Inland Revenue
Te Tari Taake

POLICY AND REGULATORY STEWARDSHIP

Tax policy report: **Matters raised by officials in the officials' report on the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)**

Date:	17 November 2022	**Priority:**	Medium
Security level:	In Confidence	**Report number:**	IR2022/488

Action sought

	Action sought	Deadline
Minister of Finance	**Agree** to recommendations **Note** the contents of this report	8 December 2022
Minister of Revenue	**Agree** to recommendations **Note** the contents of this report	8 December 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Melissa Siegel	Bill Manager	s 9(2)(a)
Natisha Jones	Policy Advisor	

17 November 2022

Minister of Finance
Minister of Revenue

Matters raised by officials in the officials' report on the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2)

Executive summary

1. This report seeks your approval on issues that could be included as "matters raised by officials" in the officials' report to the Finance and Expenditure Committee (FEC) on the Taxation (Annual Rates for 2022-23, Platform Economy and Remedial Matters) Bill (No 2) (the Bill).

2. The Bill is currently before the FEC, and the officials' report is due with the Committee by 20 January 2023.

3. While some of the issues outlined in this report are related to amendments in the Bill, others are unrelated to existing amendments in the Bill. These issues have recently been brought to our attention as requiring an urgent fix and cannot be delayed until the March 2023 omnibus bill.

4. While none of these amendments are material enough to require Cabinet approval, they require approval from the Minister of Revenue and, where there are fiscal implications, the Minister of Finance. Only two of the recommended changes have fiscal implications and these would be funded through the Tax Policy Scorecard.

5. None of these changes give rise to any material compliance or administration costs, or any significant systems or technology implications.

6. Treasury has been consulted on this report and agrees that the changes proposed in this report are consistent with Ministers' criteria for the Scorecard. There is no risk that the Scorecard may exceed its limits as a result of these changes.

Next steps

7. If you agree to the changes in this report, these will be drafted for inclusion in the officials' report. Subject to the FEC's agreement, these changes would be included in the revision-tracked version of the Bill to be reported back to the House in early March 2023.

8. Written submissions closed on 2 November 2022 and oral submissions commenced on 9 November 2022. Subsequent hearings of oral evidence are scheduled for 7 and 14 December 2022.

9. We will report to you on 1 December 2022 with a summary of submissions and our proposed recommendations to be included in the officials' report.

10. The finalised officials' report is due to the FEC no later than 20 January 2023. This will allow the Bill to be progressed in line with the FEC's current timetable, reporting back to the house by 2 March 2023. We will report to you with a draft version of the officials' report for noting in the week beginning 16 January 2023.

Recommended action

We recommend that you:

11. **indicate** in the body of this report where you agree or do not agree with the recommended amendment;

    Indicated Indicated

12. **indicate** in the body of this report where you agree with the fiscal implications resulting from the recommended change;

    Indicated Indicated

13. **agree** that the fiscal implications resulting from these changes will be managed through the Tax Policy Scorecard;

    Agreed/Not agreed Agreed/Not agreed

14. **note** the net fiscal impact of the proposed changes on the Tax Policy Scorecard is as follows:

	$m – increase/(decrease)				
	2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27 & outyears**
Impact on Tax Policy Scorecard	-	0.070	0.280	0.280	0.250

    Noted Noted

15. **note** that agreed amendments will be included in the officials' report to the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2).

    Noted Noted

s 9(2)(a)

Melissa Siegel
Bill Manager
Inland Revenue

Hon Grant Robertson
Minister of Finance
/ /2022

Hon David Parker
Minister of Revenue
/ /2022

Background

16. The Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) is currently being considered by the Finance and Expenditure Committee ("FEC"). The officials' report on submissions is due to the FEC no later than 20 January 2023**.**

17. This report sets out recommended changes that could be included as "matters raised by officials" in the officials' report to FEC as matters raised by officials. Many of these

18. We do not consider that the recommended changes in this report require Cabinet approval. Two changes in this report have fiscal implications and subject to your agreement, would be managed through the Tax Policy Scorecard.

Items with fiscal implications (Minister of Finance and Minister of Revenue)

Cost of vehicle for fringe benefit tax purposes part-funded by the State Sector Decarbonisation Fund

19. Fringe benefit tax (FBT) on a vehicle is calculated with reference to the "cost price" or the "tax value" of the vehicle to the employer or vehicle owner. The calculation is designed to reflect the average after-tax benefit an employee receives through not needing to purchase their own vehicle, which saves the employee finance, depreciation, maintenance and other running costs. FBT is designed to equate with the PAYE (pay as you earn) tax that applies to salary and wages. This promotes fairness between employees, whether they are paid in cash or in kind, and helps preserve the integrity of the employment income tax base.

20. The Public Sector Decarbonisation Fund is available to the state sector for updating their assets to less carbon intensive alternatives to reduce their carbon emissions. It is administered by the Energy Efficiency and Conservation Authority, Te Tari Tiaki Pūngao. The fund could be used to purchase vehicles that are subject to FBT.

21. s 9(2)(h) [redacted]

22. s 9(2)(h) [redacted] the general public does not have access to this fund, s 9(2)(h) [redacted] overall purpose of the FBT regime and original policy intent, which is to tax the value of the benefit that the employee receives on the basis that it is equivalent to the payment of additional salary or wages.

23. We recommend an amendment to clarify that the "cost price" and "tax value" of a vehicle for the purposes of the FBT rules is the gross cost before any State Sector Decarbonisation Fund funding.

24. The amendment should apply prospectively for benefits provided from 1 April 2023.

25. The financial implication of this proposed remedial amendment is a revenue gain of approximately $0.28 million over the forecast period, with a corresponding impact on the operating balance and net debt.

Recommendations

Agree to amend the Income Tax Act 2007 to clarify that the "cost price" and "tax value" of a vehicle for FBT purposes is the gross costs of the vehicle to the employer or vehicle owner before any amount received from the State Sector Decarbonisation Fund reduces the price or value.

Agreed/Not agreed Agreed/Not agreed

Agree that this should apply for benefits provided from 1 April 2023.

Agreed/Not Agreed Agreed/Not agreed

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

	$m – increase/(decrease)				
Vote Revenue Minister of Revenue	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Crown Revenue and Receipts: Tax Revenue	-	0.070	0.080	0.080	0.050

Noted Noted

Agree that the fiscal implications resulting from this change will be managed through the Tax Policy Scorecard.

Agreed/Not Agreed Agreed/Not agreed

Tax debt write-off rules

26. The Tax Administration Act 1994 (TAA) requires that when a taxpayer has a tax debt written off, a corresponding tax loss should be extinguished if the taxpayer has accrued tax losses. This ensures that taxpayers who benefit from a debt write-off do not receive an undue advantage.

27. The Bill contains a proposal that would allow the Commissioner to extinguish a taxpayer's ring-fenced residential rental loss when they have tax debt written off, on the basis that these ring-fenced losses are not considered to form part of a taxpayer's "tax loss".

28. In finalising the systems and operational changes for this amendment, two issues relating to the tax debt write-off rules have arisen. The first issue has a fiscal impact and requires the agreement of both the Minister of Finance and Minister of Revenue. The second issue does not have a fiscal impact and only requires approval by the Minister of Revenue.

Extinguishing excess bright-line losses

29. When someone makes a loss under the bright-line test, that loss (referred to as excess deductions) is carried forward to a later year in which the taxpayer has bright-line income and/or income from land.

30. Similar to ring-fenced residential rental losses, excess bright-line deductions are not considered a "tax loss," and therefore cannot be extinguished when a taxpayer

has a tax debt written off. This does not align with the policy intent of the debt write-off rules.

31. We recommend that for the purpose of the tax debt write-off rules, the Commissioner should be able to extinguish bright-line losses. We recommend that this should apply in relation to tax debts written off on or after 1 April 2024. This is to allow sufficient time for the required system and annual return changes to be made.

32. Because the law does not currently provide for excess bright-line deductions to be extinguished when a tax debt is written off, the fiscal cost of this change is not reflected in current tax forecasts.

33. Officials recommend that you note the reduction in tax revenue and then agree to the proposed amendment to resolve the issue, restoring tax forecasts to their present track, but for a $200,000 cost in 2022/23 and 2023/2024. This is because the forecast change applies immediately, but the recommended amendment would only take effect for tax debts written off on or after 1 April 2024.

34. The fiscal cost of the issue is difficult to quantify because data on excess bright-line deductions is not currently collected. We therefore recommend adjusting tax revenue forecasts downwards from 2022/23 onwards by $200,000 per year, and likewise treating the proposed amendment as resulting in $200,000 of additional tax revenue per year.

35. The Treasury has advised that the fiscal impact of the proposed amendment, but not the forecasting change, should be managed against the Tax Policy Scorecard.

Recommendations

Note that excess bright-line deductions are not extinguished when a taxpayer's tax debt is written off.

Noted Noted

Note the following forecast adjustment for tax revenue, with a corresponding impact on the operating balance and net debt:

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

Noted Noted

Agree that a tax loss should include excess bright-line deductions for the purposes of the debt write-off rules.

Agreed/Not agreed Agreed/Not agreed

Agree that this amendment should apply to tax debts written off on or after 1 April 2024.

Agreed/Not agreed Agreed/Not agreed

Note the following changes to tax revenue as a result of the policy decisions above, with a corresponding impact on the operating balance and net debt:

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

Noted Noted

Items without fiscal implications (Minister of Revenue only)

Limiting tax loss extinguishment obligations to align with current practice

36. The TAA also requires some tax to be written off if it meets certain qualifying criteria (e.g., low-balance write-offs). Other tax is eligible to be written off, but not mandated. In practice, several of these tax write-offs occur via Inland Revenue's auto-calc process.[1]

37. Legally, there is a concern that the loss extinguishment rules apply to these types of write-offs. However, under current practice this process does not automatically extinguish taxpayers' corresponding tax losses.

38. These types of write-offs generally relate to small balances or to liabilities that arise through no fault of the taxpayer. Consequently, to extinguish losses in these cases would seem harsh and involve significant compliance and administration costs which would outweigh any benefit from the extinguishment of losses.

39. We recommend an amendment to ensure that write-offs occurring through the auto-calc process do not result in a tax loss extinguishment. This rule would apply to general tax losses, as well as ring-fenced residential rental property and bright-line losses.

40. The proposed change has no fiscal impact as current administrative practice is not to extinguish those losses, so this amendment would bring the legislation in line with existing administrative practice. This differs from the change for extinguishing bright-line losses above as that proposal would allow bright-line losses to be extinguished, which is currently not permitted. This change would align legislation with administrative practice and as result, would not impact revenue.

41. If instead of a legislative change, Inland Revenue amended the current administrative practice to align with the current law, there would be administrative and compliance costs that would outweigh any additional benefit.

42. This proposed amendment should apply retrospectively from the 2018–19 income year following the implementation of the auto-calc process.

Recommendations

Agree that tax write-offs currently included in the auto-calc process should not result in a tax loss extinguishment.

Agreed/Not Agreed

Agree that this should apply from the 2018–19 income year.

Agreed/Not Agreed

Imputation credit accounts

43. Companies have imputation credit accounts (ICAs) to keep track of company income tax paid on their income. They attach these imputation credits to dividends paid to shareholders to ensure there is no double taxation of income. ICA companies are required to file annual ICA returns (IR4J) accounting for their ICA balance.

[1] The auto-calc process is the process that automatically calculates the tax liabilities for those taxpayers who receive only income with tax deducted at source (e.g., salary and wages).

44. Under the Income Tax Act 2007 (ITA), a group of wholly-owned companies may form a consolidated imputation group. This group has one ICA, which consolidates any debits or credits that would have arisen in individual members' ICAs.

45. When a company is part of a consolidated imputation group, these individual company returns are likely to be nil.

Leaving a consolidated imputation group

46. A concern arises when a member of the consolidated imputation group leaves the group. There are no legislative provisions regarding the allocation of the group's imputation credits that are associated with departing member's tax payments yet to be used against a liability. All imputation credits remain in the consolidated imputation group's ICA.

47. A mismatch arises because even though the imputation credits remain in the group's ICA, tax payments made to the Inland Revenue or a tax pool intermediary by the departing member remain owned by that member. This means that if the departing member obtains a tax refund or transfers their entitlement in a tax pooling account, they would have insufficient imputation credits to cover the required debits to their account. If this occurs, the refund or transfer cannot be processed.

48. Conversely, the imputation group retains excess imputation credits, allowing it to impute more than it should be able to.

49. We recommend amending the ITA so that when a member departs a consolidated imputation group, a debit arises to the consolidated imputation group's ICA and a credit arises to the departing member's ICA. The size of the debit and credit should be equivalent to the size of income tax payments made by the departing member and credited to the group's ICA which have not yet been credited to a tax liability that has or will be assessed on the departing member.

50. The proposed amendment would have no fiscal cost as there would be no change in the number of imputation credits or a company's ability to generate new imputation credits.

51. The proposed amendment would apply for the 2021–22 and later imputation years.

Recommendations

Note that this amendment does not have fiscal implications.

Noted

Agree to amend the Income Tax Act 2007 so that when a member departs a consolidated imputation group a debit arises to the consolidated imputation group's ICA and a credit arise to the ICA of the departing member

Agreed/Not Agreed

Agree that this should apply for the 2021–22 and later imputation years.

Agreed/Not Agreed

ICA returns for members of consolidated groups

52. Under current legislation, taxpayers who are members of a consolidated imputation group are required to file an IR4J return no matter whether that return is nil or not.

53. Filing these nil ICA returns has significant compliance and administrative costs for no benefit. This is because generally most changes to ICAs occur at the consolidated group level and would be included in the group's IR4J. It is therefore the norm that the ICA return of an individual member of a consolidated ICA group would be nil. Members of a consolidated group have nil ICAs because once they are a member of the group, all debits and credits will arise in the group ICA and any balance they had in their individual ICA is likely to have been transferred to the group account over time.

54. To remove these unnecessary costs, we propose an amendment that would not require an ICA company who is a member of a consolidated imputation group to file an ICA with the Commissioner if the balance of that ICA is nil at all times during the imputation year.

55. We recommend this change apply retrospectively to the 2021–22 and later imputation years to validate those taxpayers who have not filed such returns.

Recommendations

Agree to amend the Tax Administration Act 1994 to not require an ICA company who is a member of a consolidated imputation group to file an ICA with the Commissioner if the balance of that ICA is nil at all times during the imputation year.

Agreed/Not Agreed

Agree that this change apply for the 2021–22 imputation year.

Agreed/Not Agreed

Inland Revenue's confidentiality provision and its application to staff from other government departments

56. Tax legislation requires that all Inland Revenue and other agency staff who have access to taxpayer information to keep that information confidential and to sign a confidentiality declaration before accessing the information. This was the position for both Inland Revenue and other agency staff up to 18 March 2019.

57. However, in March 2019, an unintended change was made which required other agency staff to keep all Inland Revenue information confidential, not just taxpayer information. "Inland Revenue information" is broad and includes information that could be in the public domain (e.g., the number of audit staff, which could be available in Inland Revenue's annual report). This was not the policy intent of the provision as it imposes a higher obligation on staff from other government departments than those from Inland Revenue.

58. We recommend that the confidentiality provision for staff from other government departments be amended to refer to only taxpayer information instead of all Inland Revenue information. This would mirror the provision that applies to Inland Revenue staff.

59. We recommend a retrospective application date of 18 March 2019, being when the provision was amended, to ensure that other agency staff are not disadvantaged by the unintended law change. We are not aware of any instances to date where other agency staff have been adversely impacted by this error.

Recommendations

Agree to amend the Tax Administration Act 1994 to require other agency staff to keep taxpayer information shared with them confidential, instead of all Inland Revenue information.

Agreed/Not Agreed

Agree that this should applyfrom 18 March 2019.

Agreed/Not Agreed

Meaning of "company" and application to foreign companies

60. Recent work undertaken by Inland Revenue's Tax Counsel Office found that a literal interpretation of the definition of "company" in the Income Tax Act 2007 (ITA) should be clarified to preclude unintended effects. The definition specifically excludes a partnership. However, the definition of a "partnership" under the Partnership Law Act 2019 means that a company incorporated outside of New Zealand is considered a "partnership" for tax purposes rather than a "company". Foreign companies are therefore excluded from the legal definition of a "company."

61. This interpretation means that foreign companies are not subject to portions of the ITA, including the foreign investment fund (FIF) or controlled foreign company (CFC) rules. This is contrary to the policy intent as the FIF and CFC rules were designed to apply to foreign companies.

62. We recommend an amendment to the definition of "company" to exclude a limited partnership rather than a partnership. This would enable the rules to function as intended.

63. The amendment should apply retrospectively from 1 April 2008, as this was the date that a partnership was excluded from the definition of a "company" in the ITA.

64. There is no fiscal cost associated with the proposal as the change would clarify legislation in accordance with existing practice and policy intent.

Recommendations

Agree to amend the Income Tax Act 2007 to exclude a limited partnership rather than a partnership from the definition of a "company".

Agreed/Not Agreed

Agree that this should apply retrospectively from 1 April 2008.

Agreed/Not Agreed

Interest limitation: Grandparenting variable loans for disallowed residential property

65. Under the interest limitation rules, interest deductions for residential property loans drawn down before 27 March 2021 are gradually phased out between 1 October 2021 and 31 March 2025 (referred to as grandparented loans and interest).

66. When a loan drawn down before 27 March 2021 relates to both disallowed residential property and allowed property, and the borrower cannot reasonably

trace between these purposes, there is a formula to effectively apportion between the two property types.

67. This formula is used to calculate what portion of interest can be grandparented and can continue to be deducted, rather than being fully disallowed.

68. There is an error in the formula used to calculate deductible interest on certain untraceable variable loans when one of the properties is sold. If a repayment is sourced from the sale proceeds of allowed property, there should be no change to the affected loan balance that is grandparented. However, the current law does not achieve this.

69. To correct this, we recommend an amendment to ensure that sales proceeds from allowed property do not impact the affected loan balance used to calculate deductible interest for untraceable loans.

70. This change should apply from 27 March 2021, to align with the introduction of the interest limitation rules.

Recommendations

Agree that the formula in the interest limitation rules for certain grandparented variable loans should be corrected to ensure that sales proceeds from allowed property do not impact the affected loan balance.

Agreed/Not Agreed

Agree that this should apply from 27 March 2021.

Agreed/Not Agreed

Investments in Australian unit trusts

71. The Bill contains proposed changes to the foreign investment fund (FIF) and controlled foreign company (CFC) rules to limit economic double taxation of New Zealand resident investors with indirect investments in certain FIFs. These issues were identified specifically in relation to investments in Australian unit trusts (AUT).

72. The proposed changes to the dividend rules would limit economic double taxation where an investor holds an interest in an AUT CFC, which in turn holds an interest in an AUT FIF. This double economic taxation can arise if the investor is taxed in relation to the AUT FIF (under the FIF rules), in relation to the AUT CFC (under the CFC rules) and when it receives a dividend from the AUT CFC. However, a similar economic double taxation issue can arise where an AUT CFC holds an interest in an ordinary (that is, non-AUT) FIF.

73. To address this economic double taxation, it is proposed that the changes in the Bill to the dividend rules be extended to include any situations where an AUT CFC holds an interest in a FIF that has been appropriately taxed under the FIF rules.

74. This proposed amendment would apply from 1 April 2023, in line with the proposed changes in the Bill.

75. There is no additional fiscal cost with this remedial, as it falls within the original costing of the related changes that are proposed in the Bill.

Recommendations

Agree that the proposed changes to dividends from an AUT CFC be extended to all FIFs in order to limit economic double taxation.

Agreed/Not Agreed

Agree that this should apply from 1 April 2023.

Agreed/Not Agreed