Inland Revenue
Te Tari Taake

NEW LEGISLATION > ACT ARTICLES

# Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020

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The new legislation contains measures aimed at modernising and improving the settings for the administration of social policy by Inland Revenue as part of the Government's programme of transforming the tax system. This includes measures to simplify and modernise the administration of the KiwiSaver and student loan schemes.

The other major aspect of the new Act is to extend the refundability of research and development tax credits, to support Government objectives relating to increasing business expenditure on research and development.

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# On-payment of KiwiSaver employer contributions

*Sections 4, 71, 73, 74, 76, 78, 95B, 95C, 95D, 96, 98, 98A, 99, 101, 101AA, and 221B of the KiwiSaver Act 2006*

The KiwiSaver Act 2006 has been amended to allow Inland Revenue to pay employer contributions to a member's KiwiSaver scheme provider based on employment income information, in advance of the employer paying the contribution to Inland Revenue.

## Background

Inland Revenue on-pays employee contributions to a member's KiwiSaver scheme provider as soon as practicable after receiving payday employment income information that an employee contribution amount has been deducted from the member's salary and wages. As employment income information is due to Inland Revenue prior to the due date for payment of these deductions, employee contribution can be on-paid to scheme providers sooner than they otherwise would be.

However, the law previously provided no comparable arrangement for employer contributions. Instead, when Inland Revenue received employment income information relating to an employer contribution, the employer contribution was not on-paid to the KiwiSaver scheme provider until the contribution amount had been paid to Inland Revenue by the employer. This made it difficult for members to reconcile the amounts in their KiwiSaver account with the contributions listed on their payslips. It also meant employer contributions were not invested by scheme providers as soon as employee contributions were.

## Key features

The amendments allow Inland Revenue to pay KiwiSaver employer contributions to scheme providers before the contribution has been received by Inland Revenue. Employer contributions will be paid to providers as soon as is practicable after employment income information is filed with Inland Revenue indicating that an employer contribution has been made for a pay period.

Along with other KiwiSaver amendments in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020, the change will improve the administrative efficiency of

KiwiSaver as it facilitates the earlier transfer of employer contributions to KiwiSaver scheme providers. This results in a member's employer contribution being invested by their scheme provider sooner.

## Application date

The amendments apply from 1 April 2020.

## Detailed analysis

All section references are to the KiwiSaver Act 2006.

### Amendments to Inland Revenue KiwiSaver Holding Account Rules (Part 3, subpart 2)

Under section 72, Inland Revenue is required to establish a memorandum account. This is called the "Inland Revenue KiwiSaver Holding Account". All contributions made under the Act must be paid into this account in the first instance.

The Act contains a provision which allows Inland Revenue to pay employee contributions to a KiwiSaver scheme provider based on employment income information, before the contribution is paid to Inland Revenue by the employer. Section 73(3) provides that after being paid into the Inland Revenue KiwiSaver Holding Account, these contributions must be paid out of the Holding Account to a KiwiSaver scheme provider as soon as practicable.

In addition to the existing power to on-pay employee contributions, amendments to subsections 73(1) and (2) now allow Inland Revenue to on-pay employer contributions to scheme providers under section 73(3).

The amended section 73(1) provides that before on-paying the contribution amount to the scheme provider, Inland Revenue must be satisfied that the contribution has actually been deducted from salary and wage or, for employer contributions, that the employer can make the contribution at the time it is reported in employment income information. However, in the absence of evidence to the contrary, Inland Revenue can assume that this is the case if an amount has been reported on employment income information. The entitlement for Inland Revenue to make this assumption about employee contributions was previously included in section 73(6), but has been moved to new section 221B and extended to cover employer contributions.

Amended section 73(1) also clarifies that section 73 only applies to employee and employer contributions on-paid to a KiwiSaver scheme provider by Inland Revenue, before the contribution is paid to Inland Revenue by the employer. Employee and employer contributions that are not on-paid to a scheme provider before the contribution is paid to Inland Revenue, are treated as being held on trust by Inland Revenue under section 74. In addition, contributions received by Inland Revenue that are not employee or employer contributions will also continue to be subject to section 74 (for example, a contribution by a non-employer to a member's KiwiSaver account via a payment to Inland Revenue).

The Act contains a provision that prevents an employee being disadvantaged by their employer failing to make payments to Inland Revenue – previously this provision only applied to employee deductions. Amendments to section 78 extend this power to unpaid employer contributions, meaning Inland Revenue will be required to pay an unpaid employee deduction or employer contribution from a Crown Bank Account into the Inland Revenue KiwiSaver Holding Account if the employer had not paid the contribution amount by its due date.

Section 76 has been repealed. This section allowed Inland Revenue to delay on-payment of an employer contribution until a member's next employee contribution was on-paid to their KiwiSaver scheme provider. As the amendments allow employee and employer contributions to be on-paid to a KiwiSaver scheme provider at the same time, this provision is no longer necessary.

Cross referencing and nomenclature amendments have been made to sections 71 and 74(3).

## Amendments to employer contribution rules (part 3, subpart 3)

Sections 98 and 99 have been repealed. These sections set out how part payments of employer contributions to Inland Revenue were treated. Part payment rules are no longer necessary as employer contributions will now always be able to be on-paid in full to a KiwiSaver scheme provider. Instead, new section 95B specifies when an employer contribution shown on employment income information is deemed to be received by Inland Revenue, in instances where the contribution is not paid to Inland Revenue by or before its due date. This provision is consistent with the existing rule for employee contributions in section 69.

The amendments to section 73, which require the on-payment of employer contributions to a KiwiSaver scheme provider as soon as practicable after they are paid into the Inland Revenue Holding Account, are subject to the new sections 95C and 95D. Where an employer fails to provide information required by Inland Revenue about an employer contribution reported in employment income information, new section 95C allows Inland Revenue to wait to on-pay the contribution until the member it should be attributed to can be established. New section 95D provides that such a contribution is not deemed to be received by Inland Revenue until the date the person to whom it is attributable is established. These provisions are consistent with the existing rules for employee contributions in sections 70 and 71.

New section 101(1B) specifies that where an employee opts-out after an employer contribution has already been on-paid to a scheme provider the amount must be refunded to Inland Revenue. While new section 101AA provides where this amount has been paid out of a Crown Bank Account and the amount has not subsequently been received from the employer, the employer contribution must be refunded to a Crown Bank Account. This ensures that an employer is not refunded an amount they have not paid.

The amendments to the opt-out refund rules only have limited application, in circumstances when the late opt-out rules have been applied. This is because employee and employer contributions made by new KiwiSaver members are generally held by Inland Revenue for the duration of the standard opt-out period. The opt-out period ends 55 days after a person has been automatically enrolled in KiwiSaver, while the holding period for initial KiwiSaver contributions is 62 days.

A similar amendment to the one which applies to the opt-out refund rules has not been made for refunds resulting from a person being invalidly enrolled in KiwiSaver. Existing section 59D(4) already allows refunds of contribution amounts (without reference to the specific contribution type) to the Crown, where appropriate, in invalid enrolment situations.

Cross-referencing and nomenclature amendments have also been made to sections 93(5), 96 and 98A.

# Other KiwiSaver administrative refinements

*Sections 4, 18, 22, 23, 34, 38, 39, 48, 51, 56, 57, 59B, 59C, 59D, 63B, 64, 69, 75, 81, 85, 88, 93, 103, 104, 105, 107, 108, 112B, 226 and schedule 1, clause 8 of the KiwiSaver Act 2006; schedule 4 of the Tax Administration Act 1994*

A number of technical amendments have been made to the KiwiSaver Act 2006 and the Tax Administration Act 1994. These seek to enhance Inland Revenue's administration of KiwiSaver, to ensure members receive the correct contribution amounts and facilitate the faster transfer of contributions to KiwiSaver scheme providers.

## Key features

- Reducing the KiwiSaver provisional period (during which individuals who are automatically enrolled in KiwiSaver are provisionally allocated to a default KiwiSaver scheme) and initial holding period from three months to two months.
- Aligning the date KiwiSaver contributions are treated as received by Inland Revenue with a member's payday.
- Reducing the maximum period within which a scheme provider has to send information and funds to a new provider when a member transfers schemes from 35 days to 10 working days.
- Allowing members to change their contribution rate through their KiwiSaver scheme provider or Inland Revenue, in addition to through their employer.
- Removal of requirements to report employer name and address details to Inland Revenue in certain circumstances.
- Minor amendments to reporting address requirements for new members.
- Requiring employers to provide Inland Revenue with information about an employee's KiwiSaver salary and wages.
- Removing the three months grace period for members who have been incorrectly enrolled in KiwiSaver, to gain New Zealand residence.

## Application date

The amendments allowing a member to change their contribution rate through their KiwiSaver scheme provider or Inland Revenue will apply from 1 April 2022 or an earlier date set by Order in Council.

All other amendments apply from 1 April 2020.

## Detailed analysis

All section references are to the KiwiSaver Act 2006 unless otherwise stated.

### Reducing the KiwiSaver provisional period and initial holding period (sections 4, 18, 48, 51, 57, 59B, 64, 75, 81, 88, 104, 108, 112B and 226)

Amendments to section 51(4)(a) and (b) reduce the duration of the provisional period from three months to two months. Section 75 has also been amended so the initial holding period for new member's contributions has been reduced from three months to two months as well.

Where an individual has been automatically enrolled, opted-in via their employer or is no longer eligible to be a member of their existing KiwiSaver scheme, they will be provisionally allocated to a default KiwiSaver scheme under section 50. If an individual does not make an active choice to join another KiwiSaver scheme before the provisional period ends, they are treated as having accepted the offer of membership to the scheme they were provisionally allocated to. A member's initial contributions are held by Inland Revenue for the duration of the provisional period, before being on-paid to the member's KiwiSaver scheme provider (that is, because the provisional period was previously set at three months, the initial holding period was also three months long).

As the amendments will result in them receiving a member's initial contributions earlier, KiwiSaver scheme providers will be aware they have been allocated a default member sooner and will be able to engage with the member about their investment options earlier. It will also mean a member's initial contributions will be invested by their scheme provider sooner. Members will still be able to transfer to a different scheme after the provisional period ends if they wish to do so.

As a result of reducing the initial holding period, an amendment has also been made to section 81(1) so that in addition to being required to refund overpaid contributions to Inland

Revenue, a scheme provider will also be required to refund contributions to Inland Revenue when a member opts out. This provision will apply where the KiwiSaver late opt-out rules have been used, which can be up to three months after a person has been automatically enrolled in KiwiSaver (previously such a rule was not necessary as the late opt-out period ended at the same time as the holding period). A similar amendment has been made to the employer contribution specific refund rules and is discussed in the section of this Tax Information Bulletin entitled “on-payment of KiwiSaver employer contributions”.

Where section 4(3) of the Act earlier defined “3 months” to mean 92 days, section 4(3) has now been repealed and references in the Act to “3 months” have now been replaced with “92 days”. Instead of being expressed as “2 months”, section 51(4) now refers to “62 days”.

Consequential amendments to sections 48(1)(d), 56(4) and 226(1B) and (1C) have also been made to align with the reduced provisional and holding periods.

## Aligning the date KiwiSaver contributions are received with member’s payday (sections 4, 69, 78, 85 and schedule 1, clause 8 and new sections 95B and 221B)

Previously employee contributions were treated as received by Inland Revenue on the 15th day of the month they were deducted from the member’s salary or wages. Sections 69(2), 78(b), 85(1) and schedule 1, clause 8 contained a 15th of the month timing rule for employee contributions. These provisions are relevant for determining when unpaid employee contributions are treated as received, when employee contributions are treated as received for the purpose of calculating interest and when employee contributions are treated as received for the purpose of the KiwiSaver first home withdrawals rules.

Previously section 85(3) provided that employer contributions were treated as received on the first of the month that Inland Revenue received payment for the contribution. The reason employer contributions were treated as received on a different date from employee contributions was due to an inability to on-pay employer contributions to a scheme provider until the contribution amount had been paid to Inland Revenue. If interest was calculated from the 15th of the month and there was a delay in the employer contribution amount being paid to Inland Revenue, then Inland Revenue risked having to pay interest on those contributions for an extended period. However, the on-payment of employer contributions amendments included in the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act

2020 means it is no longer necessary to treat employee and employer contributions differently for timing purposes.

These timing rules for employee and employer contributions reflected the fact that Inland Revenue previously did not have sufficient information to determine the date of an employee's payday. However, the rules were unsatisfactory as, amongst other things, they resulted in the under and over-payment of interest on employee contributions and underpayment of interest on employer contributions.

As part of changes to employment income information requirements, which came into effect from 1 April 2019, employers are now required to report the date of their employee's payday to Inland Revenue. To reflect this, sections 69, 78 and 85 have been amended so that employee contributions can be treated as received by Inland Revenue on the date of the member's payday as reported by the employer. Similarly, the amended section 85 and new section 95B(2) (which relates to the date employer contributions are treated as received for the on-payment of employer contributions amendments above) specify that employer contributions are also treated as received on the date of the member's payday.

All the amendments include a carve out stating that where an employer has not provided information to Inland Revenue about an employee's payday, both employee and employer contributions are treated as received on the 15th of the month that the employee contribution was deducted/employer contribution relates to. This covers situations in which Inland Revenue has granted an employer a variation for employment income information requirements which results in them not being required to report the date of their employee's payday.

Sections 69 and 85 provide that Inland Revenue needs to be satisfied that an employee contribution had actually been deducted from salary and wages for these sections to apply. Amended section 85 and new section 95B, introduce a similar rule for employer contributions. The amendments require Inland Revenue to be satisfied that the employer can make the contribution at the time it is reported in the employment income information for these sections to apply. The new section 221B entitles Inland Revenue to assume that these requirements are met where an amount is included in employment information (unless there is evidence to the contrary).

An amendment has also been made to section 4 to clarify that "payday" has the same meaning as it does in the Tax Administration Act 1994.

## Transfer of member's information and funds to a new scheme provider (sections 56 and 57)

Section 56(4) specifies the maximum transfer period KiwiSaver scheme providers have to send a member's funds and relevant information to a new scheme after receiving notice from a member that they have opted to transfer schemes. This section has been amended to reduce this transfer period from 35 days to 10 working days. The section would continue to permit the transfer timeframe being exceeded, where this is agreed to between the old and new KiwiSaver schemes.

KiwiSaver default providers' instruments of appointment currently already require them to complete transfers within 10 working days of receiving notice that the member has transferred schemes. Therefore, the amendment results in the transfer time being aligned across all KiwiSaver scheme providers.

A consequential amendment has also been made to section 57(5).

## Changing employee contribution rates (sections 38, 39 and 64)

Section 64(2) has been amended so employees have the option of changing their KiwiSaver contribution rate by contacting Inland Revenue or their KiwiSaver scheme provider, in addition to their employer. This will reduce compliance costs for members who may be more likely to engage with Inland Revenue or their KiwiSaver scheme provider in the first instance about contribution rate changes.

New section 64(2B)–(2D) outlines information a member or their scheme provider needs provide to Inland Revenue where a contribution rate change is made, and what information Inland Revenue would be required to subsequently provide a member's employer(s) to ensure the contribution rate change is given effect to.

## Changes to employer name and address reporting requirements (sections 38, 39. 103, 105, and 107)

Amendments have been made to requirements in the Act to report employer name and address details, to address issues arising where this information is incorrectly reported to the Inland Revenue. This commonly occurs where an employer's trading name and address are different than their registered name and address.

#### Reporting requirements where member enrolled directly with scheme provider

Section 38 sets out what information a KiwiSaver scheme provider must report to Inland Revenue, when a person has enrolled in KiwiSaver directly with the provider. The requirement in section 38(2), for a scheme provider to report employer name and address details to Inland Revenue has been repealed. Instead, Inland Revenue will notify all active employers it has on record for the employee that the employee has enrolled in KiwiSaver.

Consequential amendments have also been made to section 39(1).

#### Reporting requirements where member applies for a savings suspension

The general requirement in section 103(2)(c) for an employee who applies for a savings suspension to provide Inland Revenue with the names and addresses of the employers they wish the savings suspension to apply to, has been repealed. Instead this information would now only be required under section 103(2)(c) when requested by Inland Revenue.

Amendments have also been made to sections 105(2) and 107(a), so that Inland Revenue would only be required to notify an employer that a savings suspension had been granted in respect of one of their employees, where it has requested the member provide employer name and address details.

The intended operation of these amendments is member's applying for a savings suspension via their myIR account would be able to select from a list of their employers, which they want the savings suspension to apply to (that is, in this situation Inland Revenue would be treated as requiring employer name and address details). For members applying for a savings suspension through other channels, the member would be sent a letter advising that they had been granted a savings suspension, which they could show to employers of their choice.

### Aligning employee address requirements in the KiwiSaver Act 2006 with the Tax Administration Act 1994 (sections 22, 23 and 34)

Under schedule 4 of the Tax Administration Act 1994, an employer must provide a new employee's contact address to Inland Revenue "as required" (that is, when such information is requested by Inland Revenue). However, under the KiwiSaver Act 2006 employers were always required to provide an employee's contact address to Inland Revenue for new KiwiSaver enrolments.

This created an inconsistency between the requirements of the Tax Administration Act 1994 and the KiwiSaver Act 2006, in that even where Inland Revenue did not require a new employee's contact address under the Tax Administration Act 1994, the employer would still be required to provide this information if the employee had also been enrolled in KiwiSaver.

Sections 22, 23 and 23 of the KiwiSaver Act 2006 have now been amended to clarify that an employer is only required to provide the contact address of an employee who has been enrolled in KiwiSaver if it is required by Inland Revenue.

## KiwiSaver income information (new section 63B of the KiwiSaver Act 2006 and schedule 4 of the Tax Administration Act 1994)

As part of the KiwiSaver on-boarding process, employers are required to provide Inland Revenue with certain information about new enrolments to the scheme.

To improve Inland Revenue's ability to ensure members are receiving the correct KiwiSaver contribution amounts, new section 63B requires employers to report information to Inland Revenue on the amount of salary and wages a KiwiSaver deduction is made from for an employee, if there is a difference between amounts that an employer must treat as gross earnings for the purpose of calculating PAYE tax obligations and amounts they must treat as salary and wages for the purpose of calculating KiwiSaver contributions. If there is a difference between amounts that an employer must treat as gross earnings (for calculating PAYE deductions) and amounts they must treat as salary and wages (for calculating KiwiSaver contributions), then the employer must report the latter.

As there are some amounts that are treated as income for PAYE that are exempt for KiwiSaver purposes, collecting this information will help Inland Revenue ensure that KiwiSaver contributions are being paid at the correct rate. Some examples of amounts included in gross income for PAYE that are not included within the definition of salary and wages for KiwiSaver are the value of accommodation, a benefit from an employee share scheme or a redundancy payment.

Employers need not provide this information every payday. Instead, the employer is required to report to Inland Revenue about new employees or existing employees joining KiwiSaver for the first time.

Consequential amendments have also been made to schedule 4 of the Tax Administration Act 1994. These clarify that the new reporting requirements fall within the ambit of what is considered employment information under that Act.

## KiwiSaver invalid enrolment residence grace period (sections 59, 59C, and 59D)

Section 59A provides that when an individual does not meet the KiwiSaver residence requirement, the invalid enrolment rules will apply. However, under section 59B the member was treated as meeting the KiwiSaver residence requirement for the first three months after the invalid enrolment was discovered. Section 59C then provided if the person became someone who meets the residence requirement within this three-month period, the enrolment would be retrospectively validated and their KiwiSaver account would remain open.

In practice, the three-month residence grace period did not operate as intended, as non-residents who have been invalidly enrolled in KiwiSaver typically do not intend to become a resident in the short-term (for example, individuals on temporary work visas). In recognition of this, new section 59B(2)(ab) has been inserted. This section will mean where an individual has been invalidly enrolled in KiwiSaver on the basis of not meeting the residence requirement, they will cease to be a member as soon as their scheme provider discovers, or is notified about, the invalid enrolment.

Amendments to section 59C(1) clarify that where a person who did not meet the residence requirement was invalidly enrolled, this enrolment could not be retrospectively validated. Amendments to section 59D(1) confirm that the refund process set out under this section for contributions that a person had made while invalidly enrolled apply if an individual’s account is closed on the basis of them not meeting the residence criteria when enrolled.

The effect of the amendment is to remove the three-month residence grace period and means the member’s account will be closed immediately. The individual will then be able to open a new KiwiSaver account if they later become a resident.

# Withdrawal in cases of life-shortening congenital conditions

*Sections 101C, 228, 243 and schedule 1, clauses 12B and 13 of the KiwiSaver Act 2006; section MK 2 and schedule 28 of the Income Tax Act 2007*

A new KiwiSaver withdrawal category has been introduced to allow members with life-shortening conditions to withdraw their savings before reaching the age of 65 in order to provide for themselves in retirement.

## Background

The reason for this new category of withdrawal is to recognise that people with life-shortening congenital conditions may not live until the New Zealand superannuation qualification age (currently 65) – the age at which they would ordinarily be eligible to access their retirement savings. While there is an existing withdrawal category for KiwiSaver members who are seriously ill, this does not assist those with life-shortening congenital conditions. This is because the serious illness withdrawal category is only available where the member is totally and permanently unable to engage in work for which they are suited, or else has a condition which poses a serious and imminent risk of death.

## Key features

A further ground for the early withdrawal of KiwiSaver funds has been added to schedule 1 of the KiwiSaver Act 2006. KiwiSaver members with life-shortening congenital conditions are now able to withdraw their KiwiSaver funds before they reach the general withdrawal age of 65.

Under the new withdrawal category life-shortening congenital conditions named in regulations would automatically qualify for withdrawal. An alternative process is also available to people that have a life-shortening congenital condition that is not named in the regulations to apply to their KiwiSaver provider for a withdrawal.

## Application date

The amendments will apply from 1 April 2020.

## Detailed analysis

New clause 12B of schedule 1of the KiwiSaver Act 2006 introduces a new withdrawal category which allows members with life-shortening congenital conditions to withdraw their savings early in order to provide for themselves in their retirement.

The newly enacted clause 12B(1) of schedule 1 of the KiwiSaver Act 2006 provides two avenues for members with a life-shortening congenital condition to withdraw their KiwiSaver funds. These are where the member has:

- a life shortening congenital condition which has been identified by regulation (a condition which has identified in this way is referred to as a "listed condition");[1] or
- a congenital condition which is likely to reduce their life expectancy below the New Zealand superannuation qualification age for the member or for persons in general (this is referred to as a "non-listed condition").

A KiwiSaver member with either of the above categories of congenital condition which has existed from the date of their birth may apply under clause 13 to the manager or supervisor of their KiwiSaver scheme for a withdrawal. The amount of the withdrawal may be up to the value of their accumulation in the fund.

An applicant with either a listed or non-listed condition must supply a medical certificate which verifies the member suffers from the condition. A medical certificate presented by an applicant with a non-listed condition must additionally verify that the condition the member suffers from is a life-shortening congenital condition for the member or for persons in general with the condition.

A withdrawal application must also include a statutory declaration completed by the member, acknowledging that they understand the consequences of withdrawing their savings.

[1] New section 228(1)(mb) inserts a regulation making power into the KiwiSaver Act 2006, to allow for a listed condition to be specified in regulations.

New sections 101C(cb) of the KiwiSaver Act 2006 and MK 2(cb) of the Income Tax Act 2007 provide that a member who has made a life-shortening congenital condition withdrawal will no longer be eligible for compulsory employer contributions or the annual Government contribution. This is consistent with how KiwiSaver members are treated when withdrawing for the purpose of retirement (that is, entitlement to compulsory employer contributions and the Government contribution generally cease when a member reaches the age of 65).

Consequential amendments have also been made to the complying fund rules in schedule 28 of the Income Tax Act 2007, to ensure a life-shortening congenital condition withdrawal is also a grounds for early withdrawal under these rules.

## Transitional period for KiwiSaver scheme providers

New section 243 of the KiwiSaver Act 2006 grants transitional relief to KiwiSaver scheme providers who are non-compliant with product disclosure statement requirements or other requirements to file information on a relevant disclose register under the Financial Markets Conduct Act 2013, as result of the introduction of the new early withdrawal ground. This period of transitional relief comes to an end before 31 January 2021.

# Limiting ability to reopen any repayment obligation relating to years prior to 1 April 2013

*Clauses 21–27 of Part 5 of schedule 6 of the Student Loan Scheme Act 2011*

Limiting the situations where either the Commissioner or the borrower can reopen a borrower's repayment obligation for tax years prior to 1 April 2013.

## Background

Inland Revenue was required to maintain the student loan rules back to 1992 when the scheme was introduced in case either the Commissioner or the borrower seeks to review a borrower's repayment obligation. Retaining rules back to 1992 has increased the complexity of the scheme over time as changes have been made to the scheme in 21 of the last 26 years. Compliance costs for borrowers are high, as understanding changes to their loan balance is difficult due to historical rules applying for prior years. Administration costs for Inland Revenue are also high, as are the costs of building the rules back to 1992 into new systems and processes, with little benefit.

As part of Inland Revenue's Business Transformation programme, it is proposed that a simplified set of rules will apply for the period from 1992 to 1 April 2013. This will reduce compliance costs for borrowers, the administration costs for Inland Revenue, and the time and cost of implementing changes to the student loan scheme.

The 1 April 2013 date was chosen as nearly all adjustments to borrowers' repayment obligations have occurred within this timeframe and the rules applying from that date onwards are largely the same as applies today.

## Key features

Schedule 6 of the Act is amended by introducing a new Part 5. This Part sets out the proposed new rules for tax years prior to 1 April 2013.

For the purposes of clauses 23–27 of this Part, references to "Act" refer to either the Student Loan Scheme Act 1992 or the Student Loan Scheme Act 2011, whichever is appropriate.

A new definition of closed-off tax years applies to tax years from 1992 up to 1 April 2013. During this period both the Commissioner and the borrower are precluded from reopening any repayment obligation except where the borrower:

- becomes overseas or New Zealand-based;
- has committed fraud; or
- has not filed information (for example, an unfiled return) to the Commissioner when required to do so under the Act and it is cost effective for the Commissioner to reopen the repayment obligation.

A savings provision enables the Commissioner to correct the position of any borrower who might be unduly disadvantaged by these proposals. Where a borrower considers that they are worse off, they can apply to the Commissioner and if the Commissioner agrees then their repayment obligation will be corrected.

## Residency changes

If a change in a borrower's residence status is identified after 1 April 2020 and the change relates to a closed-off tax year, a simplified set of rules will apply. Loan interest would be calculated on the borrower's loan balance from the date the borrower went overseas, or loan interest would cease to apply from date they returned to New Zealand.

Where a borrower goes from New Zealand-based to overseas-based during the closed-off period, no overseas-based borrower repayment obligation for the period will be imposed.

Where a borrower goes from overseas-based to New Zealand-based during the period, overseas-based repayments would not be collected. Any payments already collected would go against the loan balance.

However, changes to a borrower's repayment obligations due to residency changes will apply from 1 April 2013 onwards.

### Example 1

Bob went overseas in April 2008 but did not advise Inland Revenue. Since 2008, Bob has been treated as a New Zealand-based borrower (so was not charged loan interest). Bob has not met his repayment obligations since 2008. In April 2021, Bob returns to New Zealand and Inland Revenue identifies that Bob has been overseas since April 2008. Bob's obligations for the 2008–13 tax years can be reopened only to the extent that Bob must pay loan interest from April 2008. His repayment obligations for the 2008–13 tax years cannot otherwise be assessed or reassessed. Bob's obligations for the 2014–21 tax years can be reopened in full (because those tax years are not closed off). For the period from 1 April 2013 until he returned to New Zealand, Bob may be liable to an overseas-based borrowers' repayment obligation and loan interest. From 1 April 2013 onwards, associated late payment interest charges can apply.

### Example 2

Ngaire went overseas in April 2000 and advised Inland Revenue of her departure. Ngaire returned to New Zealand in July 2008 but did not advise Inland Revenue. Since April 2000, Ngaire has been treated as an overseas-based borrower (so was charged loan interest and assessed with an overseas-based repayment obligation). Ngaire has not met her repayment obligations since March 2000. In April 2021, Inland Revenue identifies that Ngaire returned to New Zealand in July 2008. Ngaire's obligations for the 2008–21 tax years can be reopened. For the period from July 2008 to 31 March 2013, the loan interest charge, and any overseas-based borrower repayment obligations, can be reversed but no New Zealand-based repayment obligation can be assessed in its place. For the 2013–14 tax year and later tax years, Ngaire can be assessed with a New Zealand-based borrowers' repayment obligation (because those tax years are not closed off). From 1 April 2013 onwards, associated late payment interest charges can apply.

### Example 3

Pip went overseas to work as a volunteer for a recognised charity in April 2008 and returned in April 2010. Pip could have applied to be treated as if still physically in New Zealand during the period of absence but did not. Pip's obligations for the 2008–09 to 2009–10 tax years can be reopened if she makes an application. For the period of absence, the loan interest charge, and any overseas-based borrower repayment obligations, can be reversed but no New Zealand-based repayment obligation can be assessed in its place.

### Fraud or unfiled returns or information

Where fraud is involved, or the borrower has failed to provide a return or information to the Commissioner, the borrower's repayment obligation may be reopened during the closed-off period. In these situations, a simplified calculation would be used to calculate the borrower's repayment obligation, namely, 10 percent of the difference between the income of the borrower that should have been used to calculate the repayment obligation and the income that was used less any unused repayment threshold. Other rules that applied in that year would be disregarded.

A one-off penalty may also apply to penalise the non-compliant action. Late payment interest will not be imposed for the closed-off period. However, late payment interest may apply from 1 April 2013 onwards.

| Example 4 |
| --- |
| Chris fraudulently failed to declare a large source of income for the 2008–09 tax year. This has implications for both income tax and student loan obligations. The 4-year (statute bar) period for making changes to an income tax obligation after a return is filed does not apply where fraud is involved. Therefore, the Commissioner of Inland Revenue amends Chris's income tax liability for the 2008–09 year and the student loan repayment obligation for that year is also amended. The reopened student loan repayment obligation is the difference between the previous income amount and the new income amount, less any unused repayment threshold, multiplied by the repayment percentage (which was 10% up to 1 April 2013). Chris could be considered for a shortfall or criminal penalty for not filing or for the fraudulent activity. |

## Application date

The amendments apply from 1 April 2020.

# Replacing the underestimation penalty with shortfall penalty

*Sections 4, 146(3)(a)(ii), and 161A of the Student Loan Scheme Act 2011*

Replacing the student loan underestimation penalty with a shortfall penalty to align it with the penalty imposed for underestimation of provisional tax for tax purposes.

## Background

Borrowers who earn income other than salary and wages and whose end-of-year repayment obligation on this income is more than $1,000, are required to make interim repayments in the following year. A borrower can base these interim repayments on either the previous year's assessed amount plus an uplift percentage or an estimate of the expected end-of-year repayment obligation.

To ensure borrowers who choose the estimate option make an accurate estimate of their interim repayment obligations, a penalty is imposed on those who significantly underestimate their interim repayments.

To provide consistency of penalties between underestimations of loan repayments and the underestimations of provisional tax, it is proposed that the current underestimation penalty be replaced with a shortfall penalty.

## Key features

Sections 4, 161A, and 146(3)(a)(ii) are amended to reflect the repeal of the underestimation penalty. The current shortfall penalties that apply to other tax positions, actions, or omissions also include not making an accurate estimate of their interim repayment obligations.

## Application date

The amendments apply from 1 April 2020.

# Repayment obligations limited to consolidated loan balance

*Sections 191(1) and (3A) and 194(2) of the Student Loan Scheme Act 2011*

Enabling repayment obligations to continue until the consolidated loan balance (including unpaid amounts and interest) is repaid.

## Background

The Student Loan Scheme Act 2011 defines the term “loan balance” as including core borrowing, loan interest charged and the administration fee, but not including unpaid amounts (which are defaults and late payment interest).

The Act also defines the “consolidated loan balance”, which includes the loan balance and unpaid amounts.

The Act previously limited a borrower’s repayment obligation to their loan balance, rather than their consolidated loan balance, meaning deductions from salary and wages could only occur until the loan balance has been repaid. This prevents salary and wage deductions from being made to repay unpaid amounts. The Act replaces “loan balance” with “consolidated loan balance” for the purpose of this limitation.

The amendment will allow salary and wage deductions to continue until the consolidated loan balance is fully repaid.

| Example 5 |
| --- |
| Ben goes overseas with a loan balance of $7,000. Based on this loan balance he is required to make repayments of $1,000 per year but does not make any repayments while overseas. He then returns to New Zealand after 5 years overseas with a “loan balance” of $2,000 and unpaid assessments of $5,000.[2] |

[2] For simplicity, the example ignores interest and the annual administration fee.

Ben begins working in New Zealand, and his employer deducts loan repayments each payday until Ben's $2,000 "loan balance" is repaid. At this point, Inland Revenue would be required to instruct the employer to stop making student loan deductions.

Inland Revenue will seek repayment of the unpaid $5,000. If Ben does not repay, Inland Revenue would need to use other tools to get him to repay their loan.

## Key features

Section 191(1) and (3A) is amended by referring to consolidated loan balance instead of loan balance.

## Application date

The amendments apply from 1 April 2020.

# Requirement to deduct repayments from schedular, election day, and casual agricultural income

*Sections 115, 118, 123, and 124 of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019*

Repealing the legislation requiring loan repayment deductions to be made from schedular, election day, and casual agricultural payments at source.

## Background

Changes enacted as part of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 require student loan repayments to be deducted from schedular, election day, and casual agricultural income each pay day, with effect from 1 April 2020.

These changes were introduced to benefit borrowers in reducing their loan balance and reducing compliance costs by making repayment deductions during the year. However, although consultation undertaken before enactment raised no compliance cost issues for employers, further consultation undertaken as part of implementing these changes has identified significant compliance costs for employers in implementing these changes. Therefore, the changes have been repealed with effect from 1 April 2020.

## Key features

Sections 115, 118, 123, and 124 of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019 are repealed.

## Application date

This amendment applies from 31 March 2020.

# Commissioner may notify employers when loan balance close to zero

*Section 62A of the Student Loan Scheme Act 2011*

Enabling Inland Revenue to notify employers of a borrower's remaining loan balance when the borrower's loan is close to being fully repaid.

## Background

Currently, employers make salary and wage deductions from their employee's wages at the rate of 12 cents in the dollar for every dollar over the repayment threshold. This continues until the loan is repaid. Inland Revenue contacts employers after loans is repaid to instruct them to cease making student loan deductions. However, as employers make deductions at a constant rate, employers often deduct more than the remaining loan balance. These overpayments often require contact between Inland Revenue and the borrower to resolve.

This amendment is possible now because since 1 April 2019, employers have been required to provide information on employees' income and deductions each payday giving Inland Revenue more timely and accurate information regarding an employee's earnings.

## Key features

A new section 62A is inserted into the Act. The section provides that Inland Revenue will notify 1 or more of the borrower's employers of the borrower's loan balance when the loan is close to being fully repaid. Where possible, Inland Revenue will also give the borrower a copy of the notification provided to the employer(s). Employers will need to reduce the amount of the final deductions so that the amount of the repayment is equal to the remaining loan balance, which will reduce the likelihood of overpayments being made.

## Application date

The amendments apply from 1 April 2020.

# Reducing annual net income threshold from $1,500 to $500

*Section 72 of Student Loan Scheme Act 2011*

## Background

The Act contains a concession where a borrower with less than $1,500 of non-salary and wage income is not required to make loan repayments on this income. This threshold reflects the compliance costs associated with the requirements to file a return and/or notify Inland Revenue of any adjustments to income for student loan purposes.

From the 2018–19 tax year, most salary and wage earners will have their tax automatically assessed. Therefore, as the compliance costs associated with complying with the filing requirements have been reduced, the threshold level has also been reduced from $1,500 to $500.

## Key features

Section 72 of the Act is amended by replacing the references to $1,500 with $500 in both places where they occur.

## Application date

The amendments apply from 1 April 2020.

# Replace repayment holiday with temporary repayment suspension

*Sections 106, 107, 107B, 108, 108A, 110, 115, and 182A of Student Loan Scheme Act 2011*

Replacing the term "Student Loan Repayment Holiday" with "Student Loan Temporary Repayment Suspension".

The repayment holiday reduces a borrower's overseas-based repayment obligation to zero. Renaming the repayment holiday will send a better signal to borrowers that their repayment obligations are only on hold. In practice, there will be no change to the effect of the policy on borrowers.

## Application date

The amendments apply from 1 April 2020.

# Date repayment deductions deemed to be made

*Section 195(3) and (3A) of the Student Loan Scheme Act 2011*

Changing the date that student loan repayment deductions are deemed to be made from the 15th of the month to the employee's payday.

## Background

Currently deductions are deemed to be made on one fixed date, the 15th of the month. This is because until 1 April 2019 Inland Revenue did not receive payday information for all employees and determining employees' paydays would impose compliance costs on employers.

The introduction of payday filing now enables Inland Revenue to deem deductions to be made on the employee's payday. This should not have adverse implications for borrowers.

## Key features

Section 195(3) and (3A) are replaced with a new subsection (3) which makes it clear that salary or wage deductions are credited on the day on which the deduction is made. All other payments (other than salary or wages) are credited on the date on which the payment is received by the Commissioner.

## Application date

The amendments apply from 1 April 2020.

# Notification of income by overseas-based borrowers applying to be treated as New Zealand-based

*Sections 74(2) and 114(3) of the Student Loan Scheme Act 2011*

Clarifying that a borrower can notify the Commissioner of their adjusted net income at the time they apply for treatment as being physically in New Zealand or a later date.

## Background

Borrowers can apply to be treated as being physically in New Zealand if the principal reason for not being in New Zealand is included within a list of categories in the Act, for example, as part of their New Zealand employment the borrower is posted overseas. If granted, borrowers' repayment obligations are income contingent and the loan is interest free for the relevant period. Borrowers can apply for this treatment before, during or after being absent from New Zealand.

As a condition of some of the listed reasons, borrowers must notify the Commissioner of their adjusted net income. However currently, it is unclear whether those borrowers who apply for this treatment after their absence must make a separate extension of time application, or whether they may notify the Commissioner of their income information at the time of application.

## Key features

Sections 74(2) and 114(3) are amended to enable the borrower to advise the Commissioner of their income at the same time as they apply to be treated as a New Zealand-based borrower.

## Application date

The amendments apply from 1 April 2020.

# Interest for New Zealand-Based borrowers

*Clause 29 of Part 5 of Schedule 6 of the Student Loan Scheme Act 2011*

Removing the requirement to impose interest and then write it off for New Zealand-based borrowers, for reassessments prior to 1 April 2020.

## Background

In the past Inland Revenue's system limitations meant that the only way to impose interest on overseas-based borrowers was to impose interest on all borrowers and then to immediately write it off for New Zealand-based borrowers. This has caused confusion and concern to borrowers.

Inland Revenue's business transformation programme means that those systems limitations no longer exist going forward. However, if changes that apply to periods before 1 April 2020 are made to a borrower's loan balance after 1 April 2020, the legislation technically requires interest to be imposed and written off for New Zealand-based borrowers.

## Key features

A new clause 29 has been inserted into part 5 of Schedule 6 to provide that loan interest does not need to be charged for changes to a New Zealand-based borrower's loan balance from 1 April 2012 onwards.

## Application date

The amendments apply from 1 April 2020.

# Aligning the write-off rules

*Sections 144, 146A, 161A, 189(1), 195(3), and 197(2) of Student Loan Scheme Act 2011*

Amending the Act to enable the Commissioner to write off amounts of $20 or less.

## Background

Currently, the Tax Administration Act 1994 allows the Commissioner to refrain from collecting tax of amounts not more than $20. In the Act the Commissioner may write off amounts less than $20. The amendment aligns these by changing the wording in the Student Loan Scheme Act to align with the Tax Administration Act 1994. This would provide consistency of treatment between small amounts of income tax and student loan obligation. This should not have a significant impact as it will adjust the threshold for a small balance write-off by one cent.

## Application date

The amendments apply from 1 April 2020.

# Early assessments of student loan adjusted net income

*Section 191(2) of the Student Loan Scheme Act 2011*

Allowing valid returns filed before the end of the tax year to be finalised and the borrower's repayment obligation to be calculated.

## Background

Currently, the Act requires that a borrower's end-of-year repayment obligation on their adjusted net income cannot exceed their loan balance on the last day of the tax year. In some cases, a borrower may file a return before the end of the tax year (for example, if they go overseas) and this requirement would delay Inland Revenue being able to complete this assessment until the end of the year.

The amendment provides that where a return is filed earlier than the last day of the tax year, the assessment could be completed, and the borrower's repayment obligation should not exceed their loan balance on the date the return is filed. If the borrower earns further income in the year, for example returns to New Zealand unexpectedly, their repayment obligation can be amended, and a further assessment issued.

## Application date

The amendments apply from 1 April 2020.

# Payment ordering rules

*Section 194(1) of the Student Loan Scheme Act 2011*

Allocating payments against the oldest unpaid period, and within each period against interest first, then the principal.

## Background

Currently, the Act requires that payments be offset first against interest on the loan, then against the principal, for non-salary and wage payments, where the borrower does not specify a treatment. Payments are generally allocated against the oldest unpaid assessment, and then against interest before principal within each period. This treatment is generally advantageous to borrowers as it will minimise any interest they are charged.

The amendment reflects the period-based allocation of payments within the new system.

## Key features

Section 194(1) is replaced to reflect the period-based allocation of payments.

## Application date

The amendment applies from 1 April 2020.

# Loans resulting from identity theft

*Section 146C and clause 28 of Part 5 of Schedule 6 of the Student Loan Scheme Act 2011*

Enabling Inland Revenue to write off loans taken out before 2000, where the Commissioner is satisfied that the borrower did not take out the loan, and the correct borrower cannot be identified.

## Background

Inland Revenue manages loans that were taken out by borrowers before 2000. However, it does not have the legislative authority to write off loans where the borrower has been able to prove that they did not take out the loan and the correct borrower cannot be identified. Loans taken out from 2000 onwards are administered by MSD who do have the power to reverse loans if they cannot locate the correct borrower.

## Key features

A new clause 28, is inserted in Part 5 of schedule 6 of the Act to allow Inland Revenue to write off loans that were transferred before 1 April 2000 where the Commissioner is satisfied that the person who has been allocated the loan did not take it out, and the correct borrower cannot be identified.

## Application date

The amendment applies from 1 April 2020.

# Overseas-based borrowers with serious illness or disabilities

*Section 25(2) and 26, 27, 176, and clause 11(1) of schedule 1 of the Student Loan Scheme Act 2011*

## Background

On application, the Commissioner of Inland Revenue may treat overseas-based borrowers who are unable to meet their repayment obligation as a result of a serious illness or disability as being physically in New Zealand.

## Key features

The change provides a new circumstance for when a borrower can be treated as being physically in New Zealand. This means they could be eligible for an interest-free loan and have repayment obligations based on their income.

Borrowers with a serious illness who are unable to meet their overseas-based repayment obligations will be able to be treated as physically in New Zealand for the purposes of determining whether they are New Zealand-based or overseas-based.

The amendment will require the borrower to provide evidence of their medical and financial position as the Commissioner of Inland Revenue requires. Unlike for hardship relief, the borrower would not necessarily need to supply evidence annually. Instead they would need to do so as the Commissioner of Inland Revenue reasonably requires.

The borrower will be required to notify the Commissioner of Inland Revenue of their annual adjusted net income. This is required of all borrowers who have repayment obligations based on their income.

## Application date

The amendment applies from 1 April 2020.

## Detailed analysis

The treatment will be available to borrowers who have an injury, illness, or disability that results in them being unable to engage in paid work, other than work for which the person is paid a token payment or a very low wage, or where that injury, illness or disability poses a serious and imminent risk of death.

The proposed amendment will not change borrowers' abilities to receive hardship relief.

| Example 6 |
| --- |
| Ben lives overseas and was seriously injured in a football game. After the accident Ben had to quit his job and he is now financially unable to meet his overseas-based repayment obligation. Ben is now working at his local community gardens, as part of the country's welfare programme. As part of this welfare programme, Ben receives a payment for his work that is below the country's ordinary minimum wage. He is eligible to apply to be treated as a New Zealand-based borrower, meaning he would have an interest free loan and repayment obligations based on his income. |

# Student Loan Scheme (Details of Borrower's Contact Person) Amendment Regulations 2020

*These regulations were made under section 215(d) of the Student Loan Scheme Act 2011. They amend regulation 3 of the Student Loan Scheme (Details of Borrower's Contact Person) Regulations 2012*

## Background

Under the Student Loan Scheme (Details of Borrower's Contact Person) Regulations 2012, borrowers are required to provide the date of birth and IRD number of their alternative contact person when they apply for their student loan. However, at that time, no equivalent regulations were passed for when borrowers apply for a repayment holiday.

The Student Loan Scheme (Details of Borrower's Contact Person) Amendment Regulations 2020 align the information required about a borrower's contact person when they apply for a student loan or a repayment holiday.

## Key features

These regulations require that borrowers provide the date of birth and IRD number of their alternative contact person when they:

- apply for a student loan repayment holiday;
- update their contact person's details; or
- nominate a new contact person.

## Application date

These regulations came into force on 1 April 2020.

# Refunding R&D tax credits

*Sections LA 5(4B), (5B), (5C), (5D), LZ 14, and YA 1 (definitions of approved research provider, eligible research and development expenditure, ESCT, FBT, levy body researcher, PAYE, and refundability cap) of the Income Tax Act 2007*

These changes affect the amount of R&D tax credits that can be refunded to a person. They replace the existing $255,000 refundability cap, corporate eligibility criteria, and R&D wage intensity test with new broader refundability rules.

## Background

Refundability is intended to ensure that all claimants doing R&D can benefit from their R&D tax credits soon after the year their R&D takes place in. Without refundability, some claimants may not be able to benefit from their credits until a much later date (if at all, depending on the circumstances of each claimant). Refundable credits enable claimants in a tax loss position, or with insufficient income tax liability to use all of their R&D tax credits in the relevant income year, to benefit from their R&D tax credits sooner.

In year 1 (the 2019–20 income year), limited refundability rules were introduced to enable some firms to access refundable credits. These rules were taken from the existing R&D tax loss cash-out regime, because tight timeframes meant there was not enough time to develop broader refundability rules. The Government committed to reviewing the refundability rules so that broader refundability would be available from year 2 of the credit (the 2020–21 income year).

Note that this section of the *Tax Information Bulletin* also incorporates changes enacted by the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020 (COVID-19 Tax Act), which amended R&D rules in the Income Tax Act 2007 and the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

## Key features

- The Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 (the KSSLRM Act) introduces new broader refundability rules.
- The application date of these new rules was brought forward to the 2019–20 income year by the COVID-19 Tax Act. They were originally intended to apply from the 2020–21 income year, which is the second year of the R&D tax credit scheme.

- Under the broader refundability rules, eligible claimants can now receive refunds of their R&D tax credits up to a new refundability cap. The new rules also remove the previous corporate eligibility and wage intensity criteria. This means a business with surplus R&D tax credits only needs to satisfy the usual R&D tax credit eligibility criteria to be eligible for refundability – no special refundability eligibility criteria (aside from the new cap) apply.
- The new refundability cap is based on the amount of labour-related taxes (PAYE, fringe benefit tax (FBT), and employer superannuation contribution tax (ESCT)) paid by a claimant in the relevant income year. Grouping rules apply to allow certain companies to allocate their labour-related taxes to other companies they control, or that sit within the same wholly-owned group.
- The cap does not restrict refunds for eligible expenditure on approved research providers or to levy body researchers (industry organisations to which a levy is payable under New Zealand statute, such as the Commodity Levies Act 1990).
- Any non-refundable R&D tax credits may still be carried forward to the next income year provided the shareholder continuity requirements in section LY 8 are met.
- The KSSLRM Act introduced a transitional provision that would have allowed claimants to include certain taxes paid in year 1 in their year 2 refundability cap. This transitional provision has been removed by the COVID-19 Tax Act, because this Act enables claimants to access the broader refundability rules in year 1.
- While the new broader refundability rules will apply from the first year of the tax credit by default, claimants who would prefer to apply the limited refundability rules can choose to apply these instead of the broader refundability rules. This needs to be signalled when a claimant is filing its R&D tax credit claim with Inland Revenue.

Table 1 illustrates the key differences between the limited refundability rules with the new broader refundability rules.

**Table 1: Key differences between the limited refundability rules and the new broader refundability rules**

| | Limited refundability rules | New broader refundability rules |
|---|---|---|
| **Eligibility criteria** | Must satisfy the corporate eligibility criteria (section MX 2) – this includes a requirement that claimants must be companies, cannot be listed, and cannot be considered a tax resident of another jurisdiction under a double tax agreement. | No corporate eligibility criteria. |
| | Must satisfy the wage intensity criteria (section MX 3) – this requires twenty percent of a firm's labour costs to be on R&D labour. | No wage intensity criteria. |
| **Exempt income exclusion** | Must not derive exempt income or be associated with a person who derives exempt income (unless the exempt income is from intercompany or foreign dividends under sections CW 9 or 10). | No exempt income exclusion for refundability (but new exempt income exclusion applies in the R&D Tax Incentive general eligibility criteria from the 2020-21 income year – refer to page 54 of this TIB). |
| **Cap** | $255,000. | The total labour-related taxes (PAYE, FBT, and ESCT) paid by the claimant (exceptions and grouping rules apply). |
| **Availability** | In the 2019-20 income year only (if a claimant opts to apply these instead of the new broader refundability rules – otherwise, the broader refundability rules apply by default). | From the 2019-20 income year onwards (these rules now apply by default to any eligible claimants). |

# Detailed analysis

## No separate eligibility rules for refundable R&D tax credits (sections LA 5(4B) and LY 3, and subpart MX)

Under the new broader refundability rules, businesses do not need to satisfy the corporate eligibility or wage intensity requirements (these had to be satisfied under the previous limited refundability rules). This means that provided a business is eligible for the R&D tax credit, and is either in a tax loss position or has insufficient income tax payable to fully utilise all of its R&D tax credits in the relevant income year, the business may access refundable R&D tax credits up to its refundability cap.

## New refundability cap (sections LA 5(4B), (5B), (5C), and section YA 1)

The new refundability cap replaces the previous $255,000 cap (which applies under the limited refundability rules). Under the new cap, a business that is unable to offset all of its R&D tax credits against its income tax liability may receive refundable R&D tax credits equal to or less than the amount of labour-related taxes (PAYE, FBT, and ESCT) they have paid for the relevant income year. That is, the maximum amount of refundable R&D tax credits the business can claim in an income year is the lesser of:

- the amount of labour-related taxes paid by the business for the relevant income year; or
- the amount of R&D tax credits claimed by the business.

| Example 7: Full refund of credits under the refundability cap |
| --- |
| In the year ended 31 March 2021, EmmaCorp has eligible R&D expenditure of $1 million, so it is eligible for $150,000 of R&D tax credits. The company has 12 employees and pays a total of $200,000 in labour related taxes (this amount is EmmaCorp's refundability cap). EmmaCorp has no income tax to pay in the 2020–21 income year.<br><br>Because its R&D tax credits ($150,000) are less than its refundability cap ($200,000) for the year, EmmaCorp can receive a refund of all its R&D tax credits.<br><br>**Variation of facts: Partial refund of credits under the refundability cap**<br><br>If EmmaCorp had only 6 employees and paid a total of $100,000 in labour-related taxes for the year, it would have a refundability cap of $100,000. Only $100,000 of its R&D tax credits would be refundable. EmmaCorp meets the shareholder continuity requirements, so the remaining $50,000 of R&D tax credits can be carried forward to the 2021–22 income year. |

### Levy body researchers and expenditure on approved research providers

The new cap does not apply to refundable R&D tax credits paid to levy body researchers or derived from eligible expenditure on approved research providers.

### Example 8: Credits paid to levy bodies are fully refundable

Levy Body A (LBA) is an industry organisation to which levies are payable under the Commodity Levies Act 1990. LBA incurred $1,000,000 of eligible R&D expenditure in the year ended 31 March 2021. It has no income tax liability and pays $50,000 of labour-related taxes for the year. LBA receives a full refund of its $150,000 R&D tax credits, because the new refundability cap does not apply to levy body researchers.

**Levy Body A – 31 March 2021**

| | |
|---|---|
| Eligible R&D expenditure | $1,000,000 |
| | x 15% |
| **R&D tax credits claimed** | **$150,000** |
| Income tax liability | $0 |
| **R&D tax credits refunded** | **$150,000** |

Example 11 illustrates how the new broader refundability rules apply to eligible expenditure on approved research providers.

### Cap can include taxes paid by other companies

The refundability cap has grouping rules, which allow certain companies to allocate labour-related taxes they have paid to other companies they control or that sit within the same wholly owned group.

The formula for calculating the refundability cap is:

*Own tax + other wholly owned tax + other controller tax − double-dip allocation*

| Term | Definition |
|---|---|
| Own tax | The labour-related taxes paid by a claimant for the relevant tax year. |
| Other wholly owner tax | The total labour-related taxes allocated to the claimant that have been paid by a member of the claimant's wholly owned group for the relevant tax year. |
| Other controller tax | The total labour-related taxes allocated to the claimant that have been paid by a company that controls the claimant for the relevant tax year. |
| Double dip allocation | Any amounts included in the claimant's refundability cap that have already been included in the refundability cap of another person (see explanation and example 10 below). |

Example 9 illustrates how the grouping rules apply.

### Example 9: Grouping rules

Misto Labs is an R&D-intensive firm eligible for $400,000 of R&D tax credits in the 2021-22 income year. It is in a tax loss position, so does not have any income tax liability to offset its R&D tax credits against.

Its refundability cap is made up of the following amounts:

| **Misto's refundability cap for the 2021-22 income year** | | |
|---|---|---|
| *Formula component* | *Amount* | *Explanation* |
| *Own tax* | $75,000 | PAYE, ESCT and FBT paid by Misto this year. |
| *Other wholly owned tax* | $100,000 | PAYE, ESCT and FBT paid by Zeus Industries this year. Zeus is a company in the same wholly-owned group as Misto. Zeus has $200,000 of its own labour-related taxes but allocates $100,000 to Misto. |
| *Other controller tax* | $100,000 | Total PAYE, ESCT and FBT paid by ZigCo this year. ZigCo controls Misto (it holds 65% of the shares in Misto). |

| | | |
|---|---|---|
| *Double-dip allocation* | ($0) | No amounts allocated to Misto by Zeus or ZigCo have been used by, or allocated to, other businesses for the purposes of calculating a refundability cap. |
| *Misto's total cap* | **$275,000** | |

Since Misto has a refundability cap of $275,000, it can obtain an R&D tax credit refund for $275,000 of its credits. Its remaining $125,000 of R&D tax credits are non-refundable in the 2021-22 income year. Misto can carry these non-refundable credits forward to the 2022-23 income year provided it satisfies the R&D tax credit shareholder continuity requirements.

The "double-dip allocation" part of the formula strips out any amounts allocated to a claimant that have already been allocated to another person. This prevents the same taxes going towards more than one claimant's labour-related tax-based cap.

It is important that any given amount of labour-related taxes is only allocated to one claimant.

### Example 10: Grouping rules with double-dip allocation

Same facts as example 9, except ZigCo claims $100,000 of R&D tax credits, half of which it offsets against its income tax payable. As with the previous example, ZigCo has paid $100,000 of PAYE, ESCT and FBT for the year. ZigCo indicates in its supplementary return that it has a refundability cap of $50,000, and so receives an R&D tax credit refund of its remaining $50,000 of credits. Despite this, ZigCo informs Misto that it will allocate $100,000 of labour-related taxes to Misto. Because ZigCo has already used $50,000 of its own labour-related taxes for its refundability cap, the double-dip allocation rules apply.

| **Misto's refundability cap for the 2021-22 income year (fact variation)** | | |
|---|---|---|
| *Formula component* | *Amount* | *Explanation* |
| *Own tax* | $75,000 | PAYE, ESCT and FBT paid by Misto this year. |
| *Other wholly owned tax* | $100,000 | PAYE, ESCT and FBT paid by Zeus Industries this year. Zeus is a company in the same wholly-owned group as Misto. Zeus has $200,000 of its own labour- |

| | | |
|---|---|---|
| | | related taxes but allocates $100,000 to Misto. |
| *Other controller tax* | $100,000 | Total PAYE, ESCT and FBT paid by ZigCo this year. ZigCo controls Misto (it holds 65% of the shares in Misto). |
| *Double-dip allocation* | ($50,000) | ZigCo has allocated $100,000 to Misto, of which it has already used $50,000 for its own refundability cap. The same amount of tax can only go towards one person’s refundability cap, so the $50,000 already used by ZigCo must not be included in Misto’s cap. |
| *Misto's total cap* | **$225,000** | |

The $50,000 “double-dip allocation” is subtracted from the other amounts included in Misto's refundability cap, because this amount has already been included in ZigCo's cap. After deducting the double-dip allocation amount, Misto's refundability cap is $225,000.

### Ordering rules for R&D tax credits (sections LA 5(4B) and LA 6(2))

Amended section LA 5(4B) retains a reference to section LA 6(2), which relates to the treatment of refundable tax credits. Any R&D tax credits claimed by a person must first be used to satisfy their income tax liability, if any, for the income year to which the credits relate (note that non-refundable R&D tax credits are applied to satisfy income tax liability before refundable R&D tax credits).

Once a person has used their credits to satisfy their income tax liability for that year, different rules apply depending on whether any remaining R&D tax credits are refundable or non-refundable.

**Table 2: Rules for the treatment of remaining R&D tax credits**

| Non-refundable credits | Refundable tax credits |
|---|---|
| Any remaining non-refundable tax credits can only be offset against income tax liabilities in the current year and must then be carried forward. | Before any remaining refundable R&D tax credits can be refunded, the credits must first be applied to any other liabilities in this order:<br>▪ an income tax liability for the current year;<br>▪ an income tax liability for a previous year;<br>▪ an income tax liability for a future tax year;<br>▪ a current provisional tax liability for a future tax year; and<br>▪ a different tax period or type (as requested by the claimant, or as applied by Inland Revenue if the claimant has any other tax outstanding). |

Example 11 illustrates the application of the ordering rules.

**Example 11: Refundable credits from approved research provider expenditure and application of ordering rules**

In the year ended 31 March 2021, Kimmie's Lab Ltd (KLL) incurred $50,000 of eligible R&D expenditure. Of the $50,000 of eligible R&D expenditure, $30,000 was incurred on eligible R&D activities performed by an approved research provider. KLL had $2,000 of income tax payable for the year and did not pay any labour-related taxes.

KLL is eligible for $7,500 of R&D tax credits:

- $4,500 of refundable R&D tax credits ($30,000 of approved research provider expenditure × 15%); and
- $3,000 of non-refundable R&D tax credits ($20,000 of other eligible R&D expenditure).

Before receiving an R&D tax credit refund, KLL's R&D tax credits must first be offset against its income tax liability for the year. KLL offsets $2,000 of its non-refundable R&D credits against its income tax liability of $2,000. KLL receives an R&D tax credit refund of $4,500 for the income year. Its $1,000 of surplus non-refundable R&D tax credits can be carried forward to the 2021–22 income year provided KLL satisfies the R&D tax credit shareholder continuity requirements.

| Kimmie's Lab Ltd – 31 March 2021 | |
|---|---|
| Eligible R&D expenditure on ARP | $30,000 |
| Other eligible R&D expenditure | $20,000 |
| **Total eligible R&D expenditure** | **$50,000** |
| Eligible R&D expenditure not on ARP | $20,000 |
| | x 15% |
| **Non-refundable R&D tax credits** | **$3,000** |
| Income tax liability | $2,000 |
| Less non-refundable R&D tax credits | ($3,000) |
| **Non-refundable R&D tax credits carried forward to 2021–22** | **($1,000)** |
| Eligible R&D expenditure on ARP | $30,000 |
| | x 15% |
| **Refundable R&D tax credits** | **$4,500** |

### The limited refundability rules (sections LA 5(5D) and LZ 14)

Section LZ 14 provides the limited refundability rules (which were previously in LA 5(4B)), which businesses can choose to apply instead of the broader refundability rules, if this is their preference and they are eligible under the limited refundability rules.

Under the limited refundability rules, a business may receive R&D tax credit refunds provided it is a company and:

- is in a tax loss position, or has insufficient income tax liability to utilise all of its R&D tax credits in the 2019–20 income year;
- satisfies the R&D tax loss cash-out corporate eligibility and wage intensity criteria in sections MX 2 and MX 3;

- does not derive exempt income, and is not associated with a person who derives exempt income;
- is not a listed company, and is not associated with a listed company; and
- does not have an outstanding tax liability.

Only the first $255,000 of the business's R&D tax credits is refundable, which is equivalent to $1.7 million of eligible R&D expenditure. Any remaining R&D tax credits may be carried forward to the 2020–21 income year if the shareholder continuity requirements in section LY 8 are met.

### Choosing between the year 1 and year 2 refundability rules

Businesses may choose to use the limited refundability rules (new section LZ 14) or the broader refundability rules (section LA 5) in the 2019–20 income year, but they cannot use both.

Only the broader refundability rules are available from the 2020–21 income year.

| Example 12: Applying the broader refundability rules |
| --- |
| Moppy's Chicken Factory ("Moppy") has brought forward tax losses from the 2018–19 income year to the 2019–20 income year. It claims R&D tax credits in the 2019–20 income year but does not have enough income tax to pay to use all of its credits. Moppy determines that it will be able to receive more refundable R&D tax credits if it applies the broader refundability rules, because it has $500,000 of surplus R&D tax credits and has paid $500,000 of PAYE in the 2019–20 income year (so its refundability cap is $500,000).<br><br>Moppy files its income tax and R&D supplementary returns soon after 31 March 2020. It advises Inland Revenue that it would like to apply the broader refundability rules. Inland Revenue processes Moppy's claim and refunds Moppy $500,000 of R&D tax credits. |

# Foreign tertiary education organisations and Callaghan innovation not eligible for R&D tax credits

*Section LY 3(2)(d)(iii) and (iv) of the Income Tax Act 2007*

Foreign tertiary education organisations and Callaghan Innovation are excluded from the tax credit, as are their associates and any entities they control. These exclusions apply from the 2019–20 income year.

## Background

The R&D tax credit regime is intended to encourage business R&D. Consequently, tertiary education organisations (as well as their associates, and any entities they control), are excluded from the regime. The amendment clarifies that overseas tertiary education organisations come within the scope of the exclusion.

Callaghan Innovation is a Government agency and is helping Inland Revenue administer the R&D tax credit. For the avoidance of doubt, this amendment ensures that Callaghan Innovation, entities it controls, and any of its associates cannot claim the R&D tax credit.

## Key features

Section LY 3(2)(d) is amended to exclude:

- foreign tertiary education organisations – section LY 3(2)(d)(iii); and
- Callaghan Innovation – section LY 3(2)(d)(iv).

These exclusions apply from the 2019–20 income year, so that they can be incorporated into the processing and administration of year 1 claims.

# Certain tax-exempt entities not eligible for R&D tax credits

*Sections LY 3(2)(f), LY 8, and YA 1 (definitions of exempt income and levy body researcher) of the Income Tax Act 2007*

Entities which receive exempt income under sections CW 38, CW 39, CW 40, CW 41, CW 42 and/or CW 55BA of the Income Tax Act 2007 are ineligible for the R&D tax credit from the 2020–21 income year. This exclusion does not apply to industry levy bodies.

## Background

The aim of this exclusion is to prevent entities which already derive substantial benefits from the tax system, in the form of deriving mostly tax-exempt income, from accessing further benefits via the tax credit. Charities, which come within the tax-exempt entity exclusion, do not pay income tax, and receive additional Government support in the form of GST concessions, exemption from FBT, and the donor tax credit regime.

Note that this section of the TIB includes amendments made by the COVID-19 Response (Taxation and Social Assistance Urgent Measures) Act 2020.

## Key features

From the 2020–21 income year ("year 2"), entities which receive exempt income under these sections of the Income Tax Act 2007 are excluded from the R&D tax credit:

- section CW 38 (public authorities);
- section CW 39 (local authorities);
- section CW 40 (local and regional promotion bodies);
- sections CW 41 and CW 42 (charities); and
- section CW 55BA (tertiary education institutions and their subsidiaries).

These excluded entities may be eligible in the 2019–20 income year. Therefore, any tax credits received by these entities for the 2019–20 income year that have not been offset against income tax payable, or refunded, for the 2019–20 income year are extinguished from the 2020–21 income year.

> **Example 13: Charity's year 1 credits extinguished**
>
> In the year ended 31 March 2020, Charity X claims $100,000 of R&D tax credits. As Charity X does not pay income tax, it has no income tax liability to offset its R&D tax credits against. It does not pay any labour-related taxes, so is unable to receive any R&D tax credit refunds.
>
> Charity X has a standard 31 March balance date. Its $100,000 of R&D tax credits from year 1 cannot be refunded in year 1, and also cannot be brought forward to year 2. They are extinguished from 1 April 2020. Charity X also ceases to be eligible for the R&D tax credit from this date.

Some entities which receive tax-exempt income under these sections in subpart CW may not wholly sit outside the tax system and may perform business R&D. To allow these entities to claim (such as through an R&D performing taxpaying subsidiary), this exclusion does not include broader association rules. Entities associated with tax-exempt entities affected by this exclusion may still claim the credit, if they otherwise satisfy the credit's eligibility criteria.

Levy body researchers (defined in section YA 1 as industry organisations to which levies are payable under an Act) are not affected by this exclusion, so may be eligible even if they receive exempt income under any of the above sections. R&D performed by levy bodies is typically funded by businesses in the relevant industry for these businesses' benefit, so levy body R&D is fundamentally business R&D.

This exclusion does not include broader association rules in relation to entities excluded for deriving these kinds of tax-exempt income. A subsidiary taxpaying business is not ineligible for the credit merely because it is owned by an entity which derives excluded tax-exempt income. This means that an excluded entity which undertakes eligible R&D may set up a non-tax-exempt subsidiary to claim the credit.

> **Example 14: Subsidiary not ineligible merely because parent derives exempt income**
>
> Charitech is a charity which performs R&D to support its charitable work. It performs R&D on adapting traditional plant medicines so that they can be used alongside modern medicine to achieve better health outcomes. Charitech would like to claim the R&D tax credit for its R&D in the 2020–21 income year, but because it derives exempt income it is ineligible to claim the credit in its own right.

Charitech establishes a subsidiary company and shifts its R&D activities, so that the activities are performed by the subsidiary instead. The subsidiary does not derive any exempt income, so is not excluded from the credit through the exempt income exclusion. Assuming the subsidiary satisfies the other R&D tax credit eligibility criteria, it will be able to claim the credit, even though its parent organisation receives exempt income.

# Allocating credits to joint venture members

*Section LY 1(4) of the Income Tax Act 2007*

The amendment changes the joint venture credit allocation rules, so that R&D tax credits must be allocated to a member of an R&D performing joint venture based on their interest in the joint venture.

## Background

The joint venture allocation rules in section LY 1(4) previously required R&D tax credits to be allocated in accordance with a claimant's interest in the income of an R&D performing joint venture. The rules now allocate credits in accordance with the claimant's interest in the joint venture, without reference to income.

This ensures the provision operates as intended for joint ventures regardless of whether they derive income.

## Key features

Section LY 1(4) is amended to remove references to income. The onus is on joint venture members to use an appropriate methodology to determine their interests in the joint venture for the relevant income year.

## Application date

The amendment applies from the 2019–20 income year.

# Internal software development changes

*Section YA 1 (definition of internal software development expenditure) of the Income Tax Act 2007*

The amendment broadens the definition of internal software development expenditure subject to the $25 million cap, so that it includes all software development expenditure that is not external software development or software development undertaken for the purpose of internal administration.

## Background

The policy intent is for software development expenditure to come within the $25 million cap if it is not software development undertaken for the purpose of internal administration (which is completely excluded) or external software development (which is not limited by a special expenditure cap).

Before this amendment, it was unclear whether the $25 million cap covered all internal software development expenditure. This amendment resolves this ambiguity by clearly bringing all expenditure on software development within the $25 million cap, unless the expenditure is on external software development or internal software development undertaken for the purpose of internal administration.

## Key features

The definition of "internal software development expenditure" in section YA 1 of the Income Tax Act 2007 is amended to ensure the $25 million cap applies to all activities that normally considered internal software development (such as operational internal software development). The expanded definition covers any software development expenditure that is not:

- software development undertaken for the purpose of internal administration of a person's business or their associate's business (this comes within the existing definition of "ineligible internal software development" in section YA 1); or
- external software development expenditure.

## Application date

The amendment applies from the 2019–20 income year.

## Detailed analysis

A $25 million expenditure cap applies to all internal software development. This means that a person can only claim $25 million of expenditure on this kind of software development in their income year, regardless of how much they have actually spent.

The cap applies to any software developed for internal purposes unrelated to administration. This includes such purposes as manufacturing, testing, quality control, or enhancing non-digital services to customers.

| Example 15: Software developed for non-administrative internal purposes |
|---|
| Eugene works for a manufacturing company developing shatter-resistant glass for car windscreens. He develops software that can track stresses on the glass during impact testing in very fine detail, increasing the quality of the testing process.<br><br>This satisfies the definition of internal software development expenditure, as the software being developed is solely for internal use in improving the quality of the testing process. As it is unrelated to back office administrative purposes, the expenditure Eugene's business incurred to develop the software is eligible - however, it is subject to the $25 million cap. |

### Software that enhances non-digital services to customers

A service is a non-digital service if the main reason why the person's customers use it is to obtain the service, not to use the software (even though that service may be enabled, supported, or facilitated by the software). This type of expenditure comes within the $25 million cap, as it is considered expenditure on internal software development.

| Example 16: Software that enhances non-digital services to customers |
|---|
| Mohammed runs a courier business and develops software that enables his customers to pinpoint the exact location and condition of their packages.<br><br>This satisfies the definition of internal software development expenditure, because Mohammed's customers are using his services to receive the goods he delivers, not to use the software Mohammed has developed. |

| |
|---|
| The expenditure Mohammed's business incurred to develop the software is subject to the $25 million cap. |

## Association rules apply to limit the amount claimable by associated persons

The $25 million cap groups a person's expenditure with internal software development already claimed by the person's associates. The rationale behind applying the cap to associated persons is to prevent the cap from being circumvented by the person splitting their expenditure across associates to effectively exceed the cap.

For partnerships and look-through companies, the cap is applied at the partnership or look-through company level (rather than the partner or individual owner level).

| Example 17: Associated persons with internal software development expenditure |
|---|
| SL Ltd incurs $20 million of internal software development expenditure and XW Ltd incurs $11.5 million. SL Ltd and XW Ltd are wholly owned by NB Ltd. As XW Ltd and SL Ltd are associated persons for tax purposes, their combined claim may not exceed $25 million. This means that $6.5 million of their combined expenditure (which totals $31.5 million) is not eligible because it exceeds the internal software development cap. |

# General approval of supporting activities

*Schedule 21, part B, clause 12 of the Income Tax Act 2007*

Businesses in the general approval regime must obtain approval of their supporting activities for these activities to be eligible for the tax credit.

## Background

Various amendments were made to the Taxation (Research and Development Tax Credits) Bill in response to submissions made to the Bill at the Select Committee stage. This included an amendment to the scope of general approval. In the Taxation (Research and Development Tax Credits) Bill as introduced, general approval only applied to core activities.

At the Select Committee stage, the Bill was amended following submissions requesting general approval be extended to cover supporting activities as well. This was to provide businesses with added certainty that their R&D would be eligible for the credit. A clause equivalent to schedule 21, part A, clause 24 should have been added into schedule 21, part B at the time these other changes were made – this was the policy intent.

This amendment adds new clause 12 into schedule 21, part B, to ensure the legislation is consistent with the policy intent. This new clause clarifies that supporting activities are ineligible if they have not been approved. This amendment applies from year 2 of the R&D tax credit regime (the 2020–21 income year), so that it can be incorporated into the administration of the tax credit once in-year approval is rolled out in year 2.

## Key features

This amendment adds clause 12 to schedule 21, part B of the Income Tax Act 2007, which lists activities that are excluded from the definition of supporting R&D activity. This clause provides that an activity is not eligible as a supporting activity if it has not been approved under the general approval regime (if the general approval regime applies to the person claiming the activity).

## Application date

The amendment applies from the 2020–21 income year.

# General approval binds the Commissioner

*Section 68CB of the Tax Administration Act 1994*

When an R&D activity is approved under the general approval regime, that approval is binding on the Commissioner.

## Background

The general approval regime is intended to provide customers with certainty that their R&D activities will be eligible for the credit during (or soon after) the income year in which those activities take place. Prior to this amendment, general approval was not binding on the Commissioner. This meant she could change her view as to whether an activity was a core or supporting activity, even if she had approved the activity as part of the general approval process.

The policy intent has always been for general approval to be binding on the Commissioner. To that end, once granted, approval by the Commissioner is binding provided all the conditions of the general approval legislation are met.

## Key features

This amendment makes general approval (both for the pilot and for the full scheme) binding on the Commissioner, provided a claimant fulfils the requirements set out in section 68CB.

## Application date

The amendment applies from the 2019–20 income year for the pilot and the 2020–21 income year for the full general approval scheme.

# Criteria and methodologies approval mandatory for significant performers

*Section 68CC of the Tax Administration Act 1994*

Criteria and methodologies approval ("CAM") is mandatory for a person who opts into the significant performer regime from the 2020–21 income year.

## Background

From the 2020–21 income year, all businesses seeking to receive R&D tax credits are required to obtain general approval or, if they qualify, opt into the significant performer regime.

A business can be eligible for the significant performer regime if it reasonably expects to have more than $2 million of eligible R&D expenditure for the relevant income year. The significant performer regime is intended to provide large R&D performers with an alternative to the general approval regime, because the compliance and administrative costs associated with obtaining general approval for large amounts of R&D activities may outweigh the benefit of the R&D tax credit for these businesses.

Businesses who spend significant amounts on R&D will still want certainty regarding their R&D tax credit claims. This led to the creation of the CAM regime, which was (prior to this enactment) optional for businesses in the significant performer regime.

This amendment makes the CAM regime mandatory, which should:

- Provide businesses who opt out of general approval (which is mandatory for businesses that are not in the significant performer regime) with more comfort regarding the eligibility of their activities and expenditure.
- Reduce the cost of obtaining R&D certificates (which businesses in the significant performer regime are required to obtain). This is because providing R&D certificates to businesses with CAMs requires significantly less work for R&D certifiers. This should reduce compliance costs for these claimants.
- Ensure businesses engage with officials regarding their R&D tax credit claims earlier in the claims process. This should reduce the need for later scrutiny and reduce the likelihood of claims being reassessed (and penalties and interest later being imposed).

## Key features

A person who opts into the significant performer regime must now obtain criteria and methodologies approval for their R&D activity and expenditure.

## Application date

The amendment applies from the 2020–21 income year.

# Timeframe for completing disputes process

*Sections 108(1E) and 113E of the Tax Administration Act 1994*

This amendment allows the Commissioner to adjust a person's R&D tax credit claim upwards if the person has initiated the disputes process through issuing a notice of proposed adjustment (NOPA) within four months of filing their income tax return or a year after their income tax return due date.

## Background

A person can only file a NOPA to increase their R&D tax credit claim once for each R&D tax credit claim they make.

Prior to this amendment, the legislation required the disputes process to be **completed** within a year of a person's income tax return due date if the person sought to increase their R&D tax credit claim. This is contrary to the policy intent, which is that a person must **initiate** the disputes process within a year of their income tax return due date.

These rules regarding initiating disputes are aimed at preventing the retrospective reclassification of expenditure. The retrospective reclassification of expenditure includes where R&D activities or expenditure are identified after the end of an income year. If a person receives R&D tax credits for R&D they were unaware of at the time the R&D activities took place, the R&D tax credit regime has not provided any incentive to the person to undertake additional R&D. The retrospective reclassification of expenditure has been problematic in other jurisdictions.

The amendment will require a person to initiate the disputes process by filing a NOPA within a year of their income tax return due date but does not require the disputes process to be completed within this time frame. This time limit is intended to provide a person with enough time to prepare the required information to file a NOPA while nevertheless discouraging the retrospective reclassification of expenditure.

## Key features

The amendments to sections 108(1E) and 113E allow the Commissioner to adjust a person's R&D tax credit claim upwards, if the person has initiated the disputes process through issuing a NOPA before the earlier of:

- four months of filing their income tax return; or
- a year after their income tax return due date.

Provided the NOPA has been filed within these timeframes, there is no specific deadline by which the disputes process must be completed.

## Application date

The amendment applies from the 2019–20 income year, so that the policy intent is met for the administration of year 1 claims.

# Approved research providers must perform core R&D activities

*Section 124ZH of the Tax Administration Act 1994*

To become an approved research provider, a person must be able to perform core R&D activities.

## Background

Businesses can access various concessions through approved research providers:

- A person needs to incur at least $50,000 of eligible R&D expenditure in an income year to claim the R&D tax credit. However, amounts under $50,000 may be eligible where the person uses an approved research provider to perform the R&D on their behalf.
- Eligible amounts spent on approved research providers may be refunded in full, if the person has surplus R&D tax credits (for example, if they are in a tax loss position or do not have enough income tax to pay to offset all their R&D tax credits against).

The policy intent is for an organisation to only be eligible to become an approved research provider if they can perform core R&D activities. These are activities that involve attempting to resolve scientific or technological uncertainty.

Previously, the legislation only required that an approved research provider be able to perform core or supporting activities for their clients. This meant an entity could become an approved research provider, even if it was only able to perform supporting R&D activities (which do not need to involve the resolution of any scientific or technological uncertainty, in and of themselves, to be eligible).

This amendment changes the requirements to become an approved research provider, so that a person must be able to perform core R&D activities to become an approved research provider.

## Key features

The requirements for approving a person's application to become an approved research provider are amended to specify that, in addition to the other existing requirements, a person must be able to perform core R&D activities.

## Application date

The amendment applies from the 2019–20 income year, so that it can be incorporated into the processing and administration of year 1 claims.

# Declining R&D certifier applications

*Section 124ZI of the Tax Administration Act 1994*

The amendment clarifies the circumstances in which a person's accepted R&D certifier application must be declined, by explicitly providing that the Commissioner must decline a person's application where approving the person as an accepted R&D certifier would adversely affect the integrity of the tax system.

## Background

Accepted R&D certifiers are able to provide R&D certificates to claimants in the significant performer regime.

From the 2020–21 income year, all claimants will be required to either obtain activity approval under the general approval regime or opt into the significant performer regime. Significant performers must provide R&D certificates to the Commissioner with their R&D supplementary returns.

The amendment provides the Commissioner with another ground for declining a person's application to be an accepted R&D certifier. The amendment is consistent with the policy intent, which is that the Commissioner should be able to decline a person's application where their status as an accepted R&D certifier would adversely affect the integrity of the tax system.

It is arguable that the Commissioner already has this ability because of section 6 of the Tax Administration Act 1994. For the avoidance of doubt, however, this amendment clarifies that the Commissioner must decline a person's application in these circumstances.

## Key features

Section 124ZI of the Tax Administration Act 1994 is amended so that the Commissioner must decline a person's application to become an accepted R&D certifier, where approving the person's application would adversely affect the integrity of the tax system.

## Application date

The amendment applies from the 2020–21 income year.

# Revoking R&D certifier status

*Section 124ZI of the Tax Administration Act 1994*

The amendment extends the circumstances in which the Commissioner must revoke a person's accepted R&D certifier status. The amendment requires the Commissioner to revoke a person's approval as an accepted R&D certifier where the accepted R&D certifier has provided an R&D certificate to another person in the last 2 years who has entered into a tax avoidance arrangement for R&D tax credits, or where allowing the accepted R&D certifier to retain their R&D certifier status would adversely affect the integrity of the tax system.

## Background

Claimants in the significant performer regime must obtain an R&D certificate from an accepted R&D certifier.

The amendment to section 124ZI is consistent with the policy intent, which is not reflected in full by this provision as currently enacted. It provides the Commissioner with additional grounds to revoke a person's approval as an accepted R&D certifier.

### Revoking approvals with adverse effect on tax system integrity

As with the other remedial amendment to section 124ZI regarding declining a person's application to be an accepted R&D certifier, the policy intent is that a person would have their approval revoked if their retaining it would adversely affect the integrity of the tax system. It is arguable that even without this amendment, the Commissioner already has this ability because of section 6 of the Tax Administration Act 1994. For the avoidance of doubt, however, this amendment clarifies that the Commissioner must revoke a person's accepted R&D certifier status in these circumstances.

### Providing certificates to participants of tax avoidance arrangements

The legislation already allows the Commissioner to revoke a person's approval as an accepted R&D certifier if they have provided an R&D certificate in the last 2 years to a person who received shortfall penalties arising from tax evasion and taking an abusive tax position (this is through the references in section 124ZI(7)(b) to sections 141D and 141E). Tax avoidance may not always involve taking an abusive tax position, however, so this amendment makes it so that providing an R&D certificate to a person who enters into a tax avoidance arrangement is another ground on which the Commissioner must revoke a person's approval.

## Key features

Section 124ZI of the Tax Administration Act 1994 is amended so that in addition to the grounds under which the Commissioner could previously revoke a person's approval, the Commissioner must also revoke a person's approval as an accepted R&D certifier where:

- allowing the person to retain their approval would adversely affect the integrity of the tax system; or
- the person has provided an R&D certificate to another person, and that other person has entered into a tax avoidance arrangement for R&D tax credits within the last two years.

## Application date

The amendment applies from the 2020–21 income year.

# Challenging the Commissioner's decisions

*Section 138E of the Tax Administration Act 1994*

The amendment prevents a person from challenging the Commissioner's decisions made for the pilot approval scheme and exceeding the $120 million cap.

## Background

### Pilot approval scheme

A pilot approval regime is in place in year 1 of the R&D tax credit scheme (the 2019–20 income year). The pilot is aimed at enabling the Commissioner to test and refine the in-year approval regimes before they are rolled out more broadly in year 2 (the 2020–21 income year).

To take part in the pilot, both the Commissioner and a person must agree that the person will take part in the pilot. The person is required to submit an approval application by a prescribed date, which the Commissioner will then approve or decline. There is a legislative requirement that the Commissioner notify the person of her intent to decline their application before declining it. This is to provide the person with an opportunity to provide additional information in support of their application where appropriate.

This amendment stops taxpayers from challenging the Commissioner's decisions made for the pilot approval scheme, other than through judicial review. This is through adding sections 68CB and 68CC to section 138E(1)(e)(iv) from the 2019–20 income year.

### Exceeding the $120 million cap

There is a cap of $120 million on the amount of eligible R&D expenditure for which a person can claim R&D tax credits. This equates to a cap of $18 million R&D tax credits. A person can apply to exceed the $120 million cap by applying for an approved R&D cap. The Commissioner can approve an application for an approved R&D cap if the Commissioner:

- is satisfied the relevant R&D activities give rise to substantial net benefit for New Zealand; and
- has consulted with the chief executive of the Ministry of Business, Innovation and Employment.

The amendment stops taxpayers from challenging the Commissioner's decisions regarding approved R&D caps. This is through adding section 68CD to section 138E(1)(e)(iv) from the 2019–20 income year.

### No right to challenge in other parts of R&D tax credit regime

Section 138E already prevents a person from challenging the Commissioner's decisions made about:

- approved research providers (sections 124ZH and 138E(1)(e)(iv));
- R&D certificates and certifiers (sections 124ZI and 138E(1)(e)(iv));
- general approval from the 2020–21 income year (sections 68CB and 138(1)(e)(iv)); and
- the significant performer regime from the 2020–21 income year (sections 68CC and 138E(1)(e)(iv)).

Adding sections 68CB, 68CC and 68CD to section 138E(1)(e)(iv) from the 2019–20 income year is consistent with the approach taken in the rest of the regime regarding decisions made by the Commissioner. It is also consistent with the policy intent, which is for decisions made by the Commissioner regarding the R&D tax credit to be final and not subject to challenge other than through judicial review.

## Key features

Decisions made by the Commissioner on the these matters cannot be challenged:

participation in the pilot approval scheme (sections 68CB and 68CC);

applications to exceed the $120 million cap on eligible expenditure (section 68CD).

## Application date

The amendment applies from the 2019–20 income year.

# Amendment to part-year override of section LY 3(2)(b)

*Section LZ 13 of the Income Tax Act 2007*

This amendment corrects a drafting error. It is intended to ensure that section LZ 13 operates as intended.

Section LZ 13 relates to claimants with late balance dates who receive Callaghan Innovation Growth Grants in the 2020–21 income year. It enables these claimants to be eligible for the R&D tax credit for the part of that year, after 31 March 2021, for which they do not receive Growth Grant payments.

## Application date

The amendment applies for the 2020–21 income year.

# Overseas donee status

*Schedule 32 of the Income Tax Act 2007*

These charities have been granted donee status from the 2019–20 and later income years:

- Little Brothers and Sisters International;
- Partners Relief & Development – New Zealand;
- Project Moroto; and
- UN Women National Committee Aotearoa New Zealand Incorporated.

The Act also makes changes to other existing charities listed on schedule 32:

- "Hope Street Charitable Trust" replaces "Orphans Refugees and Aid (ORA International) of NZ Charitable Trust" with effect from 15 June 2019.
- "Onesight New Zealand" is removed with effect from 30 May 2019.

## Background

New Zealand-based charities that apply some or all of their funds for overseas purposes and want donors to receive tax benefits in connection with any donations received, must be named as a donee organisation on the list of recipient of charitable or other public benefit gifts in the Income Tax Act 2007.

Donee status entitles individual donors to a tax credit of 331/3 percent of the amount donated to these organisations, up to the level of their taxable income. Companies and Māori Authorities are eligible for a deduction for monetary donations up to the level of their net income.

## Application dates

The new insertions apply from the 2019–20 and later income years. The other changes to the schedule apply from the dates specified above.

# Refunding overpaid PIE tax

*Sections BC 7, CX 56, HM 6, HM 36B, LA 6, LS 2, YA 1 "PIE schedular income", "residual income tax", "schedular income" of the Income Tax Act 2007 and sections 22C and 22D of the Tax Administration Act 1994*

A number of amendments have been made to introduce a year end square up process for tax on individuals' multi-rate portfolio investment entity (PIE) income, such as KiwiSaver schemes. This process uses individuals' correct prescribed investor rate (PIR) to determine whether the right amount of tax has been paid on this income during the tax year. Individuals' multi-rate PIE income is taxed separately as PIE schedular income at the PIR. An adjustment is made to the amount of the person's income tax liability at year end for over- or under- payments of tax by the PIE during the tax year.

This adjustment or PIE square-up will happen alongside the year-end process for income tax. Any refund due or tax payable resulting from over- or underpayment of tax on PIE income during the tax year is added to the investor's end of year tax position and is either refunded, payable or reduces the person's tax payable or reduces a person's tax refund.

Other miscellaneous amendments have also been made to ensure the new PIE rules are integrated smoothly into the tax system.

All references are to the Income Tax Act 2007 unless otherwise stated.

## Background

The PIE tax rules apply to collective investment vehicles where investors combine resources to make different types of passive investments, for example a managed fund and KiwiSaver. A multi-rate PIE attributes income, losses and tax credits to investors. The tax rate applied to these types of PIEs varies from investor to investor and may vary from year to year for individual investors, depending on their income in the two previous tax years.

The PIE pays tax on the PIE income of each investor based on the rate notified by their investor. If an investor does not notify a rate, the default rate of 28% applies.

Previously individuals' income from multi-rate PIE investment was generally excluded income, unless the investor had underpaid tax on their PIE income because they notified their PIE provider with a rate that is too low.

Where PIE tax has been underpaid (when the investor has notified a rate that is too low), the investor had to include their PIE income in their income tax return and it was taxed at the investor's marginal tax rate, which may be up to 33%, whereas the top PIR is 28%. The investor has a tax credit in the year-end income tax calculation for tax already paid on PIE income during the tax year.

When the correct PIR was used or where a too high rate had been used, income from a multi-rate PIE remained excluded income and did not flow through to the investor's individual income tax return and assessment. This meant that where an individual has overpaid tax on multi-rate PIE income (for example, because the investor has notified a rate that is too high or has defaulted onto the highest PIR of 28%) the PIE investor could not get the overpaid amount refunded.

The amendments ensure that individuals' PIE income from multi-rate PIEs is taxed at individuals' correct PIR with an adjustment to their terminal tax at year end for over- or under- payments of tax made during the tax year.

## Key features

The changes to the PIE rules will mean that all natural person individuals with income from multi-rate PIEs will have an end of year square up of this income using their correct PIR. An adjustment to their terminal tax for the tax year is made for over- or under- payments of tax on that PIE income during the tax year.

The key changes are as follows.

- Income of natural persons from multi-rate PIEs is no longer excluded income, but PIE schedular income. The tax rates applicable to this type of income, the prescribed investor rates under Schedule 6, clause 1, remain unchanged.
- Inland Revenue will add individuals' income from a multi-rate PIE, which is added to the list of "reportable income", to individuals' pre-populated accounts alongside the other income information for the tax year.
- Inland Revenue will calculate the tax liability on attributed multi-rate PIE income using individuals' correct PIRs based on the income information Inland Revenue holds and will make adjustments to account for any over- or underpayments that may have occurred in relation to the tax paid on that income by the PIE during the tax year.
- Inland Revenue will calculate any adjustment resulting in a refund or tax to pay in relation to PIE schedular income without the individual needing to do anything. Refunds will be paid out or will reduce their terminal tax payable without individuals having to request them and tax payable will be added to individuals' income tax liability for the tax year.

## Application date

The changes apply from 1 April 2020.

## Detailed analysis

### PIE schedular income

The new rules apply to income derived by a natural person investor in a multi-rate PIE. This income is now schedular income under section BC 7.

An amount of attributed multi-rate PIE income that a natural person who is an investor in a multi-rate PIE derives under section CP 1 (Attributed income of investors in multi-rate PIEs) to which the prescribed rates of tax set out in Schedule 6, clause 1 (Prescribed rates: PIE investments and retirement scheme contributions) apply is "PIE schedular income" (section HM 36B(6) and the definition of "PIE schedular income" in section YA 1).

### Calculation of PIE schedular income tax liability and adjustment

The income tax liability on PIE schedular income is calculated under section HM 36B.

This calculation determines whether an adjustment needs to be made by comparing the tax paid by the PIE, with the tax liability when using the correct PIR based on the income information Inland Revenue holds about an individual. The calculation also considers the tax already paid on the attributed income by the PIE as a tax credit and any credits used by the PIE to satisfy the investor's income tax liability, such as foreign tax credits and imputation credits. This is to ensure that these tax credits are not double counted or taken away through the adjustment calculation.

Multi-rate PIE income from individuals who have advised a notified investor rate that is lower than their prescribed investor rate will no longer be subject to the individual's marginal tax rate, but will be taxed at the investor's PIR (capped at 28%).

Any amount of tax that has been under-paid (section HM 36B(4) Positive adjustment) is included in the investor's schedular income tax liability for the tax year and modifies the investor's income tax liability for the tax year (section BC 7). The amount of an adjustment under section HM 36B is not included in residual income tax, for a person and for a tax year, so that the residual income tax and provisional tax are not affected by the new PIE rules (see paragraph (f) in the definition of "residual income tax" in section YA 1).

Any tax that has been overpaid (section HM 36B(5) Negative adjustment) is first applied to reduce the investor's terminal tax payable (their tax bill) for the tax year. Any remaining amount is refundable under sections RB 4, RM 2 to 8, and RM 10 (which relate to refunds and their use).

## Year-end process

Calculating PIE schedular income adjustments for natural person investors under section HM 36B is done as part of individuals' year-end income tax process. However, the new PIE rules will not alter individuals' year-end information and filing obligations.

The income from a multi-rate PIE attributed to an individual has been added to the list of "reportable income" in section 22D(3) of the Tax Administration Act 1994. The information on PIE income attributed to an individual investor for a tax year is provided to Inland Revenue by the multi-rate PIE and will then be included in individuals' pre-populated accounts.

Inland Revenue will calculate any adjustment to the person's terminal tax for an amount of PIE schedular income derived for a tax year without the individual needing to do anything. Refunds will be paid out or will reduce their terminal tax payable without individuals having to request them and tax payable will be added to individuals' income tax liability for the tax year.

A "qualifying individual" under section 22D is an individual who only earns reportable income for an income year and has no other income information that must be provided to Inland Revenue. "Qualifying individuals" will continue to be generally not required to provide any income information to Inland Revenue and in most cases their tax position, including their PIE schedular income tax, will be squared up automatically, without them having to do anything.

Inland Revenue will pay out refunds of overpaid tax on multi-rate PIE income without the individual having to provide information or confirm the tax position that Inland Revenue has calculated, unless the person is required to provide information or confirm for other reasons.

An individual who earns both "reportable" and "other income" continues to be required to provide relevant information on the other income they earn and finalise their tax position themselves. They must ensure that the information included in their pre-populated account is correct and complete before they confirm their end of year assessment. If the individual wishes to file their return shortly after the end of the tax year, and before Inland Revenue will have received all reportable income information from the relevant third parties, including PIE schedular income information from a multi-rate PIE, they must ensure that they include this information in their tax return. It follows then that it may be easier for these individuals to wait until Inland Revenue has complete "reportable income" information before filing their return.

# Widening the Commissioner's power to put investors on the correct prescribed investor rate

*Sections HM 60B and HM 60 of the Income Tax Act 2007*

The amendment widens the Commissioner of Inland Revenue's ability to provide a tax rate (prescribed investor rate) to a multi-rate portfolio investment entity (PIE) that it must apply to the investor's attributed PIE income.

## Background

The PIE tax rules apply to collective investment vehicles, including KiwiSaver schemes. A person investing in a multi-rate PIE is required to notify their PIE with a tax rate for the tax year, the notified investor rate. An investor's correct PIE tax rate for a tax year is their prescribed investor rate (PIR), which approximates their marginal tax rate (capped at 28%) and is based on the lower of income in one of the previous two tax years.

The multi-rate PIE pays tax on income attributed to individual investors based on the notified investor rate. Where the investor has not notified the PIE of a tax rate, the top 28% PIE tax rate applies by default.

Changes made to Inland Revenue's systems and processes as part of its Business Transformation programme mean that from 1 April 2019 Inland Revenue is now able to better identify instances where an investor's PIE income is being taxed at an incorrect rate.

Before the amendments, the Commissioner of Inland Revenue had an ability under section HM 60 to provide a PIE with a tax rate for an investor. However, this was limited to situations where the investor had provided the PIE with a notified investor rate and the Commissioner considered this notified rate not appropriate. It did not cover situations where the investor had not notified a rate and defaulted onto the top PIE tax rate of 28%.

## Key features

New section HM 60B allows the Commissioner of Inland Revenue to provide multi-rate PIEs with their investors' PIRs for the tax year where:

- Inland Revenue holds sufficient information to determine the investor's PIR applicable for the tax year and the Commissioner of Inland Revenue considers the notified investor rate is inconsistent with the investor's correct PIR
- the investor has not notified their multi-rate PIE with a tax rate.

The PIE must apply the rate provided by the Commissioner to the investor's attributed PIE income as soon as reasonably practicable after having been notified of the rate by the Commissioner.

The primary responsibility for determining an investor's correct tax rate and notifying it to the PIE to ensure their PIE income is being taxed correctly remain with the investor. The investor therefore has the ability to subsequently notify their PIE with a different rate which the PIE then has to apply.

Amendments to section HM 60 clarify that the "notified investor rate" refers to the rate given by the investor to the PIE.

## Application date

The changes apply from 1 April 2020.

# Taxation of trusts

*Sections BB 2(5), CX 56(1C), FC 2(4), HC 2(2) and (3), HC 4(1) and (1B), HC 7(3), HC 10(1)(ab) and (3), HC 14(2), HC 15(5C), (5D) and (6), HC 16(2) and (5), HC 25, HC 26(1), HC 27(4) AND (6),HC 28(3) and (4), HC 31B, HC 33(1B), (1C), (3),(3B). (4), (5), and (6), HC 36, HM 55D(8B), HM 56(2), RF 2(2), YA 1 "financial assistance", "New Zealand resident", "transfer of value", "trust rules", and YD 3BA of the Income Tax Act 2007*

*Section 113F of the Tax Administration Act 1994)*

## Summary of proposed amendments

The amendments to the trust rules arise from an administrative review of the taxation of trusts. This review identified several areas in the current law that were unclear and did not appropriately reflect either the policy intent or how the Commissioner applies the law. These amendments to the trust rules address those concerns.

The proposed amendments are:

- remedial in nature; and
- clarify the trust rules so that they work as intended, as described in IS 18/01.

## Background

The amendments to the trust rules arise from an administrative review of the taxation of trusts. This review identified several areas in the current law that were unclear and did not appropriately reflect either the policy intent or how the Commissioner applies the law, as set out in IS 18/01: Taxation of trusts (IS 18/01).

Many submissions were received in the process of developing IS 18/01, and were considered in formulating the amendments discussed in this Tax Information Bulletin item.

## Key features

The amendments in the Taxation (KiwiSaver, Student Loans, and Remedial Matters Act 2020 are consistent with the Commissioner's application of law and with the policy intent.

# Application dates

The application date for each amendment is set out in each of the following items relating to the taxation of trusts.

# Clarifying the relationship between section BB 2 and BF 1 of the Income Tax Act 2007

*Section BB2 of the Income Tax Act 2007*

The amendment provides consistency in terminology used in both of sections BB 2 and BF 1 of the ITA 2007.

## Key Features

The core provisions of the ITA (the core provisions) impose:

- income tax on taxable income, withholding taxes on some classes of income and other forms of tax (termed ancillary tax); and
- provide the method for calculating a person's income tax liability links to parts of the Act that set out detailed mechanisms for calculating withholding tax and ancillary taxes.

The amendment ensures that the wording in section BB 2(5) refers to both income tax and ancillary tax, to provide consistency in terminology between sections BB 2(5) and BF 1 (ITA 2007).

## Application date

The amendment applies from 23 March 2020.

# Residence of co–trustees treated as a notional single person

*Sections HC 2(2), (3) of the Income Tax Act 2007*

## Background

In the ITA 2007, the term trustee is defined to include all co-trustees for the time being. Under section HC 2 of the ITA 2007, co-trustees are treated as a notional single person for satisfying the income tax obligations for trustee income of that trust.

Prior to the amendments to HC 2, which relate to the tax residence of co-trustees, the Commissioner considered that co-trustees of a trust were resident in New Zealand if at least one of those co-trustees was a New Zealand resident in their personal capacity.[3] This view is consistent with the long-standing policy intent.

The amendments address questions raised in submissions about residence for co-trustees circumstances during the review of the taxation of trusts. The amendments give taxpayers greater certainty, and are consistent with the policy intent.

The amendments to section HC 2 confirm the Commissioner's view on how the ITA 2007 applies to determine the tax residence of co-trustees in IS 18/01.

Residence is an important factor for compliance with taxation obligations in New Zealand because:

- the trustee of the trust is the person responsible for calculating and satisfying the income tax liability;
- residence of the trustee is relevant for determining if certain tax credits can be used in satisfying the income tax liability of the trustee;

[3] Interpretation statement 18/01: Taxation of trusts (IS 18/01) and Interpretation statement 16/03: Tax residence (IS 16/03).

- payers of passive income need to know the residence status of an investor to determine the correct tax rate (for example, is the passive income subject to resident withholding tax or non-resident withholding tax); and
- the residence of the trustee is more certain when considering the application of a double tax agreement to trustee income derived by co-trustees.

If a trust has a sole trustee, the residence of the trustee is determined under the residence rules in section YD 4, determining residence based on their personal capacity.[4] Having determined tax residence on this basis, the sole trustee has always been required to satisfy their tax obligations, in their trustee capacity separate from their personal capacity.

Prior to these amendments to section HC 2, In IS 16/03 and IS 18/01,[5] the Commissioner considered that, for a trustee comprising of co-trustees, the trustee is resident in New Zealand if any one of the co-trustees is resident in New Zealand. This single notional person is also the person who:

- derives the trustee income of the trust; and
- satisfies all income tax obligations for that trustee income.

Because a trustee is responsible for calculating the income tax liability for trustee income, it is necessary for the trustee to know their tax residence status to correctly apply:

- the global /gross approach in the core provisions of the ITA 07 for calculating taxable income relating to trustee income of the trust. The global/gross approach taxes income sourced from New Zealand and the world-wide income derived by a New Zealand resident;
- the rules in section HC 25 and HC 26 relating to foreign-sourced income derived by a trustee. These rules both require knowledge of the residence of the trustee; and the settlor of the trust; and

[4] Interpretation statement 18/01: Taxation of trusts (IS 18/01) and Interpretation statement 16/03: Tax residence (IS 16/03).
[5] Interpretation statement 18/01: Taxation of trusts (IS 18/01) and Interpretation statement 16/03: Tax residence (IS 16/03).

- the rules relating to tax rates for a trustee that are applied by payers of passive income and PIE entities.

The amendments to section HC 2 clarify the treatment of co-trustees in relation to residence, consistent with how the Commissioner applies the law and the policy intent.

## Key Features

The amendments to section HC 2 clarify that at any point in time, or for a period, the trustee (as a notional single person) is a New Zealand resident for income tax purposes if at least one of the co-trustees is resident in New Zealand at that time or for that period.

Correspondingly, the trustee (as a notional single person) is a non-resident only if all the co-trustees are non-resident at that time or for that period.

The amendments also clarify that the residence of co-trustees of a trust is determined (for the purpose of:

- calculating the trust's taxable income for an income year;
- providing a joint return of income for the trust for each income year;
- self–assessing the trust's taxable income and income tax liability for each income year;
- determining the availability of foreign tax credits for foreign-sourced trustee income;
- satisfying the income tax liability on trustee income of the trust for each income year;
- satisfying withholding tax obligations for passive income distributed from the trust fund;
- complying with obligations for notifying tax rates to payers of passive income and under the PIE rules, in both cases relating to investments owned by the trustee; and
- satisfying the trustee's obligations as an agent under section HC 32 for a distribution of beneficiary income and a taxable distribution.

However, the amendments do not apply to a trustee comprised of co-trustees if that trustee has elected, under section HC 33 (the section HC 33 election), to pay New Zealand tax on the world-wide trustee income. A key effect of the section HC 33 election is that a trustee must determine their income tax obligations on the basis that the trustee and the settlor of the trust are resident in New Zealand (irrespective of the residence of the trustee). This obligation ensures that:

- foreign sourced income derived by the trustee is taxable in New Zealand; and
- passive income derived from New Zealand is subject to resident withholding tax.

## Application date

The amendments apply for income years beginning on or after 23 March 2020.

## Detailed analysis

The amendment to section HC 2(2) clarifies that treating a trustee comprising of co-trustees must meet all income tax obligations imposed under section BB 2 as a notional single person. Previously, this subsection only referred to the calculation of taxable income and satisfaction of the income tax liability for trustee income.

New section HC 2(3) clarifies that, if a section HC 33 election is not made to pay New Zealand tax on world-wide trustee income, the single notional person (a trustee comprising of co-trustees) is a New Zealand resident if any one of the co-trustees is resident in New Zealand in their own capacity.

Correspondingly, if none of the co-trustees are resident in New Zealand in their own capacity, then the single notional person trustee is not resident in New Zealand.

Section HC 2, as amended, clarifies and provides consistency of treatment across several rules that require a trustee, as a notional single person, to comply with tax obligations imposed under the ITA 007, including:

- calculating and satisfying the income tax liability on trustee income. This includes the income tax liability arising following a section HC 33 election;
- access to certain tax credits such as the foreign income tax credit; and
- notifying banks and PIEs of the correct tax rate for passive income (that is, non-resident withholding tax rate or resident rate).

In addition, under section HC 32 the trustee must also satisfy the income tax obligations for beneficiary income unless the Commissioner agrees that the beneficiary can assume that obligation.[6]

[6] Section HD 4(2)(b) ITA 2007.

# Corpus of a trust

*Sections HC 4(1), (1B), YA 1 "transfer of value" of the Income Tax Act 2007*

The amendments to section HC 4 clarify the value of a settlement of property made on trust. Under general trust law, a settlement of property is treated as a single trust and the value of that property constitutes the corpus of that trust. Section HC 3 of the ITA 2007 modifies this general law to allow multiple settlements of property made to a trustee of a trust to be treated as being made on a single trust for income tax purposes.

The amendments ensure that if multiple settlements are treated as being made on one trust, the value of the corpus of that trust is the aggregate value of those settlements.

In addition, an unintended change in the rewrite of this provision relating to a transfer of value arising from a forgiveness of debt is corrected. The Income Tax Act 2004 included certain forgiveness of debt within the meaning of a disposition of property (which was included in the meaning of a settlement of property). This unintended change is corrected by amending the definition of "transfer of value" to include a "disposition of property", as defined in the ITA 07. This ensures that the meaning of transfer of value is consistent with corresponding rules in the Income Tax Act 2004.

## Background

Under trust law, each settlement creates a separate trust. For income tax purposes, this is modified to permit trustees to elect to treat multiple property settlements on the terms of a trust deed as being additions to corpus of the same trust (section HC 3 of the ITA). The aggregate value of multiple property settlements for such a corpus was not clearly identified in the law before this amendment.

## Key features

The value of corpus for a single property settlement continues to be defined as equal to the market value at the time of the settlement.

New section HC 4(1B)) clarifies that, when a trustee treats multiple property settlements as being on one trust, the total value of corpus is the aggregate value of each property settlement, with that value being determined at the time of settlement.

This amendment:

- is consistent with commercial practice; and

- ensures that the ordering rules for distributions (section HC 16 of the ITA) are applied in a manner consistent with that practice.

In the Income Tax Act 2004, a settlement and a distribution include a forgiveness of a loan, because they are included in the definition of "disposition of property" in the Income Tax Act 2004. The rationalisation of these various rules during the rewrite may have obscured this outcome.

The amendment to the definition of transfer of value (section YA 1) in new paragraph (cb) clarifies that a forgiveness of a loan continues to be treated as a disposition of property for both a settlement on a trust and a distribution from the trust.

## Application date

The amendments to section HC 4 and the definition of "transfer of value" in section YA 1 apply from 23 March 2020.

# Certain settlements excluded from trustee income

*Section HC 7 of the Income Tax Act 2007*

The amendment to section HC 7 clarifies that certain settlements on a trust which are excluded from corpus and instead taxed to the trustee as trustee income, will not be included in trustee income if the settlement is distributed as beneficiary income.

## Background

The proposed amendment is a response to a submission made during the administrative review of trust taxation that section HC 7 contained an unintended legislative change arising in the rewrite of this provision.

Section HC 7 is intended to ensure that certain settlements excluded from corpus are taxed in the year of the settlement, to prevent a deferral of tax on undistributed income by resettling amounts on a sub-trust. Under the corresponding provisions in the Income Tax Act 2004, such a settlement could be taxed to either the trustee as trustee income or the beneficiary if distributed as beneficiary income. The rewritten provision did not give this outcome and is now corrected by this amendment.

## Key features

Excluding certain property settlements from corpus under section HC 7(3) is to mitigate against a deferral of tax in situations where those settlements would, if they were distributed, be taxable to a New Zealand resident beneficiary.

The proposed amendment clarifies that when a settlement is excluded from corpus it is included in trustee income for the income year in which the settlement occurred unless the income is distributed in the same income year to a beneficiary, either as beneficiary income or a taxable distribution.

The proposed amendment applies to the following types of resettlements:

- A re-settlement by a trustee on a sub-trust that could otherwise have been distributed as income that would be taxable to a New Zealand resident beneficiary.
- A settlement that is an allowable deduction for the settlor (for example, an employer's contribution to a trust that provides non-retirement benefits for employees).

- A settlement that would otherwise be income of the settlor and assessable for income tax in New Zealand.

## Application date

The amendment applies from 1 April 2008, and validates tax positions taken on this basis, and is consistent with commercial practice.

# Election to pay tax on worldwide trustee income

*Sections CX 56(1C), HC 25()(c)(ii), HC 26(1)(ab), HC 33, HM 55D(9), HM 56, RF 2(2)(d) of the Income Tax Act 2007 of the Income Tax Act 2007 and section 113F of the Tax Administration Act 1994*

The amendments to section HC 33 and, consequentially, other related provisions clarify:

- the circumstances in which a person (either the trustee, settlor or beneficiary of that trust) may elect to pay tax on worldwide trustee income (a section HC 33 election);
- the basis for calculating and satisfying that tax obligation; and
- the consequences for distributions from trustee income derived before, on and after this election.

In general, a section HC 33 election has effect from the date selected by that person (the effective date of the election). The effective date of the election may be retrospective, but:

- this is limited to a maximum of 4 years before the year in which the election is made; and
- is conditional on the income tax obligations being satisfied for the trustee income derived from the effective date of the election.

The amendments are intended to allow a future distribution of worldwide trustee income from income derived after the effective date of the election to be made from a complying trust (that is, the distribution is exempt income). A section HC 33 election does not change the tax treatment of distributions made before 23 March 2020.

## Background

In recent years, several situations were identified, including:

- a settlor of a foreign trust had migrated to New Zealand without an understanding of the effect that migration might have on future distributions from the trust; or
- a complying trust that ceased to have a settlor resident in New Zealand while deriving foreign-sourced income.

For these situations, it was identified that a previous amendment to the definition of complying trust could be read, in some circumstances, as permitting some taxpayers to revisit past tax positions to gain complying trust status on a retrospective basis. However, that previous amendment did not clarify:

- whether, despite not being liable for tax on worldwide trustee income, a "late election" could be made to pay tax on such trustee income; and
- how distributions from trustee income derived before and after such a late election would be treated.

As a result of this uncertainty, amendments have been made to the election rules in section HC 33. These amendments are consistent with the policy intent of both:

- the previous amendment to the definition of complying trust relating to the ability to pay tax on past year's world-wide trustee income; and
- allowing a trustee to make tax free distributions from past year's trustee income only if that trustee income has been fully subject to New Zealand tax at the trustee rate.

## Key features

The amendments clarify:

- the circumstances in which a section HC 33 election may be made for a trust to pay tax on worldwide trustee income;
- the effect of that election on passive income rules, such as the non-resident withholding tax and the notified investor rate for PIEs; and
- the tax consequences for distributions from tax-paid worldwide trustee income before and after a section HC 33 election.

For a section HC 33 election, other than one to which section HC 33(1B) applies, the effective date of the election is, at the option of person making the election, either:

- the date of the election;
- the beginning of the income year in which the election is made; or
- beginning of any of the four years preceding the income year in which the election is made.

A deemed election to which section HC 33(1B) applies, also now extends to a registered foreign trust which is also a complying trust but is not required to file an annual return of income (for example, a charitable trust described in section HC 13).

From the effective date of the election, the taxable income and income tax liability for the trustee must be calculated on the basis that both the trustee and settlor of the trust are a New Zealand resident. This has a consequential effect on the non-resident withholding tax rules and the notified PIE investor rate rules for trusts that have a non-resident trustee.

Section 113F of the TAA authorises the Commissioner to make an amended assessment to a trustee's return of income for any year as a result of a section HC 33 election being made having a retrospective effective date. Penalties and interest will not apply to such an assessment unless the trustee had adopted, for that year, either:

- an unacceptable tax position; or
- an abusive tax position; or
- a tax position for which the trustee is liable for a shortfall penalty for evasion or similar action.

The notification rules in subpart 2D of the TAA provide the framework for making a section HC 33 election. However, the election referred to in section HC 33(1B) has its own notification rule.

## Application date

The amendments apply from 23 March 2020.

## Detailed analysis

### Categories of election

There are three separate categories of a section HC 33 election. These are set out in the amended section HC 33(3), and are summarised as follows:

- an election made by giving notice to the Commissioner within the election expiry period described in section HC 30 (section HC 33(3)(a)). This election may be made by any of the trustee, settlor or a beneficiary of that trust;

- any other election made by giving notice to the Commissioner along with the date from which the election is to apply (section HC 33(3)(b). This election may be made by any of the trustee, settlor or a beneficiary of that trust; and
- a notice given in either a return of income or the annual return required under section 59D of the TAA (section HC 33(3)(c)). This election is made by the person liable to file the return of income or the return under section 59D of the TAA.

## Giving notice to the Commissioner

Section 14C in Subpart 2D of the TAA sets out how notice of the election is to be given to the Commissioner. Notifying the Commissioner through a MyIR account would meet the requirements of this provision.

## Effective date of election

HC 33(3)(a) – election to which section HC 30 applies

For an election to which section HC 33(3)(a) applies, the date of the election is the effective date. The effective date is important for applying the rules in section HC 30(3) in relation to a distribution. The amendments to section HC 33 do not change the effect of these rules.

## HC 33(3)(b) – at choice of electing person

For an election to which section HC 33(3)(b) applies, the effective date is at the choice of the taxpayer either:

- the date of the election; or
- the beginning of the income year in which the election is made; or
- the beginning of any one of the four income years preceding the year of election.

This clarification is intended to reduce compliance and administration costs for trusts when considering the tax effects on future distributions from trustee income derived in past years when the trust is not a complying trust.

### HC 33(3)(c) – deemed election

For the election to which section HC 33(3)(c) applies, the effective date of the election is from the beginning of the year in which the trust ceased to be a complying trust (that is, it is not liable for New Zealand tax on worldwide trustee income).

This notice is made when filing a return of income or, for a registered foreign trust, in the annual return required under section 59D of the TAA.

This deemed election continues to be effective until a year in which the trustee either:

- does not meet their tax obligations for worldwide trustee income; or
- does not comply with the notice requirements set out in section HC 33(1B)(1)(c).

### Amended assessments

New section HC 33(4) applies if a section HC 33 election is made. The person making the election is required to provide the Commissioner with all relevant information to allow the Commissioner to make an amended assessment under section 113F of the TAA.

New section HC 33(6) also provides that an amended assessment for a prior year that gives rise to an increased income tax liability on the worldwide trustee income will not be subject to penalties and interest unless the original tax positions taken were either:

- an unacceptable tax position;
- an abusive tax position; or
- a tax position that causes the trustee to be liable to pay a shortfall penalty for evasion or a similar action.

### Section HC 33 election, income tax obligations, passive income, and PIE entities

#### Calculation of trustee's income tax liability on worldwide trustee income

From the effective date of the election:

- the trustee must calculate their taxable income and income tax liability for trustee income for each income year;

- this obligation must be satisfied on the basis that both the settlor and the trustee of the trust are resident in New Zealand (sections HC 33(1C) and (2)); and
- a trust having a non-resident trustee who relies on a double taxation agreement to relieve the trustee from New Zealand tax will not satisfy this obligation.

If this obligation is not satisfied, the trust cannot be a complying trust.

This election and consequent obligations ensures that New Zealand tax is payable at trustee rate on the worldwide trustee income from the effective date of the election and that foreign tax credits are allowed for tax paid on foreign-sourced income.

### Passive income derived by a non-resident trustee

The amendment to section RF 2 clarifies that, passive income derived from New Zealand by a non-resident trustee is no longer liable for non-resident withholding tax (NRWT). This is consistent with:

- the trustee's obligation to calculate the trust's income tax liability for world-wide trustee income on the basis both the settlor and the trustee are New Zealand resident; and
- consistent with the policy that tax on New Zealand sourced income should not be limited to the NRWT rate.

As a result of this amendment, a trustee should notify a payer of passive income of the correct tax rate that should be applied in calculating resident withholding tax for future payments of passive income derived from New Zealand by the trustee.

### Trust investments in a PIE entity

The amendments to section HC 55D and HC 56 of the ITA 07 clarify that, following a section HC 33 election:

- a non-resident trustee is no longer eligible for the notified foreign investor rate; and
- the determination of the prescribed investor rate excludes the effect of amendment assessments for past years.

However, the transitional rule in section HC 55 ensures that the loss of eligibility for the notified foreign investor rate during an income year does not affect the PIE entity's obligations to calculate tax on the trustee's PIE income until the next income year

## Distributions made before 23 March 2020 – no change

Section HC 33(5)(a)) ensures that a distribution from trustee income before 23 March 2020:

- is treated as either beneficiary income or as a distribution from either a foreign, complying, or non-complying trust, determined at the time of that distribution; and
- ignores the effects on the status of a trust resulting from a section HC 33 election made on or after 23 March 2020.

## Distribution made on or after the effective date of election

The ordering of distributions from tax-paid trustee income is subject to the ordering rules in section HC 16 (the ordering rules). These rules treat a distribution from trustee income as being made on a first-in-first-out basis (FIFO basis) for all periods.

Under the FIFO basis for ordering distributions from trustee income, the tax treatment of the distribution is determined by the status of the trust for the period in which the trustee income was derived (that is, either as a foreign trust, or as a non-complying trust or a complying trust).

If a section HC 33 election has been made, the status of a trust for a distribution made on or after 23 March 2020 from trustee income is determined from the interaction of the ordering rules with:

- section HC 30 of the ITA 07 (no change in effect); or
- new section HC 33(5) of the ITA 07 (which applies to distribution made on or after 23 March 2020).

If a section HC 33 election has not been made, the status of a trust for a distribution from trustee income is determined from the ordering rules. As no amendments affect this outcome, the tax obligations for a distribution continue to be determined from the interaction of:

- the ordering rules; and

- the definitions of complying trust, foreign trust, or non-complying trust; and
- the definitions of distribution, beneficiary income and taxable distribution.

### Election to which section HC 33(3)(a) applies

For an election to which section HC 30(2) applies (that is, it is made within the election expiry period described in section HC 30), there is no change to the tax effects for a distribution made from trustee income derived before, on or after the effective date of the election.

These tax effects are set out in section HC 30(3) of the ITA 07. Under this provision, the tax effects are determined from how the ordering rules for a distribution from trustee income interact with the date of the election and the definitions of complying trust, foreign trust and non-complying trust.

### Election to which section HC 33(3)(b) and (c) applies

New section HC 33(5) provides the tax consequences for a section HC 33 election other than one to which section HC 30 applies. This new section ensures that, for a foreign trust of which at least one settlor has become a New Zealand resident:

- a section HC 33 election is effective if it is made after the election expiry period described in section HC 30 has ended; and
- these effects override the application of section HC 30(4) for periods from the effective date of the election.

Under section HC 33(5), the tax effects for a distribution from such a trust made on or after 23 March 2020 are determined from how the ordering rules interact with the effective date of the election and the definitions of complying trust, foreign trust and non-complying trust.

The tax effects on a distribution are illustrated in the following examples:

| Example 18: Inbound migrating settlor |
| --- |
| A settlor of a foreign trust has migrated to New Zealand and became a New Zealand resident on 30 September 2013 (after ceasing to be a transitional resident). All beneficiaries of the trust also migrate to New Zealand and become New Zealand residents from the same date. The trustee is not resident in New Zealand.<br><br>This trust has both New Zealand sourced income and foreign sourced income and the trust has existed since 2008. No section HC 33 election is made by 30 September 2014, and the trustee was |

not aware they were required to pay tax on its foreign sourced income but has paid tax on all New Zealand sourced income . The balance date of the trust is 31 March.

A distribution (not being beneficiary income) of $1M was made on 30 June 2016 to New Zealand resident beneficiaries. No New Zealand tax was paid on this distribution by the trustee or the beneficiaries.

The trustee wishes to make a distribution on 30 June 2020 and has learned that amendments have been made to the trust rules that affect the taxation of distributions. As a result of this enquiry, the trustee learns that a retrospective section HC 33 election may be made to pay tax on world-wide trustee income. The trustee makes a section HC 33 election on 5 April 2020, to apply from the beginning of 1 April 2016. This is the beginning of the fourth income year prior to the income year beginning 1 April 2020.

**Tax effect on distribution made on 30 June 2016**

Because the distribution on 30 June 2016 is made before 23 March 2020, it is necessary to determine under the ordering rules, the extent to which the distribution is made from trustee income or capital gains derived by the trustee:

- on or before 30 September 2014; or
- after 30 September 2014.

This analysis reveals that the distribution of $1M comprised:

- $400,000 from trustee income derived before 30 September 2014 (a taxable distribution from a foreign trust);
- $250,000 from trustee income derived after 30 September 2014 (a taxable distribution from a non-complying trust);
- $300,000 from a capital gain derived before 30 September 2014 (a distribution of a capital gain from a foreign trust); and
- $50,000 from a capital gain derived after 30 September 2014 (a taxable distribution from a non-complying trust).

In summary, this distribution is treated as follows

- $400,000 – as a taxable distribution from a foreign trust; and
- $300,000 – as a taxable distribution from a non-complying trust; and
- $300,000 – as a distribution of a capital gain from a foreign trust.

For the taxable distribution of $400,000, the beneficiary is liable for tax at the beneficiary's marginal rate for the year ending 31 March 2017, along with any penalty and interest assessed for the late payment of that tax. For the taxable distribution of $300,000, the beneficiary is liable for tax at the 45% rate imposed on a taxable distribution from a non-complying trust, along with any penalty and interest assessed for the late payment of that tax. No tax is payable on the distribution of the capital gain from a foreign trust.

The amendments to the trust rules do not affect this outcome.

**Proposed distribution on 30 June 2020**

However, because the trustee has made a section HC 33 election with effect from 1 April 2016 the proposed distribution can be treated as a distribution from a complying trust to the extent the distribution is from income derived on or after 1 April 2016. However, this is dependent on the trustee satisfying the tax obligations on the worldwide trustee income of the trust before the date of the distribution at 30 June 2020.

The proposed distribution is $1.5 million and the analysis of the source of that distribution shows that:

- $450,000 is to be made from trustee income derived after 30 September 2014 but before 1 April 2016 (taxable distribution from a non-complying trust);
- $1.05 million is to be made from trustee income derived on or after 1 April 2016 (distribution from a complying trust).

As a result of the analysis, and assuming the trustee has satisfied the tax obligations arising from the section HC 33 election for period from 1 April 2016, the trust is a complying trust in relation to a distribution of income from this period. This means that the trustee is liable to pay tax at 45% on the taxable distribution of $450,000 (distributed from trustee income derived before 1 April 2016) but the distribution of $1.05 million is exempt income of the beneficiary.

This treatment in section HC 33(5)(b) for trustee income derived after 30 September 2014 overrides the effect of section HC 30(4) for those periods.

These amendments also apply to the case of multiple non-resident settlors if only one of those settlors becomes a New Zealand resident. This is because the settlor regime taxes worldwide trustee income if at least one of those settlors is resident in New Zealand (HC 25).

**Outbound migrating sole settlor**

A sole settlor of a trust has migrated from New Zealand and ceases to be a New Zealand resident at 1 April 2016. The trustee of this trust is a non-resident and all beneficiaries are New Zealand resident individuals.

From 1 April 2016, the trust continues to derive foreign sourced income and interest income from New Zealand. Under the settlor regime, the foreign sourced income is no longer liable for New Zealand tax (section HC 25 applies), and the interest income is liable only for non-resident withholding tax as a final tax.

Consequently, the trustee is no longer liable for tax on worldwide trustee income and the trust becomes a non-complying trust in relation to any distribution made from trustee income derived after the date the settlor ceases being a New Zealand resident. It is proposed to make a distribution of $650,000 to the beneficiaries on 1 October 2020.

As the trustee's annual returns of income for the 2016–17 to 2018–2019 tax years did not include the foreign sourced income, the trust cannot be a complying trust for distributions of trustee income derived during those periods. However, the trustee includes the foreign sourced income in the 2019–20 return of income, ticks the return to indicate complying trust status and satisfies the New Zealand tax obligations on the world-wide trustee income for that tax year on 30 July 2020.

Analysis of the ordering rules shows that the proposed distribution of $650,000 will be sourced from trustee income as follows:

- $200,000 from trustee income derived prior to 31 March 2016 (from a complying trust);
- $120,000 from trustee income derived from 1 April 2016 until 31 March 2017 (from a non-complying trust);
- $200,000 from trustee income derived from 1 April 2017 until 31 March 2019 (from a non-complying trust.
- $130,000 from trustee income derived during the 2019–20 income year (from a complying trust).

The distribution therefore comprises of:

- a distribution of exempt income of $330,000 (distributions from income derived while the trust is a complying trust; and
- a taxable distribution of $320,000 from a non-complying trust, liable for tax at the rate of 45%.

However, the trustee could also make a section HC 33 election (HC 33(3)(b) refers) prior to the proposed distribution on 1 October 2020. This would supplant but the deemed election in the return of income for the year ending 31 March 2020 and this would not affect complying trust status for this year. If this election had been made with effect from 1 April 2016, and provided the tax obligations for all prior periods are satisfied prior to 1 October 2020, the trust will be a complying trust in relation to the entire distribution which would be treated as exempt income of the beneficiary.

# Definition of complying trust

*Sections HC 10(1)(ab) of the Income Tax Act 2007*

The proposed amendment to section HC 10(1)(ab) clarifies the point in time from when a trust may be treated as a complying trust if:

- an election has been made, under section HC 33 of the ITA 07 (section HC 33 election) to pay New Zealand tax on worldwide trustee income; and
- the trustee satisfies the New Zealand tax obligations for that trustee income.

This amendment provides consistency with the amendments to section HC 33, which allow such an election, including a section HC 33 election that has retrospective effect for up to 4 years before the year in which the election is made.

## Background

The policy intent is that, in relation to a distribution from a trust, a complying trust is one that has paid New Zealand tax on world-wide trustee income (tax-paid trustee income) and so is able to make a distribution (other than beneficiary income) that is not taxed to the beneficiary.

The amendments to section HC 10 are consistent with the amendments to section HC 33 of the ITA 07. Those amendments clarify the extent to which any trust that is not a complying trust may make a section HC 33 election to pay tax on its worldwide trustee income to gain complying trust status for distributions made after 23 March 2020 from tax-paid trustee income.

The ordering rules in section HC 16 of the ITA 07 determine whether a distribution has been made from tax-paid trustee income.

## Key features

A section HC 33 election  to pay tax on worldwide trustee income is intended to alter the tax effects on a future distribution from a trust which has not always had a New Zealand resident settlor over the life of the trust. For example:

- a trust, for which the settlor has migrated from New Zealand and is no longer resident in New Zealand; or
- a trust for which the settlor has migrated to New Zealand and become a New Zealand resident (whether or not an election is made by the election expiry date referred to in section HC 30).

New section HC 10(1)(ab) clarifies that that such a trust can gain or retain complying trust status in relation to a distribution by making  section HC 33 election as follows.

A trust for which the settlor has migrated to New Zealand is a complying trust in relation to a future distribution of trustee income:

- the section HC 33 election is made within the election expiry period referred to in section HC 30;
- the trustee satisfies all New Zealand tax obligations for worldwide trustee income derived after the date of the election and before the date of the distribution; and
- the distribution is made from trustee income derived after the date of the election and before the date of distribution.

Any other trust that has not always had a New Zealand settlor may gain complying trust status for a future distribution of trustee income if:

- the section HC 33 election is made before the distribution is made;
- the trustee satisfies all New Zealand tax obligations for worldwide trustee income derived after the date of the election and before the date of the distribution; and
- the distribution is made from trustee income derived after the date of the election and before the date of distribution.

A trustee that obtains relief from New Zealand tax on New Zealand–sourced income under a double tax agreement (treaty relief) after the effective date of an election would result in:

- the trustee not satisfying the obligation to tax on worldwide trustee income from the effective date of the election on the basis both the trustee and settlor of the trust are resident in New Zealand (sections HC 33(1C); and
- such a trust not meeting the definition of a complying trust in section HC 10 for a distribution from a period in which the trustee had obtained such treaty relief.

## Application date

The amendments to section HC 10 apply for an election made on or after 23 March 2020.

## Detailed analysis

### New Zealand resident settlor of a complying trust becomes non-resident

New section HC 10(1)(ab) applies to a trust that ceases to have a New Zealand resident settlor (other than death of a natural person settlor) for which a section HC 33 election is made, either as:

- an election to pay tax on worldwide trustee income as described in section HC 33(3)(b); or
- a deemed election because the trustee continues to self-assess worldwide trustee income at the trustee rate, as described in section HC 33(3)(c); and
- for both cases, the tax obligations for trustee income are satisfied for all periods from the date the election applies from.

The ability to make a retrospective election under section HC 33(3)(b) for a trustee that has not paid tax on worldwide trustee income after the trust ceases to have a New Zealand resident settlor:

- allows the trustee to correct past tax positions for up to 4 years before the year in which the election is made;
- ensures that a future distribution of trustee income (not being beneficiary income) from trustee income derived during the period after the effective date of the election is treated as a distribution from a complying trust.

The amendments ensure that a trust that ceases to have a New Zealand resident settlor may continue to be treated seamlessly as a complying trust in relation to a distribution of income from periods for which the trust is a complying trust.

## Settlor of a foreign trust becomes a New Zealand resident and no section HC 33 election within election expiry period

Section HC 30(4) applies to a trust of which the settlor has migrated to New Zealand and no section HC 33 election was made within the election expiry period. The consequence of not making this election is that such a foreign trust is a non-complying trust in relation a distribution from trustee income derived after that election expiry date.

Several situations have been identified of a settlor of a foreign trust migrating to New Zealand and not understanding the effect the migration might have on future distributions from the trust. Before the amendments to section HC 33 and HC 10, it was unclear:

- whether this non-complying status could be remedied by a "late election";
- how distributions from trustee income derived before and after such a late election could be treated.

These issues are addressed in the amendments in section HC 33 (see earlier in this TIB item) relating to the ability to make a "late election", and the effect for distributions from tax-paid trustee income derived in periods after such an election.

Section HC 10(1)(ab) complements those amendments to section HC 33 by clarifying that a complying trust in relation to a distribution includes a trust which has either:

- ceased to have complying trust status because the trustee is no longer liable for New Zealand tax at the trustee rate on worldwide trustee income; or
- a settlor has migrated to New Zealand and no election to pay tax on worldwide trustee income was made within the election expiry date.

These amendments do not apply to a trust with a New Zealand resident settlor that is a non-complying trust because the trustee has not satisfied their New Zealand tax obligations on world-wide trustee income. This non-complying status subject to the time bar in section 108 of the TAA, is able to be remedied by satisfying those past tax obligations including relevant penalties and interest before a distribution is made. If these past tax obligations are able to be satisfied for all prior periods the trust is a non-complying trust, complying trust status is restored for all those periods.

### Settlor of a foreign trust migrates to New Zealand and section HC 33 election made

New section HC 10(1)(ab)(i) applies to a trust of which the settlor has migrated to New Zealand and makes a section HC 33 election within the election expiry period. This period is either:

- for a settlor that is not a transitional resident, the 12-month period from the day on which the settlor becomes a New Zealand resident; or
- for a settlor that stops being a transitional resident , the 12-month period from the day the transitional resident status ceases.

Section HC 10(1)(ab) clarifies that the meaning of complying trust includes such a trust. The amendment arises from a technical submission on this point made during the Commissioner's review of the taxation of trusts. This amendment does not give rise to any change in commercial practice or the Commissioner's practice.

| Example 19: Inbound migrating settlor |
| --- |
| A settlor of a foreign trust has migrated to New Zealand and became a New Zealand resident on 30 June 2017 (after ceasing to be a transitional resident). This trust has both New Zealand sourced income and foreign sourced income and the trust has existed since 2008. No section HC 33 election is made by 30 June 2018 and the trustee was not aware they were required to pay tax on its foreign sourced income. The balance date of the trust is 31 March.<br><br>Consequently, this trust is a non-complying trust for a distribution (other than a distribution of beneficiary income) made after 30 June 2018 which is made from trustee income derived after 30 June 2018. Such distributions to are taxed at 45%, applying the source and residence principles set out in the core provisions.<br><br>However, the amendments to section HC 33 and HC 10(1)(ab) permits a retrospective election may be made after 23 March 2020.<br><br>The trustee makes this election on 1 June 2020, with an effective date of 30 June 2018. The trustee files a corrected return of income for the 2018–19 year and pays the correct amount of tax assessed for that year and for the 2019–20 and later income, the trustee satisfies tax obligations on worldwide trustee income of that trust.<br><br>Because of that election and satisfaction of the relevant tax obligations for the 2018–19 income year, a distribution after 23 March 2020 from trustee income derived after 30 June 2018 is treated as being made from a complying trust. This treatment is set out in section HC 33(5)(b), and is intended to override the effect of section HC 30(4). |

These amendments also apply to the case of multiple non-resident settlors if only one of those settlors becomes a New Zealand resident. This is because the settlor regime taxes worldwide trustee income if at least one of those settlors is resident in New Zealand (section HC 25).

**Outbound migrating sole settlor**

A sole settlor of a trust has migrated from New Zealand and ceases to be a New Zealand resident at 1 April 2018. The trustee of this trust is a non-resident

From 1 April 2018, the trust continues to derive foreign sourced income and interest income from New Zealand. Under the settlor regime, the foreign sourced income is no longer liable for New Zealand tax (section HC 25 applies), and the interest income is liable only for non-resident withholding tax as a final tax.

Consequently, the trustee is no longer liable for tax on worldwide trustee income and the trust becomes a non-complying trust in relation to any distribution made from trustee income derived after the date the settlor ceases being a New Zealand resident.

However:

- If the trustee had continued to pay tax on world-wide trustee income at the trustee rate (full New Zealand tax) and indicated in the trust's annual return of income (by marking the relevant check box) that the trust is a complying trust, the trust's complying trust status is maintained from the date of migration on a seamless basis. This is provided for in section HC 33(1B) HC 33(3)(c) and HC 10(1)(ab) of the ITA 07.
- Alternatively, an election can be made under section HC 33(3)b) to pay full New Zealand tax on trustee income derived on or after the date of migration. This election can be retrospective within the time limit set out in section HC 33(b)(ii) and (iii).

For both elections referred to above, the complying trust status is also conditional on:

- the election having been made before a distribution (not being beneficiary income) from trustee income derived after the effective date of the election; and
- the tax obligations on the worldwide trustee income are satisfied for periods after the effective date of the election.

In addition, for both cases if a section HC 33 election is not made with effect from the date of the migration, the trust will be a non-complying trust in relation to a distribution (other than beneficiary income) of trustee income derived after the date of migration.

For multiple settlors, this above example applies only if no settlor remains resident in New Zealand. If a settlor remains resident in New Zealand, then worldwide trustee income remains liable for tax at the trustee rate. If the trustee is a non-resident, then this resident settlor must satisfy the tax obligations on worldwide trustee income (section HC 29 refers). If these obligations are not satisfied the trust becomes a non-complying trust in relation to a distribution from the periods for which the tax obligations on worldwide trustee income are not satisfied.

# Transfer of value for deferral or non-exercise of right to demand payment

*Section HC 31B and section YA 1 "financial assistance" of the Income Tax Act 2007*

New section HC 31B addresses questions raised during an administrative review of the taxation of trusts relating to the valuation of financial assistance provided if there is:

- an obligation to repay interest or principal on demand; and
- the right to demand repayment is not exercised or is deferred.

## Background

The administrative review of the taxation of trusts identified that it was very difficult to value a settlement or a distribution relating to financial assistance provided by one person to another subject to an on-demand condition for principal and interest. In particular, the concerns raised related to:

- section HC 27(2)(b) that makes a person a settlor if such financial assistance is provided to the trust; and
- section HC 14 which defines a distribution as a transfer of value, which would include the value of the interest forgone on such financial assistance.

The administrative review also concluded that to reduce administration and compliance costs in valuing such financial assistance, the legislation should provide a method to calculate this value.

## Key features

The amendment addresses this issue by inserting a formula in new section HC 31B that applies when:

- financial assistance is given on an on-demand basis for either principal or interest or both; and

- not demanding the interest or principal gives rise to a transfer of value that comes within the meaning of distribution in section HC 14 or would make a person a settlor of a trust by virtue of section HC27(2)(b).

The formula calculates the value of the distribution or the settlement for any period as the amount of interest that would be foregone if the demand had instead been exercised. The value is calculated as the difference between:

- the interest that would be payable on the principal at market rate or the prescribed rate (at the choice of the taxpayer) for that period; and
- the amount of interest accrued for that period on the principal amount owing. This includes an amount that would have accrued for that period if that amount had been included in a taxable distribution.

The proposed formula is like the calculation of the value of a fringe benefit for on-demand shareholder current accounts and ensures that administration and compliance costs can be minimised when valuing such financial assistance.

The definition of financial assistance formerly located in section HC 36(5) is relocated to section YA 1 and applies for the purpose of the trust rules. This amendment clarifies the meaning of financial assistance, consistent with the Commissioner's view,  as set out in *IS 18/01: Taxation of Trusts*.

## Application date

New section HC 31B applies to determine the value of financial assistance that would give rise to a distribution or a settlement on a trust on or after 23 March 2020, including financial assistance that exists before 23 March 2020.

# Meaning of settlor and settlement

*Sections FC 2(4), HC 27 and HC 28 of the Income Tax Act 2007*

The amendments to section HC 27 and HC 28 clarify certain circumstances in which a person may become a settlor of a trust. These issues were identified in the administrative review of the taxation of trusts as:

- a potential for overreach in relation to indirect settlements;
- when a controlled foreign company (CFC) settles an amount (or has settled) an amount on a trust; and
- the interaction of section HC 27(6) with section HC 27(2) and (4).

The amendment to section FC 2(4) clarifies that the rules taxing holding gains for property before it is gifted do not apply to determine whether a transfer of value is made to a trust as a settlement on the trust.

## Background

The administrative review of the taxation of trusts identified some uncertainty in applying the rules defining a person as a settlor in relation to:

- a potential for overreach in relation to indirect settlements (section HC 27(4));
- when a person having a control interest of 10% or more in a controlled foreign company (CFC) will become a settlor of trust for which the CFC settles an amount (or has settled) an amount on a trust (section HC 38(3), (4));
- the overriding effect of section HC 27(6) with section HC 27(2) and (4) to exclude a beneficiary from being a settlor for amounts owed to the beneficiary on an on-demand basis; and
- the application of the rules in subpart FC when a gift is made to a trust as a settlement.

# Key features

## Potential for overreach in relation to indirect settlements

The amendment to section HC 27(4) clarifies that person may make an indirect transfer of value to a trust through one or more transactions. As set out in IS 18/01at paragraphs 2.60 to s.65, this rule is likely to be applied where:

- a person (person A) controls or influences the actions of another person (person B) for that transaction; and
- a result of that transaction is that a transfer of value is indirectly made to a trust.

## Trust settled by a CFC

The amendments to section HC 28(3) and (4) clarify the time at which a person having a control interest of 10% or more in the CFC will be a settlor of that trust. For the person to be a settlor of that trust, the investor must have a 10% or more control interest in the CFC at the time the CFC settles an amount on that trust.

## Relationship of sections HC 27(4) and (6)

The amendment to section HC 27(6) to cross-refer to section HC 27(2), clarifies that the exclusion under section HC 27(6) also applies in determining whether an indirect settlement has occurred.

## Interface of the meaning of a settlement with the subpart FC rules

An amendment is made to section FC 2(4) to ensures that the value of a settlement on a trust is unaffected by the rules in subpart FC. The rules in subpart FC treat a gift as a purchase and acquisition transaction to ensure that holding gains derived by the donor , including those made on revenue property, cannot be avoided by the making of a gift. If this treatment were applied within the trust rules there could be no transfer of value from the gift.

The amendment ensures that whether a gift is a transfer of value for the trust rules is not affected by the valuation and transaction rules in subpart FC.

## Application dates

The amendment to section FC 2 applies from 18 March 2019, consistent with an earlier amendment that ensures that distributions as a transfer of value are unaffected by the rules in subpart FC.

The amendments to sections HC 27 and HC 28 apply from 23 March 2020.

# Foreign-source income derived by a trustee

*Sections HC 25 and HC 26 of the Income Tax Act 2007*

The administrative review of the taxation of trusts identified that it was unclear how the rules relating to the taxation of foreign-sourced income derived by a trustee should be treated in the event either:

- no natural person settlor of the trust remained alive or the settlor had ceased to exist (for example, a corporate settlor); or
- a section HC 33 election has been made.

## Key features

### Testamentary or inter-vivos trust with resident settlor and a non-resident trustee

The amendment to section HC 25 applies to a trust that has a corporate settlor that continues to exist after the natural person settlor of that trust has died. If that corporate settlor ceases to exist, and no settlor remains, the residence of the settlor will be determined by the residence of that corporate settlor when it ceased to exist.

### Trust with non-resident settlor and resident trustee

The amendments to section HC 26 clarify that:

- The exempt income treatment for foreign-sourced income derived by the resident trustee does not apply for a distribution of minor beneficiary income which is taxed at 33% to the trustee as trustee income; and
- The exempt income treatment for foreign-sourced income does not apply if the trust has made a section HC 33 election. This is consistent with the trustee's obligation to calculate their income tax liability on the basis the settlor and trustee of the trust are both resident in New Zealand.

## Application date

The amendments apply from 23 March 2020.

# Distributions

*Sections HC 14, HC 15, HC 16 of the Income Tax Act 2007*

The amendments address some minor issues identified during the administrative review of the taxation of trusts. The amendments are consistent with the Commissioner's view set out in IS 18/01.

## Background

The administrative review of the taxation of trusts identified some minor interpretive uncertainty issues relating to:

- the payment of interest on amounts owed by a trustee to a beneficiary;
- identifying the source of capital gains and capital losses;
- the ordering of distributions; and
- the anti-avoidance rule relating to the ordering rules for distributions.

## Key features

### Distributions and payments of interest

The amendment to section HC 14 clarifies that an amount of interest paid to a beneficiary under the terms of a loan is not a distribution (that is, it is not included in beneficiary income). However, if the amount of interest exceeds the amount determined under the terms of the loan agreement, the excess amount of interest is treated as a distribution.

### Source of capital gains and capital losses

The amendments in sections HC 15(5C) and (5D) clarify how the source rules apply to a capital gain or capital loss that is taken into account as part of a taxable distribution. The source of the capital gain or loss is determined using the source rules in section YD 4.

### Ordering of distributions

The amendment to section HC 16(2) clarifies the relative order for a distribution that is beneficiary income. This addresses a tension identified in the administrative review of the taxation of trusts.

### The anti-avoidance rule and the ordering rules for distributions

Section HC 16(5) of the ITA prevents trustees using the ordering rule to manipulate the nature of a distribution for New Zealand tax purposes to stream income and capital to different classes of beneficiary (for example, resident and non-resident beneficiaries).

The rule ignores the tax effect of an earlier distribution in determining whether a subsequent distribution would be treated as either beneficiary income or a taxable distribution.

The amendments confirm that this rule does not apply to a genuine transaction that results in a distribution of beneficiary income or a taxable distribution not being placed beyond the control of the trustee. This ensures that the rule does not apply to the commercial practice of trustees crediting a distribution to a beneficiary's current account.

## Application dates

The amendments to section HC 15 apply from 23 March 2020.

The amendments to section HC 16 apply for income years beginning after 23 March 2020.

# Definitions

*Sections HC 36, YA 1, ,"disposition of property", "financial assistance" "transfer of value", "transfer of company value", "trust rules" and YD 3BA of the Income Tax Act 2007*

A few definitions are amended consequential to amendments to the substantive trust rules.

## Key features

The definition of financial assistance is relocated to section YA from section HC 36 and applies for the purpose of the trust rules and not just for section HC 36.

The definition of transfer of value is clarified by:

- removing the elements that relate to dividends from companies (this now termed transfer of company value";
- ensuring that a transfer of value includes an amount whether or not convertible into money, which is consistent with the Commissioner's view in IS 18/01; and
- correcting an unintended change arising in the rewrite of the trust rules to ensure that the definition of a disposition of property is within the meaning of transfer of value. This ensures that forgiveness of a loan is treated in the same manner as under the corresponding provisions in the Income Tax Act 2004.

The definition of trust rules is amended to include rules that apply only for trusts, consistent with their treatment under the Income Tax Act 2004, and now includes the new definition of resident of a trustee that has co-trustees (section YD 3BA)

## Application dates

The amendments to the definitions apply from 23 March 2020 with the exception of the amendment to the trust rules relating to section BD 1(4)(c), which applies from 1 April 2008.

# Māori authority distributions

*Sections LO 2 and OK 19 of the Income Tax Act 2007*

The amendments clarify:

- the calculation of the tax credit for a Māori authority distribution; and
- correct unintended changes to the Māori authority credit account rules arising in the rewrite of these provisions.

## Background

The amendments to section LO 2 and OK 19 correct an unintended legislative change in the rewrite of each of the provision.

## Key features

The amendment to section LO 2 corrects the meaning of the parameter "person's distributions" for the formula in section LO 2(2). This amendment:

- ensures that the pro-rating of Māori authority tax credits is made by reference to all distributions made to beneficiaries; and
- validates tax positions taken based on the pre-rewrite legislation from all distributions made from 1 April 2008.

The amendment to section OK 19 restores the law to give the same outcome as the corresponding provision in the Income Tax Act 2004. This amendment restores the correct policy outcome. The rule now ensures that a Māori Authority Tax Credit (MATC) may only be retrospectively attached to a distribution from a Māori authority if the Commissioner has made an assessment under the transfer pricing rules to change the effect of a past transaction.

## Application dates

The amendments to sections LO 2 and OK 19 apply from the beginning of the 2008–09 income year.

For both amendments, a savings provision protects a taxpayer who has taken a tax position based on the unamended legislation.

# Eliminating the requirement to estimate at the final instalment date for provisional tax

*Sections 120KBB of the Tax Administration Act 1994*

This amendment removes the requirement for taxpayers to switch to the estimate method at the final instalment of provisional tax when they believe their residual income tax for the year will be less than the standard instalments and retain the interest concession contained in section 120KBB of the Tax Administration Act 1994 as long as their residual income tax is $60,000 or more.

Taxpayers will continue to be able to pay what they consider is the amount remaining at the final instalment date without changing from the standard "uplift" method. This will reduce compliance costs to the taxpayer.

Taxpayers who do estimate at any time during the income year will be subject to the standard use of money interest (UOMI) rules in section 120KB of the Tax Administration Act 1994 and will potentially be subject to UOMI from the date of their first provisional tax instalment.

In practical terms, this does not affect any taxpayers as they will continue to do what they always have, however, the method in which they do that will alter. Furthermore, the compliance costs of having to make an estimate will be removed.

## Background

The interest concession rules are contained in section 120KBB of the Tax Administration Act 1994. These rules essentially allow those taxpayers who use the standard method and make the required payments to have no exposure to UOMI until the day after the final provisional tax instalment is due for the year.

This rule also applies to taxpayers who make the first two instalments using the standard method and make their final instalment under the estimation method. This rule was included in the final amending act due to a number of submissions made at the finance and expenditure committee which stated that if a person anticipated that their residual income tax (RIT) for the year in question was less than their uplifted provisional tax amount there was no legal ability for them to make a payment less than the standard instalment amount.

This was notwithstanding the UOMI calculation would have calculated UOMI correctly and no late payment penalty would have been charged.

| Example 20 |
| --- |
| Cookie Monsters Limited (Cookie) is a provisional taxpayer on a 31 March balance date who uses the standard uplift method. For the 2020–21 income year their standard instalments are based on 105% of their CY[7]-1 RIT which was $200,000. This gives them 3 instalments of $70,000. They pay both the first and second instalments on time on that basis but by the time the third instalment is due Cookie has calculated that due to the ongoing pressure from anti-obesity campaigns the market for their high sugar and fat content signature biscuit, "The Clogger", has dramatically reduced. Cookie's estimate of their 2020–21 RIT is $63,000 for the year.<br><br>Cookie decides to estimate their final instalment of provisional tax and make no payment. Cookie will still be able to use the interest concession rules even though they estimated at their final instalment date. UOMI will apply from the date of the final instalment where its tax liability is more than payments made.<br><br>This creates a compliance cost on taxpayers who then must switch provisional tax methods at their final instalment date and file an estimate. It also potentially exposes them to penalties for lack of reasonable care in making a reasonable estimate. |

## Key features

These changes allow provisional taxpayers who estimate RIT of greater than $60,000 to use the standard method to pay provisional tax to pay an amount lower than the standard method obligation on the final instalment date without having to switch to the estimation method.

## Application date

The amendment applies from the 2019–20 income year.

[7] CY=Current year.

## Detailed analysis

The amendment allows taxpayers who make provisional tax payments under the standard method to vary their final instalment payment from the standard instalment to whatever they consider is owing at that date without having to switch provisional tax methods as long as their RIT is above $60,000.

Taxpayers who have an RIT of less than $60,000 will be better off using the safe harbour provisions in section 120KE of the Tax Administration Act 1994.

As UOMI will apply to any shortfall from the final instalment date taxpayers are always incentivised to pay their "actual" liability at that date. Given the final instalment is some time after their balance date, taxpayers should be able to reasonably accurately approximate the final amount payable.

The ability to use the estimation method is removed from the interest concession rules in section 120KBB. If a taxpayer estimates at any point during the year, they will be under the estimation method for the entire year and potentially subject to UOMI from the date of the first instalment.

Practically, this will make no difference to taxpayers as they will continue to do the same as they always have but the compliance cost of switching provisional tax methods will be removed.

| Example 21 |
|---|
| Grover Grapes Limited (Grape) is a provisional taxpayer on a 30 June balance date who uses the standard uplift method. For the 2020–21 income year their standard instalments are based on 110% of their CY[8]-2 RIT which was $140,000. This gives them 3 instalments of $51,333. It pays both the first and second instalments on time on that basis. However, by the time the third instalment is due Grape has calculated that due to the grape season being adversely affected by the great grape infection of 2020 it's income will be well down on the standard uplift amount. Grape believes they will only have RIT of $76,000 for the year. |

[8] CY = Current year.

Grape realises this about 3 weeks before the payment of their third instalment and decides to immediately file an estimate of the lower amount with Inland Revenue. By filing an estimate before the third instalment date Grape as thrown itself out of the standard method and will not be able to use the interest concession rules in section 120KBB. It will be subject to use of money interest from the first instalment date under section KB.

Grape may also be subject to shortfall penalties if it did not take reasonable care in making its estimate for the year.

# Clarifying the "lesser of" calculation of interest for standard "uplift" taxpayers

*Section 120KBB of the Tax Administration Act 1994*

The amendment clarifies the legislation to reflect the application of the "lesser of" calculation for standard "uplift" taxpayers to ensure this aligns with the way in which UOMI is calculated in Inland Revenue's technology platforms.[9]

## Background

For taxpayers who qualify to be able to use the interest concession rules contained in section 120KBB of the Tax Administration Act 1994, UOMI is calculated on a different basis than for other taxpayers. Generally, a taxpayer will be exposed to UOMI on the difference between their actual liability for the year divided by the number of instalments and what they paid. For example, a taxpayer who has residual income tax[10] (RIT) of $90,000 and has paid nothing will be charged interest on $30,000 at each instalment date (that is, $90,000 ÷ 3).

The interest concession rules operate differently and calculate UOMI (and late payment penalties) based on a "lesser of" rule contained in section 120KBB(3) of the Tax Administration Act 1994. This calculates UOMI on the difference between the lesser of the amount of the standard method instalment and the actual liability, divided by the number of instalments.

For example, if a taxpayer has an actual RIT of $40,000 at each instalment and their standard uplift instalments were $30,000 at each instalment date. UOMI for interest concession taxpayers will be charged on the $30,000 amounts less the amount paid at each instalment date (except for the final instalment which will have UOMI charged on the outstanding balance of RIT less payments made to date).

[9] Inland Revenue's technology platforms are FIRST (Future Inland Revenue Systems and Technology), the heritage platform, and START (Simplified Tax and Revenue Technology), the new platform.
[10] Residual Income Tax is the amount of tax liability after tax credits such as PAYE and RWT have been deducted.

## Key features

The amendment aligns the application of the "lesser of" calculation of UOMI for standard "uplift" taxpayers with the way that Inland Revenue's technology platforms have been calculating UOMI for those taxpayers. The amendment provides that less UOMI is calculated than under the previous legislation.

## Application date

The amendment applies from the 2018–19 income year as the amendment aligns the legislation with the treatment within Inland Revenue's systems.

## Detailed analysis

The standard "uplift" provisional tax method allows taxpayers to base their provisional tax instalments for the year on 105% of the prior year's (CY[11]-1) RIT or 110% of the year previous to the prior year (CY-2) dependent on when they have filed their CY-1 tax return.

Up until the taxpayer files their CY-1 return a taxpayer will use 110% of the CY-2 RIT (initial uplift). When they file their CY-1 return and 105% of that RIT (the final uplift) is more than the initial uplift the system leaves the previous instalments at the initial uplift. The reason for this is that at that time the taxpayer made that payment, the only information they had to base the payment on was the initial uplift.

However, if the taxpayer files their CY-1 return and the final uplift is less than the initial uplift the system overwrites the initial uplift amount and replaces it with the lower final uplift amount. This is on the basis that once the taxpayer has filed their CY-1 return there is no ability to use the initial uplift and the final uplift effectively replaces that.

Logically these two rules make sense. If the initial uplift is lower than the final uplift, it should be used as it would be unfair to require a taxpayer to make a payment based on figures they had not yet calculated. Alternatively, if the final uplift is lower than the initial uplift that

[11] CY = Current year.

should replace the initial uplift as, firstly, the taxpayer would have used that amount if they had known it at the time and, secondly, once that final uplift is known the initial uplift technically is no longer available. This rule will apply to instalments prior to the date the taxpayer files their CY-1 return (that is, the return with the final uplift).

Prior to the introduction of the interest concession rules this rule generally only mattered for the calculation of late payment penalties. Since the interest concession rule was introduced, this distinction is more important as it affects the calculation of UOMI. As the lower of the two amounts is taken into account this treatment is taxpayer friendly, however, the distinction does matter when taxpayers transfer funds from a tax pool as they want to ensure they are making the correct transfer to avoid the payment of UOMI.

Inland Revenue's legal team determined that the legislation was not clear on this rule. The amendment will clarifies the legislation to ensure that the lowest amount of the initial or final uplift is used for the purposes of calculating UOMI and late payment penalties for instalments made prior to the date the taxpayer files the CY-1 tax return.

This rule does not change the obligation to pay either the initial or final uplift amounts in that if the taxpayer's final uplift is less than their initial uplift they were still required to pay the initial uplift amount notwithstanding UOMI may not be charged on that basis. This will be important in determining if a taxpayer is an interest concession taxpayer if they are subsequently subject to a reassessment.

Both the FIRST and START systems apply this rule and thus the amendment does not affect taxpayers, but rather aligns the legislation with the system and policy intent.

### Example 22

Brock Burgers Corporation Limited (Brock) is a fast food chain that specialises in plant-based burgers. It has three subsidiary companies Brock Burgers (Auckland) Limited (BBA), Brock Burgers (Wellington) Limited (BBW) and Brock Burgers (Stewart Island) Limited (BBS). Because of the seasonal demand for plant-based burgers Hadleigh, the owner of Brock, decides that the standard uplift is a perfect method for the group as it removes the risk of exposure to UOMI until the Group has a good understanding of the tax liability for a particular year.

Brock also uses a tax pool to pay its provisional tax for the year. It files its 2019–20 income tax returns between the first and second instalment dates. For the 2020–21 income years Brock's standard uplift calculation for the companies in the group is as follows:

| Table 3 | 110% uplift RIT amount A | 105% uplift RIT amount B | First instalment amount | Second instalment amount[12] |
|---|---|---|---|---|
| Brock | $21,000,000 | $15,000,000 | $7,000,000 | $3,000,000[13] |
| BBA | $12,000,000 | $10,500,000 | $4,000,000 | $3,000,000[14] |
| BBW | $24,000,000 | $27,300,000 | $8,000,000 | $10,200,000[15] |
| BBS | $4,200,000 | $1,800,000 | $1,400,000 | ($200,000)[16] |
| Total | | | $20,400,000 | $16,000,000 |

The group pays the first two instalments into the pool as calculated above (including obtaining a repayment for the $200,000 for BBS from the pool) but at the third instalment realises that the RIT for the entities is very different from the uplifted amounts. For example, BBA has had a standout year following a celebrity endorsement from a Hollywood star visiting Auckland for filming. BBS, however, has not fared as well as a competing company has captured the burger market in Stewart

[12] Once the taxpayer files their prior year tax return the 110% uplift calculation is no longer available to them.
[13] Calculated as ($15,000,000 × 2/3) – $7,000,000 = $3,000,000.
[14] Calculated as ($10,500,000 × 2/3) – $4,000,000 = $3,000,000.
[15] Calculated as ($27,300,000 × 2/3) – $8,000,000 = $10,200,000.
[16] Calculated as (1,800,000 × 2/3) – $1,400,000 = ($200,000) BBS gets this amount refunded from the tax pool.

Island with their Venison Game Burgers. The expected RIT for each of the companies for the 2020–21 income year and what Brock intends to pay for the third instalment to minimise any UOMI is as follows:

| Table 4 | 2020-21 expected RIT<br>C | 2020-21 instalments to date | Third instalment |
|---|---|---|---|
| Brock | $20,000,000 | $10,000,000 | $10,000,000 |
| BBA | $35,000,000 | $7,000,000 | $28,000,000 |
| BBW | $27,300,000 | $18,200,000 | $9,100,000 |
| BBS | NIL | $1,200,000 | ($1,240,000) |
| Total | $82,300,000 | $36,400,000 | $45,900,000 |

Once the Brock group has completed it's 2020–21 tax returns it proved their forecasting team was worth their weight in gold as the actual RIT for the year ended up being identical to the expected RIT for the year with the exception of BBW which only had actual RIT of $27,000,000 due to the cancellation of a vegan lifestyle conference in Wellington which reduced sales.

Brock then calculates the transfers required from the tax pool. Hadleigh is keen to ensure that each company pays what they need to at each instalment to ensure that no UOMI or late payment penalties are incurred. This will mean determining the lesser of the RIT or the instalment amount (being the lower of the 105% uplift or 110% uplift amounts) and the balance of tax owing on the third. Hadleigh determines the amounts to transfer from the pool at the **first two instalments** as follows (the lowest being the shaded amount):

| Table 5 | 110% instament amount<br>A | 105% instalment amount<br>B | RIT instalment amount<br>(C/3) | Lowest |
|---|---|---|---|---|
| Brock | $7,000,000 | $5,000,000 | $6,666,667 | 105% |
| BBA | $4,000,000 | $3,500,000 | $15,000,000 | 105% |

| | | | | |
|---|---|---|---|---|
| BBW | $8,000,000 | $9,100,000 | $9,000,000 | 105%/RIT[17] |
| BBS | $1,400,000 | $600,000 | NIL | RIT |

The transfers required are as follows:

| **Table 6** | **First instalment** | **Second instalment** | **Third instalment** | **Total** |
|---|---|---|---|---|
| Brock | $5,000,000 | $5,000,000 | $10,000,000 | $20,000,000 |
| BBA | $3,500,000 | $3,500,000 | $28,000,000 | $35,000,000 |
| BBW | $8,000,000 | $9,000,000[18] | $10,000,000 | $27,000,000 |
| BBS | NIL | NIL | NIL | NIL |
| Total | $16,500,000 | $17,600,000 | $47,900,000 | $82,000,000 |

Brock arranges the transfers on that basis and sells the remaining $300,000 overpayment to other taxpayers within the tax pool. All of the companies in the Brock Group can use the interest concession rules in section 120KBB as all the members of the Group are using the standard uplift method, none have filed a provisional tax estimate, and none of the anti-avoidance provisions apply. This is notwithstanding the Brock Group has only transferred the minimum amounts required to ensure that no UOMI is incurred.

However, if any of the Brock companies later receives a reassessment, UOMI could apply to the increased amount. For example, say BBS receives a reassessment two years later and some expenses claimed by BBS were capital in nature and it's RIT instalment amounts should have been $625,000 it is potentially subject to UOMI on $600,000 per instalment (being the 105% uplift instalment amount) as it did not make any payments for the year. If Hadleigh had made the uplift payments required, no UOMI would apply to the reassessment until the final instalment. Note for

[17] The lesser of instalment amount and RIT for the first instalment will be the 105% uplift but for the second instalment because BBW had filed its 2019–20 tax return prior to the second instalment the lesser amount for that instalment will be the RIT.
[18] Because BBW had filed its 2019–20 tax return prior to the second instalment the 110% uplift amount is no longer available. If BBW had not filed until after the second instalment it would have still had the lesser of the two amounts available. However, its RIT is less than the 105% uplift amount which is the lowest amount.

completeness that this later reassessment of BBS does not mean the interest concession rules are no longer applicable for the other group companies.

# Clarifying the application of late payment penalties applicable from the final provisional tax instalment date

*Section 120KBB of the Tax Administration Act 1994*

An inadvertent legislative change meant that late payment penalties were applied to a taxpayer's total provisional tax liability for the year rather than an instalment amount on the final instalment date. This amendment aligns the legislation with administrative practice and with policy intention. As such, it will have no effect on taxpayers.

## Key features

This change aligns the legislation with Inland Revenue's systems to ensure that late payment penalties are only calculated on an instalment amount at the date of the final instalment of provisional tax for the year rather than on the total outstanding tax liability at that date. UOMI will continue to accrue on the total tax liability outstanding. This change aligns the legislation with the policy intent and the system configuration of Inland Revenue's technology platforms.

## Application date

The amendment applies from the 2017–18 income year to provide certainty to taxpayers.

## Detailed analysis

The interest concession rules are contained in section 120KBB of the Tax Administration Act 1994, these rules essentially allow those taxpayers who use the standard method and make the required payments to have no exposure to UOMI until the day after the final provisional tax instalment is due for the year.

When the interest concession rules were introduced it was seen as desirable to align the basis for the calculation of UOMI and late payment penalties. This was done in the legislation and for the instalments, other than the final one. This is working as intended as both UOMI and late payment penalties are calculated using the lower of the standard instalment (105% of CY-1 or 110% of CY-2) or one third of their current year RIT.

However, on the final instalment the legislation required the same formula to be used to calculate UOMI and the late payment penalty amount.[19] For the calculation of UOMI all of the taxpayer's remaining tax liability is deemed to be due at the date of the third instalment as UOMI applies to that amount from the day after that date.

However, for late payment penalties this basis is inappropriate as charging a taxpayer for their entire RIT at that final instalment date is particularly unfair where they do not necessarily know the exact amount due. The basis for the penalty should be the lower of the instalment amount or one third of the taxpayer's RIT. Previously, legislation did not support this. Late payment penalties should only apply to an instalment amount rather than the total tax liability at that point although UOMI should apply on the full shortfall.

Inland Revenue's systems were not configured to reflect the legislation but to reflect the policy intent to charge a penalty based on the lower of the instalment amount or one third of the taxpayers RIT – the same basis as the other instalments.

The amendment aligns the legislation with the system in this case and changes the legal basis for the calculation of the penalty on the final instalment to be the lower of the standard instalment due or one third of the taxpayer's RIT.

In addition, the definition of RIT for the purposes of calculating UOMI is clarified to ensure it more clearly refers to the taxpayer's current year RIT.

| Example 23 |
| --- |
| Fowls by Fowler Limited (FbF) runs a free-range chicken egg producing farm where consumers can follow the hens on live social media to ensure the eggs they purchase are produced by chickens living the high life in large fields and luxury egg laying suites. Josh the owner, and chicken fanatic, manages the provisional tax payments for the company.<br><br>Because of the fluctuation in demand for eggs Josh uses the standard uplift method to pay provisional tax as, in the past, he has incurred UOMI costs for unexpected income received during the year.<br><br>He calculates the standard uplift amount for the 2020–21 income year as being $210,000 and makes three payments of $70,000 to Inland Revenue on the required due dates. |

[19] Note that for the final instalment taxpayers cannot use 110% of the year previous to the prior year as they must have filed their prior year return before the date of this payment.

The 2020–21 year has been particularly good for FbF due to the introduction of their online serial featuring "Henny" one of the chickens on the farm who has taken a shine to the toys placed around the farm to keep the chickens busy. Sales of special "Henny Eggs" have skyrocketed.

It turns out that the provisional tax payments made by FbF were insufficient and FbF should have made three instalments of $100,000. The following table sets out on what amount UOMI and LPPs would apply to FbF before and after the amendment.

| **Instalment** | **UOMI before** | **UOMI after** | **LPPs before**[20] | **LPPs after**[21] |
|---|---|---|---|---|
| First | Nil – as FbF paid the required instalment in full and on time | Same as UOMI before | Nil – as FbF paid the required instalment in full and on time | Nil – as FbF paid the required instalment in full and on time |
| Second | Nil – as FbF paid the required instalment in full and on time | Same as UOMI before | Nil – as FbF paid the required instalment in full and on time | Nil – as FbF paid the required instalment in full and on time |
| Third/final | Subject to UOMI on $90,000 being the actual liability ($300,000) less payments made ($210,000) | Same as UOMI before | Subject to LPP on $90,000 being the actual liability ($300,000) less payments made ($210,000) | Nil – as FbF paid the required instalment in full and on time |

[20] Practically no one has been charged an LPP based on this calculation as Inland Revenue systems have been correctly calculating LPPs based on the policy intent.
[21] Note Inland Revenue's computer systems have always been calculating in this manner it is only the legislation that has been amended.

# Removing the ability for taxpayers to choose the provisional tax instalment to which a particular payment is applied

*Sections 120L of the Tax Administration Act 1994*

## Background

The Tax Administration Act 1994 previously contained a provision that permitted a taxpayer to direct the application of a provisional tax payment made to a particular instalment. Prior to the introduction of the interest concession rules in section 120KBB of the Tax Administration Act 1994 and the removal of incremental penalties from income tax it was always beneficial for taxpayers to apply payments to the oldest debt first.

Since the introduction of the interest concession rules and removal of incremental penalties this is no longer true. A taxpayer could inappropriately apply the payment to more recent debt in order to avoid late payment penalties.

Removing the ability of taxpayers to choose the particular instalment to allocate a provisional tax payment eliminates this issue. This section also clarifies that the Commissioner is required to allocate the particular payment to the oldest debt first.

Inland Revenue's systems do not allow the allocation of a payment to particular payment dates when there is debt on a prior provisional tax date.

This amendment does not impact most taxpayers but will prohibit non-compliant taxpayers from reducing their exposure to late payment penalties.

## Key features

The ability for taxpayers to allocate their provisional tax payment to particular instalments has been removed and the Commissioner is required to allocate payments to the oldest outstanding provisional tax instalment.

## Application date

The amendment applies from the 2018–19 income year for integrity reasons. In the unlikely event of a taxpayer having previously requested and obtained a payment direction a savings provision preserves this treatment.[22]

## Detailed analysis

The payment allocation rules for provisional tax payments are contained in section 120L of the Tax Administration Act 1994. These provide that if a taxpayer makes a provisional tax payment and does not specify which instalment it should be directed to, the Commissioner must apply the payment where she thinks the taxpayer would have applied it.[23] Or, if the taxpayer does specify which instalment, the Commissioner must apply the payment to that particular instalment.[24]

Prior to the inclusion of the interest concession rules and removal of incremental late payment penalties[25] from income tax it was always beneficial to apply payments to the oldest debt first as this would reduce the taxpayer's liability to both incremental penalties and UOMI.

Since the interest concession rules were introduced it can be more advantageous for taxpayers to allocate their payments to specific provisional tax instalments to reduce their liability to late payment penalties on later instalments.

[22] This is an unlikely event as the FIRST system does not support this type of payment allocation.
[23] Section 120L(2)(b).
[24] Section 120L(2)(a).
[25] Incremental late payment penalties applied at 1% for each month the debt was outstanding. These were removed from income tax from 1 April 2018. Thus, the only late payment penalties that apply to income tax are the initial penalty of 1% the day after the due date and 4% seven days after the due date.

| Example 24 |
| --- |
| Grouchy Limited (Grouchy) is owned by Oscar and is a provisional taxpayer for the 2020–21 year. Its instalments are $25,000 at each provisional tax instalment. Oscar is a bit cash strapped and fails to pay the first instalment of provisional tax for Grouchy. Grouchy is charged a late payment penalty on the $25,000 debt of $1,250 as well as UOMI for that debt. At the second instalment date Grouchy has a spare $25,000 and decides to make a payment as provisional tax.<br><br>Prior to the removal of incremental penalties and the interest concession rules it would be more beneficial for Oscar to allocate that payment of $25,000 to the first instalment of provisional tax to reduce both incremental penalties and UOMI on that outstanding debt.<br><br>Subsequent to the changes Oscar now considers it more advantageous to allocate that payment to the second instalment. This will avoid any late payment penalties or UOMI arising on that payment. Given that there are no further late payment penalties on the debt from the first instalment and only UOMI is accruing on that, he will be $1,250 better off by allocating the payment to the second instalment. |

This example is not appropriate. It gives a benefit to taxpayers who have outstanding debt. In addition, both the FIRST system and the configuration of the START system cannot allocate payments in this manner.

The amendment removes the ability for taxpayers to request which provisional instalment their payment is allocated to. This removes the ability for non-compliant taxpayers to reduce their exposure to late payment penalties and UOMI. A provision has also been added to the legislation to require the Commissioner to apply payments to the oldest unpaid instalment first.

# Clarifying the way in which provisional tax is truncated to whole dollars

*Section 120KF of the Tax Administration Act 1994*

## Background

It is Inland Revenue's operational practice to truncate provisional tax amounts to whole numbers and its technology platforms have been designed in keeping with that practice.

However, Inland Revenue's legal team concluded that the way in which its technology platforms truncates instalments to whole numbers was not consistent with the legislation.

Inland Revenue's systems have been configured to apply these rules on truncated whole dollars and will not prevent taxpayers receiving a concession when partial dollars are truncated. The amendment confirms that configuration. In practical terms, this amendment will not affect any taxpayers.

## Key features

The amendment confirms that where Inland Revenue systems truncate provisional tax amounts to whole numbers, payment of those whole dollar amounts rather than the amount including cents will be considered to meet the requirements to take advantage of concessionary regimes such as the safe harbour in section 120KE.

## Application date

The amendment applies from the 2017–18 income year.

## Detailed analysis

Truncating to whole dollars for any instalment is beneficial to taxpayers both through simplicity and marginally financially. However, it can have negative consequences when assessing whether taxpayers meet certain requirements, such as the safe harbour[26] from UOMI. If cents are included and taxpayers pay the truncated whole dollar amount which the system has told them to pay, technically, they do not meet the requirements of the safe harbour.

Inland Revenue's legal team reviewed the legislation that deals with the calculation of provisional tax instalments and the application of UOMI to any shortfalls.

One of their conclusions was that the legislation and the system did not align for the way in which amounts are truncated. When provisional tax instalments are calculated under the standard method the legislation requires the uplifted amount to be divided into three equal instalments. For simplicity to taxpayers the system ignores, or truncates, any cents in that calculation.

**Example 25**

Assume that Grover Limited (Grover) is a provisional taxpayer who uses the standard uplift method. Their RIT for the 2020–21 income year was $124,567. This will make their standard method uplift amount for the following year $130,795.35. Grover's three instalments will be calculated as follows:

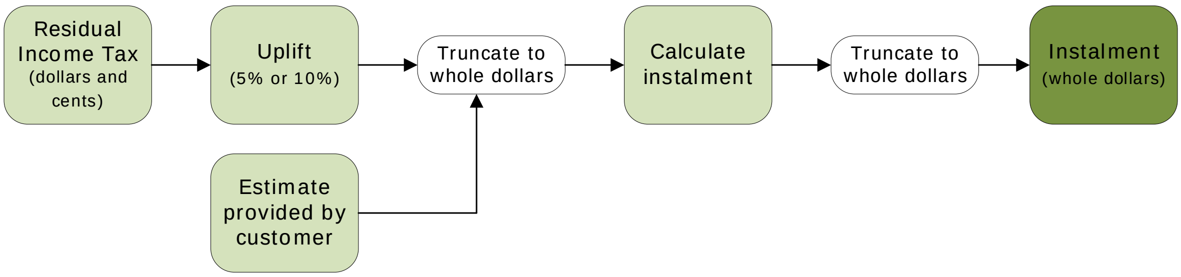
| Instalment | Calculation | Amount of instalment | Truncated amount |
|---|---|---|---|
| 1 | $130,795.35 ÷ 3 | $43,598.45 | $43,598 |
| 2 | ($130,795.35 × (2 ÷ 3)) – $43,598.45 | $43,598.45 | $43,598 |
| 3 | ($130,795.35 – $43,598.45 - $43,598.45) | $43,598.45 | $43,599 |
| Total | | $130,795.35 | $130,795 |

[26] The safe harbour includes taxpayers with RIT of less than $60,000 who have made the required standard instalments. In this case UOMI will not start until the terminal tax date (usually 7 February the following year).

However, to determine whether a taxpayer has met the criteria for the interest concession rules, for example, technically the taxpayer should have paid the instalment outlined in the amount of instalment column in the table, which is $43,598.45. The system does not use this amount and assesses the ability to use concessions based on the truncated whole number.

This is a taxpayer friendly treatment and is much simpler. The amendment aligns the legislation with the system to ensure that taxpayers are not prohibited from using a concession because they have not paid the cents for an instalment.

Within Inland Revenue's new technology platform, truncating now takes place at two points in calculating a taxpayer's provisional tax instalments. In the majority of cases this process will give the same result as noted above. Diagrammatically the new truncation process can be illustrated as follows:




## Example 26

Recalculating the example above, Grover's RIT for the 2020–21 income year was $124,567. This will make their standard method uplift amount for the following year $130,795.35. Grover's three instalments will be calculated as follows (highlighted in grey):

| | |
|---|---|
| 105% uplift | $130,795.35 |
| Truncate | $130,795.00 |
| Divided by three instalments | $43,598.33 |
| Truncate | $43,598.00 |
| First instalment | $43,598.00 |
| Second Instalment ($130,795.00 × (2/3) – ($43,598.00)) | $43,598.66 |
| Truncate | $43,598.00 |

| | | |
|---|---|---|
| Third/Final Instalment ($130,795.00 − ($43,598.00 × 2)) | $43,599.00 | |

# Non-standard provisional tax instalments

*Section 139B(6)(bb) of the Tax Administration Act 1994*

## Background

An amendment was made to section 139B(6)(bb) of the Tax Administration Act 1994 when the interest concession rules in section 120KBB were inserted into the Tax Administration Act 1994 to ensure the definitions worked with the new rules. A taxpayer that has more or less than three instalments of provisional tax, was not correctly dealt with and this is corrected for clarity.

## Key features

This amendment alters section 139B(6)(bb) of the Tax Administration Act 1994 to account for taxpayers who have a non-standard number of instalments of provisional tax.

## Application date

The amendment applies from the 2019–20 income year.

## Detailed analysis

When the interest concession rules were introduced in the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 a late change was made to the legislation to deal with taxpayers who had more or less than three instalments of provisional tax.

A number of references were correctly altered in the final Act to account for this change, however, one was missed. A definition in section 139B(6) of the Tax Administration Act 1994 was not updated for the inclusion of these taxpayers and still referred to three instalments of provisional tax.

This has not adversely affected any taxpayers as Inland Revenue has applied that section as it was intended. However, the amendment updates the definition to account for taxpayers who have more or less than three provisional tax instalments from the 2019–20 income year.

# Amend the date a goods and services tax credit becomes available for a taxpayer to use

*Section 173L of the Tax Administration Act 1994*

## Background

This amendment moves the day a GST credit is available from the day after the return was filed, to the day the credit arises. As this amendment is minor and is taxpayer favourable this change has already been operationalised within Inland Revenues system and thus does not practically affect any taxpayers.

## Key features

This amendment alters the date that a GST credit becomes available to a taxpayer when they file their GST return other than on the due date for the return. It moves the date the credit is available to be used from the day after the return is filed to the day the return is filed.

## Application date

The amendment applies from the date the original change was made, for taxable periods on or after 1 April 2018, as practically this will have no impact on any taxpayer and it will protect those taxpayers who have already received credits at the earlier date.

## Detailed analysis

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 made a change to the day on which a GST refund was available to a taxpayer. This more closely aligned the availability of a GST refund to when the taxpayer filed the return in which the credit arose.

Credits were available on:

- the earlier of either the day after the taxpayer filed their return or the day after the GST period which the credit relates to if the taxpayer filed early, or

- the day after the end of the GST period to which the refund relates if they filed on the due date, or
- the day after they filed their return if they filed their return late.

Having the credit available the day after it arises (that is, the day the return is processed, and the refund established) is problematic for administrative purposes. It is generally good practice to have the credit available on the same date that it arises within the system. As a consequence, the date in the legislation has been changed to the date the GST refund arises.

As this change is taxpayer friendly and the issues that arose from treating the credit available the day after it was assessed were problematic this change has already been operationalised within Inland Revenues START environment. The legislative change has no practical effect on taxpayers.

# Clarification for taxpayers who pay provisional tax in one or two instalments

*Sections RC 13(3) and RC 14 (2) of the Income Tax Act 2007*

## Background

Section RC 9(4)(c) of the Income Tax Act 2007 applies where a person is liable to pay provisional tax but has not provided a return in the preceding year and whose residual income tax (RIT) in the year before the preceding year is less than $2,500.

Section RC 9(10) then states that sections RC 13(1)(b) or RC 14(1)(b) will apply so that provisional tax is payable in either two or one instalment(s), depending on when the prior year's return is filed.

There was an interpretation issue with sections RC 13(3) and RC 14(2) of the Income Tax Act 2007 which reference section RC 9(9)(b) and (c).

There was a missing link for these scenarios in sections RC 13(3) and RC 14(3) respectively. These sections referred only to "initial provisional taxpayers", so taxpayers were not provided legislative guidance as to how many instalments to pay or how to apply sections RC 13 or RC 14 in other cases.

## Key features

These changes remove the restriction to RC 9(9)(b) for sections RC 13(3) and RC 14(3) to more clearly provide legislative guidance for those taxpayers to whom section RC 9(4)(c) applies and how many provisional tax instalments they are required to make for a year.

## Application date

The amendment applies from the 2020–21 income year.

## Detailed analysis

The amendment removes reference to section RC 9(9)(b) from sections RC 13 and RC 14 which will now not restrict these to "initial provisional taxpayers".

Taxpayers’ and Inland Revenue’s administrative practice is to ignore the fact that section RC 9(9) only technically applies to initial provisional taxpayers and thus it is not expected this amendment will practically affect many taxpayers

Although taxpayers to whom section RC 9(9)(b) does apply are only required to make one or two provisional tax instalments use-of-money interest will apply across three instalments rather than the number of instalments. However, the distinction is important when considering the application of late payment penalties and whether taxpayers have met conditions for interest concession rules, such as the safe harbour.

# Calculating standard provisional tax instalments for amalgamated and consolidated companies

*Section RC 29 and RC 33 of the Income Tax Act 2007*

## Background

Sections RC 29 and RC 33 of the Income Tax Act 2007 outline how a new consolidated group or amalgamated company should calculate their standard method uplift amount of provisional tax.

These sections previously only referred to the year preceding the current tax year. This wording did not correctly deal with the situation where those amalgamating or consolidating companies have not filed their prior year tax returns.

## Key features

The changes clarify that, when calculating provisional tax instalments for an amalgamated company or a consolidated group, the taxpayer can use the prior year or the year proceeding the prior year (as applicable) to calculate their standard uplift instalments.

## Application date

The amendments apply for the 2020–21 and later income years.

## Detailed analysis

The standard method uses either 105% of the preceding year current year-1 (CY-1) or 110% of the year prior to the preceding year (CY-2). Previously, both sections RC 29 and 33 only referred to the CY-1 calculation.

The sections have been amended to refer to the CY-2 year where the entities forming the group or amalgamated company have yet to file their CY-1 tax return and can therefore only base their provisional tax on the CY-2 residual income tax.

We understand taxpayers have practically been applying this rule so it should not have any practical effect on taxpayers.

# Ensuring the provisional tax rules apply appropriately to partners and members of unincorporated bodies

*Section YA 1 of the Income Tax Act 2007*

## Background

In determining whether a person has an initial provisional tax liability the definition of "taxable activity" is used to determine if someone has started a business.

This definition refers to the definition in the Goods and Services Tax Act 1985 but currently excludes taxpayers who earn exempt supplies (that is, the initial provisional taxpayer rules apply to taxpayers who make exempt supplies).

However, the definition excluded partners of partnerships and members of other unincorporated bodies as, for GST purposes, it is the partnership/unincorporated body which is carrying on the taxable activity. This appeared to be an omission which was not consistent with the framework of the provisional tax regime as these entities are look-through entities they are not themselves subject to provisional tax.

## Key features

The definition of "taxable activity" in the Income Tax Act 2007 relating to provisional tax has been amended to include partners and members of unincorporated bodies within the definition of initial provisional taxpayer.

## Application date

The amendment applies for the 2020–21 and later income years.

## Detailed analysis

The amendment modifies the definition of "taxable activity" within section YA 1 of the Income Tax Act 2007 to ensure that partners and members of unincorporated bodies are not excluded from the definition of an initial provisional taxpayer.

# Ensuring the early payment discount applies as intended

*Section RC 37 of the Income Tax Act 2007*

## Background

"Small business persons" are entitled to an early-payment discount of income tax. The purpose of that discount is to encourage the payment of income tax in the income year before the income year in which the small-business person is required to pay provisional tax.

Inland Revenue's legal team identified an issue with the legislation and the application of the early payment discount to taxpayers who meet the criteria. Inland Revenue's systems have been applying the law as it should apply, however, to improve certainty for taxpayers the legislation has been aligned with this practice.

## Key features

Section RC 37 of the Income Tax Act 2007 has been amended to ensure that the early payment discount applies as intended by changing the wording "not liable to pay provisional tax" to "liable to pay provisional tax under section RC 3(1)(a) but not obligated to make any payments under section RC 3(3)".

## Application date

The amendment applies for the 2020–21 and later income years.

# Clarify the definition of provisional tax

*Section 120L of the Tax Administration Act 1994*

## Background

Formerly, the wording of section 120L of the Tax Administration Act 1994 referred only to "provisional tax" which is not defined. This section has been amended to include both provisional tax and any late payment penalties on that provisional tax.

## Key features

Section 120L of the Income Tax Act 2007 is amended to ensure that the term "provisional tax" includes any late payment penalties.

## Application date

The amendment applies for the 2020–21 and later income years.

# Align the treatment of overpaid tax by a company using the accounting income method (AIM) with tax paid on behalf of aim shareholders

*Section RC 35B of the Income Tax Act 2007*

## Background

There are two ways in which an AIM company can transfer overpaid tax to its shareholders.

The first is where the company creates a provision for shareholder employees' salary and pays tax on that on behalf of the shareholders to enable the company to take a tax deduction for the provision. In this situation the company acts as an "agent" for the shareholder employee and the tax is "transferred" as a tax credit reducing the shareholder employee's residual tax liability.

The second situation is where the company overpays tax most likely because shareholder remuneration is not deducted by the company until the end of the year in which case the overpayment transfers at the shareholder's provisional tax dates.

## Key features

This amendment standardised the treatment of overpayments by an AIM company so that in both situations the transfer will reduce the residual income tax of the shareholder employee (subject to the safeguards that already exist to reduce the ability to game the rules).

## Application date

The amendment applies from the 2019–20 income year.

# Inclusion of a tolerance for provisional tax instalments

*Section 120KF of the Tax Administration Act 1994*

## Background

The Tax Administration Act 1994 contains a safe harbour provision from the application of use-of-money interest (UOMI) to some provisional taxpayers.

The safe harbour applies where a taxpayer has residual income tax that is less than $60,000, they have used the standard uplift provisional tax calculation method, and they paid all their instalments as required.

The result of this concession is that no UOMI is charged on any unpaid tax until the taxpayer's terminal tax date (which is generally February of the year after the income year where the liability arises).

If the safe harbour does not apply, then UOMI would generally apply from the date of their final instalment of provisional tax for the income year in question. This is generally nine months earlier than the terminal tax date. Thus, the safe harbour provides a significant concession to those who fit the criteria.

Some issues have arisen, the result of which is that a small underpayment is providing an adverse result to taxpayers that is disproportionate to the error being made. In one case a taxpayer who accidently underpaid their instalments by 30 cents resulted in a UOMI bill of $2,400 because of the loss of the protection of the safe harbour.

## Key features

This amendment adds a tolerance in the legislation to deal with these issues. This tolerance allows taxpayers to retain the benefits of the safe harbour even though they underpaid by a small amount.

The amount of the tolerance is $20 per instalment which aligns to the amount of the small balance write-off amount (for tax other than auto-calculation assessments). This will ensure that a person who underpays by small amounts will not be disproportionately penalised for that omission.

## Application date

The amendment applies for the 2017–18 and later income years and retrospectively addresses the existing cases where taxpayers have been disadvantaged.

## Detailed analysis

This amendment adds a tolerance to provisional tax payments which are slightly short paid. For payments made that are within $20 or less of the instalment amount the taxpayer will be deemed to have paid the instalment amount for the purposes of determining if the taxpayer has met the requirement of paying their instalments in full and on time to use the safe harbour concession.

This change only allows a tolerance for the amount paid and not the date of the payment. Taxpayers who pay late will continue to fall out of the safe harbour.

| Example 27 |
| --- |
| Phyllis' Bakers Limited (PBL) is a small bakery business based in Papakura. Phyllis is the owner of PBL and while she is a fantastic baker her accounting and tax skills are less so. She has We Get It Right Accountants Limited (WGRA) to do the accounting and tax work for her successful business.<br><br>PBL is a provisional taxpayer with a 31 March balance date and for the 2019–20 income year is required to pay three instalments of $10,000 to Inland Revenue. Phyllis asks WGRA to make the required payments as and when they come due. WGRA makes the first instalment on 28 August 2019 for $10,000. But then for the second instalment on the 15th of January 2020 PBL is also required to pay a supplier an amount of $9,999.70.<br><br>Due to a clerical mix up at WGRA the numbers for provisional tax and the payment to the supplier were transposed incorrectly. PGL only pays $9,999.70. On the third instalment date WGRA does pay the correct instalment of $10,000.<br><br>When they get to the end of the year the residual income tax for PBL is $57,000. WGRA tells Phyllis that she will have to pay $27,000.30[27] on the 7th of Feb and no UOMI will be charged because she is in the safe harbour as her residual income tax for the year is less than $60,000.<br><br>Unfortunately, one of the requirements to use the safe harbour concession is that payments are made full and on time. Because PBL paid their second instalment 30 cent less than the required |

[27] RIT – payments to date = $57,000 − ($10,000 + $9,999.70 + $10,000).

instalment they will be charged UOMI from the third provisional tax instalment date. This equates to $1,678.25.

However, because the payment made was made within $20 or less of the actual instalment amount the tolerance will ensure that PBL is deemed to have made the instalment in full and therefore they will meet the safe harbour requirements, no UOMI will be charged and WGRA does not have to have a courageous conversation with Phyllis explaining why she ended up with a large interest bill.

# Amend the definition of "start tax type" in the Tax Administration Act 1994 to include Release 4 tax types

*Section 3 of the Tax Administration Act 1994*

## Background

Release 4 of Business Transformation will migrate more tax types onto Inland Revenue's new technology platform, START.

Section 183C of the Tax Administration Act 1994 deals with rules around the cancellation of interest. These rules are specific to the START platform only and as taxes migrate to that platform the rules for cancellation of interest change over what was done in the old technology platform, FIRST.

It was necessary to include those tax types that are being migrated to START as part of Release 4 in the definition of "START tax type" so that the cancellation of interest rules are applied correctly.

## Key features

These tax types are now included in the definition of START tax types in the Tax Administration Act 1994:

- PAYE deductions;
- child support deductions made by an employer;
- student loan deductions made by an employer;
- KiwiSaver deductions made by an employer;
- compulsory employer KiwiSaver contributions; and
- specified superannuation contribution tax (SSCWT or ESCT or both).

## Application date

The amendment applies from 1 April 2020.

# Adding START tax types to section 184A(5) of the Tax Administration Act 1994

*Section 184A(5) of the Tax Administration Act 1994*

## Background

As part of Release 4 of Business Transformation, new tax types are being introduced into START. With the inclusion of the new tax types Inland Revenue is able to direct credit refunds through section 184A of the Tax Administration Act 1994. However, some of the tax types included in Release 4 did not fall within the definition of tax in section 184A(5).

## Key features

The following tax types are now included in the definition of tax in section 184A(5) of the Tax Administration Act 1994:

- reserve schemes (income equalisation schemes and environmental restoration account schemes); and
- unclaimed monies for the purpose of the Unclaimed Money Act 1971.

## Application date

The amendment applies from the date of enactment.

# Self-correcting certain errors in subsequent returns

*Section 113A of the Tax Administration Act 1994*

Several amendments have been made to resolve ambiguities that were identified following changes made in 2019 to the rules that allow taxpayers to self-correct certain errors in returns for income tax, GST and FBT.

## Background

The Tax Administration Act 1994 contains rules which recognise the compliance and administration costs associated with making amendments to returns and assessments which contain errors. These rules allow errors which do not breach certain prescribed thresholds to be corrected in the next return due, following discovery of the error. These rules are contained in section 113A and apply in respect of errors that relate to returns for income tax, FBT, and GST.

These rules were amended in 2019 as part of a suite of changes made to modernise core components of the Act by the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019. Following enactment of the changes, several ambiguities within the application of the new thresholds were identified. The amendments made by the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 are intended to resolve these ambiguities to make the application of the thresholds clearer.

## Key features

The key features of the amendments:

- confirm that the $10,000 limit in the materiality threshold test refers to the tax discrepancy caused by all of the errors in a return and not the amount of the individual errors themselves;
- ensure that there is no confusion between the application of the thresholds in section 113A of the Act and other provisions within the Inland Revenue Acts and associated regulations which allow for the self-correction of errors in relation to other tax types; and

- clarify that multiple errors that do not exceed the materiality threshold can be corrected, provided the total discrepancy caused by the errors do not exceed the threshold.

## Application date

These amendments apply from 23 March 2020, the date of enactment.

## Detailed analysis

Section 113A of the Tax Administration Act 1994 allows taxpayers to correct certain errors contained in returns for income tax, FBT, and GST, provided the total tax discrepancy of the errors do not breach prescribed thresholds.

Subsection (2) provides that the rules contained in section 113A which enable taxpayers to self-correct errors within the prescribed thresholds do not apply to ancillary taxes (as defined in section YA 1 of the Income Tax Act 2007) other than fringe benefit tax. The amendment is intended to resolve a possible conflict between the rules in section 113A and rules which provide for the self-correction of errors for other ancillary taxes.[28]

The prescribed thresholds in section 113A are contained in subsections (3) and (4).

The $1,000 threshold is provided for in subsection (3). This allows errors which, for a single return, result in a total tax discrepancy of $1,000 or less, to be corrected in the next return due following discovery of the errors.

Subsections (3B) and (4) contain the rules for the correcting errors which are, in relation to the taxpayer, not considered to be material errors. Errors which are not material can be corrected in the next return due following discovery of the errors.

Subsection (4) provides the requirements for determining whether errors are material. Errors are not material for these purposes where the total tax discrepancy of all of the errors in a single return do not exceed both $10,000 and two percent of the person's:

[28] For example, for errors relating to employment-related taxes such as PAYE, see the Tax Administration (Correction of Errors in Employment Income Information) Regulations 2019 and for errors relating to RWT and NRWT, see sections RA 11 and RA 12 of the Income Tax Act 2007.

- annual gross income,[29] for errors relating to income tax and FBT; and
- output tax, for errors relating to GST.

The following examples demonstrate how the rules are intended to apply.

| Example 28: Application of the $1,000 threshold for an income tax return |
|---|
| Michael's Fun Sails Ltd (MFS) is a company specialising in the development of cutting-edge and quirky boating apparatus.<br><br>The in-house accountant determines that depreciation has been overclaimed on an industrial sewing machine. This error was included in the income tax return for the 2019–20 income year.<br><br>The overclaimed depreciation amounted to $2,500. MFS is a close company which means the overclaimed depreciation represents a total tax discrepancy in the 2019–20 income tax return of $700 (that is, $2,500 x 28 percent).<br><br>As the total tax discrepancy caused by the error is not more than $1,000, the error can be corrected in the next income tax return which is due following discovery of the error. |

| Example 29: Application of the $1,000 threshold for a GST return |
|---|
| Josh's Flowers Ltd is a close company which is operated by Josh, the company's sole shareholder and employee.<br><br>The company is registered for GST and files its returns on a six-monthly basis.<br><br>When reviewing the company's accounts for the last six-monthly period, Josh identifies one month's worth of taxable supplies had not been recorded in the GST return due to a glitch with his accounting package. The amount of missing supplies was $1,800.<br><br>The total tax discrepancy in the return owing to the omitted taxable supplies is $270 (that is, $1,800 x 15 percent).<br><br>As the total tax discrepancy caused by the error is not more than $1,000, the error can be corrected in the next GST return which is due following discovery of the error. |

[29] "annual gross income" is defined in section BC 2 of the Income Tax Act 2007 and applies for these purposes. This refers to a person's total assessable income which is allocated to their corresponding income year.

### Example 30: Application of the $1,000 threshold for an FBT return

Claire's Clown Cars Ltd (CCC) is in the business of leasing cars to circuses across New Zealand. CCC has a mixture of special vehicles which are used in circus performances as well as a fleet of ordinary vehicles. CCC allows its employees to use vehicles for private purposes and is accordingly registered for FBT.

CCC's accountant Patt Milkinton identifies an error in an FBT return which was filed two quarters ago. The error resulted in FBT not being paid on the value of fringe benefits provided to one of CCC's employees, who had one of CCC's ordinary vehicles for 15 days during the relevant quarter.

The vehicle had a tax book value (including GST) of $15,000. The accountant notes that the amount of FBT that was not paid to Inland Revenue as a result of the error, and thus the total tax discrepancy caused by the error was $140.16.

As the total tax discrepancy caused by the error is not more than $1,000, the error can be corrected in the next FBT return due following discovery of the error.

### Example 31: Application of the $1,000 threshold with multiple errors in the same return

When conducting a routine review of the GST returns for Bary's Brownies and Liqourice Rolls Ltd the company's bookkeeper Phil identifies that both the output tax and input tax deductions recorded in the company's GST return for the taxable period ending 31 March 2020 were both understated.

Phil determines that the output tax was understated by $2,000 and the input tax deductions were understated by $1,500. The total tax discrepancy caused by these two errors is $500 (that is, $2,000 of output tax minus the $1,500 of input tax deductions).

As the total tax discrepancy caused by the errors is not more than $1,000, both errors can be corrected in the next GST return due following discovery of the errors.

### Example 32: Application of the materiality threshold for an income tax return

The accountant at JASE Co Ltd, a close company, identifies an error with the depreciation calculations which resulted in an understatement of the company's profit for the income year ending 31 March 2020.

The error resulted in depreciation being overclaimed of $20,000. This represents a tax discrepancy of $5,200 (that is, $20,000 x 28 percent).

The annual gross income as stated in JASE Co Ltd's accounts for the 2019–20 income year is $300,000. Two percent of this is $6,000.

As the total tax discrepancy caused by the error does not exceed both $10,000 and two percent of JASE Co Ltd's annual gross income, the error can be corrected in the next income tax return due following discovery of the error.

### Example 33: Application of the materiality threshold for a GST return

Laura's Library of Books Ltd (LLB) is a company that comprises of a chain of bookstores specialising in contemporary fiction. Laura has 30 stores across New Zealand.

After reconciling information provided by all of the stores to the head office in Wellington, the bookkeeper Matt realises that the Pahiatua store's sales are missing from the GST return for the taxable period up to 31 March 2018 which has resulted in the incorrect amount of output tax being paid to Inland Revenue.

The total omitted sales were $10,000. This represents a total tax discrepancy of $1,500 (that is,, $10,000 x 15 percent).

The output tax that was paid to Inland Revenue for the period was $75,000 and two percent of the output tax for the period is $1,500.

As the total tax discrepancy that was caused by the error does not exceed both $10,000 and two percent of LLB's output tax for the period, the error can be corrected in the next GST return due following discovery of the error.

### Example 34: Application of the materiality threshold for an FBT return

Ben and Ben's Running Emporium Ltd (B&BRE) stocks rare and specialist running equipment. B&BRE also manufacture and sell high-end running gear to both New Zealand and international consumers. On occasion, some of the product B&BRE manufacture is sold to employees at a discount. Consequently B&BRE is registered for FBT and files returns on a quarterly basis.

Thomas, the accountant for B&BRE realises that for the quarter ending 30 June 2020 an error was made in determining the amount of FBT it was liable for.

The total taxable benefits B&BRE provided during the quarter was $14,000 to 28 of the store's sales staff. B&BRE use the standard rate to determine the amount of fringe benefit tax payable and therefore the correct amount of fringe benefit tax payable for the quarter was $8,721.09.

The amount shown on the return sent to Inland Revenue for the quarter however showed total taxable benefits of $10,000, with an amount to pay in FBT of $6,229.35.

The total tax discrepancy caused by the error in the return is $2,491.74 (that is, the difference between the FBT that was originally declared as being payable and the correct amount of FBT that is payable).

B&BRE's annual gross income for the most recently completed income year was $150,000 and two percent of this is $2,500.

As the total tax discrepancy caused by the error does not exceed both $10,000 and two percent of B&BRE's annual gross income, the error can be corrected in the next FBT return due following discovery of the error.

### Example 35: Application of the materiality threshold with multiple errors in the same return

Marley's Poodle Grooming Services Limited (MPGC) files GST returns on a two-monthly basis. It operates poodle grooming services through multiple stores located all across New Zealand. Linda, the accountant, identifies multiple errors in the company's GST return for the period ending 31 May 2020.

The output tax as stated in the original return was $100,000. The errors resulted in output tax being understated by $4,000 and input tax deductions being understated by $2,000.

The total tax discrepancy caused by the errors is $2,000 (that is, $4,000 of output tax minus $2,000 of input tax deductions).

As the total tax discrepancy of the errors do not exceed both $10,000 and two percent of MPGS's output tax for the return, the errors can both be corrected in the next return due following discovery of the errors.

Minor amendments have been made to subsection (5) to reflect the fact that taxpayers do not make assessments for fringe benefit tax. The purpose of subsection (5) remains the same, which is to provide that a person cannot apply the materiality threshold if their main purpose for doing so is to delay the payment of tax. This is intended to ensure that the purpose of these rules is targeted at providing a mechanism to resolve genuine errors which are identified after returns have been submitted to Inland Revenue.

# Amendments relating to the binding rulings regime

*Sections 91EI, 9ESB, and 91FJ of the Tax Administration Act 1994*

Several minor amendments have been made to the binding rulings regime in Part 5A of the Tax Administration Act 1994 to ensure the rules operate as intended.

## Background

The provisions that enable the binding rulings regime are contained in Part 5A of the Tax Administration Act 1994. The purpose of the binding rulings regime is to provide taxpayers with certainty about the way the Commissioner will apply taxation laws and help them meet their obligations under those laws by enabling the Commissioner to issue rulings that will bind the Commissioner on the application of those laws.

Several changes have been made to the scope of the binding rulings regime in recent years, including through the introduction of a new type of binding ruling – short-process rulings – and extending the scope of the binding rulings regime to enable the Commissioner to issue binding rulings for a broader range of matters, including those that do not require an "arrangement".

The amendments made by the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 ensure that the recent changes work as intended.

## Key features

The key features of the amendments:

- Provide the Commissioner of Inland Revenue with the ability to withdraw short-process rulings. This is based on existing provisions which enable the Commissioner to withdraw other forms of binding rulings; and
- Enable a person who has a binding ruling that has been withdrawn to continue to rely on that binding ruling where the ruling was for a matter not involving an arrangement.

## Application dates

The amendment that enables the Commissioner to withdraw short-process rulings applies from 23 March 2020 (the date of enactment), and an application provision has been included to ensure that there is no ambiguity as to whether the Commissioner can withdraw short-process rulings that have been issued before 23 March 2020 but prior to the passing of the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020.

The amendments that allow for continued reliance on withdrawn binding rulings apply from 18 March 2019. This is the date from which the Commissioner has been able to issue binding rulings in respect of certain matters not involving arrangements.

## Detailed analysis

### Ability to withdraw short-process rulings

New section 91ESB of the Tax Administration Act 1994 provides the Commissioner with the ability to withdraw short-process rulings. It might be appropriate in the circumstances for the Commissioner to withdraw a short-process ruling where there is a change in the interpretation of the law by either the courts or the Commissioner, or where the relevant ruling needs to be replaced with a variation.

For the Commissioner to withdraw a short-process ruling, the Commissioner must issue a notice informing the person to whom the ruling applies that the ruling is to be withdrawn. The Commissioner will do this by issuing a notice of withdrawal. The notice of withdrawal will also specify the date that the withdrawal takes effect, and this date cannot be earlier than the date on which the person could reasonably be expected to receive the notice of withdrawal.

Where a short-process ruling for a person has been withdrawn, there are two circumstances in which the person can continue to rely on that ruling. These are where:

- The ruling relates to a matter involving an arrangement. In these circumstances, if the person has already entered into the arrangement before the ruling was withdrawn, the person can continue to rely on the ruling for the period specified in the ruling. If, however, the arrangement had not been entered into before the date the ruling was withdrawn, the ruling no longer applies. This is provided for in section 91ESB(3) of the Act.

- The ruling relates to a matter not involving an arrangement, for example where the ruling relates to a person's status.[30] In these circumstances, if the ruling is withdrawn, the person can continue to rely on the ruling for the period specified in the ruling. This is provided for in section 91ESB(4) of the Act.

## Date withdrawal takes effect where ruling was for a matter not involving an arrangement

Since March 2019 the Commissioner has been able to issue binding rulings for a broader range of matters which do not require the existence of an arrangement. Section 91CB of the Act enables the Commissioner to issue binding rulings on:

- a person's status (for example, whether they are a resident or a non-resident for tax purposes in New Zealand);
- whether an item of property meets the definition of "trading stock" or "revenue account property" as defined in section YA 1 of the Income Tax Act 2007; and
- whether an amount derived by a person is income under certain provisions in subpart CB of the Income Tax Act 2007 relating to land transactions.

The Commissioner can issue private and product rulings in relation to these matters. It was therefore appropriate that amendments be made to the provisions that enable the Commissioner to withdraw private rulings (section 91EI of the Act) and product rulings (section 91FJ of the Act) to ensure that where a ruling has been issued on such matters, the dates from which the ruling no longer applies is clear.

The amendments provide that if a private ruling or a product ruling has been issued for such a matter as described above, and that ruling is subsequently withdrawn, the person to whom the ruling applies can continue to rely on the ruling for the period or tax year specified in the ruling.

[30] For a list of matters that the Commissioner is able to issue certain binding rulings in relation to that do not require an arrangement, see section 91CB of the Act.

# Process for removing a person from the list of tax agents and disallowing status as a nominated person or representative

*Section 124G of the Tax Administration Act 1994*

Minor amendments have been made to the provision of the Tax Administration Act 1994 that enables the Commissioner of Inland Revenue to remove a person from the list of tax agents, or disallow their status as a representative or a nominated person. The amendment ensures the process operates as intended.

## Background

A broader range of third parties and intermediaries who act on behalf of others have been recognised in the Tax Administration Act 1994 since March 2019, following amendments made by the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019. In addition to consolidating the provisions relating to third parties and intermediaries into new Part 7B of the Tax Administration Act 1994, 2 new types of third parties and intermediaries were added. This includes “nominated persons” and “representatives”. These are explained in further detail in Tax Information Bulletin Vol 31 No 4 at pages 67 to 70.

Following enactment of the changes it was identified that the statutory rules which outline the process the Commissioner of Inland Revenue must follow to remove a person’s status as a tax agent (or disallow a person’s status as a nominated person or a representative) contained ambiguities as to the timing of certain actions that the Commissioner was required to take. These rules have therefore been amended to ensure the process the Commissioner must follow in the circumstances are clear.

## Key features

The key features of the amendments:

- Provide that before the Commissioner removes a person from the list of tax agents or disallow a person’s status as a representative or a nominated person, the Commissioner must issue a notice to the person informing them of the

Commissioner's intent to remove them. An exception to this general requirement has been retained where the Commissioner considers it necessary in the circumstances to protect the integrity of the tax system; and

- Make it clear that the Commissioner is not required to disclose information that could, under other enactments, be withheld.

## Application date

The amendments apply from 23 March 2020, the date of enactment.

## Detailed analysis

The process that the Commissioner of Inland Revenue must generally follow when taking an action to remove a person from the list of tax agents or disallow a person's status as a nominated person or a representative is as follows:

- The Commissioner must first issue a notice to the person informing the person that the Commissioner intends to remove them from the list of tax agents or disallow the person's status as a nominated person or a representative.
- The Commissioner must then consider any arguments against the exercise of the discretion that are provided within 30 days from the date of the notice. A later period may be set by the Commissioner if appropriate in the circumstances.
- After having considered the arguments, the Commissioner will either be satisfied that the person can remain on the list of tax agents or have their status as a nominated person or a representative retained; or the Commissioner will issue a subsequent notice to the person informing them that they have been removed from the list of tax agents or had their status as a nominated person or a representative disallowed. The effective date of the removal or disallowance, as applicable, will be specified within this subsequent notice.

The Commissioner is not required to follow this process if the Commissioner considers it necessary in the circumstances to protect the integrity of the tax system. If this is the case, the Commissioner will issue a notice to the person informing them that they have been removed from the list of tax agents or had their status as a nominated person or representative disallowed, and the effective date of the removal will be the date the Commissioner issues the notice informing the person that this action has been taken.

An amendment was also made to make it clear that where the Commissioner is going to exercise the discretion to remove a person from the list of tax agents, or disallow a person's status as a nominated person or a representative, that the Commissioner is not required to divulge information that could be withheld under other enactments, such as the Official Information Act 1982 for example. The Commissioner will, where practicable, notify the person of the reason or reasons for the exercise of the discretion (or proposed exercise of the discretion).

# Employee share schemes – definition of market value

*Sections CE 7CB, CW 26DB, YA 1 of the Income Tax Act 2007*

New sections CE 7CB and CW 26DB and amended section YA 1 of the Income Tax Act 2007 (ITA) expand the definition of 'market value' for the purposes of the employee share scheme (ESS) and exempt ESS rules to include a 5-day 'volume weighted average price' or an equivalent, and other methods accepted by the Commissioner of Inland Revenue. This makes it easier for companies offering ESSs to value their shares, reducing compliance costs and improving accuracy of valuations.

## Background

For the purposes of valuing listed shares, 'market value' is currently defined in section YA 1 of the ITA as the 'middle market quotation'. This is the average of the best buying and selling prices quoted by market makers, taken at the close of the market each day. Obtaining this middle market quotation is reported to be difficult in practice, and a much more common and practical measure is a 'volume weighted average price'. This is the total value of the shares traded divided by the number of shares traded over a particular time period. In her operational statement CS 17/01, the Commissioner accepts a 5-day volume weighted average price (amongst other methods) for valuing shares obtained under an ESS.[31]

Expanding the definition of 'market value' for the purposes of the ESS rules to include these methods makes it easier for companies to value their shares, and reduces compliance costs.

## Key features

New section CE 7CB provides that 'market value', for an employee share scheme:

[31] It is intended that a refreshed Commissioner Statement will be released soon.

- has the same meaning as in section YA 1 (Definitions), definition of **market value**, paragraphs (a) and (b); and
- includes, for a share or option quoted on the official list of a recognised exchange, at the time, an amount equal to the five-day volume weighted average price or any other method that is accepted by the Commissioner or is comparable to the five-day volume weighted average price, for such shares or options.

New section CW 26DB provides the same as above, but for the exempt ESS rules.

The definition of 'market value' in section YA 1 is amended to link to the new sections above.

## Application dates

Section CE 7CB applies from 29 September 2018 – the date the reforms to the general ESS rules came into effect.

Section CW 26DB applies from 29 March 2018 – the date the reforms to the exempt ESS rules came into effect.

The amendments to section YA 1 have the same application dates as the sections they link to – the application dates for sections CE 7CB and CW 26DB respectively.

# Exempt employee share schemes – takeovers and similar reorganisations

*Section CW 26C(7) of the Income Tax Act 2007*

Amended section CW 26C(7) adds an exception to the 'period of restriction' in the exempt ESS rules for takeovers and similar reorganisations.

## Background

In order for an ESS to qualify as exempt, the terms of the scheme must provide that shares are held by the employee for a period of time – generally three years – before they are disposed of. This is to ensure the scheme achieves the objective of aligning employee and employer incentives, and also to prevent employers from granting employees shares which the employee can sell immediately to realise an untaxed cash benefit (when remuneration in cash would have been taxed).

Exempt ESS trust deeds and similar constituting documents often provide for the sale of scheme shares pursuant to takeovers and other corporate reorganisations. If a takeover occurs, which can include the shares of minority shareholders being compulsorily acquired, this could breach the period of restriction requirement and mean the scheme fails to meet the statutory criteria; the shares may then become taxable. This is despite these events being outside the control of the employee.

Adding to section CW 26C(7) an exception for transfers of shares to or by an employee before the end of the restricted period in the case of takeovers and similar reorganisations ensures that companies and participating employees are not penalised for selling their shares before expiry of the three-year period due to such uncontrollable events. The scheme will remain exempt.

## Key features

Sections CW 26C(7)(a) and (b), after the words 'disposed of', incorporate the words 'other than as part of a takeover or similar share reorganisation'.

## Application date

Amended section CW 26C(7) applies from 29 March 2018, the date the new exempt ESS rules came into effect.

# Employee share schemes – flexibility to allow employees to keep shares if they leave employment

*Section CW 26C(8) and (8B) of the Income Tax Act 2007*

New section CW 26C(8) allows for alternative approaches where the period of restriction ends because the employee leaves the company voluntarily. The employee may either have the choice to keep their ESS shares, or be required to return them to the company for the lesser of cost[32] or market value.[33] This update to the legislation allows alignment of the treatment of these so-called 'bad leavers' under the New Zealand exempt scheme rules with their treatment under the Australian exempt scheme rules, which will make it easier for trans-Tasman companies to offer the same scheme in both countries.

## Background

Prior to this amendment, upon expiry of the 'period of restriction' in section CW 26C(7), 'good leavers' – employees whose employment ends due to their death, accident, sickness, redundancy, or retirement at normal retiring age – or their estate, could choose whether to keep their shares in the company or have them acquired for the lesser of cost or market value (under section CW 26C(9)). But 'bad leavers' – employees who leave for other reasons (for example, going to work for a competitor) – had to have their shares acquired for the lesser of cost or market value. There was no flexibility for the company to allow bad leavers to keep their shares.

One objective of the 2018 amendments to the ESS rules was to allow trans-Tasman companies to offer Australian exempt schemes to their New Zealand employees. However, Australian exempt schemes may require that bad leavers have the choice to keep their

[32] The cost of the shares to the employee.
[33] The market value of the shares on the date the period of restriction ends.

shares. This was in conflict with New Zealand's rule for bad leavers, making it difficult for trans-Tasman companies to offer the same scheme in both countries.

While Australian schemes could be amended for New Zealand employees, so as to comply with the New Zealand rules, this carried compliance costs and meant New Zealand employees could end up with a commercially less favourable exempt ESS than their Australian counterparts. Aligning New Zealand's exempt scheme rules with Australia's rules by allowing companies to choose whether bad leavers can keep their shares should make it significantly easier for trans-Tasman companies to offer their schemes in both countries.

## Key features

New section CW 26C(8) provides two options for employers to choose from when designing the terms of an ESS arrangement with respect to the end of the 'period of restriction' for a bad leaver.

### First option (subsection CW 26C(8))

When the period of restriction ends, the shares are transferred to the employee if they have not already been transferred, or – if the employee chooses – the shares are acquired from the employee or trustee for the lesser of cost and market value.

### Second option (subsection CW 26C(8B))

When the period of restriction ends:

If the employee is currently employed, the shares are transferred to the employee if they have not already been transferred, or – if the employee chooses – the shares are acquired from the employee or trustee for the lesser of cost and market value.

If the employee is not currently employed, the shares are acquired from the employee or trustee for the lesser of cost and market value.

This second option simply replicates the current law, so there is no need for schemes that are currently exempt to change.

## Application date

New section CW 26C(8), and subsection (8B), apply from 29 March 2018, the date the current exempt ESS rules came into effect.

## Detailed analysis

The first option is appropriate for employers that do not wish to make a distinction between the circumstances of an employee's departure, and prefer to give all employees the choice between keeping their shares or having them acquired by the employer again. This option may make it easier for some Australian exempt schemes to be replicated in New Zealand.

The second option is suitable for employers that do not want 'bad leavers' to have the choice to keep their shares. This arrangement replicates the law prior to this amendment.

As part of the amendment, all instances of the word 'purchased' have been replaced with 'acquired'. The reason for this change in terms is that the word 'purchase' implies an amount of consideration, whereas in some cases the employer may have granted the employee the shares for free, so 'purchasing' them back from the employee for the lesser of cost and market value will result in a purchase for nil consideration, which as a matter of strict interpretation might not be possible. The word 'acquired' is less problematic as it clearly covers both possibilities.

# Ring-fencing of residential property deductions

*Sections EL 3, EL 4, EL 5, EL 7, EL 8, EL 15, EL 16, and EL 18 of the Income Tax Act 2007*

Some remedial amendments have been made to the residential property deduction ring-fencing rules, to ensure they operate as intended.

## Background

The new ring-fencing rules in subpart EL, which apply from the start of the 2019–20 income year, were introduced to limit deductions for residential property to income from the property.

Before the introduction of these rules, loss-making investors could use the excess deductions from their rental properties to offset their income from other sources (such as salary and wages), thus reducing their income tax liability.

A number of remedial amendments have been made to ensure the rules operate as intended.

## Key features

The key remedial amendments ensure that:

- The carry forward of amounts that remain ring-fenced after a taxable property sale, because they have been transferred from another property which was not taxed on sale.
- It is clear that amounts of residential income can only be counted once in applying the ring-fencing rules.
- The interposed entity rules operate as intended.

## Application date

The amendments came into force on 1 April 2019 – the date the ring-fencing rules in subpart EL came into force.

# Detailed analysis

## Unused excess deductions not released on taxable sale of portfolio or property

Sections EL 5 and EL 7 of the Income Tax Act 2007 have been amended to ensure the carry forward of unused deductions that are not released on a taxable sale of a residential property or portfolio.

If a property-by-property basis residential property is taxed on sale, or if all of the properties in a portfolio are sold and all sales were taxed, any excess deductions remaining (after use against the rental income and net land sale income) are released from the ring-fencing rules. This means those amounts can be used against income from other sources, such as salary and wages. However, if there has been an unused excess transferred to the property or portfolio from another property or portfolio that was not taxed (or not fully-taxed) on sale, the amount transferred is not released.

These amendments ensure there is a mechanism for any unfenced amount remaining after a taxable sale to be treated as relating to (and transferred to) another property, consistent with the mechanism that does this for excess amounts remaining after non-taxed disposals.

In making these amendments, the opportunity was also taken to incorporate what was section EL 8 (which dealt with the treatment of previously transferred amounts on a fully-taxed disposal) into sections EL 5 and EL 7, which deal with sales of portfolios and property-by-property basis residential properties, respectively. This amendment is a rationalisation of the provisions – it does not affect the way the rules operate.

## Operation of the interposed entity rules

Sections EL 16 and EL 18, which may apply if residential property is held in a "residential land-rich entity", have been amended to ensure they operate as intended.

Section EL 16(2) suspends excess interest deductions related to investing in a land-rich entity. These are deductions that exceed the person's share of the entity's residential income, taking into account the level of capital used to acquire the residential property.

Under the wording of these provisions as originally introduced, the suspended deductions would have been carried forward to a later income year in which the person derives residential income or a distribution from the entity (to the extent such distribution relates to residential land). But the excess deductions would then not have been used against either of those types of income, but rather added to the person's interest expenditure and used against the person's share (effectively) of the "entity's net residential income". As originally introduce, section EL 16(2)(b)(i) and (ii) therefore did not bear any relation to the income the excess deductions could be used against.

Section EL 16(2)(b) has been amended so the excess deductions are carried forward to a later income year in which the entity derives residential income. Paragraph (b)(i) and (ii) do not serve any purpose and should be removed.

There was a related issue in section EL 18(a) which has also been fixed up. In the wording of that provision as originally introduced, the person's residential income for the year would have been treated as their share of "net residential income". That is fine when the only residential property the person has is held in the entity. But the person may also hold other residential property directly. If they do, they should not be able to use excess interest deductions related to the investment in the entity against that other residential income. As such, section EL 18(a) has been amended so that the person's residential income for the income year **from the property held in the entity** is what is treated as their share of net residential income.

## Clarifying that amounts of residential income can only be counted once

An amendment has been made to clarify that amounts of residential income from residential property outside the ring-fencing rules can only be counted once for the deduction allocation rules.

This clarification is required because a taxpayer may apply the ring-fencing rules on a portfolio basis for some properties and on a property-by-property basis for another property, or they may have 2 or more properties on a property-by-property basis. In these situations, the deduction allocation rule is applied to each property (or a property and the portfolio) separately.

In section EL3, paragraphs (a) to (c) of "residential income" are amounts from the particular property or portfolio, so cannot be counted when looking at another property or portfolio.

However, paragraph (d) includes amounts of income from property outside the rules. On the face of it, there was nothing to preclude a taxpayer counting such amounts more than once – for example, once in ascertaining their "residential income" for their portfolio, and once in ascertaining their "residential income" for a property-by-property basis property.

This amendment clarifies that if an amount of residential income has been counted, it cannot be counted again for allocating deductions for another property.

## Clarifying that current year excess deductions can be transferred within a wholly-owned group

An amendment has been made to clarify that current year excess deductions can be transferred within a wholly owned group under section EL 15.

As originally introduced, the terminology in section EL 15 suggested that it was only excess deductions that had been carried forward from prior years that could be transferred within a wholly owned group. That was not intended, and the amendment ensures that current year excess deductions can also be transferred.

## Cross referencing errors corrected

An amendment has been made to section EL 3, to correct a cross-referencing error in the definition of "residential land". As the definition was originally worded, deductions for residential property in the ring-fencing rules could be used against income from the property (or portfolio) and against net rental income and net depreciation recovery income from residential property that is outside the rules because it is held on revenue account. This amendment ensures that deductions can also be able to be used against net sale income from such revenue account property.

A cross-referencing error in the definition of "land sales provisions" in section EL 3 has also been corrected, to ensure that section CB 15 is included in that definition.

# Taxation of life insurance business – transitional relief

*Sections EY 30 of the Income Tax Act 2007; section 65 of the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019*

Changes have been made to section EY 30 in response to submissions on the bill regarding remedial changes to the life insurance transitional rules made by the Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019. The changes:

- Replace the current description of the CPI period being, "consisting of the last four quarters preceding the year", with a reference to the CPI percentage change movement to the annual rate specified in the formula in the life policy.
- Revise the application section (section 65(4) of Taxation (Annual Rates for 2019–20, GST Offshore Supplier Registration, and Remedial Matters) Act 2019) to ensure that life insurers wanting to use the amendment can do so.

The changes respond to concerns raised by submitters that the legislative changes made by the earlier bill did not reflect life insurer practices regarding the calculation of CPI benefits, and that the savings provision that accompanied the legislative change was too limited in scope.

## Application date

The amendments apply from 1 July 2010.

# Exemption for certain Government grants provided to social housing providers

*Section 5(6F) of the Goods and Services Tax Act 1985*

Section 5(6F) of the Goods and Services Tax Act 1985 has been amended to clarify that all types of payments by the Government to social housing providers under a tailored agreement to provide social housing are exempt from GST.

## Background

Like other residential landlords, social housing providers are exempt from GST in respect of their supplies of accommodation in dwellings provided to their tenants.

In 2015, a provision was added to the GST Act to ensure that payments made by the Government to social housing providers under reimbursement agreements and tailored agreements to provide social housing are treated as consideration for an exempt supply of accommodation in a dwelling.

The tailored agreements that have subsequently been agreed include several types of payment; a rent subsidy, an operating supplement, and in limited cases, a capital grant.

There was uncertainty as to whether or not all of these types of payment would qualify for the GST exemption in section 5(6F). This was because section 5(6F) originally required that the payment be for "the provision of accommodation in social housing." It was unclear if this requirement would be met for the operating supplement and capital grant payments as these payments are only indirectly used to pay for the provision of accommodation.

If the GST exemption was found to not apply to some types of payment, the Government would need to gross up these payments to social housing providers in order to subsidise the same amount of tenancies in social housing accommodation.

The overall purpose of a tailored agreement is to provide social housing tenancies, so the intended policy is that all types of payments made under a tailored agreement should be deemed to be consideration for an exempt supply. The remedial change provides certainty and reduces compliance costs for social housing providers and the Government.

## Key features

Section 5(6F) has been amended to remove the requirement that the payment must be for "the provision of accommodation in social housing".

This change clarifies that section 5(6F) applies to all types of payments made under either the reimbursement agreements or tailored agreements that are enabled by the Public and Community Housing Management Act 1992. Section 5(6F) deems these payments to be consideration for an exempt supply of accommodation in a dwelling. This means that the social housing providers which receive these payments will not be liable to return GST output tax on any of the relevant payments.

Currently, there are 3 types of relevant payment; a rent subsidy, an operating supplement and a capital grant. However, if, in future, other types of payment are developed and paid under the relevant agreements, section 5(6F) would also apply to those new types of payment.

## Application date

The remedial amendment applies from 28 May 2015 which is the date that section 5(6F) first took effect.

# GST deductions for capital raising costs of participatory securities

*Section 20H of the Goods and Services Tax Act 1985*

Section 20H of the Goods and Services Tax Act 1985 has been amended so that the rules for allowing GST deductions for capital raising costs also apply when funding is raised using participatory securities.

## Background

Section 20H allows GST-registered businesses to recover GST on their costs of raising capital to fund a taxable activity. This provision originally only applied to capital raised through equity or debt securities.

Like equity and debt securities, participatory securities can be issued by businesses to raise capital. A remedial amendment has been made so that section 20H also applies to participatory securities.

## Key features

Section 20H(1)(d) has been amended to add references to "participatory securities", so these rules apply to debt securities, equity securities, and participatory securities.

This remedial amendment allows GST registered persons which principally make taxable supplies to claim back the GST on the funding support services that they acquire when using participatory securities to raise capital for their taxable activity.

## Application date

The remedial amendment applies from 1 April 2017 which is the date that section 20H first took effect.

# GST on low-value imported goods remedials

*Sections 8(4B)(bb), 10B(2)(b), 10C, 12(1B), 24(4)(g), 24(5D), 24BAB(2)(e), 24BAC, 60C(1)(ab), 60D(1)(ab), 77(3)(aa) and 85C of the Goods and Services Tax Act 1985; and section 143A(1)(g) and (h) of the Tax Administration Act 1994*

Amendments have been made to the Goods and Services Tax Act 1985 (the GST Act) and the Tax Administration Act 1994 to address technical issues with the new GST on low-value imported goods legislation (referred to here as "the distantly taxable goods rules") to ensure that these rules and similar GST rules applying to supplies of remote services work as intended.

All legislative references are to the GST Act unless stated otherwise.

## Background

From 1 December 2019 GST applies to goods valued at or below $1,000 that are imported from non-resident suppliers by consumers in New Zealand. The new rules require non-resident suppliers, as well as operators of electronic marketplaces and redeliverers to register and return GST on these supplies of "distantly taxable" goods if they exceed, or are expected to exceed, $60,000 in total over a 12-month period.

Prior to these changes, GST was only collected on imported goods at the border by the New Zealand Customs Service (Customs). However, GST was not typically collected on imported goods below the customs de minimis of $60 of duty (this equated to a parcel with a value of $400 if GST was the only applicable duty).

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

The new rules are intended to maintain the broad base of New Zealand's GST system and level the playing field between domestic and offshore suppliers of low-value goods.

## Key features

The following amendments have been made to the new distantly taxable goods rules and the remote services rules:

- The reverse charge in section 8(4B) has been amended to prevent potential double taxation from occurring when a GST-registered business imports goods for a mix of taxable and non-taxable use and pays GST to either Customs or to the supplier of the goods.
- The marketplace rules have been amended to ensure they do not apply when a New Zealand-resident supplies remote services through a marketplace operated by a New Zealand resident. The amendments ensure that the marketplace rules do not override existing agency rules that apply to these types of domestic arrangements.
- The Tax Administration Act 1994 has been amended to provide that a recipient or a non-resident underlying supplier of distantly taxable goods commits a knowledge offence if they knowingly provide false, misleading or altered information which results in GST not being charged on a supply when it should have been.
- Amendments have been made so that suppliers only need to take reasonable steps to ensure their GST registration number and information about whether GST was paid at the point of sale is made available to Customs when GST has been charged at the point of sale on all or some of the goods in the consignment.
- The requirement for suppliers of distantly taxable goods to include the amount of GST on receipts provided to consumers has been removed. This means that if GST has been charged on all the goods included on the receipt, the receipt requirements can be met by simply including the total GST-inclusive price on the receipt and stating that this price includes GST.
- An amendment to section 10B(2)(b) clarifies the wording of the provision.

- An amendment to section 10C clarifies that the 75 percent test for an election to treat high-value goods[34] as distantly taxable goods is a self-assessed test.
- An amendment to section 77(3) clarifies that, when doing a foreign exchange calculation to determine the New Zealand dollar amount of GST required to be returned to Inland Revenue, the currency conversion can be done on the date the supply was made.
- Corrections have been made to cross-references in sections 12(1B), 24(4)(g), 24(5D) and 85C.

## Application dates

The following amendments, which are either taxpayer-friendly in nature or mere clarifications of the policy intent, apply on and after 1 December 2019, the date that the distantly taxable goods rules came into force:

- amendment to the reverse charge provision (section 8(4B)(bb));
- amendments to the marketplace rules (sections 60C(1)(ab) and 60D(1)(ab));
- amendment to the reasonable steps requirements for reporting GST information to Customs (section 24BAC);
- amendment removing the requirement to state the amount of GST on a receipt (section 24BAB(2)(e));
- clarification of wording of section 10B(2)(b); and
- insertion of cross-reference in section 85C.

Savings provisions apply to protect tax positions taken by registered persons between 1 December 2019 and 23 March 2020 if those tax positions are consistent with either the reverse charge provision in section 8(4B) or the marketplaces rules in sections 60C and 60D, as the law originally stood on 1 December 2019. However, it should be noted that the

[34] Items valued above $1,000.

savings provision relating to the reverse charge amendment is optional for taxpayers to apply. This means that if a taxpayer returned GST in accordance with the previous version of section 8(4B) and wishes to claim a refund of this GST based on the amendment, they can do so.

The following amendments apply on and after 23 March 2020, being the date the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020 was enacted:

- amendments to the knowledge offences in section 143A of the Tax Administration Act 1994;
- amendment clarifying that the 75 percent test for an election to treat high-value items as distantly taxable goods is a self-assessed test (section 10C); and
- amendments to cross-references in sections 12(1B), 24(4)(g), and 24(5D).

The amendment to the currency conversion rules (new section 77(3)(aa)) applies on and after 1 October 2016, the date that the remote services rules came into force.

## Detailed analysis

### Amendment to reverse charge

Except when a non-resident supplier has made a valid election to charge GST on business-to-business supplies below $1,000, GST does apply to distantly taxable goods supplied by non-residents to New Zealand GST-registered businesses. The rationale for this is that applying GST to business-to-business supplies is broadly revenue neutral, as GST-registered businesses purchasing goods and services will generally claim back any GST charged by the supplier as an input tax deduction.

However, in some cases, a GST-registered person may purchase goods from a non-resident supplier for non-taxable use (for example, private use). Section 8(4B) was amended in 2019 to require a GST-registered New Zealand business to return GST under the reverse charge when they purchase distantly taxable goods from a non-resident supplier for partial private or exempt use. However, the scope of the reverse charge ended up being wider than was intended, creating the potential for double taxation to occur in the type of situation described in the example below.

| Example 36: Inappropriate application of reverse charge when goods are in New Zealand at the time of supply |
| --- |
| A Co, a GST-registered landscaping business, purchases landscaping and gardening equipment from B Co, a non-resident who is not registered for GST. The goods are already in New Zealand at the time of supply. A Co intends to use the goods for 20 percent private use and 80 percent taxable use.<br><br>Under the previous version of section 8(4B) of the GST Act, A Co would be treated as making a supply to itself at the standard rate of 15 percent and would be entitled to an input tax deduction based on 80 percent of the purchase price.<br><br>The issue is that B Co already paid GST to Customs on the importation of the goods into New Zealand and the price paid by A Co for the supply was marked up on account of this. This means that the private use of the goods by A Co has effectively been taxed twice. |

To rectify this, section 8(4B)(bb) has been inserted so that the reverse charge only applies to a supply of goods when:

- the goods are imported by the recipient of the supply in a consignment with a total value of $1,000 or less; and
- the recipient does not pay GST to Customs, or to the supplier of the goods.

| Example 37: Remedial amendment to reverse charge rule |
| --- |
| Consider A Co and B Co in the example above and assume the same set of facts applies as before. As a consequence of the remedial amendment, A Co is not treated as making a supply to itself (because A Co did not import the goods into New Zealand as required by new paragraph (bb)). This means that A Co is not required to account for output tax under the reverse charge. |

## Marketplace rules – interaction with existing agency rules

Prior to the distantly taxable goods rules, the marketplace rules in sections 60C and 60D only applied to marketplaces for remotely-supplied services and digital products (remote services) operated by non-residents. As part of extending the marketplace rules to supplies of distantly taxable goods, the requirement that the operator of the marketplace is a non-resident was removed. This means that, since 1 December 2019, New Zealand-resident marketplace operators are liable to return GST on supplies of remote services and distantly taxable goods made through their platforms by non-residents to consumers in New Zealand.

An unintended consequence of this change was that the electronic marketplace rules also applied to arrangements that were purely domestic in nature and which were already covered by existing agency rules in the GST Act. Because there is only a very limited ability to opt out of the electronic marketplace rules, the effect was that the electronic marketplace rules trumped the existing agency rules as they applied to these domestic arrangements, which was not intended.

To address this issue, new sections 60C(1)(ab) and 60D(1)(ab) require that if the marketplace is operated by a New Zealand resident, the underlying supplier must be a non-resident – otherwise the marketplace rules do not apply to a supply of goods or remote services. This means that if an underlying supplier is a New Zealand resident, they are liable to register and return GST – unless the underlying supplier and the New Zealand-resident marketplace operator have an arrangement whereby the marketplace operator makes the supply as an agent of the underlying supplier.

## Knowledge offence – providing incorrect or misleading information

Section 143A(1)(g) of the Tax Administration Act 1994 has been amended so a recipient of a supply of distantly taxable goods commits a knowledge offence if they deliberately provide altered, false or misleading information to avoid being charged GST. This is a criminal penalty and a person convicted of a knowledge offence is liable for a fine of up to $25,000 for a first-time offence or $50,000 for repeated offences.

| Example 38: Consumer makes misrepresentations about GST registration status |
| --- |
| Luke purchases a number of distantly taxable goods online, including clothing, footwear, and nutritional supplements. Luke is not registered for GST. To avoid paying GST, Luke continually informs offshore suppliers he is GST registered and provides a false GST registration number.<br><br>Luke has repeatedly committed a knowledge offence under section 143A(1)(g) of the Tax Administration Act 1994 and, if convicted more than once, could be liable for a fine of up to $50,000 on the second conviction and any subsequent convictions. If convicted just once, Luke could be liable for a fine of up to $25,000. |

New section 143A(1)(h) provides that an underlying supplier of distantly taxable goods or remote services through a marketplace commits a knowledge offence if it knowingly provides altered, false, or misleading information relating to the country or territory in which it is resident, resulting in GST not being returned on the supply by the marketplace operator when it should have been. Unlike paragraph (g), paragraph (h) does not require the incorrect information to have been provided for the purpose of avoiding GST. This is because the underlying supplier's intention may be difficult to establish in practice.

| Example 39: Underlying supplier makes misrepresentations about residency |
| --- |
| Jave Dordan, a non-resident underlying supplier on the NZ Marketplace website, deliberately provides false information about himself (including using a VPN to fake a New Zealand IP address, providing a false mailing address in New Zealand and falsely stating that the goods are shipped from New Zealand) with the intention of misleading potential customers in New Zealand. The fact that NZ Marketplace will not charge GST on the supply as a result of Jave's deception is not Jave's primary objective in making the misrepresentations, but is merely a secondary benefit from Jave's perspective.<br><br>Section 143A(1)(h) of the Tax Administration Act 1994 does not require that Jave's purpose in providing the false information was to avoid GST. Therefore, it does not matter whether Jave had a purpose of avoiding GST—it only matters that he knowingly provided the incorrect information. Jave has committed a knowledge offence under section 143A(1)(h) of the Tax Administration Act 1994. |

## Reasonable steps requirement – providing GST information to Customs

An amendment to section 24BAC provides that a supplier of distantly taxable goods is required to take reasonable steps to ensure that certain GST information is provided to Customs if GST is charged on the supply under section 8(1) at a rate greater than zero percent.

For the purpose of preventing double taxation, section 24BAC requires a supplier of distantly taxable goods to take reasonable steps to ensure that its GST registration number is included in the import documentation, along with an indication of whether GST was paid at the point of sale for each item being shipped. This requirement previously applied to all supplies of distantly taxable goods – including supplies that are generally excluded from the requirement to charge GST at the point of sale, such as supplies to GST-registered businesses.

The amendment ensures that suppliers of distantly taxable goods are not required to report GST information to Customs in relation to consignments of goods that have not had GST charged at the point of sale at the standard rate of 15 percent. Given that GST will be collected on these goods by Customs anyway, it is not necessary for the supplier to report its GST registration number to Customs in these cases.

## Removal of requirement to include amount of GST charged on receipt

An amendment to section 24BAB(2)(e) has removed the requirement for suppliers of distantly taxable goods to include the amount of GST charged on receipts issued to consumers.

For the purpose of preventing double taxation, section 24BAB requires a supplier of distantly taxable goods to issue a receipt if GST has been charged on a supply. This provides the consumer purchasing the goods with documentation that they can provide to Customs as evidence that GST was charged at the point of sale, so that Customs does not collect GST again when the goods are imported into New Zealand.

This means that if GST has been charged on all the goods included on the receipt, the requirement in section 24BAB(2)(f) and (g) to indicate those items that had GST charged at the point of sale and those that did not can be met by simply including the total GST-inclusive price on the receipt and stating that this price includes GST. However, if GST was charged on only some of the goods supplied, this requirement is met by including the amount of GST for each of the goods.

## Clarification of wording – section 10B(2)(b)

Section 10B(2) deals with the valuation of goods for the purposes of determining whether the goods are distantly taxable goods. The section sets out that the value of an item for these purposes will be the amount of consideration for the supply of the item, less the amounts referred to in paragraphs (a) to (c).

Paragraph (b) as it was first enacted referred to “tax charged on the item under section 8”. Two separate technical issues with this wording were identified, as detailed below:

- The wording of the paragraph presumed that the supplier knew whether tax was charged on the item under section 8. However, at the time of doing the calculation, the supplier probably would not know whether tax was charged on the item under section 8, as the sole purpose of performing the calculation was to work out whether GST applied.

- The wording of paragraph (b) also did not work when a non-resident supplier (who had not made an election to treat high-value goods as distantly taxable goods) supplied goods to New Zealand consumers on delivered-duty-paid terms – meaning that the supplier charged the recipient an estimate of the customs charges (including any GST charged under section 12(1)) and paid these charges to Customs on the recipient's behalf.

In the second scenario described above, GST is charged under section 8(1) on items individually valued at $1,000 or less, but not on items valued above $1,000 unless the supplier has elected to treat high-value items as distantly taxable goods. Because the goods are supplied on delivered-duty-paid terms, the supplier will in all cases include an amount in the price to cover the amount of GST. However, when an item is valued over $1,000, the GST is not "tax charged on the item under section 8", as it is tax charged under section 12(1).

To address these technical issues, paragraph (b) has been amended so that it now refers to the amount of tax that would be chargeable on the supply of the item under section 8(1) if the supply was made by a resident and for the same consideration.

### Meaning of "tax chargeable on the supply of the item if the supply was made by a resident"

Section 8(1) applies GST at the rate of 15% to supplies made in New Zealand by registered persons in the course or furtherance of a taxable activity. Section 8(2) treats all supplies by New Zealand residents as being made in New Zealand. The reference to "the amount of tax that would be chargeable on the supply of the item under section 8(1) if the supply was made by a resident" in section 10B(2)(b) therefore requires the supplier to do the following:

- First, assume for the purpose of the calculation that GST is charged on the supply under section 8(1) (so the consideration for the supply includes a nominal amount of GST), regardless of whether GST is in fact charged on the supply.
- Second, subtract from the consideration, the nominal amount of GST (calculated by multiplying the amount of consideration by 3/23). This gives the value of the item for the purpose of determining whether it is a distantly taxable good (and therefore whether GST is required to be charged on the supply of the item under section 8(1)).

## 75 percent test for election to charge GST on high-value goods

Amendments have been made to section 10C to clarify that the 75 percent test that applies for determining a supplier's eligibility to elect to treat high-value goods as distantly taxable goods is a self-assessed test. Under the test, a supplier may make the election if it considers that 75 percent or more of the total value of goods[35] it will supply in the 12-month period starting on the first day the election is intended to be effective for, will consist of items each having a value[36] of $1,000 or less. Suppliers making an election under this test are only required to notify the Commissioner of the election.

The introductory words of section 10C(2) previously stated that the Commissioner may **agree** with an election made under subsection (1). However, as mentioned above, the 75 percent test is a self-assessment test and was never intended to require the Commissioner's agreement or consent. Suppliers making an election under this test are only required to notify the Commissioner of the election.

To clarify that the 75 percent test is a self-assessment test, the introductory words of section 10C(2) now provide that an electing supplier may make the election if the requirements of paragraphs (a) and (b) are met. Other minor wording amendments to subsections (1), (2) and (3) have been made in support of this change.

## Currency conversion on date of supply

When remote services or distantly taxable goods supplied to New Zealand consumers are priced in a foreign currency, the supplier of those goods or services will need to convert the foreign currency price to New Zealand dollars to determine the amount of GST required to be returned to Inland Revenue. Section 77(3) provides non-resident suppliers with a range of currency conversion options for these purposes, including allowing the supplier to do the currency conversion on the last day of its taxable period or on the date the return was filed.

[35] Excluding any alcohol or tobacco products.
[36] Determined under section 10B(2).

New section 77(3)(aa) has been inserted to clarify that the currency conversion can be done on the date the supply was made.

## Corrections of cross-references

The following amendments to cross-references have been made:

- In section 12(1B), an incorrect cross-reference to paragraph (d) has been removed.
- Previously omitted cross-references to section 9(3)(aa) have been inserted into section 85C.
- In section 24(4)(g), a cross-reference to subsection (5BB) has been inserted.
- In section 24(5D), an incorrect cross-reference to section 8(4) has been removed.

The provision now explicitly provides that the supply is treated as being made in New Zealand when the supplier has incorrectly treated the supply as made in New Zealand and opted to provide a tax invoice to the GST-registered recipient (so that the recipient can make an input tax deduction for the incorrectly charged GST).

# Bright-line main home exclusion

*Sections CB 16A and FB 3A of the Income Tax Act 2007*

The main home exclusion for the bright-line test requires that a person use the land as their main home for most of the time they own the land. The amendment aligns the period of ownership for the main home exclusion for the bright-line test with the period in the bright-line test itself.

A further amendment clarifies when this period of ownership starts for land transferred on a settlement of relationship property as define in section FB 1B.

## Background

The main home exclusion for the bright-line test in section CB 16A applies where land has been used predominantly, for most of the time the person owns the land, for a dwelling that was the main home for the period.

"Own" is defined in section YA 1 for land as having an estate or interest land. "Estate or interest" is defined as including all estates and interests in land whether legal or equitable. Under these definitions, a person will typically own land from the date a binding contract to purchase the land is formed until the date of registration of the transfer on sale.

However, this period can be different from the period that is counted for the purpose of the bright-line test. Under section CB 6A(1), a person generally acquires land for the purposes of the bright-line test on the date the instrument to transfer the land to the person is registered. Th bright-line test period ends on the "bright-line date", which is defined in section CB 6A (7) as the earliest of the date the person enters into an agreement for the disposal of the land, or the date on which the land is disposed of (including by way of gift, compulsory acquisition or mortgagee sale).

Because the period that a person "owns" land for the purposes of the main home exclusion can be different from the period that the bright-line test applies for, it is possible that taxpayers may not be eligible for the main home exclusion because, although they have used land as their main home for most of the period the bright-line test applies to, they have not used it a their main home for most of the time they owned the land. The opposite could also occur.

Section FB 3A applies where residential land that may be subject to the bright-line test is transferred on a settlement of relationship property. It clarifies that the transfer will be treated as occurring for an amount equal to the cost of the land to the transferor, and at the date the transferor acquired the land. Section FB 3A currently applies for the purposes of section CB 6A (the bright-line test) but not for the purposes of section CB 16A (the main home exclusion for the bright-line test).

## Key features

The amendment clarifies that, for the purpose of the main home exclusion for the bright-line test in section CB 16A, the period a person owns the land is the same as the period that the bright-line test applies for. It is consistent with the policy intent for the periods to be aligned.

A further amendment clarifies that rules for residential land transferred on a settlement of relationship property in section FB 3A also apply for the purpose of the main home exclusion for the bright-line test in section CB 16A.

## Application date

The amendments apply from the date of enactment.

# Consideration for grant of easement and other land rights

*Sections CC 1 and CC 1B of the Income Tax Act 2007*

The amendments to sections CC 1 and CC 1B of the Income Tax Act 2007 ('the Act') make two clarifications regarding the tax treatment of certain land use related payments. The first clarification is that a payment directly for the grant, renewal, extension or transfer of a land right (defined as a leasehold estate or a licence to use land) is taxable. The second clarification ensures that a one-off payment for the grant of a permanent easement is not taxable, as has always been intended.

## Background

### Grant, renewal, extension or transfer of a land right

Before this amendment, section CC 1B was drafted in such a way that it only taxed consideration for the "agreement" by a payee to the grant, renewal, extension or transfer of a land right (that is, an inducement type payment). Section CC 1B did not tax consideration that was directly for the grant, renewal, extension or transfer of the land right. From a policy perspective it was intended that such payments were taxed under section CC 1. However, the Court of Appeal in *Commissioner of Inland Revenue v Vector Limited* [2016] NZCA 396 concluded that was not the case. These payments should be taxable, because they can be a substitute for what would otherwise be an ongoing series of rental payments, which would be taxable.

The amendment clarifies that these payments are income for the recipient.

### One-off payment for grant of a permanent easement

A leasehold estate is defined in section YA 1 of the Act as any estate or interest in land other than a freehold estate. An easement is an interest in land and, therefore, a leasehold estate as defined in the Act. Easements can be permanent or non-permanent. A permanent easement is substantively equivalent to a freehold estate because it lasts indefinitely. Consideration for the sale of freehold land is in most cases not taxable under New Zealand income tax law. Therefore, it is appropriate that a one-off payment for the grant of a permanent easement is also not taxable.

The Act contained an exception for such a payment in section CC 1(2C). However, the court in *Vector* found that a lump sum payment for the grant of an easement could not be taxable under section CC 1. This was because a one-off payment is a capital receipt and could not fall under ‘other revenues’ in section CC 1(2)(g), and none of the other amounts listed in section CC 1(2) was applicable. Therefore, a one-off payment for the grant of a permanent easement was not captured by section CC 1, and consequently section CC 1(2C), the specific exception for that type of amount, was redundant and could be repealed.

The amendment to section CC 1B discussed in the previous section, if made by itself, would make consideration for the grant of all easements taxable. Therefore, section CC 1B is also amended to carve out one-off payments for the grant of a permanent easement, consistent with the policy intent.

## Key features

Section CC 1B has been amended to:

- clarify that it includes as income consideration for ‘the grant, renewal, extension or transfer of a land right’
- clarify that a one-off payment for the grant of a permanent easement is not taxable.

A land right is a leasehold estate or licence to use land.

Section CC 1 has been amended to remove subsection (2C), which provided the exception for a one-off payment for the grant of a permanent easement, as the decision in Vector made it clear that such a payment was never taxable under section CC 1.

## Application date

The repeal of section CC 1(2C) applies from 1 April 2015, the date section CC 1(2C) was introduced. The new subsection CC 1B(6), which replicates the wording of the repealed section CC 1(2C), also applies from 1 April 2015.

The substantive clarification of section CC 1B is achieved through two amendments:

- an amendment to the section as it existed from its introduction in 1 April 2013 up to 1 April 2015, when it was replaced (for reasons unrelated to the current amendment); and
- an amendment to the section as it has existed from 1 April 2015.

Both amendments are subject to a savings provision which means they do not apply to an amount for which the person relies on a tax position taken by the person in a return of income filed with the Commissioner, or on a binding ruling issued by the Commissioner:

- in the period beginning with 1 April 2013 and ending before 23 August 2019; and
- that is inconsistent with the amendment.

The savings provisions in the amendments to section CC 1B protect tax positions taken before the Minister of Revenue made a public announcement of the amendments on 23 August 2019.

# Interest limitation remedials

*Sections FE 6, FE 16B, and GC 16 of the Income Tax Act 2007*

Three changes have been made to the interest limitation rules which apply to cross-border related debt. These changes:

- remove the inbound thin capitalisation de minimis when the group has related party debt from a non-resident;
- exclude certain financial arrangements from being a non-debt liability in the thin capitalisation calculations where the funding is pro rata with a group member's shareholding or by a group member with a substantial shareholding; and
- ensure the optional credit rating method can be calculated based on secured debt.

## Key features

### Inbound thin capitalisation de minimis

The term "adjust" in section FE 6(3)(ac) is zero when the de minimis does not apply. Section FE 6(3)(ac)(i) has been extended to cover entities that have related party debt from a non-resident so that the de minimis is not available in this situation.

### Non-debt liabilities – shareholder loans

Section FE 16B calculates non-debt liabilities by prescribing which amounts can be subtracted from the group's liabilities. This section has been extended to ensure financial arrangements provided by a member of the worldwide group are excluded from non-debt liabilities when the funds are pro-rata with a shareholding.

### Restricted transfer pricing – optional credit rating method

The word "unsecured" has been removed from section GC 16(5) which will allow a taxpayer to calculate the optional credit rating method based on long-term senior debt that is not related party debt whether it is secured or unsecured.

## Application date

These amendments apply from 1 July 2018 to align with the original changes introduced in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018.

## Detailed analysis

### Inbound thin capitalisation de minimis

The thin capitalisation rules contain a de minimis in section FE 6(3)(ac) of the Income Tax Act 2007 so that certain excess debt entities do not need to make adjustments upon breaching the thin capitalisation threshold. This applies when these entities have a group finance cost of up to $1 million and abates up to a group finance cost of $2 million.

Changes in the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 extended this de minimis from the outbound thin capitalisation rules to also apply to the inbound thin capitalisation rules provided the borrower does not have any owner-linked debt.

However, owner-linked debt, which is described in section FE 18(3B) of the Income Tax Act 2007, exists only where the borrowing is, directly or indirectly, from an owner who is not a member of the group. It was always intended that the de minimis should not be available where there was borrowing from a non-resident member of the same group. This is because a group with related party lending that does not have to apply thin capitalisation could have very high levels of debt in New Zealand and derive a return on their total investment without making any taxable profits due to high interest deductions. This is not appropriate, even where the interest expense is less than $1 million or $2 million.

Therefore, access to the de minimis has been restricted to also not be available when the borrower has related party debt from a non-resident that does not have a New Zealand branch.

### Non-debt liabilities – shareholder loans

Section FE 16B(1)(b) and (c) exclude certain shares and shareholder loans from being non-debt liabilities for thin capitalisation purposes. The intention of these sections is to exclude shareholder funding that is not within the definition of total group debt in section FE 15 (and is therefore not excluded from non-debt liabilities by section FE 16B(1)(a)) and is akin to group equity.

The previous wording of section FE 16B(1)(b) applied only to certain financial arrangements entered into by a member of the group with a shareholder that was also a member of the group. This was narrower than the intended scope which was for certain financial arrangements entered into by a member of the group with a shareholder of the group.

# Disregarded hybrid payment rule – exception for reimbursement of third-party expenditure

*Sections FH 5(2) and FH 5B of the Income Tax Act 2007*

Remedial amendments to the hybrid and branch mismatch rules introduce a new exception to the disregarded hybrid payment rule in section FH 5 of the Income Tax Act 2007. This exception ensures the New Zealand branch of a non-resident company or New Zealand hybrid entity is allowed a deduction for a payment to the extent that:

- the payment reimburses a control group member for third-party expenditure; and
- the third-party expenditure is non-deductible (in New Zealand or in the foreign jurisdiction) because income of the branch or hybrid entity is not taxable in the foreign jurisdiction.

All section references are to the Income Tax Act 2007.

## Background

The disregarded hybrid payment rule in section FH 5 seeks to deny a deduction in New Zealand for a payment by a New Zealand resident or New Zealand branch, or charged by a New Zealand branch, if the payment is disregarded by the payee jurisdiction due to the status of the payer. The rule, therefore, addresses a situation where a deduction-no inclusion outcome would otherwise arise.

However, the original design of section FH 5(2) meant a New Zealand branch of a non-resident company or a New Zealand hybrid entity would be denied a deduction for a payment that reimbursed a member of the non-resident's control group for third-party expenditure, where the member of the non-resident's control group was not allowed a deduction in the relevant foreign jurisdiction for the third-party expenditure. A foreign jurisdiction, such as Australia, might deny a deduction for third-party expenditure in such a situation if the expenditure relates to the exempt income of a New Zealand branch (i.e. the activities of the payer). This would mean a deduction would be denied in respect of a payment that does not produce the net deduction-no inclusion hybrid outcome section FH 5 is targeted at; the group would not be allowed a deduction in either jurisdiction for legitimate third-party expenditure. The exception introduced in this amendment addresses this situation.

This outcome was also inconsistent with the treatment of third-party costs imposed on a New Zealand branch by way of a charge from the branch's non-resident head office (rather than by a reimbursement payment to another member of the non-resident's control group). In this situation section FH 5(3) would apply and the New Zealand branch would be allowed a deduction for the third-party expenditure charge.

## Application date

The amendments apply with retrospective effect for income years beginning on or after 1 July 2018, to align with the general application date of the hybrid and branch mismatch rules.

## Detailed analysis

To address the issue, section FH 5(2)(c) and section FH 5B establish a new exception to the disregarded hybrid payment rule in section FH 5.

An exception to section FH 5 has been introduced for situations where a payment from a New Zealand branch or hybrid entity to a non-resident group member reimburses the payee for third-party expenditure. A key element of the new exception to FH 5 is that no deduction for the third-party expenditure is allowed in the payee jurisdiction because some part of the payer's income (the income earned through a New Zealand branch or hybrid entity) is not taxable in the payee jurisdiction. The exception is drafted with a focus on the supply of goods and services that match the payments producing the tax outcomes.

Section FH 5B(2) sets out the requirements a supply of goods or services from the payee to the payer must meet for the exception to apply. These requirements are:

- a supply of goods or services (referred to as the "prerequisite group supply") is received and paid for by the payee, or a member of the payee's control group who is also resident in the payee's jurisdiction;
- the prerequisite group supply is made by a third-party (i.e. a person who is not a member of a control group including the payee or payer);
- the payment for the prerequisite group supply is non-deductible (nor is any equivalent tax relief available) in the payee jurisdiction on the basis that income of the payer is not taxable in the payee jurisdiction; and

- the payment is not deductible (nor is any equivalent tax relief available) in any other country or territory.

If a supply of goods or services meets these requirements it will be deemed to be a "payer supply" for the purpose of section FH 5B.

## Expenditure excluded – one payer supply and one prerequisite group supply

Section FH 5B(3) sets out the amount of expenditure that is excluded from the scope of section FH 5 where the payee, or a member of the payee's control group, has made a single payer supply to the payer (i.e. there are not multiple supplies made in or before that income year meeting the requirements of sub-section (2)), and this relates to a single prerequisite group supply. In this situation the amount of excluded expenditure will equate to the lessor of the consideration for the payer supply or the amount that is non-deductible to the payee for the prerequisite group supply.

## Expenditure excluded – multiple payer supplies and/or prerequisite group supplies

Section FH 5B(4) allows for expenditure to be excluded from section FH 5 where there are multiple payer supplies and/or prerequisite group supplies (i.e. where consideration for a payer supply reimburses for multiple prerequisite group supplies or where consideration for multiple payer supplies reimburses for a single prerequisite group supply). To satisfy this sub-section, the excluded amount for a payer supply, when taken in conjunction with any excluded expenditure relating to other payer supplies, must meet the following requirements:

- where a payer supply is linked to multiple prerequisite group supplies, the excluded amount must not exceed the consideration for the payer supply; and
- the total excluded amount must not exceed the amount for the prerequisite group supply that is non-deductible to the payee.

Sub-section (4) also contains an ordering rule, which sets out how payer supplies and prerequisite group supplies should be prioritised for the purpose of determining which amounts of expenditure can be excluded from section FH 5. Payer supplies and prerequisite group supplies will be prioritised based on the order which they are made, or for payer supplies or prerequisite group supplies made at the same time, the order chosen by the payer.

## Design of the exception

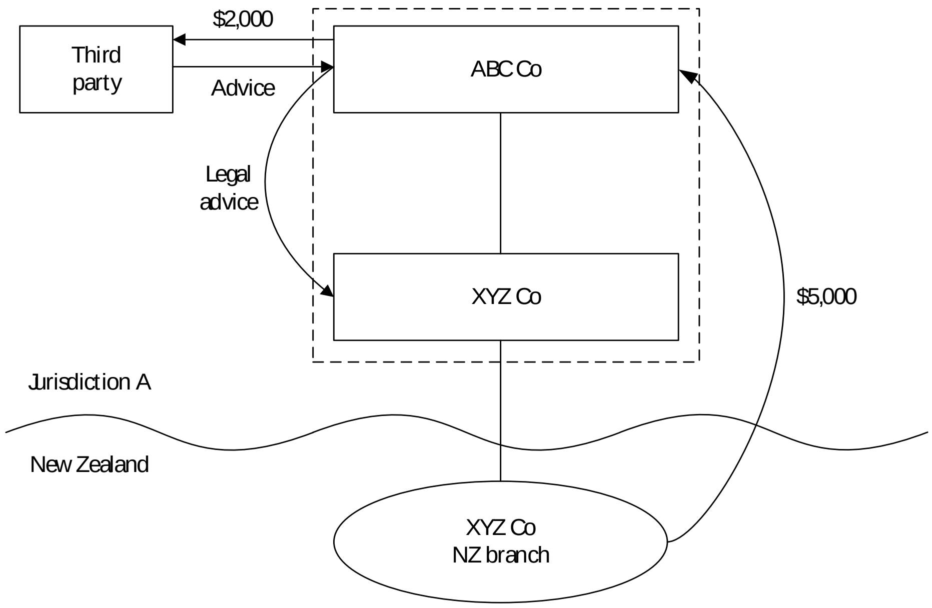
This amendment is intended to cover a broad range of intra-group payments for goods and services provided they have a connection to legitimate third-party expenditure. For instance, financing sourced from an external lender could count as a "prerequisite group supply" of services if that financing is advanced to the New Zealand branch of a non-resident company (that is, that it is a "prerequisite") and the other conditions of this exception rule are met. Another example could be payments relating to goods sourced from an external supplier and sold in the New Zealand market.

However, as outlined in the example below, a payment can only meet this exception to section FH 5 to the extent of the foreign non-deductibility. In a "mark-up" arrangement where the amount of the New Zealand branch intra-group payment exceeds the amount of external costs of the group which are being reimbursed, the "mark-up" component of the payment will be outside the scope of section FH 5B and will likely be a mismatch amount for which a deduction is denied under section FH 5. This aligns with the rule for branch charges in section FH 5(3).

Where there are multiple payments and/or amounts of third-party expenditure, the amendment provides that an amount of non-deductible third-party expenditure can only be matched up to a payment it relates to once for the exception to apply.

## Example 40

**Figure 1**




XYZ Co, a resident of foreign jurisdiction A, operates a branch in New Zealand. XYZ Co is part of the same consolidated group as another company in jurisdiction A, ABC Co.

ABC Co provides legal advice to XYZ Co. In the provision of this service ABC Co has to obtain specialist advice from a third-party law firm, which costs $2,000.

XYZ Co is required to pay ABC Co $5,000 for this service. This represents the $2,000 worth of costs ABC Co incurred, plus an additional $3,000 arm's length mark-up. XYZ Co on-charges the $5,000 to its New Zealand branch to pay.

In jurisdiction A, transactions within a consolidated group are disregarded, meaning the amount paid by the New Zealand branch of XYZ Co to ABC Co will not be treated as income of ABC Co. ABC Co is not permitted a deduction for the third-party costs it incurred in the provision of the service to XYZ Co on the basis costs have been allocated to the New Zealand branch. (Income of XYZ Co earned through its New Zealand branch is not taxable in jurisdiction A because that jurisdiction's tax law exempts income and expenditure of a resident company to the extent it is attributed to a foreign branch).

The $2,000 cost component of the payment will satisfy the requirements of section FH 5B(2) and as it involves only one payer supply and one prerequisite group supply section FH 5B(3) would exclude it from the scope of section FH 5. However, the $3,000 profit component of the payment would not satisfy the requirements of section FH 5B and as such a deduction may be denied for this part of the payment under section FH 5.

# Reverse hybrid payment rule – allowing deductions where payment is taxable in New Zealand

*Section FH 7 of the Income Tax Act 2007*

This amendment repairs an error in the reverse hybrid payment rule in that the rule would have denied a deduction to a New Zealand resident company for a payment to a related non-resident company if that payment was exempt under foreign tax law but taxable in New Zealand through the non-resident company's New Zealand branch. Denying a deduction in this situation is not consistent with the policy intent of the rule which is to address deduction-no inclusion hybrid outcomes.

The rule has now been amended for this situation. Payments subject to taxation in New Zealand are now removed from the scope of the rule under section FH 7(1)(d).

## Application date

This amendment applies with retrospective effect for income years beginning on or after 1 July 2018, to align with the general application date of the hybrid and branch mismatch rules.

# Adjusting payment due dates for some tax credit recipients

*Section 142AC of the Income Tax Act 2007*

The amendment allows Inland Revenue to adjust the terminal tax due dates for some tax credit recipients, if their assessment cannot be finalised within 30 days of their payment due date because Inland Revenue needs to finalise their partner's or ex-partner's assessment first, to determine entitlement to tax credits.

## Background

Eligibility for Working for Families (WFF) requires an assessment of family income. This requires both partners to be assessed for income tax. This can result in a timing issue when one partner has an extension of time for their tax obligations. This means that some peoples' income tax assessments are unable to be finalised by their tax due date, because they are dependent on another person's income tax assessment being completed first.

Those people affected are:

- WFF recipients who had a partner at any time during the year; and
- Those with potential entitlement to the independent earner tax credit (IETC) who were a partner of a WFF recipient at any time during the tax year.

Under current rules, any tax payable of $100 or more is subject to penalties and interest from the original payment due date. Some recipients were therefore subject to penalties and interest from a date that is earlier than when the result of the assessment was known.

## Key features

The amendment allows Inland Revenue to adjust the payment due date for tax credit recipients who meet the following criteria:

- The person has an entitlement (or potential entitlement) to WFF or IETC;
- The person has met their own filing obligation (if any);

- Their assessment could not be finalised because Inland Revenue needs to complete another person's assessment first to determine their entitlement to tax credits;
- The person's assessment was finalised within 30 days of their terminal tax date, or after their terminal tax date; and
- The person's assessment is a debit.

The adjustment to the terminal tax date for those who meet the criteria above provides a further 30 days to pay a debit amount from the date the assessment was completed before it will be subject to interest and penalties.

Credit assessments retain the current due date. This means that any credit interest payable will continue to be calculated from the original date and ensures that no person will be worse off because of this change.

The change in due date impacts any payment due for that person on the terminal tax date, that is WFF, income tax, and student loan.

## Application date

The amendment applies to assessments for the 2019–20 tax year onward.

# Reinstatement of ability to reconcile Working for Families for MSD recipients

*Section MF 6 of the Income Tax Act 2007*

The amendment reinstates the ability for Inland Revenue to choose to complete an end-of year Working for Families (WFF) tax credits reconciliation for recipients who received all their payments from MSD.

## Background

The Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 made significant changes to individual income tax provisions for the 2019 year onwards. As part of these changes the provision that allowed Inland Revenue to choose whether to not to complete a WFF reconciliation for a person who received all of their WFF payments from MSD was inadvertently not carried forward into the new provisions.

## Key features

The amendment reinstates the ability for Inland Revenue to choose to complete an end-of-year WFF for recipients who received all their payments from MSD.

## Application date

The amendment applies from 1 April 2019.

# Reciprocal exemption for income from inbound international air transportation

*Sections CW 56 of the Income Tax Act 2007, CW 45 and OB 1 of the Income Tax Act 2004, CB 14 of the Income Tax Act 1994, and 64A of the Income Tax Act 1976*

As a member of the International Civil Aviation Organisation (ICAO), New Zealand is obligated to reciprocally grant a full income tax exemption to non-resident aircraft operators. New Zealand gives effect to this obligation in section CW 56 of the Income Tax Act 2007, first introduced in 1985 as section 64A of the Income Tax Act 1976.

Previously CW 56 only permitted an exemption to be granted for income from outbound air transport. The amendment ensures an exemption can also apply to inbound air transport.

## Background

ICAO member jurisdictions are obligated to reciprocally grant an exemption from income tax to international aircraft operators "to the fullest possible extent". Members are primarily required to give effect to this obligation by including a reciprocal exemption mechanism in their double tax agreements (DTAs). As a backup, members are also required to include a domestic legislation provision that enables reciprocal exemptions to be granted in the absence of a DTA. As an ICAO member, New Zealand introduced a domestic legislative provision to give effect to the backup exemption mechanism in 1985. The provision is currently located at section CW 56 of the Income Tax Act 2007.

Section CW 56 is not an automatic exemption. Rather, to ensure reciprocity, the provision authorises the Commissioner of Inland Revenue to exempt income of a non-resident aircraft operator from New Zealand tax if the Commissioner is satisfied that in reciprocal circumstances the other jurisdiction will exempt the income of a New Zealand aircraft operator. The exemption is typically exercised by means of an exchange of letters, in which each side's tax administration confirms that it will exempt the other side's international airlines. The exemption mechanism only needs to be exercised on rare occasions, as most international air services to and from New Zealand are with jurisdictions with which New Zealand has a DTA. On the few occasions that it has been exercised, the Commissioner has granted full exemption (that is, for both inbound and outbound transportation).

However, section CW 56 only expressly referred to income that is attributable to "carriage outside New Zealand by an aircraft of cargo, mail or passengers emplaned or embarked on the aircraft at an airport in New Zealand" (outbound transportation). The provision was silent about income from the carriage of cargo, mail or passengers into New Zealand (inbound air transportation).

Income derived by an international airline from inbound transportation has a New Zealand source under section YD 4(2) or (3) of the Income Tax Act 2007 to the extent that it is attributable to business carried out in New Zealand or a contract made or performed in New Zealand. This means that at least some inbound air transportation is potentially taxable in New Zealand.

## Key features

The amendment corrects a deficiency in section CW 56. As previously worded, the provision only permitted an exemption to be granted for income from outbound air transport when it should also apply to inbound air transport.

To meet the ICAO obligation to grant an income tax exemption to the fullest possible extent, section CW 56 now expressly applies to inbound air transportation, to the extent there is reciprocity.

## Application dates

The amendment applies retrospectively from 1 April 1984 for section 64A of the Income Tax Act 1976 (the application date of the original legislation). The application date of the amendments to equivalent provisions in subsequent Acts (the Income Tax Act 1994, the Income Tax Act 2004 and the Income Tax Act 2007) are the original date of enactment of each of those Acts. Retrospective application ensures that any full exemption previously granted by the Commissioner under any Act has been granted correctly.

# Individuals' income tax remedials

*Sections 22H, 89C, 106, 120C, 141JA, and Schedule 8 of the Tax Administration Act 1994*

Several amendments have been made to the Tax Administration Act 1994 to ensure that the individuals' income tax changes that were made in the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 are aligned with the policy intent. The measures contained in that Act simplify individuals' year-end income tax filing obligations and help them to use more appropriate rates of withholding during the year.

All references are to the Tax Administration Act 1994 unless otherwise stated.

## Application date

The amendments to sections 22H, 89C, 106, 120C, 141JA, and Schedule 8 apply retrospectively from 1 April 2019.

## Detailed analysis

### Finalising accounts (section 22H)

Section 22H(2) has been amended to clarify that an individual can finalise their pre-populated account up to and including 7 July. A further clarification has been made in section 22H(4) to ensure that a taxpayer is allowed to finalise their account outside the due date, as this ability to late file had inadvertently been removed.

### Date interest starts (section 120C)

The definition of "date interest starts" has been amended to ensure that an individual who is treated as a "qualifying individual"[37] for the purposes of the individuals' income tax rules

[37] Under the individuals' income tax changes, a "qualifying individual" is an individual who only earns reportable income for an income year and has no other income information that must be provided to

receives the same treatment as an individual that meets the definition of "qualifying individual".

## Notices of proposed adjustment required to be issued by Commissioner (section 89C)

This amendment clarifies that the Commissioner is not required to issue a notice of proposed adjustment before finalising the account of a qualifying individual under section 22H.

## Appealing redundant provisions (sections 106(1C) and 141JA)

Sections 106(1C) and 141JA have been repealed. Section 106(1C) is an unnecessary hangover from the previous regime of personal tax summaries. Existing provision 106(1A) is sufficient to give rise to a default assessment as intended, and therefore 106(1C) is unnecessary. Section 141JA deals with the application of penalties to non-filing taxpayers. This is redundant under the new individuals' income tax regime as all taxpayers now have a square up at year end.

## Schedule 8

Schedule 8 now includes a rule, which applies retrospectively from 1 April 2019, to allow the Commissioner to write off small amounts of tax payable in certain circumstances. This change is necessary to support the operation of some of the other write off rules that were enacted as part of the individuals' income tax changes. For example, one of the write off rules enacted as part of the individuals' income tax changes ensures that an individual who derives income solely from an income tested benefit and has additional tax payable will have that tax payable written off (see schedule 8, part B clause 1).

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Inland Revenue (see section 22D(2)). If the Commissioner treats an individual as a "qualifying individual" and that individual then turns out to have other sources of income, that individual should be afforded the same benefits as a "qualifying individual".

The amendment made in the KiwiSaver Act 2006 prevents the individual from being excluded from the income-tested benefit write off by virtue of deriving a small amount of interest income from a bank account.

# Amendments to investment income withholding and reporting rules

*Sections RE 4, RE 10C, RF 2, RF 4, and YA 1 of the Income Tax Act 2007; sections 25B, 25E and 25MB of the Tax Administration Act 1994*

These amendments clarify the application of the investment income withholding and reporting rules to custodial institutions. The amendments enable custodial institutions to access limited relaxations to the normal rules.

Two remedial matters have also been addressed:Amenda clarification of the error correction rules; and

- the inclusion of an additional foreign exchange rate for the calculation of resident withholding tax (RWT).
- These amendments are available to all payers of investment income, including custodial institutions.

## Background

The Taxation (Annual Rates for 2017–18, Employment and Investment Income, and Remedial Matters) Act 2018 made changes to improve the administration of investment income information. The changes aimed to enable the pre-population of tax returns and to ensure that taxpayers' tax obligations and social policy entitlements are calculated more accurately during the year. Monthly reporting of investment income is compulsory from 1 April 2020.

Custodial institutions hold investment assets and undertake various functions including settlement services and asset management. As an intermediary entity, the custodial institution is a conduit between an investment income payer (for example, a company paying a dividend) and the final or "end" investor. As a result of its intermediary function, there are circumstances in which a custodial institution may be best placed to undertake withholding and reporting. Clear rules are necessary to reduce compliance costs and provide for simpler administration of investment income for tax purposes.

## Key features

- A definition of a "custodial institution" has been introduced for the purposes of the investment income withholding and reporting rules.
- The obligation to withhold and report investment income will pass from the investment income payer to a custodial institution that pays to an "end investor".
- The investment income rules have been relaxed to allow a custodian who pays investment income to a non-resident custodial institution to:
  - withhold and report on an aggregate basis; and
  - treat the non-resident custodial institution as an end investor.
- The investment income reporting rules have been relaxed to allow a custodial institution that undertakes reporting to provide the information set out in rows 9, 17 and 20[38] only if the information is held by the custodial institution.

## Application date

The amendments apply from 1 April 2020.

## Detailed analysis

Where an investor invests directly with a payer of investment income, the payer is obliged to withhold tax and report the relevant information to Inland Revenue.

| Example 41 |
| --- |
| Gerda invests $5,000 in Jet Planes Incorporated (Jet), a publicly listed company on the NZ stock exchange. When Jet pays a dividend, it will withhold and report investment income to Inland Revenue in respect of Gerda. |

[38] See schedule 6 of the Tax Adminstration Act 1994.

One or more custodial institutions may sit between the investor and the payer. Where this is the case, it is desirable to confirm which entity in the investment chain will be obliged to withhold tax and report to Inland Revenue. The rules introduced by the new Act are intended to provide the broad framework for withholding and reporting purposes: an entity that meets the definition of "custodial institution"; and pays investment income to an "end investor" will have an obligation to withhold and report investment income. That institution may make arrangements to outsource or transfer its obligations (as described below).

The rules that require a payer to withhold where an investor invests directly with the payer will remain unchanged. Likewise, the specific provisions that allow "nominees", "trustees", and "agents" to undertake withholding will continue to apply to those entities.

## Definitions of "custodial institution", "end investor", and "investment income"

New sections RE 10C of the Income Tax Act 2007 and section 25MB of the Tax Administration Act 1994 define key terms used in the withholding and reporting rules.

### Custodial institution

A "custodial institution" is defined as:

- an entity that holds financial assets as a bare trustee on account for another person; and
- whose activities are supervised or regulated under prescribed New Zealand legislation. (This includes legislation that is substantially similar to the New Zealand legislation in other jurisdictions.)

### End investor

An "end investor" is defined as an investor to whom a payment of investment income is made who is:

- a direct investor who is the beneficial owner of the investment; or
- a non-resident custodial institution.

The definition of "end investor" also includes a trustee, PIE, or PIE proxy that is obliged to provide investment income information to the Commissioner. A trustee, PIE or PIE proxy is subject to its own obligations under existing law (such as the reporting obligations a PIE will have under the PIE rules). It is not expected that a custodial institution withholds or reports on the beneficiaries of a trust or investors in a PIE.

The purpose of defining an "end investor" is to capture who the end recipient of the income should be for New Zealand tax purposes, regardless of the entities it may have passed through before reaching the person who is ultimately entitled to the income. Where the income is finally received by an individual, the information is pre-populated and reflected in the taxpayer's income profile for the tax year.

In most cases a non-resident withholding tax (NRWT) liability will be a final tax. Most non-residents are not required to file a New Zealand tax return nor will they have an Inland Revenue income profile. As such, less detailed information is required by Inland Revenue where the ultimate investor is tax resident outside New Zealand.

The inclusion of a "non-resident custodial institution" as an end investor ensures that withholding and reporting for New Zealand tax purposes occurs on or before the investment income leaves New Zealand. Treating a non-resident custodian as an end investor also reduces the compliance burden on the custodian undertaking the withholding and reporting. This treatment confirms that the final New Zealand custodian does not have to "look through" the non-resident custodian to identify the ultimate investors. It is expected that non-resident custodial institutions are subject to regulatory requirements and reporting obligations under the Common Reporting Standard or US Foreign Account Tax Compliance Act.

### Investment income

"Investment income" is defined as:

- resident passive income; or
- non-resident passive income subject to a withholding obligation and attributed income of investors in portfolio investment.

## Withholding obligations of custodial institutions

### Section RE 4

A custodial institution that pays or transfers an amount of investment income to an end investor has been added to the list of persons who have withholding obligations under section RE 4.

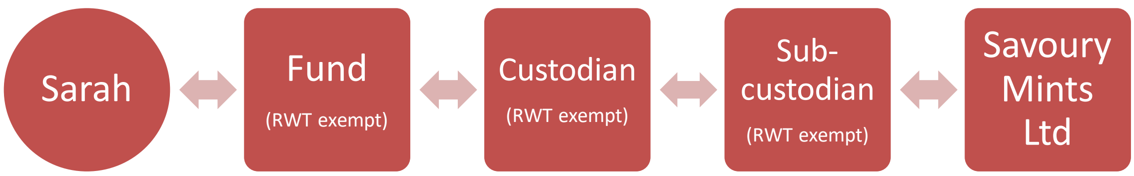
### Section RE 10C

New section RE 10C sets out when a custodial institution will have an obligation to withhold tax. It also makes provision for the custodial institution to outsource or transfer that withholding obligation. The obligation will crystallise where the custodial institution that receives a payment of gross investment income pays or transfers the amount to an end investor. The obligation only applies to the extent that the correct amount of tax has not already been withheld.

Section RE 10C overrides sections RE 7 and RE 8, which will still apply to amounts paid to trustees and nominees who do not meet the “custodial institution” definition.

**Example 42**

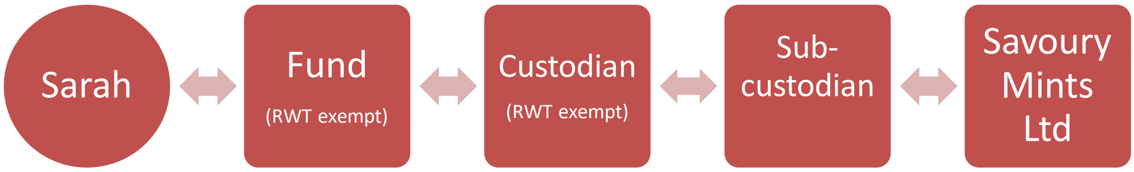
Sarah is a New Zealand resident who makes investments via a managed fund. The managed fund invests into Savoury Mints Ltd (Savoury), a company listed on the New Zealand stock exchange, via a custodian and sub-custodian arrangement. The sub-custodian, custodian and managed fund each have RWT exempt status;[39] Sarah is the “end investor” and beneficial owner of the asset and does not have RWT exempt status. The managed fund is obliged to withhold RWT in respect of Sarah.




[39] An entity that has RWT exempt status will not have RWT withheld from payments it receives.

**Variation**

In this variation of the above scenario, the sub-custodian does not have RWT exempt status. Entities will determine whether they have to withhold RWT based on the RWT status of the entity receiving the payment.




Savoury will withhold RWT in respect of the dividend and pay it to Inland Revenue. The sub-custodian will then pass the net dividend through the chain and the managed fund will pass this on to the end investor. The managed fund will have no obligation to withhold under RE 10C because the obligation exists only to the extent that RWT has not already been withheld.

## Agreement to transfer withholding obligations: outsourcing or passing the withholding obligation

The purpose of sections RE 10C(4) and RE 10C(5) is to provide a custodial institution with the ability to outsource or transfer their withholding obligations. This allows custodial institutions to determine how the obligation will be performed; for example, they may make use of a shared services centre or a service provider.

Under section RE 10C(4), a custodian that is required to withhold RWT may, before the date on which the payment is received by the institution, enter into an agreement with another person for that person to undertake the withholding obligation. The term "another person" is deliberately wide. This allows the custodian to outsource their withholding obligation to another entity that may not meet the stringent "custodial institution" definition (and hence be subject to the same level of regulatory oversight). In this circumstance, the legal liability for failure to withhold remains with the custodial institution.

Section RE 10C(5) allows a custodian that is paying to an "end investor" to enter into an agreement with another custodial institution for that custodial institution to take on the withholding obligation. In this circumstance, the withholding obligation passes to that institution which agrees to undertake the obligation and the obligation on the first custodian is discharged. The transfer of liability reflects the fact that "custodial institutions" may step into each other's shoes for the purposes of meeting the withholding obligation.

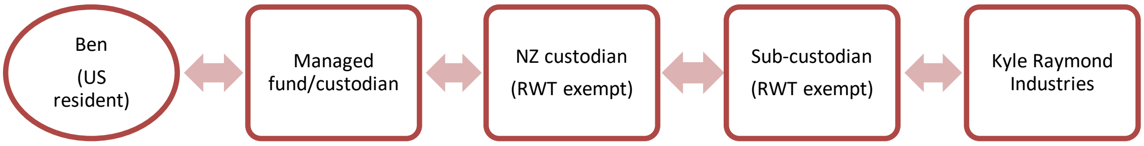
### Withholding obligations of custodial institutions in respect of non-resident passive income

Section RF 4 places withholding obligations on "agents and others" that receive a payment of non-resident passive income on behalf of another person, if some or all the amount of tax has not been withheld. This section has now been amended to include custodial institutions.

**Example 43**

Ben, a US tax resident, is looking to invest some money into New Zealand equities. Ben invests $50,000 via a managed fund which invests into a diversified portfolio of New Zealand equities.

The fund invests Ben's money via a New Zealand custodian (NZ custodian). A portion of Ben's $50,000 is invested into Kyle Raymond Industries (KRI), a company on the New Zealand stock exchange.




When KRI pays a dividend, the gross income will pass in turn to the sub-custodian and NZ custodian, following their RWT exempt status.

When New Zealand custodian pays the income to the managed fund, the nature of the income changes from resident to non-resident passive income: it is clear that the income has a New Zealand source and has been derived by a non-resident. At this point, as tax has not been withheld, the New Zealand custodian must deduct NRWT and pay the withheld tax to Inland Revenue.

### Agreement to transfer withholding obligations: outsourcing or passing the withholding obligation

In line with the provisions for transferring an RWT obligation, section RF 4 has also been amended to allow a custodial institution that has an obligation to withhold NRWT to outsource or pass on that obligation. Where the obligation is outsourced, liability for any default remains with the institution. Where the obligation is passed by agreement to another custodian, the first institution discharges its liability for withholding.

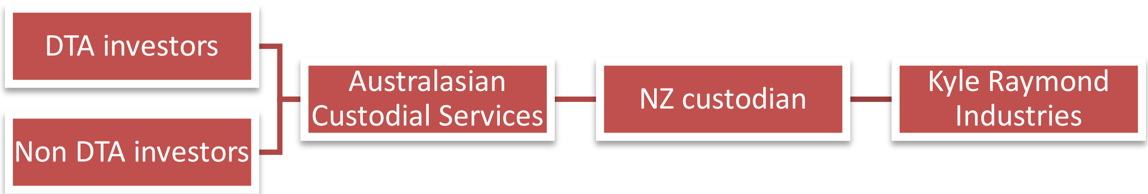
### Aggregate level withholding and reporting

Many global custodians will invest on behalf of a large number of investors. A new provision has been added to allow a custodian that is undertaking withholding to supply aggregated information when an end investor is a non-resident custodial institution.

Section 25MB(6)(a) allows for the specific information required in schedule 6 in respect of various types of income to be provided in aggregate form where the end investor is a non-resident custodial institution. The example below demonstrates aggregate reporting and tax withholding.

**Example 44**

Australasian Custodial Services (ACS) is a foreign custodian that operates out of Australia and specialises in investing in Australasian companies for its clients. Fifty investors comprised of individuals from the United Kingdom, China and Italy (countries that have a double taxation treaty with New Zealand) have all invested via ACS into KRI. Another fifty individual investors from Hungary, Pakistan and Greece (countries which do not have a double taxation treaty with New Zealand) have also invested into ACS for the purposes of investing into KRI. ACS has advised New Zealand custodian of the withholding rates for each pool of investors (treaty rates and non-treaty rates).




When KRI pays a dividend, NZ custodian will withhold NRWT on the proportion of income payable to each pool of investors in accordance with the rates advised by ACS.

## Reporting obligations of custodial institutions

Under the Investment Act, the original payer of investment income could not pass the reporting obligation on to a custodian, although in practice, the custodial institution, not the original payer, has access to the individual investor's details. In line with the rules for withholding tax, the reporting rules have been clarified.

### Section 25B

New subsection 25B(4) clarifies that a custodial institution that pays on or transfers an amount of investment income to an end investor is treated as a payer.

### Section 25E

Section 25E sets out who must provide investment income information to the Commissioner. A custodial institution that pays on or transfers an amount of investment income to an end investor is required to report investment income information.

By their nature, custodial institutions can be both a payer (in that they pay on or transfer income) and a payee. New section 25E(3) recognises this dual role. This means that a payer is required to report in respect of the investment income they have paid to the custodian. It is noted that this reporting will be much more limited in nature. Ultimately the custodial institution who is paying the end investor will be reporting in respect of the beneficial owners of the investment.

**Example 45**

Sarah, a New Zealand tax resident, invests $10,000 via a mutual fund (custodian) into Savoury. When Savoury pays a $500 dividend, it will be required to report investment income information to the Commissioner in respect of the custodian (the payee). When the custodian pays the dividend to Sarah, it will undertake reporting in respect of Sarah as the end investor.


The example above demonstrates that, because a custodial institution has sight of the underlying investors, they are often best suited to undertake reporting. If the payer was required to report in respect of the end investors, it would need to look through the custodian or have the custodian provide them with this information. A transfer of this information poses both confidentiality concerns and an administrative burden.

## Section 25MB

New section 25MB prescribes the way in which reporting on investment income will be undertaken by a custodian that pays an end investor. It is similar to the rules prescribed for the purposes of withholding RWT and NRWT.

### When section 25MB applies

Section 25MB sets out when a custodial institution will have an obligation to report investment income and also makes provision for the custodial institution to transfer that withholding obligation. Section 25MB will apply to a custodial institution that:

- receives a payment of investment income; and
- pays or transfers the amount to an end investor.

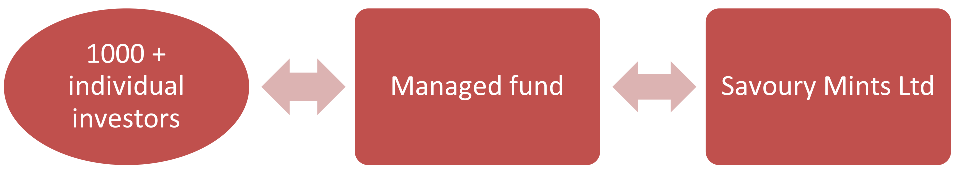
Unlike section RE 10C which sets out when a custodial institution will have a withholding obligation for RWT, there is no requirement in section 25MB for the custodian to be RWT exempt. This is because section 25MB applies to the reporting of investment income information generally (that is, it does not matter whether the custodial institution receives gross or net income).

### Providing investment income information

Under new section 25MB(3), a custodial institution that pays an amount of investment income to an "end investor" (as defined) must provide the information required under section 25E to the Commissioner.

**Example 46**

A large number of individual investors invest their money into a managed fund (custodian), who then invests their money into Savoury Mints. In total, these investors invest $1000,000 into Savoury Mints.




Savoury Mints pays a dividend of $20,000 and will undertake a simple line of reporting in respect of the custodian in accordance with the requirements in table 1 of Schedule 6 of the Tax

Administration Act 1994. For illustrative purposes, an example including some of the fields that Savoury Mints would report is set out below:[40]

| Row | Items |
|---|---|
| 1 | The name of the payer: **Savoury Mints Ltd** |
| 2 | The tax file number of the payer: **123456** |
| 3 | The contact address of the payer: **1 Law Lane, Wellington NZ** |
| 4 | The name of the investor: **Managed fund** |
| 5 | The tax file number of the investor, if held by the payer: **888888** |
| 6 | The contact address of the investor: **4 Potato Terrace, Auckland, NZ** |
| 7 | The date of birth of the investor, if held by the payer: **N/A** |
| 8 | The amount and type of income of the investor for the period: **$20,000 dividend income** |

By contrast, when custodian undertakes its reporting in respect of its investors, it will have multiple lines to report in respect of every individual investor.

**Agreement to transfer reporting obligations: outsourcing or passing the obligations**

As with the obligation to withhold RWT or NRWT, there may be some circumstances where the custodian makes other arrangements for reporting.

As is the case with the withholding rules, where the obligation is outsourced to another person, the custodial institution remains liable in the event of a default. In contrast, where the custodial institution enters into an agreement with another custodial institution, the reporting obligation passes to that institution and the obligation on the custodian that is paying to the end investor to report is discharged.

**Limited information**

New section 25MB(6)(b) provides a reporting relaxation for custodial institutions in respect of lines 9 (in so far as it relates to approved issuer levy (AIL)), 17 and 20 of schedule 6 of the Tax

[40] There are more reporting fields than this as required by schedule 6 but these have not been included here as this is for illustrative purposes only.

Administration Act 1994. Custodial institutions are only required to provide this information to the extent that it is held by the institution. Lines 9, 17 and 20 are as follows:

| Row | Items |
|---|---|
| 9 | The tax withheld on behalf of, or approved issuer levy paid in relation to, the investor for the period |
| 17 | The number of shares for which the dividend is declared, or in the case of a dividend that is a bonus issue, the number of shares included in the bonus issue |
| 20 | If the dividend is paid in Australian currency by an Australian ICA company, the exchange rate between the NZ dollar and the Australian dollar that was used to calculate the imputation ratio |

The purpose of these relaxations is to strike a balance between the information required by the Commissioner vis-à-vis the information that is available to custodians and costs that custodians may incur in obtaining this information.

## Remedial amendment

A remedial amendment has been made to allow reporting and withholding using the foreign exchange rate on the transaction date. This amendment applies to both custodial institutions and other payers of investment income.

### Allowing reporting and withholding using the foreign exchange rate on the transaction date

Section RE 4(7) provides the rules for converting an amount of foreign currency withheld for RWT to be paid to the Commissioner. An additional option has been added to the sub-section to allow RWT to be converted to New Zealand currency at the exchange rate on the date on which the payment of income is received by the investor. This amendment is intended to provide greater flexibility to the payers of investment income. It is expected that in most cases, using an exchange rate for the date on which the payment of the income is received will allow for the amount of investment income received by the investor and the amount of tax received by Inland Revenue to be more closely aligned.

### Example 47

Tūké Ares is a New Zealand tax resident whose marginal rate of tax is 33%. Tūké invests $1,000 via Squash Investments Ltd (Squash), a custodian operating out of New Zealand, into Oceanic Cotton Co (an ASX-listed company that is subject to the FIF exemption). Under the double tax agreement (DTA) that New Zealand has Australia, 15% withholding tax can be deducted from dividends paid.

On 7 July Oceanic Cotton Co pays a dividend of $850 (net of foreign tax) in Australian dollars to Squash to be held on Tūké's account. Squash then deducts another $180 for New Zealand tax due. As a result, Tūké has suffered 33% tax. Squash then uses the FX rate as at 7 July to advise Tūké of the net dividend he has received and pay him accordingly. The $670 net dividend in AUD works out to be $703.50 in NZD ($1 AUD is $1.05 NZD).

Reporting using the exchange rate on the first working day of the month after the month in the day RWT was withheld

Prior to this amendment, Squash was required to use the exchange rate on 1 August, when $1 AUD is $1.10 NZD. Using this method, the gross dividend reported to Inland Revenue is $1,100 and the net dividend is $737. These amounts are recorded in Tūké's prepopulated account for the tax year. This means that, although Tūké has received a net dividend of $703.50 from his investment, he is liable for $737 for tax purposes.

Reporting using the exchange rate on the date on which the income is received

Using this method, when Squash used the FX rate on 7 July to advise Tūké of his dividend and make payment to him, the corresponding amount would also be reported to Inland Revenue and reflected in Tūké's pre-populated account accordingly.

# Information sharing provision between Inland Revenue and the Serious Fraud Office to be replaced by sharing of information under an approved information sharing agreement

*Schedule 7, Part A, clause 7 of the Tax Administration Act 1994*

The legislative provision enabling Inland Revenue to share information with the Serious Fraud Office to assist the investigation of serious fraud, is repealed with effect from a date to be determined by Order in Council.

The information sharing for serious fraud will now be allowed under the Serious Crime Approved Information Sharing Agreement (AISA) under Part 9A of the Privacy Act 1993.

Repealing the current legislative provisions ensures that there is no overlap between legislation and regulations.

## Background

Currently, there is a legislative provision under the Tax Administration Act 1994 (Schedule 7, Part A, clause 7) enabling the sharing of information between Inland Revenue and the Serious Fraud Office. The provision only enables sharing and use of the information for investigation or prosecution in relation to any suspected Inland Revenue offence.

The Serious Crime AISA between Inland Revenue and the New Zealand Police has been extended to include information sharing with the Serious Fraud Office and the New Zealand Customs Service. Under the AISA, the Serious Fraud Office will be able to request information from Inland Revenue and Inland Revenue will be able to proactively share information in relation to any suspected offences that fit the definition of serious crime, not limited to Inland Revenue offences.

The current legislation governing the information sharing between Inland Revenue and the Serious Fraud Office will need to be repealed with effect from the same date the AISA applies from, to avoid any overlap and conflict between legislation and regulation.

## Key features

Clause 7 of Part A of Schedule 7 of the Tax Administration Act is repealed.

## Application date

This legislative provision is repealed with effect from a future date to be determined by Order in Council. This date will align with the date the AISA comes into force.

# Meaning of charitable or other public benefit gift

*Section LD 3 of the Income Tax Act 2007*

The Income Tax Act 2007 has been amended to confirm that gifts made by way of debt forgiveness are not eligible for donation tax credits or gift deductions.

## Background

On 17 December 2019 the Court of Appeal found in Commissioner of Inland Revenue v Roberts that donation tax credits and gift deductions were available for gifts made by way of debt forgiveness. This was contrary to the long-standing policy that donation tax credits and gift deductions were only available for gifts paid in cash or by payment methods such as credit cards, electronic bank transfer, or cheque.

## Key features

New section LD 3(1)(c)(ii) confirms that a gift made by forgiving some or all of a debt does not meet the definition of a "charitable or other public benefit gift". As such, debt forgiveness does not qualify for either donation tax credits or gift deductions. Instead donation tax credits and gift deductions are only available for gifts paid in cash or by payment methods such as credit cards, electronic bank transfer, or cheque.

### Savings provision

The amendment to the definition of charitable or other public benefit gift applies from the 2008–09 income year onwards. However, a savings provision applies to preserve positions taken no later than 16 December 2019. Therefore, a person is entitled to rely on the previous law if they filed a return or applied for a donation tax credit on or before 16 December 2019.

## Application date

The section applies for the 2008–09 and later income years. A savings provision applies to positions taken on or before 16 December 2019.

# Income attribution rule and foreign tax credits

*Sections GB 29 and LJ 2 of the Income Tax Act 2007*

The amendments to sections GB 29 and LJ 2 ensure that under the income attribution rules, if an associated entity of a working person pays tax overseas, a foreign tax credit (FTC) is available to the working person for the foreign tax paid.

## Background

The income attribution rules apply when an individual ("the working person") earns income from providing their own services to a buyer ("personal services income") through an interposed entity ("the associated entity")[41] that has one main source of such income. These rules disregard the entity and tax the working person directly, at the end of the income year, to prevent tax on income from the individual's personal services being paid at the lower company rate (currently 28%) instead of at the working person's higher marginal rate of tax (currently 33%).

Under the income attribution rules:

- an amount attributed from the associated entity to the working person is income of the working person under section CE 8; and
- the associated entity is allowed a deduction for the amount attributed to the working person under section DC 8 so that the personal services income derived by the entity is not subject to double taxation.

Under the policy framework for the availability of FTCs, if the associated entity pays tax overseas, either the entity or the working person should be entitled to an FTC for the foreign tax paid. However, due to the mechanics of the income attribution rules prior to these amendments, this was not possible. This is because an FTC is calculated in relation to a segment of net income of the person who paid the foreign tax. Because the associated entity

[41] 'Working person', 'associated entity' and 'personal services' income are technical terms used in the legislative provisions for the income attribution rules. They are replicated in this TIB for precision.

is required to attribute all its personal services income to the working person at the end of each year, the entity never had net income on which it could claim an FTC, even though it paid tax on the income.

## Key features

The following amendments to sections GB 29 and LJ 2 operate together to allow an FTC to the working person for the tax paid by the entity:

- New section GB 29(1B) clarifies that for the purposes of calculating the associated entity's net income for the corresponding tax year in the application of section GB 29(1), section DC 8 is ignored; and
- New section LJ 2(8), (9) and (10) allows the working person an FTC for foreign income tax paid by the associated entity on an amount of attributed income.

The amendments to section LJ 2 acknowledge that because the working person normally has control over the associated entity, they economically earn the income on which the foreign tax is paid, and so should enjoy the benefit of the FTC.

## Application date

The amended sections GB 29 and LJ 2 apply for the 2008–09 and later income years.

# Income attribution rule and treatment of dividends

*Section GB 27 of the Income Tax Act 2007*

The amendment to section GB 27 ensures that under the income attribution rules, a dividend paid by a company that has been required to attribute income to an individual shareholder will be exempt. However, the exempt treatment applies only to the extent the dividend cannot be imputed and the company can show that the dividend has been paid out of income that has already been attributed to and taxed in the hands of the shareholder.

## Background

The income attribution rules apply when an individual ("the working person") earns income from providing their own services to a buyer ("personal services income") through an interposed entity ("the associated entity")[42] that has one main source of such income. The rules disregard the entity and tax the working person directly, at the end of the income year, to prevent tax on income from the individual's personal services being paid at the lower company rate (currently 28%) instead of at the working person's higher marginal rate of tax (currently 33%).

The income attribution rules distinguish between two types of dividend paid by an associated entity to the working person:

- a dividend paid during the income year in which the income was derived and is to be attributed, or before the end of six months after the end of that income year ("in-year dividend"); and
- a dividend paid later than six months from the end of the income year in which the income was derived and attributed ("post-year dividend").

[42] "Working person", "associated entity", and "personal services" income are technical terms used in the legislative provisions for the income attribution rules. They are replicated in this TIB for precision.

The distinction between the two types of dividend is intended to ensure that the working person is not subject to double taxation. This is achieved by:

- excluding an in-year dividend from the associated entity's calculation of the amount of income to attribute to the working person; and
- treating as exempt income the amount of a dividend sourced from personal services income previously attributed to the working person (and taxed under the income attribution rules), but only to the extent the dividend is not fully imputed.

However, the previous wording of section GB 27(4), which treats post-year dividends as exempt from tax, was not sufficiently clear that its application is limited to dividends paid out of income that has already been attributed.

## Key features

Amended section GB 27(4) limits the exemption to post-year dividends.

A requirement is included for the company to keep sufficient records to enable the Commissioner to verify the source of the dividend.

## Application dates

The amended section GB 27 applies for the 2008–09 and later income years. However, there is a savings provision for tax positions taken between 1 April 2008 and the date on which the Taxation (KiwiSaver, Student Loans, and Remedial Matters) Bill was introduced (27 June 2019) that relied on the previous law. The savings provision ensures those existing tax positions are not disturbed.

# Taxation (Use of Money Interest Rates Setting Process) Amendment Regulations 2020

*Taxation (Use of Money Interest Rates Setting Process) Regulation 1997*

An Order in Council has been made to ensure that the Commissioner's use of money interest paying rate cannot be set at a negative rate.

The Taxation (Use of Money Interest Rates Setting Process) Regulation 1997 outlines the methodology to be used when setting the use of money interest rates. This has been amended to specify that when setting the Commissioner's paying rate, that it must be set at the higher of:

- the 90-day bank bill rate minus 100 basis points; or
- 0%.

In effect, this prevents it being set at a negative rate.

## Background

The use of money interest (UOMI) rates are a cornerstone of the tax compliance system in New Zealand. UOMI interest is paid by the taxpayer where tax has been underpaid and by the Commissioner where tax has been overpaid. The rate of UOMI payable for overpaid tax is referred to as the Commissioner's paying rate. The legislated twin objectives of the UOMI provisions are to:

- fairly compensate the party (either the Crown or the taxpayer) that does not have the use of its money; and
- encourage taxpayers to pay the right amount of tax at the right time.

The method used for setting the overpayment rate is outlined in the Taxation (Use of Money Interest Rates Setting Process) Regulation 1997. This method uses the Reserve Bank of New Zealand (RBNZ) 90-day bank bill rate minus 100 basis points (1%).

When the UOMI rates were last set, at the start of July this year, the UOMI for the Commissioner's paying rate was reduced to 0.81%, as the 90-day bank bill rate was 1.81%. However, since then, the RBNZ has decreased the Official Cash Rate (OCR) further to 1.00. This has caused the 90-day bank bill rate to drop to 1.27% for the month of January 2019.

## Key features

The measure prevents the Commissioner's use of money interest paying rate being set at a negative rate.

## Application date

The Order in Council came into force on 9 April 2020.

# Tax Administration (Direct Credit of Refunds of Excess Financial Support and Student Loan Payments) Order 2020

*Sections 184A and 184B of the Tax Administration Act 1994*

An Order in Council has been made to include refunds for excess payments of financial support and student loan deductions as tax types refundable by direct credit under section 184A of the Tax Administration Act 1994.

The provisions in sections 184A and 184B require tax refunds to be paid via direct credit to a bank account nominated by the taxpayer and were introduced to benefit taxpayers by eliminating time delays associated with the postal system and costs related to cheques.

Tax Administration (Direct Credit of Refunds of Excess Financial Support and Student Loan Payments) Order 2020 mandates the direct credit of refunds for excess payments of financial support and student loan deductions. Financial support means child support and domestic maintenance as defined in the Child Support Act 1991. Student loan deductions are salary or wage deductions as defined in section 4(1) of the Student Loan Scheme Act 2011. Section 184A still allows the Commissioner to provide an exemption when direct crediting would cause undue hardship or is impracticable.

## Background

Compulsory direct crediting for income tax and gaming machine duty was implemented when their administration was moved to Inland Revenue's new technology platform (START), which modernises and improves information flows, and enables more online self-service and automated processes. The administration of financial support and student loan deductions are to be moved to START in the next phase of Inland Revenue's business transformation project, planned for April 2020.

Whilst the intent was that the Commissioner of Inland Revenue would eventually be required to direct credit all refunds of excess tax paid, the progressive implementation for various tax types through Orders in Council was legislated for to allow Inland Revenue the necessary flexibility to choose the optimal dates to implement direct crediting of refunds for each tax type.

## Application date

The Order in Council came into force on 9 April 2020.

# Kāinga Ora–Homes and Communities consequentials

*Schedule 2 of the Income Tax Act 2007*

Various references in the Income Tax Act 2007 have been updated to reflect the establishment of Kāinga Ora–Homes and Communities.

## Background

The Kāinga Ora–Homes and Communities Act 2019 was enacted in September 2019. It established, from 1 October 2019, the Crown entity, Kāinga Ora–Homes and Communities. This new entity took over many of the functions of the former Housing New Zealand Corporation, plus several additional functions. As a result of this development, a range of references in the Income Tax Act to Housing New Zealand Corporation have been updated to now instead refer to Kāinga Ora–Homes and Communities.

## Application date

The amendment applies from 1 October 2019.

# Maintenance amendments

## Summary of amendments

The amendments reflect minor technical maintenance items arising from both the rewrite of income tax legislation and subsequent changes.

## Application dates

Commencement dates for each proposed amendment are stated in table 7.

## Minor maintenance items

The amendments relate to minor maintenance items to correct any of the following:

- ambiguities;
- compilation issues;
- cross-references;
- drafting consistency, including readers' aids – for example, the defined terms lists;
- grammar;
- consequential amendments arising from substantive rewrite amendments; or
- the consistent use of terminology and definitions.

**Table 7 Maintenance amendments – schedule of clause numbers and changes to text**

| **Enactment** | **Section** | **Amendment** | **Commencement date** |
|---|---|---|---|
| KiwiSaver Act 2006 | 51(1B) | Correction of cross-reference | 1 December 2014 |
| Income Tax Act 2007 | CW 38 | Correction to subsection headings | 1 April 2008 |

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| | CW 38B | Correction to subsection headings | 18 March 2019 |
| | CW 39 | Correction to subsection headings | 1 April 2008 |
| | EE 47 | Correction to subsection headings | 28 June 2018 |
| | FE 5 | Improving drafting consistency | 1 July 2011 |
| | GC 10 | Improving drafting consistency | 1 April 2008 |
| | HM 3 | Improving drafting consistency | 29 March 2018 |
| | IQ 4 | Improving drafting consistency | 1 April 2008 |
| | LD 6 | Correction to defined terms list | 6 January 2010 |
| | RD 5 | Improving drafting consistency | 1 April 2019 |
| | RZ 16 | Correction of cross-reference | 1 April 2008 |
| | YA 1 "deductible output tax" | Correcting grammar | 1 April 2011 |
| | YA 1 "employee" | Correcting grammar | 29 March 2018 |
| | YA 1 "premium" | Correcting grammar | 1 July 2010 |
| | YA 1 "RWT proxy" | Correction of cross-reference | 23 March 2020 |
| | YA 1 "services" | Correction of cross-reference | (a) 1 July 2018<br>(b) 1 April 2019 |

| | | | |
|---|---|---|---|
| Tax Administration Act 1994 | 22(2)(ke) | Correction of cross-reference | 1 April 2019 |
| | 36BB | Correction of cross-reference | 1 April 2019 |
| | 78D | Improving drafting consistency | 1 April 2019 |
| | Schedule 8 | Correcting grammar | 1 April 2019 |
| Taxation (Annual Rates for 2018-19 Modernising Tax Administration and Remedial Matters) Act 2019 | 34 | Repeal redundant provision | 23 March 2020 |
| | 375 | Omit redundant cross-reference | 1 October 2019 |
| Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018 | 332 | Repeal redundant provision | 23 March 2020 |
| Income Tax (Adverse Event Income Equalisation Scheme Rate of Interest) Regulations 1995 | Revocation | Revoke redundant regulation | 18 March 2019, applies from beginning of income years after 18 March 2019 |

# References

## Legislative References

*Taxation (KiwiSaver, Student Loans, and Remedial Matters) Act 2020*

# About this document

An explanation of changes to legislation