australia and New Zealand)

We also recommend that the Government introduce an optional simplified method for returning taxable income. Many find it difficult to track trades over time. One solution would be to allow taxpayers to pay tax on an unrealised basis year on year. One of the simplified methods in the foreign investment fund rules (such as the fair dividend rate or comparative value methods) could be used as a template for this.

Comment

Officials agree it is important to simplify income tax compliance and record keeping for cryptoassets. Officials note that cryptoassets are traded much more frequently, and by a larger number of retail investors, than typical investment products (such as shares or property). We recognise that taxing cryptoassets on disposal is complex.

Officials acknowledge the matter raised in this submission. However, any further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Support for retrospective application

Submission

(Chartered Accountants Australia and New Zealand)

We do not generally believe that legislation should be backdated. However, in this case the amendments are either to clarify the law or to bring it in line with existing practice. We agree that in this situation it is appropriate the amendments are backdated.

Recommendation

That the submission be noted.

DEFINITION OF CRYPTOASSET

Clause 5(2) and 127(2)

Issue: Support for wide definition

Submission

(Chartered Accountants Australia and New Zealand)

We support the inclusion of a wide definition of cryptoasset that will encompass almost all cryptoassets except non-fungible tokens. We agree that this is appropriate.

Recommendation

That the submission be noted.

Issue: Cryptoassets should be defined as currency

Submission

(Deloitte)

Cryptoassets should be defined as currency, rather than being excluded from the definitions of "goods" and "service" in the Goods and Services Tax Act 1985 (GST Act).

The submitter's view is that the approach proposed in the Bill brings into doubt the GST treatment of "wraparound services" supplied in connection with cryptoassets (such as brokering and commission).

Comment

Under current law, the types of services referred to by the submitter (such as brokering and commission) are exempt financial services. The problem raised by the submitter is that it is not clear whether brokerage services that apply specifically to cryptoassets are also exempt financial services. This is because the definition of "financial services" in the GST Act includes "currency", and the definition of "currency" does not include a cryptoasset.

This means that brokerage services provided for cryptoassets are currently subject to GST, and this treatment is not consistent with share or currency brokering services, which would be exempt financial services.

Officials agree with the submitter that brokerage services provided for cryptoassets should not be subject to GST, but we do not agree that defining cryptoassets as currency is the best way to achieve this objective. This is because cryptoassets are much more like property than they are a currency and including cryptoassets in the definition of "currency" could result in taxpayers confusing cryptoassets with legal tender – which they are not.

Point of difference

Officials propose that a separate amendment is made to provide that brokering, commission and related services provided in relation to cryptoassets are not subject to GST.

Recommendation

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

Issue: Fungibility component of the definition of cryptoasset

Submission

(New Zealand Law Society)

In the definition of “cryptoasset”, the wording “is designed to be fungible” in the second limb of the definition could be improved. “Designed” implies intent, which is difficult to measure and limited to a point in time. Further, fungibility is not an absolute term. This wording leaves the GST treatment uncertain for cryptoassets that are semi-fungible, change in nature over different points of their lifecycle, or differ in practice from the initial intent at the point of “design”. It is expected that these issues will be exacerbated as cryptoassets continue to evolve and the boundaries of fungibility become increasingly blurred.

Comment

The purpose of including a fungibility requirement in the cryptoasset definition was to carve non-fungible tokens out of the definition so they would remain subject to GST. Officials agree with the submitter’s proposal that a fungibility requirement can potentially be problematic and ambiguous.

Point of difference

However, officials recommend the fungibility requirement be removed from the cryptoasset definition and a definition of “non-fungible tokens” be inserted instead. Non-fungible tokens will be explicitly excluded from the definition of “cryptoasset”. This approach avoids the complexities of having to define fungibility, particularly as cryptoassets are an emerging industry and constantly evolving.

Recommendation

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

Issue: Fungibility requirement too simplistic

Submission

(PwC)

The proposal that tokens are inside or outside of the GST net based on whether they were designed to have the characteristic of “fungibility” may be too simplistic. This is because the assumption underlying this distinction is that tokens designed to be fungible are designed to function primarily as a store of value and/or as a medium of exchange (that is, like money).

The submitter stated that fungible tokens exist that allow holders to obtain goods and services without having to spend them. The submitter also cited examples of instances where fungible tokens are issued for accessing products or benefits. In such situations, the tokens are designed to be fungible, but also function in a manner analogous to a club membership. Therefore, to the extent the supply of these tokens is for consideration, such tokens should be subject to GST (adopting a broad base/minimal exemptions approach).

Comment

The policy intent behind these changes is that cryptoassets should not be subject to GST. However, where goods and services are purchased with cryptoassets, they should generally be subject to GST. There are some exceptions to this, such as with financial services, which are an exempt supply.

Officials acknowledge the submitter's concern that tokens that can be redeemed for goods and services without redeeming the token are a threat to the GST base as they may avoid the application of GST on the purchase of goods and services. On the face of it, these tokens should be made subject to GST on purchase. However, a complicating factor is that the primary purpose of the token may be to act as a store of value. For example, if a token similar to Bitcoin also provided access to a good or service by virtue of holding it, making that token subject to GST on purchase would also tax the 'store of value' component and result in significant GST compliance costs if it was traded regularly.

Officials consider cryptoasset tokens that provide users with goods or services with no requirement to redeem the token are currently edge cases. Therefore, officials do not recommend legislating for this issue at this stage. Officials will continue to monitor these situations as they arise and as the cryptoasset market continues to develop, and we will issue guidance or recommend legislative change when it becomes necessary. Existing case law can be relied on to determine the nature of a supply for GST purposes, and this will protect the GST base if users try to defeat the application of GST through such means.

Recommendation

That the submission be declined.

EXCLUDING CRYPTOASSETS FROM GST

Clauses 5(2) and (3)

Issue: Support for proposals

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Chartered Accountants Australia and New Zealand, Deloitte, New Zealand Law Society)

We support the proposals to exclude cryptoassets from GST.

Recommendation

That the submission be noted.

INPUT CREDITS FOR CAPITAL RAISING

Clause 22

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposed amendment to allow GST-registered businesses that raise funds by issuing cryptoassets with features similar to debt or equity securities to claim input tax credits on their capital-raising costs.

Recommendation

That the submission be noted.

EXCLUDING CRYPTOASSETS FROM THE FINANCIAL ARRANGEMENTS RULES

Clause 79

Issue: Support for proposals

Submission

(Accountants & Tax Agents Institute of New Zealand, Chartered Accountants Australia and New Zealand, Russell McVeagh)

We welcome the proposed clarification to exclude cryptoassets from the financial arrangements rules. We support the proposal that cryptoassets that are economically equivalent to debt arrangements should remain subject to these rules.

Recommendation

That the submission be noted.

Issue: Impact on PIEs of excluding cryptoassets from financial arrangements rules

Submission

(EY)

Although we support the proposals to exclude cryptoassets from the financial arrangements rules, officials should consider the impact that this proposal has on the ability of portfolio investment entities (PIEs) to invest into cryptoassets. Specifically, whether PIEs should be able to invest in cryptoassets in an unrestricted manner and whether that should be the case for all types of cryptoassets, including those that more closely resemble "money".

Currently, most sophisticated cryptoassets fall outside the scope of the financial arrangements rules as they do not represent an arrangement where money is received for money provided. While some cryptoassets do possess functionality that could be construed as a debt arrangement, the generally accepted position is that an individual cryptoasset is not itself a financial arrangement and is more akin to property. We understand the proposed amendment is meant to formalise this industry understanding.

However, this conclusion has flow on impacts for the PIE rules. Under section HM 11, a PIE must have 90% of the value of its assets in land interests, financial arrangements, excepted financial arrangements, or a right or option for any of these interests. As such, a PIE is not eligible to invest in cryptoassets as they are not considered a financial arrangement or an excepted financial arrangement.

With the inclusion of cryptoassets as excepted financial arrangements under the proposed amendment, PIEs would be eligible to invest in these forms of assets on an unrestricted basis. In effect, it would be possible for a PIE that held exclusively Bitcoin to be established, with the investors gaining the benefit of the prescribed investor rates (PIR). With the current difference between PIR and top personal tax rates, this could create a strong incentive to establish a cryptoasset PIE.

Comment

As part of the changes introduced in the Bill, it is intended that cryptoassets should have a similar tax treatment to other investment products or asset classes that are close substitutes for the cryptoasset. It is not intended that cryptoassets would receive a concessionary tax treatment or be disadvantaged in any way compared to other investment products.

Officials are therefore comfortable with the outcome that a PIE can invest in a cryptoasset on an unrestricted basis. This will ensure the law does not bias investment decisions away from cryptoassets when compared to other investment products, such as shares.

Further, officials note there are already foreign exchange traded funds that hold Bitcoin or other cryptoassets that New Zealand investors can invest into (although these are subject to tax under the foreign investment fund rules rather than the PIE rules).

Officials will ensure this consequence of the proposed changes is included in the *Tax Information Bulletin* released following enactment of the Bill.

Recommendation

That the submission be noted.

Issue: Derivatives over cryptoassets

Submission

(EY)

We submit that it would be prudent for the rules to clarify the tax treatment of derivatives applicable to cryptoassets. Specifically, whether derivatives over cryptoassets should also be treated as excepted financial arrangements.

Comment

Officials agree with the submitter that the tax treatment of derivatives applicable to cryptoassets should be made explicit in the legislation.

To not bias investment decisions across investment products, officials consider that derivatives over cryptoassets should receive the same treatment as derivatives over shares, which are a broadly equivalent asset.

This means that futures over cryptoassets would be subject to the financial arrangements rules, whereas options over cryptoassets would be excepted financial arrangements.

The Goods and Services Tax Act 1985 should also be amended to clarify that the provision of futures and other financial options over cryptoassets is a financial service.

Additionally, officials consider that the application of the financial arrangements rules over derivatives generally is worth further consideration. However, further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be accepted.

Issue: Drafting issue

Submission

(PwC)

The language in proposed section EW 5(3BAB) is ambiguous and should be clarified. The current language would lead to inappropriate outcomes in the following situations:

- A cryptoasset that functions in a similar manner to a share could fall within the scope of section EW 5(3BAB) because the return to a holder is calculated by reference to the number of tokens held and on a basis that is known in advance (that is, the profitability of the underlying business).
- A token that functions in an economically equivalent manner to debt would fall outside the scope of section EW 5(3BAB) (and therefore be treated as an excepted financial arrangement) if it was disposed of before any return being received by a holder.

Proposed section EW 5(3BAB) should be amended to read: "A cryptoasset is not an excepted financial arrangement if a consequence of ownership of the cryptoasset is that the owner receives **or is entitled to receive**, during the period of ownership, amounts that are determined by reference to the quantity or value of the cryptoasset and on a basis that is known by the owner in advance (**other than amounts determined by reference to the profitability of a business**)."

Comment

Officials agree and will refer the matter to the drafter.

Recommendation

That the submission be accepted.

GST – ABILITY TO AGREE APPORTIONMENT METHOD WITH INLAND REVENUE

Clauses 21(5) and 23(2)

Issue: General support for proposed amendments

Submission

(Bruce Lay, Chartered Accountants Australia and New Zealand, Deloitte, The Retirement Villages Association of New Zealand Inc)

Submitters support the proposal to remove the \$24 million turnover threshold for agreeing an apportionment method with the Commissioner. It is a sensible measure that will help reduce compliance costs.

Recommendation

That the submission be noted.

GST – DISPOSAL OF ASSET WITH TAXABLE AND NON-TAXABLE USE

Clauses 7(4) and 25

Issue: Support for proposals

Submission

(Chartered Accountants Australia and New Zealand)

We fully support the proposals to remove the cap that limits the final adjustment to the GST paid on acquisition and to retain a cap on persons whose taxable activity is supplying land (that is, property developers).

Recommendation

That the submission be noted.

Issue: Proposed cap should better target property developers

Submission

(New Zealand Law Society)

Section 21F(6) should be redrafted to clarify that the cap on input tax deductions applies to property developers who are not using the land to conduct another type of taxable activity. Registered persons who are not ordinarily considered property developers will be caught under proposed section 21F(6), and this contradicts the stated policy intent of the provision. The cap could be targeted by simply referring to a registered person who carries on a business of developing land. Language, such as that used in section CB 10(1)(b) of the Income Tax Act 2007, could be used to ensure the provision is drafted to achieve the stated purpose.

Comment

Officials agree the drafting of the proposed amendment could be better targeted at property developers and will refer this to the drafters.

Recommendation

That the submission be accepted.

Issue: Application of section 21F to depreciating assets

Submission

(Bruce Lay)

Where proposed new section 21F(6) does not apply, section 21F will apply to an asset that has depreciated rather than appreciated in value. Presumably that was not the intended result.

Comment

Both the current section 21F and the proposed section, as amended by the Bill, would not limit the final adjustment available to a registered person on disposal of an asset if the asset has depreciated in value. For depreciating assets, the adjustment provided under section 21F achieves an appropriate policy result as the net GST returned on disposal of the asset will be equal to the taxable proportion of the asset's use.

For example, a GST-registered business purchases a vehicle for \$57,500. Ninety percent of its use is taxable, and ten percent is private use by the business owner. After two years, the business sells the car for \$46,000. The business is required to return \$6,000 as output tax, but it can claim an adjustment of \$600 under section 21F. As such, the net GST the business returns on disposal of the car is \$5,400 (90 percent of the \$6,000 of output tax). This recognises that ten percent of the use of the car was non-taxable.

Recommendation

That the submission be declined.

Issue: Repeal of section 5(18)

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Jim Gordon Tax Limited)

We do not support the proposal to repeal section 5(18). Given the use of the provision is still widespread, we do not believe that the provision should be repealed without full public consultation. If it is to be repealed it should be done as part of an overall review of the GST apportionment rules. *(Chartered Accountants Australia and New Zealand)*

The repeal of section 5(18) should be deferred so that it can be considered together with a tax policy response to the issue of the disposal of a dwelling. *(Jim Gordon Tax Limited)*

We support the proposal of clause 7(4) to repeal section 5(18). However, such a change should have been discussed in the Commentary to the Bill, so that it was clear why the change is being made. *(Corporate Taxpayers Group, Deloitte)*

Comment

Officials note both the support and the opposition to the repeal of section 5(18). It is also acknowledged that all submitters considered there should have been more consultation or explanation provided on the reason for the change. Officials note the proposed repeal of section 5(18) was publicly consulted on in the apportionment chapter of the February 2020 *GST policy issues* officials' issues paper.

Currently under the Goods and Services Tax Act 1985 (GST Act), both section 5(18) and section 21F can apply when a registered person sells a dwelling that they have partly used to make taxable supplies (such as for business premises or supplying commercial accommodation to guests) and partly used privately (such as for owner-occupation) or to make exempt supplies (such as for a residential tenancy).

Section 5(18) operates by limiting the output tax liability to the extent that the dwelling is used to make taxable supplies. Section 21F operates by allowing an additional input tax deduction (final adjustment) that reflects the non-taxable use of the dwelling.

The proposed amendment to section 21F removes the cap that limits the final adjustment to the GST paid on acquisition (other than for property developers who have a taxable activity that includes developing the land being sold). As a result, a registered person who applied section 21F would return the same net GST on sale as they would from applying section 5(18). The proposed amendment does this by allowing a larger input tax deduction for the vendor (rather than limiting the output tax charged). Officials consider that this is a better mechanism than limiting the output tax charged, as it only affects the GST position of the vendor and not the purchaser.

Furthermore, section 5(18) is a targeted rule that has much more limited application than the general rule in section 21F, which applies to all goods and services (including but not limited to dwellings) that have some taxable and non-taxable use. Section 5(18) only applies to certain dwellings for which a person claimed a partial input tax deduction at the time the dwelling was acquired (as opposed to a taxable use that began after the dwelling was acquired). Also, the definition of "dwelling" in the GST Act requires the dwelling be a principal place of residence for which the person has quiet enjoyment and not a commercial dwelling – this excludes some houses, such as holiday homes.

Consequently, a further proposed amendment repeals section 5(18), as the provision would become redundant following the proposed change to section 21F. Retaining both provisions would create an overlap that could increase complexity and result in unintended consequences. Officials consider it is best to repeal the specific rule in section 5(18) to remove the overlap with the more general rule in section 21F.

The above explanation will be included in the *Tax Information Bulletin* following enactment to ensure it is clear why the consequential amendment was made.

We acknowledge submitters' concerns regarding how GST should apply to the disposal of dwellings that are used by registered persons for both taxable and non-taxable use. However, a policy response to this issue would require further public consultation to ensure any resulting options adequately address the issue and do not create unintended consequences. Further work on this issue would require prioritising and resourcing as part of the Government's tax policy work programme

Recommendation

That the submission be declined.

Issue: Wider review of apportionment rules required

Submission

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

We consider a more general review of the apportionment rules is needed. The review should improve coherence and readability and consider the output tax position of assets used partly for taxable and non-taxable purposes.

Comment

Officials acknowledge the matter raised by submitters. Subject to other Government priorities, officials intend to consult on some policy options for reforming and simplifying the GST apportionment rules.

Recommendation

That the submission be noted.

DOMESTIC TRANSPORT SERVICES SUPPLIED AS PART OF THE INTERNATIONAL TRANSPORT OF GOODS

Clause 11

Issue: Support for the proposed amendment

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Customs Brokers and Freight Forwarders Federation of New Zealand Inc, Deloitte, EY, PwC, Russell McVeagh)

Submitters supported the proposed amendment that seeks to expand the existing GST treatment of domestic transport services to consider subcontracting arrangements, simplifying GST compliance for domestic transport suppliers.

Recommendation

That the submission be noted.

Issue: Clarify when domestic transport services have been supplied

Submission

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

The Goods and Services Tax Act 1985 should include a prescriptive definition of when domestic transport services have been supplied as part of the international transport of goods.

Comment

Officials acknowledge that further certainty would be beneficial to ensure the provision is easily understood and correctly applied by taxpayers.

Officials have reservations about including a prescriptive definition in primary legislation, as an overly prescriptive definition may result in otherwise legitimate transport services being excluded from the proposed zero-rated treatment. As well, it would be undesirable for a definition to impact on industry terms or methodologies, or new delivery technology.

Point of difference

Consequently, officials propose to provide guidance and examples in the *Tax Information Bulletin*. In addition, it is anticipated that the response to ["Issue: Clarify that a separate supply of domestic transport services should be zero-rated"](#) below will provide further certainty to the rules and assist taxpayers in correctly identifying when a given transport service should be zero-rated.

The policy intent of the proposed amendments is to ensure the zero-rated treatment will apply to the transport of goods from their place of origin in New Zealand to their last place in New Zealand before export, and likewise for imported goods, from the first place in New Zealand after importation to their ultimate destination in New Zealand. The existing documentation that contains the ultimate destination of the goods (such as the Bill of lading

or Airway bills) can be used to identify when the goods are in transport, and therefore the underlying transport service can be zero-rated.

Officials intend to monitor the effectiveness of the proposed amendments to ensure they are delivering on the policy intent, including regular consultation with affected stakeholders.

Recommendation

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

Issue: Clarify that a separate supply of domestic transport services should be zero-rated

Submission

(PwC)

The drafting should clarify that the separate supply of domestic transport services by a subcontractor to a main supplier (who has contracted to deliver international transport including a domestic leg) should be zero-rated.

Comment

As noted in "[Issue: Clarify when domestic transport services have been supplied](#)" above, officials acknowledge that further certainty on the proposed amendments would be of benefit to submitters.

Officials recommend the proposed amendment is modified to make it clear that domestic transport services for goods, where those transport services involve moving the goods along their pre-arranged journey from point A in New Zealand to point B outside New Zealand (or vice versa), also includes transport services provided by way of a subcontract arrangement (either from the main transport provider or a subcontractor). Therefore, these subcontracted transport services should also be zero-rated.

Recommendation

That the submission be accepted.

Issue: Ancillary transport services

Submission

(Customs Brokers and Freight Forwarders Federation of New Zealand Inc, EY)

The guidance for ancillary transport services should be updated and include other freight-associated ancillary services (such as port service charges and de-hire fees).

Comment

Currently, operational guidance to establish which services are "ancillary transport services" was last prepared by Inland Revenue in 2008 and issued to industry representatives at that time.

Officials acknowledge the time since the operational guidance was last prepared and that certain fees and charges may not be clearly subject to the zero-rated treatment. It is important the guidance reflects modern commercial practices and emerging technology in the freight industry. Officials will seek to update the 2008 operational guidance, subject to the prioritisation and resourcing of Inland Revenue's operational guidance work programme.

Given the nature of this work, cooperation with both the New Zealand Customs Service and industry representatives will be important in ensuring that any updated guidance reflects the full extent of the fees and charges applied.

Recommendation

That the submission be accepted.

Other policy items

COVID-19 INFORMATION SHARING – REMOVAL OF TIME LIMIT

Clause 173(1)

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

Submitter supports the proposed amendment

Recommendation

That the submission be noted.

Issue: Sunset clause time limit should be retained

Submission

(Russell McVeagh)

The sunset clause in clause 23B of schedule 7 of the Tax Administration Act 1994 should be retained.

As clause 23B is a large discretion allowing the sharing of sensitive revenue information collected by Inland Revenue under its extremely wide information-gathering powers, the sunset clause is an effective and necessary mechanism to keep users of public power accountable. A sunset clause on this power to disclose sensitive revenue information is appropriate where, given the breadth of the power, regular review is essential.

Comment

Officials disagree. The sunset clause in the COVID-19 sharing provision provides that the sharing of information can only occur within two years of enactment of the provision (17 March 2020), but that this time limit can be extended by Order in Council. It has now become clear that COVID-19 will be with us for longer than 2 years (past 17 March 2022), and that some forms of government assistance will also need to be administered for longer than two years. For example, applications are now due to close on 31 December 2023 for the Small Business Cashflow (Loan) Scheme, and the loans are repayable over five years.

Officials have reviewed the COVID-19 sunset period and consider that the two-year period does not add any additional protection beyond that provided by the requirement for sharing to occur only for COVID-19-related measures.

The two-year period for the sharing of information was the result of balancing the need for information with the considerations of proportionality and best practice, as promoted by the Office of the Privacy Commissioner. This was agreed at the start of the outbreak when quick decisions were needed. The Office of the Privacy Commissioner has been consulted and do not take issue with the proposal to remove the two-year period.

Having an open-ended time limit on this provision will not remove the limitations on information sharing. They will continue to be tied specifically to the delivery and administration of the relevant COVID-19-related initiatives. The provisions are therefore inherently self-limiting in the powers they provide.

The submitter suggested an agency requiring information to administer a COVID-19-related measure should request that information itself. Officials disagree. Requesting information from an individual or business that is available from another agency would impose compliance and administration costs at a time of restrictions or lockdowns when information may be harder for an individual or business to obtain.

Recommendation

That the submission be declined.

Issue: COVID-19 information-sharing provision should not be retained in perpetuity

Submission

(Deloitte)

The information-sharing provision should not apply in perpetuity.

While generally supportive of the measures introduced by the Government to assist departments in sharing information when operating COVID-19-related initiatives, the submitter considers an open-ended power provides no incentive to Government departments to complete COVID-19-related work in a timely fashion and means businesses have no certainty as to when reviews will be completed. If the information-sharing ability is extended in perpetuity, the submitter considers Inland Revenue should publish further guidance confirming when the information-sharing abilities can be used and clarifying what "in relation to COVID-19" means.

Comment

Officials disagree that the removal of the two-year time limit will mean the information-sharing power will go on in perpetuity. Information sharing under this provision will only occur for as long as the administration of the COVID-19-related assistance continues.

Regarding certainty of when reviews of the COVID-19 assistance will be completed, the provision of government assistance is ongoing, and the review process is part of each initiative, rather than the information-sharing provision.

Recommendation

That the submission be declined.

OFFENCES RELATING TO ELECTRONIC SALES SUPPRESSION

Clauses 135(3), 160–162 and 165

Issue: Support for proposed amendments

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposal to penalise electronic sales suppression tools. We also support the proposed definition of an electronic sales suppression tool.

Recommendation

That the submission be noted.

Issue: Civil penalties not an offence

Submission

(New Zealand Law Society)

The use of the word “offence” in proposed section 141EE(4), which provides for a civil penalty for acquiring or possessing electronic sales suppression tools, is inappropriate. This section deals with civil penalties, not criminal penalties.

Comment

Officials agree that the word offence should be removed from the proposed section.

Recommendation

That the submission be accepted.

Issue: Penalty period for possession penalties

Submission

(New Zealand Law Society)

The intended effect of proposed sections 141EE(4) and 143BC(4) is that one penalty is imposed for each period of possession or control of, or right to use, the suppression tool. If there is one or more new periods of possession or control of, or right to use, the suppression tool after the period to which the penalty relates, then fresh penalties may be imposed for those later periods. The present wording of the proposed sections does not achieve this, and they should be reworded.

Comment

Officials agree with the submitter’s premise that a single penalty is imposed for all tax types and periods but consider that the current wording already achieves this. Further guidance will be provided in a *Tax Information Bulletin* after the legislation is enacted.

Recommendation

That the submission be declined.

Issue: **Wording of denial of penalty reduction**

Submission

(New Zealand Law Society)

It should be clarified that proposed new section 141FB(6), which denies a reduction of penalties for previous behaviour, applies to the penalty under section 141E(1).

Comment

Officials consider the proposed wording is sufficiently clear and that further changes are not required. Proposed new section 141FB(6) references section 141FB(1), which only applies to penalties imposed under section 141E(1).

Recommendation

That the submission be declined.

Issue: **Criminal penalty for manufacture or supply of tools**

Submission

(New Zealand Law Society)

The criminal penalty for manufacture or supply of electronic sales suppression tools in proposed new section 143BB should include a prison sentence.

The offence is essentially supplying devices to enable tax evasion, which is itself a serious offence carrying a penalty of up to five years imprisonment. Criminal law generally regards offences that facilitate an underlying offence as being of equivalent seriousness – for example, money laundering offences typically receive sentences equivalent to the offence for which the proceeds are laundered (for example, drug dealing). By analogy, one would expect a prison sentence for supplying the means to evade taxes.

Additionally, it may be expected that many suppliers of sales suppression software would be based overseas. Without a provision for a sentence of imprisonment, the proposed section would have no effective sanction against such overseas suppliers, as a fine levied by a New Zealand court is not generally enforceable in a foreign court. Such a supplier would also not be able to be extradited to New Zealand to face trial, as the offence would not be an “extradition offence” as defined in section 4 of the Extradition Act 1999.

Comment

Officials do not consider a prison sentence is required. Although the evasion penalty in section 143B of the Tax Administration Act 1994 carries a prison sentence, the penalty in proposed section 143BB carries a higher potential fine (up to \$250,000, rather than \$50,000) and therefore should not be considered less serious than evasion. No prison sentence is also consistent with the penalties applied in most other comparable countries with sales suppression penalties, though there are exceptions.

Officials acknowledge the potential difficulty in applying this penalty to a non-resident. This has also been acknowledged by revenue authorities in comparable countries applying their own sales suppression penalties. In practice, officials consider a jail sentence that would require extradition would be unlikely to be imposed for manufacture or supply even if it were available. Much of the value in the proposed penalty is likely to come from the deterrent factor, which applies equally well with a significant fine rather than a prison sentence.

Officials also consider that, in general, a prison sentence should not be introduced solely to allow for extradition. Doing so could create a potential prison sentence for New Zealand residents that may be disproportionate to the offence.

Inland Revenue officials have consulted with officials from the Ministry of Justice. They agree with the above assessment.

Recommendation

That the submission be declined.

Issue: Education campaign on electronic sales suppression

Submission

(Chartered Accountants Australia and New Zealand)

We recommend that a public education campaign be developed to raise awareness about the criminal nature of sales suppression tools.

Comment

Inland Revenue periodically runs information campaigns on areas of potential risk. An education campaign on sales suppression tools could be considered as part of Inland Revenue's normal prioritisation process.

Recommendation

That the submission be noted.

Issue: Reconsider regulation if penalties prove ineffective

Submission

(Chartered Accountants Australia and New Zealand)

We recommend that the use of regulation be reconsidered if it subsequently becomes apparent there is widespread use of these tools, and the penalty regime is not effective in combating the problem.

Regulation, including mandated software or EPOS systems, cloud-based software, and mandatory fiscal tills, has been used effectively overseas to combat the spread of electronic sales suppression tools.

Comment

The intent of the penalty regime is to provide a deterrent to the adoption of electronic sales suppression tools. As there is no evidence of sales suppression being widespread in the New Zealand tax base, officials believe the high compliance costs associated with regulation are unwarranted when a preventative approach is expected to achieve a similar result at a lower cost.

Inland Revenue's operational areas will monitor the success of the regime and the spread (or otherwise) of suppression tools in the tax base as part of their normal work. If the evidence suggests the penalty regime is not effective and the software is spreading in the tax base, officials agree that further work could then be considered. In such a scenario, it may be that a regulatory regime would be the most appropriate response, but officials would consider all the available options.

Recommendation

That the submission be noted.

Issue: Definition of electronic sales suppression tool

Submission

(Matter raised by officials)

The proposed definition of "electronic sales suppression tool" should be amended to include tools that hide or conceal the creation of a record.

The Bill, as introduced, defines an "electronic sales suppression tool" as "a [device or thing] that can modify, falsify, destroy, or prevent the creation of a record that a person is required under a tax law to make or keep..." (clause 135(3)).

This definition is intended to mirror legislative definitions used overseas, particularly in Australia and the United Kingdom. However, these jurisdictions also include devices or things that can hide or conceal the creation of a record required under tax legislation. The lack of explicit language dealing with hiding or concealing a record in the proposed definition means that devices or things that suppress sales records in this way could arguably not be subject to sales suppression penalties, contrary to the policy intent.

To correct this, the proposed definition should be amended to include tools that hide or conceal a record.

Recommendation

That the submission be accepted.

Issue: Due date for civil penalty

Submission

(Matter raised by officials)

The due date for a payment of a civil penalty for acquisition or possession of an electronic sales suppression tool should be not less than 30 days after the date on which a notice of assessment is issued for the penalty.

The due date for shortfall penalty payments is set out in section 142B of the Tax Administration Act 1994. Section 142B(1)(a) provides that the due date for payment of a shortfall penalty where the tax shortfall is an amount of unpaid tax shall be not less than 30 days after the date on which a notice of assessment is issued for the penalty (unless a new due date has been set). Payments of all other shortfall penalties are covered by section 142B(1)(b), which provides that the payment is due on the date the Commissioner notifies the taxpayer is the due date for payment of the penalty.

The civil penalty for acquisition or possession of an electronic sales suppression tool is intended to function similarly to other shortfall penalties. This includes the due date for payment of the penalty. However, as the penalty is not calculated with reference to an amount of unpaid tax, the due date for the penalty would currently be determined under section 142(1)(b), rather than section 142(1)(a).

An amendment should be introduced clarifying that the due date for payment of the civil penalty for acquisition or possession of an electronic sales suppression tool should be determined according to section 142(1)(a), in line with the policy intent.

Recommendation

That the submission be accepted.

Issue: No incremental late payment penalty

Submission

(Matter raised by officials)

It should be clarified that non-payment of a civil penalty for acquisition or possession of an electronic sales suppression tool does not incur incremental late payment penalties.

In the Bill, as introduced, non-payment of the civil penalty for acquisition or possession of an electronic sales suppression tool in proposed new section 141EE would accrue incremental late payment penalties under section 139B of the Tax Administration Act 1994. Section 139B imposes an initial late payment penalty on the day after the due date and the seventh day after the due date where a taxpayer has not paid an amount of tax by the due date. Further incremental late payment penalties are then imposed at monthly intervals on any amount still unpaid. However, section 139B(2B) prevents incremental late payment penalties for specified tax types and periods, including GST, income tax, and civil penalties for the specified tax types and periods.

The civil penalty for acquisition or possession of an electronic sales suppression tool is intended to function similarly to other shortfall penalties. However, as the penalty has no relation with a specific tax type or period, it is not currently covered by the exception from incremental late payment penalties for civil penalties in section 139B(2B)(e). This is counter to the policy intent. An amendment should be introduced to ensure that the civil penalty in

proposed new section 141EE is covered by the incremental late payment penalty exception in section 139B(2B).

Recommendation

That the submission be accepted.

Issue: Electronic sales suppression penalty is a shortfall penalty

Submission

(Matter raised by officials)

The electronic sales suppression penalty in proposed section 141EE should operate as a shortfall penalty even though it is not necessarily linked to a tax shortfall.

The sales suppression penalty in proposed section 141EE will be a shortfall penalty as defined in section 3 of the Tax Administration Act 1994. This was an intentional feature and reflects the close relationship between the evasion penalty and the electronic sales suppression penalty. However, several provisions within the shortfall penalty rules rely on the existence of a tax shortfall. For example, section 141(2) requires the calculation of a tax shortfall each time a taxpayer is liable to pay a shortfall penalty. As liability for an electronic sales suppression penalty does not require the suppression tool to be used to reduce tax payable, it is not linked to a specific tax shortfall.

Therefore, officials recommend a number of consequential amendments to ensure that the electronic sales suppression shortfall penalty operates as intended despite not being linked to a specific tax shortfall.

Recommendation

That the submission be accepted.

LOCAL AUTHORITY TAXATION – DIVIDENDS AND DEDUCTIONS

Clauses 54, 55, 58–60, 62, 63, 83, 91, 108, 109 and 116

Issue: Scope and timing of proposals

Submissions

(Auckland Council, Bay of Plenty Regional Council, Chartered Accountants Australia and New Zealand, Christchurch City Council, Deloitte, EY, Hawke’s Bay Regional Council, Hawke’s Bay Regional Investment Company Ltd, PwC, Taituarā)

Submitters raised concerns that the scope of the proposed changes do not go far enough to create a coherent framework for the taxation of local authorities, and that instead they only address some issues with the current tax rules. An overarching policy project should be undertaken to explore the core principles of how and why the local government sector should be taxed (if at all), as well as the current role of council-controlled organisations (CCOs).

Submitters noted that the local government sector is in the midst of a period of considerable disruption due to the Three Waters Reform, the Review into the Future for Local Government, the Resource Management Act reform, and the impact of COVID-19. The Government should avoid piecemeal changes and should undertake a broader review of the policy settings for local government. A broader review could occur either in conjunction with the Review into the Future of Local Government or after the outcome and impact of these wider reforms are known.

A multi-staged approach to changes to tax settings for local authorities, rather than a comprehensive review, would add extra burdens and additional compliance costs, and would result in less optimal outcomes and increase the risk of incoherent outcomes in the long term.

Comment

The proposed measures in the Bill are intended to address specific integrity concerns, and officials’ view is that they should not be deferred until a comprehensive review of local authority taxation can be undertaken.

Exempting dividends derived by local authorities will improve the simplicity and coherence of local government taxation, and the imputation and corporate gift deduction proposals address existing integrity issues. Both these proposals do not hinge on the wider local government reforms underway.

As noted below, officials are recommending that the financing deduction proposals be deferred (see [“Issue: Opposition to financing deductions proposals”](#)). These proposals hinge on the CCO and council-controlled trading organisation (CCTO) definitions in local government legislation. Deferring these proposals will allow officials to consider the CCO definitions and the financing deduction integrity issues after the impact of the wider local government sector reforms is known. This will remove the risk of introducing measures now that would require further amendments in the short term.

Recommendation

That the submissions be noted.

Issue: Impact of proposals

Submission

(Auckland Council, Christchurch City Council, Deloitte, PwC, Taituarā)

Submitters raised concerns that the proposals seem to address concerns relating to a small number of councils but will have significant compliance and economic impacts on all councils. The material impact of the proposed changes on the local government sector would benefit from more in-depth policy consultation.

Comment

As stated in ["Issue: Scope and timing of proposals"](#) above, officials consider that the current proposals are necessary to address several integrity concerns and it is not necessary to wait for a comprehensive review to be undertaken before proceeding with the proposals.

However, as noted in the Issue above, we are proposing the deferral of the financing deductions proposals. Withdrawing the financing deductions proposals will significantly reduce the impact of the proposals on the local government sector.

The financial impact of preventing local authorities from accessing the corporate gift deduction will also be significantly reduced by the proposal to exempt dividends derived by local authorities (see ["Issue: Dividend exemption should be extended"](#) below). Currently, a local authority can only claim a deduction for donations to donee organisations up to their net income. The proposal to exempt dividends will significantly reduce local authorities' net income, thereby reducing the maximum amount of corporate gift deductions (see ["Issue: Opposition to corporate gift deduction proposal"](#) below).

Recommendation

That the submission be noted.

Issue: Support for dividends proposal

Submission

(Auckland Council, Chartered Accountants Australia and New Zealand, Christchurch City Council, Christchurch City Holdings Limited, Deloitte, EY, Hawke's Bay Regional Council, Hawke's Bay Regional Investment Company Ltd, KPMG, Taituarā)

Submitters support the proposal to treat dividends derived by local authorities from wholly-owned CCOs, port companies or energy companies as exempt income. Submitters noted that the proposal will lower compliance costs and should simplify and reduce the cost of undertaking a local government group restructure.

One submitter supported this proposal if a complete review of the tax policy settings for local authorities was not being undertaken (see ["Issue: Scope and timing of proposals"](#) above). *(Chartered Accountants Australia and New Zealand)*

Recommendation

That the submission be noted.

Issue: Dividend exemption should be extended

Submission

(Auckland Council, Christchurch City Council, Christchurch City Holdings Limited, Deloitte, KPMG, Taituarā)

- a. Submitters noted that it is not uncommon for council-controlled organisations (CCOs), port companies or energy companies to be owned by multiple local authorities, and that the proposed tax exemption for dividends should be extended to dividends derived by local authorities from partly-owned CCOs, port companies and energy companies. *(Auckland Council, Christchurch City Council, Christchurch City Holdings Limited, Deloitte, KPMG, Taituarā)*
- b. Two submitters also argued that the proposed dividend exemption should be further extended to include dividends derived by a local authority-owned CCO from another CCO, port company or energy company. *(Christchurch City Holdings Limited, KPMG)*

Comment

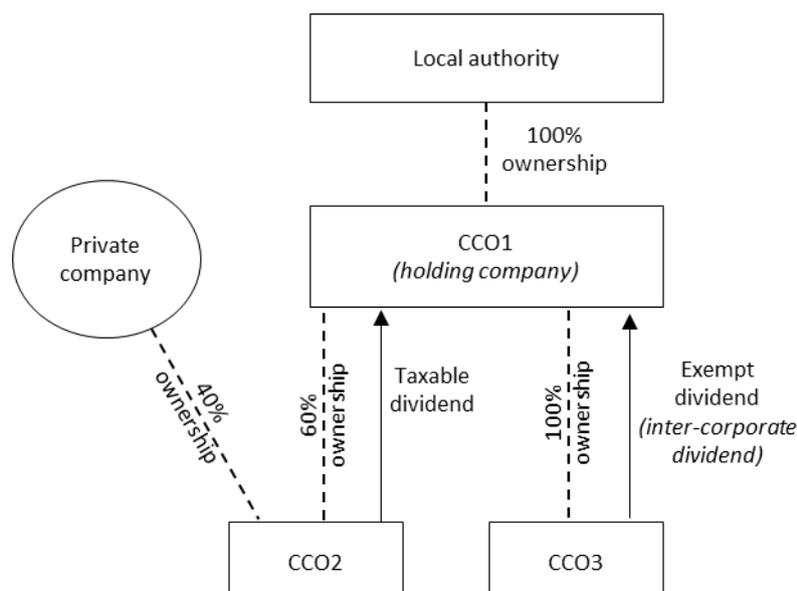
- a. Officials agree. Under current law, the income derived by a local authority is exempt from income tax except for income derived from a CCO, a port company or an energy company. The purpose of taxing income derived by a local authority from these types of entities is to prevent profit shifting from these taxable entities to exempt local authorities. Without this provision, income from a CCO could be extracted tax-free, for example, by the local authority charging the CCO above-market rental or management fees that would be deductible to the CCO but not taxable to the local authority, due to its tax-exempt status. As a dividend is not a deductible expense of a CCO, there are no profit-shifting concerns with treating dividends from both wholly- and partly-owned CCOs as exempt income of the local authority.

Officials recommend that both the current proposal in the Bill and this proposed extension apply to dividends derived by local authorities in the 2022–23 and later income years.

- b. Officials acknowledge that the proposed extension of the dividend exemption to all dividends derived by local authorities could disadvantage local authorities that choose to use a CCO as a holding company.

Under current law, a dividend derived by a holding company CCO from a wholly-owned CCO would be exempt income of the holding company CCO (because of the inter-corporate dividend exemption in section CW 10). However, dividends derived by a holding company CCO from a partly-owned CCO would be taxable to the holding company CCO.

Current tax law – dividends derived by CCOs



Point of difference

Officials agree with the submitter's proposal to extend the dividend exemption to dividends derived by CCOs with the following adjustment.

Dividends derived by a holding company CCO (a CCO wholly-owned by a local authority) from a CCO, port company or energy company with 100% public ownership (that is, local authority and public authority ownership) should be exempt from tax. This would apply to dividends received by a holding company CCO in the 2022–23 and later income years.

Dividends derived by a holding company CCO from a CCO with some non-public ownership should remain subject to tax. Exempting these dividends would be an integrity risk and could result in taxable income being streamed to the exempt local authority part-owner and capital gains to the taxable non-public part-owner. That is, this structure could be used to shelter profits from tax. This situation could also result in the streaming of imputation credits to the non-public part-owner.

Recommendation

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

Issue: Opposition to corporate gift deduction proposal

Submission

(Auckland Council, Bay of Plenty Regional Council, Chartered Accountants Australia and New Zealand, Christchurch City Council, Deloitte, Hawke's Bay Regional Council, Hawke's Bay Regional Investment Company Ltd, PwC, Taituarā)

Submitters raised a range of concerns with the proposal to prevent local authorities from accessing the corporate gift deduction. Submitters argued that local authorities should be encouraged as much as any organisation or company to make gifts (outside of their statutory responsibilities) for the betterment of society and that the availability of the corporate gift deduction for local authorities falls within the intent of the law.

Local authorities are not wholly tax-exempt and continue to be taxable on income derived from commercial activities from group entities. A local authority should be able to claim a corporate gift deduction up to their level of taxable income, in the same way as any other corporate entity. The corporate gift deduction allows local authorities to direct more funding into the charitable sector than perhaps they would otherwise be able to give.

The proposal to exempt dividends from wholly-owned CCOs, port companies and energy companies will effectively remove much of the benefit of the corporate gift deduction for local authorities, without the need to remove it entirely. The exemption of dividends will significantly reduce the assessable income of local authorities and therefore the level of corporate gift deduction they can claim.

Comment

The corporate gift deduction is an integrity risk for local government taxation. The legislated purpose of local authorities is to promote the social, economic, environmental, and cultural wellbeing of communities. The corporate gift deduction falls within this legislated purpose. Officials consider it is neither intended nor appropriate that the tax system provide a tax subsidy for these statutory purposes. These activities are primarily funded from local authorities' rating bases – this is exempt income and should not give rise to tax deductions.

The corporate gift deduction rule can distort the spending decisions of local authorities by providing a deduction for some donations made by local authorities as part of their ordinary community support function. The tax system should not incentivise a local authority to outsource its community support function to a third party to obtain the corporate gift deduction instead of directly conducting that activity itself (which would not give rise to a deduction).

Currently, a local authority can only claim a corporate gift deduction up to its level of net income. Although the proposal to exempt dividends derived by local authorities (see "[Issue: Dividend exemption should be extended](#)" above) will reduce local authorities' assessable income, the corporate gift deduction remains an integrity risk.

Continued access to the corporate gift deduction could incentivise local authorities to increase their net income by, for example, charging above-market management fees (which are taxable to the local authority). This would increase the local authority's net income and, therefore, the amount a local authority could claim for a corporate gift deduction.

Recommendation

That the submissions be declined.

Issue: Corporate gift deduction and consolidated tax groups

Submission

(Auckland Council, PwC)

Submitters seek confirmation of how the proposed change to the corporate gift deduction will apply when a local authority is part of a consolidated tax group. The proposals do not limit corporate gift deductions for CCOs. If a local authority is a part of a consolidated tax group, it will not impact on the availability of a deduction for the consolidated group if a CCO makes a charitable donation.

Comment

Officials are not proposing to prevent CCOs within a consolidated group from accessing the corporate gift deduction.

Recommendation

That the submission be noted.

Issue: CCO definition

Submission

(Auckland Council, Deloitte, EY, PwC, Taituarā)

Submitters noted that the definition of a “council-controlled organisation” (CCO) is different in the Income Tax Act 2007 (ITA) and the Local Government Act 2002 (LGA). In the ITA, the definition of a CCO includes the LGA definitions of a CCO and a council-controlled trading organisation (CCTO), as well as other specific entities. All these entities are taxable under the ITA. Therefore, by only including CCTOs within the financing deductions proposals, funding for other taxable CCOs is excluded.

Submitters consider the definition of a CCO should be carefully reviewed to ensure the draft legislation applies as intended. References to CCOs and CCTOs in the proposals are driven from the definitions in section 6 of the LGA and are not tax concepts. An assumption that all CCTOs are commercial and profit-driven, while CCOs are something less than a CCTO, is too simplistic and incorrectly narrows the deductibility of interest expenditure.

Comment

Officials agree with submitters that there are outstanding issues with the ITA definition of a CCO, and that the definition should be reviewed carefully.

Officials note that wider local government reforms currently underway may also impact on these definitions. As the financing deductions proposals in the Bill hinge on these definitions, officials have recommended withdrawing these proposals (see [“Issue: Opposition to financing deductions proposals”](#) below). This will allow officials to undertake further work on the CCO and CCTO definitions once the outcome and impact of these wider reforms are known.

Recommendation

That the submission be accepted.

Issue: Opposition to financing deductions proposals

Submission

(Auckland Council, Bay of Plenty Regional Council, Christchurch City Council, Deloitte, EY, PwC, Quayside Holdings Ltd, Taituarā)

Submitters raised a range of concerns with the proposals to limit deductions for financing deductions, including that the proposals will increase the taxable income of councils, increase compliance costs, add unfairness and ambiguity to the tax system, result in inappropriate outcomes, and complicate the tax legislation.

Comment

The financing deductions proposals in the Bill propose to limit a local authority's deductions for finance costs (including finance costs relating to financial derivatives, such as interest rate hedges) to finance costs incurred:

- on loans made to a council-controlled trading organisation (CCTO)
- on borrowings to acquire shares in a group company that is a CCTO, and
- on base price adjustments for financial arrangements involving CCTOs.

The financing deductions proposals hinge on the council-controlled organisation (CCO) and CCTO definitions in the Income Tax Act 2007. There are existing issues with these definitions (see "[Issue: CCO definition](#)" above). Wider local government reforms are also currently underway that may impact these definitions. Due to the reliance of these proposals on the CCO and CCTO definitions, officials recommend withdrawing the financing deductions proposals from the Bill.

Deferring these proposals will allow officials to consider both the CCO and CCTO definitions and the integrity issues after the impact of the wider local government sector reforms is known. This will remove the risk of introducing measures now that would require further amendments in the short term. Subject to prioritising and resourcing as part of the Government's tax policy work programme, this will also provide an opportunity to review and consider broader matters in local government taxation.

Recommendation

That the submission be noted.

Issue: Support for imputation proposals

Submission

(Auckland Council, Hawke's Bay Regional Council, Hawke's Bay Regional Investment Company Ltd, PwC, Taituarā)

There is general support from submitters for the proposed changes to the imputation regime.

Recommendation

That the submissions be noted.

Issue: Preventing local authorities from converting unused imputation credits to a tax loss

Submission

(Christchurch City Council, Deloitte, PwC, Taituarā)

Some submitters oppose the proposal to prevent local authorities from converting unused imputation credits to a tax loss. Removing the ability to convert unused imputation credits to a tax loss in respect of assessable dividends received by local authorities from non-wholly-

owned CCOs would prejudice local authorities compared to all other taxpayers who are able to carry forward a benefit from unused imputation credits.

Submitters suggest that extending the dividend exemption to non-wholly-owned CCOs, port companies and energy companies would remove the need for the separate proposal to prevent a local authority from converting unused imputation credits to a tax loss. This would be a simpler approach, and it would achieve the same effect as the proposal and provide more straightforward compliance. *(Christchurch City Council, Deloitte)*

Some submitters consider that this proposal should be limited to imputation credits received from entities within the same group. Losses can only be offset where the group loss offset rules are met. Imputation credits received from non-group council-controlled organisations should be able to be converted to a loss as there is no risk that the resulting loss can be offset against the income of the entity paying the dividend. *(PwC, Taituarā)*

Comment

Officials agree that exempting all dividends derived by local authorities would make this imputation proposal unnecessary. Officials have recommended that the exemption should be extended to all dividends derived by local authorities (see ["Issue: Dividend exemption should be extended"](#) above).

Based on officials' recommendation to exempt all dividends derived by local authorities, a local authority will only be able to derive exempt dividends. Under current law, any imputation credits attached to an exempt dividend will not give rise to a tax credit for the recipient.

The proposal in the Bill was intended to address an integrity risk relating to local authorities' unused imputation credits being converted to a tax loss. Exempting all dividends derived by local authorities will resolve this integrity risk.

Officials recommend withdrawing the proposal to prevent a local authority from converting an imputation credit to a tax loss.

Recommendation

That the submission be accepted.

Issue: Support for consolidated group ICA proposals

Submission

(Christchurch City Council, Deloitte)

- a. Submitters support this proposal and note that the proposed change should simplify compliance for local authorities.
- b. Submitters note that if all dividends derived by local authorities were tax exempt, then an amendment to prevent a credit arising to a consolidated group imputation credit account (ICA) for imputation credits received by local authorities would not be required.

Comment

- b. Under current law, when a company in a consolidated group receives an imputation credit, a credit arises to the consolidated group's ICA. The credit arises to the group's account regardless of whether the dividend was exempt income.

As noted in [“Issue: Preventing local authorities from converting unused imputation credits to a tax loss”](#) above, if all dividends derived by local authorities are exempt, then a local authority will not receive a tax credit for any imputation credits received. However, this is not the case for consolidated group ICAs. The proposal to prevent a credit arising to a consolidated group’s ICA for any imputation credits received by local authorities maintains the existing policy setting of local authorities not being allowed to maintain their own ICA.

Recommendation

- a. That the submission be noted.
- b. That the submission be declined.

Issue: Application date of consolidation group ICA proposals

Submission

(Christchurch City Council, Deloitte)

The proposal to ensure that a credit would not arise to a consolidated group’s imputation credit account (ICA) for imputation credits attached to a dividend derived by a local authority will apply from the 2022–23 income year onwards.

Submitters note that, for clarity and ease of tracking in a group’s ICA, it may be warranted to consider making this change have retrospective effect, with a savings provision to the extent a debit ICA balance would otherwise arise from the change so as not to prejudice any groups that had previously relied on this section in good faith when declaring dividends.

Comment

Officials consider that applying this proposal retrospectively could create unnecessary compliance costs for some local authorities. This proposal is intended to address an integrity measure on a prospective basis.

Recommendation

That the submission be declined.

Issue: Attaching imputation credits to exempt dividends

Submission

(Hawke’s Bay Regional Council, Hawke’s Bay Regional Investment Company Ltd, PwC, Taituarā)

Submitters seek confirmation that there will not be a requirement to attach imputation credits when paying a dividend to a local authority to achieve exempt dividend status.

Comment

Officials are not proposing a statutory requirement for council-controlled organisations (CCOs) to attach imputation credits to dividends paid to local authorities. However, CCOs may choose to attach imputation credits to dividends they pay to local authorities.

Recommendation

That the submission be accepted.

Issue: Loss grouping

Submission

(PwC)

Submitter seeks confirmation that officials do not intend to prevent local authorities from offsetting losses against the income of group companies and that a local authority's historic tax losses will still be able to be carried forward.

Comment

Officials earlier considered a proposal to prevent local authorities from grouping losses to address integrity issues relating to deductions available to local authorities.

Officials do not intend to progress such a proposal. Local authorities can incur genuinely deductible expenditure, and this can give rise to tax losses. Local authorities should be allowed to offset these losses against the income of group companies.

Recommendation

That the submission be accepted.

FAIR DIVIDEND RATE FOREIGN CURRENCY HEDGES

Clauses 71-78

Issue: General support for proposals

Submission

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

The submitters broadly support the proposals to amend the rules for hedging of foreign currency movements in Australian non-attributing shares and attributing FDR method interests (FDR FX hedges rules) and agree that the changes should improve the functionality of the rules from a practical perspective.

Recommendation

That the submission be noted.

Issue: Support for new portfolio method

Submission

(Financial Services Council, KPMG, New Zealand Superannuation Fund)

The submitters support the introduction of the new portfolio method for calculating fair dividend rate hedge portions.

Recommendation

That the submission be noted.

Issue: Portfolio method should be available to non-daily unit valuers

Submission

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

The submitters consider that the proposed limitation on use of the new portfolio method for calculating FDR hedge portions to daily unit valuers should be removed. Non-daily unit valuers can also have a significant hedging activity and access to the portfolio method would reduce their compliance costs.

Instead, the portfolio method should be available to all taxpayers:

- with a unit pricing frequency of a month or less *(KPMG)*
- eligible to apply the rules. *(Chartered Accountants Australia and New Zealand, PwC)*

Comment

Officials agree that non-daily unit valuers should have access to the portfolio method as this will reduce their compliance costs.

Point of difference

Officials consider this should be limited to taxpayers with a unit pricing frequency of a month or less, aligning with the frequency requirement for calculating FDR hedge portions, to ensure that no more than one FDR hedge portion calculation is required per unit pricing period.

Recommendation

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

Issue: Portfolio method - period should be aligned to hedging policy period

Submission

(Financial Services Council, KPMG)

The period for calculating FDR hedge portions under the proposed portfolio method will be limited to a maximum of one month. While most hedges will mature monthly this will not always be the case and some taxpayers will have a hedging policy of entering hedges with a period greater than a month. To provide more flexibility, the submitters consider that the rules should allow the period chosen under the portfolio method to match the actual hedging strategy of the fund. Otherwise, where a hedging policy is greater than one month, taxpayers will have different tax outcomes from applying the portfolio method compared with the hedge-by-hedge methods.

If a time limit on the portfolio period is required, it could be capped at a quarter. *(KPMG)*

Comment

When designing the portfolio method, it was officials' expectation that there will be hedges that have different FDR hedge portions applying to them over their life. This is due to the FDR hedge portions being reset on a periodic basis, rather than being set at the time the hedge is first entered into.

Officials also expect that taxpayers will have different tax outcomes by applying the portfolio method compared to the hedge-by-hedge methods, regardless of how regularly FDR hedge portions are reset. This is because the FDR hedge portion applied to a hedge will be determined on a whole-of-portfolio basis rather than on a hedge-by-hedge basis.

Officials' primary reason for limiting the maximum portfolio period to one month is to balance lowering compliance costs for taxpayers (that is, by having to perform FDR hedge portion calculations less frequently) with some degree of accuracy in the FDR hedge portions. Officials consider a maximum portfolio period of one month strikes the right balance.

Recommendation

That the submission be declined.

Issue: Portfolio method – election to apply the method binding for four years

Submission

(KPMG)

The submitter considers that the requirement to ensure consistency by applying the new portfolio method for a minimum of four years after election is too onerous. To provide flexibility, this requirement should be shortened to 12 months.

Comment

Officials consider that a consistency requirement is needed to maintain the integrity of the rules and prevent taxpayers from changing between different methods for calculating income from foreign currency hedges to gain a tax advantage.

The four-year period was chosen to align with the approach set out in section EX 52A in relation to changing between the annual and periodic methods for calculating FDR income. However, officials agree that this period could be shortened.

Points of difference

Officials consider that reducing the period to 24 months (rather than 12 months as submitted) will provide adequate balance between flexibility for taxpayers and integrity in the rules.

Further, there should be a corresponding restriction on re-electing to apply the portfolio method for 12 months to prevent taxpayers changing between methods for calculating income to gain a tax advantage.

To help make the system more flexible, officials consider that the Commissioner should also be allowed to agree to a reduced election and re-election period prospectively when there are genuine commercial reasons that require a change in method for calculating FDR hedge portions. Where the Commissioner agreed, taxpayers would then be able to cease an election to apply the portfolio method within 24 months or re-elect within 12 months. Genuine commercial reasons that warrant a change in method could include where a taxpayer changes service provider and the new service provider only supports one of the methods for calculating FDR hedge portions.

Recommendation

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

Issue: Portfolio method – election of calculation period binding for four years

Submission

(KPMG)

The submitter considers that the four-year consistency requirement for the periodic basis used to calculate the FDR hedge portion under the portfolio method is unduly restrictive. This is because hedging strategies can and will change over time. The periodic consistency requirement should be limited to 12 months.

Comment

Officials agree. The consistency requirement should apply for an income year.

Recommendation

That the submission be accepted.

Issue: Clarification of portfolio method opening values

Submission

(New Zealand Superannuation Fund)

In proposed section EM 5B, the FDR hedge portion is to be calculated at the start of the period, based on closing values for the last day of the previous period. However, the example in the Commentary to the Bill refers to values for the first day of the period. The submitter considers that the appropriate treatment should be clarified.

Comment

Officials consider that the FDR hedge portion under the portfolio method is intended to be calculated using the opening values for the period. In practice, the opening values are the closing values of the previous period. The example in the Commentary to the Bill is meant to reflect this treatment. Clarification will be provided in the *Tax Information Bulletin* issued by Inland Revenue after the Bill's enactment.

Recommendation

That the submission be noted.

Issue: Introduce a determination-making power

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Financial Services Council, KPMG)

The submitters consider that the FDR FX hedges rules are very technical and taxpayers can strike difficulties ensuring they meet the specific requirements. To provide for greater flexibility in the rules, a determination-making power should be introduced to allow taxpayers to come to an agreed application with the Commissioner of Inland Revenue. This would allow taxpayers' unique circumstances to be taken into account while also ensuring any proposed methodology is consistent with the policy intent of the rules.

Comment

Officials disagree that a determination-making power should be introduced.

Officials consider that the current proposals, particularly the new portfolio method, will address the issue of taxpayers not being able to apply the rules from a practical perspective. This position is strengthened by the above recommendations to improve the portfolio method (see ["Issue: Portfolio method should be available to non-daily unit valuers"](#), ["Issue: Portfolio method – election to apply the method binding for four years"](#), ["Issue: Portfolio method –](#)

[election of calculation period binding for four years](#)” above). Further, it would be preferable to determine if the current proposals adequately address taxpayers’ concerns before consideration is given to introducing a determination-making power.

In addition, determination-making powers can be difficult to apply in practice and require ongoing Inland Revenue resources to administer.

Recommendation

That the submission be declined.

Issue: Multiple methodologies/formulas in section EM 5

Submission

(KPMG)

The submitter considers that, while the modification to the second hedge-by-hedge formula for calculating fair dividend rate (FDR) hedge portions is required, it adds further complexity to an already complex and technical set of rules. Additionally, the inclusion of both hedge-by-hedge methods for calculating FDR hedge portions in section EM 5 can lead to confusion. Therefore, section EM 5 should be modified to clearly separate the two hedge-by-hedge methods. At a minimum, there needs to be clear signposting of the different methods.

Comment

The proposed amendments to section EM 5 are required to ensure that the second hedge-by-hedge formula for calculating FDR hedge portions works as intended when a taxpayer’s non-eligible assets are fully hedged. However, officials acknowledge that the layout of section EM 5 following the proposed changes could make it difficult to follow.

Points of difference

Officials consider this issue could be best addressed by changing the legislative wording in section EM 5 from “formula” to “method” and including appropriate signposting in the legislation of the two different hedge-by-hedge methods for calculating FDR hedge portions.

Recommendation

That the submission be accepted, subject to officials’ comments above.

Issue: Support for de minimis threshold for non-eligible assets

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Financial Services Council, KPMG)

The submitters support the principle of introducing a de minimis threshold for non-eligible assets to ensure that immaterial foreign cash balances do not reduce FDR hedge portions.

Recommendation

That the submission be noted.

Issue: De minimis threshold should be 5% of the market value of the fund

Submission

(Corporate Taxpayers Group, Deloitte, Financial Services Council)

The submitters consider that the de minimis threshold for non-eligible assets should be set at 5% of the market value of the fund, rather than the value of the fund's eligible assets. This is because foreign cash holdings can fluctuate due to large applications or redemptions with negative implications for FDR hedge portions.

Comment

The purpose of the de minimis threshold for non-eligible assets is to provide a concession where foreign cash is held for liquidity purposes by a fund that invests in eligible assets, or due to outstanding settlements of eligible assets or dividends derived from eligible assets. Therefore, in officials' view, it is appropriate to calculate the de minimis threshold based on the value of eligible assets.

Recommendation

That the submission be declined.

Issue: Temporary breaches of de minimis threshold should be allowed

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Financial Services Council, KPMG)

Submitters consider the rules should include an allowance for a temporary breach of the de minimis threshold for non-eligible assets. This is because taxpayers will often temporarily exceed the 5% threshold due to large investor redemptions, significant applications or investment rebalancing. The increase in non-eligible assets held resulting from these events will often only last a few days and will cause taxpayers to breach the de minimis threshold when they occur on or near valuation dates.

To address this issue:

- The de minimis threshold should be extended to account for circumstances where a taxpayer does not hedge the cash assets and may exceed the 5% threshold for only a short period of time. *(Corporate Taxpayers Group, Deloitte)*
- The de minimis threshold should include an allowance for a temporary breach for 2-3 days at any point. *(Chartered Accountants Australia and New Zealand)*

- The de minimis threshold should allow for large investor redemptions where the increase in non-eligible assets (that is, foreign cash) is solely due to an investor redemption across the quarter end. (*Financial Services Council*)
- Breaches that result from an unexpected sudden fall in market values should be allowed to be corrected within a period from where the event has occurred at quarter end. (*Financial Services Council*)
- The de minimis threshold should allow limited breaches for defined events. Alternatively, the de minimis threshold should be applied on a weighted average assets basis over the relevant calculation period. (*KPMG*)

Comment

Officials agree that foreign cash held due to investor redemptions, applications, investment rebalancing or dividend payments should be excluded from non-eligible assets to the extent they relate to investment in eligible assets. The de minimis threshold is intended to provide a low compliance cost solution to this problem by allowing foreign cash, with a maximum value of less than 5% of eligible assets, to be excluded from non-eligible assets.

Officials note this exclusion applies even if the actual foreign cash balances held equal or exceed 5% of the value of eligible assets, that is, breaches of the threshold do not have a cliff edge effect. Officials consider the 5% threshold strikes the right balance between compliance cost savings and the need for accuracy in non-eligible asset value calculations.

Point of difference

However, to provide further flexibility, officials recommend introducing an alternative to the 5% de minimis threshold that would allow taxpayers to exclude actual foreign cash balances from non-eligible assets to the extent they relate to eligible assets and FDR hedge portions – for example, foreign cash held due to dividend payments, redemptions, applications and investment rebalancing in connection with eligible assets and foreign cash held for the purpose of settling margin calls in connection with FDR hedge portions.

Under this approach, where a taxpayer breached the 5% threshold, they would then have the alternative option of determining the actual value of foreign cash held in connection with eligible assets that should be removed from the quantum of non-eligible assets.

Recommendation

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

Issue: Support for optional look-through rule

Submission

(*Corporate Taxpayers Group, Deloitte, Financial Services Council, KPMG*)

The submitters support the proposal to introduce an optional look-through rule to allow funds to include their indirectly held eligible assets in their calculation of eligible assets.

Recommendation

That the submission be noted.

Issue: Optional look-through rule should be extended beyond single inter-funding level structure

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Financial Services Council)

The proposed new optional look-through rule allows taxpayers to look through an investment in a multi-rate PIE for the purposes of determining the value of eligible assets. Submitters consider this rule should be broadened to allow taxpayers to look through multiple layers of multi-rate PIEs.

Comment

Officials agree that broadening the rule in this way is appropriate and consider this will align with the policy intention of the proposal in the Bill.

Recommendation

That the submission be accepted.

Issue: Hedges entered and settled within a valuation period

Submission

(KPMG)

The submitter acknowledges that there is a concern that hedges entered into and settled within a valuation period might avoid a tax liability under both the FDR FX hedges rules and the financial arrangements rules. However, the submitter is concerned it may add further complexity to an already very complex regime.

Comment

Officials' view is that the proposed change to the treatment of hedges entered into and settled within a valuation period should proceed.

Taxpayers who are non-daily unit valuers can enter into hedges with a term less than their valuation period. While an FDR hedge portion is required to be calculated for these hedges under the current rules, no income or loss is determined because the hedges have no opening value. The relevant hedge portions are also outside the scope of the financial arrangements rules and therefore outside the tax base.

The proposed change will ensure that an amount of income (or loss) is calculated for these hedges. Officials consider that this is an appropriate outcome, and any added complexity is appropriate to maintain the integrity of the rules.

Recommendation

That the submission be declined.

Issue: Timing of quarterly FDR hedging ratio test

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Financial Services Council)

Under section EM 7, a taxpayer must calculate a quarterly FDR hedging ratio to ensure that their FDR hedge portions for eligible hedges remain appropriate.

Submitters consider that requiring this calculation to be performed on the last day of each quarter can increase the chance of the ratio being breached. This is because taxpayers will often rebalance their hedging activity early in the month. Further, performing the calculation on the last day of each quarter is difficult from a practical point of view due to the timing delays for unit pricing and New Zealand time differences with global exchanges.

This requirement should be amended so that taxpayers can elect their own date within a quarterly period.

This suggested change could be subject to a consistency requirement, so that taxpayers undertake the quarterly testing at the same time in every quarter. *(Chartered Accountants Australia and New Zealand)*

As an alternative solution, the requirement to reset FDR hedge portions should not apply where the ratio is brought back within the acceptable level within a defined short period, for example, three working days. *(Corporate Taxpayers Group, Deloitte)*

Comment

Officials agree.

Taxpayers should be allowed to elect their own date within a quarter for performing the quarterly FDR hedging ratio calculation.

Point of difference

However, this election should be subject to a consistency requirement whereby taxpayers are required to perform the calculation on the same day of each quarter for an income year.

Recommendation

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

Issue: Support for amendment of eligible hedge requirements

Submission

(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Superannuation Fund)

Submitters support the amendment to remove the requirement that an eligible hedge must have one leg in New Zealand dollars, provided these hedges are entered into to adjust the hedging position of existing hedges on hand that have one leg in NZD.

Recommendation

That the submission be noted.

Issue: Support for proposed amendments

Submission

(KPMG)

Submitter supports the proposal to allow for the transfer of eligible hedges by amending the definition of "eligible hedge".

Submitter supports the amendment to the rules to ensure they work as intended when applied to a hedge of a hedge.

Submitter supports the proposal to exclude New Zealand securities listed on foreign exchanges from the definition of non-eligible assets.

Recommendation

That the submissions be noted.

Issue: Proposals should apply retrospectively

Submission

(New Zealand Superannuation Fund)

The application date for the proposed amendments is currently income years beginning on or after 1 April 2022. Given the rules have been in place for several years, and the amendments largely allow for the rules to work in practice, the submitter considers taxpayers should be allowed to apply the amendments retrospectively for any period not yet finalised at the date of enactment.

Comment

The FDR FX hedges rules only apply to eligible hedges prospectively once an election to apply the regime to those hedges has been made. This is to ensure taxpayers cannot gain a tax advantage by choosing to apply the rules to historic foreign currency gains or losses on hedges. Officials do not support a retrospective application of the rules for this reason.

Recommendation

That the submission be declined.

Issue: Examples should be removed

Submission

(Corporate Taxpayers Group, Deloitte, Financial Services Council)

The submitters consider that the examples in proposed sections EM 5(10B) and EM 8(b)(i) should be removed and instead be incorporated into appropriate guidance.

Comment

Officials agree with this submission.

Recommendation

That the submission be accepted.

Issue: Minor drafting error

Submission

(Matter raised by officials)

Clause 73 of the Bill contains a minor drafting error.

The word "to" should be inserted before "income or expenditure" in the last sentence of the proposed new section EM 4(1).

Recommendation

That the submission be accepted.

USE OF TAX POOLING TO SATISFY A BACKDATED TAX LIABILITY

Clause 125

Issue: Support for proposal

Submission

(Corporate Taxpayers Group, Deloitte, PwC)

Submitters support the proposal to allow taxpayers to satisfy a tax liability arising from a voluntary disclosure where there is no existing assessment.

Recommendation

That the submission be noted.

Issue: Guidance on “reasonable time”

Submission

(PwC)

Inland Revenue should issue clear guidance as to what the Commissioner of Inland Revenue will set as a “reasonable time”.

Comment

Further guidance will be published as to what will be considered a “reasonable time” in a *Tax Information Bulletin*.

Recommendation

That the submission be noted.

Issue: Application where no shortfall penalties

Submission

(PwC)

The proposed amendment should be amended so that the use of tax pooling to satisfy a liability arising from a voluntary disclosure where there is no existing assessment is available to taxpayers where no shortfall penalties have been imposed following a voluntary disclosure.

Comment

Although the imposition of shortfall penalties is a good measure of the taxpayer failing to take reasonable care, officials note that it may be a different measure than failing to take reasonable care for the purposes of this clause. In addition, the Commissioner could use her discretion not to impose shortfall penalties for failure to take reasonable care in certain situations, but the Commissioner exercising this discretion should not automatically allow taxpayers to make use of the proposed amendment.

Recommendation

That the submission be declined.

OVERSEAS DONEE STATUS

Issue: Update of charity name

Submission

(Matter raised by officials)

Schedule 32 should refer to Child Rescue Charitable **Aid** Trust (emphasis added) from 11 August 2017, the date the trustees changed the charity's name.

Destiny Rescue Charitable Aid Trust (the Trust) was granted overseas donee status with effect from 1 April 2016. In 2017, the trustees changed the charity's name to Child Rescue Charitable Aid Trust. Schedule 32 was updated to reflect the change as part of the Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018.

However, the word "Aid" was omitted from the relevant amendment. The trustees have asked officials to correct the reference to the Trust's name.

Officials have not identified any administrative or compliance concerns with backdating the reference to the Trust to that date.

Recommendation

That the submission be accepted.

Interest limitation

GENERAL ISSUES

Clause 64E

Issue: Support for interest limitation rules

Submission

(Christopher Buddenhagen, Deborah Pickstone, Jonathan Braniff, Michael Nieuwoudt, Sam Gribben, Sarah Russell, Susie Brown)

Submitters support the proposed interest limitation rules.

Recommendation

That the submission be noted.

Issue: Opposition to interest limitation rules

Submission

(Carol Jopson, Chartered Accountants Australia and New Zealand, Deborah Lomax, Deloitte, EY, Findex, Kiwi Property Group Limited, KPMG, Magan Lal, Michael Fox, nsaTax Limited, Olivershaw Limited, Real Estate Institute of New Zealand, Richard Jordan, Sarah Meikle, Simeon Clarke, Terence Denton, The Bluekiwi Property Consulting Trust)

Submitters expressed opposition to the proposed interest limitation rules.

Many submitters considered the proposed rules to be unfair:

- Tax is generally levied on net, rather than gross, income, and interest is a legitimate business expense for landlords, as for other businesses. *(Carol Jopson, Deborah Lomax, Michael Fox, Sarah Meikle, Simeon Clarke, Terence Denton)*
- The proposed rules negatively impact smaller taxpayers but will not significantly affect larger taxpayers. *(Simeon Clarke, The Bluekiwi Property Consulting Trust)*

Submitters also considered the proposed rules were inefficient, and some doubted whether they would have the desired impact of reducing house prices:

- The proposed rules will create distortions and inefficiencies. *(EY, Findex, KPMG)*
- The proposed rules discourage saving for retirement. *(Terence Denton)*
- The proposed rules increase the tax risk of investing into New Zealand and send a negative signal to investors. *(Magan Lal, Olivershaw Limited)*
- High house prices were driven by factors other than tax, such as supply. *(KPMG, Real Estate Institute of New Zealand, Terence Denton)*
- The proposed rules will not discourage investment into residential property but will merely alter the mix of investors in the sector. Investors will use debt to fund their purchases of new builds and use their equity to buy existing properties. *(EY)*
- High house prices are driven by speculators and the proposed rules target long-term investors rather than speculators. *(Magan Lal)*

- The proposed rules discourage developers from building new houses. (*Magan Lal*)

Comment

Officials note the points raised by submitters in opposition to the interest limitation rules.

Officials consider that additional taxes on rental housing are unlikely to be an effective way of boosting overall housing affordability. While they would put downward pressure on house prices, they would put upward pressure on rents and may reduce the supply of new housing developments in the longer term. However, officials note that the proposed interest limitation rules are part of a wider package of Government reforms on housing. While the interest limitation rules are focused on the Government's demand-side housing objectives, the Government has also progressed other measures aimed at increasing the supply of housing in the longer term. Those supply-side measures may offset the impact of the interest limitation rules on housing supply.

Overall, officials consider the benefit of increased housing affordability for first-home buyers is outweighed by negative impacts on rents and housing supply, high compliance and administration costs for an estimated 250,000 taxpayers, and the erosion of the coherence of the tax system. Officials' views are set out in more detail in the *Regulatory Impact Statement: Limiting interest deductibility on residential investment property* (8 September 2021).

Recommendation

That the submission be noted.

Issue: Complexity of the rules

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Chartered Accountants Australia and New Zealand, Deloitte, EY, Findex, Jim Gordon Tax Limited, KPMG, nsaTax Limited, Olivershaw Limited, Terence Denton)

The proposed interest limitation rules are very complex and should be simplified where possible.

The complexity of the rules will increase compliance costs. In particular, many taxpayers who will have to apply the rules will not be sophisticated taxpayers and may not use tax advisors. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Chartered Accountants Australia and New Zealand, EY, Findex, Olivershaw Limited)*

The complexity of the rules is going to be difficult to administer for Inland Revenue. *(Findex)*

Some of the complexity in the rules is unnecessary. An example is the overlap with existing provisions such as the residential rental loss ring-fencing rules. *(Chartered Accountants Australia and New Zealand, EY, KPMG)*

The drafting could also be made easier to read and more user-friendly. *(Chartered Accountants Australia and New Zealand, Deloitte, EY, KPMG, nsaTax Limited)*

Comment

Officials agree the proposed rules are complex and complexity tends to increase compliance costs. However, most taxpayers will not need to deal with most of the complexity.

Based on recent return data, around 80 percent of landlords use a tax agent. Taxpayers who do not use a tax agent are likely to be smaller taxpayers with relatively straightforward affairs. Such taxpayers are unlikely to need to understand all the rules. For example, some of the proposed rules apply only to companies, but around 90 percent of the landlords that are companies have a tax agent.

The reasons for complexity are:

- Some complexity is inevitable and inherent in the proposed rules themselves. For example, the rules apply only to residential properties, but some properties are used for both commercial and residential purposes.
- Some complexity is due to the various exemptions and concessions in the rules. For example, rollover relief allows taxpayers to change how property is held without triggering a 'disposal' under the bright-line test or losing grandparenting treatment of interest deductions.
- Some complexity arises because the rules need to apply to existing loans. For example, taxpayers who had previously used their borrowings for both residential rental and other business purposes will need to work out how much of their borrowings are allocated to residential rental purposes, and this may be complex.
- Lastly, some complexity is needed for integrity reasons. For example, interposed entity rules ensure that taxpayers cannot get around the rules by borrowing to acquire residential property indirectly, but most taxpayers will not need to apply these necessarily complex rules.

In designing the rules, officials have endeavoured to keep the rules and the drafting simple where possible. Officials are very conscious that the rules will apply to some smaller taxpayers that have limited interaction with the tax system and do not use tax advisors. The drafting of legislation often involves a trade-off between accuracy and simplicity.

Where submitters have given specific examples of complexity, the point is dealt with separately (for example, the interaction with the existing residential rental loss ring-fencing rules is addressed in ["Issue: Repeal of residential rental loss ring-fencing rules"](#) below).

Inland Revenue is investing in data and analytics to assist with the administration of the rules and support their integrity. While initially the focus is on providing taxpayers and third parties with clear information and assistance, automated analytic and intervention capabilities will be deployed, with follow-up activity for cases of obvious deliberate non-compliance.

Recommendation

That the submission be noted.

Issue: Impact on renters

Submission

(Carol Jopson, Jonathan Braniff, Kiwi Property Group Limited, Magan Lal, Michael Fox, nsaTax Limited, Olivershaw Limited, Real Estate Institute of New Zealand, Richard Jordan, Sarah Meikle, Terence Denton)

Submitters considered that the proposed interest limitation rules would negatively impact renters. Several reasons were given:

- Some landlords will exit the rental market, which will reduce the supply of rentals and lead to increased rents. (*Carol Jopson, Olivershaw Limited, Real Estate Institute of New Zealand*)
- Landlords that remain in the market will pass on their increased costs by increasing rents. (*Jonathan Braniff, Kiwi Property Group Limited, Magan Lal, Michael Fox, nsaTax Limited, Real Estate Institute of New Zealand, Sarah Meikle, Terence Denton*)
- Landlords will prefer new builds, which will come with significantly higher rental. Renters who are not in the position, or do not want, to buy a home will generally not be able to afford the higher rental. (*Olivershaw Limited*)
- The proposed rules would discourage landlords from upgrading and renovating their properties. (*Magan Lal*)

Comment

As noted in "[Issue: Opposition to interest limitation rules](#)" above, officials agree that the interest limitation rules will put upward pressure on rents. Officials consider that, in the long run, affordability for renters will not be promoted by taxing the provision of rental properties by landlords more heavily.

In the immediate term, property investors are constrained in their ability to increase rents in response to the interest limitation changes. This is because rents can only be increased once every 12 months.

After that initial 12-month period, in the short term, it is unlikely that landlords will be able to pass on any significant share of the additional tax costs, but this may not hold in specific circumstances where tenants have limited choice.

In the medium to long term, rents may rise in line with any impact on the supply of new build housing. The reduction of interest deductions may lead to fewer investors purchasing property as rental accommodation and may tend to reduce new house building and housing supply in the long run. This decrease of rental accommodation being added to the rental market may lead to increased rent.

Recommendation

That the submission be noted.

Issue: Impacts for low- to middle-income landlords

Submission

(*Anglican Financial Care, Terence Denton*)

Limiting interest deductions would increase a person's taxable income above what their actual (net) income is, which can have flow-on impacts for taxpayers. For example, it could push them into a higher marginal tax bracket, affect the prescribed investor rate (PIR) used for their KiwiSaver and other investments, and affect their benefit entitlements.

These flow-on impacts affect lower income earners more than higher income earners, which makes the proposed rules regressive. (*Terence Denton*)

The rules should be revised to be consistent in terms of their treatment of KiwiSaver taxation for all taxpayers irrespective of property ownership. One option is for net rent to be taxed as

a separate income stream, similar to the way portfolio investment entities (PIEs) are currently taxed, with new builds qualifying for a lower PIR. (*Terence Denton*)

Comment

Officials agree that limiting interest deductions can have flow-on impacts for a person's marginal tax rate, PIR, Working for Families (WFF) and other means-tested entitlements. It is also true that these flow-on impacts are likely to be felt more by low- and middle- income landlords than high-income landlords. High-income landlords will typically already be on the highest marginal tax rate and PIR and are less likely to receive means-tested entitlements.

Marginal tax rates and PIRs are both determined according to a person's "taxable income", as calculated under the Income Tax Act 2007. Officials consider that the flow-on impact on marginal tax rates and PIRs is an inherent and unavoidable consequence of limiting interest deductions. Taking interest expenses into account when determining marginal tax rates and PIRs, even if those expenses were not deductible in calculating a person's taxable income, would increase the complexity of the rules and be extremely confusing for most taxpayers.

Similarly, the limiting of interest deductions has a consequential impact on the amount of WFF entitlements a landlord may be entitled to. WFF entitlements are calculated based on "family scheme income". Family scheme income is based on a person's (and their partner's) "net income".¹ If a landlord earns rental income or derives a taxable gain on the sale of land (for example, under the bright-line test), that income or gain would be included in their net income and therefore their family scheme income. Limiting interest deductions would therefore increase a landlord's family scheme income and, consequently, reduce any WFF entitlements they may receive.

For the following reasons, officials do not recommend any changes to the proposed interest limitation rules to still allow interest deductions when determining a landlord's marginal tax rate, PIR or WFF entitlements (family scheme income):

- The flow-through impact of the interest limitation rules is inherent in the design of the rules. If interest deductions were still allowed when calculating family scheme income for WFF purposes, it would effectively mean landlords receiving WFF (and other means-tested entitlements) would be compensated for the removal of interest deductibility at the expense of non-landlords receiving WFF (and other means-tested entitlements). This result was not intended.
- For WFF entitlements in particular, the number of landlords affected is very small. We estimate approximately 5,600 WFF recipients could potentially be affected by the interest limitation rules once they are fully phased in by 2025.² This figure represents around 1.6 percent of all WFF recipients.
- It would increase the complexity of the rules and be extremely confusing for taxpayers. In particular, under the interest limitation rules, previously limited interest deductions would be allowed on sale if a landlord's property is sold for a taxable gain. In such a case, the landlord's taxable income/family scheme income would be reduced by those interest deductions in the year of sale. However, if those interest deductions had already been taken into account in earlier income years in determining, for example, the person's WFF entitlements, it would not be appropriate for those deductions to be taken into account again in the year of sale. "Backing out" those deductions in the year of sale would create further complexity.

¹ Net income, unlike taxable income, does not take into account any tax losses a person may have. For the purposes of calculating a person's family scheme income, there may be certain adjustments made to net income. For example, some income that is exempt from tax is nevertheless taken into account in calculating family scheme income.

² This is a conservative upper estimate based on 2020 tax year data.

Recommendation

That the submission be declined.

Issue: Application date

Submission

(Kiwi Property Group Limited, KPMG, Terence Denton)

Several submitters considered the application date should be deferred.

A later application date would mean that taxpayers do not have to take tax positions based on rules that have not yet been enacted and are still pending. *(Kiwi Property Group Limited, KPMG)*

A later application date would:

- give more time for Inland Revenue, taxpayers and other stakeholders to ready their systems for a smooth transition
- allow affected parties to better understand and prepare for the changes to avoid confusion and non-compliance, and
- allow tax practitioners to provide timely and accurate advice to their clients.

In contrast, a rushed application could lead to unintended consequences. *(Kiwi Property Group Limited)*

Submissions differed in how the application date could be deferred.

- a. Two submitters suggested deferring the date from 1 October 2021 to 1 April 2022. *(Kiwi Property Group Limited, KPMG)*
- b. Alternatively, the application date could be split so that the rules for existing properties acquired before 27 March 2021 would only apply from 1 April 2022, while the rules for properties acquired on or after 27 March 2021 would still apply from 1 October 2021. *(KPMG)*

Comment

Officials note that by the time taxpayers have to take a tax position (that is, by the time they have to file income tax returns or make a provisional tax payment), the rules will have been enacted.

For almost all affected taxpayers, the changed rules will affect their income tax year ended 31 March 2022. Taxpayers with a standard balance date will not have to file their income tax return until July 2022. Taxpayers with a tax agent and an extension of time will have until March 2023 to file their return.

Taxpayers who pay provisional tax may have an increased residual income tax liability resulting from the proposed changes that they may not have taken into account in their provisional tax calculation. Most of those taxpayers will be able to avoid incurring use of money interest (UOMI) following enactment of the new rules by including the difference in either their third provisional tax payment (due by 7 May 2022) or in their terminal tax date payment due in February or April 2023 (whichever applies to the particular taxpayer). However, officials note that taxpayers who choose to estimate their provisional tax liability,

instead of applying the standard uplift, may incur UOMI if they do not factor in the proposed changes and thereby underestimate their increased residual income tax.

- a. Officials consider there is some merit in the suggestion to defer the application date to 1 April 2022. A later application date would give taxpayers and their advisors more time to familiarise themselves with the new rules.

However, the Government has already announced and committed to an application date of 1 October 2021. Inland Revenue has been working towards that application date, so a later application date would make the transition more difficult (rather than easier) for Inland Revenue. There are also other stakeholders, such as software providers and third parties, who have prepared themselves for an application date of 1 October 2021 and may have to rearrange things if the application date were changed.

Inland Revenue also plans to run a targeted communication campaign. Initially this will be to raise awareness and ensure taxpayers can access relevant information easily following enactment. Closer to the filing due dates, it will be to educate customers about what they need to do differently when they file their income tax return.

Deferring the application date to 1 April 2022 is estimated to have a fiscal cost of around \$80m.

- b. Officials do not consider a split application date for properties acquired before and after 27 March 2021 is justified. There is no reason why taxpayers with properties acquired before 27 March 2021 need more time to become familiar with the rules than taxpayers acquiring property on or after 27 March 2021. A split application date would also add unnecessary complexity.

Recommendation

- a. That the submission be declined.
- b. That the submission be declined.

Issue: Permanent grandparenting

Submission

(Magan Lal, Terence Denton)

Interest deductions on all loans drawn before 27 March 2021 for existing residential property investments should be excluded from the proposed interest limitation rules.

Excluding all loans drawn down before 27 March 2021 will reduce the unforeseen impact of the proposed rules on retirement planning. *(Terence Denton)*

Comment

Officials disagree. The purpose of the proposed interest limitation rules is to reduce investor demand for existing residential properties and increase housing affordability. Permanent grandparenting (that is, excluding loans drawn down before 27 March 2021) will significantly lessen the impact of the proposed rules. It could also be seen as unfair for new property investors, as they would face a higher tax cost than existing investors even if they had the same level of debt and owned the same value of residential property.

Permanent grandparenting is also likely to create a "lock-in" effect. Existing investors would have a strong incentive to retain properties acquired using grandparented loans (and not to

pay down that debt),³ which may frustrate the objective of the proposed rules. Permanent grandparenting also tends to create complexity as taxpayers try to maintain grandparenting status for as long as possible.

Temporary grandparenting is already proposed for loans drawn down before 27 March 2021. The proposed rules progressively deny interest deductions for grandparented loans from 1 October 2021 to 31 March 2025, with interest deductions fully limited from 1 April 2025. This will mitigate cash flow concerns for existing investors without creating a strong lock-in effect.

Recommendation

That the submission be declined.

Issue: Exemptions for small investors

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Deborah Lomax, Findex, Kathryn Law, Kelly Moore, Sarah Meikle, Simeon Clarke, Terence Denton)

The rules should not apply to taxpayers with gross rental income of less than \$30,000. Smaller investors will be hit hardest by additional costs, but they are not the cause of high house prices as they cannot leverage up significantly and outbid first home buyers. They may also not have access to the level of advice necessary to comply with the rules. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)*

The rules should not apply to small “mum and dad” investors generating income for retirement. *(Deborah Lomax)*

The rules should not apply to taxpayers with only one rental property, as they are generating income for retirement. This may mitigate the impact of the rules on renters. Taxpayers with only one rental property may have to either increase their rents to cover the cost of denied interest deductions or sell their properties (which will impact tenants). *(Findex, Kathryn Law, Sarah Meikle)*

The rules should not apply to taxpayers with fewer than three rentals. *(Kelly Moore, Simeon Clarke)*

Comment

Officials disagree. The various exemptions suggested by submitters could significantly reduce the effectiveness of the proposed interest limitation rules on housing affordability. The proposed exemptions would also make the rules significantly harder for Inland Revenue to administer and enforce.

In addition, officials consider the suggested exemptions would create integrity issues and increase overall complexity, rather than reduce it. As noted above under [“Issue: Complexity of the rules”](#), most small investors would have relatively straightforward affairs and would not need to incur significant compliance costs in applying the rules. It is generally better to

³ Although table loans, under which the loan principal is repaid over time, are most common in New Zealand, there are other loans (for example, interest-only, revolving credit) where the loan principal does not have to be repaid. If permanent grandparenting were allowed, taxpayers would have an incentive to refinance into these other types of loans.

lower compliance costs by simplifying rules where possible rather than by providing exemptions that create new boundary issues.

If, for example, the rules did not apply to taxpayers with only one rental property, a family with multiple properties could restructure so that properties were owned by different individuals. Issues would also arise with properties held in family trusts or companies. Addressing situations where a taxpayer bought another property or changed their “exempt” property could also be complex. A taxpayer would be incentivised to elect for a more expensive property, or a property they intended to sell outside the bright-line period, to be exempt from the interest limitation rules.

Recommendation

That the submission be declined.

Issue: Total loan cap per taxpayer

Submission

(Terence Denton)

There should be a total loan cap per taxpayer under which interest remains fully deductible. For example, taxpayers with total loans less than \$500,000 would not have to apply the proposed interest limitation rules. This would reduce compliance costs for smaller investors.

Comment

A loan cap would significantly reduce the effectiveness of the interest limitation rules on housing affordability, particularly if it were set at \$500,000. A loan cap would also raise many of the same integrity and complexity issues outlined above under [“Issue: Exemptions for small investors”](#).

Recommendation

That the submission be declined.

Issue: Taxpayers required to live in accommodation connected to their employment

Submission

(Anglican Financial Care)

Persons required to live in accommodation connected to their employment (for example, clergy living in a vicarage) will often acquire a property intending to live in it when they retire and rent the property out in the interim. These persons should not be subject to the interest limitation rules.

Comment

Officials disagree. A person renting out a residential property is a landlord. Officials do not consider it relevant what type of accommodation that landlord lives in. Landlords living in accommodation connected to their employment are not in a different situation from landlords living in ordinary rental accommodation. Landlords may live in rental accommodation for

various reasons (for example, they may be on a secondment for work, or they may not be able to afford a property in the city in which they live). Landlords living in owner-occupied housing are arguably in a different position, but the fact a person is not using one tax exemption (the main home exemption) does not mean they should be allowed another tax exemption.

It is also irrelevant whether that person intends to live in that rental property in the future. A person buying a property they intend to live in in the future does not currently get interest deductions under the law unless there is a nexus with assessable income (for example, they rent it out). An exemption based on intention is also very difficult to administer.

Officials also note there may be integrity risks if persons who do not live in owner-occupied housing are more generally excluded from the rules. For example, a person may buy a property, rent it out in their child's name and say that their child intends to live in it in the future.⁴

Recommendation

That the submission be declined.

Issue: Partial interest deductions

Submissions

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Christopher Buddenhagen, Kathryn Law, Terence Denton)

Submitters suggested that only 50 percent of interest deductions should be limited, rather than 100 percent:

- a. This would better reflect the current position that capital gains on sales are untaxed. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)*
- b. This would offset some of the negative impacts of the rules. *(Terence Denton)*
- c. This should apply for a taxpayer's first or only investment property. *(Christopher Buddenhagen, Kathryn Law)*

Comment

The proposed interest limitation rules are aimed at reducing investor demand for residential properties and increasing housing affordability. Partially limiting interest deductions would lessen the impact of the proposed rules without reducing any of the complexity or compliance costs.

- a. Although one reason for limiting deductions is because the interest expense is incurred partly to derive a non-taxable capital gain, the primary reason for the rules is to help achieve the Government's housing objectives. Officials note that other expenses relating to a residential rental property (for example, holding costs) are fully deductible, even if they are also arguably incurred in part to derive a capital gain.
- b. Limiting 50 percent of interest deductions would reduce the positive impacts of the rules as well as some of the negative impacts.

⁴ While the exclusion could be restricted so that it does not apply to minors, the issue can also arise with adult children.

- c. Limiting 50 percent of interest deductions for a taxpayer's first or only investment property would give rise to integrity issues and increase the complexity of the rules. The reasons for officials' views on this are largely the same as those outlined above (see ["Issue: Exemptions for small investors"](#)).

Recommendation

That the submissions be declined.

Issue: Guidance

Submission

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

Submitters recommended that clear and comprehensive guidance be provided by Inland Revenue to help taxpayers comply with the interest limitation rules.

The guidance should illustrate the interaction between the bright-line rules and interest limitation rules. *(Chartered Accountants Australia and New Zealand)*

There should be clear guidance on how the specific anti-avoidance rules in sections GB 53B and GB 53C may be applied in practice. *(KPMG)*

Comment

Inland Revenue will provide guidance and tools, such as guided help, online calculators and 'how-to' videos, to help customers work out if the new rules apply to them, whether any exemptions apply, and how to calculate the amounts of interest deductions. The guides and tools will be available online by April 2022 to align with taxpayers beginning to file their tax returns.

Inland Revenue will work with tax professionals to get their feedback and input into the tools, products, and services for tax agents and their customers.

A targeted education campaign is planned if, and once, the proposed rules are enacted. This will raise awareness of the new rules and educate taxpayers about the changes and what they will need to do differently when they file their income tax return.

Recommendation

That the submission be noted.

Issue: Sunset provision

Submission

(Jim Gordon Tax Limited)

The interest limitation rules were originally proposed as an extraordinary response to the unprecedented increases in house prices. If house price increases slow or stop, the rules should be "turned off", perhaps via an Order in Council or a sunset clause.

Comment

Officials do not consider a sunset provision would be suitable. Tax law is more complex than situations where sunset provisions have previously been used. It would not be as simple as merely repealing the relevant sections of the Income Tax Act, as transitional issues would need to be addressed. Including a mechanism in the legislation to 'turn off' these rules would also create uncertainty for the taxpayers who must apply them. Officials therefore see no benefit in including a sunset provision. If it were later decided the rules were no longer needed, they could be repealed then and legislation enacted to deal with transitional issues.

Recommendation

That the submission be declined.

Issue: Review

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Magan Lal)

Submitters suggested the effectiveness of the proposed interest limitation rules on increasing housing supply should be reviewed. Submissions differed as to when this review should take place:

- Within one year of enactment. *(Magan Lal)*
- Completed before 1 April 2024. By this time, 75 percent of interest will be non-deductible, so it should be evident whether the rules are meeting the intention of enabling more home ownership. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)*

Comment

One of the reasons given by submitters for why a full review is warranted was because these rules have been developed outside of the usual generic tax policy process (GTTP), and that this has limited full consideration of the proposals and could result in rules that do not meet their stated objectives and have unintended consequences on both housing affordability and housing supply.

Officials disagree. While the GTTP has not been followed in full, there has been considerable consultation with multiple opportunities for the public to make submissions on the rules. The discussion document *Design of the interest limitation rule and additional bright-line rules* was released on 10 June 2021 and open for public consultation for almost five weeks. While slightly shorter than the standard six-week consultation period, late submissions were also accepted. Almost 500 submissions were received. There has also been targeted stakeholder consultation throughout this process, both before and after the release of the discussion document.

There is currently no commitment to a formal review of the rules. However, Inland Revenue will be committing resources to reviewing remedial changes that may be required once the rules are implemented. It should be noted that the objective of the proposed interest limitation rules is to reduce investor demand for existing houses, not increase housing supply. Certain areas of the rules, such as the new build exemption, aim to ensure investment in new builds is not disincentivised, but the rules overall do not aim to increase supply.

Further, Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD) is responsible for the monitoring of New Zealand's housing and urban development system. As

part of this role HUD collects and analyses data and research on New Zealand's housing and urban development system, including measures of housing and rental affordability.

Monitoring the precise impact of the proposed interest limitation rules on the housing and urban development system is likely to prove difficult owing to the many varied factors impacting upon that system. In particular, the interest limitation rules will be introduced at a time when there will also be interest rate rises, the reinstatement of the Reserve Bank's loan-to-value ratio restrictions and the proposed introduction of debt-to-income ratio restrictions. This will make it difficult to specifically attribute any housing market impacts to the interest limitation rules.

Recommendation

That the submission be declined.

Issue: Alternative tax measures for residential property

Submissions

(Christopher Buddenhagen, Deborah Pickstone, Findex, Jim Gordon Tax Limited, Robyn Dainty, Terence Denton)

Submitters considered that in addition to, or instead of, denying interest deductions on residential rental properties, other taxes should be adopted. They suggested a range of taxes and approaches.

- A comprehensive capital gains tax. *(Christopher Buddenhagen, Deborah Pickstone, Robyn Dainty)*
- A deemed rate of return, with a ten-year capital gains tax wash-up when a property is sold. *(Jim Gordon Tax Limited)*
- An asset classification regime for non-main home properties requiring taxpayers to declare whether such properties are on capital or revenue account. Capital and revenue account rental properties would both be subject to the residential rental loss ring-fencing rules and tax on sale would only apply to revenue account rental properties. *(Findex)*
- Rental property income should be treated as a separate income stream and taxed at a higher rate, with rental income from new builds taxed at a lower rate. *(Terence Denton)*

Comment

Officials acknowledge the matters raised in these submissions but note that they are outside the scope of this Bill. If further work were to be done on these matters, it would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submissions be declined.

Issue: Non-tax measures for housing

Submission

(Jonathan Braniff, Robyn Dainty, Sarah Russell)

Submitters suggested housing-related measures that should be introduced in addition to, or instead of, the proposed interest limitation rules:

- Rent controls to prevent landlords passing on to tenants the cost of interest limitation by increasing rents. *(Jonathan Braniff, Robyn Dainty, Sarah Russell)*
- Minimum occupancy requirements to prevent landlords from renting properties to tenants who do not maximise the occupancy of the properties. For example, a three-bedroom property should only be rented to at least four occupants. *(Robyn Dainty)*
- Banks should be prevented from using interest rates that are higher than actual rates to assess mortgage serviceability of borrowers. *(Sarah Russell)*

Comment

Officials acknowledge the matters raised in these submissions but note that they are not tax measures and are outside the scope of this Bill.

Recommendation

That the submission be declined.

Issue: Purpose statement

Submission

(EY)

There should be a clear purpose statement outlining the intended scope of the proposals to assist courts and advisors in interpreting the rules.

Comment

Officials disagree. Proposed subpart DH contains a purpose provision – section DH 1. It explains that the purpose of subpart DH is to deny a deduction for certain interest, notwithstanding any other provision in Part D. The details concerning the nature and scope of interest that is subject to denial are specified in the detailed rules in subpart DH.

A purpose provision is a general statement, or summary, of the purpose of an Act or part or subpart of an Act. A purpose provision for a subpart is necessarily limited in the extent to which it can provide interpretative guidance on the meaning of the provisions in the subpart. Officials consider that the best interpretative guidance as to the purpose and intended scope of the specific provisions in proposed subpart DH is the detailed wording of the actual provisions themselves. To assist taxpayers and advisors in applying the rules in subpart DH, the Commissioner will publish comprehensive guidance setting out her view on the interpretation and application of the rules (see also [“Issue: Guidance”](#) above). If taxpayers are uncertain as to how the rules apply to their specific arrangements, they can apply to the Commissioner for a binding ruling on how the rules apply to their arrangements.

Recommendation

That the submission be declined.

Issue: Revenue should be set aside for related housing programmes

Submission

(Findex)

The revenue raised by the interest limitation rules should be set aside (hypothecated) for related Government policy spending, such as Kāinga Ora — Homes and Communities. Applying the revenue to the Government's general consolidated fund implies that the policy is not wholly directed at housing but is partially a revenue-raising policy.

Comment

It is not proposed that revenue from limiting interest deductions will be set aside for any specific government spending. Officials recommend against setting aside revenue from the proposed interest limitation rules to fund specific housing programmes for two reasons.

First, the taxation measure of limiting interest deductions on money borrowed for residential properties should not be conflated or joined with non-taxation measures to spend on housing programmes. The amounts required for housing programmes may be more or less than the amounts raised by interest limitation. Decisions to spend on specific housing programmes require scrutiny and evaluation against other government priorities (as is the case with any government spending programme). Setting aside revenue from interest limitation to spending on housing programmes may result in reduced scrutiny, evaluation and focus on that spending.

Secondly, the revenue from the proposed interest limitation rules will be uncertain, which would make it administratively difficult to set aside the revenue for specific spending programmes. Because previously limited interest deductions will be allowed when the relevant property is sold for a taxable gain (for example, if it is sold within the bright-line period), it cannot be known how much of the revenue generated by the interest limitation policy in a current year will have to be "refunded" in future years when properties are sold. Although attempts could be made to estimate how many debt-funded properties will be sold within the bright-line period, these estimates are unlikely to be accurate. This is because of uncertainty in relation to various factors, including behavioural changes by investors in response to the bright-line extension, changes in house prices and changes in interest rates and inflation. All this uncertainty makes it impracticable to set aside revenue from interest limitation for housing programmes.

Recommendation

That the submission be declined.

Issue: Location of definitions

Submission

(nsaTax Limited)

All definitions should be in section YA 1, not subpart DH

The 1994 rewrite moved away from self-contained definitions within separate parts and subparts. Proposed subpart DH includes its own set of definitions in section DH 5, which reverts to the pre-rewrite structure of the Income Tax Act. For example, “new build land” is defined in section DH 5. The definition, however, is relevant for both the interest limitation rules (in proposed subpart DH) and for the bright-line rule (in proposed section CB 6A).

Comment

As a general approach, definitions are placed in section YA 1. However, this approach is not an inflexible rule. For example, sections EE 61 to EE 67 contain definitions of terms used in subpart EE (Depreciation), and section LY 2 contains definitions of key terms used in subpart LY (Research and development credits). The location in section DH 5 of the definitions used in proposed subpart DH is intended to improve the readability of the subpart.

In relation to the submitter’s specific concern regarding the location of the definition of “new build land”, officials note that the Bill proposes that this term be inserted into section YA 1, with that definition cross-referring to the detailed definition of the term in section DH 5.

Recommendation

That the submission be declined.

Issue: Specific definition of “property”

Submission

(EY)

A specific definition for “property” should be added to improve clarity and provide greater certainty.

Comment

The term “property” is already widely used in the Income Tax Act 2007 and officials are not aware of concerns with its use more generally. A specific definition for “property” would impact other areas of tax and any proposed definition would need to be consulted on widely.

Recommendation

That the submission be declined.

Issue: Using START to support administrative practices

Submission

(Chartered Accountants Australia and New Zealand)

The increased functionality and capacity of the START system should be used to support administrative practices and record-keeping requirements imposed by the proposed interest limitation rules to ensure efficiency and streamline the process.

Comment

Records enable taxpayers to work out their income and expenses and self-assess their tax. Taxpayers are required to keep and retain records of income and expenses for at least seven years after the end of the income year in which they earned the income and claimed a deduction. This is also the case for records on interest expenses. Inland Revenue may check records in an audit.

Taxpayers currently provide income and expense information on their income tax return. To allow for the administration of the proposed interest limitation rules, additional key points for total interest on residential rental property, interest expense claimed and any exemption reason, will be added to the income tax returns. Taxpayers can see a record of information they provided, and the income tax returns they filed, in their MyIR account for previous income tax years.

START functionality will be used to pre-populate the form taxpayers need to complete for property sales that fall within the bright-line rules with relevant property information Inland Revenue holds.

Recommendation

That the submission be declined.

PROPERTY SUBJECT TO INTEREST LIMITATION

The aim of the proposed interest limitation rules is to reduce investor demand for residential property in New Zealand by making residential property investment less attractive for investors.

Taking this into account, the intent is that the rules should apply to property that is, or could foreseeably be, used for long-term residential accommodation.

The proposed rules focus on the functional structure of a building or place and not whether it is actually used to provide long-term accommodation (either as owner-occupied or rental accommodation). The emphasis is on whether the property is of a type that is generally available to the public for residential accommodation.

For example, a house or apartment that is let out for short-stay accommodation would be subject to interest limitation. This ensures there is no advantage under the rules for an investor to use their property for short-term, rather than long-term, accommodation. A difference in treatment depending on the type of accommodation provided within a property would create an incentive to convert the property to the advantaged accommodation type. This would impact overall housing supply by reducing the number of properties available for long-term rent or owner-occupation.

Broadly speaking, the proposed interest limitation rules provide that land that is, is planned to be, or could be, used for residential accommodation will be subject to interest limitation. Several exceptions from the rules are also proposed, including but not limited to:

- business premises
- commercial-scale accommodation (such as hotels, motels, and hostels)
- accommodation in medical or care facilities, and
- certain employee and student accommodation.

Several considerations are relevant when determining whether an exception would be appropriate:

- Incentives for conversion – Would an exception create incentives for converting existing properties to this type?
- Barriers to conversion – Can properties be converted to an excepted property type without significant effort and/or expenditure?
- Structural configuration – Does the structure of the property support use as a private residence (whether owner-occupied or as residential rental accommodation)?
- Regulatory framework and population – Is the property subject to a specific regulatory framework? Are there well-defined rules around who can reside in the property?
- Unconditional occupation – Is it possible for a person to occupy the property as a residence indefinitely, or is their occupation conditional on external factors (such as being a student or holding a particular employment position)?

The scope of property proposed in the interest limitation rules – both the definition of disallowed residential property and the various exceptions – represents a balance of these factors. In many respects, it follows the scope of property covered by existing regimes in the Income Tax Act 2007 relating to land and residential property, such as the bright-line test and the residential loss ring-fencing rules. However, as the intent of the interest limitation rules differs from these regimes, the scope of property affected by interest limitation also differs in places.

DISALLOWED RESIDENTIAL PROPERTY DEFINITION

Clauses 64E (proposed section DH 5(2)), 127(4B) and (7B), 131B, and schedule 1A

Issue: Focus of definition

Submission

(Chartered Accountants Australia and New Zealand)

We agree the definition of “disallowed residential property” used by the interest limitation rules should focus on property structure or configuration, not use. However, functionally, we believe the definition will lead to boundary issues and should be simplified.

Comment

Officials welcome the support for the focus of the definition. The complexity of property means that boundary issues are inevitable. The various exceptions proposed in the interest limitation rules are intended to clarify some of these issues and provide taxpayers with certainty around whether their properties are in or out of the rules.

Recommendation

That the submission be noted.

Issue: Narrow test for bare land

Submission

(EY)

The test for “bare land” should be narrowed. For various reasons, not all land that “may be used” for erecting residences under the relevant operative district plans will be able to be built on. For example, some land lacks accessibility, or is in an inconvenient or under-populated location, which means it is uneconomic to build on even if the council would allow it.

We suggest the inclusion of a self-assessment test that looks at whether land was reasonably capable of being built on at the time of acquisition, rather than relying on council district plans as a proxy for development potential.

Comment

The proposed treatment of bare land in the definition of “disallowed residential property” is consistent with other land rules in the Income Tax Act 2007. It is defined as bare land that may be used for constructing a place of residence or abode under the rules in the relevant operative district plan.

Officials consider this definition to be reasonably clear and robust. Other tests would create uncertainty and ambiguity, making it difficult for taxpayers to be confident that they are complying with the rules.

Recommendation

That the submission be declined.

Issue: Support for exclusion of land outside New Zealand

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

We support the proposed exclusion of land and property outside New Zealand.

Recommendation

That the submission be noted.

Issue: Overseas land exclusion will drive investment offshore

Submission

(Real Estate Institute of New Zealand)

We are concerned the exemption for property outside New Zealand will drive property investment offshore, which will reduce the number of properties available for rent in New Zealand.

Comment

Officials acknowledge the submitter's concern. However, the aim of the proposed interest limitation rules is to reduce investor demand for residential property in New Zealand by making the tax rules for residential investment property less attractive. The proposed interest limitation rules would not apply to properties outside New Zealand on the basis that investments in such properties have no direct impact on housing in New Zealand.

It is expected that some residential property investors will exit the market and invest in other assets or abroad. However, others may continue to hold on to their residential property portfolios or invest in new build properties.

Recommendation

That the submission be noted.

Issue: Exceptions will distort investment

Submission

(Real Estate Institute of New Zealand)

The proposed exceptions from the scope of disallowed residential property will distort investment in favour of those asset classes while reducing investment in disallowed residential property.

Comment

As noted in "[Issue: Overseas land exclusion will drive investment offshore](#)" above, the aim of the proposed interest limitation rules is to reduce investor demand for residential property in New Zealand by making the tax rules for residential investment property less attractive. It is expected that some residential property investors will exit the market and invest in other

assets or abroad. However, others may continue to hold onto their residential property portfolios or invest in new build properties.

Recommendation

That the submission be noted.

SOCIAL, EMERGENCY, TRANSITIONAL, AND COUNCIL HOUSING EXEMPTIONS

Clause 64E (proposed sections DH 4(4), (5) and (6))

Issue: Support for social housing proposals

Submission

(Chartered Accountants Australia and New Zealand, Pukeroa Oruawhata Trust and Ngati Whakaue Tribal Lands Inc, The Bluekiwi Property Consulting Trust)

We support the proposed exemption for social, emergency, and transitional housing.

We support the proposal to restrict the exemption to registered community housing providers. *(The Bluekiwi Property Consulting Trust)*

Recommendation

That the submissions be noted.

Issue: Scope of social housing proposals

Submission

(Chartered Accountants Australia and New Zealand, PwC)

The Government should consider whether tying the proposed social housing exemption to the definition of a community housing provider in the Public and Community Housing Management Act 1992 is broad enough. If there are other non-charity community housing providers, they should also be covered. *(Chartered Accountants Australia and New Zealand)*

The proposed social housing exemption is too narrow. It should be expanded to include all properties used to provide social housing regardless of the person doing the providing. *(PwC)*

Comment

Social housing plays an important role in providing accommodation for low-income people in New Zealand, and the purpose of the proposed social housing exemption is to ensure that the supply of social housing is not disrupted.

To qualify for the social housing exemption, two conditions must be satisfied. If these are satisfied, interest incurred on the property would not be subject to interest limitation, even if the owner of the property is a private landlord who has no relationship with the individual tenants.

First, the property must be rented or owned by one of the following: a registered community housing provider, Kāinga Ora–Homes and Communities or a wholly owned subsidiary of Kāinga Ora, or a government department listed in schedule 2, part 1 of the Public Services Act 2020.

Second, the property must also be used for social housing, or temporary accommodation for people in need seeking more permanent accommodation. Social housing is defined in section 2 of the Public and Community Housing Management Act 1992 as housing provided by a community housing provider or Kāinga Ora–Homes and Communities.

The community housing provider regime is administered by the Community Housing Regulatory Authority, an arm of Te Tūāpapa Kura Kāinga—Ministry of Housing and Urban Development. There are currently 64 registered community housing providers with more than 15,000 properties.

Officials consider that, overall, the proposed exemption applies broadly enough to cover social housing in New Zealand in its various forms while still being straightforward to apply. Because it links into the community housing provider regime and the public register of community housing providers, it provides certainty to taxpayers that they qualify for the proposed exemption while ensuring that the integrity of the rules is maintained.

Recommendation

That the submission be declined.

Issue: Application to Oranga Tamariki and other agencies

Submission

(New Ground Capital)

Proposed section DH 4(4)(a), which lists the ways in which a property must be used to qualify for the social housing exemption, should either be expanded to include housing leased by Oranga Tamariki or repealed. As currently worded, the exemption for social housing does not include housing leased to Oranga Tamariki—Ministry for Children. This means Oranga Tamariki housing is not on an equal footing with other social housing.

Comment

As noted above in ["Issue: Scope of social housing proposal"](#), the social housing exemption has two limbs - the first looks at who owns or leases the property, and the second looks at the nature of the housing provided.

Because of the way in which "social housing" is defined in the Public and Community Housing Management Act 1992, the exemption as currently drafted would only be available for interest incurred on housing leased by Oranga Tamariki that is used for emergency or transitional housing. Officials understand that housing and wraparound services provided by Oranga Tamariki to tamariki and rangatahi would not necessarily meet this requirement.

Officials note that this concern also arises for other government departments listed in schedule 2, part 1 of the Public Services Act 2020, for example, the Ministry of Health and housing it leases to provide accommodation alongside addiction/rehabilitation services.

This is not the policy intent. Officials agree that the drafting of the exemption should be clarified to ensure that interest incurred on other housing leased by government departments that is used to provide accommodation for the public on a non-transitional or non-emergency basis should qualify for the exemption.

Recommendation

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

Issue: Scope of council housing proposal

Submission

(PwC)

If the social housing exemption is not expanded to all social housing regardless of the person doing the providing (see [“Issue: Scope of social housing proposals”](#) above), the council housing exemption should be expanded to cover properties rented by local authorities and council-controlled organisations from private landlords to provide social housing in a manner consistent with the social housing exemption.

Comment

The social housing exemption provides that interest incurred on housing that is owned or rented by a social housing provider to provide social housing or temporary accommodation is exempt from interest limitation. However, as currently drafted, the council housing exemption applies only to housing owned by a council-controlled organisation and used by that organisation or a local authority to provide housing. It does not apply to housing rented from private landlords by a council-controlled organisation for the same purpose.

Officials agree with the submission and consider that the council housing exemption should be expanded to include housing leased by a local authority or council-controlled organisation and used to provide council housing.

Recommendation

That the submission be accepted.

Issue: “Sole purpose” wording too narrow

Submission

(Deloitte, PwC)

The use of the words “sole purpose” in the exemptions is potentially too narrow.

It may exclude wraparound services provided in the same building. *(Deloitte)*

It may exclude buildings used for other (non-social housing) purposes. This approach is contrary to the “to the extent” approach used elsewhere in the rules. The definition of social housing should be amended to ensure that interest incurred in relation to mixed-use (social and non-social housing) can be apportioned. *(PwC)*

Comment

The policy intent is that the social housing exemption should operate on a unit-by-unit basis, such that the whole residential unit or building must be leased by the social housing provider to qualify for the exemption. If there are multiple residential units or buildings on a single piece of land, each unit or building would be considered separately. For example, the exemption should not be available if one bedroom in a five-bedroom boardinghouse is used to provide emergency or transitional housing and the others are rented out to the public. The “sole purpose” wording is intended to restrict the application of the exemption in this situation.

Officials note that this differs slightly from the apportionment approach proposed elsewhere in the interest limitation rules. This difference was intended, as a “to the extent” approach

would mean that the exemption would be available for the one bedroom in the example outlined above.

The purpose of the social housing exemption is to ensure that the supply of social housing is not negatively impacted by the proposed interest limitation rules in situations where a property may otherwise be withdrawn from the market. This concern does not arise in the situation where a house is rented out on a room-by-room basis with only some of those rooms being used for social housing and other rooms being rented out to the public.

Officials note that the “sole purpose” wording was not intended to exclude situations where wraparound or connected services are also provided, either in the same building or another building on the same land.

Officials agree that the current wording may not achieve the intent stated and recommend the drafting be revisited to ensure it operates as intended.

Recommendation

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

Issue: Rebate programme for community housing providers

Submission

(The Bluekiwi Property Consulting Trust)

In addition to the proposed social housing exemption, a rebate programme of up to one-third of their interest costs should be introduced for property owners leasing to registered community housing providers.

Comment

Officials acknowledge the matter raised in the submission. However, as noted in [“Issue: ‘Sole purpose’ wording too narrow”](#) above, the purpose of the social housing exemption is to ensure that the supply of social housing is not negatively impacted by the proposed interest limitation rules in situations where a property may otherwise be withdrawn from the market. Therefore, the intent of the proposed exemption is to preserve the existing treatment of interest deductions.

Officials consider the submission would go beyond the status quo and provide additional financial assistance for owners of properties used for social housing. This is a broader issue and goes beyond the scope of the proposed interest limitation rules. Any further work on this matter would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be declined.

APPLICATION TO COMPANIES

Clause 64E (proposed sections DH 3, DH 5 and DH 12)

Issue: Use of tax book values and financial account values

Submission

(Chartered Accountants Australia and New Zealand)

Further consideration should be given to whether the use of tax book values or financial accounts values will skew the threshold calculations used to determine if a company is a "residential land company" or a "residential land wholly-owned group member".

Comment

The 50 percent threshold is intended to reduce compliance costs for companies whose core business does not involve disallowed residential property. The threshold is set at a level that provides a reasonable buffer if tax book values or financial accounts values for non-disallowed residential property assets are too low. This is because companies whose core business does not involve disallowed residential property would usually be well under the 50 percent threshold.

While it would be most accurate to require taxpayers to use market values for all assets, this would be very costly for taxpayers. Allowing tax book values and financial accounts values is much simpler for taxpayers and will reduce compliance costs.

Recommendation

That the submission be declined.

Issue: Valuation of assets that are not disallowed residential property

Submission

(Deloitte)

The rules do not clarify how shares and other assets that are not land are to be valued.

Comment

Officials agree it is unclear. The policy intent for assets other than land (except land subject to one of the development exemptions) is that tax book values or financial accounts values would be used. Officials recommend changes to the proposed new section DH 12 to achieve this.

Recommendation

That the submission be accepted.

Issue: Residential land companies

Submission

(KPMG)

Taxpayers should be allowed to apply the 50 percent calculation in the “residential land company” and “residential land wholly-owned group member” definitions on an averaged quarterly basis, instead of a daily basis.

Comment

Officials do not agree. The fact that the definitions are met if the 50 percent threshold is exceeded at any point in an income year is offset by the threshold being reasonably high. As mentioned in [“Issue: Use of tax book values and financial accounts values”](#) above, companies whose core business does not involve disallowed residential property would usually be well under the 50 percent threshold so will not need to test daily.

The tests to determine if a company is a residential land company or residential land wholly-owned group member have been designed to be simple to reduce compliance costs. Requiring taxpayers to apply an averaged quarterly test is likely to increase compliance costs.

If the averaged quarterly test were allowed as an option (instead of a requirement), officials recommend lowering the threshold (for example, to 25 percent) to ensure that companies whose core business involves disallowed residential property remain properly subject to the rules.

Recommendation

That the submission be declined.

Issue: Close companies

Submission

(Olivershaw Limited)

Close companies should be subject to the same rules as non-close companies. That is, close companies should only have to apply the proposed interest limitation rules if more than 50 percent of their total assets consist of disallowed residential property. Like other companies, most close companies below the 50 percent threshold will be able to restructure their affairs to ensure their interest deductions are not affected.

Comment

Officials do not agree. A close company is a company where control is held by five or fewer natural persons or trustees. Many close companies are wholly-owned by a single person or family. With such concentrated control, the risk of avoidance and distortionary behaviour is greater.

Officials are concerned that if close companies could also apply the 50 percent threshold, taxpayers may be incentivised to set up a company to hold their disallowed residential property and put other assets into that company (for example, shares, cash, vehicles) to fall below the 50 percent threshold and avoid the interest limitation rules.

Recommendation

That the submission be declined.

Issue: References to “property” instead of “assets”

Submission

(Deloitte, nsaTax Limited)

Submitters have suggested that the term “property” may be confusing when used to refer to property other than real property (land) and that the term “assets” may be more appropriate.

Some resource consents may not be considered “property” for tax purposes (except for depreciation, in some cases).⁵ It is unclear why these have been excluded from the definition of “total assets”. *(nsaTax Limited)*

Comment

The term “property” is not limited to real property. It also includes personal property and intangible property.

It is not clear how a resource consent that is not legally “property” can nevertheless be an “asset” as the submitter suggests. Officials do not consider a specific definition to include resource consents is necessary. It is expected that there will be very few, if any, companies that hold a significant amount of residential property and resource consents.

Recommendation

That the submission be declined.

Issue: Existing “residential land-rich entity” definition

Submission

(EY)

The new term “residential land company” is substantially similar to the existing term “residential land-rich entity” used in the residential rental loss ring-fencing rules in subpart EL. This term could have been replicated and modified as necessary. Adding a new, but similar, term is confusing.

Comment

Officials do not agree. The types of property covered by the residential rental loss ring-fencing rules are substantially different to those covered by the proposed interest limitation rules. For example, for properties that are used as business premises as well as for residential purposes, the interest limitation rules apply an apportionment approach, while the residential rental loss ring-fencing rules apply a “predominant” test (the property is residential land unless it is used predominantly as business premises). The interest limitation rules also

⁵ See section 122 of the Resource Management Act 1991 and section 72 of the Exclusive Economic Zone and Continental Shelf (Environmental Effects) Act 2012.

specifically exclude overseas property, excepted Māori land and student accommodation, whereas the residential rental loss ring-fencing rules do not.

In addition, there are significant differences between the types of entities covered by the two terms. The term “residential land company” only includes companies (whether close companies or not), while “residential land-rich entity” includes partnerships, trusts and close companies (but not non-close companies).

Officials consider it would have been more confusing to use the existing term “residential land-rich entity”, with the very substantial modifications that would have been required for the interest limitation rules, than to introduce a new term.

Recommendation

That the submission be declined.

EXCEPTED RESIDENTIAL LAND – COMMERCIAL ACCOMMODATION

Schedule 1A

Issue: Exception for commercial boardinghouses

Submission

(CEG Limited, PwC, Shared Living Limited)

That the treatment between boardinghouses and other kinds of commercial accommodation is inconsistent, because boardinghouses are not explicitly carved out of the interest limitation rules. Many boardinghouses are of a scale and configuration that make them clearly commercial and unviable for purchase as an owner-occupier.

Submitters made the following suggestions for ways to remove the inconsistency:

- an exception for boardinghouses as per other tax rules
- an exception for boardinghouses with 10 or more rooms
- an exception for certain boardinghouses with defined features that reflect a commercial nature, or
- if none of the above are possible, the definition of “new build land” should be altered so that rest homes converted into boardinghouses are exempt.

Comment

The proposed interest limitation rules are intended to apply to a property that is, or could foreseeably be, used for long-term accommodation, with an emphasis on whether the property is of a type that is generally available or suitable for owner-occupation. This means the rules should apply regardless of whether the whole house is rented out on a standard residential tenancy contract, each room is rented out individually, or the property is used to provide short-stay holiday accommodation.

Officials agree with the submission that large-scale commercial boardinghouses should not be subject to interest limitation on the basis they are not configured in a way that is suitable for owner-occupation. These properties have no impact on regular housing prices and including them in the proposed interest limitation rules would not further the intent of the rules.

However, officials do not consider it appropriate to simply include an exception for “boardinghouses”. Officials note that in developing the interest limitation rules, it became apparent that “boardinghouse” could be misinterpreted by taxpayers as being the same as the term “boarding house”, as used in the Residential Tenancies Act 1986 (the RTA). “Boarding house” as used in the RTA means residential premises containing one or more boarding rooms occupied, or intended by the landlord to be occupied, by at least six tenants at any time.

“Boardinghouses” are excluded from the definition of “dwelling” in section YA 1 of the Income Tax Act 2007 (ITA), which is used for the bright-line test and certain other provisions. A “boardinghouse” in the ITA is undefined and ultimately depends on the facts and circumstances, but it generally requires a higher level of servicing, management, and oversight than a “boarding house” as used in the RTA. There is also a sense of scale with a “boardinghouse” that is not necessarily present with an RTA “boarding house”.

While large-scale commercial operators would be aware that the two terms are not the same, the interest limitation rules will be applied by landlords around New Zealand, some of whom may only be familiar with the term in a residential tenancy context. An exception for “boardinghouses” could therefore create confusion for many taxpayers and could negatively impact compliance with the rules.

Point of difference

Officials therefore recommend introducing a targeted exception using a new defined term, such as “commercial lodging establishment”, as the most effective approach. Incorporating a requirement for a minimum number of rooms, along with other commercial factors, would provide certainty to large-scale commercial operators, while minimising the risk that people could structure into the exception. It would also minimise any potential confusion for landlords who happen to rent their properties out on a room-by-room basis. Relevant factors that could be included in such a definition include:

- A minimum of 10 boarding rooms that are not self-contained.
- Communal living facilities, including shared kitchens and living areas available to all residents.
- Servicing and management by the business.

Given officials’ comments above, a change to the definition of “new build land” to account for rest homes converted into boardinghouses is not necessary.

Recommendation

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

Issue: Inconsistent treatment of boardinghouses

Submission

(Deloitte)

That the proposed inclusion of boardinghouses under the interest limitation rules is inconsistent with the exclusion of boardinghouses from the bright-line test. The different tax treatments will lead to confusion for taxpayers.

Comment

Officials note the recommendation in [“Issue: Exception for commercial boardinghouses”](#) above to introduce a targeted exception from the interest limitation rules for certain boardinghouses using a new defined term, such as “commercial lodging establishments”.

A boardinghouse is currently excluded from the definition of “dwelling”, which is used in other provisions, such as the bright-line test and the residential rental ring-fencing rules. “Boardinghouse” differs from the term “boarding house”, which is used in the Residential Tenancies Act 1986, but the terms could easily be confused. In response to the potential confusion that could arise, officials recommended a new defined term, such as “commercial lodging establishment”, be introduced for the proposed interest limitation rules.

Officials acknowledge that this could create inconsistency or confusion between the interest limitation rules and other income tax provisions where a boardinghouse is excluded. This includes the bright-line test and the residential rental ring-fencing rules, as well as non-residential building depreciation.

Point of difference

Officials propose that the definition of “dwelling” in section YA 1 be amended to refer to this proposed new defined term, “commercial lodging establishment”, instead of “boardinghouse”. This would ensure there was no inconsistency between the treatment of such boardinghouses between the interest limitation rules and the bright-line test, and it would also provide certainty to taxpayers across the various income tax provisions that apply to residential property.

Officials propose that the change should apply for the 2022-23 and later income years.

Recommendation

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

Issue: Serviced apartments

Submission

(Kiwi Property Group Limited, Property Council New Zealand)

There should be an exception for serviced apartments, based on the requirements in paragraph (b)(iii) of the definition of “dwelling” in section YA 1 of the Income Tax Act 2007. These properties are distinct from rental accommodation in that a resident of a serviced apartment does not have “quiet enjoyment” as considered in the Residential Tenancies Act 1989, while a tenant in a regular rental apartment does. This reflects a commercial purpose more akin to a hotel room than a regular apartment.

We do not believe this poses any conversion risk. The owners of residential rental apartments gain more benefit from keeping their apartments as residential rentals and are therefore unlikely to convert their apartments to serviced apartments to circumvent interest limitation.

Comment

Serviced apartments were originally excluded from the definition of dwelling because of the rules on the depreciation of commercial fit-out. However, they are specifically brought back into the definition for the bright-line test and residential ring-fencing rules.

Officials consider that the inclusion of serviced apartments in the proposed interest limitation rules is appropriate. The proposed rules focus on the functional structure of a building or place and not whether it is actually used to provide long-term rental accommodation. For example, a house or apartment that is let out on a digital platform for short-stay accommodation would be subject to interest limitation. This is to ensure there is no income tax advantage to providing short-term accommodation over long-term accommodation, because otherwise there would be an incentive to change the type of accommodation provided to qualify for interest deductions. This would impact the availability of housing available for people to live in – either as a rental property or for owner-occupation.

Additionally, the structural and regulatory barriers preventing conversion of a regular rental apartment into a serviced apartment are minimal, and the potential benefits of doing so if serviced apartments are excluded are enough that some investors may choose to do so to circumvent interest limitation.

Officials therefore believe that excluding serviced apartments could undermine the integrity of the regime and have a negative impact on housing supply, especially in urban centres.

Recommendation

That the submission be declined.

Issue: Short-stay accommodation

Submission

(Olivershaw Limited, Rebekah Walton)

- a. It is inequitable to subject short-stay accommodation to interest limitation but exempt hotels and other forms of commercial accommodation, as they serve a similar purpose. *(Olivershaw Limited)*
- b. There should be an exception for property used as visitor accommodation where the property has a specific resource consent under an operative district plan that permits and requires its use as such. These properties reflect a legitimate commercial use, and as they require a specific consent from the relevant local authority, the risk of conversion is low. *(Rebekah Walton)*

Comment

- a. As noted in ["Issue: Serviced apartments"](#) above, the proposed interest limitation rules focus on the functional structure of a building or place and not whether it is actually used to provide long-term rental accommodation. For example, a house or apartment that is let out for short-stay accommodation should be subject to interest limitation in the same way as if it were rented out as a long-term residential tenancy. This is to ensure that investors are not incentivised to provide one type of accommodation over another.

Short-stay accommodation typically involves properties that are structurally identical to regular residential property, and the barriers to conversion between the two types of property are low. An exception could incentivise investors to convert their properties to short-stay accommodation to avoid interest limitation, thereby undermining the integrity of the rules. This could have a negative impact on housing supply available to renters or owner occupiers.

- b. A small number of local authorities across New Zealand designate visitor accommodation as a controlled activity requiring a resource consent under the Resource Management Act 1991. However, there is inconsistent treatment of such accommodation across local authorities. Many local authorities do not operate such a consented visitor accommodation regime, and those that do have differing requirements for when a resource consent is necessary or what is required to obtain such a consent.

Officials understand this consent regime is not necessarily restricted to large-scale purpose-built commercial accommodation. It includes standard residential properties that are used to provide short-stay accommodation. For example, in some locations, consent could be required if a property is intended to be used to provide accommodation for six or more people at a time – this could include a three-bedroom house with a queen bed in each room.

At this stage, officials do not consider it appropriate to tie an exception from the interest limitation rules to this regime. It would create substantial complexity given the application of the visitor consent regime differs from region to region. In addition, it would not resolve concerns about the use of residential properties for short-stay accommodation versus long-term accommodation.

Recommendation

- a. That the submission be declined.
- b. That the submission be declined.

EXCEPTED RESIDENTIAL LAND – MAIN HOME EXCEPTION

Schedule 1A

Issue: Pre-existing definition of “main home”

Submission

(Deloitte)

The proposed main home exception in the interest limitation rules duplicates the “main home” definition used elsewhere in the Income Tax Act 2007 (ITA). The exception’s intended meaning (that is, that it is designed to cover flatmate, home office, and bed & breakfast situations) would be clearer if that “main home” definition were used in the proposed exception.

Comment

While the concept of a main home is used in both the bright-line test and the proposed interest limitation rules, using the definition of “main home” provided in section YA 1 of the ITA would not be appropriate for the interest limitation rules. This is because the section YA 1 main home definition is centred on the concept of a “dwelling”, also defined in section YA 1.

The “dwelling” definition is used for most of the tax regimes in the ITA that deal with residential property. However, it is not used in the interest limitation rules. The interest limitation rules are primarily based on property structure or configuration, while the pre-existing property tax regimes and their associated definitions are based on other factors, such as time and use. To reflect this different scope and to avoid confusion between the concepts of property used by the different regimes, it was decided to draft the proposed interest limitation rules as a standalone set of rules. The duplication of the “main home” definition is a consequence of this drafting decision.

To provide additional clarity, further information will be provided in guidance material.

Recommendation

That the submission be declined.

Issue: Main home exception for trusts

Submission

(Matter raised by officials)

The main home exception in the interest limitation rules should be clarified to ensure that a trustee of a trust may only qualify for the exception for a beneficiary or settlor of that trust if a principal settlor of the trust does not have a separate main home.

The intent of the main home exception in the proposed interest limitation rules is to ensure that where there is an income-earning use of a person’s main home, the status quo is maintained. This means that a portion of a person’s interest expense should continue to be deductible for the main home, to the extent that the main home is used in earning assessable income. An example of this is where a person rents out a spare bedroom to a flatmate or runs a business from a home office.

The exception will also be available to trusts in certain circumstances, given the common use of trusts to hold residential property in New Zealand. The intent is that the main home exception for trusts should follow that used in the bright-line test, that is, it should only be available for a property held on trust where the property is a beneficiary's main home, but only if a principal settlor does not have another main home. This is meant to ensure that, if a parent settles a house on trust and the child (a beneficiary) lives in the house, the main home exception will only apply if the parents do not live elsewhere, or if the original settlor of the land is deceased.

The current drafting does not achieve this policy intent as the reference to the settlor not having a different main home was inadvertently omitted.

This means that a trustee could claim the main home exception for situations where a beneficiary of the trust lives in a property even when the settlor lives somewhere else, creating an unintended loophole in the rules. It also means a property investor could circumvent the interest limitation rules by transferring the property into a discretionary trust and listing one of the tenants as a beneficiary. They could remove and add new tenants as beneficiaries when one lease ends and another begins.

Recommendation

That the submission be accepted.

EXCEPTED RESIDENTIAL LAND – STUDENT ACCOMMODATION

Clause 127(17B), schedule 1A

Issue: Support for student accommodation proposal

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposed exception for student accommodation.

Recommendation

That the submission be noted.

Issue: Student accommodation subject to GST

Submission

(Olivershaw Limited)

The scope of the student accommodation exception should be expanded to cover all student accommodation subject to GST.

Comment

Officials understand that the submitter is primarily concerned with the situation where a property owner leases a building to a university and the university operates a hall of residence, rather than the property owner operating the student accommodation themselves. The submitter was also concerned with the situation where the accommodation is rented to non-students over the summer break and whether this would continue to be covered by the exception.

The student accommodation exception is intended to apply to a property that meets the requirements of section 5B of the Residential Tenancies Act 1986, regardless of whether it is the property owner or the tertiary institution that operates the hall of residence. This means that the student accommodation exception would be available to the underlying property owner in the situation described above.

Officials have revisited the drafting in light of the submitter's concerns and are satisfied that no further changes are required to address this.

Regarding the use of halls of residence over semester breaks by non-students, the policy intent is that the exception would be available for the full year. The proposed provisions contemplate this by using the words "even if they are used mainly for the accommodation of students, and not exclusively for the accommodation of students". Provided the building is used as a hall of residence for most of the year, the drafting ensures that the exception would apply for the full year. Officials consider that no further changes are required.

Recommendation

That the submission be declined.

EXCEPTED RESIDENTIAL LAND – MĀORI EXCEPTED LAND

Clauses 64E (proposed sections DH 3 and DH 5(4)), 127(7D) and (10C), and schedule 1A

Issue: Wholly-owned subsidiaries of a Māori entity

Submission

(Chapman Tripp, Ngāti Whātua Ōrākei Trust)

An amendment should be made to the proposed definition of “Māori excepted land” to ensure land held by a subsidiary of a Māori authority (or entity eligible to be one) is covered by the proposed exceptions.

Comment

Māori excepted land is included within the list of excepted residential land in proposed schedule 15. “Excepted residential land” is excluded from being “disallowed residential property” and is therefore not subject to interest limitation.

The proposed Māori excepted land definition includes housing on land owned by a Māori authority or an entity eligible to be one (Māori entity) where the housing is provided to a beneficiary or shareholder of the Māori entity. As currently drafted, the definition accounts for situations where land is owned by a Māori entity and housing is managed by a subsidiary company, so long as the tenant is a beneficiary or shareholder of the Māori entity. However, in cases where a subsidiary of the entity owns the property, rather than the entity itself, the land is not covered by the definition and the interest limitation rules will apply. This leads to inconsistent outcomes among different land-owning structures, which is not intended.

To resolve this, the definition should be expanded to cover housing provided to a shareholder or beneficiary of a Māori entity on land owned by either that entity or other entities within its “qualifying Māori group”. Entities within this group would include any wholly-owned company, trust, or charitable arm. This would allow for a nested structure – for example, where the top-level Māori authority is a trust, and the land is held in a company that is wholly owned by the trustee.

Additionally, it is not clear whether land acquired through a Treaty of Waitangi settlement would satisfy the definition if the land were subsequently transferred around the group. The intent is that the land should continue to be Māori excepted land, as the land is still owned by the Māori entity, albeit indirectly. To allow for this, the definition of Māori excepted land should be amended to incorporate this new “qualifying Māori group” term to allow for movement within the group.

Recommendation

That the submission be accepted.

Issue: Collective housing approaches

Submission

(Hāpai Housing Limited Partnership and Ka Uruora Housing Trust)

In general, we support the proposed exclusions for certain kinds of Māori land and community housing. However, we believe the proposed wording inadvertently disadvantages collective

housing projects, as it is only designed to apply to situations where a single Māori entity owns land, and the land is used to house its members. It does not adequately account for situations where multiple Māori entities own or manage land.

We recommend the exception be expanded to include situations where:

- land (any land, not just designated Māori title land) is owned by a partnership, and
- all partners in the partnership or other arrangement are Māori authorities or entities eligible to be one (or wholly-owned subsidiaries of such entities), and
- the land is used to provide housing that is made available to Māori as a priority, and only where there is a lack of demand can it then be made available to the wider public.

Comment

Land that satisfies the proposed definition of “Māori excepted land” is not subject to the interest limitation rules. This includes where the land is owned by a Māori authority or an entity eligible to be one (Māori entity), and it is used to provide housing to shareholders or beneficiaries of that entity. This is intended to ensure that papakāinga and kaumātua housing are not negatively impacted by the proposed new rules.

Under the current drafting, the definition successfully accounts for situations where a single Māori entity owns land, and the land is used to house its members.

However, the current drafting would not work where multiple iwi or hapū work together to provide papakāinga housing on land through a limited partnership. In this situation, each Māori entity is a limited partner in the partnership, with the partnership developing homes on the land for use by members of the Māori entities.

Under the current wording of the definition, the entities in these limited partnerships may only be able to claim a fraction of their interest relating to the properties in question. This inadvertently disadvantages collective housing projects relative to housing projects run by a single Māori entity.

This is not the policy intent and officials agree that this should be resolved.

Points of difference

Officials recommend the definition should be expanded to include land held through the partnership to the extent housing is provided to a member or shareholder of one of the partners or the “qualifying Māori group” of each of those partners (see [“Issue: Wholly-owned subsidiaries of a Māori entity”](#) above).

This would allow land to be Māori excepted land for a partner in a collective housing group to the extent it is used to provide a residence to a member of an iwi or hapū that is a partner in said collective housing group.

Officials do not recommend that the definition be expanded to cover situations where the housing is rented to the wider public. In these situations, the Māori entity or partnership is acting as a regular residential landlord. Officials consider that an exclusion from the interest limitation rules in this case would be inappropriate (see [“Issue: Exclusion for Māori authority trusts”](#) below).

Note that apportionment rules would apply, so that if some housing on the land is provided to the wider community, interest limitation would only apply to that portion.

Recommendation

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

Issue: Exclusion for Māori authority trusts

Submission

(Pukeroa Oruawhata Trust and Ngati Whakaue Tribal Lands Inc)

A blanket exclusion, like the exempt Māori company one, should also apply to trusts that are Māori authorities to exclude them from the interest limitation rules for all land held.

Currently, general title land owned by trustees that is residential property (and not transferred as part of a Treaty settlement) is only proposed to be excluded where it is being used to provide housing to iwi or hapū.

Comment

Two separate exclusions are proposed for Māori excepted land (which applies to the land itself, regardless of who owns it) and exempt Māori companies (which applies to companies that meet certain requirements). The submission refers to both.

Māori excepted land

Land that satisfies the definition of "Māori excepted land" is not subject to the interest limitation rules. The definition includes land owned by a Māori authority or an entity eligible to become a Māori authority if it is provided as a residence to a shareholder or beneficiary of that Māori authority or entity.

The purpose of this is to provide an exception for Māori community housing on general title land, not for all residential properties owned by Māori authorities. Despite being on general title land, Māori community housing forms such as papakāinga or kaumātua housing are not available for purchase by the general public, and they serve a specific purpose of community development rather than property speculation. As such, it is appropriate to exclude these properties from the interest limitation rules, as they do not affect the general property market and their inclusion would add complexity and cost to Māori communal housing projects to no purpose.

Where housing owned by a Māori authority on general title land is available for rent on the general market, the housing is not covered by the definition and is therefore still subject to interest limitation. Officials consider it would be inconsistent with the policy intent to expand the definition to cover situations where a Māori authority is simply acting as a regular residential landlord.

Exempt Māori companies

The proposed exclusion for exempt Māori companies only applies if the company is not a residential land company or a residential land wholly-owned group member. A company will meet this test if disallowed property makes up less than 50 percent of the company or group's total assets. The proposed exclusion for companies is intended to reduce compliance costs. Unlike trusts, companies generally do not have to trace their borrowings to obtain interest deductions.

Trusts, whether they are Māori authorities or not, have always been required to trace their borrowings to obtain interest deductions. An exclusion to reduce compliance costs is therefore

not necessary and officials do not consider any trusts with less than 50 percent disallowed property should be excluded from the rules.

Recommendation

That the submission be declined.

Issue: Ground lessee exception too broad

Submission

(Matter raised by officials)

An amendment should be made to the Māori excepted land definition to ensure that ground lessees can only satisfy the definition for Treaty settlement land if they are owned by the same entity that owns the land.

Excepted residential land, which includes Māori excepted land, is not subject to the interest limitation rules. For land acquired through a Treaty of Waitangi settlement, the proposed definition of Māori excepted land is satisfied to the extent the land is owned by a Māori authority or an entity eligible to become a Māori authority.

In some situations, the landowner will enter into a lease to enable the land to be developed or used productively. The intent is that the definition of Māori excepted land should generally not apply to the lessee, only to the lessor (the landowner), unless the lessee is effectively a subsidiary of the entity that owns the land. This generally arises when the land-holding entity is restricted in the activities it may undertake in relation to the land, but the iwi or hapū would still like to develop the land. The definition should still be satisfied in this situation, so that the land is not subject to the interest limitation rules.

Under the current drafting, the definition would be satisfied for ground leases relating to land transferred under a Treaty of Waitangi settlement the lessee is owned by *any* Māori authority or entity eligible to be one. This is broader than the policy intent, as the definition would be satisfied where the lessee is a completely separate Māori entity.

The definition should be clarified to ensure it is only satisfied where the lessee is owned, directly or indirectly, by the same Māori entity that holds the Treaty settlement land or an entity in the same “qualifying Māori group” (see [“Issue: Wholly-owned subsidiaries of a Māori entity”](#) above).

Recommendation

That the submission be accepted.

OTHER SCOPE OF PROPERTY SUBMISSIONS

Issue: Ground leases

Submission

(Bell Gully, Chartered Accountants Australia and New Zealand, Heimsath Alexander, PwC)

Ground leases in large-scale commercial ground lease residential arrangements should be excluded from the interest limitation rules. The legal estate of a ground leaseholder does not include any improvements on the land and is not equivalent to that of a freehold owner or a lessee of land and buildings. A ground leaseholder does not own, have exclusive possession of, or control over, any residential dwellings on the land. Neither does a ground leaseholder control whether a residential dwelling on the land is owner-occupied or an investment property.

Submitters made the following suggestions of features that could be required for ground leases to enable an exclusion to apply:

- a minimum number of residential leasehold dwellings on the land
- a minimum term of the ground lease
- the rent payable must be based on a percentage of the unimproved land value
- the ground lease must be subject to a residential leasehold sublease under which the sub-lessee has a right of exclusive possession, the sub-lease has a term of 35 or more years, and the sub-lessor has the right to charge ground rent based on a percentage of the unimproved land value
- the Commissioner must approve the exclusion applies to a taxpayer, and
- the exclusion should not apply to the extent the ground leaseholder, or an associated person, holds a residential leasehold sub-lease.

Comment

Officials do not consider an exemption for large-scale commercial ground lease residential arrangements to be appropriate.

In some ground lease situations, there may be a chain of ground leases. The freehold owner of the land enters into a ground lease with a developer or other party (the ground leaseholder) to develop the land. The ground leaseholder then enters into a chain of subleases, with the ultimate apartment owners holding one of the subleases in the chain.

Ultimately, a ground leaseholder holds an investment in land that is used for residential purposes. Officials consider they should be treated the same as someone who owns and leases out land with residential buildings on it.

Providing an exemption for ground leases would create an integrity concern, as it would provide a more favourable treatment for leasehold interests than freehold interests. This might encourage the use of lease structures to effectively separate out the land from the building to circumvent the interest limitation rules, and this could impact the legal structuring of land interests in New Zealand for many years to come. For example, cross leases were originally used to circumvent subdivision restrictions.

A targeted exemption, as suggested by submitters, would create arbitrary outcomes and would not mitigate integrity risk. For example, while an exemption would need to specify a

minimum number of dwellings to limit distortionary behaviour, any minimum number would essentially be arbitrary and would create inequities between ground leaseholders that fall on either side of the line. However, it would also encourage residential developments on leasehold land to contain this prescribed number of dwellings. A similar issue arises with a prescribed minimum term length (for example, 35 years).

Note that the proposed interest limitation rules do contain a limited exclusion for ground leases for land transferred as part of a settlement under the Treaty of Waitangi (for further information, see ["Issue: Ground lessee exception too broad"](#) above). However, this applies in limited circumstances and does not raise the same integrity issues.

Submitters suggest that if no exemption is provided ground leaseholders may be incentivised to convert existing residential leasehold arrangements to non-residential uses. Given the legal complexity of large-scale ground lease residential leasehold arrangements and the large number of residential leasehold interests commonly involved in such arrangements, officials consider there are likely to be significant legal and commercial impediments to such conversions becoming commonplace.

Submitters also suggest that if no exemption is provided for ground leaseholders, prime land available for future large-scale high-density residential development may be redirected to commercial developments. Officials note that the proposed new build land and development exemptions for certain land businesses will apply to ground leaseholders. Officials consider these proposed exemptions will diminish the incentives for such land to be directed to commercial developments. While the 20-year period for the new build exemption would not necessarily align with the term of the ground lease (which in some cases can be for up to 150 years), providing a separate exemption for the ground leaseholder would provide them with a more favourable treatment than other taxpayers with new build land.

Submitters suggest that, due to the large scale of commercial ground lease arrangements, the acquisition and on-going funding of ground leases can only be funded by long-term debt. Officials consider scale is not a reason for an exemption. Scale of cost is relative to each taxpayer. The purchase of residential land frequently requires long-term debt because of the significant scale of the purchase for the purchaser. If ground leaseholders were exempted from the interest limitation rules based on scale, this would treat ground leaseholders more favourably than other taxpayers and would be inequitable.

Recommendation

That the submission be declined.

Issue: Safe harbour for dual-purpose buildings

Submission

(Olivershaw Limited)

There should be a safe harbour provision for business premises to exclude properties from interest limitation if 33% or more of the premises is used for commercial purposes.

Comment

Officials consider that a safe harbour for dual-purpose premises would be counter to the "to the extent" approach applied in the rest of the proposed interest limitation rules. It would also introduce additional complexity and provide undesirable concessionary tax treatment in certain situations.

Commercial premises are already outside the scope of the interest limitation rules.

Properties are also already not subject to the rules to the extent to which they are business premises. A complete exclusion for properties above a certain threshold of business use would create a concessionary treatment for mixed-use business and residential assets when compared to other excepted residential land classes, and this may push investment towards dual-purpose buildings, which is not the policy intent.

Recommendation

That the submission be declined.

Issue: Order-in-Council mechanism for schedule 15

Submission

(Deloitte)

A legislative mechanism should be developed to allow the addition of new types of property to proposed new schedule 15 (which lists excluded asset classes) by Order in Council.

Comment

Officials do not consider an Order-in-Council mechanism to be necessary. If the proposed interest limitation rules are enacted and the exclusions do not operate as intended, additions to, or removals from, schedule 15 should be considered by Parliament.

Recommendation

That the submission be declined.

Issue: Apportionment approach

Submission

(Chartered Accountants Australia and New Zealand)

The use of land area as the basis for apportionment under the proposed interest limitation rules will confuse taxpayers as this is different to the bright-line test, which uses predominant use and time.

Comment

The bright-line test was designed for simplicity of application and can produce a binary result, that is, a property is generally either fully captured by the bright-line test or fully excluded. Given that the disposal of a property is only taxed under the bright-line test if it is disposed of within a certain timeframe, predominant use is appropriate for most aspects of the bright-line test.

This “all or nothing” approach was not considered to be appropriate in the context of the proposed interest limitation rules, as a few square metres or a few days could make the difference between all interest deductions being denied or not.

The current drafting does not state what the basis for apportionment should be. It uses standard “to the extent” wording, which is used elsewhere in the Income Tax Act 2007.

Depending on the circumstances, this could include both elements of time and area. For example, a property may only be used as employee accommodation for part of a year; if it is then rented out to a member of the public, it would no longer qualify for the employee accommodation exclusion for the remainder of the year.

Officials recognise that for some taxpayers who are familiar with the application of the bright-line test, it may take some getting used to the apportionment rules in the interest limitation rules. However, Inland Revenue will provide guidance to ensure that taxpayers are able to understand the rules and ascertain what interest they are still able to deduct.

Recommendation

That the submission be noted.

Issue: Multiple units on one title

Submission

(CEG Limited, John Cuttance, New Zealand Law Society, Taranaki Property Investors' Association Inc)

There should be an exception for buildings with multiple residential units held on a single title. They are an asset class that is solely available to investors, and as such are outside the scope of the interest limitation regime.

Comment

The proposed interest limitation rules are intended to apply, broadly speaking, to land with a house on it. If a property is physically suitable for use as a residence, it should be subject to the proposed interest limitation rules. It should not matter whether, on a given legal title, there is one house or multiple houses, as may be the case with a "home and income" property or a villa that has been split into three flats.

An exclusion for multiple residential units on a single title from the interest limitation rules could incentivise this type of structure from a tax perspective and change New Zealand's housing landscape in unintended or undesirable ways. For example, cross leases became popular in New Zealand in the second half of the 20th century to circumvent subdivision restrictions before the introduction of the Resource Management Act 1991.

Regarding existing properties, officials understand that, while there are costs to individually unit-titling the units in a block of flats built on a single title, it is feasible to do so and does occur.

Recommendation

That the submission be declined.

Issue: Employee accommodation

Submission

(Matter raised by officials)

The proposed exclusion from the interest limitation rules for employee accommodation should be clarified to ensure it is available in situations where the employer owns the property themselves, or where it is owned by another company in the same wholly-owned group.

Excepted residential land would not be subject to the proposed interest limitation rules. This includes property if it is used as employee accommodation. Under the proposed definition of "employee accommodation", if the employee is associated with the employer, the definition would only be satisfied if the accommodation is due to the remoteness or nature of the business carried on.

The proposed definition is intended to ensure that businesses are not impacted by the interest limitation rules where they own housing used to accommodate their employees.

However, officials consider the current drafting should be clarified to ensure that the definition would not be satisfied where a standard property investor rents their property to a business that happens to use the property for employee accommodation. In that case, the property should be subject to the interest limitation rules. There is a risk that otherwise investors would be better off renting their property to a business rather than an individual.

In addition, officials understand that, in corporate group scenarios, it is not uncommon for property to be held in a separate company to the company that is the employer. Officials therefore propose that the legislation be amended to ensure that the employee accommodation definition would be satisfied where the company incurring the interest expense is part of the same wholly-owned group as the employer.

Recommendation

That the submission be accepted.

Issue: Terminology

Submission

(Chartered Accountants Australia and New Zealand)

The Income Tax Act 2007 (ITA) already contains several terms with significant overlap with the new terms introduced by the proposed interest limitation rules, including "residential land" and "dwelling." To reduce complexity, the rules should use these existing terms, rather than defining new ones.

In addition, several new terms in the proposed interest limitation rules, including "disallowed residential property", have little meaning on their face or are confusing. To aid comprehension, we suggest the terms used in the rules be redrafted in accordance with the plain English philosophy employed elsewhere in the ITA.

Comment

While the proposed interest limitation rules may be similar to other regimes in the ITA (for example, the bright-line test and the residential rental loss ring-fencing provisions) because they relate to land, the rules serve a different purpose.

It is for this reason that the interest limitation rules have been drafted as a set of standalone rules, separate to other land-related regimes. Officials consider that using pre-existing terms or creating nested definitions in the ITA that support a different purpose would lead to inconsistencies within the interest limitation rules and reduce its effectiveness.

Recommendation

That the submission be declined.

Issue: Technical drafting issues

Submission

(Deloitte)

- In the main home exception, in the phrase “used predominantly for place...”, the word “for” should be replaced with “as a”.
- The phrase “if that place was the main home for 1 or more of the following people...” should be written in present tense as “if that place is the main home for 1 or more of the following people...”.
- The term “dwelling” should be removed from the proposed social and council housing exemptions, consistent with the language used elsewhere in the proposed interest limitation rules.

Comment

Officials will refer the submissions to the drafters for their consideration.

Recommendation

That the submission be noted.

Issue: Use of tohūtō in the word “Māori”

Submission

(EY)

The proposed amendments use the word “Māori” in several places (proposed sections DH 5(4)(a) and (b), and the amendments to section YA 1) without the appropriate macron or tohūtō. This should be corrected.

Comment

Officials raised this submission with Inland Revenue drafters and the Parliamentary Counsel Office (PCO).

Inland Revenue drafters follow the PCO style guide when using te reo Māori terms in legislation. That style guide provides that the current orthographic convention is to use tohūtō. However, several defined legislative terms predate the introduction of this convention. This means that pre-existing terms in the Income Tax Act 2007, such as “Māori authority”, do not use tohūtō.

Proposed new terms do include tohutō (for example, “exempt Māori company” and “Māori excepted land”).

While this means there is some inconsistency in the use of tohutō in the Income Tax Act 2007, PCO have confirmed that this approach is in line with their style guide.

Recommendation

That the submission be noted.

LAND BUSINESS EXEMPTION

Clause 64E (proposed section DH 4(2))

Issue: General support

Submission

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

Submitters support an exemption from interest limitation for land acquired for a land-related business described in section CB 7.

Recommendation

That the submission be noted.

Issue: Extend to all revenue account taxpayers

Submission

(Chartered Accountants Australia and New Zealand, Olivershaw Limited)

The land business exemption should be extended to cover all taxpayers holding property on revenue account. Distinguishing between section CB 7 taxpayers and other revenue account taxpayers subject to tax on disposal creates unnecessary complexity.

Comment

The land business exemption applies to residential property held on revenue account under section CB 7. Section CB 7 applies to taxpayers carrying on a business of developing, building on, subdividing, and/or dealing in land. Full-time professional property developers generally hold land on revenue account under section CB 7 and so qualify for this exemption.

There are other revenue account property provisions that may apply to occasional or one-off property development activities that do not otherwise meet the requirements of section CB 7 (see sections CB 9 to CB 13). The submitters suggest the land business exemption should also apply to interest incurred by taxpayers subject to these other sections. However, some revenue account property provisions contain criteria that are not relevant to the land business exemption, such as applying only if the development begins within 10 years of acquisition. Including such sections would have been unduly complex as they would require many modifications to apply. Having a general development exemption, rather than extending the land business exemption, allows the rules to remain simple from both an administrative and compliance perspective.

Recommendation

That the submission be declined.

EXEMPTION FOR PROPERTY DEVELOPMENT

Clause 64E (proposed sections DH 4(3) and DH 5(7))

Issue: General support

Submission

(Chartered Accountants Australia and New Zealand, Kiwi Property Group Limited, Property Council New Zealand, Real Estate Institute of New Zealand)

Submitters support an exemption from interest limitation for property development.

Recommendation

That the submission be noted.

Issue: Simple and broad exemption

Submission

(Kiwi Property Group Limited, Property Council New Zealand)

The exemption should be simple and broad. If a development is increasing housing supply, it should qualify. The exemption should also apply to one-off developments.

Comment

The proposed development exemption has been designed to be as simple as possible and to apply to a broad range of activities that contribute to increasing housing supply. It would apply to any taxpayer with an undertaking or scheme that involves building on, subdividing, or developing land to create new build land. The proposed development exemption, as drafted, could apply to taxpayers who undertake one-off developments.

Recommendation

That the submission be declined.

Issue: Consequences for first home buyers and owner-occupiers

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)

The development exemption may have unintended consequences by accentuating the existing ability of developers and investors to leverage their property portfolios and outbid first home buyers and other owner-occupiers.

Comment

Officials acknowledge the concern raised by submitters. However, while new build prices may increase (or not be dampened by interest limitation), more investor demand is expected to

shift away from older housing stock. This would make older housing stock more affordable for first home buyers and owner-occupiers, while still ensuring that continued investment in new builds is not disincentivised.

Recommendation

That the submission be noted.

Issue: Application after land disposed of

Submission

(Chartered Accountants Australia and New Zealand)

The development exemption should apply after land is disposed of. If a taxpayer sells a property at a loss after developing it, the proposed development exemption would not allow interest to be deducted after the property is disposed of. This could discourage people from taking risks and would not help with housing supply.

Comment

Officials agree that allowing the development exemption to continue to apply after property is disposed of at a loss would help ensure the interest limitation proposals do not negatively impact on new housing supply.

Recommendation

That the submission be accepted.

Issue: Subdivision should be sufficient

Submission

(nsaTax Limited)

A person who just subdivides land with a view to selling the lots as bare land may not qualify for the development exemption, even if they are taxed under section CB 12 of the Income Tax Act 2007. The development exemption should apply where a person subdivides land to create residential sections for sale. It should not matter whether they have built, or entered into an agreement to construct, a new build on the sections.

Comment

The proposed development exemption is intended to ensure investment in new housing supply is not negatively impacted by the proposed new interest limitation rules. Therefore, any undertaking or scheme involving subdivision must occur for the purpose of creating new build land. The same requirement applies to other land activity that is not subdivision but may lead to increased housing supply (that is, development and building). Where development or building activities are occurring on land, a taxpayer must also show an intention to add new builds to the land to obtain the development exemption. Development or building activity on its own is insufficient. Subdivision on its own, with no purpose of adding new builds to the land, would also fail to meet the threshold required to qualify for the exemption. However, if the land is taxed under section CB 12 when it is sold, then the interest

incurred for the property would be deductible on disposal (provided it would be deductible under existing tax rules).

Recommendation

That the submission be declined.

Issue: Eligibility of interest incurred for existing dwellings

Submission

(Chartered Accountants Australia and New Zealand, Findex, Kiwi Property Group Limited, KPMG, Magan Lal, Olivershaw Limited, Property Council New Zealand, Real Estate Institute New Zealand)

Various submissions were made regarding the eligibility of interest incurred in relation to expenditure on existing dwellings.

- a. **Improving, renovating, repairing, and maintaining existing dwellings:** Interest on borrowing relating to renovations, repairs and maintenance should be deductible. Denying deductions for improvements to a property conflicts with the Government's approach of encouraging warm, dry rentals. Property owners who make repairs and upgrades to their properties to satisfy existing requirements, such as the healthy homes standards, should not have to absorb the cost. *(Findex, Magan Lal, Olivershaw Limited)*
- b. **Remediation of existing dwellings:** Interest on remediation expenditure should qualify. *(Kiwi Property Group Limited, Olivershaw Limited, Property Council New Zealand, Real Estate Institute New Zealand)*

Submitters suggested ways the exemption could be designed:

- Taxpayers could make a statutory declaration when they claim the exemption. *(Kiwi Property Group Limited, Property Council New Zealand)*
 - Interest on borrowing related to any new capital expenditure should continue to be deductible. *(Olivershaw Limited)*
 - Alternatively, interest on any 'significant' expenditure required for a dwelling to meet the requirements to be rented out should qualify. *(Olivershaw Limited)*
- c. **Extensive remediation of uninhabitable dwellings:** The definition of new build land should be expanded to include the extensive remediation of a residential property that was previously uninhabitable (such as a property damaged by a natural disaster). *(Chartered Accountants Australia and New Zealand, KPMG)*

Comment

These submissions are relevant to both the development exemption and the new build exemption. To the extent remediation results in a "new build", it would qualify for the development exemption while the remediation is taking place. However, to the extent it does not, it would not.

See "[Issue: Eligibility of interest incurred for existing dwellings](#)" below for a full discussion of these submissions and the extent to which remediation should be deemed to result in a new build.

Recommendation

See ["Issue: Eligibility of interest incurred for existing dwellings"](#) below.

NEW BUILD DEFINITION

Clause 64E (proposed section DH 5(7))

Issue: Support for inclusion of commercial to residential conversions

Submission

(Kiwi Property Group Limited, Property Council New Zealand)

Submitters support commercial to residential conversions qualifying for the new build exemption.

Recommendation

That the submission be noted.

Issue: Date of code compliance certificate

Submission

(Magan Lal, New Ground Capital, Scott Farrand, The Bluekiwi Property Consulting Trust)

The definition of a new build should:

- Include properties that have been continuously owned by the same investor since completion, regardless of when the code compliance certificate (CCC) was issued. *(Magan Lal)*
- Include properties that have been continuously owned by the same or related entities since completion if the CCC was issued up to ten years before 27 March 2020. *(New Ground Capital)*
- Include all dwellings that have had their CCC issued in the last five years. This would allow investors who can no longer afford to hold their investment properties to sell without being impacted by the bright-line test. *(Scott Farrand)*
- Only apply to dwellings that have their CCC issued on or after 27 March 2021 and should not be backdated to 27 March 2020. *(The Bluekiwi Property Consulting Trust)*

Comment

“New build land” is generally defined to mean residential land to which a self-contained dwelling has been added, provided the dwelling receives its CCC on or after 27 March 2020. This definition is used for the new build exemption and the new build bright-line test, both of which are aimed at ensuring the proposed property tax changes do not negatively impact upon new housing supply. The following factors were considered when the 27 March 2020 date was selected:

- **Tilting the playing field away from investors and towards first home buyers:** The date selected cannot undermine the objective of the interest limitation rules, which is to tilt the playing field for residential property away from investors and towards first home buyers/owner-occupiers. The further back the date is, the more existing properties would qualify for the new build exemption and therefore be unaffected by interest limitation.

Selecting a date that is too far in the past increases the likelihood of the special rules for new builds undermining the interest limitation rules.

- **Objective of not disincentivising investment in new builds:** The date selected must ensure investment in new housing supply is not disincentivised. Therefore, the ideal date would be after the announcement of the proposals, which would mean that only land to which a dwelling was added on or after 27 March 2021 would qualify as new build land. Dwellings that were added to residential land before this date have already become part of existing housing stock, so need no further incentive. The further back the CCC date is, the less likely the special rules for new builds are to have a positive impact on new housing supply. This is because there would be less of an incentive to invest in a “new” new build (as there would be a greater number of “old” new builds that would also qualify for concessionary treatment).
- **March 2021 announcement:** When the interest limitation proposals were announced, the Government indicated that a “new build” would include properties acquired on or after 27 March 2021 *and* within 12 months of the new build dwelling receiving its CCC. This meant that a dwelling that received its CCC *after* 27 March 2020, but *before* 27 March 2021, could qualify as a new build, depending on when it was acquired. To ensure taxpayers who relied on the Government announcement are not disadvantaged, the definition of “new build land” needs to include residential land with dwellings that received their CCCs on or after 27 March 2020.

The rules announced in March were complex, both for taxpayers to apply and for Inland Revenue to administer, because the eligibility of some new build properties hinged upon when they were acquired and when they received their CCCs. To make the rules simpler, while ensuring any taxpayers who acted in reliance on information provided by the Government in March 2021 are not disadvantaged, officials recommend that land with a dwelling on it that receives its CCC on or after 27 March **2020** will qualify as “new build land”, regardless of when the land was acquired. This date is also consistent with the objectives of the special rules for new builds and the interest limitation proposals.

Recommendation

That the submissions be declined.

Issue: Conversions not requiring a code compliance certificate

Submission

(Deloitte, EY)

Like hotel or motel conversions, other conversions of commercial buildings (such as inns and boarding houses) to residential dwellings that do not require a code compliance certificate (CCC) to be issued should qualify as new build land. The definition of “new build” is too narrow. All newly available residential properties should be included, regardless of what the building was previously used for.

Comment

It is proposed that a dwelling that was formerly a hotel or motel can qualify as “new build land” if territorial or building consent authority records show that the conversion from a hotel/motel to a dwelling took place on or after 27 March 2020. This is an exception from the general requirement that a dwelling must receive a CCC to qualify as a new build.

The exception to the CCC requirement is proposed to apply only to the conversion of hotels/motels into dwellings because these are the only conversions officials are aware of that may occur without requiring a CCC on completion. In the absence of clear examples of situations where the CCC requirement could pose a barrier to commercial to residential conversions taking place, officials consider having only a narrow category of exceptions to the CCC requirement is preferable, given extending it further could result in unintended consequences.

Recommendation

That the submission be declined.

Issue: Statement of principle

Submission

(Chartered Accountants Australia and New Zealand)

The definition of new build land should contain a broad statement of principle, so the legislation is able to easily respond to changes in building trends and practices.

Comment

Officials do not believe a broad statement of principle is necessary because the proposed definition of new build land is already quite broad. If either a change to the definition of new build land or the inclusion of a statement of principle is later considered necessary, these could be made in a future tax Bill.

Recommendation

That the submission be declined.

Issue: Clarify meaning of “added to the land”

Submission

(New Zealand Law Society)

It should be clarified whether an existing house that is shifted to a different location on the same piece of land/title and has its code compliance certificate (CCC) issued on or after 27 March 2020 would meet the definition of new build land.

Comment

The property described by the submitter would qualify as new build land. It is expected that, in most instances, a dwelling would generally only be moved to a different position on the same site to allow for additional dwellings to be added to the land. The difficulty and cost of shifting a house, and obtaining a CCC, is expected to be significant enough that taxpayers are unlikely to engage in this sort of behaviour just so their land qualifies as “new build land”. Officials note that if a taxpayer shifted a house to a different position on the same piece of land/title solely to gain the new build exemption, this would be considered tax avoidance. Officials note that Inland Revenue will provide guidance on the intended meaning of “added to the land”.

Recommendation

That the submission be declined.

Issue: Clarify definition of “self-contained residence or abode”

Submission

(Chartered Accountants Australia and New Zealand, EY)

The meaning of “self-contained residence or abode” is unclear and needs to be better defined in guidance issued by Inland Revenue. Specifically, it is unclear whether a dwelling would qualify if it:

- shares a roof with another dwelling,
- shares an entranceway with another dwelling,
- has an internal door through which the main home can be accessed, or
- shares power or utilities with another dwelling.

Relying only on a dwelling having a separate kitchen or bathroom could result in unintended behavioural outcomes. *(Chartered Accountants Australia and New Zealand)*

Comment

“New build land” is generally defined to mean residential land to which a self-contained dwelling has been added, provided the dwelling receives its code compliance certificate on or after 27 March 2020. “Self-contained” is intended to mean the dwelling has its own kitchen, bathroom, and entranceway.

It is intended that if a dwelling:

- **Shares a roof with another dwelling:** provided it is self-contained (with its own kitchen and bathroom), the dwelling would qualify.
- **Shares an entranceway with another dwelling:** provided it has a separate “front door”, the dwelling would qualify, even if it shares with another dwelling an entrance way or such other communal area or areas as are necessary to enable access to the front door of the dwelling. (This part of officials’ comments incorporates changes made following a discussion with the Committee’s advisor.)
- **Has an internal door that can be used to access another dwelling:** if the internal access door can be locked and the dwelling is otherwise self-contained (that is, has its own kitchen, bathroom, and front door), the dwelling would qualify.
- **Shares a power or utilities connection with another dwelling:** provided it is self-contained, the dwelling would qualify (it should not matter whether the dwelling shares a power or utilities connection with another dwelling).

Officials will ensure that guidance is released explaining the intended meaning of “self-contained”.

Recommendation

That the submission be accepted, subject to officials' comments, as discussed with the Committee's advisor.

Issue: Guidance on "reasonable proportion of shared areas of land"

Submission

(Chartered Accountants Australia and New Zealand, EY)

Inland Revenue should publish guidance setting out the meaning of "reasonable" in proposed section DH 5(7)(b) and how it would be satisfied

Comment

The proposed definition of new build land includes land used exclusively by a new build and a reasonable proportion of shared areas attributable to the new build, such as a shared driveway. Guidance will be published explaining the intended meaning of "reasonable proportion of shared areas of land".

Recommendation

That the submission be accepted.

Issue: Off-the-plans acquisitions

Submission

(Deloitte)

Proposed new section DH 5(7)(c) is unnecessary because proposed new section DH 4(2)(3) applies to bare land.

Comment

The Bill proposes that new build land includes land for which there is an agreement to add a self-contained dwelling, provided the dwelling will receive its code compliance certificate on or after 27 March 2020. The proposed development exemption would apply where a taxpayer is developing, subdividing or building to create new build land.

Proposed new section DH 5(7)(c) is necessary because it is intended to work in conjunction with the new build exemption in proposed section DH 4(1) to enable a taxpayer who **acquires** a new build off the plans to qualify for the new build exemption before the new build is complete (for example, to enable interest to be deducted where there is a nexus with income and a taxpayer has put a deposit down to purchase a new build off the plans).

Proposed new section DH 4(3) applies to the **developer** who is adding the new build to the land, not the taxpayer who acquires the new build off the plans. The development and new build exemptions are intended to apply concurrently to the acquirer and the developer where a new build is acquired off the plans.

Recommendation

That the submission be declined.

Issue: Drafting issues

Submission

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

- a. Commercial to residential conversions: it is not clear from the legislation that commercial to residential conversions (other than hotel or motel conversions) can qualify as new build land. The legislation should be clarified *(Chartered Accountants Australia and New Zealand, Deloitte, EY, KPMG)*
- b. Single dwelling converted into multiple dwellings: it should be clarified that where an existing dwelling on residential land is converted into two or more self-contained dwellings, this will meet the definition of new build land. *(Chartered Accountants Australia and New Zealand)*

Comment

- a. It is intended that commercial to residential conversions would qualify as new build land provided they receive a code compliance certificate (except where the exception for hotels/motels applies). Officials recommend the legislation be amended so that conversions explicitly qualify as new build land.
- b. Existing dwellings that are converted into two or more self-contained dwellings are also intended to meet the definition of new build land, and officials consider the draft legislation already satisfies the policy intent in this regard. However, officials will refer this submission to the drafter for their consideration.

We will also publish further guidance on the eligibility of conversions.

Recommendation

- a. That the submission be accepted.
- b. That the submission be noted.

EXEMPTION FOR NEW BUILD LAND

Clause 64E (proposed sections DH 4(1), DH 5(1), (7)), 127(1E) and 127(10D)

Issue: General support

Submission

(Accountants & Tax Agents Institute of New Zealand, Kiwi Property Group Limited, Magan Lal, Property Council New Zealand, Real Estate Institute of New Zealand)

The submitters support applying an exemption from interest limitation to new builds.

Recommendation

That the submission be noted.

Issue: Encourage increasing supply

Submission

(Kiwi Property Group Limited, Property Council New Zealand)

The regulatory settings should encourage increasing supply as much as possible.

Comment

The proposed exemption has been designed to capture a broad range of scenarios where new housing supply has increased. However, its design must also consider the need to ensure the exemption does not undermine the objective of the interest limitation rules, which is to tilt the playing field for residential property away from investors and towards first home buyers and owner occupiers. If the exemption was designed too broadly, it would undermine that objective because a greater proportion of existing housing stock would qualify for an exemption from interest limitation. Officials consider the design of the proposed exemption strikes an appropriate balance between these objectives.

Recommendation

That the submission be noted.

Issue: Opposition

Submission

(Terrence Denton)

New builds should be incentivised by means other than tax. The proposed new build exemption is extremely generous and will create a severe distortion of the rental and housing markets. Income tax should be based on actual income, not "phantom income" that will not be realised. Taxing capital gains of non-new builds at a higher tax rate and having a capital gains tax concession for new builds would be better because it does not affect cash flow.

Comment

The Government has decided to introduce the current proposals to tilt the playing field for residential property away from investors and towards first home buyers and owner-occupiers. The purpose of the exemption is to ensure interest limitation would not negatively impact on the supply of new housing. Implementing a capital gains tax is not within the scope of the proposed measures.

Recommendation

That the submission be declined.

Issue: Consequences for first home buyers and owner-occupiers

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)

The exemption may have unintended consequences by accentuating the existing ability of investors to leverage their property portfolios and outbid first home buyers and other owner-occupiers.

Comment

Officials acknowledge the concern raised by submitters. However, while new build prices may increase (or not be dampened by interest limitation), more investor demand is expected to shift away from older housing stock. This would make older housing stock more affordable for owner-occupiers, while still ensuring that continued investment in new builds is not disincentivised.

Recommendation

That the submission be noted.

Issue: Arbitrage possibilities

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)

The new build exemption, combined with allowing deferred interest deductions to become deductible on revenue account, could create unforeseen arbitrage possibilities.

Comment

Officials acknowledge the concern raised by submitters. Creating new definitions and boundaries may create the opportunity for arbitrage. However, we have endeavoured to design the rules so that such boundaries are robust, clear, and easy to comply with.

Recommendation

That the submission be noted.

Issue: Impacts on investors

Submission

(EY, Simeon Clarke)

The proposals will simply alter the mix of investors in the sector. *(EY)*

The measures should focus on the larger players, not the smaller ones. *(Simeon Clarke)*

Comment

It is unclear what impact the proposals would have on different types of residential property investors, but it is possible that the proposals may have the consequences suggested by the submitters. The Government considers the proposals necessary to ensure that new housing supply is not negatively impacted by the proposed interest limitation rules, while still tilting the playing field for residential property away from investors and towards owner-occupiers/first home buyers. They are not targeted towards any particular investor, but rather are intended to apply broadly to investors with residential property.

Recommendation

That the submission be noted.

Issue: Negative impact on tenants

Submission

(Olivershaw Limited)

Landlords will prefer new builds over existing builds, and new builds will cost more to rent. This will impact tenants who cannot afford the rent for a new build. Affected tenants could include:

- tertiary students
- taxpayers who have left the family home but do not have capital to fund acquisition of a new home
- taxpayers planning an OE or a move to another city in the short-to-medium term
- new migrants to New Zealand and people who have come to New Zealand for an OE or work experience
- taxpayers who experience a change in family circumstances, such as a relationship break up, and
- taxpayers who are retired or have low wages and cannot afford to own their own home.

Comment

The concerns raised by the submitter may be relevant to the overall policy of interest limitation, as the Government has decided to introduce the interest limitation rules to tilt the playing field for residential property away from investors and towards first home buyers/owner-occupiers. However, we do not agree that the new build exemption will increase rents. Without it, costs to investors in new builds would be higher, their investment in all property would be less, and rents would probably be higher than they will be with the

exemption. The Government has also introduced a suite of other non-tax measures that are aimed at addressing current housing issues in New Zealand to increase supply and minimise upward pressure on rents.

Recommendation

That the submission be noted.

Issue: Review of effectiveness

Submission

(Magan Lal)

The effectiveness of the new build exemption at increasing new housing supply should be reviewed after it has been in place for a year.

Comment

Reviewing the effectiveness of the rules after they have only been in place for one year is unlikely to provide enough information to assess whether the exemption has achieved its objective.

There is currently no commitment to a formal review of the rules. However, Inland Revenue will be committing resources to reviewing remedial changes that may be required once the rules are implemented.

Further, Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD) is responsible for the monitoring of New Zealand’s housing and urban development system. As part of this role, HUD collects and analyses data and research on this system, including measures of housing and rental affordability.

Recommendation

That the submission be declined.

Issue: Eligibility of interest incurred for existing dwellings

Submission

(Chartered Accountants Australia and New Zealand, Findex, Kiwi Property Group Limited, KPMG, Magan Lal, Olivershaw Limited, Property Council New Zealand, Real Estate Institute of New Zealand)

Various submissions were made regarding the eligibility of interest incurred in relation to expenditure on existing dwellings.

- a. **Improving, renovating, repairing, and maintaining existing dwellings:** Interest on borrowing relating to renovations, repairs and maintenance should be deductible. Denying deductions for improvements to a property conflicts with the Government’s approach of encouraging warm, dry rentals. Property owners who make repairs and upgrades to their properties to satisfy existing requirements, such as the healthy homes standards, should not have to absorb the cost. *(Findex, Magan Lal, Olivershaw Limited)*

- b. Remediation of existing dwellings:** Interest on remediation expenditure should qualify. (Kiwi Property Group Limited, Olivershaw Limited, Property Council New Zealand, Real Estate Institute of New Zealand)

Submitters suggested ways the exemption could be designed:

- Taxpayers could make a statutory declaration when they claim the exemption. (*Kiwi Property Group Limited, Property Council New Zealand*)
 - Interest on borrowing related to any new capital expenditure should continue to be deductible. (*Olivershaw Limited*)
 - Alternatively, interest on any “significant” expenditure required for a dwelling to meet the requirements to be rented out should qualify. (*Olivershaw Limited*)
- c. Extensive remediation of uninhabitable dwellings:** The definition of new build land should be expanded to include the extensive remediation of a residential property that was previously uninhabitable (such as a property damaged by a natural disaster). (*Chartered Accountants Australia and New Zealand, KPMG*)

Comment

The purpose of the exemptions from interest limitation is to ensure that investment in new housing supply is not negatively impacted by the interest limitation rules. Officials agree that in principle, interest incurred in relation to expenditure on existing dwellings should qualify for an exemption if the expenditure helps prevents a dwelling falling out of existing housing stock. Furthermore, ideally tax settings would not influence decisions to remediate or demolish and replace a property.

Officials recommend expanding the definition of “new build land”⁶ so that it includes:

- dwellings previously on the earthquake-prone buildings register that have been remediated and removed from the register on or after 27 March 2020⁷, and
- previously leaky buildings that have been reclad, provided at least 75%⁸ of the dwelling is reclad and a code compliance certificate (CCC) for the recladding work is issued on or after 27 March 2020.

Whether existing dwellings have been on the earthquake-prone buildings register, or have been leaky but substantially reclad, can be verified through external records. This means whether such a property is eligible for the new build exemption is objectively verifiable by both Inland Revenue and potential subsequent purchasers of these dwellings.

Given the significant cost of such remediation work, and because the eligibility of these properties would be objectively verifiable, we consider it appropriate for them to qualify for the new build exemption once the remediation work is complete.

⁶ Land that becomes “new build land” because an existing dwelling on it is remediated may also qualify for the 5-year new build bright-line test, because the term “new build land” is also used by that test.

⁷ Provided a CCC has also been issued on or after 27 March 2020 evidencing the building work to remediate the dwelling is complete. Alternatively, if no CCC is issued, then the work must be recorded as having been completed on or after 27 March 2020 in local authority or building consent authority records, and the records must show that a suitably qualified engineer has verified the work is complete.

⁸ Officials do not consider it appropriate to allow the 20-year new build exemption to apply to leaky buildings that have been less than 75% reclad. The new build exemption applies to all interest incurred for a new build property for 20 years and can be passed on to subsequent purchasers during this period. Officials consider the amount of work undertaken must be significant for a property to qualify as a new build. Therefore, we do not recommend extending the exemption to apply to leaky buildings that are less than 75% reclad.

- a. **Improving, renovating, repairing, and maintaining existing dwellings:** Officials disagree with this submission and do not recommend expanding the exemption to cover interest on such expenditure for the following reasons:
- Landlords are already required to maintain their properties to a reasonable state of repair. Providing an exemption should not impact upon behaviour if it is already required under existing law.
 - The amount of interest on expenditure incurred to bring a property up to the healthy homes standards (such as to install a heat pump) is unlikely to be significant. Incurring such expenditure is already required for a property to be rented out, so providing an exemption for interest on the expenditure should not make any difference to whether the expenditure is incurred. This sort of work also does not stop a dwelling dropping out of existing housing stock - dwellings that do not meet the healthy homes standards may still be occupied by first home buyers/owner-occupiers, even though they cannot be rented out to tenants.
 - The addition of a room, or an upgrade to the kitchen or bathroom of a home, is not required to stop a house from falling out of the existing stock. While an extra room may be used as a bedroom, it may instead be put to another use (for example, it could be used as a home office). Therefore, adding another room may not necessarily increase the number of people that live in a property. Upgrading a kitchen or bathroom may make a property nicer to live in, but it does not otherwise directly impact upon housing stock/supply.

Points of difference

- b. **Remediation of existing dwellings:** Officials agree that some remediation should qualify but do not recommend expanding the exemption beyond the two categories recommended above (which would expand the exemption to remediated properties that were on the earthquake-prone buildings register or were leaky and have been more than 75% reclad). Officials disagree with the design suggestions put forward by the submitters for the following reasons:
- Requiring statutory declarations when the exemption is claimed would increase administration and compliance costs. What is considered "remediation", and whether a property satisfies whatever threshold is set, would not be objectively verifiable from a statutory declaration alone. Some remediation work may not result in a CCC, so subsequent purchasers of the property may find it difficult to verify whether a property qualifies for the exemption.
 - Expanding the exemption to all capital account expenditure on existing dwellings would significantly expand the number of taxpayers that qualify for the exemption. Instead of applying to a small subset of investors, the exemption would potentially apply to all residential property investors. This would make it challenging for Inland Revenue to monitor and enforce compliance with the proposed new rules. The same arguments made for not expanding the exemption in the discussion of submission a. above would also apply to expanding the exemption to interest on capital account expenditure.
 - Introducing a rule that allows interest on "significant" expenditure to qualify would increase the complexity and uncertainty of the rules, especially if the definition of "significant" was left for the courts to decide (as suggested by the submitter). As the rules need to be clear and easy to apply, we do not recommend adopting the submitter's suggested rule.
- c. **Extensive remediation of uninhabitable dwellings:** There is an argument that these properties should qualify because remediating them brings them back into New Zealand's housing stock. However, apart from the two categories mentioned above, officials do not

recommend expanding the new build exemption to cover other remediated (formerly) uninhabitable dwellings for the following reasons:

- It is difficult to define “habitable” and “uninhabitable”. Dangerous and insanitary building notices are infrequently used, so tying the definition of “uninhabitable” to the issue of such notices would be impractical.
- There may not be any objective record that taxpayers and Inland Revenue could use to confirm that a property was uninhabitable, or that the property has since become habitable again. This could pose difficulties for subsequent purchasers, in particular, as they would need to be able to check the eligibility of these properties for the exemption over a 20-year period.
- Properties damaged in a natural disaster or fire should have insurance cover if they are debt funded, so the owners of these properties should receive an insurance payout should damage be caused by such an event.
- Some properties may become uninhabitable because of deferred maintenance and repairs (that is, they have ended up uninhabitable through neglect and would have continued to be habitable if they had been regularly maintained and repaired). Providing an exemption for remediating such properties could create perverse incentives.

Recommendation

- a. That the submission be declined.
- b. That the submission be accepted, subject to officials’ comments.
- c. That the submission be accepted, subject to officials’ comments.

Issue: Application period

Submissions

(Kiwī Property Group Limited, New Ground Capital, Ockham Residential, Property Council New Zealand)

The exemption should apply:

- To all taxpayers for 25 years. *(Ockham Residential)*
- To all taxpayers in perpetuity. *(New Ground Capital)*
- To initial owners in perpetuity and to subsequent owners either in perpetuity or for 50 years. *(Kiwī Property Group Limited, Property Council New Zealand)*

Comment

Allowing the exemption to apply for more than 20 years could undermine the objectives of the proposed interest limitation rules and the new build exemption. The longer the exemption applies for, the less impact it is likely to have on the following:

- Tilting the playing field for residential property away from investors and towards first home buyers/owner-occupiers over time. A longer exemption period would likely result in a greater portion of existing properties eventually becoming exempt from the interest

limitation rules. That is, a longer exemption is more likely to undermine the interest limitation rules as a whole.

- Investment in new housing supply over time. There would be less of an incentive for investors to invest in “new” new builds if there were a greater number of “old” new builds that still qualified for an exemption.

Twenty years was seen as the period most likely to strike an appropriate balance between these two objectives, given the Government’s commitment to both the proposed interest limitation rules and introducing an exemption for new builds.

Recommendation

That the submissions be declined.

Issue: Application period for conversions

Submission

(Kiwi Property Group Limited, Property Council New Zealand)

The exemption should apply for 50 years from the date of completion for dwellings converted from commercial buildings.

Comment

It is intended that commercial buildings converted to dwellings will qualify for the new build exemption, provided they receive a code compliance certificate (CCC) on or after 27 March 2020 confirming the conversion is complete (unless the dwelling was previously a hotel or motel, in which case it is proposed that an exception to the CCC requirement would apply).

However, allowing the exemption to apply for 50 years for these properties would undermine the objectives of the proposed interest limitation rules and the new build exemption. For these reasons, officials do not recommend the exemption be extended to 50 years for these properties.

Recommendation

That the submission be declined.

Issue: Start of 20-year period

Submission

(Chartered Accountants Australia and New Zealand)

For a property that has a code compliance certificate (CCC) issued between 27 March 2020 and 30 September 2021 (inclusive), the 20-year exemption period should begin on 1 October 2021. The exemption is not relevant before this date because interest limitation does not apply until 1 October 2021.

Comment

While it is correct that the exemption is not relevant until 1 October 2021 (because that is when the interest limitation rules apply from), if the 20-year exemption period started from this date for these properties, this would increase the complexity of the rules.

Under current proposals, for most new builds, the 20-year exemption period is counted from the date a new build's CCC is issued. If the exemption applied from a different date for a small subset of properties, despite those properties having CCCs confirming that they are new builds, this would increase complexity for both Inland Revenue and taxpayers looking to apply the rules.

Recommendation

That the submission be declined.

Issue: Support for existing apportionment methods

Submission

(Property Council New Zealand)

We agree that existing apportionment principles should apply where a new build and existing build are on the same title.

Recommendation

That the submission be noted.

Issue: Drafting issues

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, EY, PwC)

- a. The references to section DH 5(5) in section DH 4(1) should be to section DH 5(7).
(Chartered Accountants Australia and New Zealand, Deloitte, EY, PwC)
- b. The legislation should confirm the start date of the exemption for off-the-plans purchases.
(Chartered Accountants Australia and New Zealand)

Comment

Officials will refer these submissions to the drafters for their consideration. Some comments on the points raised:

- a. Officials agree.
- b. Officials consider the legislation already satisfies the policy intent. The new build exemption commences when residential land becomes new build land. In the case of an off-the-plans purchase, this date is when an agreement to add a new build to the land is entered into (proposed new section DH 5(7)(c)). For off-the-plans new builds, even though the exemption applies from the date the agreement was entered into, the 20-year period is counted from the date the new build receives its code compliance certificate.

This means the exemption applies for more than 20 years for new builds purchased off the plans.

Recommendation

- a. That the submission be accepted.
- b. That the submission be noted.

Issue: Extended exemption for build-to-rent developments

Submission

(Kiwi Property Group Limited, New Ground Capital, Property Council New Zealand, PwC, Russell McVeagh)

The exemption should apply for more than 20 years for build-to-rent (BTR) developments.

A transitional rule for existing BTR dwellings (BTRs) should be considered. *(PwC)*

Comment

The extent to which the interest limitation rules will impact upon the BTR sector is unclear, as the sector is still new to New Zealand. Self-contained dwellings in new BTR developments would qualify for the development exemption while they are being added to land, and they would qualify for the new build exemption for 20 years after they receive their code compliance certificates.

Officials do not recommend extending the new build exemption so that it applies for more than 20 years. We also do not recommend amending the exemption so that it applies to existing BTRs. Doing as submitters suggest would run the risk of the new build exemption undermining the overall policy objective of the proposed interest limitation rules.

The Government is considering whether special rules for BTRs should be introduced and, if so, how these rules should be designed. Further information on whether the Government intends to introduce special rules for BTRs, and how those rules might be designed, will become available in 2022.

Recommendation

That the submission be declined.

TREATMENT OF BUILD-TO-RENT (BTR) PROPERTIES

Issue: BTR exclusion from interest limitation is required

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Kiwi Property Group Limited, Property Council New Zealand, Ockham Residential, Real Estate Institute of New Zealand, Russell McVeagh)

BTR dwellings (BTRs) should have a specific exclusion from interest limitation because BTRs:

- do not compete with first home buyers
- are more comparable with commercial assets, such as student accommodation and retirement villages
- will not grow in New Zealand without an exemption that applies in perpetuity, and
- provide benefits, such as security of tenure and prompt maintenance for tenants.

Comment

The Government is currently considering whether there should be an exclusion for large-scale BTR developments and, if so, how the exclusion should be designed.

Recommendation

That the submission be noted.

Issue: Design of BTR exclusion

Submission

(Kiwi Property Group Limited, Magan Lal, Property Council New Zealand, Russell McVeagh,)

Various suggestions for how a BTR exclusion could be designed were put forward by submitters. In addition to applying to new build BTR dwellings (BTRs), design features suggested by submitters included:

- **Application to existing (that is, non-new build) BTRs** - the exclusion should apply to:
 - all existing BTRs, or
 - only to existing BTRs that received their code compliance certificates (CCCs) in the ten years before 27 March 2021, provided they have always been owned by a legitimate BTR developer/investor since being constructed
- **Scale** - the exclusion should apply to:
 - any BTR dwelling, regardless of scale, or
 - BTR developments of a sufficient scale (for example, comprised of a portfolio of at least 50 self-contained dwellings)

- **Unified ownership** - the BTRs should be let separately but held in unified ownership
- **Exemption period** - the exemption should apply in perpetuity
- **Designed for long-term tenancy** - the exemption should apply to assets specifically designed, constructed, or adapted for long-term residential tenancies
- **Required to have shared amenities** - some form of shared amenity should be required
- **Minimum period of use as long-term tenancy** - the BTRs should be dedicated to residential tenancies for at least eight years
- **Management standards** - the BTR developments should be run by professional and qualified management, with oversight under a single entity
- **Always used as a rental** - the BTRs should be required to have been continually configured as dwellings used as residential premises for the purposes of the Residential Tenancies Act 1986 since the CCCs were issued for the dwellings
- **Always owned by the same person** - the ownership of the BTRs must not have been transferred since the time they received their CCCs, and
- **GST requirements** - the rental income from the BTRs must be GST exempt, and GST on inputs must not have been deducted by the owners.

Some submitters put forward specific wording for use in the legislation, and it was suggested that the definition of a BTR could be added to section YA 1 of the Income Tax Act 2007.

Comment

The Government is currently considering whether there should be special rules for BTRs and, if so, how those rules should be designed. The design suggestions put forward by submitters will be considered if the Government decides to put special rules for BTRs in place.

Recommendation

That the submission be noted.

ROLLOVER RELIEF – INTEREST LIMITATION

Clauses 80B, 80C and 80D

Issue: Drafting issues

Submission

(Chartered Accountants Australia and New Zealand, EY)

The drafting of the proposed rollover relief provisions for interest limitation purposes is unclear.

- a. The legislation needs to clearly state that a loan drawn down by, or transferred to, the recipient of disallowed residential property will be treated as meeting the requirements of proposed section DH 5(5) if a loan held by the transferor was a grandparented transitional loan. *(Chartered Accountants Australia and New Zealand)*
- b. There are no specific provisions dealing with the transfer of financial arrangements under a relationship property agreement (except where the financial arrangement is one existing before the introduction of the financial arrangements rules). *(Chartered Accountants Australia and New Zealand)*
- c. Proposed section FC 9(4) should be amended to make clear the amount the executor, administrator or beneficiary of an estate can claim as a deduction if they derive income from the disposal of disallowed residential property. *(Chartered Accountants Australia and New Zealand)*
- d. The language used in proposed section FC 9(4) is confusing and should be clarified. A plain English substitution for the existing wording would be preferable. Section FC 9(5) also refers to “disallowed residential property land”, which is a term not used elsewhere in the proposals. *(EY)*

Comment

- a. Officials acknowledge that the proposed interest limitation rollover relief provisions need to be clarified so that they reflect the loan drawdown date, rather than being based on the transferor’s acquisition date (which is the case for bright-line rollover relief). An amendment should also be made to provide that a loan drawn down by, or transferred to, the recipient of disallowed residential property is treated as meeting the requirements for interest deductibility if the loan held by the previous owner was a grandparented transitional loan. This will only be the case to the extent that the transferee’s loan balance does not exceed the loan balance of the previous owner at the time, or immediately before, the property was transferred.
- b. Officials acknowledge the matter raised in the submission. However, further work on this matter would require prioritising and resourcing as part of the Government’s tax policy work programme

Officials note there may be issues arising from the enactment of the proposals that require future remedial legislation, and we are committing resources towards addressing these issues.

- c. The intention is to provide rollover relief on a transitional basis, so the amount of any interest deductions will be determined by the rules for grandparented transitional loans. The references in proposed section FC 9(4) to the cost of disallowed residential property were made in error. As noted in a. above, the language of section FC 9(4) should be replaced with a statement that a loan drawn down by, or transferred to, the recipient of

disallowed residential property will be treated as meeting the requirements for interest deductibility if a loan held by the transferor was a grandparented transitional loan (to the extent the transferee's loan balance does not exceed the transferor's loan balance at the time of, or immediately before, the transfer).

- d. As per the comment at a. above, officials agree the proposed rollover relief provisions should be clarified. Officials consider that, rather than adopting the submitter's suggestions, the recommendation for a. above will sufficiently address the problems raised with the interest limitation rollover relief proposals.

Recommendation

- a. That the submission be accepted.
- b. That the submission be declined.
- c. That the submission be declined.
- d. That the submission be declined.

Issue: Company amalgamations

Submission

(Matter raised by officials)

Consistent with existing rollover relief provided for the bright-line test, rollover relief should apply for interest limitation purposes to a transfer of property as part of a company amalgamation in certain circumstances. Officials recommend that rollover relief apply when disallowed residential property passes from an amalgamating company to an amalgamated company on a resident's restricted amalgamation on or after 27 March 2021, provided the amalgamating company had a grandparented transitional loan immediately before the transfer.

This rollover relief would only be available if the amalgamating and amalgamated companies are New Zealand tax residents and are not treated as non-resident under a tax treaty. This would ensure that, consistent with the rules for bright-line rollover relief, rollover relief for interest limitation purposes would only be provided on the condition that the property remains within the New Zealand tax base.

Recommendation

That the submission be accepted.

GRANDPARENTED TRANSITIONAL LOANS THAT CANNOT BE TRACED

Clause 64E (proposed sections DH 7 and DH 8)

Issue: Stacking should not be limited to loans that cannot be traced

Submission

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

The stacking approach proposed for grandparented transitional loans that cannot be traced should not be limited to loans where tracing is impossible. In theory, all loans can be traced with enough time and effort.

- a. The stacking approach should also be allowed for loans where tracing is not easy or is difficult. *(Chartered Accountants Australia and New Zealand, EY, KPMG)*
- b. The stacking approach should be allowed for all loans drawn down before 27 March 2021, as the discussion document suggested that tracing would be optional. Alternatively, guidance should be provided on what efforts are required to trace loans. *(PwC)*

Comment

Officials agree that the stacking approach should not be limited to loans where tracing is impossible, but we disagree with the suggestion that, in theory, all loans can be traced with enough time and effort. Some taxpayers will genuinely be unable to trace their grandparented transitional loans if the records required to trace them no longer exist or cannot be legally accessed by the taxpayer.

Requiring taxpayers to trace grandparented transitional loans wherever possible could impose excessive and unnecessary compliance costs in some cases. Some taxpayers may be able to trace grandparented transitional loans only with enormous amounts of time and effort, disproportionate to the value of the loan.

- a. Officials agree that the stacking approach should also be allowed in some cases where tracing is not easy or difficult. Officials consider, however, that the stacking approach should not apply to loans that can be traced with reasonable efforts.
- b. Officials note that the discussion document did not say tracing would be optional. Rather, it said that the *transition approach* — that is, stacking (or apportionment, which was still being considered at the time) — would be optional, so that taxpayers could still trace if they wanted to.

Allowing stacking for all grandparented transitional loans is not appropriate as many loans can be easily traced, and taxpayers should not be allowed to treat loans clearly used to acquire disallowed rental property as being used to acquire other assets, such as shares or KiwiSaver interests.

Point of difference

- a. To mitigate unnecessary compliance costs, officials consider that the stacking approach should be extended to loans that cannot reasonably be traced.

Recommendation

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

- b. That the submission be declined.

Issue: Repayments for taxpayers that have applied the stacking approach

Submission

(Matter raised by officials)

Proposed section DH 7(4) should be amended so that a repayment sourced from the disposal of allowed property repays the loan allocated to that allowed property first.

When a taxpayer applies the proposed stacking approach to a grandparented transitional loan, their actual loan can effectively be split, for tax purposes, into two “notional” loans — one is treated as being used for disallowed residential property, and one is treated as being used for allowed property. Rules are needed to determine which notional loan a repayment is treated as reducing.

Proposed section DH 7(4) contains both a general rule and an exception to it:

- The general rule provides that a repayment is applied against the notional loan principal first (that is, the repayment first reduces the notional loan treated as being used for disallowed residential property).
- However, the exception to that general rule provides that if the repayment is sourced from the disposal of allowed property described in section DH 7(3)(b), the notional loan principal is not reduced by the repayment.

Thus, under proposed section DH 7(4), if a taxpayer has applied the stacking approach to a grandparented transitional loan, repayments of that loan will not reduce the notional loan principal if the repayment is sourced from the disposal of allowed property.

If a repayment is greater than the 26 March 2021 value of the allowed property that was disposed (for example, if the allowed property has since increased in value), this exception can cause the notional loan principal under proposed section DH 7 to be greater than the actual balance of the grandparented transitional loan. This is unintended.

For example, assume a taxpayer has a \$500,000 grandparented transitional loan used for both disallowed residential property and allowed property. The value of the taxpayer’s allowed property on 26 March 2021 is \$300,000, so the notional loan principal under proposed section DH 7(4) is \$200,000.

The taxpayer then sells the allowed property for \$350,000 and uses the proceeds to make a \$350,000 repayment. The balance of the grandparented transitional loan is reduced to \$150,000. However, as the repayment is sourced from the disposal of allowed property, the exception in proposed section DH 7(4) provides that the notional loan principal is not reduced and remains \$200,000.

Accordingly, proposed section DH 7(4) should be amended so that if a repayment is sourced from the disposal of allowed property, it should first repay the loan allocated to the allowed property disposed of, with any remainder being allocated to the notional loan principal.

Recommendation

That the submission be accepted.

HIGH WATER MARK

Clause 64E (proposed section DH 10)

Issue: Drafting of high water mark

Submission

(EY, KPMG)

The drafting of proposed section DH 10 could be simplified and improved.

Comment

Officials agree that the drafting of section DH 10 can be improved to ensure its intended purpose, consistent with the Commentary to the Bill, is clearer. These recommended improvements have been influenced by the submissions provided and have been discussed with submitters.

Recommendation

That the submission be accepted.

Issue: Variable balance loans

Submission

(Chartered Accountants Australia and New Zealand)

The high water mark proposal should be limited to apply only to variable balance loans (such as a revolving credit facility or overdraft). The fact that a loan that may be drawn down in several tranches does not mean it is a variable balance loan.

Comment

Officials disagree. Proposed section DH 10(1) provides that the high water mark will apply only to a person who chooses to rely on that method. While a taxpayer who has a loan drawn down in several tranches may not benefit from the high water mark proposal (for example, because a subsequent draw down takes them over the initial loan balance), it will still be optional whether they apply it. Even if they choose to apply it, they will not be impacted beyond the additional compliance costs of considering the section, as it is not intended to reduce the interest deductions that would otherwise be available. Rather than risk excluding a taxpayer who could benefit from the provision, officials consider it is better to have the provision apply more widely, even if it is of no benefit to many of the taxpayers who could be eligible.

Recommendation

That the submission be declined.

Issue: Variable balance loans used for multiple purposes

Submission

(Chartered Accountants Australia and New Zealand)

Where a variable balance loan has been used for multiple purposes, section DH 10 should clarify that a person must first establish what part of the variable balance loan applies to disallowed residential property before the section applies.

Comment

Officials agree this calculation must be made before calculating the initial loan balance and subsequent amounts. The initial loan balance would be equal to the loan balance attributed to disallowed residential property if section DH 10 was not applied. While this was always intended, officials agree this could be clarified in the legislation.

Recommendation

That the submission be accepted.

Issue: Deposits before 27 March 2021 and the high water mark

Submission

(Terence Denton)

The high water mark needs to take account of deposits made into revolving credit type facilities before 27 March 2021. Given these deposits are likely to be sporadic and typically of many small amounts, the task of tracking these back over the life of the facility will be insurmountable in most cases.

Comment

Officials disagree. The high water mark proposal minimises compliance costs by determining the initial loan balance on 27 March 2021. It will still be necessary to trace (or stack, when tracing is not possible) funding to disallowed residential property, but this is not specific to the high water mark. A deposit made shortly before 27 March will not provide the same high water mark benefit as one made shortly after 27 March. However, this is an unavoidable consequence of a rule that applies from a specified date.

Recommendation

That the submission be declined.

Issue: Compound interest

Submission

(Terence Denton)

Compound interest should not be captured under the high water mark and grandparenting provisions as new lending when it is associated with the original loan.

Comment

Officials disagree. Compound interest arises when interest charged on a loan is added to the outstanding loan balance and interest is then charged on the new higher loan balance. As the loan balance increases by the amount of interest charged, this is new lending in the same way that increasing the loan balance to pay costs of holding a disallowed residential property is also new lending. This new lending was not made before 27 March 2021 and so would not be eligible to be treated as grandparented residential interest. Therefore, it should not be added to the initial loan balance for calculating the high water mark.

Recommendation

That the submission be declined.

REFINANCING

Issue: Support for refinancing

Submission

(Capital Accounting Associates Limited, Chartered Accountants Australia and New Zealand, KPMG)

Submitters support the inclusion of a provision allowing a second loan taken out to repay a grandparented transitional loan to follow the treatment of that grandparented transitional loan.

Comment

The proposed legislation, as released, did not include this provision, but officials will recommend the committee agree to include one.

Note that provisions for refinancing will have application beyond the transitional period to 31 March 2025 to ensure that refinanced loans have the same use as the original loan (for example, a loan to acquire shares in an interposed residential property holder).

Recommendation

That the submission be noted.

Issue: Refinancing with a foreign currency loan

Submission

(Chartered Accountants Australia and New Zealand)

The refinancing provision should also apply when a taxpayer refinances with a loan denominated in a foreign currency.

Comment

This submission relates to the submitter's separate submission that a foreign currency loan should be eligible for deductions as grandparented residential interest (see "[Issue: Deduction for foreign currency loans](#)" below). As officials recommend that interest from foreign currency loans for disallowed residential property should not be deductible from the start of the rules, there is no need for interest on a loan refinanced into a foreign currency to be treated as grandparented residential interest.

Recommendation

That the submission be declined.

LOANS IN FOREIGN CURRENCY

Clauses 55B and 64E (proposed section DH 9)

Issue: Support for excluding income from foreign currency loans

Submission

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

If interest on a foreign currency loan is not deductible, the submitters support exempting the income arising from a foreign currency loan.

Recommendation

That the submission be noted.

Issue: Deduction for foreign currency loans

Submission

(Chartered Accountants Australia and New Zealand, KPMG, nsaTax Limited, Russell McVeagh)

Taxpayers should not be denied interest deductions during the transitional phase for a foreign currency loan.

To overcome complexity, the transitional phasing rule for these types of loans could allow taxpayers to convert the interest payments (excluding any foreign exchange gain or loss) into NZD using the appropriate exchange rate.

Comment

Officials agree that, conceptually, interest on a foreign currency loan should be treated consistently with interest on a New Zealand dollar loan. However, we continue to consider that the complexity of the rules required to give effect to the proposal outweighs this.

Under the financial arrangements rules, there is no distinction between interest incurred and foreign exchange gains and losses, with the net of these amounts being treated as interest. Interest rates can vary significantly across different currencies. However, under covered interest parity, exchange rate movements would be expected to more closely align the expected total cost to a borrower. Allowing a deduction for the New Zealand dollar equivalent of a foreign currency interest expense could result in a deduction that was larger (and potentially sometimes much larger) than the amount actually incurred by the borrower.

Furthermore, this treatment would require the transitional period to be carved out of the treatment as a single financial arrangement. This is because any foreign exchange movements would need to be excluded from the base price adjustment when the arrangement matured.

While these issues are not insurmountable, they would add significant complexity to both the housing proposals and the financial arrangements rules. The treatment itself would benefit very few taxpayers and only during the transitional period until 31 March 2025. While we expect that not all affected taxpayers would be willing or able to refinance into a New Zealand Dollar loan to retain partial interest deductibility, the taxpayers that do will further reduce

the pool of affected taxpayers. On balance, we continue to consider that denying all interest deductions on foreign currency loans for disallowed residential property from the start date of the rules is appropriate.

Recommendation

That the submission be declined.

Issue: **Base price adjustment for previously taxed foreign currency loans**

Submission

(EY)

There should be a base price adjustment (BPA) triggered for any loans that have been previously taxed under the financial arrangements rules. This mechanism would allow a wash-up on exit to ensure there is no over- or under-taxation.

Comment

Officials agree that a BPA should be required when a foreign currency loan is no longer deductible to ensure that any foreign currency gains and losses are brought within the tax base and no over- or under-taxation occurs. However, this is an existing issue with the financial arrangements rules, and no provision to deal with these circumstances currently exists. For example, if a person's variable principal debt instruments (for example, credit cards) drop below \$50,000 for all days of a year, they become excepted financial arrangements and cease to be financial arrangements, and yet there is no explicit provision to trigger a BPA.

Officials agree that the legislation in this area could be clearer. However, in our opinion this should be considered more generally as part of a wider financial arrangements project, rather than just for disallowed residential property.

Recommendation

That the submission be declined.

Issue: **Interest rate swaps**

Submission

(PwC)

Gains or losses on interest rate swaps for affected loans should be non-assessable or non-deductible as applicable.

Comment

As with ["Issue: Base price adjustment for previously taxed foreign currency loans"](#) above, this is an existing issue within the financial arrangements rules. For example, under the financial arrangements rules, there is no carve out for an interest rate swap that effectively converts a New Zealand dollar loan used for private purposes into a foreign currency loan. In

our opinion, it would be more appropriate to consider this as part of a future wider review of the financial arrangements rules.

Recommendation

That the submission be declined.

MIXED-USE ASSETS

Clauses 64B to 64D

Issue: Mixed-use asset rules should be reviewed

Submission

(Chartered Accountants Australia and New Zealand, Findex)

The mixed-use asset (MUA) rules are overly complex and do not always work as intended. In addition, there is overlap with the proposed interest limitation rules – both limit interest deductions where there is a business purpose, but the Government considers there is a private benefit. The MUA rules should be reviewed to determine whether they are still needed, and whether they are fit for purpose. If they are needed and fit for purpose, they should be simplified.

Comment

It is not correct that the proposed interest limitation rules reflect a government view that interest deductions give rise to a private benefit. The rationale for the proposed rules is quite different from the rationale for the MUA rules. Though they can both apply to the same subject matter (for example, a holiday home that is rented out), the MUA rules also apply to new build holiday homes, and to boats and aircraft.

The MUA rules are complex only in relation to allocation of interest to mixed-use assets held in close companies. Officials understand it is relatively uncommon for assets to be held in this way.

Recommendation

That the submission be declined.

Issue: Interest allocation rules for MUAs should be aligned to tracing approach for residential property

Submission

(Olivershaw Limited)

Having two different interest allocation rules relating to mixed use residential rental property held by close companies results in extreme complexity. The mixed use asset interest allocation rule should be aligned to the tracing rules. This would ensure consistency and simpler rules.

Comment

Officials agree it would have been simpler to have one set of interest allocation rules. However, we also understand that the effect of the existing mixed-use asset (MUA) interest allocation rules is that MUAs are very rarely held by closely-held companies. Accordingly, the practical impact of the complexity created by two sets of rules is likely to be limited. We note also that it would be unfortunate if the more rigorous interest allocation rules for MUAs that are not residential rental properties were abandoned as a consequence of the residential rental property interest limitation.

Recommendation

That the submission be declined.

Issue: Further amendments required to clarify interest allocation

Submission

(Matters raised by officials)

Further amendments are required to clarify that interest incurred by a close company or certain related parties is intended to be allocated under section DG 9 as well as section DG 10.

The proposed introduction of subpart DH has made it desirable to re-organise the method of allocating interest incurred by a close company in relation to a mixed-use asset (MUA) that is also subject to interest limitation under proposed new subpart DH. Because subpart DH applies a tracing approach to the allocation of interest, when interest is allocated to a MUA that is subject to subpart DH:

- That interest should also be allocated to the MUA for the purposes of subpart DG. This requires applying section DG 9 (which uses a tracing approach), rather than section DG 10 and section DG 11 (which use a stacking approach).
- The stacking allocation in sections DG 10 to DG 13 needs to take account of the prior tracing allocation.

Clause 64D contains some amendments to achieve this. However, further amendments are required to section DG 10 and section DG 11 to ensure this result. For example, section DG 10(1) should not apply to interest relating to residential land that is subject to subpart DH.

Recommendation

That the submission be accepted.

Issue: Amendments required to reduce scope of sections DG 12 and DG 13

Submission

(Matter raised by officials)

New clauses are needed to reduce the scope of existing sections DG 12 and DG 13 to exclude interest that relates to disallowed residential property or an interest in an interposed residential property holder.

Section DG 12 applies when a company (Company B) is a member of a group of companies with a close company or qualifying company (Company A) that holds a mixed-use asset (MUA) where Company A's debt is less than the value of the MUA. In this case, a portion of Company B's interest is allocated (using a stacking approach) to Company A's MUA and subject to deduction denial on the basis that it has a private purpose. This should not apply to the extent that interest on Company B's debt is already denied a deduction because it

relates to disallowed residential property or an interest in an interposed residential property holder.

Section DG 13 similarly denies deductions in certain circumstances for interest expenditure incurred by a company that is a direct or indirect shareholder in a company that holds a MUA or is in the same group as such a company. It applies only if the amount of debt on which deductions have been denied under sections DG 8, DG 11 and DG 12 is less than the value of the MUA. As with section DG 12, section DG 13 needs to be amended so it does not apply to the extent that the shareholder company's debt is already denied a deduction because it relates to disallowed residential property or an interest in an interposed residential property holder.

Recommendation

That the submission be accepted.

Issue: Amendment required to section DG 14 to apply section DH 8(1)(c) first

Submission

(Matter raised by officials)

An amendment is required to section DG 14 to ensure it does not deny a deduction for interest where a deduction is already denied under section DH 8(1)(c).

If section DG 14 applies to shares in a company that are also an interest in an interposed residential property holder, then there are two different rules that deny a deduction for interest on debt relating to those shares. A rule is needed to co-ordinate the application of these two rules. Officials consider the best approach is to apply section DH 8(1) first. This will deny a deduction completely for a portion of the interest equal to the residential property percentage. This percentage is calculated on the basis that mixed-use assets are not disallowed assets. Section DG 14 can then apply to the portion of the debt/interest expense for which a deduction has not been denied.

Recommendation

That the submission be accepted.

Issue: Residential property percentage formula in proposed section DH 6 needs correction

Submission

(Matter raised by officials)

In the Bill as it currently exists, the residential property percentage formula compares the value of disallowed residential property **excluding mixed-use assets** (MUAs) with the value of all property **excluding MUAs**. The second exclusion is not appropriate. The purpose of the formula is to determine the percentage of the company's assets that is represented by disallowed residential property. Because disallowed residential property that is also a MUA is subject to an entirely different regime for dealing with interposed entities, such assets are excluded from the numerator of the formula. There is no basis, however, for excluding those assets from the denominator.

Recommendation

That the submission be accepted.

DISPOSAL OF DISALLOWED RESIDENTIAL PROPERTY SUBJECT TO INTEREST LIMITATION

Issue: Treatment of disposals of disallowed residential property

Submissions

(Accountants & Tax Agents Institute of New Zealand, Chartered Accountants Australia and New Zealand, Kiwi Property Group Limited, KPMG, Olivershaw Limited, Property Council of New Zealand)

Submitters were generally supportive of the proposal to allow the disallowed interest that would otherwise be deductible to be deducted when the property was sold on revenue account, but they also asked that the circumstances where the deduction was available be expanded and that restrictions on allowing the deductions be reduced or removed.

They submitted that:

- a. Interest should be deductible when the sale is on revenue account under the bright-line test. *(Accountants & Tax Agents Institute of New Zealand)*
- b. Limitations on deducting the interest under the bright-line test anti-arbitrage rule and the residential rental loss ring-fencing rules should not apply. *(Kiwi Property Group Limited, Property Council of New Zealand)*
- c. To the extent interest exceeds any non-taxable capital gain, it should be deductible when property is sold on capital account. *(KPMG, Olivershaw Limited)*

Comment

- a. Inland Revenue is proposing to consult on its views on the deductibility of holding costs for residential investment property, including interest. This will include the situation of a property being sold and taxable under the bright-line test. The outcome of that process should determine how previously denied interest would be treated in a bright-line sale.
- b. Officials consider that the bright-line test anti-arbitrage rule and residential rental loss ring-fencing rules should continue to apply as they currently do. The residential rental loss ring-fencing rules are discussed further below (see "[Issue: Repeal of residential rental loss ring-fencing rules](#)").
- c. Officials consulted on the possibility of extending the proposal to allow deductions for interest on capital account sales in the discussion document *Design of the interest limitation rule and additional bright-line rules* (Option F in Chapter 5). However, it was decided that this would increase complexity of the rules and reduce the effectiveness of the interest limitation policy by reducing demand from investors for residential investment property.

Recommendation

That the submissions be declined.

INTERPOSED ENTITY RULES

Clause 64E (proposed sections DH 5, DH 6 and DH 8)

Issue: Interposed entity rules necessary

Submission

(Chartered Accountants Australia and New Zealand)

The submitter agrees in principle that interposed entity rules are necessary.

Recommendation

That the submission be noted.

Issue: Interposed entity rules require simplification

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The rules are complex and confusing, will be difficult for most taxpayers to apply and should be simplified.

Comment

Officials have tried to keep the interposed entity rules as simple as possible. Some minor drafting changes are proposed with a view to improving readability. Given the complex nature of interposed entity arrangements and the need for rules to prevent taxpayers from using such arrangements to obtain deductions for interest on loans that indirectly fund residential investment property, some complexity in the rules is inevitable.

Most taxpayers will not be required to apply the interposed entity rules. The rules will not apply simply because a disallowed residential property is held in a trust or company. The rules will only apply if a taxpayer borrows to acquire a share in the company or to become a beneficiary of the trust and the value, as a percentage, of disallowed residential property held by the company or trust exceeds a proportion of the company's or trust's total assets. The proportion of disallowed residential properties held by companies is very small.⁹ While the proportion of disallowed residential properties held by trusts is slightly greater,¹⁰ it is highly unusual for people to borrow money to become a beneficiary of a trust.

Recommendation

That the submission be declined.

⁹ Around 4% of taxpayers reporting rental income in 2019.

¹⁰ Around 8% of taxpayers reporting rental income in 2019.

Issue: The effect of the proposed rules overreach

Submission

(Deloitte)

The proposed interposed entity rules overreach because they deny all interest incurred for an interposed company, even if 49% to 89% of the company's assets are not disallowed property.

Comment

Close companies

The submitter appears to misinterpret the draft legislation. When the interposed residential property holder is a close company, the amount of interest that will be denied is in proportion to the disallowed assets held by the company. For example, if a close company's disallowed assets comprise 75% of its total assets, 75% of the person's interest expenditure will be denied. For the rule to apply, at least 10% of the close company's total assets must be disallowed assets.

Non-close companies

When the interposed residential property holder is a non-close company, all interest incurred by a person to acquire shares in the company will be denied if the value of the company's disallowed assets is more than 50% of its total assets at any time in the income year.

This approach is less accurate than the proposed approach for interposed close companies but is simpler, although harsher in effect. The apportionment approach that will apply to interposed close companies would be difficult and impractical to apply to a company that is widely held. Accordingly, all interest deductions will be denied if the interposed non-close company holds more than 50% disallowed assets.

Recommendation

That the submission be declined.

Issue: No grandparenting for interposed entities

Submission

(Deloitte)

The submitter has queried whether it is intended that grandparenting of interest will not apply to interposed entities.

Comment

The proposed interest limitation rules provide for the grandparenting of interest incurred on loans drawn down before 27 March 2021 for disallowed residential property. Interest on such loans will be progressively denied from 1 October 2021 to 31 March 2025. It is proposed that interest incurred to acquire shares in, or become a beneficiary of, an interposed entity will not qualify for grandparenting.

Officials note that the number of existing interposed entities is likely to be very small.¹¹

To extend grandparenting to interest incurred to acquire shares in, or become a beneficiary of, an interposed entity would require complex rules to deal with any changes in the mix of disallowed residential property and other assets held by the interposed entity after 27 March 2021.

For example, assume a person borrowed \$1m to acquire shares in an interposed close company before 27 March 2021, and the interposed close company has \$500,000 disallowed assets and \$1m total assets on 27 March 2021. On 27 March 2021, the interposed close company's residential property percentage would be 50% and, if grandparenting were allowed, 50% of the person's interest deductions would be limited but grandparented. After 27 March 2021, the interposed close company acquires more disallowed assets so that its residential property percentage increases to 80%. The percentage of the person's interest deductions that should be limited accordingly increases to 80% but, as some of the close company's disallowed assets were acquired after 27 March 2021, not all the limited interest deductions should be grandparented.

The rules required to determine the correct amount of grandparenting in such a situation would be very complex, especially as situations in practice are likely to involve many more fluctuations in the close company's residential property percentage over the transitional period.

Recommendation

That the submission be declined.

Issue: Restructuring to fall outside rules should not be tax avoidance

Submission

(Deloitte)

It should be made clear that taxpayers who choose to restructure commercial arrangements to fall outside of the interposed close company rules are not committing "tax avoidance".

Comment

The application of section BG 1 of the Income Tax Act 2007 (the general anti-avoidance provision) is an intensely fact-based inquiry. Whether section BG 1 applies to a restructuring arrangement that has a purpose or effect of falling outside of the interposed entity rules will depend on the specific facts of the arrangement. An exemption from section BG 1 for restructuring arrangements is not appropriate because, depending on the facts, such arrangements might be tax avoidance arrangements. Taxpayers contemplating undertaking restructuring arrangements can apply for a binding ruling to obtain certainty on whether section BG 1 applies to their arrangement.

¹¹ Based on 2019 tax returns, around 4% of taxpayers returning rental income are companies and around 8% are trusts. Of these, only a very small proportion are likely to be interposed entities (which would require the borrowing to occur at the shareholder or beneficiary level rather than at the company or trust level).

Recommendation

That the submission be declined.

Issue: Specific rules for LTCs and partnerships not necessary

Submission

(Chartered Accountants Australia and New Zealand)

It is not necessary to have specific interposed entity rules for look-through companies (LTCs) and partnerships because they are already look-through entities.

Comment

Officials agree that specific interposed entity rules are not generally needed for LTCs and partnerships.

Point of difference

However, one instance where a specific rule for LTCs is needed is when a close company elects to become an LTC. This is covered below (see ["Issue: Interposed close company elects to become an LTC"](#)).

Recommendation

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

Issue: Interposed close company elects to become an LTC

Submission

(Matter raised by officials)

A provision is required to specify the treatment that applies to a person who incurs interest to acquire shares in an interposed residential property holder that is a close company that becomes a look-through company (LTC).

Under the proposed interest limitation rules, interest incurred by a person to own shares in an interposed close company will be denied according to the value of disallowed residential property held by the close company in proportion to its total assets.

The Income Tax Act allows close companies to elect to become LTCs, which are treated as transparent for tax purposes. Under the LTC rules, a person with a look-through interest (a shareholder) is treated as holding the property the LTC holds, in proportion to the person's look-through interest (shareholding) in the LTC, and the LTC is treated as not holding the property. If an LTC holds disallowed residential property, a person with a look-through interest will be treated as holding the disallowed residential property in proportion to their look-through interest.

The proposed interest limitation rules do not presently contain a rule that specifies what happens if a close company that is an interposed residential property holder makes an election to become an LTC. Such a rule is required to provide certainty. A rule providing for a transition from the interposed entity apportionment approach (pre-LTC status) to the

transparent approach (post-LTC status) would be very complex, both in its drafting and application.

As a simplicity measure, officials recommend that a person applying the interposed entity apportionment approach to a close company that makes an LTC election should continue applying that apportionment approach after the effective date of the LTC election until the existing borrowings are repaid. This proposed rule will not affect a person with *new* borrowings to acquire shares in the LTC after the effective date of the LTC election, which will be subject to the transparent approach (rather than the apportionment approach).

Recommendation

That the submission be accepted.

RESIDENTIAL RENTAL LOSS RING-FENCING RULES

Issue: Repeal of residential rental loss ring-fencing rules

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, EY, KPMG, Olivershaw Limited)

The residential rental loss ring-fencing regime should be repealed. It is no longer necessary and repealing it would reduce complexity.

Comment

Officials disagree. The residential rental loss ring-fencing regime was enacted in 2019 to reduce the tax benefits from investing in housing. The proposed interest limitation rules will reduce the frequency that the regime applies to restrict deductions.

However, it is not redundant. There are many exemptions to the interest limitation rules, such as the 20-year new build exemption, that mean the loss ring-fencing rules could still apply. Repealing the loss ring-fencing rules would mean that some investors would get a better tax result than they do currently, even with the addition of interest limitation. This is contrary to the intent of interest limitation rules, which is to reduce the tax benefits for investors to reduce their demand relative to owner-occupiers.

Recommendation

That the submission be declined.

Issue: Exclusion for Māori authority companies

Submission

(Pukeroa Oruawhata Trust and Ngati Whakaue Tribal Lands Inc)

The residential rental loss ring-fencing rules do not apply to companies other than close companies. Close companies that are Māori authorities, eligible to be a Māori authority, or wholly-owned by a Māori authority or entity eligible to be a Māori authority should also be excluded from the residential rental loss ring-fencing rules.

Comment

Officials acknowledge the matter raised in this submission but note that it proposes a change to the residential rental loss ring-fencing rules that is not a necessary result of the proposed interest limitation changes. This would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

SPECIFIC ANTI-AVOIDANCE RULES

Clause 85D

Issue: On-lending specific anti-avoidance rule not required

Submission

(Chartered Accountants Australia and New Zealand)

The specific anti-avoidance provision in proposed section GB 53C is not required. This is because transactions falling within the scope of the proposed rule are likely to be very limited and extreme, and therefore section BG 1 (the general anti-avoidance rule) will apply to such contrived transactions.

The submitter also suggests that a person who on-lends at a discounted rate to an associated party will have their deductions limited based on an existing Australian case in any event (*Ure v FC of T* 81 ATC 4100).

Comment

Officials agree that on-lending arrangements falling within the scope of proposed section GB 53C will likely be outside of Parliament's contemplation and fall within the scope of section BG 1 (the general anti-avoidance provision). However, as the proposed section GB 53C is a specific anti-avoidance provision, it will provide certainty for taxpayers with on-lending at discount arrangements.

Officials also consider that a specific anti-avoidance rule will provide greater certainty for both taxpayers and the Commissioner than relying on Australian case law. Officials are not aware of any New Zealand case law directly on point. The case referred to by the submitter is an Australian decision that has not been applied in New Zealand and has only been mentioned in passing in two New Zealand decisions of the Taxation Review Authority. It is also likely that many taxpayers are unaware of the Australian decision.

Recommendation

That the submission be declined.

Bright-line test changes

5-YEAR NEW BUILD BRIGHT-LINE TEST

Clauses 48, 49, 64E (proposed section DH 5(7)), and 127(1B) and (1C)

Issue: General support

Submission

(KPMG, Ockham Residential)

Submitters support a 5-year bright-line period for new builds.

Recommendation

That the submission be noted.

Issue: Opposition

Submission

(Baucher Consulting Limited)

The submitter does not support the proposed 5-year period for the purposes of the bright-line provisions. The shorter bright-line test period may have unintended consequences and encourage churn in such properties.

Comment

The Government decided to introduce a 5-year bright-line test for new builds to ensure the supply of new builds is not disincentivised by the 10-year bright-line test. Officials acknowledge that a 5-year bright-line test may result in a person selling a new build earlier than they otherwise would have had a 10-year test applied instead. However, this is not inconsistent with the policy objective of the new build bright-line test, as it may result in 'newish' builds being available sooner for purchase by first home buyers. The key point is to ensure that the supply of new builds is not disincentivised, which this policy should achieve.

Recommendation

That the submission be declined.

Issue: Clarification needed

Submission

(Deborah Lomax)

If there needs to be a bright-line test, the identification of a new build needs further clarification. If delays outside the taxpayer's control result in a new build's construction being delayed, it is not equitable for a more stringent bright-line test to apply than would have been the case had construction proceeded as planned.

Comment

A definition of “new build land” is proposed in the Bill, which officials intend to provide further guidance on.

Officials recognise that delays in constructing a new build may be out of a taxpayer’s control. However, such delays should not impact a taxpayer’s ability to benefit from the new build bright-line test. Provided a completed new build is on the land at the time of disposal, the 5-year bright-line period would apply and be counted from the date the land is acquired, not the date the new build is completed.

Recommendation

That the submission be declined.

Issue: Support for apportionment

Submission

(Kiwi Property Group Limited)

We agree that apportionment should apply where a new build and an existing build are on the same title.

Recommendation

That the submission be noted.

Issue: Valuation apportionment approach

Submission

(PwC)

Taxpayers should be permitted to apportion based on actual valuation, as apportionment based on land area may not provide the most appropriate outcome.

Comment

The proposed amendments provide that, where a new build and an existing build are on the same title, only the portion of the land that is attributable to the new build is subject to the 5-year new build bright-line test. A land area test is used to determine the new build portion. This means that where land is sold more than 5 years after acquisition, but before 10 years have passed, only the portion of the land relating to the existing build will be taxed.

Officials recognise that applying only a land area approach may not necessarily result in the most technically accurate outcome in all cases (when compared with an actual valuation approach), but it is simple and robust.¹² It should therefore be easier for both taxpayers to apply and for Inland Revenue to administer.

¹² For example, by comparison, taxpayers using an actual valuation method could choose higher valuations for the new build portion of the land so less of their income is taxed when the property is

Recommendation

That the submission be declined.

Issue: “On the land when disposed of” requirement

Submission

(Chartered Accountants Australia and New Zealand)

The requirement that a new build must be on the land when disposed of is unfair where a house is destroyed due to natural disaster or fire.

Comment

Proposed new section CB 6A(2)(b)(iii) requires that land must be new build land at the time of its disposal for the new build bright-line test to apply. This rule was put in place to prevent a person moving a dwelling (for example, a tiny house) on and off the land at the time of sale to enable the new build bright-line test to apply.

However, officials agree with the submitter that it is not appropriate for this to apply where a new build has been destroyed due to a natural disaster or fire. Therefore, officials recommend amending the new build bright-line test to provide that residential land does not need to be new build land at the time of disposal where a new build on the land has been destroyed due to a natural disaster or fire that occurred while the taxpayer owned the land.

Recommendation

That the submission be accepted.

Issue: Application to subsequent purchasers

Submission

(Kiwi Property Group Limited, KPMG, Property Council New Zealand)

The new build bright-line test should apply to subsequent purchasers of a new build, so that it is available for the same period as the new build exemption from interest limitation.

Comment

Proposed new section CB 6A(2) provides that a person must acquire new build land no later than 12 months after the land first meets the definition of new build land for the new build bright-line test to apply. This ensures the new build bright-line test only applies to early owners of a new build, so that the first genuine investor can benefit from the new build bright-line test. A new build may change hands several times after it is first completed before it is finally acquired by a person as a long-term residential investment property. For example, it may be transferred between different companies in the same group (such as from a subsidiary that holds properties during development to another subsidiary company that holds properties ready for sale) before it is finally sold at arm’s length to an investor.

disposed of after 5 years of ownership. Unlike a land area test, an actual valuation approach would potentially allow taxpayers to choose from a range of valuations.

Officials disagree with submitters that the new build bright-line test should apply to subsequent purchasers. This would not be consistent with the test's objective, which is to ensure the supply of new housing is not negatively impacted by the extended bright-line test. Allowing the new build bright-line test to apply to subsequent purchasers would potentially incentivise investors to invest in "newish" builds, rather than in "new" new builds.

Recommendation

That the submission be declined.

Issue: "New" new build added to existing new build land

Submission

(Matter raised by officials)

Proposed new section CB 6A(2)(b)(i) should be amended so that the 5-year new build bright-line test may apply where a person acquires land that has previously been new build land, but a "new" new build has been added to the land within the last 12 months.

Proposed new section CB 6A(2)(b)(i) provides that a person must acquire new build land no later than 12 months after the land first meets the definition of new build land for the 5-year new build bright-line test to apply. "New build land" is generally defined to mean residential land to which a self-contained dwelling has been added, provided the dwelling receives its code compliance certificate (CCC) on or after 27 March 2020. This creates an issue where land is existing new build land but, some years later, another new build (a "new" new build) is added to it, and the land is then sold within 12 months of the "new" new build being added to the land.

For example, assume someone has a new build on a large piece of land ("original new build") and then adds a "new" new build to the land six years later. If they sell the land within 12 months of the "new" new build being added to it and receiving its CCC, then the policy intent is for the subsequent purchaser to qualify for the new build bright-line test for the "new" new build portion of the land. The portion of the land attributable to the original new build would not qualify for the new build bright-line test for the subsequent purchaser, because the subsequent purchaser is acquiring that part of the property more than 12 months after the original new build received its CCC. However, under the legislation as currently drafted, the subsequent purchaser would not be able to access the new build bright-line test for any part of the land, including the "new" new build portion. This is because the land first met the definition of "new build land" when the original new build was added to it, which was six years before it was acquired by the subsequent purchaser.

Officials recommend that section CB 6A(2)(b)(i) is amended to resolve this issue, so that the subsequent purchaser in the example above can access the new build bright-line test for the "new" new build portion of the land.

Recommendation

That the submission be accepted.

Issue: Agreement to add new build to land insufficient

Submission

(Matter raised by officials)

Proposed new section CB 6A(2)(b)(iii) should be amended to provide that the land must meet the requirements of paragraph (a), (b), or (d) of the definition of new build land at the time of its disposal.

Proposed new section CB 6A(2)(b)(iii) provides that land must be “new build land” at the time of its disposal for the new build bright-line test to apply. Paragraph (c) of the definition of new build land includes land for which there is an agreement that a new build will be added to the land (that is, an off-the-plans purchase). This means that the new build bright-line test would apply where, at the time of disposal, there was an agreement in place to construct a new build on the land. This was not intended. The new build bright-line test should only apply where a new build is on the land at the time of its disposal.

Recommendation

That the submission be accepted.

Issue: Application to subdivided bare land

Submission

(nsaTax Limited)

The new build bright-line test should also apply to a taxpayer who only subdivides land (regardless of whether they also add a new build to it), otherwise taxpayers will be discouraged from subdividing land to sell as bare lots.

Comment

Officials disagree with the submitter. The objective of the new build bright-line test is to ensure the supply of new housing is not discouraged. It is inconsistent with this objective to allow bare land to qualify for concessionary treatment. Bare land by itself does not increase housing supply. The new build bright-line test is only intended to apply to land that has a new build added to it.

Recommendation

That the submission be declined.

Issue: Guidance on land area test

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

Guidance should be published clearly explaining the meaning of “land area test”.

Comment

Inland Revenue will publish guidance on the meaning of “land area test”.

Recommendation

That the submission be accepted.

Issue: Clarify acquisition “no later than 12 months”

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The “no later than 12 months rule” is unclear where land is purchased but a new build is not added until years later. *(Chartered Accountants Australia and New Zealand)*

Guidance should confirm that the 5-year new build bright-line test applies to bare land that is converted into “new build land”. Section CB 6A(2)(b)(i) as currently drafted could suggest the land needs to be new build land when it is acquired. *(Deloitte)*

Comment

For the new build bright-line test to apply to residential land, proposed new section CB 6A(2) provides that the person must acquire the land no later than 12 months after it first meets the definition of new build land.

Officials consider the legislation already satisfies the policy intent, which is for residential land to qualify for the new build bright-line test if it becomes new build land after it is acquired by the taxpayer. For example, this could include a situation where a taxpayer adds a new build dwelling to a bare section after they acquired the section. The land will only satisfy the new build land definition when the new build is added to the land. Therefore, the taxpayer would satisfy the requirement of section CB 6A(2) because they acquired the land before it became new build land, that is, before 12 months passed since the land first met the definition of new build land.

Inland Revenue will publish guidance clarifying the eligibility of land for the new build bright-line test where the land becomes new build land after its original acquisition.

Recommendation

That the submission be accepted.

Issue: Drafting suggestions

Submissions

(Chartered Accountants Australia and New Zealand, Deloitte)

“New build land” and “bright-line acquisition dates” should be included in the list of defined terms and in section YA 1.

It is unnecessary for section CB 6A(1) to refer to “land area test” since section CB 6A(2) does. *(Deloitte)*

The items in the formula in section DB 23C should be defined in one single subsection (similar to proposed new section DH 6(2)), rather than in separate subsections. (*Deloitte*)

Comment

Officials have referred these suggestions to the drafter.

Recommendation

That the submissions be noted.

MAIN HOME EXCLUSION FROM THE BRIGHT-LINE TEST

Clauses 48 and 49

Issue: Support for main home changes

Submission

(Ockham Residential)

We support the proposed amendments.

Recommendation

That the submission be noted.

Issue: Support for amendment for main home that takes longer than 12 months to construct

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

Submitters support the main home exclusion still applying where construction of a main home takes longer than 12 months.

Recommendation

That the submission be noted.

Issue: Test for main home that takes longer than 12 months to construct unclear

Submission

(Chartered Accountants Australia and New Zealand, New Zealand Law Society, Olivershaw Limited)

It is unclear:

- when “reasonable efforts” to construct commence
- whether a reasonable period between the owner acquiring the land and starting to engage in the building process is covered, and
- what is captured by the term “to construct” – it needs to include all aspects of the build process, for example, resource consenting.

The main home exclusion should cover the entire build process within a reasonable timeframe. Inland Revenue should not set a fixed period – it should be fact specific. Follow-up should only be required where Inland Revenue considers the period excessive. *(Chartered Accountants Australia and New Zealand)*

Comment

The main home exclusion from the bright-line test applies where a property is the owner's main home for the entire period it is owned. Adjacent periods of 12 months or less where the property is not used as a main home (for example, where the new owner of a property does not move in until six months after it was purchased) are ignored.

This rule was not intended to tax a person who purchased bare land to construct their main home if the construction period took longer than 12 months.

To address this, the Bill (as introduced) proposes to allow the period when a person is making reasonable efforts to construct their main home to be counted as "main home days" and not be subject to the bright-line test.

Officials agree with submitters that a "reasonable time" test would be more appropriate. This means that for a period during which a person constructs a dwelling that they then use as their main home, the entire period would be counted as main home days and outside the bright-line test, provided the period was reasonable.

In most, if not all, cases, the person is likely to be making reasonable efforts to construct the dwelling as there is no benefit to delaying construction due to:

- the cost over-runs, and
- the fact that the main home is outside the bright-line test.

Recommendation

That the submission be accepted.

Issue: 12-month buffer rule insufficient

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Mayne Wetherell, New Zealand Law Society, Olivershaw Limited)

The 12-month buffer rule should extend to other situations that exceed 12 months. Some taxpayers caught by the main home changes would not normally file tax returns. The unexpected tax liability the rule will impose on these taxpayers will raise complexity, compliance costs, and stress. It should be extended to include the following situations:

- hospitalisation
- work secondment
- transition to retirement villages
- renovations, seismic strengthening, remediation of leaky homes, etc
- displacement due to natural disasters, and
- unforeseen circumstances requiring the owner to move elsewhere for more than 12 months.

Taxpayers who have not rented their family home should not be subject to the bright-line test. *(Olivershaw Limited)*

Comment

Officials do not agree with the submission that the 12-month buffer rule is insufficient.

In general, a property must be a person's main home for "all of the days" in the bright-line period for the main home exclusion to apply. However, this is subject to the 12-month buffer. Under this buffer, any period (or periods) of up to 12 months where the property is not used as the person's main home may be counted as a main home period provided it precedes or follows a period of main home use. If the 12-month buffer applies, that period will therefore not be subject to the bright-line test. Where the main home exclusion does not apply, periods of main home use or periods subject to the 12-month buffer will still not be taxed under the bright-line test.

These settings were introduced by the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 and apply to property acquired on or after 27 March 2021.

Under the previous rules, a property had to be **mainly used** as the taxpayer's main home for it to be excluded from the bright-line test. This meant that a property would be taxed where less than half the land was used as the main home (for example, because there was a rental property or business on the same title), or where the land was not used for a main home for more than 50% of the time it was owned.

This was a simple "all or nothing" test that applied under the previous 2-year and 5-year bright-line tests but that could lead to disproportionate results under a 10-year bright-line test.

For example, consider a property that is owned for seven years before it is sold and is prima facie subject to the bright-line test. Under the previous settings, if the property was used as a main home for three years and as a rental property for four years, all the gain on sale would be taxed under the bright-line test. Conversely, if the property was used as the main home for four years and then as a rental property for three years, none of the gain on sale would be taxed under the bright-line test.

The amendments made in March 2021 and the changes proposed in this Bill provide a more consistent treatment for similar situations. They ensure that the main home is only taxed where it stops being a main home for a period (or periods) of more than 12 months. In the example above, where the property is used as the main home for four of the seven years, three-sevenths of the gain would be taxed. Where the property is used as the main home for three of the seven years, four-sevenths of the gain would be taxed.

The 12-month buffer rule is relevant where the property is no longer the taxpayer's main home. There is a difference between having an absence from the main home and a property that is no longer the taxpayer's main home. For example, if a taxpayer goes on holiday for a month, the property is still their main home, despite not being used as their main home for that period. This is because the concept of a main home looks at the property where the taxpayer usually lives and with which the taxpayer has the greatest connection if they have more than one home.

There will be clear cases where the property is no longer the taxpayer's main home – such as where they rent out their home under a residential tenancy or where they have another home with which they have a greater connection.

However, the property may also stop being the taxpayer's main home where the property is vacant. The Inland Revenue Tax Counsel Office's public guidance work programme includes a project to provide guidance on what constitutes a main home.

Consequently, officials do not consider further exemptions are necessary.

The 12-month buffer is designed to keep the rules as simple as possible while also catering for many life events where a person may be away from their main home for a reasonable period. Officials consider this will be sufficient in most situations.

As noted at [“Issue: Test for main home that takes longer than 12 months to construct unclear”](#) above, the Bill proposes to extend the 12-month buffer where a taxpayer is constructing their main home.

Submitters have already noted the complexity of the rules and officials consider that multiple, highly prescriptive exceptions would add additional complexity, particularly where a given specific exception would only impact a small number of people.

In relation to the specific scenarios raised by submitters:

- **Hospitalisation** – A taxpayer’s residence would still be their main home while they are in hospital, and therefore, the 12-month buffer would not be relevant.
- **Work secondment** – Where a taxpayer moves to another city for a work secondment and rents out or leaves their main home vacant, it is appropriate that they pay tax on gains attributable to the period they were away. This is because the property is not their main home during that time, especially where the property is rented. It would be inappropriate to have an uncapped exemption from the bright-line test simply because the property was once the main home.
- **Transition to a retirement village** – The 12-month buffer is designed to deal with this kind of scenario. Officials consider that the 12-month buffer is sufficient to enable the taxpayer to sell their property. It is appropriate that any vacancy beyond that may be taxed under the bright-line test
- **Renovation** – The 12-month buffer is designed to deal with this kind of scenario. Officials consider it unlikely many taxpayers will be displaced from their home for more than 12 months because of renovations.
- **Displacement due to natural disaster** – Specific relief could be considered in the event of a natural disaster that displaces people from their homes for an extended period. However, a natural disaster would likely impact other aspects of the tax system, and officials consider it would be more appropriate to look at the whole tax system when providing disaster relief.
- **Unforeseen circumstances** – The 12-month buffer is also designed to deal with this scenario. It would be inappropriate to allow a property to remain outside the bright-line test indefinitely just because it was once used as a main home. Officials consider that 12 months continues to be an appropriate period.

Officials disagree with the submission that taxpayers should only be subject to the bright-line test where they have rented out their family home. This would encourage taxpayers to leave their house empty (when they may have otherwise rented it out) to avoid tax under the bright-line test.

Recommendation

That the submissions be declined.

Issue: Electing a main home

Submission

(Chartered Accountants Australia and New Zealand, The Bluekiwi Property Consulting Trust)

A taxpayer should be able to elect a main home:

- Provided it was their main home at some point. *(Chartered Accountants Australia and New Zealand)*
- Regardless of whether they are living in it. *(The Bluekiwi Property Consulting Trust)*

Comment

Officials disagree.

The key consideration in determining if a property is the taxpayer's main home is whether it is the place they usually live. If it is not the place they usually live, then it is not their main home. It is not appropriate for a taxpayer to be able to claim the main home exemption if their property is rented out or vacant for extended periods of time. The property is clearly not their main home for such periods.

The 12-month buffer is intended to offer a reasonable period to account for life's complexities without worrying about the resulting tax implications. A rental property should not be exempt from the bright-line test just because it was once a main home. Other rental properties are subject to income tax if sold within the relevant bright-line period. The tax rules should not encourage a person to leave a property vacant for an extended period.

Officials do not agree with the submission that every taxpayer should be able to elect a main home regardless of whether they are living in it. This would create an integrity risk and could result in a significant number of rental properties never being subject to the bright-line test. For example, consider a couple who have a main home and a rental property. One person elects the family home as their main home, and the other elects the rental as their main home. Under this submission, if the couple sold the investment property within the bright-line period, it would not be subject to tax because it was elected as a "main home", despite never being used as one.

Electing a main home would also impose additional compliance costs as taxpayers would need to update their election with Inland Revenue on a regular basis (for example, annually or whenever they move to a new house). Electing a main home would allow a person to claim the main home exclusion for periods where the property was not in fact their main home. For most taxpayers this would be unnecessary as the property would always be used as their main home or they would own it for longer than the bright-line period.

Recommendation

That the submission be declined.

Issue: Clarification of 12-month buffer rule not required

Submission

(Chartered Accountants Australia and New Zealand)

It is unnecessary to clarify that a person can have multiple 12-month buffer periods provided they are not consecutive.

Comment

Officials agree with the submitter that the amendment is not strictly required, but it is being proposed to make this point clearer in the legislation.

Recommendation

That the submission be declined.

Issue: Clarification of 12-month buffer rule supported

Submission

(KPMG)

Submitter supports clarifying the application of the 12-month buffer rule to ensure multiple non-consecutive periods of non-main home use of less than 12 months each are not a disqualifying event.

Recommendation

That the submission be noted.

Issue: Period of main home use between two buffer periods

Submission

(Chartered Accountants Australia and New Zealand)

Guidance is required on what would be considered an appropriate period for a property to be used a main home between two periods of non-main home use.

Comment

Officials disagree. There is no minimum period. The question is whether the property is the taxpayer's main home. This will be a fact specific inquiry.

However, the longer the period the more likely a property is to be considered the taxpayer's main home. For example, it is highly unlikely Inland Revenue would agree with a taxpayer who said the property was their main home for one day.

Recommendation

That the submission be declined.

Issue: Repeal the rules – too complex

Submission

(Corporate Taxpayers Group, Deloitte, Mayne Wetherell)

Repeal the main home changes made in March 2021 and the ones in the current Bill as they are complex, and they will require taxpayers who might not otherwise need to file a return to file one and likely need to obtain expert tax advice.

Comment

Officials disagree that the rules should be repealed.

As noted at [“Issue: 12-month buffer rule insufficient”](#) above, the changes to the main home exclusion were enacted in March 2021 to ensure a property is never taxed while it is used as the main home. The previous settings would lead to disproportionate results under the 10-year bright-line test, with a few months making the difference between the profit on a sale being fully taxed or not taxed at all.

The rules may be more complicated in certain scenarios when compared with the previous settings, but this is unlikely to impact many taxpayers, and it ensures consistent and fair results across different situations.

Recommendation

That the submission be declined.

Issue: Main home percentage – apportionment based on land area

Submission

(Deloitte)

Using the percentage area of land may inappropriately skew the quantification formula as the value of the land with the main home on it may be much higher than any bare land.

Comment

Officials disagree. The current main home exclusion from the bright-line test in section CB 16A applies where more than half the land is used for a main home. This means that a main home can fall outside the existing main home exclusion, and be subject to tax, if less than half the land is used as a main home. For example, if two rental properties were built on the same title as a main home and those rental properties took up more than half the land, the existing main home exclusion would not apply. All the gain on the sale of the property would be taxed if the land was sold within the applicable bright-line period, not just the gain attributable to the rental properties.

The Bill proposes to introduce an apportionment rule so that, where the main home exclusion does not apply because less than half the land has been used for a main home, gains attributable to the main home portion of the land will not be taxed. This is achieved through the quantification formula in proposed new section CB 6A. The “main home percentage” in the quantification formula determines the amount of income attributable to the use of the property as a main home and subtracts that from the income on disposal of the property. It

generally only applies where there is more than one dwelling on the same title – such as a main home and a rental property.

If there was just a main home on the land, then the remaining land would typically be part of the main home. Whether all the land is to be included in the main home percentage will be a question of fact to be determined by considering whether all the land is used for or in connection with the main home. Land that has been used for a dwelling is not limited to the land on which the dwelling is situated or to the surrounding curtilage (like a yard or garden) and can, depending on the facts, include other areas used in connection with or for the benefit of the dwelling.

Officials consider that a land-area-only approach is simple and not able to be manipulated (for example, by persons choosing higher valuations for the main home portion of the land so less of their income is taxed). It is most likely to apply where a person has built some rental properties on the same title as their main home. In this case, a land area apportionment rule is likely to give a more taxpayer-friendly outcome than a value apportionment approach. This is because the main home would likely take up more of the land than any new builds added to the land, and the building itself would potentially be worth less, given it would be older.

Recommendation

That the submission be declined.

Issue: Quantification provision should be in section CB 16A

Submission

(Deloitte)

The quantification provision in proposed new section CB 6A(8) should be in section CB 16A instead as it is an adjustment to the main home exclusion and the provision contains numerous cross references to section CB 16A.

Comment

Officials do not agree. Section CB 16A is concerned with whether the bright-line test applies at all. Section CB 6A quantifies income. It does not make sense for the quantification provision (which ensures periods where a property is a main home are excluded from the calculation of income under the bright-line test) to be in section CB 16A (which is not an income quantification provision).

Recommendation

That the submission be declined.

Issue: Naming of “unadjusted amount”

Submission

(Deloitte)

“Unadjusted amount” in section CB 6A should be “income”.

Comment

The quantification formula in section CB 6A(8) refers to an “unadjusted amount”, which is the amount the person receives from selling the land before applying the formula. Officials consider it inappropriate to refer to this as “income” given it may be subject to adjustment. However, a more intuitive term could be used, and the matter has been referred to the drafter.

Recommendation

That the submission be declined.

Issue: **Definitions of terms used in quantification formula unclear**

Submission

(Deloitte)

The definition of “main home days” is hard to follow and should be defined as the number of days the property qualified as a main home.

“Adjustment days” should be renamed as “main home days” to be more intuitive.

Comment

Officials disagree.

“Main home days” cannot be defined as the number of days the property qualified as a main home as the land does not satisfy the “predominantly” criterion in section CB 16A(2). In summary, the term “main home days” is defined as the number of days the land has been used for a main home where the main home takes up less than half the land (for example, because a rental property is also on the same title).

“Adjustment days” cannot be renamed to “main home days” as the Bill already contains the term “main home days”.

Officials acknowledge that the terms used in the formula could better describe what they are trying to achieve. We have suggested to the drafter that “main home days” be renamed “non-predominant main home days” and “adjustment days” be renamed “predominant main home days”.

Recommendation

That the submission be declined.

Issue: **“Excluded main home” should be a defined term**

Submission

(Deloitte)

“Excluded main home” should be a defined term.

Comment

Officials agree.

Recommendation

That the submission be accepted.

Issue: Incorrect cross-reference

Submission

(New Zealand Law Society)

Section CB 16A(6) should refer to "main home days" as defined in section CB 6A(11), not section CB 6A(10)(b).

Comment

Officials agree.

Recommendation

That the submission be accepted.

ROLLOVER RELIEF – BRIGHT-LINE TEST

Clauses 48(1), 80B, 80C and 80D

Overview

Rollover relief is not an exemption from income tax. Rollover relief in the context of the bright-line test defers the taxing point until a subsequent disposal of the land occurs that does not qualify for rollover relief. To achieve this, rollover relief 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 at the date of the transfer. For the bright-line test, the recipient is deemed to take on the transferor's original date of acquisition along with the transferor's cost base.

As the bright-line test was originally introduced as a two-year test, extensive rules providing for rollover relief were not designed. Consequently, the rollover relief currently available under the bright-line test is very limited. With the recent extension of the test to ten years, there is cause for extending the relief available to cover the most common scenarios where taxpayers change how they hold residential land. The proposed rollover relief provisions are only intended to apply in some relatively simple and common scenarios where the economic ownership of the residential land has not changed and no gain on the transfer of the land has been realised. Officials do not consider it appropriate to provide rollover relief for all associated persons transactions (as this would go further than providing relief only in cases where economic ownership has not changed), or to ignore a gain if one has been realised (which is effectively what rollover relief would do). It is for these reasons the proposed provisions include the requirement that a transfer be made for cost or less to qualify for bright-line rollover relief.

The above principles are broadly consistent with rollover rules internationally. Other jurisdictions, such as Australia and the United States, do not provide rollover relief for transfers between associated persons. The exception is specific relief provided in some jurisdictions for transfers between spouses, such as under relationship property settlements, which New Zealand's existing bright-line rollover rules already apply to. We also understand that the rules in the United Kingdom for transfers to spouses, civil partners, children or charities are generally limited to situations where the property is gifted with no mortgage secured over the property.

Issue: Application date

Submission

(Baker Tilly Staples Rodway Wellington, PwC)

The application date for clause 80D should be clarified. The information sheet stated an application date of 1 April 2022, but as drafted it is the date of enactment. Submitters support a 27 March 2021 application date, as this would align with the application date of most of the proposed housing-related amendments.

Comment

Officials agree that the application date of the provisions should be clarified but recommend an application date of 1 April 2022. The proposed bright-line rollover relief provisions were intended to apply from 1 April 2022, but an application clause specifying this date was inadvertently omitted. This means the application date currently proposed is the date of enactment.

Point of difference

Officials consider a prospective, rather than retrospective, application date is appropriate. With a 1 April 2022 application date, the proposed rollover relief would apply to a qualifying disposal occurring on or after 1 April 2022. Rollover relief would be available even if the original acquisition pre-dates the introduction of the bright-line test.

Officials recommend prospective application because the current law is clear, and taxpayers have been paying income tax on that basis. A retrospective application date, even 27 March 2021, could encourage taxpayers to restructure to fit within the proposals. If the conditions for rollover relief change, or the proposals are not enacted, this could leave taxpayers in an unfortunate position if they do not end up qualifying for relief.

Recommendation

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

Issue: Consideration requirement

Submission

(KPMG)

The amount of consideration for the disposal should not need to be less than or equal to the total cost of the land to the transferor for rollover relief to apply.

Comment

The proposed bright-line rollover relief provisions are designed to account for scenarios where two main principles are satisfied: there is no (or little) change in the economic ownership of the residential land and no gain has been realised.

Even when economic ownership does not change, there will usually be some consideration for the transfer of the land, for example, a mortgage is discharged. If the original owner has realised a gain on the transfer (because the consideration for the transfer exceeds their original acquisition price), this gain should be subject to income tax at that time if the transfer occurs within the bright-line period.

Officials do not consider it is appropriate to ignore a gain if one has been realised, which is effectively what rollover relief would do.

Rollover relief provided in other jurisdictions is typically subject to a reinvestment condition (that is, a requirement that the sale proceeds are used to buy a similar asset). It would therefore be unusual to provide rollover relief, or an exclusion, from the bright-line test for a transaction where a person has sold property for a realised profit they do not (or are not required to) reinvest.

The reinvestment condition in other jurisdictions is normally in the context of a comprehensive capital gains tax. Officials do not support a reinvestment condition in the context of the bright-line test as this could create an incentive to invest in residential property over other types of assets. This is because residential property investors generally do not fully exit the property market but rather use the sale proceeds to invest in more property.

Point of difference

However, officials consider that some relief could be provided.

Officials note there is an existing rule in section GC 1 of the Income Tax Act 2007 that deems disposals to be made at market value. This is an anti-avoidance rule that, in most circumstances, operates as intended, but it can sometimes exacerbate cashflow issues.

To provide some relief for taxpayers in situations where residential land is sold or transferred to their family trust, partnership or look-through company (LTC) for more than the acquisition cost, officials recommend switching off the market value rule in section GC 1.

This would mean that instead of having to pay tax on the difference between the market value of the land and the transferor's acquisition cost, the transfer would be treated as having been made for the greater of that acquisition cost or the actual sale price.

In addition, to ensure the bright-line period is not reset by virtue of the land being transferred into the taxpayer's family trust, partnership or LTC, the receiving entity could be treated as having acquired the property on the same date that it was acquired by the first owner. Officials recommend that this apply even if that first owner makes a gain on sale.

Example 1

Carla acquired a residential property in April 2018 for \$500,000 and is subject to the five-year bright-line test. In May 2022, Carla transfers the property to her family trust (which meets the requirements set out in proposed section FC 9B) for \$750,000, even though the market value of the property at this time is \$1 million. The family trust then disposes of the residential property in August 2024 for \$1.5 million.

Under the existing proposals, Carla's transfer would not qualify for bright-line rollover relief, and she would be taxed on a gain of \$500,000 (being \$1 million less \$500,000), even though her realised gain is only \$250,000. The bright-line clock for the family trust would restart and, when the trust disposes of the property, it would be taxed on a gain of \$500,000 (being \$1.5 million less \$1 million).

Adopting officials' suggestions above, Carla would only be taxed on her realised gain of \$250,000. The trust would take on Carla's acquisition date of April 2018. This would mean that when the trust ultimately disposes of the property in August 2024, there are no further bright-line tax implications.

Recommendation

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

Issue: Family and associated persons transactions

Submission

(Accountants & Tax Agents Institute of New Zealand, Chartered Accountants Australia and New Zealand, EY, Gilligan Rowe & Associates LP, KPMG, PwC)

Rollover relief should apply to all land transfers between associated persons.

Alternatively, rollover relief should apply to all land transfers occurring in the ordinary course of family life or business succession that are not profit-motivated sales. *(Accountants & Tax Agents Institute of New Zealand, EY, Gilligan Rowe & Associates LP, PwC)*

Consideration should be given to whether transfers between natural persons for reasons of "natural love and affection" should be excluded from the bright-line test. Alternatively, all land transfers that do not result in a material change in economic ownership should be disregarded for the bright-line test. *(EY)*

Consideration should be given to a carve-out from the bright-line test for family-related transactions. (*Chartered Accountants Australia and New Zealand, KPMG*)

Comment

As noted in "[Overview](#)" above, the bright-line rollover relief proposals only apply in limited circumstances, namely where there is no (or only a very minor) change in economic ownership of the land and the vendor has not realised a gain on sale.

Officials do not recommend providing rollover relief or a full exclusion from the bright-line test in the types of circumstances suggested by submitters.

The associated persons rules in the Income Tax Act 2007 are anti-avoidance provisions designed to ensure the integrity of the tax system. Hence, the existing associated persons definitions are deliberately broad so that they capture a wide range of transactions. Allowing rollover relief for all land transfers between associated persons or for family transactions would be a significant policy change. This change would go beyond the policy intention of allowing rollover relief in some common situations where taxpayers change how they hold residential land with no resulting change in economic ownership. This could result in rollover relief applying in instances where there has been a change in economic ownership and would introduce integrity risks. For example, the risk that taxpayers on the highest personal income tax rates would transfer residential land to their spouse or an adult child on a lower personal tax rate.

To provide specific relief to individuals who can purchase residential property to on-sell to family members would be a substantial shift in policy. Other aspects of the land sale provisions may also need to be considered (for example, the so-called intention test, where a gain on the sale of a property acquired with the intention of disposal is taxed). Given the broader implications of such a policy change, further work on this issue would require prioritising and resourcing as part of the Government's tax policy work programme.

Individuals can provide financial support to family members in other ways without becoming a legal owner of the relevant residential property. This could include, for example, providing a monetary gift to help with a deposit or acting as a guarantor for a loan. In most circumstances, acting as a guarantor should not bring someone within the scope of the bright-line test. We understand that in very limited circumstances financial institutions may request that guarantors be on the legal title of the property where there are other concerns regarding equity and/or income.

Taxpayers should seek professional advice when contemplating property transactions to ensure all legal implications are understood.

Recommendation

That the submissions be declined.

Issue: Changes in co-ownership of property

Submission

(*Chartered Accountants Australia and New Zealand, Deloitte, KPMG*)

The bright-line period should not be reset every time there is a change in the co-ownership of a property.

Comment

This issue often arises when parents become co-owners of residential property with their adult children and partly dispose of their share over time, so that eventually the children are the sole owners of the property. When a part share in residential land is disposed of, that share could be subject to tax under the bright-line test.

Inland Revenue recently released a draft interpretation statement to clarify the treatment of such arrangements (see [PUB00411: Income tax – application of the land sale rules to changes to co-ownership, subdivisions, and changes of trustees](#)). The draft interpretation statement noted that the bright-line test hinges on changes to the legal title and, as currently drafted, the bright-line period for the portion of land not disposed of would be reset on each disposal of a part share. This resetting of the bright-line clock is not the policy intention, and officials agree the legislation should be amended to clarify this.

Recommendation

That the submission be accepted.

Issue: Transactions involving LTCs

Submission

(Gilligan Rowe & Associates LP, KPMG, nsaTax Limited)

- a. Transfers between look-through companies (LTCs) where the shareholding in each LTC is identical should be entitled to rollover relief. *(nsaTax Limited)*
- b. Transfers between LTCs and trusts should be entitled to rollover relief if the requirements of sections FC 9B and FC 9E are met by the relevant individuals. *(nsaTax Limited)*
- c. The proposed rule relating to LTCs should be extended to explicitly apply to a deemed disposal and acquisition due to a cessation of LTC status. *(KPMG)*
- d. Rollover relief should apply to a transfer of residential land from an individual to an LTC where the shares in the LTC are owned by a trust that meets the criteria set out in proposed section FC 9B(2). *(Gilligan Rowe & Associates LP)*
- e. Rollover relief should apply to a transfer of shares in a residential land-rich LTC to the trustees of a family trust. *(Gilligan Rowe & Associates LP)*

Comment

Officials note that the issues raised in these submissions are also relevant for the rollover relief provisions in the proposed interest limitation rules. Officials' comments and recommendations below apply for both the proposed interest limitation rules and the bright-line test.

- a. Officials agree with the submission. We note that an LTC wanting to transfer residential land to another LTC with identical shareholding could get rollover relief under the existing proposals. However, the LTC would have to transfer the land to the shareholders, who would then transfer it to the other LTC. It makes more sense to allow taxpayers to do this in just one transaction, rather than requiring two separate transactions to qualify for rollover relief.
- b. Officials agree with the submission, provided:

- the relief is limited to situations where the principal settlor of the trust is also a beneficiary of the trust
- the requirements set out in proposed section FC 9B for the other beneficiaries of the trust (such as the requirement that they are a relative of the principal settlor) are met, and
- the principal settlor of the trust is the owner of the LTC.

As outlined in a. above, taxpayers in this situation could get rollover relief under the existing proposals by carrying out two separate transactions, rather than transferring the land from the LTC to the trustees directly (or vice versa). As above, it makes sense to allow taxpayers to transfer the land in one step, rather than requiring a two-step process. This should also apply to partnerships (that is, when residential land is transferred between a partnership and a family trust, provided the requirements set out in proposed section FC 9B for the beneficiaries of the trust are met, and the principal settlors of the trust are also the partners in the partnership).

- c. Officials do not consider that rollover relief should apply when a company's LTC status is revoked. When a company ceases to be an LTC, the owners of the company are treated as having disposed of the underlying property of the company (including, but not limited to, any residential land holdings of the company) at market value. This triggers a tax obligation for the owners, while the company is treated as having immediately acquired the property again at the same market value. This is in recognition of the differentials between the company and personal tax rates and the fact that flow-through treatment no longer applies to the taxable income derived by the company (meaning that income is taxed at the owner's personal tax rates, rather than at the company level). Officials see no compelling reason to provide rollover relief specifically for deemed disposals of residential land upon revocation of LTC status and note that to do so would be at odds with the scheme of the LTC regime.
- d. Officials agree with the submission. As in a. and b. above, taxpayers in this situation could get rollover relief under the existing proposals by carrying out two separate transactions rather than transferring the land directly to the LTC. In addition, officials also recommend that rollover relief be provided going in the other direction (that is, when the LTC transfers the land to an individual who is both a principal settlor and beneficiary of the trust and all the requirements in proposed section FC 9B(2) for beneficiaries of the trust are met). This should also apply to partnerships.
- e. Officials are concerned that providing rollover relief in the scenario described by the submitter would go beyond what the proposed amendments are trying to do, which is to limit relief to just those scenarios that are both common and relatively straightforward. Officials caution against going broader with rollover relief as doing so may give rise to undue complexity and potentially result in some unexpected and unintended outcomes.

Recommendation

- a. That the submission be accepted.
- b. That the submission be accepted.
- c. That the submission be declined.
- d. That the submission be accepted.
- e. That the submission be declined.

Issue: Certain corporate transactions

Submission

(KPMG, PwC)

- a. Transfers between co-owners of land who are partners in a joint venture should be entitled to rollover relief. *(PwC)*
- b. There should be rollover relief for transfers within wholly-owned corporate groups. *(KPMG)*

Comment

Officials note that the issues raised in these submissions are also relevant for the rollover relief provisions in the proposed interest limitation rules. Officials' comments and recommendations below apply for both the proposed interest limitation rules and the bright-line test.

- a. As noted in "[Overview](#)" and discussed in "[Issue: Family and associated persons transactions](#)" above, the intent of the proposed rollover relief provisions is deliberately limited to common situations where taxpayers change how they hold residential land with no resulting change in economic ownership (or, in the specific case of a transfer to a family trust, only a very minor change in economic ownership). A transfer of an ownership interest in land between co-owners of that land would amount to a change in the economic ownership of the part-share of the land that was transferred, and on that basis, officials do not consider allowing rollover relief in this scenario is appropriate.
- b. Officials agree that when residential land is transferred within a wholly-owned group of companies, there may be little change in economic substance to the ownership of the land. We therefore agree that rollover relief should be available.

Point of difference

However, to mitigate integrity risks, officials consider this relief should only be available for transfers within a wholly-owned tax consolidated group, meaning it would only be available to New Zealand-resident companies. In addition, the consolidation regime provides specific crystallisation rules when a member leaves the group.

Recommendation

- a. That the submission be declined.
- b. That the submission be accepted, subject to officials' comments.

Issue: Trusts

Submission

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, BDO, Chartered Accountants Australia and New Zealand, EY, KPMG, New Zealand Law Society, nsaTax Limited, PwC)

- a. Rollover relief should apply when land is transferred from the trustees back to the settlors of the land. *(EY, New Zealand Law Society)*

- b. The drafting of the provisions around transfers from a trust back to a settlor is unclear and should be revisited. *(PwC)*
- c. Rollover relief should apply when land is transferred from the trustees to a beneficiary of the trust. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, BDO, Chartered Accountants Australia and New Zealand, EY, KPMG, nsaTax Limited)*

Such rollover relief could be overlaid with an anti-avoidance rule to limit it to valid trust transactions that do not have the purpose or effect of defeating the bright-line rules. *(KPMG)*
- d. Resettlements of trusts should qualify for rollover relief in some circumstances, such as where the beneficiaries of each trust are identical, or at least one of the principal settlors resettling the property is also a principal settlor of the recipient trust and each beneficiary of the recipient trust has the prescribed relationship with the principal settlor. *(New Zealand Law Society, nsaTax Limited, PwC)*
- e. Relief should apply to transfers to trusts generally, not just family trusts. *(PwC)*

Comment

Officials note that the issues raised in these submissions are also relevant for the rollover relief provisions in the proposed interest limitation rules. Officials' comments and recommendations below apply for both the proposed interest limitation rules and the bright-line test.

- a. The proposed rollover relief provisions would apply to a transfer of residential land to a family trust in certain circumstances. Submitters have correctly noted that the current proposed provisions do not apply when residential land is transferred from the trustees of the trust back to the settlors. Officials agree that the proposed rollover relief provisions should apply in both directions and not just when land is settled on a trust. We further recommend that rollover relief also apply when residential land subject to the Te Ture Whenua Māori Act 1993 is transferred back to the settlors of the land by a trustee that is, or is eligible to be, a Māori authority.
- b. As noted in a. above, officials agree with submitters that rollover relief should apply when residential land is transferred from the trustees of a family trust back to the settlors of the land. Officials recommend this be clarified in the legislative drafting.
- c. As noted in ["Overview"](#) and discussed in ["Issue: Family and associated persons transactions"](#) above, it is only appropriate to allow rollover relief in instances where the economic ownership of the land has not changed. This includes situations where economic ownership has changed to a limited degree because the property is settled onto a family trust. However, if the trustees then disposed of the property by way of sale or transfer to the beneficiaries, substantive ownership would change, and transfers of this nature should continue to be taxed under the bright-line test. This is the same result as would occur if the settlor had sold or transferred the property to the beneficiary directly without using a trust as an intermediary.
- d. Officials agree that rollover relief should apply to resettlements of trusts when at least one of the principal settlors resettling the property is also a principal settlor of the recipient trust and each beneficiary of the recipient trust has the prescribed relationship with the principal settlor as set out in proposed section FC 9B(2). We note that our recommendation to accept the submission in a. above means that taxpayers would be able to achieve this result anyway. However, in the interests of clarity, officials recommend that the legislation explicitly provide for resettlements of trusts. As the Māori trust proposal is intended to apply in similar familial situations, this recommendation should also apply in that context.

- e. As discussed in c. above, the application of the proposed rollover relief provisions is deliberately limited to common situations where taxpayers change how they hold residential land with no resulting change in economic ownership (or, in the specific case of a transfer to a family trust, only a minor change in economic ownership). The family trusts provisions are limited to the scenario where residential land is gifted or transferred at cost to a “typical” family trust. A broader rollover relief rule for trusts in general would be novel and may introduce integrity risks. Further work on this matter would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

- a. That the submission be accepted.
- b. That the submission be accepted.
- c. That the submission be declined.
- d. That the submission be accepted.
- e. That the submission be declined.

Issue: Cost basis of Treaty settlement property

Submission

(Matter raised by officials)

The wording of the proposed rollover relief provision for the transfer of Treaty settlement property should be clarified.

The proposed rollover relief provision provides that if a settlement entity transfers residential land received as part of a settlement under te Tiriti o Waitangi to a member of the claimant group, rollover relief should be provided. This means that the receiving member should “step into the shoes” of the settlement entity for the acquisition date and acquisition cost of the land. The wording of the proposed provision should be clarified to provide that the settlement entity’s acquisition cost is the market value at the time the land is transferred to them from the Crown to ensure that the bright-line test operates on a net, and not gross, basis.

Recommendation

That the submission be accepted.

Issue: Application to other land sale provisions

Submission

(Gilligan Rowe & Associates LP)

The proposed rollover relief provisions should be extended to also apply for the other land provisions in the Income Tax Act 2007.

Comment

Officials do not recommend extending the proposed rollover relief provisions to apply for the other land provisions at this time. The current proposals were developed for the bright-line

test, and it would be necessary to ensure they are fit for purpose for other aspects of the land sale rules before they could be extended. Further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Specific review process for further rollover relief

Submission

(EY)

The Commissioner should commit to reviewing the rules periodically to assess whether further rollover relief is warranted.

Comment

Officials acknowledge the submitter's point that it would be helpful if there was an ongoing process for taxpayers and advisors to raise examples of transactions that should fall outside the scope of the bright-line rules or qualify for rollover relief. However, a specific review process for the rollover relief rules would require prioritising and resourcing as part of the Government's tax policy work programme.

Officials note there may be issues arising from the enactment of the proposals that require future remedial legislation, and we are committing resources towards addressing these issues.

Recommendation

That the submission be declined.

Issue: Technical errors

Submission

(Chartered Accountants Australia and New Zealand, Mayne Wetherell, New Zealand Law Society)

- a. Section CB 6A(11F) contains a cross-reference to section CB 6AB which does not exist. The cross-reference should be to new sections FC 9B to FC 9E. *(New Zealand Law Society)*
- b. The term "test trust" used in some of the provisions should be replaced with a more meaningful term, as the term "test trust" has no relevance. *(Chartered Accountants Australia and New Zealand)*
- c. Proposed new sections CB 6A(5B) and (5C) respectively refer to the date on which a joint tenancy or a tenancy in common is "granted", which is incorrect. "Granted" should instead read "acquired". *(Mayne Wetherell)*

Comment

- a. Officials agree there is a cross-referencing error and recommend that it be rectified.

- b. Officials have referred this to the drafter.
- c. Officials agree that "granted" is not the correct term and that the wording should be corrected.

Recommendation

- a. That the submission be accepted.
- b. That the submission be noted.
- c. That the submission be accepted.

OTHER ISSUES

Clause 48

Issue: Bright-line period

Submission

(Michael Fox, The Bluekiwi Property Consulting Trust)

Submitters suggested that the bright-line period be:

- Returned to two years, because a 10-year period penalises people whose circumstances change over time. *(Michael Fox)*
- Increased to 20 years, because genuine property investors frequently retain rental properties for 20 years and speculators will abuse a 10-year period. *(The Bluekiwi Property Consulting Trust)*

Comment

The matters raised in these submissions are outside of the scope of this Bill.

Recommendation

That the submission be declined.

Issue: Grace period from bright-line test for investors affected by interest limitation

Submission

(Scott Farrand)

A grace period of five years should be introduced for current investors that cannot afford to hold their investment property due to the interest limitation rules. Investors in this position who decide to sell should not be taxed under the bright-line test.

Comment

Officials disagree. A grace period for investors who cannot afford to hold residential properties would give rise to potential abuse and complex compliance issues because it would be difficult to determine whether unaffordability was, in fact, the reason for sale.

Recommendation

That the submission be declined.

GST remedials

MODERNISING INFORMATION REQUIREMENTS FOR GST

Clauses 5(1), 9, 12, 19, 21(1)–(3), (9) and (10), 24, 26–34, 36, 38–40, 42–44

Issue: Support for proposed amendments

Submission

(Accounting & Tax Agents Institute New Zealand, Baucher Consulting Limited, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, EY, KPMG, Mayne Wetherell, New Zealand Law Society, PwC)

That the proposals to modernise information requirements for GST to better reflect current business record-keeping practices are supported.

Recommendation

That the submission be noted.

Issue: Modernising invoicing requirements

Submissions

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

- a. That the term “invoice” should be retained. In the alternative, we agree that the use of the term “information” is appropriate. *(Chartered Accountants Australia and New Zealand)*
- b. That the proposal to allow the collection of particular “information”, which may be held in any way, is supported. *(Chartered Accountants Australia and New Zealand)*
- c. That the proposals to modernise the invoicing and information aspects of the GST legislation falls short in several instances and may impose a greater administrative burden on some taxpayers. *(Corporate Taxpayers Group, Deloitte, Mayne Wetherell)*
- d. That the drafting of the proposals be simplified to improve readability and lower the risk of errors arising. *(Corporate Taxpayers Group, EY, KPMG)*
- e. That Inland Revenue should provide taxpayers with guidance on the rules before they are enacted, and that Inland Revenue should run an awareness campaign about these changes to ensure taxpayers are made aware of what is changing and when. *(EY)*

Comment

- a. Officials support the alternative submission to use the term “information” and note that the term “invoice” is not proposed to be repealed. See also [“Issue: Preserving the use of the terms ‘tax invoice’, ‘credit note’, and ‘debit note’”](#) below.
- c. Officials note this submission and that many aspects of the proposals are addressed in more detail in the following items: [“Issue: Preserving the use of the terms ‘tax invoice’, ‘credit note’, and ‘debit note’”](#); [“Issue: Supplier’s taxable supply information requirements”](#); [“Issue: Different taxable supply information requirements for supplier and recipient”](#); [“Issue: Date of taxable supply information”](#); [“Issue: Taxable supply information requirements for a registered recipient”](#); and [“Issue: Information requirements to support a deduction of input tax”](#).

- d. Officials note this submission and will work with the drafter to improve the readability of the proposals.
- e. Officials note the submission and consider it has merit. We also note that Inland Revenue is considering an operational response to provide guidance on several proposed changes in the Bill. A *Tax Information Bulletin* will also provide guidance on these provisions once they are enacted.

Recommendations

- a. That the submission be accepted.
- b. That the submission is noted.
- c. That the submission is noted.
- d. That the submission is noted.
- e. That the submission is noted.

Issue: Preserving the use of the terms “tax invoice”, “credit note”, and “debit note”

Submission

(Corporate Taxpayers Group, Deloitte, Mayne Wetherell)

That the removal of the terms “tax invoice”, “credit note”, and “debit note” will have significant impact on existing legal and commercial documentation. An amendment of some form to the proposals is required to preserve the effect of current documentation.

Comment

Officials support the submission.

We agree it would be helpful to insert a provision to ensure that references to the old terminology in existing documentation (such as contracts, process documentation, Inland Revenue publications and software) is treated as a reference to the new terminology to the extent necessary to give effect to the intention of the documentation.

Recommendation

That the submission be accepted.

Issue: Supplier’s taxable supply information requirements

Submissions

(Corporate Taxpayers Group, Deloitte, KPMG, Mayne Wetherell, PwC)

- a. That the requirement for a supplier to hold information about the recipient is an unworkable requirement for a supplier having many small transactions. It may lead to a significant increase in compliance costs for some retailers. The proposed requirement

should apply for supplies that exceed the value of common everyday transactions. *(Corporate Taxpayers Group, Deloitte, KPMG, Mayne Wetherell)*

- b. That officials should consider why, in a modern business environment, the requirement for a supplier to hold recipient details is included in proposed section 19E given that this information would be collected as part of general business record-keeping requirements. *(Corporate Taxpayers Group, Deloitte)*
- c. That the proposed requirement that a GST-registered person making a taxable supply to another GST-registered person should provide the taxable supply information to the recipient on the day of the supply, unless a later date is agreed in writing, should not proceed. The requirement to provide the information on the day of supply is a significant deviation from the current rule, which requires the supplier to provide this information within 28 days in all instances, and the current 28-day rule should be retained. *(Corporate Taxpayers Group, Deloitte, Mayne Wetherell, PwC)*
- d. That the taxable supply information requirements should provide an option for the supplier to treat all their customers as non-registered. *(KPMG)*
- e. Consistent with the policy intent of providing greater flexibility for businesses, the proposals should not impose additional obligations on GST-registered suppliers by requiring changes to existing business systems and processes. *(PwC)*

Comment

- a. Officials support this submission and consider the requirements should be simplified. We also recommend incorporating the requirements in the current law for tax invoices where a taxable supply does not exceed \$1000, as retaining this threshold value would help to ensure compliance costs are not increased.
- b. Officials consider that the proposals formalise the information requirements that are necessary to support the integrity of the GST system. The information requirements proposed are based on existing record-keeping practices. The proposals do not require recipient information to be collected in any particular form and, in most cases, general business record keeping would meet the requirement for the supplier to hold this information and so should not impose additional compliance costs.
- c. Officials agree with the submission to provide the supplier with a 28-day period in which the information is to be provided. We note that a registered recipient will need this information to support their input tax deductions. Therefore, we consider it is no longer appropriate for the law to require taxable supply information to be provided only on request (this is the current law position for tax invoices). We note that the modern business practice of using electronic information exchange generally means taxable supply information is provided without such a request, and retail businesses having lower value transactions generally apply the practice of asking customers if they would like a GST receipt or tax invoice.
- d. Officials do not support this submission. We consider the provision of taxable supply information to a registered recipient is fundamental to the integrity of the GST system. This submission raises potential risks to the integrity of the GST system.

The submission appears to be concerned about the potential compliance cost impact for medium-sized businesses with large volumes of small value transactions. We note that it is common business practice for a retailer to ask the recipient if they would like a GST invoice, and we expect this practice would continue. Officials consider this would continue to be sufficient to determine at the time of the supply transaction if a customer would need to be provided with taxable supply information.

- e. Officials support the principle of not imposing additional compliance costs. Consequently, we recommend the taxable supply information provisions be simplified further to achieve this. In particular, we recommend that proposed section 19F be omitted from clause 19 of the Bill.

Recommendations

- a. That the submission be accepted.
- b. That the submission be declined.
- c. That the submission be accepted.
- d. That the submission be declined.
- e. That the submission be accepted.

Issue: Different taxable supply information requirements for supplier and recipient

Submission

(Corporate Taxpayers Group, Deloitte)

That it is unclear why proposed section 19E and section 19F contain different information requirements for suppliers and recipients, respectively, than is required for the new “taxable supply information” in section 19K(8).

Comment

Officials agree that the information requirements should be consistent between the provisions.

The information requirements should be aligned where possible, subject to other recommendations on information requirements for both the supplier and the recipient.

Recommendation

That the submission be accepted.

Issue: Date of taxable supply information

Submissions

(Corporate Taxpayers Group, Deloitte, KPMG, Mayne Wetherell)

Several submissions were received on the issue of the date of taxable supply information:

- That the date recorded in the taxable supply information should be the date of the taxable supply information. *(Corporate Taxpayers Group)*
- That the proposed requirement to record the time of supply as determined other than under section 9(1) is potentially impractical as this information may not necessarily be

available at the time a supply transaction is entered into. (*Corporate Taxpayers Group, Deloitte*)

- That the date requirements in both proposed section 19K(8)(c) and section 19L(1)(b) should refer to the date of the taxable supply information. (*Corporate Taxpayers Group, Deloitte*)
- That the proposed requirement to record the date of the taxable supply information may be impractical in some circumstances. For example, the date of an invoice and the date of issue of the invoice may differ due to logistical issues around bulk invoicing. (*Deloitte*)
- That the proposed requirement for a GST registered recipient to keep a record of the time of supply, or anticipated time of supply, under section 19F(2)(d) could be onerous. (*KPMG*)
- That the requirement in proposed section 19K(5) to agree that the taxable supply information may be issued at a later date should be changed to an alternative date. (*KPMG*)
- That proposed section 19K(8) should be amended to require the supplier to confirm the time of supply for the transaction in situations where the date of issue of taxable supply information does not trigger the time of supply. (*KPMG*)

Comment

Officials support these submissions.

Recommendation

That the submissions be accepted.

Issue: Taxable supply information requirements for a registered recipient

Submission

(*Accountants & Tax Agents Institute New Zealand, Baucher Consulting Limited, Corporate Taxpayers Group, Deloitte, KPMG, PwC*)

That it does not seem appropriate that a recipient should have to hold information about “the time, or anticipated time, of the supply” under proposed section 19F(2)(d), as the “time of supply” or “anticipated time of supply” could be uncertain. This requirement should either be removed or be consistent with the record-keeping requirement that would apply for a supplier under proposed section 19E(2).

Comment

Officials support this submission. We consider this requirement could be omitted, as the time of supply is a defined term that is determined as a factual matter from business records and does not need to be recorded separately.

Recommendation

That the submission be accepted.

Issue: Information requirements to support a deduction of input tax

Submissions

(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited, Corporate Taxpayers Group, Deloitte, PwC)

- a. That more clarity is needed in relation to the requirements for enabling an input tax deduction to be claimed for expenditure under the suggested low-value threshold. *(Accountants & Tax Agents Institute of New Zealand, Baucher Consulting Limited)*
- b. That to reflect the “threshold amount” for suppliers, recipients of a supply should be able to assume all supplies received under \$200 were taxable supplies, unless there is evidence to suggest otherwise. *(Corporate Taxpayers Group, Deloitte)*

That proposed new section 19F be amended to exclude taxable supplies valued under \$200, consistent with the position under current law whereby the recipient of a supply valued below \$50 is not required to hold a tax invoice to support an input tax deduction. *(PwC)*

Comment

- a. Officials support this submission. We also note that Inland Revenue has published the following guidance on its website ([How tax invoices work for GST](#)), which relates to the record-keeping requirements in the GST Act:

“When you buy supplies worth \$50 or less it’s still a good idea to get a receipt. If you want to claim the GST on these purchases, you will need a record of the:

- date
- description
- cost
- seller.”

We consider this published item would continue to be an appropriate guideline for low-value transactions (under \$200) under the proposed modernisation of the GST invoicing rules.

- b. Officials do not agree with these submissions. In consultation, the submitters commented that accepting these submissions could have compliance cost reduction implications, particularly for organisations dedicating resources to managing employee expense claims. We consider that firms will still have to provide checks and balances to ensure employees expense claims are appropriately made. We also consider these business practices would ensure businesses are complying with commercial and employment legislation for such transactions.

The record-keeping requirements in section 75 of the Goods and Services Tax Act 1985 require evidence of all supplies made to or by a registered person. Officials consider that reducing evidential requirements for supplies having a value under \$200 has the potential to create an integrity risk for the GST system, as there would then be no legislative checks and balances for input tax deductions for low-value transactions.

Recommendations

- a. That the submission be accepted.

- b. That the submission be declined.
-

Issue: Supply correction information requirements

Submissions

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

- a. That the proposed term "supply correction information" is supported. *(Chartered Accountants Australia and New Zealand)*
- b. That the proposed simplification in proposed section 19N for correcting errors in taxable supply information is supported. *(Corporate Taxpayers Group, Deloitte)*
- c. That the proposed section 19N should also extend to corrections required for invoices issued for Customs GST to allow importers to correct the GST claimed in the GST return when the correction information is received from the freight forwarder/broker. *(KPMG)*
- d. That the circumstances in which supply correction information is issued should not be constrained to "errors" and should contemplate any reason for changing the original taxable supply information. *(Mayne Wetherell)*

Comment

- c. Officials consider this submission has some merit and note that Customs GST is not supported by an invoicing process. We note that Inland Revenue is considering issuing operational guidance on the application of the current invoicing requirements to Customs GST, and this may require some minor changes to clause 21(2) of the Bill.

Recommendations

- a. That the submission be noted.
 - b. That the submission be noted.
 - c. That the submission be noted.
 - d. That the submission be accepted.
-

Issue: Copies of information

Submissions

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

- a. That the proposal to remove the requirement to mark copies of taxable supply information or supply correction information with the term "copy only" is supported. *(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte)*
- b. That the requirement in proposed section 19K(6) to keep a record of all issued copies of invoices should be removed from the Bill *(Corporate Taxpayers Group, Deloitte, PwC)*

Recommendations

- a. That the submission be noted.
 - b. That the submission be accepted.
-

Issue: Support for increased threshold for exemption

Submission

(Corporate Taxpayers Group, Deloitte)

That the proposal to increase the threshold for exempting a supplier from the requirement to provide taxable supply information is supported.

Recommendation

That the submission be noted.

Issue: Regulatory power

Submission

(Regulations Review Committee)

That proposed section 19F and section 19H should be amended either to:

- remove the regulatory power to set a threshold of \$200 from the primary legislation and make the setting of thresholds a matter for secondary legislation, or
- simply remove the regulatory power.

Comment

Officials support the submission, and we recommend removing the regulatory power from the proposed provisions.

Recommendation

That the submission be accepted.

Issue: Buyer-created supply information

Submissions

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

- a. That the proposal to allow a registered person to issue a buyer-created tax invoice provided there is an agreement between the parties is supported. *(Chartered Accountants Australia and New Zealand)*

- b. That the proposals to remove the requirement for taxpayers to apply to the Commissioner for approval to issue buyer-created tax invoices are supported. (*Corporate Taxpayers Group*)
- c. That the requirement to reach an agreement is vague and unclear on whether the taxpayers must sign an agreement or separately record that an agreement has been made. The proposed requirements that an agreement be recorded along with the reasons for entering the agreement are also overly onerous. The reasons for the agreement should be documented by the recipient of the supply, but the requirement to record an agreement between the parties should be removed. (*Corporate Taxpayers Group, Deloitte*)

Comment

- c. Officials support this submission. The points raised will be addressed by a combination of improved clarity in the proposed legislation. In addition, Inland Revenue is considering providing operational guidance as to what would constitute an agreement for these purposes.

Recommendations

- a. That this submission be noted.
- b. That this submission be noted.
- c. That this submission be accepted.

Issue: Shared invoices

Submissions

(*Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, PwC*)

- a. That the improved rules for shared tax invoices and supplier groups contained in proposed new section 55B are supported. (*Corporate Taxpayers Group, Deloitte*)
- b. That there is no reason why these rules should be restricted only to registered persons who are not part of a GST group as this unnecessarily restricts their application. (*Corporate Taxpayers Group, Deloitte*)
- c. That proposed new section 55B(1) be amended to refer to members of the "same GST group". (*PwC*)
- d. That joint and several liability should not be necessary to issue shared tax invoices as this will limit the entities able to utilise the proposed changes. (*Chartered Accountants Australia and New Zealand, Deloitte, PwC*)
- e. That consideration be given to expanding the ability of entities to utilise the agency opt-out rules in sections 60(1B) and (2B). (*Deloitte*)
- f. That consideration be given to treating opt-out transactions as occurring on a net basis, rather than the current gross approach, as this is likely to reduce compliance costs with no fiscal impact. (*Deloitte*)

Comment

- b. Officials support this submission.
- c. Officials support this submission.
- d. Officials support this submission.
- e. Officials acknowledge the matter raised in this submission but note that, as it is beyond the scope of modernising the GST invoicing rules, further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.
- f. Officials acknowledge the matter raised in this submission but note that, as it is beyond the scope of modernising the GST invoicing rules, further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendations

- a. That the submission be noted.
- b. That the submission be accepted.
- c. That the submission be accepted.
- d. That the submission be accepted.
- e. That the submission be declined.
- f. That the submission be declined.

Issue: Application of agency rules

Submission

(KPMG)

That section 60 be amended to allow for payment or collection agents who may not be legal agents (as set out in Interpretation Statement [IS 21/01: GST and agency](#)) to issue or receive taxable supply information in their own name on behalf of a principal.

Comment

Officials acknowledge the matter raised in this submission. However, further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme

Recommendation

That the submission be declined.

Issue: Application

Submission

(Corporate Taxpayers Group, Deloitte)

That the application dates for the modernisation of information requirements for GST should be reviewed and reconsidered for any changes to allow taxpayers sufficient lead time to understand and implement the changes before they take effect.

Comment

Officials support the submission. We recommend that application dates for provisions modernising the information requirements are deferred by one year and apply for taxable periods beginning on or after 1 April 2023.

Point of difference

In consultation, stakeholders have indicated this would be sufficient lead time to understand and implement the changes, but that proposed compliance cost reduction measures (such as the proposed changes to buyer-created invoices, GST groups, shared invoices and corrections to supply information) should not have a deferred application date.

Officials agree with this distinction and recommend that the application dates for proposed provisions that seek to reduce compliance and administration costs not be deferred or alternatively be redrafted to be consistent with the framework of the current framework for tax invoices, credit notes and debit notes.

Recommendation

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

Issue: Inconsistent commencement dates

Submissions

(Deloitte)

The commencement dates for clauses 5(1), 9 and 44(3) are inconsistent between the Bill and the Commentary to the Bill and the correct commencement dates should be clarified.

Comment

The submission raises points about the difference between commencement dates and application. An amending provision that has no specific application provision both commences and applies from the commencement date. An amending provision that has a commencement date that differs from its specific application provision comes into force on the commencement date (that is, the legislation is amended), but its application is determined by the application for that amendment. For example, clause 44 comes into force on the day the Act receives the Royal assent, but clause 44(4) provides the provision will not have operative effect (that is, apply) until the first taxable period commencing on or after that date.

Points of difference

We consider the Bill correctly states the commencement date for clauses 5(1) and 9 as the day on which the Act receives the Royal assent. These clauses are primarily definitional in

nature and will only have effect in interpreting operational provisions proposed in the Bill. This is because proposed substantive provisions that would rely on these definitions generally will apply for taxable periods commencing with the first taxable period after assent (although note application may be deferred see "[Issue: Application](#)" above). While it is not necessary for these definitional provisions to align with application, it would make sense to defer either their commencement or application to avoid confusion.

For clause 44, officials note that the Bill states the commencement date as the day on which the Act receives the Royal assent. The application for this proposal is correct for clauses 44(1) and (2). However, we consider that the application of clause 44(3) should be aligned with the application for clauses 44(1) and (2), namely that it applies for taxable periods starting on or after the day on which the Act receives the Royal assent (subject to any deferral of application). We note that clause 44 addresses aspects of supply correction information that provide compliance cost benefits. These aspects would not be deferred but could instead be addressed by amending the provisions in the current law relating to debit and credit notes.

Officials recommend that clause 44(4) should be amended to include clause 44(3) within its scope.

Recommendation

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

Issue: GST trade name

Submission

(Corporate Taxpayers Group, Deloitte, KPMG, PwC)

- a. That the requirement in proposed section 19E(2)(a) (and mirrored in other sections) for a GST trade name to be included in taxable supply information should be removed. If the IRD number for a supplier is included in the taxable supply information, then the supplier can easily be identified and there is no need to know the trade name(s) of a taxpayer. *(Corporate Taxpayers Group, Deloitte, PwC)*
- b. That proposed section 19L(1)(a) should be amended to allow that only the GST trade name and registration number of the member making the supply is included in the taxable supply information issued for the supply made by the member of a GST group. *(KPMG)*

Comment

- a. Officials support this submission and consider it would be appropriate to remove the proposed definition of GST trade name. Officials consider that the GST trade name would not necessarily provide unique identifying information that would support the integrity of the GST system. Consequently, we recommend requiring the name and GST number of the taxpayer, rather than the GST trade name.
- b. Given that this submission is inconsistent with a. above (which we recommend be accepted), we recommend this submission be declined.

Recommendation

- a. That the submission be accepted.
- b. That the submission be declined.

Issue: Organisation of Act's provisions

Submission

(New Zealand Law Society)

The proposed inclusion of section 8AA is unnecessary as it provides very little utility, and the provision should be removed from the Bill.

Comment

The purpose of proposed section 8AA is to provide a signpost to provisions that have an overriding effect on the application of the general rules (for example, determining who is the supplier and who is liable to pay GST).

Point of difference

Proposed section 8AA(9) points to special cases where the supplier differs from the person who is usually treated as making the supply. The issue addressed by this proposed provision is to overcome perceived ambiguity as to who the supplier is for the purposes of the Act.

We have discussed this point with the submitter, and they acknowledged that they had not considered the detailed subclauses that would give the purpose for the proposed rule. However, they suggested that this policy purpose could be achieved by amending the definition of supplier.

Officials therefore recommend that the drafter consider amending the definition of supplier in the way suggested by the submitter.

Recommendation

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

Issue: Taxable supply information for GST groups and supplier groups

Submission

(KPMG)

Proposed section 19L(1) should be amended to refer to a taxable supply instead of a member supply.

Comment

Officials agree with the technical point that the term "member supply" does not include a supply made by a member of a GST group.

Point of difference

However, officials consider the issue raised could be addressed by including GST groups within the meaning of the term "member supply".

Recommendation

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

Issue: Drafting issues – taxable supply information

Submissions

(KPMG, New Zealand Law Society, PwC)

- a. The reference to “taxable supply information” in proposed section 19H(2)(b) appears to be a drafting error and should instead refer to “supply information”. *(KPMG)*
- b. Paragraph (f) in the proposed definition of “taxable supply information” should be updated to refer to the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Act 2022 (rather than 2021). *(New Zealand Law Society)*
- c. The ability to agree alternative information requirements under section 24BAC(d) should be preserved. *(PwC)*

Comment

- a. Officials support the submission and agree the drafting should be reconsidered.
- b. The year reference in the title of the Act would be updated as part of the assent process. No drafting action is required for this submission at the FEC stage of the Bill.
- c. Officials consider the submitter has overlooked that the ability to agree alternative information requirements for certain imported goods is preserved in the proposed relocated provision (proposed new section 12C in clause 12 of the Bill).

Recommendations

- a. That the submission be accepted.
- b. That the submission be declined.
- c. That the submission be noted.

Issue: Rounding of amounts for fractions of cents

Submission

(Corporate Taxpayers Group, Deloitte)

- a. That the clarification of the rounding provisions in the GST are supported.
- b. That there should be further clarification that a supplier making multiple supplies to one customer on a regular basis can choose to apply the rounding of amounts on either a supply-by-supply basis or as a single rounding calculation on an aggregate basis for amounts charged during a usual billing period.

Comment

- b. Officials support providing an option to allow the rounding to be on either an aggregate or individual item basis. This option would allow a reduction in compliance costs.

Recommendation

- a. That the submission be noted.

- b. That the submission be accepted.
-

Issue: The GST Act should undergo a rewrite

Submission

(Corporate Taxpayers Group, KPMG)

That it is timely for a rewrite and re-ordering of the Goods and Services Tax Act 1985 (GST Act) to be considered.

Comment

Officials acknowledge the matters of legislative complexity within the GST Act that were raised by submitters in their submissions. However, further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

SECONDHAND GOODS INPUT TAX CREDIT – ASSOCIATED PERSONS SUPPLIES

Clause 6

Issue: Application date

Submissions

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, New Zealand Law Society, PwC)

- a. That the proposal is supported and that it should be backdated to 2011. *(Chartered Accountants Australia and New Zealand)* That the proposed amendment should apply retrospectively to supplies made on or after 1 March 2018. *(PwC)*
- b. That the proposal in clause 6 be supported, specifically the backdating of the proposal allowing it to apply to purchases of goods dating back to 1 October 1986. *(Corporate Taxpayers Group, Deloitte)*
- c. That further clarity should be provided generally as to the timing of the application of the current or amended law. *(PwC, New Zealand Law Society)*

Comment

- a. Officials do not support the submissions that the amendment apply retrospectively. Officials consider that accepting these submissions would result in a retrospective effect that would affect settled tax positions. Officials consider the law has always been clear about its intent and its effect, and therefore consider a retrospective application is not justified.

We note that PwC commented that the current law arises from a drafting error. We do not agree with the submitter on this point. No evidence exists of a drafting error having occurred as the current law achieves its policy objective, which was to deny input tax credits for purchases of secondhand goods from an associated person.

- b. Officials note this submission expresses support for the proposal to allow an input tax deduction for an acquisition of secondhand goods from an associated person, provided that:
 - the associated person has acquired the secondhand goods from an unrelated party, and
 - that unrelated person acquired the secondhand goods on or after 1 October 1986.

To address circumstances involving a chain of related-party transactions, a tracing rule is available to identify if an earlier transaction with an unrelated party (on or after 1 October 1986) has occurred relating to the goods being acquired from the associated person. That earlier transaction is used to determine the value of the input tax deduction.

- c. Officials do not consider this is necessary. We consider it is clear the proposed provision would apply to a supply of secondhand goods occurring after its application date. However, see also ["Issue: Drafting issues"](#) – submission c. below, in which we recommend a transitional measure to accommodate an agreement made after the Bill was introduced for the acquisition of secondhand goods.

Recommendations

- a. That the submission be declined.
 - b. That the submission be noted.
 - c. That the submission be declined.
-

Issue: Drafting issues

Submissions

(New Zealand Law Society, PwC)

- a. That proposed section 3A(2)(ab)(ii) should be amended to read “have not been owned, since 1 October 1986”, rather than “since that acquisition”. *(New Zealand Law Society)*
- b. That proposed section 3A(3)(a)(i) and (ib) should be amended to clarify the time at which a supplier is associated with a previous supplier or recipient of the secondhand goods. *(New Zealand Law Society)*
- c. Because an input tax credit is only available to the extent payment has been made for a supply of secondhand goods, further clarity should be provided as to the GST position if an agreement is entered into before the application date, but payment is made after the application date. *(PwC)*

Comment

- a. Officials consider the submission has merit and would provide improved clarity to the drafting.
- b. Officials agree the drafting of the proposed provision is not clear about the time at which the test of association should be met. The submission has been referred to the drafter to improve the clarity of the proposed provision.

Points of difference

- c. Officials agree that the position could be clarified. However, we consider the point raised in the submission should only apply if the agreement has been entered into after the Bill was introduced. This would provide greater certainty for transactions made in this transitional period. We recommend clause 6 be amended so that it applies to an acquisition of secondhand goods made under an agreement made after the Bill was introduced and for which payment was made on or after the start of the first taxable period following the Act receiving Royal assent.

Recommendation

- a. That the submission be accepted.
 - b. That the submission be accepted.
 - c. That the submission be accepted, subject to officials’ comments.
-

Issue: Error in commentary example

Submission

(New Zealand Law Society)

That Example 21 in the Commentary to the Bill contains a computational error and should be amended before it is included in a *Tax Information Bulletin* or other publication.

Comment

Officials agree with the submission and will provide a correct example in the *Tax Information Bulletin*.

Recommendation

That the submission be accepted.

GST INPUT TAX RECOVERY FOR NON-RESIDENT BUSINESS

Clause 21(8)

Issue: Support for proposed amendment

Submission

(Deloitte)

We support the proposed amendment.

Recommendation

That the submission be noted.

Issue: Restriction on input tax deduction for Customs GST

Submission

(PwC)

That the proposed restriction to prevent a GST-registered non-resident from claiming an input tax deduction for GST paid to Customs on imported goods that are outside New Zealand at the time of supply to a final consumer in New Zealand be removed.

The main issue with the current GST settings is that a GST-registered non-resident business that imports goods to a GST-registered business in New Zealand cannot claim back the Customs GST paid by them on the imported goods where the goods are outside New Zealand at the time of supply.

Comment

Officials note that the proposed amendment addresses the submitter's concern by allowing the GST-registered non-resident business an input tax deduction for GST paid by them to Customs, except in cases where the goods are outside New Zealand at the time of supply and are then delivered to a final consumer in New Zealand. This restriction is necessary to ensure that GST is collected on a supply by a GST-registered non-resident business to a final consumer in New Zealand. Officials have spoken with PwC about this, and PwC has subsequently clarified that they agree with officials that the restriction is necessary.

Recommendation

That the submission be declined.

EXPORTS OF GOODS DELIVERED TO A RECIPIENT'S VESSEL IN NEW ZEALAND

Clause 10

Issue: Support for the proposal

Submission

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

The submitters support the proposed amendment.

Recommendation

That the submission be noted.

GROUND LEASES PAID VIA A UNIT TITLE BODY CORPORATE

Clause 7(3)

Issue: Change from GST exempt to zero-rated

Submission

(Chartered Accountants Australia and New Zealand)

Any portion of a levy should be zero-rated if it is charged by a GST-registered unit title body corporate that is charged for supplies that would be exempt supplies if they were provided directly to the member. The current proposed amendment, which deems the body corporate not to be making supplies for that portion, will impose compliance costs on the body corporate as they would have to undertake regular apportionment calculations.

Comment

Officials consider that making the relevant supply an exempt supply is necessary to achieve the correct policy outcome. The supply of accommodation in a dwelling is exempted from GST to ensure that those in rental accommodation are not disadvantaged compared with owner-occupiers. For the same reason, people who own leasehold apartments through body corporates should have an exempt GST treatment for any ground rent they pay to a body corporate. This ensures neutrality with other owners of residential properties who pay ground rent directly to the landowner of leasehold land.

If the supply of ground rent was zero-rated instead, the body corporate could theoretically claim input tax deductions for these supplies, and this could advantage GST-registered unit title body corporates over other types of residential property ownership. However, in practice a body corporate seems unlikely to incur significant expenses passing on the bill for ground rent to its members, and any such expenses (for example, legal fees) should be obviously connected to the exempt supply of ground rent.

For these reasons, officials also consider that the proposed exempt supply rule will not require apportionment, and the compliance costs associated with that, as inputs the body corporate incurs should be directly attributed either to making the exempt supply of ground rent (no input tax deduction) or to the body corporate's taxable supplies (a full input tax deduction).

Finally, officials note that if the treatment was changed to zero-rating, the body corporate would still face additional compliance costs as they would have to calculate the correct amount of output tax to be charged to their members and returned to Inland Revenue.

Recommendation

That the submission be declined.

GST B2B COMPULSORY ZERO-RATING OF LAND RULES

Clauses 7(5) and 33(1), (3) and (4)

Issue: Support for the proposed amendments

Submission

(Chartered Accountants Australia New Zealand)

The submitter supports the proposed amendments and notes that they will make compliance easier.

Recommendation

That the submission be noted.

Issue: Scope of section 25AB limited

Submission

(New Zealand Law Society, Russell McVeagh)

That the proposed amendment in clause 33(1) significantly narrows the scope of section 25AB.

The proposed provision limits the scope of included supplies to those affected by an event referred to in section 25AA(1)(a). However, section 25AA(1) only applies to supplies of goods or services that are made by a non-resident and that are treated by sections 5B and 8(4B) as being made in New Zealand by the recipient of the supply. The current provision applies to the supply of goods and services by any registered person. The events listed in section 25AA(1)(a) are also more limited than in the current provision, and it is not clear in the Commentary to the Bill why this change in scope was necessary.

Comment

Officials agree that the proposed amendment to section 25AB(1)(a) limits the scope of that section. This reduction in scope was not intended. Officials recommend that the reference to section 25AA(1)(a) be removed and a list of the events to which the current section 25AB(1)(a) should apply be inserted into the provision.

Recommendation

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

Issue: Clarification required

Submission

(Deloitte)

The proposed amendment to section 5(23) should be further clarified by providing that it is the vendor who decides to zero-rate the supply of land by way of recording the supply in

their GST return. The submitter supports the proposed amendment but considers that this further amendment is required to clarify who treats, and how they treat, section 11(1)(mb) as applying.

Comment

Officials acknowledge the matter raised by the submitter. However, officials consider it would be inappropriate to make any further changes without further consultation with stakeholders and affected parties on the issues and potential amendments. Further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Deemed non-taxable supply of secondhand goods

Submission

(New Zealand Law Society)

The proposed amendment should be redrafted to provide for a deemed non-taxable re-supply of secondhand goods in section 5(23). This is necessary to allow the recipient to claim a secondhand goods input tax credit.

Comment

Officials consider that the proposed amendment achieves the desired policy outcome of allowing the recipient to claim a secondhand goods input tax credit where the supply of land has been incorrectly zero-rated because of the registration status of the vendor or because the vendor is not making a taxable supply.

Under current law, a recipient in this situation can claim a secondhand goods input tax credit when the incorrect zero-rating is discovered. This is because the supplier (vendor) would be able to make an adjustment correcting the previous incorrect treatment, making it a non-taxable supply. This would then allow the recipient (purchaser) to claim a secondhand goods deduction. However, this deduction is reversed under current law because section 5(23) also operates in this situation so that the recipient is required to return output tax on the value of the land.

Officials consider that by restricting the operation of section 5(23) to cases where a taxable supply was incorrectly zero-rated, a recipient will not have to return this output tax and will thus have a net input tax deduction for their secondhand goods.

Recommendation

That the submission be declined.

GST GROUPS

Clauses 19 and 37

Issue: Support for proposed amendments

Submissions

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, KPMG, New Zealand Law Society, PwC)

That the amendments to remove ambiguity in the GST group rules are supported. *(Corporate Taxpayers Group, Deloitte, KPMG, PwC)*

That the amendments to treat the GST group as a single company and the representative member as carrying on all activities for the GST group are supported. *(Chartered Accountants Australia and New Zealand, KPMG, New Zealand Law Society)*

That the proposals to allow GST group members who exit the GST group to be relieved from joint and several liability are supported. *(Corporate Taxpayers Group, Deloitte)*

That the proposal to align a GST group's joint and several liability to that of consolidated groups in the Income Tax Act 2007 is supported. *(KPMG)*

Recommendation

That the submissions be noted.

Issue: Taxable supply information for GST groups

Submission

(Corporate Taxpayers Group, Deloitte)

That the date information requirements for a GST group in proposed section 19L(1)(b) of the Goods and Services Tax Act 1985 should be identical to the general date information requirements in proposed section 19K(8)(c), and that both provisions should refer to the date of the taxable supply information.

Comment

Officials support this submission.

Recommendation

That the submission be accepted.

Issue: Practical guidance

Submission

(PwC)

That detailed practical guidance should be provided on the operation of the grouping rules.

Comment

Officials agree that guidance on the application of the grouping rules would be useful. This will be provided through a *Tax Information Bulletin*.

Recommendation

That the submission be accepted.

Issue: Joint and several liability

Submission

(Corporate Taxpayers Group, Deloitte, PwC)

- a. That the proposed amendment should apply to remove joint and several liability for returns filed before the assent date for relevant transaction entered into after introduction of the Bill. For example, this would enable the proposals to apply to commercial merger and acquisition transactions commenced after the Bill was introduced and completed before enactment. *(Corporate Taxpayers Group, Deloitte)*
- b. That the provision allowing relief from joint and several liability for members leaving a group should be drafted to align more closely with the equivalent income tax provision. *(PwC)*

Comment

- a. Officials agree that the submission has merit but consider there should be a reasonable time constraint on the retrospective application suggested. Officials consider the retrospective application could be based on the date of introduction of the Bill, namely 8 September 2021.
- b. Officials agree with this submission. Given the proposed provisions are based on similar rules in the Income Tax Act, they will be reviewed by the drafter to improve their consistency with the rules in the Income Tax Act.

Recommendations

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

Issue: Clarify the GST treatment of business asset sales

Submission

(Chartered Accountants Australia and New Zealand, Mayne Wetherell, New Zealand Law Society)

That the proposed amendments to section 55 of the Goods and Services Tax Act 1985 should clarify the GST treatment of business asset sales involving multiple vendors in the same GST group for the zero-rating rules for land and going concerns.

Comment

Officials acknowledge the matter raised in this submission but note that the submission relates to the scope of the zero-rating rules as they apply to sales of land and the going concern rules and is outside the scope of the proposals to amend the GST grouping rules. Officials note the matter raised in the submission would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Drafting issue

Submission

(EY, KPMG)

That section 55 of the Goods and Services Tax Act 1985 (GST Act) be rewritten to enable a better logic flow and enhanced readability.

Comment

Officials acknowledge the matter raised in this submission but note it is similar in effect to other submissions that recommend a rewrite of the GST Act. Officials note that such a rewrite would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

NON-STATUTORY BOARDS

Clause 8

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

The proposal to amend section 6(3)(c)(iii) to remove the word "statutory" is supported.

Recommendation

That the submission be noted.

MORE FLEXIBILITY FOR CHANGING END DATE FOR TAXABLE PERIOD

Clauses 13–18

Issue: Support for proposed amendments

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

That the proposed amendments to provide increased flexibility for GST period end dates are supported. It is sensible to allow a registered person to account for GST according to their business cycle.

Recommendation

That the submission be noted.

Issue: Alternative methods should be available

Submissions

(Deloitte, PwC)

- a. That the proposed provisions are unclear and may not fully align with the commercial needs of GST-registered persons. *(Deloitte)*
- b. That GST-registered persons should be able to elect to use an alternative methodology to determine the end date of a taxable period. *(PwC)*

Comment

- a. Officials consider the proposal accommodates a wide range of possible situations provided there are good commercial reasons for making an application. We have consulted with the submitter, and they do not have any specific concerns that would give rise to compliance cost concerns.
- b. Officials do not agree that GST-registered persons should be able to apply to use an alternative methodology to that proposed in the Bill. We consider the proposal accommodates a sufficiently wide range of possible situations, provided there are good commercial reasons for making an application. The proposals in the Bill were also developed on the basis that the Inland Revenue START system would not require any change. Providing for alternative methodologies to those proposed could impact on the START system. We have consulted with the submitter, and they now accept the proposed provisions have a wider application than they considered possible when making their submission.

Recommendation

- a. That the submission be declined.
- b. That the submission be declined.

TAXABLE SUPPLIES OF GOODS NOT YET IN PHYSICAL POSSESSION

Clause 21(4)

Issue: Proposed amendment should be removed from Bill

Submission

(Chartered Accountants Australia and New Zealand, Deloitte, PwC)

The amendment is unnecessary and should not proceed.

Comment

Officials note the proposals originally stemmed from submissions made on a GST Issues Paper published in February 2020. Officials have reviewed the present submissions against the background of those earlier submissions and now agree the proposals are unnecessary. Accordingly, we recommend that clause 21(4) be omitted from the Bill.

Recommendation

That the submission be accepted

OTHER ISSUES

Issue: GST B2B election under section 20F

Submission

(Deloitte)

The current rules should be changed so that all GST-registered persons are treated as having made a business-to-business (B2B) election under section 20F unless they elect out.

Where a business fails to lodge the B2B election, it is prevented from using the GST B2B zero-rating of financial services rules. It will therefore end up paying more GST than it should from a purely policy perspective. Two identical businesses can end up with different GST outcomes simply because one business was advised to lodge the GST B2B election and the other was not. When section 20F was originally issued for consultation, the default position was that every taxpayer was in the rules unless they elected out of them.

Comment

Section 20F of the Goods and Services Tax Act 1985 was introduced as one of several amendments to allow supplies of financial services between businesses to be zero-rated (taxed at the rate of zero percent).

The amendment was first introduced in 2003 as clause 111 of the Taxation (GST, Trans-Tasman Imputation, and Miscellaneous Provisions) Bill. It was proposed that the rules would be compulsory for all GST-registered persons supplying financial services to recipients meeting the statutory criteria to receive zero-rated supplies of financial services. Provision was made for taxpayers to be able to elect out of the rules and continue to exempt their supplies of financial services from GST.

A submission on that Bill noted that the proposed changes would have compliance costs on GST-registered persons as they would have to gather the required statistics and information to establish whether supplies of financial services in New Zealand should be zero-rated. It was submitted that a financial institution wishing to take advantage of the new zero-rating provisions should have to elect into those rules, and that this was consistent with other elective provisions in the GST Act that involved an element of compliance cost.

The submission was accepted and, in its report on the Bill, the Finance and Expenditure Committee noted that electing into the zero-rating rules would allow providers of financial services to:

- assess the benefit of providing zero-rated services to their customers balanced against the compliance cost of determining a customer's eligibility to receive zero-rated services, and
- consider the benefit of an increased entitlement to input tax credits.

Clause 111 was replaced with an elect-in rule in clause 114 of the Bill, which was then enacted as section 155 of the Taxation (GST, Trans-Tasman Imputation, and Miscellaneous Provisions) Act 2003.

The current submission notes that there would be no additional compliance costs for taxpayers in being within the B2B zero-rating of financial services rules. This is because the sole purpose of the rules is to increase the level of GST refunds a business can claim.

The current Bill does not amend the rules supporting B2B supplies of zero-rated financial services, and officials note that no work or consultation has been done to test the correctness of the submitter's assertion.

However, officials note that the rationale for an elect-in system was based on business systems as they existed nearly twenty years ago. It is possible that the associated compliance costs created by the statistical requirements of the zero-rating rules has decreased over time. Any work on retesting the assumptions underpinning the elect-in framework would need prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Income tax remedials

HYBRID AND BRANCH MISMATCHES – IMPORTED MISMATCH RULE

Clauses 81, 82 and 127(10)

Issue: Support for changes

Submission

(Corporate Taxpayers Group, Deloitte, KPMG, PwC)

Submitters support the changes to section FH 11, particularly the inclusion of the concept of surplus assessable income and the carry forward of denied deductions and surplus assessable income.

Recommendation

That the submission be noted.

Issue: Inclusion of branch charges in imported mismatch rule

Submission

(Corporate Taxpayers Group, Deloitte)

Deductible charges made to New Zealand branches by their parents should not be subject to deduction denial under the imported mismatch rule. This was not contemplated by the OECD hybrids and branch mismatch report.

Comment

The submitters are correct that the relevant reports do not deal with branch charges. However, there is no reason in principle not to apply the imported mismatch rule to a branch charge, since this is a payment that is deductible in New Zealand in the same way as a payment to a third party. This should also not give rise to any co-ordination issues with other countries in applying the imported mismatch rule.

However, the submissions do make the point that including branch charges in the imported mismatch rule is a new decision, rather than correction of an oversight, and that it is not taxpayer favourable. These two points support a conclusion that the proposed change to section FH 11(1)(b) should only apply from enactment of the Bill.

Recommendation

That the submission be declined, but that the effective date of proposed section FH 11(1)(b) should be enactment of the Bill.

Issue: Inclusion of payments by NZ branches in imported mismatch rule

Submission

(PwC)

The legislation should clarify whether proposed section FH 11(1)(b) is intended to apply to a payment by a payer that is a New Zealand deducting branch of a non-resident.

Comment

Officials agree. The current legislation applies to such a payment. However, while the proposed new section FH 11(1) makes it clear that the imported mismatch rule applies to a deductible charge to a New Zealand deducting branch, the language dealing with straightforward payments made by a New Zealand deducting branch is no longer clear. This should be clarified.

Recommendation

That the submission be accepted.

Issue: Amendments unnecessary

Submission

(Deloitte)

Section FH 11(5) should be extended to also apply to deduction denial under section FH 11(3) (the structured imported mismatch rule), rather than amending section FH 11(1).

The requirement in existing section FH 11(5) that amounts denied under the unstructured mismatch rule be determined consistently with chapter 8 of the hybrid mismatch report is sufficient to ensure that payments made through an intermediate entity in a country with hybrid rules do not give rise to deduction denial under section FH 11(4) (the unstructured imported mismatch rule). This should be extended to also apply to deduction denial under the structured imported mismatch rule. The current "bottom-up" approach articulated in the legislation is not consistent with the "top-down" approach in the OECD Final Report.

Comment

As a general proposition, officials think it preferable to provide rules in the legislation itself, rather than referring to other sources. While the complexity of the unstructured rule meant that the costs of a legislatively prescriptive approach outweighed the benefits, this does not seem to be the case for the structured rule. On balance, officials remain of this view. The amendments are intended to ensure that the bottom-up approach produces the same outcome as the OECD top-down approach.

Recommendation

That the submission be declined.

Issue: Tracing “payments” between members of a consolidated group

Submission

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

There should be no requirement to trace payments from one tax consolidated group member to another. This would be complex, and there is no guidance from the OECD as to how it might be done. It will significantly increase the work for New Zealand taxpayers when considering the application of the rules.

Comment

Officials disagree. We acknowledge that it is more complex to apply tracing to a payment made to a consolidated group member company on the basis that consolidation involves an implicit payment from members who are in profit to members who are in loss than it is in cases where there is a specific grouping of profit and loss between a profit and a loss company. However, proposed section FH 11(5) does not specifically require tracing on that basis. It only requires that the approaches described in the OECD hybrid mismatch report be followed. This allows some flexibility and, most importantly, a common approach to be taken. For example, to the extent that a payment is deemed to exist between profit and loss members of a tax consolidated group when Australia applies its imported mismatch rule, there is no reason for that not to apply under New Zealand rules as well. The purpose of expanding section FH 11(5) is to allow a common approach to be taken by jurisdictions with hybrid mismatch legislation.

Recommendation

That the submission be declined.

Issue: More should be done to simplify section FH 11

Submission

(EY)

While the changes to section FH 11 are welcome, more needs to be done to simplify the section.

Comment

Officials acknowledge that the imported mismatch rule, in particular, is complex. However, any further work on this matter would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be declined.

Issue: Inland Revenue should publish a list of countries with hybrid mismatch legislation

Submission

(EY, PwC)

Inland Revenue should publish a list of countries that it considers have hybrid mismatch legislation, as section FH 11 requires a taxpayer to determine whether another country has such legislation, and this information may not be publicly available.

Comment

Officials have received a number of requests for such a list. Officials have discussed this with other tax administrations, and we are not aware of any other country having published such a list. Publication of a list inevitably has risks and creates continued pressure to keep the list up to date. Officials also are of the view that most advisers working in the hybrids area are aware of which counterparty countries have hybrid rules. Therefore, no list is currently contemplated. If other countries do publish lists, the practice in New Zealand may be reviewed.

Recommendation

That the submission be declined.

Issue: Inland Revenue should publish examples

Submission

(KPMG)

The proposed amendments to section FH 11 are welcome, but Inland Revenue should publish examples of offsets and other matters that give rise to imported mismatches.

Comment

Officials note the support for the amendments.

Examples will be included in the *Tax Information Bulletin* published following enactment of the amendments.

Recommendation

That the submission be accepted.

Issue: Rules dealing with branch mismatches should be separated from other mismatch rules

Submission

(KPMG, Mayne Wetherell)

There should be separate sections in the Income Tax Act 2007 (the Act) dealing only with branch mismatches.

The Act currently deals with branch mismatches and hybrid mismatches in the same sections. This adds to the length of the sections and makes for convoluted drafting. Separate sections dealing only with branches would simplify and clarify the rules.

Comment

Officials disagree. A trade-off must often be made between concise legislation and legislation that deals separately with closely related areas. Officials' view is that the current law is not sufficiently unsatisfactory that the costs of undoing the current grouping of the branch and other mismatches in the same section would justify the benefits.

Recommendation

That the submission be declined.

Issue: Hybrid and branch mismatch rules should be subject to a post-implementation review

Submission

(Mayne Wetherell)

A post-implementation review should be undertaken to assess whether the complexity and compliance burden of the hybrid and branch mismatch rules is warranted and whether simplification is desirable.

Comment

Officials disagree. The hybrid and branch mismatch rules only took effect for most taxpayers in the income year ending 1 April 2020, with the unstructured imported mismatch rule applying for income years beginning on or after 1 January 2020. There is no indication that other countries with hybrid rules are making significant changes to their rules. Officials consider it too early to undertake a post-implementation review. As the submitter noted in their submission, the operation of the rules has been under active review by Inland Revenue and changes have been made to ensure the rules apply appropriately.

Recommendation

That the submission be declined.

Issue: Retrospective effect should be limited

Submission

(Mayne Wetherell)

Taxpayers should be entitled to file their tax returns for years beginning on or before the enactment of the Bill in reliance on the law existing before the amendments in the Bill if they wish to do so.

Comment

Officials agree some form of protection from retrospectivity could be given. The proposed amendments are intended only to more accurately reflect the OECD recommended imported mismatch rule, and they are generally taxpayer friendly. The only amendment that is likely to increase tax obligations is clause 81(4), and this is stated in clause 81(6) to apply only for income years beginning on or after the date the Bill receives the Royal assent. However, it is not impossible that the amendments might lead to the imposition of further tax. Preserving the position would mean taxpayers did not have to revisit returns they have already filed.

Recommendation

That the submission be accepted

Issue: Drafting issues

Submission

(NZLS, PwC)

Submitters suggested the following drafting changes should be made to clauses 81 and 82:

- a. The definition of "hybrid mismatch legislation" in section FH 15 should extend to regimes intended to comply with the OECD hybrid and branch mismatch reports. *(NZLS, PwC)*
- b. Proposed section FH 11(1B)(g) should not include the words "that counteracts the hybrid mismatch". This would simplify compliance for taxpayers. *(NZLS, PwC)*
- c. Proposed section FH 11(6)(b) should be omitted as unnecessary. *(NZLS)*
- d. Section FH 11 should contain a definition of a "funded payment", rather than relying in section FH 11(5) on the OECD guidance. *(NZLS)*
- e. Proposed section FH 11(1B)(g) should be amended so that the section is not satisfied if the payer jurisdiction counteracts the mismatch. *(PwC)*

Comment

- a. Section FH 1(2) states that subpart FH implements the recommendations made by the OECD in the hybrid and branch mismatch reports. Section FH 1(4) contains a section-by-section mapping of the provisions of subpart FH to the OECD recommendations. Accordingly, the reference in the definition of "hybrid mismatch legislation" to legislation having "an intended effect" corresponding to the effect of a provision in subpart FH incorporates the principles of the OECD reports. Officials do not consider a further explicit reference necessary.
- b. We agree that the words "that counteracts the hybrid mismatch" can be omitted.

- c. We agree that proposed paragraph FH 11(6)(b) can be omitted.
- d. There is no need for a definition of a funded payment. Proposed section FH 11(1B)(a) says it is a payment from a person in a country outside New Zealand to a person in the same or another country outside New Zealand, for which an original payment or charge provides funds. Whether the original payment or charge does provide funds is determined by applying the OECD top-down tracing principle. Accordingly, there does not seem to be a basis for a definition separate from section FH 11(5).
- e. Officials do not agree that section FH 11(1B)(g) should be amended by including a reference to the payer jurisdiction. Section FH 11(1B) only applies if a funded payment gives rise to a hybrid mismatch. A hybrid mismatch only arises if an amount is deductible. If the payer has hybrid mismatch legislation, the payment will not be deductible.

Recommendation

- a. That the submission be declined.
- b. That the submission be accepted.
- c. That the submission be accepted.
- d. That the submission be declined.
- e. That the submission be declined.

Issue: Definition of hybrid mismatch legislation needs to be limited

Submission

(Matter raised by officials)

The reference to hybrid mismatch legislation in section FH 11(1)(b) and section FH 11(1B)(c) needs to be narrowed to legislation having the same effect as subpart FH. Those sections are intended to ensure section FH 11 does not apply if a payment is made to a payee in a country with comprehensive hybrid mismatch legislation. However, the reference to "hybrid mismatch legislation" means that the section does not apply if a payment is made to a payee in a country whose law counteracts the effect of only one type of hybrid mismatch (see proposed amendment to paragraph (b) of the definition of "hybrid mismatch legislation" in clause 82(2) of the Bill).

Recommendation

That the submission be accepted.

EARLY-PAYMENT DISCOUNT RATE CHANGES

Clause 111

Issue: Application date

Submission

(Deloitte)

The current early-payment discount (EPD) rate of 6.7% should continue to apply until 31 March 2022 to align with the last filing date for returns with an extension of time. The commencement date for the proposed amendment should be changed to 1 April 2022 to provide certainty for affected taxpayers.

Comment

Officials agree that taxpayers should be able to benefit from the EPD rate of 6.7% for the 2021–22 tax year. Therefore, the proposed change should only apply for the 2022–23 and later income years.

Recommendation

That the submission be accepted.

Issue: Alignment with FBT prescribed rate

Submission

(Chartered Accountants Australia and New Zealand)

The EPD rate should equate with the FBT prescribed rate of interest. The method for determining the rate at which the Commissioner pays use of money interest (UOMI) on overpaid tax is flawed. Therefore, determining the EPD rate by reference to the Commissioner's UOMI rate would exacerbate this issue.

Comment

Officials disagree that the way the Commissioner's UOMI payment rate is set is flawed. Therefore, officials consider the need to align it with a different rate is not necessary. The Commissioner's paying rate is designed to be aligned with market rates and is therefore an appropriate measure.

Recommendation

That the submission be declined.

Issue: Proposed amendment should not proceed

Submission

(KPMG)

The proposed amendment should not proceed as this is clearly not a remedial change but rather an explicit policy change. The rationale for the 6.7% rate is that it is approximately equivalent to a 10% pre-tax discount on tax payable for early payment. The proposed amendment alters the rate to tie it to the prevailing use of money interest credit rate plus 200 basis points. However, there does not appear to be any policy rationale as to why the effective 10% pre-tax discount on tax payable is no longer appropriate.

Comment

The policy rationale has not changed. The EPD rate is designed to incentivise early payment. It is appropriate for this rate to be pegged to market interest rates so it can adapt to changing economic circumstances. Having it set at 6.7% in primary legislation causes it to be inflexible and significantly above market interest rates.

The proposed amendment aims to ensure the EPD rate better aligns with what would be expected from market rates. Aligning it with the Commissioner's paying rate, which is itself aligned with market rates, does this.

Recommendation

That the submission be declined.

RESTRICTED TRANSFER PRICING REMEDIALS

Clauses 51 and 86

Issue: Deemed dividend remedial should not proceed

Submission

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

Submitters consider that the proposed deemed dividend remedial should not proceed. This is because:

- It is inconsistent with the rationale of a dividend arising when a transfer of value is made by a company to a shareholder. In transfer pricing situations, the value transferred is the amount of interest in excess of what would have been paid by third parties (that is, the arm's length amount). This is not the same for an amount of interest denied under the restricted transfer pricing rules since the amount of deductible interest is below the arm's length amount. *(EY)*
- The arbitrary nature of the restricted transfer pricing rules, which can result in arm's length amounts of interest being non-deductible, should not be compounded by then deeming such amounts to also be a dividend when they are an arm's length amount of interest. *(Corporate Taxpayers Group, Deloitte)*
- At the time the restricted transfer pricing rules were introduced, they were stated to be consistent with the arm's length principle. Therefore, the proposal should not be necessary as the restricted transfer pricing rate and the arm's length rate should be the same. If officials disagree, then a review of the restricted transfer pricing rules is required. *(Chartered Accountants Australia and New Zealand)*

Comment

Officials disagree. The purpose of the restricted transfer pricing rules is to provide a more robust method of determining an appropriate price for an intra-group loan than an unmodified arm's length approach. If a New Zealand company is paying more than the amount determined by the restricted transfer pricing rules, the excess is a transfer of value by the company to its shareholder and must logically be a dividend.

Officials also note that this proposal does not affect how the restricted transfer pricing rules apply to the deductibility of interest incurred. It merely confirms that interest charged above the deductible amount is a transfer of value to the shareholder and should be treated as a deemed dividend. This outcome is consistent with the policy intent when the restricted transfer pricing rules were introduced.

Recommendation

That the submission be declined.

Issue: More guidance required

Submission

(Chartered Accountants Australia and New Zealand, EY, KPMG, New Zealand Law Society, PwC)

If the proposed deemed dividend remedial proceeds, it needs to be supported by additional detailed guidance – in particular, clear guidance on how the deemed dividend rules and the non-resident withholding tax rules interact together. *(Chartered Accountants Australia and New Zealand, EY, New Zealand Law Society, PwC)*

Clear guidance should be provided on whether the restricted transfer pricing rules are interest limitation rules or a form of transfer pricing rules, and there should be confirmation that Inland Revenue will consistently apply this characterisation. *(KPMG)*

Comment

Officials agree that clear guidance should be provided as to the interaction of the deemed dividend rules and the non-resident withholding tax rules. This will be included in the *Tax Information Bulletin* published after enactment of the Bill.

Point of difference

On the issue of the characterisation of the restricted transfer pricing rules, officials do not consider it necessary to characterise them as either transfer pricing or interest limitation rules. The rules were implemented to address specific base erosion and profit shifting concerns and their characterisation as a certain type of rule is unnecessary.

Recommendation

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

Issue: Commissioner to agree acceptable pricing with taxpayers

Submission

(EY)

A streamlined process should be available to taxpayers to provide certainty on how amounts denied under the restricted transfer pricing rules, in excess of the amount that would be denied under the arm's length amount, should be treated.

This process should give the Commissioner of Inland Revenue the discretion to deviate from the amounts calculated under the restricted transfer pricing rules, where appropriate, to align the outcome with the arm's length principle. This flexibility would recognise that applying the rules can produce outcomes that do not align with the arm's length principle and would allow for an agreed resolution that takes into account the taxpayer's specific circumstances.

Comment

Officials disagree that the Commissioner should be given a discretion to override the restricted transfer pricing rules. This would undermine the certainty of an agreed outcome and create an unsatisfactory tension between the rules-based regime of the restricted transfer pricing rules and a regime based on arm's length pricing principles. Allowing a

separate discretionary rule would move the rules closer to standard transfer pricing rules, which have been shown to be inadequate to deal with base erosion and profit shifting challenges.

Recommendation

That the submission be declined.

Issue: Amending section CD 39 will not achieve intended result

Submission

(Matter raised by officials)

The proposed amendment to section CD 39(8) will not achieve the intended outcome of ensuring that the deemed dividend that arises when interest is disallowed under the restricted transfer pricing rules is calculated based on the amount disallowed under those rules, rather than the arm's length amount.

Section CD 39 calculates a dividend when value is transferred by a company to its shareholder. For example, when a company provides a below market interest loan to its shareholder, the shareholder derives a dividend equal to the market interest they would have paid. Under section CD 39(5), the amount of the dividend is the excess (if any) of interest calculated for the quarter on the basis of the benchmark rate specified in section CD 39(6) to (8) over the actual amount of interest accruing on the loan in the quarter.

However, in the context of cross-border loans, the transfer pricing and restricted transfer pricing rules are aimed at scenarios where money is lent by an offshore shareholder (for example, a parent company) or associate to a New Zealand company at excessive interest rates, that is, the transfer of value is through the interest paid to the shareholder being above market, rather than the interest paid by the shareholder being below market. Therefore, section CD 39 will not apply in the context of interest disallowed under the restricted transfer pricing rules.

Consequently, officials recommend that section CD 38, which provides the general calculation of transfer of value from a company, should instead be amended consistent with the intention of the original proposed amendment to section CD 39(8).

Recommendation

That the submission be accepted.

FOREIGN CURRENCY LOANS THAT FINANCE RESIDENTIAL RENTAL PROPERTY IN A FOREIGN JURISDICTION

Clause 70

Issue: Support for proposed amendment

Submission

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

The submitters support the proposed amendment.

Recommendation

That the submission be noted.

Issue: Application date

Submission

(Deloitte)

The proposed amendment should apply from the 2021–22 income year, rather than from income years beginning on or after the date of enactment, so that taxpayers with an early balance date can apply this amendment in their tax returns.

Comment

Officials agree that taxpayers with an early balance date should be able to apply the proposed amendment in the same income year as taxpayers with a standard or late balance date. However, for taxpayers with a standard or late balance date, the amendment would apply from the 2022–23 income year based on the application date proposed in the Bill, not the 2021–22 income year. Therefore, to enable taxpayers with an early balance date to apply the amendment in their tax returns in the same income year as taxpayers with a standard or late balance date, the application date should be from the 2022–23 income year.

Recommendation

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

Issue: Amendment not required

Submission

(PwC)

The proposed amendment is not required because the residential rental property loss ring-fencing rules do not apply to foreign exchange losses. Foreign exchange gains or losses arise because of the application of the financial arrangements rules, and foreign exchange losses on financial arrangements that finance residential rental properties are not incurred in relation to residential rental properties for the purposes of section EL 4 of the Income Tax Act 2007.

Comment

The policy intention is that the residential rental property loss ring-fencing rules apply to all expenditure that arises because of the application of the financial arrangements rules to a foreign currency loan that finances a residential rental property. Officials therefore consider that this expenditure, including foreign exchange losses, is incurred in relation to residential rental properties for the purposes of section EL 4 and is ring-fenced. As a result, the amendment is required.

Recommendation

That the submission be declined.

FRINGE BENEFIT TAX – UNCLASSIFIED BENEFITS PAID BY ASSOCIATES

Clause 114

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

Submitters support the amendment to exclude unclassified benefits paid by an employer's associate to that associate's employees from the calculation of the de minimis concession when the employer and its associate are not part of the same commonly owned group.

Recommendation

That the submission be noted.

Issue: De minimis rule should be reviewed

Submission

(Deloitte)

The de minimis rule is an area of high compliance costs for business and it would be of benefit to review this rule in its entirety.

Comment

Officials acknowledge the matter raised by the submitter. However, further work on this matter would require prioritising and resourcing as part of the Government's tax work policy programme. We note that Inland Revenue is currently undertaking a stewardship review of FBT, and the findings of this review will be taken into consideration for future FBT changes by the Government.

Recommendation

That the submission be declined.

Issue: Provide certainty of the documentation required

Submission

(Deloitte)

The requirement to categorise payments will add to compliance costs. Certainty as to what documentation must be kept to prove that payments have been correctly categorised should be provided.

Comment

General record-keeping obligations are set out in section 15B of the Tax Administration Act 1994. These include that taxpayers must keep all necessary information to support their tax position. The proposed changes in the Bill will not change those requirements. It will simply mean that in this case records to confirm that any associated employers excluded from the de minimis are justified must be kept.

Recommendation

That the submission be declined.

ELECTION DAY WORKER TAX CODE

Clause 127(6)

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendment to the definition of “election day worker”.

Recommendation

That the submission be noted.

APPROVED ISSUER LEVY AND SECURITY TRUSTS

Clause 119

Issue: Further amendments should be made to prevent the overreach of the associated person rules

Submission

(Australian Securitisation Forum)

- a. The proposed amendment to remove the overreach of the associated person rules for security trusts in the approved issuer levy rules is welcomed by the submitter.
- b. Further amendments to the overreach of the associated persons rules should also be made. A person should not be associated with a securitisation SPV (or treated as holding related-party debt) simply because the person (or an associate of the person) is a settlor of the securitisation SPV, has the power to appoint, or is a beneficiary of a security trust solely as an incident of the person's role as a creditor to the securitisation SPV.

Comment

- b. The submitter points out that the relevant association tests appear to have been drafted with a family trust or similar private arrangement in mind, where being a settlor or having the power to appoint might carry the necessary degree of control or influence to give rise to association. For a securitisation SPV, on the other hand, the trust is a mechanism to hold receivables and allocate cash to noteholders. Any rights held over the trust by a creditor are usually an incident of the person's role as a creditor to the trust and are not a quasi-ownership right. Therefore, such rights should not give rise to association. The submitter also acknowledges that it is possible to structure around the overreach in the existing association tests, but states that this results in increased costs and complexity.

Officials acknowledge the matter raised by the submitter. There does seem to be the potential for the associated person rules to overreach in the circumstances identified by the submitter. However, the requested amendments are beyond the scope of the proposed amendment to the approved issuer levy rule. Further work would be required to understand the impact of amending the associated person rules in those contexts. For example, excluding association as an incident of a creditor relationship might inadvertently extend to cases where there is a substantive association that co-exists with a creditor relationship. Further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

- a. That the submission be noted.
- b. That the submission be declined.

ELECTING INTO THE SECURITISATION REGIME

Clause 89

Issue: An earlier date for election into the regime should be allowed

Submission

(Australian Securitisation Forum, Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Russell McVeagh)

- a. Submitters support the proposed amendment.
- b. The amendment should allow the election to be made earlier. The requirement that the election into the securitisation regime be made “after the first transfer of assets to the debt funding special purpose vehicle” may be restrictive in practice.

The election should be able to be made any time after the creation or appointment of the debt funding special purpose vehicle (securitisation SPV). *(Russell McVeagh)*

Comment

- b. There is no particular reason why the election into the securitisation regime cannot be made before the first transfer of assets is made to the securitisation SPV. Accordingly, allowing an earlier date seems beneficial if it would facilitate use of the regime. Officials consider that the election should be able to be made any time after the creation of the securitisation SPV.

Point of difference

However, the intent of the amendment is to allow an earlier date than is currently provided for, not a later date. Therefore, the election should not be able to be made after the return has been filed for the income tax year in which the first transfer of assets by the originator to the securitisation SPV was made (being the time at which an election may be made under the current legislation).

Recommendation

- a. That the submission be noted.
- b. That the submission be accepted, subject to officials’ comments.

Issue: Transfers between special purpose vehicles

Submission

(Australian Securitisation Forum)

The position regarding whether an election can be made for a new securitisation SPV following the transfer of assets from a previous securitisation SPV should be confirmed by Inland Revenue guidance or (if necessary) remedial amendment.

Sometimes assets must be transferred between securitisation SPVs. For example, the originator may establish a “warehouse trust” securitisation SPV to hold assets before they are transferred to a second securitisation SPV. Assuming that both the warehouse trust and

the second securitisation SPV are consolidated (for financial reporting purposes) with the originator, and that an election into the regime has been made for the warehouse trust securitisation SPV, the question may arise whether an election can be made for the second securitisation SPV. The submitter considers this is already the position as a matter of interpretation of the relevant statutory provisions, but given the importance of this fundamental eligibility point, it considers this should be clarified.

Comment

The intention of the securitisation regime is that a securitisation SPV subject to the regime is transparent for tax purposes. Accordingly, if the originator of a securitisation SPV elects into the regime for a securitisation SPV, and that securitisation SPV transfers its assets to a second securitisation SPV, then that transfer should be treated as a transfer of the assets by the originator into that second securitisation SPV. Therefore, section HR 9 should apply as if the transfer of assets into the second securitisation SPV was made directly by the originator. This means that the second securitisation SPV should be able to elect into the securitisation regime (assuming the other requirements are met for the originator and the second securitisation SPV).

Officials agree with the submitter that this is the result under the current law. For clarity, guidance will be provided in a *Tax Information Bulletin*.

Recommendation

That the submission be noted.

Issue: Transfers from a securitisation SPV that does not elect into the regime

Submission

(Australian Securitisation Forum)

Where a company or trustee that meets the definition of "debt funding special purpose vehicle" but has not elected into the regime (Transferor SPV) transfers its assets to another company or trustee (Transferee SPV) that also meets the definition of "debt funding special purpose vehicle" and is consolidated for financial reporting purposes with the originator of the Transferor SPV, the transfer should be able to be treated (by election) for tax purposes as a transfer by the Transferor SPV to the originator(s), and in turn by the originator(s) to the Transferee SPV.

Comment

The submitter points out the difficulties that can arise where a securitisation SPV meets the criteria to elect into the securitisation regime under section HR 9 but cannot easily make the election into the regime. This often arises for legacy securitisation arrangements. In these cases, it is preferable for the securitisation SPV to transfer its assets to a new securitisation SPV, and for that new securitisation SPV to elect into the regime. However, this is not possible under the current law due to a requirement that all originators are members of the same wholly owned group. The submitter also identifies that a workaround currently exists using a two-stage transfer via the originator, but that it may be undesirable for legal or commercial reasons, and it imposes greater transaction costs on the parties.

Officials acknowledge the issue raised by the submitter but note that it is outside the scope of the proposed amendment. Further work is required to understand its implications, particularly given that it involves a deemed transfer of assets and would allow assets to be directly contributed to a securitisation SPV from outside the originator's wholly owned group

(which is outside the initial policy intent). Further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Some anti-avoidance rules overreach in relation to securitisations

Submission

(Australian Securitisation Forum)

Notes issued by a securitisation SPV should be excluded from section GC 18 of the transfer pricing rules.

Where an originator holds junior notes, the restricted transfer pricing rules require the junior notes to be priced for tax purposes as if they ranked equally with the senior notes under the transfer pricing rules (as the originator and securitisation SPV will be associated parties). This means part of the interest paid by the securitisation SPV will not be deductible. This is because section GC 18 requires subordination to be disregarded. However, subordination is fundamental to the structure and purpose of a securitisation, and it should not be disregarded in this case.

Comment

Officials acknowledge the matter raised by the submitter but note that it is outside the scope of the proposed amendment and would involve a change in policy. Further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Securitisation vehicles should be excluded from the thin capitalisation rules

Submission

(Australian Securitisation Forum)

Securitisation vehicles should be excluded from the thin capitalisation rules. Currently there is an on-lending concession available to securitisation vehicles. This allows a securitisation SPV to 100% debt fund its assets, but only to the extent its assets are financial arrangements or property incidental to financial arrangements. Where a securitisation SPV holds assets that are not financial arrangements (such as operating leases), the thin capitalisation rules may deny deductions for interest paid by the securitisation SPV on the debt that funds those non-financial arrangement assets.

It is possible to work around this by ensuring that no more than 10% of the securitisation SPV's debt is issued to the originator or its associates. However, this creates a material

restriction on the amount of owner-linked debt that is permitted and is contrary to steps being taken internationally to encourage risk retention.

Comment

Officials acknowledge the matter raised by the submitter but note that it is outside the scope of the proposed amendment to the approved issuer levy regime and would involve a change in policy (rather than being a remedial amendment). Further consideration of this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

TAX POOLING AND EARLY-PAYMENT DISCOUNT SETTINGS

Clauses 112, 124 and 126

Issue: Support for proposals

Submission

(Chartered Accountants Australia and New Zealand, KPMG)

The submitters support the proposals.

Recommendation

That the submission be noted.

Issue: Application date

Submission

(PwC)

The application date of the proposed amendments should have a retrospective effect to ensure the use of purchased tax pooling funds by qualifying taxpayers in the preceding years that have been erroneously denied an early-payment discount credit are remedied.

Comment

The proposed amendment is designed to remedy an unintended consequence of system changes. It is therefore appropriate for the proposed amendment to be retrospective to the date of the change. The proposed amendments should therefore apply from the 2019–20 income year.

Recommendation

That the submission be accepted.

Issue: Guidance should be issued

Submission

(PwC)

It should be clarified that a rate of 6.7% will be used to calculate the outstanding early-payment discount (EPD) of taxpayers who should have received the EPD but did not due to Inland Revenue's Business Transformation.

Comment

Officials acknowledge the matter raised by the submitter and will recommend that Inland Revenue provide guidance on this matter.

Recommendation

That the submission be noted.

Issue: Non-safe harbour taxpayers

Submission

(KPMG)

Non-safe harbour taxpayers should be able to access tax pooling to meet their tax liabilities in their first year as a provisional taxpayer.

Comment

Non-safe harbour taxpayers can already access tax pooling in their first year as a provisional taxpayer.

Recommendation

That the submission be declined.

CUSTODIAL INSTITUTIONS – DEFINITION OF END INVESTOR

Clauses 117 and 140

Issue: Support for proposed amendments

Submission

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

The proposed amendments are supported.

Recommendation

That the submission be noted.

CORPORATE SPIN-OUTS AND SHAREHOLDING CONTINUITY

Clause 129

Issue: Support for proposed amendments

Submission

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

The submitters support the proposals.

Recommendation

That the submission be noted.

Issue: Determination-making power

Submission

(Corporate Taxpayers Group, Deloitte, KPMG, Mayne Wetherell)

The proposed amendments will address a specific shareholder continuity problem caused by corporate spin-outs, but they will not address all shareholder continuity problems caused by these transactions. The submitters consider that the Commissioner of Inland Revenue should be given the power to determine that there has been no change in shareholder continuity where, in substance, there has been no change in shareholding, even though certain specific requirements in section YC 13 of the Income Tax Act 2007 (as well as certain other provisions in subpart YC) are not met.

Comment

Officials acknowledge the matter raised in this submission. However, expanding the scope of the corporate spin-outs and shareholder continuity proposals to introduce a determination-making power would be a significant change that would require further work and consultation. Any further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

SHARE-FOR-SHARE EXCHANGES AND AVAILABLE CAPITAL DISTRIBUTION AMOUNT

Clause 53(1)

Issue: Support for proposed amendment

Submission

(Corporate Taxpayers Group, Deloitte, Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council, PwC)

The submitters support the proposals.

Recommendation

That the submission be noted.

Issue: Application to historic liquidations

Submission

(PwC)

The proposed amendment should be enacted with retrospective effect, so it applies to historic liquidations as well.

Comment

As noted in the Commentary to the Bill, the proposed amendment will apply to liquidations from the date of enactment, including where the share-for-share exchange or sale occurred before the date of enactment. Officials understand that the problem dealt with by this amendment was known to many advisors for a long time and their advice to their clients was usually either not to do a share-for-share exchange or not to liquidate a company in this circumstance. Therefore, we expect the number of historical liquidations where tax on the gain arose would be relatively few.

Part of the benefit of the proposed amendment is to remove the disincentive for commercially sensible restructures that were being prevented solely due to tax. Applying the proposed amendment to historical liquidations would potentially open the Government up to an incalculable fiscal risk, while not being able to affect whether, or how, a restructure had happened in the past.

Recommendation

That the submission be declined.

Issue: Alternative proposals should be considered

Submission

(KPMG)

There is no good policy reason to retain the current available subscribed capital (ASC) limitation in the absence of a comprehensive capital gains tax and alternative proposals should be considered.

The ASC limitation was previously necessary to prevent revenue reserves being converted to tax-free capital gains. Its introduction was a reaction to companies creating internal capital gains to make tax-free distributions. However, this was a historical problem as the associated person capital gains rules have since addressed this.

Comment

While the ASC limitation was originally introduced to prevent internally generated capital gains being distributed in preference to (taxable) revenue reserves, the policy also applies to externally generated capital gains. New Zealand has a policy that capital gains can only be distributed tax free from an ordinary company upon its liquidation, and the ASC limitation supports that policy. Without the ASC limitation, a group could transfer a company with an existing gain to a second company via a share-for-share exchange and then distribute the gain (now in the form of ASC) tax free without having to liquidate or pay tax on the distribution.

Removing the ASC limitation, or otherwise allowing capital gains to be distributed by a company in the ordinary course of business, would be a significant change and would require consideration of the impact on other aspects of the tax system. Further work on this matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Capital gains sold to an associated party

Submission

(Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council)

The restriction to non-associated disposals is unnecessary and will result in genuine capital gains being permanently taxable.

Comment

Rather than being a restriction on internally generated capital gains, the restriction to sales to third parties will prevent capital gains being distributed without an entity being in-substance liquidated. This restriction ensures that a group cannot distribute a capital gain without liquidating a company by restructuring via a share-for-share exchange then selling the target company to another group company. In the absence of the restriction to third party sales, this series of transactions would allow a capital gain to be distributed to shareholders without any assets being sold outside the group.

While this restriction may limit some restructures, this would only be the case in a small subset of cases where a group has been restructured twice since the capital gain was

generated. The overall proposal is taxpayer favourable considering that disposals in this circumstance are currently taxable whether the sale is to a third party or a related party.

Recommendation

That the submission be declined.

Issue: Memorandum accounts for ASC and capital gains

Submission

(KPMG)

Memorandum accounts for ASC and capital gain amounts should be established and the time bar rules should apply to the amounts recorded in these accounts.

The proposed amendment will require the capital gain amount to be amended. This could be some time after the Target is acquired in the share-for-share exchange and the information may not be readily available at that time. A memorandum account with an applicable time bar would motivate the Commissioner to confirm the company's position on a more real-time basis.

Comment

While the time between the share-for-share exchange and the liquidation may be several years, at the time the share-for-share exchange occurs the taxpayer will be aware of the future benefit in retaining this information. Indeed, if the taxpayer considers it beneficial, nothing prevents them from maintaining a memorandum account of ASC and capital gains already, although there is no formal capacity to provide this to Inland Revenue.

Requiring a memorandum account to be filed with Inland Revenue would have much wider implications than the scope of the current proposed amendment. Officials note that this matter is under consideration.

Recommendation

That the submission be declined.

Issue: Capital losses

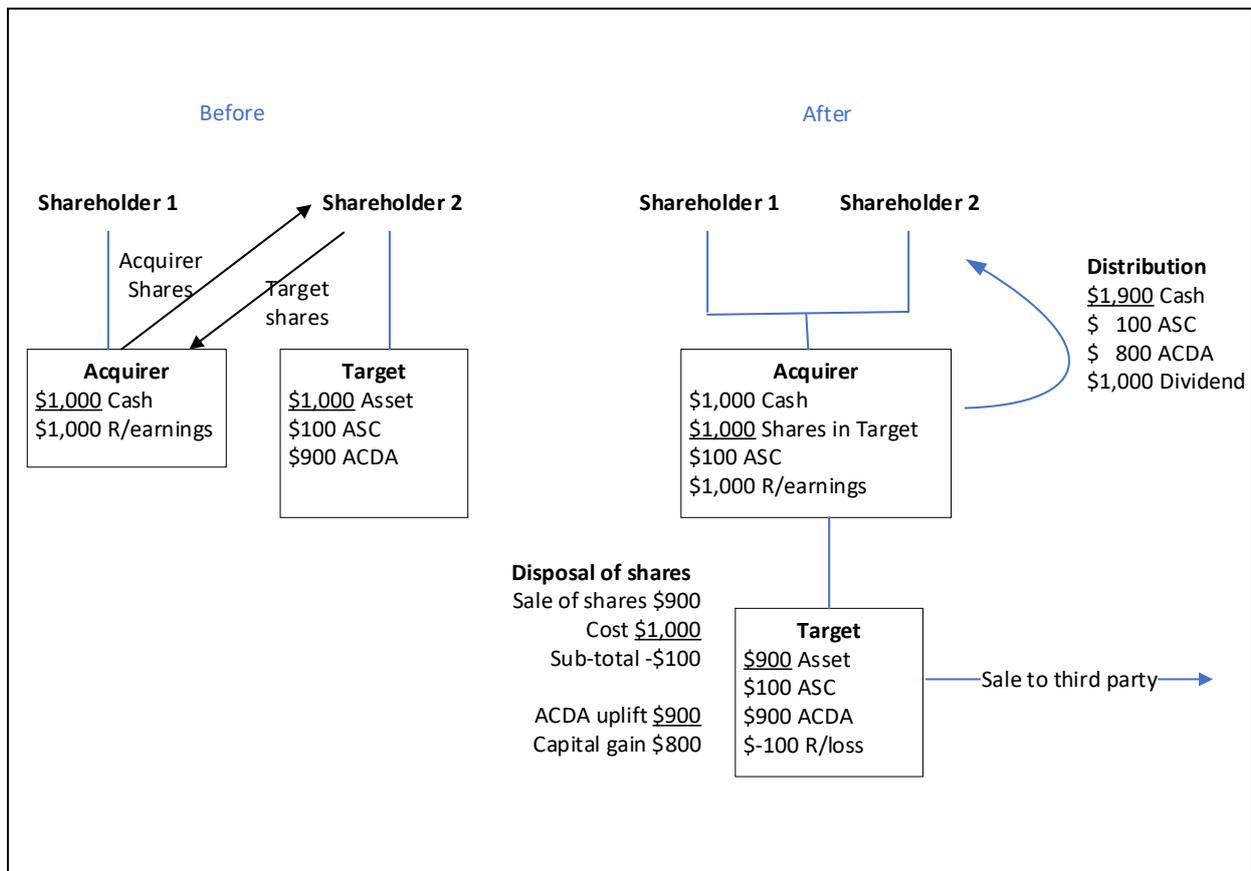
Submission

(KPMG)

Officials should confirm the intended effect of the proposed amendment if the value of the Target decreases.

Comment

The submission provides an example. We have amended this slightly to make it more consistent with example 29 in the Commentary to the Bill.



As shown in this diagram, under the proposed amendment, Acquirer makes a \$100 capital loss on the sale of Target shares for \$900 that were acquired for \$1,000; however, they also make an additional capital gain amount equal to the ASC limitation of \$900. When considered together, these amounts total to a capital gain of \$800. This is consistent with the result in the submitter's example.

Recommendation

That the submission be noted.

DEBT REMISSION WITHIN AN ECONOMIC GROUP

Clauses 50, 52, 53(2)–(3), 65, 80, 85 and 127(11), (14) and (15)

Issue: Support for proposed amendments

Submission

(Corporate Taxpayers Group, Deloitte, Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council, KPMG)

Submitters support the debt remission proposals. *(Corporate Taxpayers Group, Deloitte, KPMG)*

The submitter strongly supports the extension of the rule to remissions of debt owed by a New Zealand branch of a non-resident to a member of the non-resident's wholly-owned group. *(KPMG)*

The submitter supports the proposal that available subscribed capital that arises in a New Zealand resident borrower when a parent company remits a debt owed by the borrower is extended to include remission within a wholly owned group by a New Zealand resident parent. *(Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council)*

Recommendation

That the submissions be noted.

Issue: Amounts forgiven before the date of enactment

Submission

(Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council)

We seek confirmation that amounts forgiven within a wholly owned group before the date of enactment will result in an available subscribed capital (ASC) uplift if ASC is calculated after the date of enactment.

Comment

As introduced in the Bill, the proposed debt remission provisions would have applied to debt remitted after the date of enactment. This is because ASC arises when a transaction occurs, rather than at some later time when a taxpayer has a reason to calculate their ASC.

However, officials have reconsidered the application date of the proposed changes and consider they should apply to debt remitted on or after 30 March 2017. This is the date that sections CD 43(6B)-(6D), which provide for ASC upon a debt remission in other circumstances, were introduced by the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Act 2017.

Recommendation

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

EMPLOYER SUPERANNUATION CONTRIBUTION TAX ON CONTRIBUTIONS FOR PAST EMPLOYEES

Clause 115

Issue: Retrospective application of change in rate

Submission

(Deloitte, EY, Financial Services Council)

The proposed amendment to change the flat rate of employer superannuation contribution tax (ESCT) for contributions made for past employees to 33% should have an application date of 1 April 2021. This would ensure the reversal of any overtaxation that has occurred since the 39% personal tax rate was introduced.

Comment

The Taxation (Income Tax Rate and Other Amendments) Act 2020 increased the flat rate of ESCT that applies when employers make superannuation cash contributions for the benefit of a past employee from 33% to 39%. This was to mirror the new top personal income tax rate that was introduced by the same Act.

Limited data on ESCT contributions made for past employees was available to Inland Revenue at the time policy decisions on the 39% rate were taken and engagement with external stakeholders was not possible. The original rationale behind aligning the ESCT rate for past employees (and the rate for defined benefit schemes, where the employer chooses to) with the new top rate was that defined benefit schemes are generally legacy schemes no longer open to new employees and members tend to be on higher incomes compared with the standard population. In the absence of detailed information on such contributions, officials considered that not aligning the past employee ESCT rate with the top rate would create an integrity risk.

After receiving more recent data from the Workplace Savings Committee of the Financial Services Council, officials accepted that a 39% rate resulted in overtaxation in almost all cases and there was minimal integrity risk associated with reducing the rate to 33%.

We initially recommended this change apply proactively from 1 April 2022. This is the approach normally taken with changes to withholding taxes, because of potential issues with reopening periods. There are also risks associated with recommending a 1 April 2021 application date (for example, if the legislation does not pass and taxpayers have used the incorrect rate).

However, on balance we accept that a 1 April 2021 date should apply to remedy the full extent of overtaxation.

Recommendation

That the submission be accepted.

Issue: Contributions made to defined benefit scheme

Submission

(EY)

An additional amendment is necessary to ensure that employers who make contributions to defined benefit schemes can also use the 33% flat rate.

Comment

An additional amendment is not necessary. This is because, for contributions to a defined benefit scheme, employers can allocate contributions to a particular employee and use their correct personal rate. It is therefore appropriate for the option to elect the top personal income tax rate of 39% to be available.

Allowing employers to elect a 33% flat rate would pose an integrity risk where an employee to whom the contribution applies should be on the 39% rate.

Recommendation

That the submission be declined.

DEFINITION OF DECOMMISSIONING IN THE PETROLEUM MINING REGIME

Clause 127(4)

Issue: “Permanently” should not be inserted

Submission

(Chartered Accountants Australia and New Zealand, Corporate Taxpayers Group, Deloitte, Energy Resources Aotearoa, PwC)

The word “permanently” should not be inserted into the definition of “decommissioning”. It will have unintended consequences in the context of plugging and abandonment.

Comment

The intent of the proposed amendment is to ensure that the refundable tax credit for expenditure on decommissioning is not available for expenditure on wells that are only suspended with the possibility of being used again in the future. The refundable tax credit was always intended to be available for expenditure on permanently plugging and abandoning wells.

However, officials recognise that the steps required to permanently plug and abandon a well involve suspending a well first. In addition, decommissioning can take place over several income years. Therefore, under the proposed amendment, the refundable credit may not be available in years before the petroleum miner finishes the permanent plugging and abandoning of the well. This is not an intended outcome of the change, as it was always intended that the refundable credit be available each year that qualifying losses were incurred. Officials still intend that this credit is only for wells that are permanently plugged and abandoned. However, this must include wells that are intended to be permanently plugged and abandoned even if this process has not finished at the time the credit is calculated.

Recommendation

That the submission be accepted.

Issue: Removal of certain exploratory wells

Submission

(Corporate Taxpayers Group, Deloitte, Energy Resources Aotearoa)

The proposals will alter a petroleum miner’s economic decisions and behaviour regarding decommissioning, and tax costs should not be driving a petroleum miner’s decommissioning decisions.

A blanket removal of certain exploratory wells would have significant unintended implications for petroleum miners and deny eligible exploratory wells access to the tax credit. *(Energy Resources Aotearoa)*

Exploratory wells could instead be excluded from the tax credit if they are drilled toward the end of the field production life and there is insufficient subsequent income to cover the decommissioning costs of those wells. *(Energy Resources Aotearoa)*

Comment

The proposed amendments currently remove certain exploratory wells from the definition of decommissioning. These are wells that are plugged and abandoned in a permit area together with a commercial well geologically contiguous with the exploratory well. It has been determined that the phrase "geologically contiguous" may be wider than initially contemplated when the decommissioning definition was developed. This may result in expenditure on decommissioning some exploratory wells being eligible for the refundable tax credit in cases where that was not intended. The proposed amendment was intended to ensure that this was not the case.

Expenditure on drilling an exploratory well can be considered analogous to a business in another industry spending money developing a new product that may or may not be commercially successful. If this expenditure is incurred before, or while, the business is profitable, this expenditure will reduce the business's tax liability (either in the year incurred or as a loss brought forward). Expenditure on decommissioning an exploratory well can be deferred for commercial reasons much later than the expenditure on drilling that well in the first place. The refundable credit should be available to an exploratory well that could have been decommissioned while the miner was still profitable so that the decommissioning expenditure would reduce the tax liability in that year, even if the decommissioning was deferred for commercial reasons. Access to the refundable credit in this circumstance prevents the tax outcome influencing the commercial decision regarding when is most efficient to decommission the well.

Officials agree that the proposed amendment could be better targeted at the wells for which there are specific policy concerns. Officials agree with the suggestion to make expenditure on exploratory wells ineligible if the well is drilled toward the end of the field production life and there is insufficient subsequent income to cover decommissioning. This would be a better targeted approach to achieve the policy intent without providing a fossil fuel subsidy or support measure.

Recommendation

That the submission be accepted.

Issue: Decommissioning definition should not change

Submission

(Corporate Taxpayers Group, Deloitte, Energy Resources Aotearoa)

- a. Any concerns with the decommissioning definition as it relates to expenditure on certain exploratory wells being eligible for the tax credit should be addressed by amending the tax credit rules rather than the decommissioning definition.
- b. To ensure there are no unintended consequences relating to the deductibility of decommissioning expenditure, the definition of decommissioning should not be altered. *(Energy Resources Aotearoa)*

Comment

- a. Officials acknowledge the concern that there may be a difference in how the refundable credit operates for certain exploratory wells depending on where in the legislation the relevant rules are inserted. Amendments should be made to the refundable credit rules to bring back in scope the type of wells for which decommissioning expenditure was always intended to qualify for the refundable credit. These include wells that are drilled relatively early in a field's life but are decommissioned later for commercial reasons.

- b. Officials do not have concerns regarding the linkage between the decommissioning definition applying to exploratory wells and the deductibility of expenditure on decommissioning an exploratory well. Although the current proposed amendment would result in expenditure on certain exploratory wells no longer being deductible as decommissioning expenditure under section DT 16, that expenditure would still be deductible in the same period under the general rules for petroleum exploration expenditure. Section DT 1 provides a deduction for petroleum exploration expenditure, which includes expenditure on abandoning an exploratory well. Officials have discussed this with the submitter and understand they now agree that deductibility will not be affected.

Points of difference

- a. Officials agree with the submitter's proposal with the following adjustment. As a substantive rule, officials agree it is better to situate access to the refundable credit for qualifying exploratory wells within the provisions for the refundable credit rather than in the definition of decommissioning. However, as the current paragraph (b)(ii) of the decommissioning definition in section YA 1 of the Income Tax Act 2007 includes exploratory wells that are not intended to be within the scope of the refundable credit, it is recommended to continue with the proposed amendment to repeal paragraph (b)(ii), then add the qualifying exploratory wells back into the refundable credit provision, rather than cross-referencing to a subset of exploratory wells within the decommissioning definition.

Recommendation

- a. That the submission be accepted, subject to officials' comments.
- b. That the submission be declined.

Issue: Consequential amendment

Submission

(Matter raised by officials)

Repealing paragraph (b)(ii) of the definition of decommissioning in section YA 1 of the Income Tax Act 2007 leaves a redundant reference to exploratory wells in paragraph (d)(i). This reference to exploratory wells should be removed.

It was always intended that paragraph (d) simply covered monitoring of sites and wells that were included within the other paragraphs of the decommissioning definition, rather than having a wider scope (for example, monitoring all exploratory wells). As the proposed amendment removes all references to exploratory wells by repealing paragraph (b)(ii), the reference to exploratory wells in paragraph (d) will be made redundant. It is possible an exploratory well is also included within paragraph (b)(iii); however, the monitoring of these wells would still be included within paragraph (d) as an "other well referred to in paragraph (b)".

Recommendation

That the submission be accepted.

AMENDING MEMORANDUM ACCOUNTS WHEN MAKING TRANSFER FROM PREVIOUS YEARS

Clauses 98–107

Issue: Support for amendments to section OB 4

Submission

(Chartered Accountants Australia and New Zealand, Deloitte)

The submitters support the amendments to section OB 4.

The amendments will reduce compliance costs for taxpayers and administrative costs for Inland Revenue. *(Deloitte)*

Recommendation

That the submission be noted.

Issue: Amendment should be extended to tax purchases transferred to Inland Revenue from a tax pool

Submission

(Corporate Taxpayers Group, Deloitte)

The amendment to section OB 4 should be extended to tax purchases transferred to Inland Revenue from a tax pool.

Comment

Following discussions with officials, submitters now agree the proposed amendment as drafted addresses this issue.

Recommendation

That the submission be declined.

BUSINESS CONTINUITY TEST

Clauses 89B–89K

Issue: Support for proposed amendments

Submission

(Corporate Taxpayers Group, Deloitte, EY, Mayne Wetherell)

Submitters support the proposed amendments, although question whether some of the amendments are necessary.

Comment

Officials note that some of the amendments provide clarification where provisions could be interpreted differently than the policy intent. Whilst these existing sections can be read in line with the policy intent, officials consider that clarification is preferable for the avoidance of doubt.

Recommendation

That the submission be noted.

Issue: Drafting issue

Submission

(EY)

In proposed new section IP 1(1)(c), the reference to section IB 3(2)(b) and (c) should be changed to section IB 3(2)(b) and/or (c) to make it clear that only one of the subsections needs to be satisfied for subpart IP to apply.

Comment

Officials agree that the provision would be clearer using an “or” rather than “and” and will redraft the provision.

Recommendation

That the submission be accepted.

Issue: Taxpayers not in business

Submission

(PwC)

The business continuity test (BCT) should be extended to include companies that are not in business, such as a not-for-profit entity or a taxpayer that has deductible pre-commencement expenditure but is not yet in business.

Comment

Officials do not consider the BCT should be used to enable losses to be carried forward in either of the situations raised by the submitter. We consider that to allow the BCT to apply in those situations would increase the risk of taxpayers being able to trade tax losses.

Recommendation

That the submission be declined.

Issue: Deferred expenditure under the hybrid mismatch rules

Submission

(PwC)

The business continuity test (BCT) currently does not provide for deferred expenditure under the hybrid and branch mismatch rules contained in subpart FH to be carried forward provided the BCT is satisfied. These excess deductions should be able to be carried forward and used following a continuity of ownership breach if the requirements of the BCT have been met.

Comment

Officials consider that the current rules do permit deferred expenditure under the hybrid and branch mismatch rules to be carried forward if the taxpayer would meet the requirements of Part I of the Income Tax Act 2007 if they had a tax loss that would meet the BCT. We have discussed this with the submitter, and they concur with this interpretation.

Recommendation

That the submission be declined.

Issue: Clarify the definition of “group of companies”

Submission

(EY)

The definition of a “group of companies” in the business continuity test (BCT) rules should be restricted to New Zealand tax resident members of a group.

Comment

The BCT allows a company to carry forward tax losses to future years if they have a change in ownership provided there is no major change in the nature of the business activities of the company.

The BCT rules provide that companies purchased as a group are one company for the BCT. The current definition of “group of companies” can include non-resident companies that are not in the New Zealand tax base. This definition was intended to be restricted to New Zealand tax resident members of a group. Officials recommend an amendment to clarify that policy intent.

The proposed amendment should apply from the 2020–21 income year, when the BCT originally applied from.

Recommendation

That the submission be accepted.

Issue: Business continuity test for subsequent ownership changes

Submission

(Matter raised by officials)

Ensure a new business continuity period is created for subsequent changes in shareholding and pre-2020–21 tax losses.

When a company has an ownership breach, the business continuity test (BCT) will apply. For most companies, provided they do not have a major change (unless it is a permitted major change), they will be able to continue to carry forward losses. For most companies, they must not have a major change for five years after they apply the BCT.

The intention was that if a company had a subsequent breach in shareholding, the BCT period would be re-started for the new shareholders. Otherwise, it would be possible for a company to be purchased subsequently for the tax losses and the remainder of the business continuity period would simply run until its expiry. This was done for losses incurred in the 2020–21 and subsequent income years, but the rule does not work as intended for losses incurred before the 2020–21 income year.

Officials recommend an amendment to align the treatment for losses incurred before the 2020–21 income year with that for losses incurred in the 2020–21 and subsequent income years. The proposed amendment would apply from the 2020–21 income year, when the BCT originally applied from.

Recommendation

That the submission be accepted.

Issue: Measurement of ownership continuity

Submission

(Matter raised by officials)

The way in which shareholder continuity is determined for the business continuity test (BCT) should be modified for the purposes of the BCT to prevent minor changes in shareholding triggering a new business continuity period (BCP).

Continuity of ownership is counted from the date a loss is incurred to the date the loss is used or the business continuity period ends. For a company that is maintaining losses under the BCT, this may mean that small subsequent changes in shareholding may trigger a further business continuity period where there has been no breach in shareholding continuity.

Example 2: Existing position

Charlie and Keith own 52% and 48% of Watts Electrical Limited respectively. The company has tax losses. Charlie sells to Ron, which results in the BCP applying. Six months later, Keith sells to Mick. The continuity of ownership test measures the lowest percentages from the time the loss was incurred until the change in ownership. In this case, this means Charlie = 0, Keith = 0, Ron = 0 and Mick = 0. This would be a breach and reset the BCP. However, as Ron is still holding 52% of the shares and Keith is only selling 48% (a change of less than 49%), this should not be a breach and trigger a shareholding continuity issue.

Officials recommend that, for the BCT only, the rules should be modified to deem a purchasing shareholder to have owned their interest from the time the loss was incurred until the date of the next breach.

Example 3: Proposed change

Reconsidering Example 2 above, when Charlie sells to Ron, Ron would be deemed, for the purposes of the BCT only, to have held his 52% of the shares from the date the losses being carried forward under the BCT were incurred.

When Keith then sells to Mick, that will trigger Watts Electrical Limited to reassess whether it has breached continuity. In this case, the calculation will then be (with Ron being deemed to have held his shares from the date the loss subject to the BCT was incurred) Charlie = 0, Keith = 0, Ron = 52% and Mick = 0. This would not be a breach, nor reset the BCP.

Recommendation

That the submission be accepted.

Issue: Exclusion of mining companies**Submission**

(Matter raised by officials)

The exclusion of mining companies from the business continuity test (BCT) should be extended to losses incurred by mining companies from mineral mining.

Mining companies are excluded from the BCT on the basis that they have their own similar business test that allows them to carry forward losses for a particular mining permit despite a change in shareholding continuity. However, those losses cannot be used against other income unless shareholder continuity is maintained.

Technically a mining company that changes its business before a change in ownership will no longer be a mining company at the time of the change in ownership. This may allow that company to use the BCT. Given that the quantum of mining losses could be material, it could be beneficial for a company to change from being a mining company before a change in ownership and to maintain the alternate business for five years to utilise the tax losses.

Officials therefore recommend an amendment to exclude losses incurred by mining companies from mineral mining as an integrity measure. The proposed amendment would apply from the 2020–21 income year, when the BCT originally applied from.

Recommendation

That the submission be accepted.

Issue: Clarify the application of the permitted major changes

Submission

(Matter raised by officials)

The wording of the permitted major changes under the business continuity test (BCT) should be clarified to ensure they relate to business activities performed before the ownership change in the company.

The BCT allows companies to carry forward tax losses to future years if they have a change in ownership, provided there is no major change in the nature of the business activities of the company.

However, even if there is a major change, provided that major change fits within the permitted major changes in existing section IB 3(5), the company will still be able to carry forward its tax losses. There is a concern that several of the permitted major changes do not specifically refer to a business activity of the company that was undertaken before a shareholding breach, although this was the policy intent.

The policy intent behind the permitted major changes was to allow for growth and innovation within companies. However, it was not intended that they would also allow for new business activities (other than the pivoting scenario, which is dealt with separately in the legislation).

Officials therefore recommend an amendment to clarify this and ensure the permitted major changes relate to business activities carried on before the shareholding breach. The proposed amendment would apply from the 2020–21 income year, when the BCT originally applied from.

Recommendation

That the submission be accepted.

FBT – POOLED ALTERNATE RATE OPTION

Clauses 114B to 114E

Issue: Threshold should be simplified

Submission

(Corporate Taxpayers Group, Deloitte)

The proposed threshold for the new pooled alternate rate option of \$129,681 in all-inclusive pay should be amended to something that can be estimated with greater certainty. For example, consideration could be given to allowing employers to pay FBT at the rate of 49.25% on attributed benefits for employees receiving gross salary and wages of \$160,000 or less if the benefits provided to the employees are less than \$13,500 annually per employee.

Comment

Submitters note that the proposed new FBT calculation option may not represent much of a simplification for employers in cases where an employee earns less than, but close to, \$180,000 before tax. This is because the employer would need to calculate the employee's all-inclusive pay to determine if the employee is above or below the \$129,681 threshold.

In theory, it should be clear in most cases that a given employee is either above the threshold (because they earn more than \$180,000 in salary or wages before tax) or (more likely) below it (because they earn well below \$180,000 and do not receive significant fringe benefits, which is true of most employees). However, "all-inclusive pay"¹³ is not the most intuitive concept, and it may not be obvious to employers what the threshold is trying to achieve. As such, employers may struggle to determine whether a given employee is above or below the \$129,681 threshold (potentially even in some cases where the employee is in fact well below the threshold).

Officials agree the proposal could be simplified by using a clearly defined "safe harbour" threshold based on the amount of

- the employee's pre-tax salary or wages, and
- the benefits attributed to the employee

that together would be equivalent to \$129,680 in all-inclusive pay (rather than a threshold defined as a specific dollar amount of all-inclusive pay, as currently proposed).

Point of difference

Officials propose a safe harbour rule based on gross salary and wages of \$160,000 or less (as suggested by the submitters) but with a maximum allowable amount of attributed benefits of \$13,400 per employee (rather than \$13,500). This is because the all-inclusive

¹³ "All-inclusive pay" of an employee is calculated as the employee's after-tax cash pay plus the value of any fringe benefits received. Thus, the amount of all-inclusive pay at which the top FBT rate of 63.93% applies is determined by reference to the personal income tax rates and the income brackets at which these rates apply. This top FBT rate applies to employees with an all-inclusive pay of \$129,681 or more. This equates to an employee earning a before-tax salary of *more* than \$180,000 (and in some cases less than that amount, depending on the value of fringe benefits provided to the employee). FBT rates are based on the concept of all-inclusive pay, rather than monetary remuneration, because it is important to include the value of fringe benefits received when determining an employee's FBT rate – otherwise employers may be incentivised to provide fringe benefits instead of cash remuneration to employees earning near the personal income tax brackets.

pay of someone who earns \$160,000 before tax and receives attributed benefits to the value of \$13,400 is \$129,680.

Officials further recommend that employers still be allowed to choose to pay FBT at the rate of 49.25% on benefits attributed to employees receiving all-inclusive pay below \$129,681, even if the employee earns over the \$160,000 safe harbour threshold detailed above. This would ensure that employers with employees earning between \$160,000 and \$180,000 but who receive only relatively modest fringe benefits (such that the employees each receive less than \$129,681 in all-inclusive pay) can pay FBT at the lower 49.25% rate on benefits attributed to those employees.

Recommendation

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

Issue: Treatment of non-attributed benefits provided to major shareholders

Submission

(Chartered Accountants Australia and New Zealand)

Employers should be allowed to pay FBT at the 49.25% rate on non-attributed benefits provided to employees who are major shareholders if those employees receive less than \$129,681 in all-inclusive pay.

Comment

Most fringe benefits that employers provide to their employees are required to be attributed to the individual employee receiving the benefit when calculating the employer's FBT liability. Other fringe benefits (referred to as non-attributed benefits) must be pooled. FBT is required to be paid at the top rate (currently 63.93%) on non-attributed benefits provided to employees who are major shareholders or to persons associated with an employee who is a major shareholder. FBT is paid at the second-highest FBT rate (currently 49.25%) on non-attributed benefits provided to all other employees.

The requirement to pay FBT at the top rate on non-attributed benefits provided to employees who are major shareholders is a long-standing policy setting. This setting is in recognition of the control that such major shareholders are likely to have in determining the respective levels of salary, fringe benefits and dividends they receive from their companies. This control gives them the ability to substitute between different forms of remuneration or income subject to different taxation regimes.

The proposed new pooled alternate rate option is intended to simplify the calculation of FBT on **attributed** benefits, which include most fringe benefits provided to employees. The new option would allow employers to pay FBT on attributed benefits at the second-highest rate for most employees. This would mean employers would not have to pay FBT at the top rate on all attributed benefits (including on those provided to employees earning well below \$180,000 before tax) or otherwise perform complex calculations for each individual employee. The intention of the proposal is not to change the policy settings for **non-attributed** benefits. As a category distinct from attributed benefits, officials consider the current policy settings for non-attributed benefits are appropriate.

Recommendation

That the submission be declined.

OTHER ISSUES

Issue: Donations of trading stock to charities

Submission

(Jim Gordon Tax Limited)

The tax law should be amended so that the changes to the trading stock rules implemented in response to COVID-19 are a permanent part of the Income Tax Act 2007.

Comment

As a COVID-19 response measure, the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 introduced an exclusion from the deemed income rule in the Income Tax Act 2007 for donations of trading stock in certain circumstances.

This exclusion ensures businesses donating trading stock are not taxed on the market value of any donation (for example, when businesses donate food to food banks or face masks to hospitals).

This exclusion is for a limited period (from March 2020 to March 2022) with the ability to extend that period by Order in Council. Officials are currently progressing a 12-month extension to March 2023.

Officials note it is intended to progress a permanent solution to the donated trading stock rules in 2022. However, further work on this matter will require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Definition of "capital contribution"

Submission

(Russell McVeagh)

The term "capital contribution" is defined in section CC 1B. However, there is no reference to section CC 1B in the definition of "capital contribution" in section YA 1. It should be clarified that paragraph (a) of the definition of "capital contribution" in section YA 1 applies for the purposes of section CC 1B.

Recommendation

That the submission be accepted.

Issue: Tax rate for ACC lump sum payments

Submission

(Baucher Consulting Limited)

Backdated weekly ACC payments should be taxed at the claimant's average tax rate for the year before the year of claim.

The current tax treatment of the payment of backdated ACC weekly compensation is inequitable and can result in a lump sum payment being taxed at higher rates than would have been the case if the weekly compensation payments had been paid when originally due.

The Income Tax Act 2007 should be amended to tax payments of backdated weekly ACC compensation at the claimant's average income tax rate for the income year before the income year in which the claim resulting in the backdated compensation was first lodged.

Comment

Officials acknowledge the matter raised by the submitter. However, further work on the matter would require prioritising and resourcing as part of the Government's tax policy work programme.

Recommendation

That the submission be declined.

Issue: Remedial amendment for PIE losses

Submission

(BDO, Bruce Lay)

A remedial amendment to section DB 53(1)(b) of the Income Tax Act 2007 is required.

Section DB 53(1)(b) was replaced by the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021. The previous version of paragraph (b) limited a deduction for a PIE loss to zero-rated investors and certain exiting investors. However, the new wording has the unintended effect of expanding the scope of the provision when section HM 36B does not apply (that is, when the investor is not a natural person). This should be corrected.

Comment

Officials do not consider that the wording change has expanded the ability to use PIE tax losses, as an investor still needs to satisfy section HM 40 and the criteria for claiming a loss in section HM 40 have not changed. Therefore, although section DB 53(1)(b) and section HM 40 do not interact in the way they should (that is, if you satisfy section HM 40 you get a loss under section DB 53(1)(b)), a taxpayer's entitlement to a deduction for a loss for their PIE income is not altered because the criteria in section HM 40 remain the same.

Point of difference

However, officials agree the wording should be aligned and have discussed and agreed with the submitter that this will be done in a future tax Bill, subject to government priorities.

Recommendation

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

Issue: Racing entities income tax exemption

Submission

(Deloitte)

Consistent with other racing organisations (the Racing Codes and TAB NZ), the Racing Integrity Board should be exempt from income tax.

The Racing Integrity Board is an independent statutory body established by the Racing Industry Act 2020 (RIA) to regulate aspects of the activities of the Racing Codes, which are each statutorily exempt from income tax under section CW 47 of the Income Tax Act 2007 (ITA). There is no clear reason why the Racing Integrity Board should be subject to income tax and the compliance costs of being a filing taxpayer and determining a tax filing position.

Comment

Officials agree with the submission and note that similar issues also arise for Racing New Zealand. The Racing Industry Act 2020 created these two new organisations, the Racing Integrity Board and Racing New Zealand, but overlooked the income tax treatment of these new entities. TAB NZ and the three Racing Codes are listed as being exempt from income tax under section CW 47.

Point of difference

The income tax exemption in section CW 47 of the ITA should be updated to include references to both Racing New Zealand and the Racing Integrity Board.

Recommendation

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

Issue: Depreciation treatment of grandparented structures

Submission

(BDO)

The definitions of "building" and "grandparented structure" in the Income Tax Act 2007 should be reinstated to enable a deduction to be claimed for the loss on disposal of a "grandparented structure".

Comment

Inland Revenue's interpretation statement [IS 10/02](#): "Meaning of 'building' in the depreciation provisions", which applies from 30 July 2009, brought within the definition of "building" certain items that were previously "structures", such as barns, carpark buildings and site huts. This changed the way these were treated for tax depreciation purposes.

Buildings were subject to a 0% depreciation rate from 2010. However, the structures affected by IS 10/02 were grandfathered to preserve their depreciation treatment. To facilitate this grandfathering, the definition of “building” did not include these affected structures.

The definitions of “building” and “grandparented structure” were repealed by the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 as part of the reinstatement of depreciation on non-residential buildings. This means that grandfathered structures are now buildings for the Income Tax Act and are no longer eligible for depreciation deductions for loss on disposal. This was not intended.

Point of difference

Officials consider the reinstatement of deductions for loss on disposal of a grandfathered structure can be achieved without reinstating the definition of “building”. Instead, officials propose to reinstate the definition of “grandparented structure” and provide that section EE 48(3) does not apply to grandfathered structures. Section EE 48(3) prevents a deduction for loss on disposal for buildings, except in very narrow circumstances.

Recommendation

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

Issue: Alignment of ICA provisions relating to tax pooling

Submission

(Matter raised by officials)

The wording in the imputation rules between individual companies and consolidated imputation groups for the transfer of tax pooling funds should be aligned to make them consistent.

In 2009, a remedial amendment was made to the imputation rules for individual companies to correct a rewrite issue relating to tax pooling.

The imputation rules for individual companies are replicated almost identically for consolidated imputation groups. However, the 2009 amendment to the individual company imputation rules was not replicated in the consolidated imputation group rules. The proposed amendment will correct this and realign the rules.

Recommendation

That the submission be accepted.

Other remedials

EXTENDING USE OF MONEY INTEREST RELIEF DURING COVID-19

Clause 169

Issue: Support for proposed amendment

Submission

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

General support for the proposed amendment.

Recommendation

That the submission be noted.

Issue: Relief should be broader

Submission

(Matter raised by officials)

Given the restrictions brought on by COVID-19 in the second half of 2021, further use of money interest (UOMI) relief measures should be allowed for provisional taxpayers that are significantly adversely affected in their ability to make a reasonably accurate forecast of their residual income tax.

The existing amendments in the Bill increase the scope of relief available for taxpayers for some, but not all, types of UOMI. A taxpayer may choose to revise their estimate of their residual income tax downward due to anticipating that COVID-19 will obstruct their trading, allowing them to pay less provisional tax during the year. However, if the taxpayer makes an inaccurate forecast and revises their estimate down too far, they will be charged with UOMI because of underpaying amounts at provisional tax dates relative to what their ultimate residual income tax liability is. Situations like these are not within the scope of the proposed amendments as currently drafted.

Legislation was enacted in August 2020 to allow remission of UOMI charged in this situation as it was not covered by the general COVID-19 UOMI remission rules. This relief is currently available for UOMI charged on residual income tax payable for the 2020–21 tax year. Owing to the recent COVID-19 Alert Level changes, officials consider that this relief should also be available for the 2021–22 tax year.

Recommendation

That the submission be accepted.

USE OF MONEY INTEREST RELIEF DURING EMERGENCY EVENTS

Issue: Eligibility test

Submission

(Matter raised by officials)

The existing eligibility test for remission of use of money interest (UOMI) under the emergency events provisions requires that an emergency event “physically prevents” a taxpayer from making a payment of tax on time.

When UOMI remission rules were developed in response to the economic impact of COVID-19, a new eligibility test was introduced. Under that test, UOMI remission is allowed if the taxpayer is “significantly adversely affected” by COVID-19 in their ability to make a payment of tax on time. This wider test allows remission for a broader range of reasons, including being physically prevented from being able to pay tax or being financially affected by COVID-19.

Officials now consider that the broader test for COVID-19 should be applied to the emergency events rules. This would mean that a taxpayer can receive UOMI remission in response to an event like a flood or earthquake if the event significantly adversely affects the taxpayer’s ability to make a tax payment on time.

Recommendation

That the submission be accepted.

Issue: Revised estimate of residual income tax too low

Submission

(Matter raised by officials)

Use of money interest (UOMI) remission during emergency events is allowed if a taxpayer has not made a payment required by a tax law on or before the due date for the payment.

When an equivalent measure was introduced for COVID-19, it was determined that this did not cover situations where a taxpayer had underpaid their provisional tax instalments at a due date because they had revised their estimate of their residual income tax liability down to pay less tax but had revised it down too far. Revising an estimate may be justified when a provisional taxpayer genuinely expects their income to fall during the year, but it was recognised that taxpayers may face difficulties in accurately revising their estimate. Legislation was later enacted to ensure that UOMI charged in this situation could also be remitted. (See also [“Issue: Relief should be broader”](#).)

No equivalent provision exists for emergency events; UOMI remission for this reason is only available for COVID-19. Officials consider that UOMI remission should also be allowed when an emergency event significantly adversely affects a provisional taxpayer’s ability to forecast their residual income tax reasonably accurately.

Recommendation

That the submission be accepted.

INVESTMENT INCOME INFORMATION – ALIGNING FILING AND PAYMENT DATE FOR SIX-MONTHLY PAYERS OF INVESTMENT INCOME

Clause 141

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

Submitter supports the proposal to align the filing and payment date for six-monthly payers of investment income.

Recommendation

That the submission be noted.

NON-ACTIVE ESTATES RETURN FILING

Clause 143

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia New Zealand, KPMG)

The submitters support the amendment.

Recommendation

That the submission be noted.

Issue: Application date

Submission

(Deloitte)

The submitter supports the proposed amendment but believes the amendment should apply from 1 April 2021. Given tax returns for the 2021–2022 income year are not due until 7 July 2022, which is after the likely date of enactment of the Bill, making the application date 1 April 2021 would reduce compliance costs for non-active estates.

Comment

The proposed date of application of 1 April 2022 allows Inland Revenue to implement the system and administrative changes necessary. Bringing this date forward to 1 April 2021 would make it administratively challenging to implement the change in time.

Recommendation

That the submission be declined.

REPEAL OF INFORMATION-SHARING CLAUSES FOR ACC AND THE REGISTRAR OF COMPANIES BY AN ORDER IN COUNCIL

Clause 173(2) and (3)

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposed amendments.

Recommendation

That the submission be noted.

Issue: Application date

Submission

(Regulations Review Committee)

That the Committee consider whether the clauses should be enacted with a fall-back commencement date or whether the amendments could be enacted once the approved information sharing agreements (AISAs) are closer to coming into force.

The submitter usually takes the position that, where commencement of a provision is by Order in Council, the clause should also include a date whereby the Bill or provision will come into force automatically (fall-back date). This ensures the Bill comes into force as Parliament intended and in a timely manner.

Comment

Inland Revenue is developing AISAs with the Accident Compensation Corporation (ACC) and the Ministry of Business, Innovation, and Employment (MBIE). The two AISAs will replace existing information-sharing provisions in the Tax Administration Act 1994, and the proposed amendments will repeal the related provisions once the AISAs are in force.

The Privacy Act 2020 requires that, before recommending the making of an Order in Council, the relevant Minister must be satisfied that, among other things, any potential conflicts or inconsistencies between the sharing of personal information under an AISA and any other enactment have been identified and appropriately addressed. If primary legislation was in force at the same time, it would result in a conflict and would mean part of the AISA would not be operational until the conflict was resolved.

Officials consider that having a fall-back date is not appropriate in this instance. Having a fall-back date is appropriate when legislation is being brought into force. However, in this situation, legislation is being repealed from a date to be specified by Order in Council.

Officials have reconsidered whether both amendments should be enacted now or whether, as suggested by the submitter, the amendments should be enacted when the AISAs are closer to coming into force.

Point of difference

The MBIE AISA is progressing well and is likely to come into force in 2022. The amendment should therefore remain in the current Bill.

Officials have discussed the AISA with ACC and they have advised that, due to other work commitments, the AISA is not likely to apply until 2023. Due to this delay, officials recommend the amendment relating to the ACC AISA be removed from the current Bill and included in the next available taxation Bill.

Recommendation

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

COMMISSIONER'S REMEDIAL POWERS – DISPUTABLE DECISIONS

Clause 155(1)

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to clarify that decisions of the Commissioner using the remedial powers are not subject to the disputes and challenge procedures of the Tax Administration Act 1994.

Recommendation

That the submission be noted.

CHALLENGE NOTICES – WHETHER REQUIRED AFTER AMENDED ASSESSMENT ISSUED

Clause 148

Issue: Support for proposed amendment

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the proposal to clarify the Commissioner is not required to issue a challenge notice if, following completion of the disputes process, the Commissioner issues an amended assessment that reflects some, but not all, of the proposed adjustments.

Recommendation

That the submission be noted.

REMOVING FAX AS A MODE OF COMMUNICATION

Clauses 41, 128, 136, 137, 138, 199 and 200

Issue: Support for proposed amendments

Submission

(Chartered Accountants Australia and New Zealand)

The submitter supports the amendments.

Recommendation

That the submission be noted.

Issue: Application date

Submission

(Deloitte)

The amendments should apply retrospectively from 1 August 2021, as faxes were no longer supported from 1 August 2021.

Comment

Officials considered applying the amendment from 1 August 2021. However, there is a general presumption in law against retrospective legislation. Officials decided, on balance, that the amendments should apply once the Bill is enacted. This allows tolerance for any interim communication arrangements made throughout the transition period away from faxes.

Recommendation

That the submission be declined.

R&D TAX INCENTIVE – EXTENSION OF DUE DATES

Clauses 142 and 145

Issue: Support for proposed amendments

Submission

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

General support for the proposed amendments.

Recommendation

That the submission be noted.

Issue: Extension for criteria and methodologies applications

Submission

(KPMG)

A further six-month extension is required for applications for criteria and methodologies approval to mitigate the need for R&D-performing businesses to also submit a general approval application for the same activities.

Comment

For the purposes of the R&D Tax Incentive, significant performers of R&D may have their activities approved through either a general approval (GA) application or through a criteria and methodologies (CAM) application. CAM applications require the applicant to submit information on the processes the business uses to meet R&D standards. This can allow a range of activities to be covered, which may be preferable to filing multiple GA applications. If a CAM application was intended to cover a certain activity but is declined, the applicant can still seek approval of the activity through the GA process.

However, significant performers run the risk that they may be notified their CAM application has been declined too late to have enough time to prepare a GA application. To mitigate this risk, some businesses are filing both CAM and GA applications for the same activities.

Officials agree that an extension of the GA application date, contingent on the business filing a CAM application on time but not having been notified of the outcome as the GA application deadline approaches, would be desirable. This is because such an extension would reduce compliance costs for businesses because they would not have to file two applications for the same activities. It would also reduce administrative costs, as Callaghan Innovation and Inland Revenue would not have to process multiple applications for the same activities.

Points of difference

Officials agree with the submitter's proposal with the following adjustments:

- Officials recommend that a three-month extension be allowed rather than the suggested six-month extension.

- Officials recommend that the extension period is determined from the date the applicant has been notified of the outcome of their CAM application, rather than from the ordinary GA application due date. If the extended date would fall earlier than the ordinary GA application due date, then no extension is necessary.

Recommendation

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

R&D TAX INCENTIVE – TAX YEAR CUT-OFF FOR CLAIMING SUPPORTING ACTIVITIES

Clauses 92 and 144

Issue: Support for proposed amendments

Submission

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

General support for the proposed amendment.

Recommendation

That the submission be noted.

Issue: Year supporting activity occurs

Submission

(EY)

- a. An R&D activity must be approved under the Tax Administration Act 1994 (TAA) to be able to claim the R&D Tax Incentive. This requirement must also be satisfied for any supporting activity made eligible because of this amendment. To achieve this, the proposed provisions must be amended to provide that supporting activity in the year immediately before or after the year of the core activity is deemed to occur in the year the core activity was conducted.
- b. Despite the deeming rule proposed in a. above, for applicants in the significant performer regime, R&D expenditure should be included in the year it is incurred rather than deemed to occur in the year of the core activity.

Comment

- a. Officials consider that deeming supporting activity to occur in the year of the corresponding core activity is not required to achieve the desired outcome. Sections 68CB(2) and 68CC(3) of the TAA already permit approval of R&D activities in years outside of the income year.
- b. Given that officials recommend that the substantive suggestion in a. above be declined, consideration of this submission is not necessary.

Recommendation

- a. That the submission be declined.
 - b. That the submission be declined.
-

Issue: Supporting activity in additional years

Submission

(PwC)

Supporting activity should be allowed in income years beyond the year either side of the related core activity. The proposed period of one year either side of the related core activity for claiming supporting activity does not reflect R&D in practice and should be extended. Businesses should be required to state the estimated timeframes of their activities with no time limits.

Comment

Officials agree that, in some cases, expenditure on supporting activities may be incurred in relation to a core activity outside the permitted period of one income year either side. However, on average, the link between a supporting activity and a core activity becomes weaker as the period between those two activities increases. Officials consider that allowing supporting activity in the year immediately before and after the core activity is a balanced period for maintaining the integrity of the R&D Tax Incentive regime.

Recommendation

That the submission be declined.

Issue: Multi-year approvals

Submission

(Matter raised by officials)

A further amendment is needed to ensure that multi-year approvals, which can include up to two further years, apply from the initial income year of the core activity, rather than from the year of the supporting activity in the year before the core activity.

The current proposed amendment is intended to allow expenditure on supporting activities that take place in the year before the corresponding core activity to be eligible for the R&D Tax Incentive. The legislation should therefore recognise that, for some applicants, the amendment will bring an extra year of R&D activities into a general approval application or criteria and methodologies approval application. A consequential amendment is needed to ensure the additional year can be included in those applications under the Tax Administration Act 1994.

Recommendation

That the submission be accepted.

R&D TAX INCENTIVE – TRANSITIONAL SUPPORT PAYMENT

Clauses 56, 64 and 132

Issue: Support for proposed amendments

Submission

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

General support for the proposed amendments.

Recommendation

That the submission be noted.

ADMINISTRATIVE AMENDMENTS TO THE CHILD SUPPORT ACT 1991

Clauses 175–186

Issue: Time bar exclusion for administrative reviews

Submission

(Matter raised by officials)

An additional exception to the time bar is needed for administrative reviews to be reflected in an assessment that relates to a time-barred period.

The Child Support Amendment Act 2021 (the Amendment Act) introduced a four-year time bar to reassessments of child support that applies following the end of a child support year. The time bar means that, after the four-year period, changes to the assessment cannot occur, subject to specified exceptions. The time bar provides more certainty for parents and reduces administration costs, while balancing equity concerns through specified exceptions.

One of the key factors in calculating child support is each parent’s income. The Child Support Act 1991 (the Principal Act) allows a person’s special circumstances that affect the formula assessment, such as their unexpected costs, to be considered through an administrative review process.

In most cases, the time bar prevents a person from applying for an administrative review of the time-barred period. The Amendment Act introduced a four-month exception to this, which allows a person to apply for an administrative review of an assessment that relates to a time-barred period. The application must be received by Inland Revenue within four months of the date of the latest notice of assessment. This ensures that a parent will have a short window to apply for an administrative review, while maintaining the policy intent of the time bar. If a departure from the formula assessment is granted under the Principal Act, the intention is to allow the time-barred period to be reassessed. However, the current exclusions to the time bar in the Principal Act do not allow successful administrative reviews under this provision to then be reflected in a child support assessment.

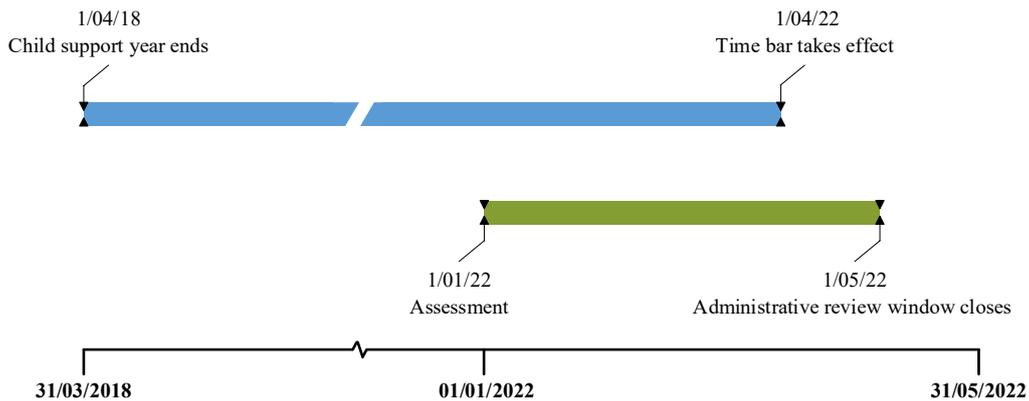
Example 4

On 1 January 2022 Inland Revenue notifies Caoimhe of an assessment for the child support year from 1 April 2017 to 31 March 2018. The assessment is dated three months before the period will become time barred (1 April 2022).

Caoimhe has four months from 1 January (the date she was notified by Inland Revenue) to apply for an administrative review. That is, she could apply for an administrative review up until 30 April 2022 (one month after the period has become subject to the time bar).

However, even if her administrative review is successful, there is no exception to the time bar that allows the time-barred period to be reassessed after 1 April 2022.

Figure 2



The specified exceptions to the time bar, such as if a court order is received for the time-barred period, are listed in the Principal Act. However, this list does not include an exception to the time bar for administrative reviews that occur within the four-month window. This means that an administrative review successfully applied for under the four-month exception cannot be applied to time-barred assessments as intended.

An additional exception to the time bar is needed to allow for administrative reviews that are received within the four-month window. This would ensure that the policy intent can be achieved, that is, to provide a limited period for reassessments.

Recommendation

That the submission be accepted.

Issue: Clarification of the definition of “reconciliation period”

Submission

(Matter raised by officials)

An additional amendment is required to the proposed amendment to the definition of “reconciliation period” to ensure it operates correctly when Inland Revenue receives a backdated estimation that spans multiple child support years.

The income used in child support assessments is based upon earlier periods. If a parent believes their income will be lower than the amount used in their child support assessment,

they may estimate their income. An estimate can be made for the whole child support year or at any time during the child support year (this is referred to as an election period). At the end of the child support year, the estimate is reconciled with the amount earned.

The Amendment Act introduced a "reconciliation period" to ensure that if a parent estimates their income, the income used for the end-of-year reconciliation accurately reflects what has been earned over the period the estimate applies to. The reconciliation period applies from the start of the month in which notice of an election is given until the day before the next election. If there is only one estimate, or if it is the last estimate in the year, the reconciliation period is from the start of the month in which notice of an election is given until the end of the child support year.

The definition of "reconciliation period" is tied to the first day of the month in which notice of an election is given. However, this does not work with the new backdated estimations introduced by the Amendment Act. These estimations allow a person to make an election after the end of the child support year to which the election relates, provided Inland Revenue receives the estimation within 28 days of the notification of assessment. Because these estimations are backdated, notice would be given after the start date of the assessment.

Therefore, an amendment is proposed to the definition of "reconciliation period" to allow backdated estimations to be squared up accurately. The proposed amendment provides that a reconciliation period will start on the first day of the month in which the formula assessment begins. This ensures the reconciliation period will not start too late to cover the correct period.

However, the proposed amendment does not work in cases where Inland Revenue receives a backdated estimation that spans multiple child support years. This is because, when multiple years are involved, the estimation for the second year onwards would be applied from the start of the child support assessment, which could be part way through the year, rather than from the start of the child support year. In those cases, where a backdated estimation for multiple years is involved, the definition should apply to the first day of the child support year. This could occur, for example, when a parent receives their notice late.

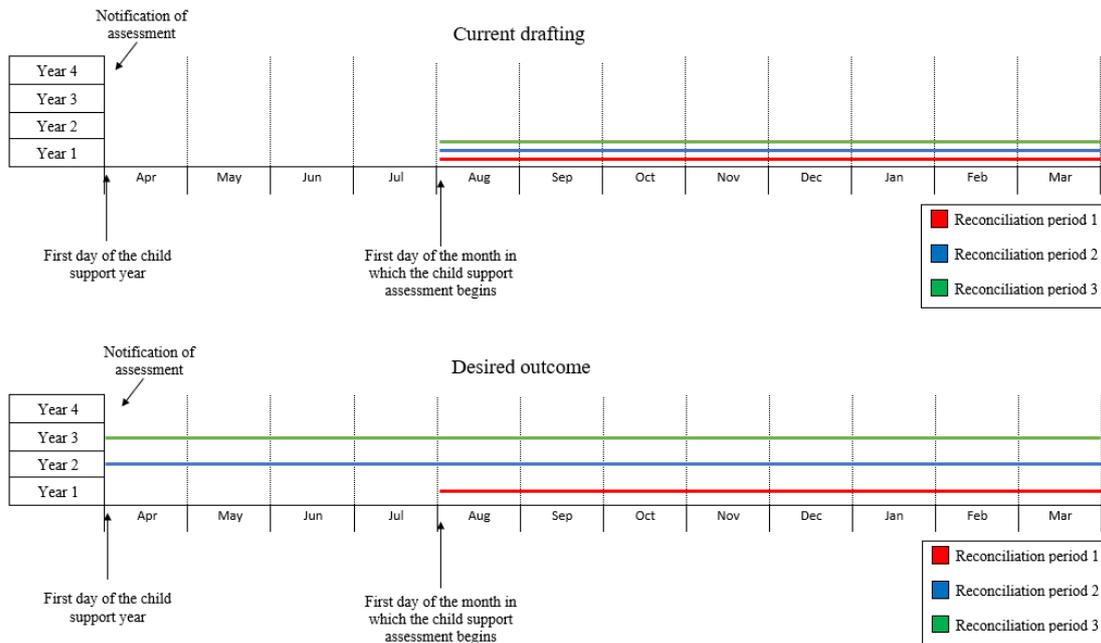
Example 5

Hubert is a newly liable parent. On 1 April (Year 4), he is notified of his child support assessment. However, the relevant child support assessment begins on 1 August (Year 1). This delay is because a backdated parenting order has taken place, and Hubert has only just been confirmed as the liable parent of his daughter Kim.

Hubert is entitled to make a backdated estimation to the start date of the new assessment, provided it is received within 28 days of the notification of the assessment. In early April (Year 4), he makes backdated estimations covering multiple child support years. These assessments will be squared up using the reconciliation rules.

Currently the drafting refers to the first day of the month in which the formula assessment begins. This means the start date for the reconciliation periods for Years 2 and 3 are incorrect. The start date should instead refer to the first day of the child support year.

Figure 3



An amendment is needed to allow for consistency between the definitions of “election period” and “reconciliation period” relating to new backdated estimations. This will provide for an accurate reconciliation of these estimations.

Recommendation

That the submission be accepted.

Issue: Additional transitional provision for reconciliations

Submission

(Matter raised by officials)

A new transitional provision is required that allows the old reconciliation rules to be used for estimations made for child support years before 1 April 2022.

The Amendment Act introduced a transitional provision to the Principal Act. The provision has the effect that the Principal Act applies as it was enacted, before any amendments made under the Amendment Act, for financial support for child support years before 1 April 2021.

The current Bill proposes the repeal of this provision. This is because it is unnecessary and may result in some difficulty with the application of certain amendments to the Principal Act. For example, it would limit the retrospectivity of new backdated estimations and their subsequent reconciliations.

However, in removing the provision, any reconciliations made by Inland Revenue must use the new rules, including when the reconciliation is for a child support year before 1 April 2022. This means Inland Revenue would be required to use rules that do not work for a particular year because of, for example, changes to the child support assessment formula.

Officials therefore recommend the introduction of a transitional provision that allows the old reconciliation rules to be used for the earlier child support years in which they apply.

Recommendation

That the submission be accepted.

Issue: Correction to the reference to “taxable income:

Submission

(Matter raised by officials)

The Amendment Act has amended the definition of “income” used for child support purposes to better reflect a parent’s financial capacity to pay child support by incorporating investment income and no longer offsetting losses from earlier years. References to “taxable income” in the Child Support Act will be replaced with references to this broader definition of “income” from 1 April 2022.

However, an amendment, which has not yet entered into force, refers to “taxable income”. As this amendment comes into force at the same time as the new “income” definition, it is uncertain whether the reference in the amendment will be updated.

An amendment is needed to ensure the new definition is used.

Recommendation

That the submission be accepted.

Issue: Application dates

Submission

(Matter raised by officials)

The application dates for the proposed amendments to the Principal Act should be amended to be consistent with the application date of the Amendment Act.

When the Amendment Act was introduced, it was intended that the child support scheme would move to Inland Revenue’s START system in April 2021. However, due to COVID-19, this move was delayed until the second half of 2021. Because of this delay, the

commencement dates of many of the proposals in the Amendment Act were changed to 1 April 2022 or an earlier date as set by Order in Council.

The Child Support Amendment Act 2021 Commencement Order 2021 moved the commencement dates of several amendments to 26 October 2021 to align with the START transfer. Where appropriate, the application dates for the proposed amendments should be amended to be consistent with that Order.

The proposed amendment to the penalty rules should apply from 1 April 2021 to align with the simplification of penalty definitions under the Amendment Act.

Recommendation

That the submission be accepted.

DEFINITIONS OF “SENSITIVE REVENUE INFORMATION” AND “REVENUE INFORMATION”

Clause 139

Issue: Support for proposed amendment

Submission

(Corporate Taxpayers Group, Deloitte)

The submitters support the proposed amendment.

Recommendation

That the submission be noted.

Issue: Amendment too broad

Submission

(Chartered Accountants Australia and New Zealand)

The wording of proposed s 16C(3)(c) of the Tax Administration Act 1994 should be changed. It is too broad and does not achieve its purpose. Nothing in the proposed wording prevents the Commissioner from releasing information capable of being used to identify a person or entity.

Comment

The amendment is to avoid the potential for a court to interpret the definition as restricting Inland Revenue from disclosing routine information that other government agencies would release. Officials consider the amendment clarifies this and does not change the current protections that keep taxpayer information confidential.

Recommendation

That the submission be declined.

Issue: Purpose of the amendment

Submission

(KPMG)

The need for the amendment is overstated and ignores the policy intent of the most recent amendments to the secrecy rules. However, it is likely to be more efficient to amend the Act than to leave the issue open.

Comment

When responding to requests under the Official Information Act, the legal department of Inland Revenue has raised concerns with phrases in section 16C of the Tax Administration Act 1994.

The phrase "information relating to the affairs of a person or entity" could include all the information the Commissioner holds, which would prevent routine information from being disclosed. This would run counter to the purpose of modernising the confidentiality rules, which was to enable more information held by Inland Revenue to be made available. The amendment does not have any impact on taxpayer information, which is required to be kept confidential.

Recommendation

That the submission be noted.

AMENDING AND LATER REPEALING THE DEFINITION OF "START TAX TYPE"

Clauses 135(6) and (7) and 170

Issue: Support for proposed amendments

Submission

(Chartered Accountants Australia and New Zealand)

We support the proposed amendments to amend and later repeal the definition of "START tax type".

Recommendation

That the submission be noted.

ACC AND KIWISAVER BEING MADE SUBJECT TO A TIME BAR

Clauses 146, 147, 149–151, 154, 156, 189–191, and 193–197

Issue: Support for proposed amendment

Submission

(Corporate Taxpayers Group, Deloitte, KPMG)

Submitters support the proposed amendment

Recommendation

That the submission be noted.

Issue: Treating KiwiSaver deductions like other PAYE deductions

Submission

(Financial Services Council)

The proposed treatment is not appropriate for KiwiSaver contributions. There should be consistency between different types of employee entitlements, rather than with the treatment of PAYE deductions, for limitation periods. Alternatively, any time bar should not apply where an employer electively wishes to make remediation payments for shortfalls outside the proposed time bar period.

Although KiwiSaver contributions are administered through the tax system, those contributions are employee entitlements analogous to salary and wages, and therefore, the ordinary limitation period principles should apply in the case of error remediation (for example, for Holidays Act 2003 remediation and addressing wages shortfalls).

Employers should also be able to make voluntary remediation payments for employer contribution shortfalls that may not come to light for a long period. Under the proposed amendments, employers would be prohibited from doing so if it was outside the time bar period.

Comment

Officials disagree. Introducing a time bar on assessments for KiwiSaver contributions will improve consistency and certainty for taxpayers, fund providers, and Inland Revenue, and will represent an overall strengthening of the integrity of the tax system. However, officials acknowledge that a time bar is a trade-off between the accuracy of payments, and certainty and reduced compliance and administration costs for employers, providers and Inland Revenue.

There are three types of adjustments that can be made to KiwiSaver contributions: adjustments to the income of an employee, adjustments to the calculation of KiwiSaver contributions and adjustments relating to who the funds are credited to.

Adjustments to income (for example, where an employer omits to pay wages to the employee for a period) are recalculated and paid in the current pay period and KiwiSaver deductions are also made. This is the same treatment as under the Holidays Act 2003. The proposed

time bar would not apply to income adjustments, and this is consistent with the treatment of adjustments to salary and wages.

Adjustments to the calculation of deductions that do not result from an income adjustment would be subject to the proposed time bar. To ensure deductions are correct on a pay period basis, Inland Revenue undertakes automated checks of employer-filed KiwiSaver contributions to identify errors in the payment of contributions. These errors are therefore adjusted before the four-year time bar applies.

If an error occurs that neither Inland Revenue, the employer nor the employee identifies before the four-year time bar applies, then the error will not be able to be corrected once the time bar is introduced.

However, the employer is not restricted from electing to make a voluntary contribution on behalf of an employee, either through Inland Revenue or direct to the fund, to address an underpayment of an employer contribution.

Adjustments relating to who the KiwiSaver contributions are credited to will continue to occur regardless of the time bar provision.

Officials note that records show the number of adjustments that have been made in these circumstances more than four years after an error has occurred has been very low.

Recommendation

That the submission be declined.

PENALTY FOR FAILURE TO KEEP TAXPAYER INFORMATION CONFIDENTIAL

Clause166

Issue: Support for proposed amendment

Submission

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

Submitters support the proposed amendment.

Recommendation

That the submission be noted.

OTHER ISSUES

Issue: R&D Tax Incentive – expenditure exclusions

Submission

(Deloitte)

Oil and gas businesses are more adversely affected by R&D exclusions than other industries. Amendments were made in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 to make ineligible some expenditure incurred by petroleum/mineral miners. The changes go much further than their intention of bringing the treatment of expenditure on assets in the mining industries in line with the treatment of expenditure on depreciable tangible assets in other industries. Consequently, petroleum miners are restricted to only being able to claim employee and contractor labour costs incurred for core R&D activities, regardless of whether those costs are deductible immediately or over time.

Comment

The amendments in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021 were designed to take a more comprehensive, end-to-end approach to the petroleum and mineral mining industries. One element was to recognise that these industries have their own tax regimes outside of the depreciation rules and, consequently, are not covered by the R&D tax credit exclusions relating to depreciable intangible property. The intention of the amendments was to bring the tax treatment of expenditure on assets in these industries in line with the general treatment of depreciable intangible property.

Officials agree that it was not intended to disadvantage the mining industries relative to other industries for revenue account spending on R&D. However, further consideration of this matter would require prioritising and resourcing as part of the Government’s tax policy work programme.

Recommendation

That the submission be noted.

MISCELLANEOUS SUBMISSIONS

The Committee has received the following submissions and officials recommend these be noted:

Submission description	Submitter
The Government and officials should take greater account of the negative impact that tax legislation regarded as being inappropriate could have on the willingness of taxpayers to pay tax.	Jim Gordon Tax Limited
General support for remedial amendments to the Goods and Services Tax Act 1985 and Income Tax Act 2007.	Corporate Taxpayers Group
Support for addressing drafting errors and unintended consequences through remedial amendments.	Mayne Wetherell
A shift to principles-based drafting supported by interpretative guidance, rather than specific rules, should be considered.	
The Government should devote adequate resourcing to addressing drafting errors and unintended consequences in tax legislation through remedial amendments.	
The Bill should promote equity in taxation by taxing those with the most to redistribute to those with the least.	Alexandra Cohen
Companies that create the highest greenhouse gases should be taxed to fund the creation of a green economy.	
All those in New Zealand should receive the same pay rate and be taxed at the same rate. (Likewise, for overseas business owners, managers, operators and investors.)	Aorangi Kawiti
<p>The Revenue Acts should include provision to include Te Ao Māori and tikanga Māori concepts similar to those set out or referenced in:</p> <ul style="list-style-type: none"> • The Strategic Partnership Relationships with Te Tiriti o Waitangi Tangata Whenua Partners (specifically the partnership relationships). • Te Whakaputanga me te Tiriti o Waitangi. • The Waitangi Tribunal Te Paparahi o te Raki Report 2014 (specifically tino rangatiratanga and mana motuhake). • The Waitangi Tribunal Muriwhenua Report 1997. • The Reform of the Law of Succession 1996 (specifically te o Māori concepts). • The claims to the Waitangi Tribunal, High Court, District Court, Māori Land Court and Appellate Court. 	
Rates should not be levied on Māori land.	

Public Works Act takings of Whenua Māori for the business of access to land should be taxed retrospectively.	
Toll entry to hapū and whānau whenua tuku iho could be charged instead of tax/rates.	
Government must achieve systemic economic transformation.	Catherine Murupaenga-Ikenn
Māori Authority tax rates should remain at the current, or a lower, level.	
The Government should reform taxes and install a carbon tax.	
Wealth should be taxed instead of income because those on low incomes cannot make climate responsible choices.	
Living under financial hardship depletes people of energy.	
Those who contribute most to the climate crisis should pay their fair share of tax to help remedy the crisis.	
A pollution tax should be applied to major polluting industries, including the agricultural sector.	
Policy makers should consider the relationship between wealth distribution and the country's ability to take crisis mitigation and adaptation action.	
The Government should take proactive measures on wealth distribution.	
A tax-free allowance should be introduced for all taxpayers as in the UK. This should be reviewed annually to account for inflation.	Frank Fordham
The tax thresholds should be adjusted for inflation.	
Secondary tax should be abolished.	Gary Wills
Support for the Bill.	Jonathan Braniff
Rent controls should be on all residential properties.	
GST should be removed from food and essential services.	Libby Good, Rhoda De Felton
Healthier foods should be more accessible to lower socio-economic households.	Libby Good
The public should not be taxed until ACC is taxed.	Tui Williams
Submissions should be run privately rather than by government.	

Maintenance items

MAINTENANCE AMENDMENTS

Clause 47

Issue: Correcting the list of defined terms in section BC 5

Submission

(Chartered Accountants Australia and New Zealand)

The amendment to remove “tax loss” from the list of defined terms for section BC 5 should not proceed. “Tax loss” is still a defined term in section YA 1 of the Income Tax Act 2007.

Comment

The defined term “tax loss” is not used in section BC 5. The defined term used in the section is “available tax loss” and this is included in the list of defined terms. Officials’ view is that a term should not be included in the list of defined terms for a provision if it is not used in that provision.

Recommendation

That the submission be declined.

Issue: References to “grandparented structure” should be removed

Submission

(Chartered Accountants Australia and New Zealand)

The definition of “grandparented structure” was repealed with effect from 1 April 2020 with application for the 2020–21 and later income years, and therefore the term should be removed from sections EE 47(4) and EE 48(3)(a) of the Income Tax Act 2007.

We also suggest officials review sections EZ 23B, EZ 23BB, EZ 23BC and EZ 73 for the reference to “grandparented structure”.

Comment

Officials note they have recommended the definition of “grandparented structure” be reinstated to enable a deduction to be claimed for the loss on disposal of a grandparented structure – see [“Issue: Depreciation treatment of grandparented structures”](#) above. However, officials agree that the references to “grandparented structure” in sections EE 47(4), EE 48(3)(a), EZ 23B, EZ 23BB, EZ 23BC and EZ 73 are unnecessary and should be removed.

Recommendation

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

Matters raised by officials

BACK-DATED VALIDATION OF KIWISAVER ENROLMENT

Issue: Back-dated validation of enrolment of KiwiSaver members who joined KiwiSaver aged 65 years or over

Submission

(Matter raised by officials)

KiwiSaver members who were aged 65 years or over at the time of their enrolment in KiwiSaver should be permitted to remain in KiwiSaver by allowing the back-dated validation of their enrolment.

Before 1 July 2019, a person of New Zealand superannuation qualification age (65 years) or over could not enrol in KiwiSaver. On 1 July 2019, a legislative change was made to allow people aged 65 years or over to opt in to KiwiSaver. However, automatic enrolment into KiwiSaver is still prevented for those people.

Where a person aged 65 years or over opted in to KiwiSaver before 1 July 2019, or they are automatically enrolled at any time, their enrolment is invalid and cannot be subsequently validated.

The KiwiSaver Act 2006 should be amended to allow back-dated validations for those persons who were over 65 at the time they joined KiwiSaver and were still a member of KiwiSaver on 1 September 2021.

Some consequential amendments will also be required to ensure the back-dated validation works correctly with the existing KiwiSaver rules.

Recommendation

That the submission be accepted.

SMALL BUSINESS CASHFLOW (LOAN) SCHEME AND COVID-19 SUPPORT PAYMENTS SCHEME

Issue: Recovery of funds from ineligible applicants

Submission

(Matter raised by officials)

The recovery provisions in the Tax Administration Act 1994 (TAA) for the Small Business Cashflow (Loan) Scheme (SBCS) and COVID-19 Support Payments (CSP) Scheme should be amended to allow the Commissioner of Inland Revenue to recover funds in situations where an ineligible applicant receives a loan and/or grant amount, but the funds are received by, or otherwise passed on to, an associated person.

The SBCS provisions in the TAA (section 7AA) provide that a person who has received a loan under the scheme must immediately repay the total amount to the Commissioner if they do not meet the eligibility requirements.

This provision allows for the recovery of funds from ineligible applicants. An issue arises when the loan has been received by the applicant, but the benefit of the funds has been received directly or indirectly by an associated person. The TAA only provides for a statutory right of recovery from the applicant.

For example, a company applies for (and receives) a loan under the SBCS and has paid the funds to its 100% shareholder/director as a dividend. If the company was ineligible to receive the loan, the Commissioner only has a statutory right of recovery against the applicant (the company) and not the associated person (shareholder/director) who has received the funds. No contractual relationship exists with that other person, and there is no statutory provision requiring repayment from that person in this situation. Often in these cases, the company is just a shell or deregistered and the Commissioner cannot recover the funds from the company. However, the Commissioner has no statutory right to recover the funds from the other party (albeit that the Commissioner could, depending on the circumstances, have a claim against that other party for money they had received).

The CSP Scheme (formerly the Resurgence Support Payments Scheme) was designed on similar principles to the SBCS. This same integrity risk applies to the CSP Scheme (section 7AAB of the TAA). The lack of statutory right of recovery from an associated party that has received the benefit of a SBCS loan or CSP Scheme grant from an ineligible applicant is an integrity risk.

The proposed amendment would allow the Commissioner to recover funds from persons who have directly or indirectly received the benefit of the funds in connection with an ineligible application. This would be limited to associated persons of the applicant that have received the benefit of the funds for no or inadequate consideration (that is, the funds have not been provided for goods or services).

The proposed amendment would apply prospectively to any contracts entered into from the day after the Bill receives the Royal assent and would not affect any existing contracts.

Recommendation

That the submission be accepted.

DOMESTIC TRUST DISCLOSURE RULES

Issue: Minor and incidental non-cash distributions

Submission

(Matter raised by officials)

Section 59BA of the Tax Administration Act 1994 (TAA) should be amended to exclude distributions that are minor services incidental to the operation of the trust from the disclosure requirements with effect for the 2021–22 and later income years.

Trustees subject to the disclosure rules in section 59BA must disclose details of each settlement that is made on the trust in the income year. The exception to this is if the settlement is the provision to the trustee, at less than market value, of minor services incidental to the operation of the trust. In contrast, trustees must disclose details of every distribution made by them in the income year. There is no equivalent exclusion for minor and incidental distributions.

The disclosure rules were introduced to evaluate whether the new top personal tax rate of 39% is working effectively and to gain insight into the use of structures and entities by trustees in New Zealand. The requirement to disclose minor and incidental, non-cash distributions imposes unnecessary compliance costs on trustees and provides negligible benefit to Inland Revenue.

Officials recommend requiring all cash distributions and all taxable distributions to be disclosed. This will support the policy intent of evaluating whether the new 39% rate is working effectively.

A “minor and incidental” test should be introduced in section 59BA(2)(d) to provide relief from disclosing minor and incidental non-cash, non-taxable distributions.

Recommendation

That the submission be accepted.

Issue: Nature of distributions

Submission

(Matter raised by officials)

Section 59BA of the TAA should be amended to explicitly require trustees of trusts subject to the disclosure requirements to disclose the nature of each distribution made by the trustee in the income year, with effect for the 2021–22 and later income years.

The disclosure rules require trustees to disclose the amount of each distribution made by the trustee of the trust in the income year. The rules do not specifically require trustees to disclose the nature of each distribution.

This poses a risk for the quality of data collected. Requiring trustees to disclose the nature of distributions would help ensure the quality of information collected is sufficient to draw informed conclusions. Trustees would be required to disclose whether the distributions were cash, land, buildings, shares/ownership interests, provision of trust property for less than market value or forgiveness of debt.

To align the disclosure requirements for settlements and distributions and to improve the clarity of the legislation, officials recommend a retrospective amendment to the new disclosure rules to explicitly state that trustees subject to these rules must disclose the nature of distributions.

Recommendation

That the submission be accepted.

Issue: Non-resident trusts

Submission

(Matter raised by officials)

Section 59BA of the TAA should be amended to fully exclude all non-resident trusts from the domestic trust disclosure rules with effect for the 2021–22 and later income years.

The Taxation (Income Tax Rate and Other Matters) Act 2020 introduced increased disclosure requirements for domestic trusts from the 2021–22 and later income years. The new rules were introduced to evaluate whether the new top personal tax rate is working effectively and to gain insight into the use of structures and entities by trustees in New Zealand.

Trustees that are required to make a return under section 59D (which relates to foreign trusts) were excluded from the disclosure rules, as foreign trusts already have a disclosure regime.

However, not all non-resident trusts are captured by section 59D. A non-resident trust with no New Zealand resident trustees or settlors may earn New Zealand-sourced income and be subject to the new rules in section 59BA. Subjecting these types of trusts to the disclosure rules raises several practical issues, including:

- how a de minimis threshold would be measured for foreign assets, income and expenditure
- who would be responsible for ensuring compliance with the new rules if there are no New Zealand resident trustees or settlors, and
- whether the non-resident trust would need to prepare branch accounts for its New Zealand assets and income.

Inland Revenue's records show that approximately 180,000 domestic trusts will be subject to these new rules, whereas no more than 700 non-resident trusts file income tax returns each year. Requiring non-resident trusts to comply with the new rules is likely to impose unnecessary compliance costs for limited benefit.

Section 59BA should be amended to exclude all non-resident trusts from the domestic trust disclosure rules. Non-resident trusts with no New Zealand resident trustees or settlors but with New Zealand-sourced income are outside the intended scope of the rules.

Recommendation

That the submission be accepted.

PROVISIONAL TAX – SAFE HARBOUR CONCESSION

Issue: Removing the requirement to pay in full and on time

Submission

(Matter raised by officials)

Sections 120KE and 120KF of the Tax Administration Act 1994 (TAA) should be amended to remove the requirement to pay in full and on time to retain the safe harbour concession.

The safe harbour concession for provisional tax is available to standard method provisional taxpayers whose residual income tax (RIT) is less than \$60,000, provided they meet the requirements in the TAA. Qualifying as a safe harbour taxpayer prevents use of money interest (UOMI) being charged for underpaid provisional tax during the income year. A safe harbour taxpayer will only be charged UOMI after the terminal tax due date.

In 2017 the concession was amended to include a requirement that the person must have paid their provisional tax instalments in full and on time to qualify as a safe harbour taxpayer.

At the time the change was made, the number of taxpayers who unintentionally pay one or two days late was underestimated. A large number of taxpayers have since been caught out by this change, and this has resulted in them incurring UOMI as well as late payment penalties. In these circumstances, the application of UOMI and late payment penalties is not proportionate to the offence committed.

We consider it appropriate to allow taxpayers to retain the safe harbour concession even if they miss a payment. This is because late payment penalties should be a sufficient penalty to incentivise taxpayers to continue to make their payments on time.

To address this, we recommend that the requirement to pay in full and on time to access the safe harbour concession be removed. The proposed amendment would apply for the 2022–23 and later income years.

Recommendation

That the submission be accepted.

REGULAR COLLECTION OF BULK DATA

Issue: Including government departments within the scope of section 17L

Submission

(Matter raised by officials)

Section 17L of the Tax Administration Act 1994 (TAA) should be amended to include government departments within its scope.

Section 17L of the TAA authorises the making of regulations covering regular and/or ongoing requests for bulk data. The section was intended to improve transparency, efficiency and certainty when information collection is sought on a regular and repeated basis.

When enacted, this section was intended to facilitate the regular collection of information, particularly from other government departments. The section was intended to provide an efficient alternative to the one-off data collection requests available under section 17B of the TAA. However, the section may not apply to the Crown or government departments.

To address this, we recommend that the section be amended to make clear it applies to the Crown and government departments. The amendment would apply from the date of Royal assent.

Recommendation

That the submission be accepted.

INCOME EQUALISATION RESERVE AND ENVIRONMENTAL RESTORATION FUND ACCOUNTS

Issue: Removal of reference to special bank accounts

Submission

(Matter raised by officials)

The references to specific bank accounts relating to the income equalisation reserve and environmental restoration fund should be removed as specific accounts are no longer used.

Sections EH 2 and EK 1 of the Income Tax Act 2007 currently require that Crown bank accounts called the "Income Equalisation Reserve Account" and the "Environmental Restoration Funds Account" are maintained. All deposits for the main income equalisation scheme, the thinning operations income equalisation scheme and the environmental restoration fund are deposited are made into these accounts.

Historically, deposits into these accounts were made by cheque and put into special bank accounts. With the removal of cheques, it is now much simpler and easier for taxpayers to deposit funds directly with Inland Revenue through internet banking into Inland Revenue's general account.

This change also provides better information for taxpayers, as they have visibility on the amounts that sit within their income equalisation accounts through MyIR.

Consequently, the requirement to keep a separate bank account for these funds seems redundant. There is no change in security of the funds as both those accounts are backed by the government.

Recommendation

That the submission be accepted.

FINANCE LEASE DEFINITION

Issue: Reference updated

Submission

(Matter raised by officials)

The reference to NZIAS 17 in subparagraph (c)(iii) of the definition of “finance lease” in section YA 1 of the Income Tax Act 2007 should be replaced with NZ IFRS 16.

Subparagraph (c)(iii) of the definition of “finance lease” refers to NZIAS 17, but this accounting standard has been replaced by NZ IFRS 16. The recommended change will ensure that the definition continues to apply as intended and will not change its scope.

This change should be effective from 1 January 2019, with application for income years beginning on or after 1 January 2019, to align with the application date of NZ IFRS 16.

Recommendation

That the submission be accepted.

DEFINITION OF REPORTABLE INCOME

Issue: Amendment required

Submission

(Matter raised by officials)

The Wage Subsidy Scheme (WSS) and Leave Support Scheme (LSS) were introduced in March 2020, and the Short-Term Absence Scheme (STAS) was introduced in February 2021.

However, because the definition of “reportable income” within section 22D(3) of the Tax Administration Act 1994 (TAA) does not include WSS, LSS and STAS receipts, taxpayers who received payments under these schemes were required to file an IR3 return. Approximately 50,000 of these taxpayers had previously been eligible for an Inland Revenue “auto-calc” income assessment.

The requirement for recipients of the various scheme payments to file an IR3 return increased compliance costs for taxpayers, as well as raising administrative costs for Inland Revenue.

To address this issue, for the 2021–22 tax year, we recommend that the definition of “reportable income” within section 22D(3) be amended to include amounts received under the WSS, LSS and STAS. This will allow taxpayers who receive only reportable income, including receipts under these schemes, to receive an auto-calc assessment. This will ensure they are no longer required to complete an IR3 return, and it will reduce compliance and administrative costs for taxpayers and Inland Revenue.

Recommendation

That the submission be accepted.

INCOME TAX TREATMENT OF VOLUNTARILY CANCELLED EMISSIONS UNITS

Issue: Remedial amendments

Submission

(Matter raised by officials)

Two remedial amendments are proposed:

- That the income tax treatment of emissions units voluntarily cancelled through the New Zealand Emissions Trading Scheme be amended so that the taxpayer is not deemed to derive income when they cancel an emissions unit.
- That past tax positions taken by taxpayers for cancelled emissions units be preserved.

The first proposed amendment is necessary to remove an unintended consequence that arises when a person purchases and voluntarily cancels an emissions unit. Specifically, income equivalent to the market value of the unit is deemed to be derived by the taxpayer when they cancel an emissions unit, although no consideration is received for the unit. The recommended amendment would remove this deemed income. This recognises that the purchase and cancellation of an emissions unit is a cost incurred by the business for which they should receive a net deduction equivalent to the cost of the unit. The proposed amendment would apply to positions taken in tax returns filed on or after 1 April 2022.

Officials understand there has been widespread non-compliance with the current provisions because those provisions are unclear and counter intuitive. Officials therefore consider it necessary to include the second amendment to preserve past positions taken by taxpayers who have cancelled emissions units so that past tax returns do not need to be revisited. This amendment would apply to cancellations included in tax returns filed before 1 April 2022.

Recommendation

That the submission be accepted.

UNCLAIMED MONEY ACT CROSS REFERENCE

Issue: Correction to cross reference required

Submission

(Matter raised by officials)

Section 8(5)(c) of the Unclaimed Money Act 1971 refers to a reporting period that ends after the date on which "this Act" (that is, the Unclaimed Money Act 1971) receives the Royal assent.

However, as section 8(5) was inserted into the Unclaimed Money Act 1971 as part of the recent administrative reforms to the unclaimed money regime, the reference should be amended to the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021.

Recommendation

That the submission be accepted.

Summary of recommendations

SUMMARY OF RECOMMENDATIONS

GST policy items

Tax treatment of cryptoassets

Rec #	Recommendation description	Submitter	Page #
1.	Confirm brokering, commission and related services provided in relation to cryptoassets are not subject to GST	Deloitte	21
2.	Remove fungibility requirement from cryptoasset definition and create a definition of a non-fungible token	New Zealand Law Society	22
3.	Confirm derivatives over cryptoassets are excepted financial arrangements	EY	27
4.	Clarify drafting of proposed section EW 5(3BAB)	PwC	28

Disposal of assets with taxable and non-taxable use

Rec #	Recommendation description	Submitter	Page #
5.	Clarify how the cap applies to property developers	New Zealand Law Society	30

Domestic transport services supplied as part of the international transport of goods

Rec #	Recommendation description	Submitter	Page #
6.	Clarify that a separate supply of domestic transport services should be zero-rated	PwC	34

Other policy items

Offences relating to electronic sales suppression

Rec #	Recommendation description	Submitter	Page #
7.	Remove word "offence" from the electronic sales suppression civil penalty	New Zealand Law Society	41
8.	Extend definition to include hiding or concealing the creation of a record	Officials	44
9.	Confirm due date for payment of civil penalty is 30 days after the notice of assessment is issued	Officials	45
10.	Remove incremental late payment penalties for non-payment of the civil penalty.	Officials	45

Rec #	Recommendation description	Submitter	Page #
11.	Confirm civil penalty is a shortfall penalty despite no tax shortfall	Officials	46

Local authority taxation – dividends and deductions

Rec #	Recommendation description	Submitter	Page #
12.	Remove proposals relating to financing deductions	7 submitters	47
13.	Extend dividend exemption to dividends from partly-owned CCOs, port companies and energy companies	6 submitters	49
14.	Extend dividend exemption to dividends derived by a holding company CCO from a CCO with 100% public ownership	2 submitters	49
15.	Remove proposal to prevent a local authority from converting an imputation credit to a tax loss	2 submitters	53

Fair dividend rate foreign currency hedges

Rec #	Recommendation description	Submitter	Page #
16.	Extend the portfolio method to non-daily unit valuers	3 submitters	57
17.	Reduce consistency requirement for portfolio method to 24 months	KPMG	59
18.	Reduce consistency requirement for the periodic basis to 12 months	KPMG	59
19.	Clarify second hedge-by-hedge formula	KPMG	61
20.	Introduce an alternative to the 5% de minimis	5 submitters	62
21.	Extend the optional look through rule to look through multiple layers of multi-rate PIEs	4 submitters	64
22.	Allow electing a date for calculating the quarterly FDR hedging ratio	4 submitters	65
23.	Remove examples from legislation and move into guidance	3 submitters	67
24.	Correct a minor drafting error	Officials	67

Overseas donee status

Rec #	Recommendation description	Submitter	Page #
25.	Correct the name of Child Rescue Charitable Aid Trust	Officials	70

Interest limitation

Social and council housing exemptions

Rec #	Recommendation description	Submitter	Page #
26.	Expand social housing exemption to housing leased by a Government department to provide accommodation for the public on a non-transitional or non-emergency basis	New Ground Capital	95
27.	Expand council housing exemption to housing leased by a local authority or council-controlled organisation from private landlords that is used to provide council housing	PwC	96
28.	Clarify that exemptions still apply where wraparound or connected services are provided in the same building or on the same land	2 submitters	96

Application to companies

Rec #	Recommendation description	Submitter	Page #
29.	Change section DH 12 to clarify that for assets other than land (other than land subject to one of the development exemptions), tax book values or financial accounts values would be used	Deloitte	98

Excepted residential land – commercial accommodation

Rec #	Recommendation description	Submitter	Page #
30.	Introduce a “commercial lodging establishment” exclusion	3 submitters	102
31.	Amend the definition of “dwelling” so that it refers to “commercial lodging establishment” instead of “boardinghouse” from the 2022–23 income year	Deloitte	103

Excepted residential land – main home exception

Rec #	Recommendation description	Submitter	Page #
32.	Clarify the main home exception so that a trustee may only qualify for the exception for a beneficiary/settlor if a principal settlor does not have a separate main home	Officials	107

Excepted residential land – Māori excepted land

Rec #	Recommendation description	Submitter	Page #
33.	Extend the exclusion to cover housing provided to a shareholder/beneficiary of a Māori entity on land owned by either that entity or other entities in its “qualifying Māori group”. Amend the definition of Māori excepted land to incorporate the new “qualifying Māori group” term	2 submitters	110

Rec #	Recommendation description	Submitter	Page #
34.	Expand the exclusion to cover land held through partnership, to the extent housing is provided to a member/shareholder of one of the partners or the partners' qualifying Māori group	2 submitters	110
35.	Narrow the definition of Māori excepted land so that ground lessees can only claim an exception for Treaty settlement land if they are owned by the same entity that owns the land	Officials	113

Other scope of property submissions

Rec #	Recommendation description	Submitter	Page #
36.	Ensure the employee accommodation exception is available where the employer (or another company in the same wholly-owned group) owns the property themselves, but not where a standard property investor happens to rent their property to a business who uses the property for employee accommodation	Officials	118

Exemptions for land businesses, property development, and new builds

Rec #	Recommendation description	Submitter	Page #
37.	Allow the development exemption to continue to apply after land is disposed of	Chartered Accountants Australia and New Zealand	123
38.	Clarify that commercial to residential conversions (other than hotel/motel conversions) can qualify as "new build land"	4 submitters	131
39.	Expand the definition of "new build land" to cover certain dwellings previously on the earthquake prone buildings register and former leaky buildings that are at least 75% reclad	8 submitters	135
40.	Change references to section DH 5(5) in section DH 4(1) to section DH 5(7)	4 submitters	140

Rollover relief

Rec #	Recommendation description	Submitter	Page #
41.	Clarify the provisions so that they reflect the loan drawdown date. Provide that a loan drawn down by (or transferred to) the recipient of disallowed residential property is treated as meeting the requirements for interest deductibility if the loan held by the previous owner was a grandparented transitional loan.	Chartered Accountants Australia and New Zealand	144
42.	Rollover relief should apply for interest limitation to a transfer of property as part of a company amalgamation in certain circumstances	Officials	145

Grandparented transitional loans that cannot be traced

Rec #	Recommendation description	Submitter	Page #
43.	Extend the stacking approach to loans that cannot reasonably be traced	4 submitters	146
44.	Amend section DH 7(4) so that if a repayment is sourced from the disposal of allowed property, it should first repay the loan allocated to the allowed property disposed of, with the remainder allocated to the notional loan principal	Officials	147

High water mark

Rec #	Recommendation description	Submitter	Page #
45.	Simplify and improve the drafting of section DH 10	2 submitters	148
46.	Clarify in section DH 10 that where a variable balance loan has been used for multiple purposes, a person must first establish what part of the variable balance loan applies to disallowed residential property	Chartered Accountants Australia and New Zealand	149

Refinancing

Rec #	Recommendation description	Submitter	Page #
47.	Include a provision that allows a second loan taken to repay a grandparented transitional loan to follow the treatment of that grandparented transitional loan	2 submitters	151

Mixed-use assets

Rec #	Recommendation description	Submitter	Page #
48.	Clarify that certain interest is allocated under a tracing approach as well as a stacking approach	Officials	156
49.	Reduce the scope of existing provisions that would apply to disallowed residential property or an interest in an interposed residential property holder	Officials	156
50.	Remove disallowance of interest that has already been disallowed under the interest limitation rules	Officials	157
51.	Add mixed-use assets back into denominator of residential property percentage formula	Officials	157

Interposed entity rules

Rec #	Recommendation description	Submitter	Page #
52.	Remove specific interposed entity rules for LTCs and partnerships	Chartered Accountants Australia and New Zealand	163
53.	Specify that where a person applying the interposed entity apportionment approach to a close company that subsequently makes an LTC election, the interposed entity apportionment approach continues to apply until the existing borrowings are repaid	Officials	163

Bright-line test changes

5-year new build bright-line test

Rec #	Recommendation description	Submitter	Page #
54.	Add an exception to the requirement that the land must be new build land when it is disposed of, provided there was previously a new build on the land, but it was destroyed due to a natural disaster or fire that occurred while the taxpayer owned the land	Chartered Accountants Australia and New Zealand	171
55.	Allow land to qualify for the new build bright-line test even if it has previously been new build land, provided a "new" new build has been added to the land within 12 months of it being acquired	Officials	172
56.	Ensure new build land cannot qualify for the new build bright-line test if there is an agreement to add a new build to the land but the new build has not actually been added to the land by the time it is disposed of	Officials	173
57.	Minor drafting changes	2 submitters	174

Main home exclusion from the bright-line test

Rec #	Recommendation description	Submitter	Page #
58.	Allow the main home exclusion to apply where a person is constructing their main home, unless the period time taken to construct the home is unreasonable	3 submitters	176
59.	Make "excluded main home" a defined term	Deloitte	184
60.	In section CB 16A(6), refer to "main home days" as defined in section CB 6A(11), not section CB 6A(10)(b)	New Zealand Law Society	185

Roll-over relief from the bright-line test

Rec #	Recommendation description	Submitter	Page #
61.	Clarify that the application date is 1 April 2022	2 submitters	186
62.	Switch off the market value rule in section GC 1 to provide some relief for taxpayers where residential land is sold/transferred to a family trust/partnership/LTC for more than their acquisition cost, and (for the purposes of the bright-line test) treat the receiving entity as having acquired the property on the same date it was acquired by the first owner	KPMG	187
63.	Clarify that, when a part share of a property is disposed of, the bright-line period is not reset for the part share of the property that has not been disposed of	3 submitters	189
64.	Provide rollover relief for transfers between two LTCs where shareholding in each LTC is identical	nsaTax Limited	190
65.	Provide rollover relief for transfers between LTCs and trusts if: - the requirements of section FC 9B for other beneficiaries of the trust are met, and - the principal settlor of the trust is both a beneficiary of the trust and the owner of the LTC.	nsaTax Limited	190
66.	Provide rollover relief for transfers of residential land from an individual to an LTC where the shares in the LTC are owned by a trust that meets the criteria in section FC 9B(2), and also provide relief for land going in the other direction (from an LTC to an individual who is both principal settlor and beneficiary and all the requirements in section FC 9B(2) are met). Also provide this relief for partnerships	Gilligan Rowe & Associates LP	190
67.	Provide rollover relief for transfers within a wholly-owned tax consolidated group of companies	KPMG	192
68.	Provide rollover relief for transfers from trustees back to settlors	3 submitters	192
69.	Provide rollover relief where trusts are resettled if at least one of the principal settlors resettling the property is also a principal settlor of the recipient trust and the beneficiaries of the recipient trust satisfy the prescribed relationship requirements in section FC 9B(2)	3 submitters	192
70.	Clarify that if a settlement entity transfers residential land received as part of a settlement under te Tiriti o Waitangi to a member of the claimant group, the settlement entity's acquisition cost is the market value at the time the Crown transfers the land to them	Officials	194
71.	Change the cross-reference to section CB 6AB in section CB 6A(11F) to sections FC 9B to FC 9E	New Zealand Law Society	195
72.	Correct the wording in sections CB 6A(5B) and (5C), so they say the date a joint tenancy or tenancy in common is "acquired" instead of "granted"	Mayne Wetherell	195

GST remedials

Modernising information requirements for GST

Rec #	Recommendation description	Submitter	Page #
73.	Insert a provision to preserve the effect of the terms "tax invoice", "credit note" and "debit note" in commercial and legal documents	3 submitters	202
74.	Reduce requirements for the supplier to hold information about the recipient	5 submitters	202
75.	Align taxable supply information requirements for supplier and recipient	2 submitters	204
76.	Simplify the date of taxable supply information	7 submitters	204
77.	Require recipient to have information to support their input tax claim	5 submitters	206
78.	Minor changes to supply correction information requirements for when a correction can be issued	Mayne Wetherell	207
79.	Remove requirement to keep a record of all copies of invoices issued	4 submitters	207
80.	Remove power to set threshold by regulation	Regulations Review Committee	208
81.	Clarify requirements for agreement for buyer-created supply information	2 submitters	208
82.	Extend shared invoice rules	4 submitters	209
83.	Defer application date to 1 April 2023 other than for items that reduce compliance costs	2 submitters	211
84.	Amend commencement date of clause 44(3) to align with related provisions	Deloitte	211
85.	Remove requirements for information to include a GST trade name	4 submitters	212
86.	Remove proposed signpost provision and amend definition of "supplier"	New Zealand Law Society	213
87.	Include GST groups within the meaning of the term "member supply"	KPMG	213
88.	Update a drafting error in proposed section 19H(2)(b)	KPMG	214
89.	Clarify rounding of amounts for fractions of cents for a single customer can be on a supply-by-supply or aggregate basis	2 submitters	214

Secondhand goods input tax credit - associated persons supplies

Rec #	Recommendation description	Submitter	Page #
90.	Correct minor drafting issues	2 submitters	217

GST B2B compulsory zero-rating of land rules

Rec #	Recommendation description	Submitter	Page #
91.	Extend the scope of qualifying events	2 submitters	222

GST Groups

Rec #	Recommendation description	Submitter	Page #
92.	Amend date information requirements for GST groups to align with general requirements	2 submitters	224
93.	Extend removal of joint and several liability to include transactions after introduction of the Bill but in a return filed after assent	2 submitters	225
94.	Joint and several relief provisions more closely aligned with the equivalent Income Tax Act provisions	PwC	225

Taxable supplies of goods not yet in physical possession

Rec #	Recommendation description	Submitter	Page #
95.	Remove proposal around taxable supplies of goods not yet in physical possession	3 submitters	229

Income tax remedials

Hybrid and branch mismatches - imported mismatch rule

Rec #	Recommendation description	Submitter	Page #
96.	Change application date to the enactment of the Bill	2 submitters	235
97.	Clarify section FH 11(1) applies to a payment by a payer that is a NZ deducting branch of a non-resident	PwC	236
98.	Introduce a savings provision for taxpayers who file before the proposed rules are enacted	Mayne Wetherell	240
99.	Minor drafting changes	2 submitters	240
100.	Narrow reference to hybrid mismatch legislation	Officials	241

Early-payment discount rate changes

Rec #	Recommendation description	Submitter	Page #
101.	Change the application date to 1 April 2022	Deloitte	242

Restricted transfer pricing remedials

Rec #	Recommendation description	Submitter	Page #
102.	Relocate proposed dividend change	Officials	246

Foreign currency loans that finance residential rental property in a foreign jurisdiction

Rec #	Recommendation description	Submitter	Page #
103.	Change application date to cover taxpayers with an early balance date	Deloitte	247

Electing into the securitisation regime

Rec #	Recommendation description	Submitter	Page #
104.	Allow elections before the transfer of assets	5 submitters	253

Tax pooling and early payment discount settings

Rec #	Recommendation description	Submitter	Page #
105.	Change application date to the 2019/20 tax year	PwC	257

Debt remission within an economic group

Rec #	Recommendation description	Submitter	Page #
106.	Change application date to debt remitted on or after 30 March 2017	Hawke's Bay Regional Investment Company Ltd and Hawke's Bay Regional Council	265

Employer superannuation contribution tax on contributions for past employees

Rec #	Recommendation description	Submitter	Page #
107.	Change application date to 1 April 2021	3 submitters	266

Definition of decommissioning in the petroleum mining regime

Rec #	Recommendation description	Submitter	Page #
108.	Remove proposal to add the word “permanently”	5 submitters	268
109.	Allow a refundable credit for exploratory wells drilled while sufficient tax is still being paid by the miner	3 submitters	268
110.	Consequentially remove monitoring of exploratory wells from the decommissioning definition	Officials	270

Business continuity test

Rec #	Recommendation description	Submitter	Page #
111.	Minor drafting change to clarify section IP 1(1)(c)	EY	272
112.	Group of companies to be restricted to New Zealand tax resident members of a group	EY	273
113.	Reset the business continuity test for losses incurred before the 2020–21 income year if there is a subsequent shareholding change	Officials	274
114.	Deem a purchasing shareholder to have owned their interest from the time the loss was incurred until the date of the next breach	Officials	274
115.	Extend the exclusion of mining companies to include losses incurred while the company was a mining company	Officials	275
116.	Clarify the carve outs for changes to business activities carried on before the shareholding breach	Officials	276

FBT – pooled alternate rate option

Rec #	Recommendation description	Submitter	Page #
117.	Introduce a simplified threshold for paying FBT at 49.25%	2 submitters	277

Other issues

Rec #	Recommendation description	Submitter	Page #
118.	Update cross reference for the definition of capital contribution	Russell McVeagh	279
119.	Extend an income tax exemption to include Racing New Zealand and the Racing Integrity Board	Deloitte	281
120.	Reintroduce definition of “grandparented structure” and provide that section EE 48(3) does not apply to grandparented structures	BDO	281
121.	Align ICA rules for tax pooling of consolidated groups with rules for individual companies	Officials	282

Other remedials

Extending use of money interest relief during COVID-19

Rec #	Recommendation description	Submitter	Page #
122.	Extend relief to the 2021–22 tax year for taxpayers that are significantly adversely affected in their ability to forecast their residual income tax	Officials	285

Use of money interest relief during emergency events

Rec #	Recommendation description	Submitter	Page #
123.	Widen the eligibility test for relief to people “significantly adversely affected” by an event	Officials	286
124.	Allow relief for taxpayers who are significantly adversely affected in their ability to forecast their residual income tax	Officials	286

Repeal of information sharing clauses for the ACC and the Registrar of Companies by an Order in Council

Rec #	Recommendation description	Submitter	Page #
125.	Remove the repeal of the information sharing agreement with ACC from the Bill	Regulations Review Committee	289

R&D Tax Incentive - extension of due dates

Rec #	Recommendation description	Submitter	Page #
126.	Extend the general approval application date for taxpayers that have had their criteria and methodologies application declined	KMPG	294

R&D Tax Incentive – Tax year cut-off for claiming supporting activities

Rec #	Recommendation description	Submitter	Page #
127.	Allow for an additional year for pre-commencement supporting activity in the general approval application provisions	Officials	297

Administrative amendments to the Child Support Act 1991

Rec #	Recommendation description	Submitter	Page #
128.	Allow an exclusion to the time bar for administrative reviews	Officials	299
129.	Clarify the definition of reconciliation period	Officials	300

Rec #	Recommendation description	Submitter	Page #
130.	Introduce an additional transitional provision for reconciliations for years before 1 April 2022	Officials	302
131.	Update a reference to "income" instead of "taxable income"	Officials	303
132.	Change application dates to align with the 26 October 2021 transfer to START	Officials	303

Maintenance amendments

Rec #	Recommendation description	Submitter	Page #
133.	Remove references to "grandparented structure"	Officials	317

Matters raised by officials

Backdated validation of KiwiSaver enrolment

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134.	Back-date validation of enrolment, before 1 July 2019, of KiwiSaver members who joined KiwiSaver aged 65 years or over	Officials	321

Small Business Cashflow (Loan) Scheme and COVID-19 Support Payments Scheme

Rec #	Recommendation description	Submitter	Page #
135.	Allow recovery of funds from people who have received funds from an associated ineligible applicant	Officials	322

Domestic trust disclosure rules

Rec #	Recommendation description	Submitter	Page #
136.	Exclude minor and incidental non-cash distributions to beneficiaries from the disclosure rules	Officials	323
137.	Require disclosure of the nature of distributions to beneficiaries, rather than just the amount	Officials	323
138.	Exclude all non-resident trusts from the domestic trust disclosure rules	Officials	324

Provisional tax – safe harbour concession

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139.	Remove the requirement to pay provisional tax in full and on time to retain the safe harbour use of money interest concession	Officials	325

Regular collection of bulk data

Rec #	Recommendation description	Submitter	Page #
140.	Include government departments within the scope of a bulk data sharing provision	Officials	326

Income equalisation reserve and environmental restoration fund accounts

Rec #	Recommendation description	Submitter	Page #
141.	Remove reference to specific bank accounts	Officials	327

Finance lease definition

Rec #	Recommendation description	Submitter	Page #
142.	Update the definition to refer to NZ IFRS 16	Officials	328

Definition of reportable income

Rec #	Recommendation description	Submitter	Page #
143.	Update definition to exclude the Wage Subsidy Scheme and Leave Support Scheme so recipients do not need to file an income tax return	Officials	329

Income tax treatment of voluntarily cancelled emissions units

Rec #	Recommendation description	Submitter	Page #
144.	Remove deemed income when emissions units are voluntarily cancelled	Officials	330
145.	Preserve past tax positions by taxpayers for cancelled emissions units	Officials	330

Unclaimed Money Act cross reference

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146.	Update reference to correct Act	Officials	331