

APPENDIX D TO TIB NO.3, SEPTEMBER 1989

EXPLANATION OF INCOME TAX AMENDMENT ACT 1989: SUPERANNUATION

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1.0 BACKGROUND

Reforms to the taxation regime in relation to private superannuation began with the removal of the remaining personal concession for superannuation and life insurance with effect from 17 December 1987. At the same time employer contributions to superannuation schemes were made subject to fringe benefit tax. On the completion of the consultation process the Taxation Reform Bill (No.5) 1988 was introduced. This Bill became the Income Tax Amendment Act 1989 which was assented to on 22 March 1989. This put into place the taxed/taxed/exempt regime for superannuation which means that:

- contributions to schemes come out of tax paid income;
- earnings of schemes are taxed when derived;
- all benefits paid (from 1 April 1990) will be tax free.

Alongside the review of the taxation treatment of private superannuation there was also a review of the regulatory regime. This resulted in the Superannuation Schemes Act 1989 (previously the Superannuation Schemes Bill 1988) which is administered by the Government Actuary's Office. This Act provides for the reduction of scheme benefits in the light of the tax changes and provides a new regulatory regime. The regime will involve approved category 1 and 2 schemes becoming registered schemes.

2.0 CONTRIBUTIONS TO SUPERANNUATION SCHEMES

The legislation ensures that contributions made by individuals, employees or employers are in effect made out of tax paid income

2.1 Employee and Individual Superannuation Contributions

Contributions made by employees or by individuals to personal schemes continue to be non-deductible.

2.2 Employer Superannuation Contributions

The legislation ensures that employer superannuation contributions will in effect come from tax paid income.

2.2.1 Deductibility

The amendments to the Act do nothing to change the existing scheme of the Act in respect of superannuation contribution deductibility. The section 104 tests must first be met, followed by the general denial of deductibility under section 106(1)(m), with section 150 finally governing deductibility.

Section 106(1)(m) of the Act has been amended together with a new section 106(ma) (section 8 of the Amendment Act) to make it clear that accrued liabilities cannot be deducted until payment is made. (But see para 2.2.7).

Section 150 of the Act has been amended (section 10 of the Amendment Act) with the basic aim of removing the previous restriction on the amount which is deductible (from 1 April 1989).

The scheme of the amended section 150 of the Act is as follows:

- (i) Subsection (2A) - allows a deduction for "employer superannuation contributions" made on or after 1 April 1989;
- (ii) "Employer superannuation contribution" is defined in section 2 of the Act (by section 2 of the Amendment Act). It covers any "superannuation contribution" provided by an employer for the benefit of their employees;
- (iii) "Superannuation contribution" is defined in section 2 of the Act (by section 2 of the Amendment Act). This covers contributions of money or other property for the benefit of a "superannuation scheme".
- (iv) "Superannuation scheme" is defined in section 2 of the Act (by section 2 of the Amendment Act). The definition covers the following entities and arrangements where retirement benefits are provided to natural persons:
 - A trust or unit trust (as defined in section 211 of the Act);
 - Any company not resident in New Zealand;
 - Any New Zealand or foreign statutory arrangement (e.g., the Government Superannuation fund).

Subsection (2B) of section 150 then goes on to deny a deduction for superannuation schemes where those schemes are neither "superannuation funds" nor "companies". "Superannuation funds" as defined in section 2 of the Act means superannuation category 1 and 2 schemes and schemes registered under the Superannuation Schemes Act 1989. The amendment which includes registered schemes in the definition of "superannuation fund" is contained in the 3rd schedule to the Superannuation Schemes Act 1989. Section 2(5) of the Amendment Act however excludes overseas schemes approved under regulations 29 or 30 of the Superannuation Schemes Regulations 1983 from the definition of "superannuation fund" from the beginning of the 1988/89 income year.

"Companies" includes entities which come under the definition of company contained in section 2 of the Act. It also includes schemes or arrangements which are deemed to be unit trusts and therefore deemed to be companies under section 211 of the Act. This unit trust definition covers any scheme or arrangement which has the effect of providing facilities for partici-

pation as beneficiaries under a trust by contributors in income or gains subject to that trust (excluding “superannuation funds”). This means that employer superannuation schemes to which employees contribute (not being “superannuation funds”) will be treated as companies for income tax purposes. This will be the situation both for New Zealand and overseas contributory schemes. Employer superannuation schemes which are not superannuation funds and which do not have employee contributors will not meet the definition of unit trust and unless they are otherwise a company, the employer will be unable to claim a deduction for contributions made. This continues the treatment given to non-approved New Zealand schemes and meshes with the new international tax regime introduced by the Income Tax Amendment Act (No.5) of 1988.

2.2.2 Taxing of Contributions

Monetary contributions made on or after 1 April 1989 to approved New Zealand schemes will be subject to the specified superannuation contribution withholding tax. Non-monetary contributions and all contributions to non-approved schemes will continue to be subject to fringe benefit tax. Paragraph 2.2.9 refers to certain exemptions from fringe benefit tax for approved schemes.

Section 2 of the Amendment Act amends definitions contained in section 2 of the Act to make it clear that employer superannuation contributions are not:

- (a) Expenditure on account of an employee (Section 2(2) of the Amendment Act);
- (b) Monetary remuneration (Section 2(3) of the Amendment Act); and
- (c) Salary or wages (Section 2(4) of the Amendment Act).

2.2.3 Employer Contributions to Approved New Zealand Schemes

All contributions made by employers to approved NZ superannuation schemes (superannuation funds) on or after 1 April 1989 will be deductible (except for the situation outlined in para 2.2.8).

Employer superannuation contributions made in monetary form on or after 1 April 1989 to approved New Zealand schemes (“superannuation funds”) are subject to the specified superannuation contribution withholding tax (SSCWT). This tax is provided for in section 20 of the Amendment Act which inserts new sections 336Z to 336ZK into the Principal Act. New subsection (gb) of section 336N(1) of the Act (inserted by section 19 of the Amendment Act) exempts contributions from fringe benefit tax where SSCWT applies.

2.2.3.1 Specified Superannuation Contribution Withholding Tax (SSCWT) (a final tax)

Section 336ZA(1) imposes SSCWT on any “specified superannuation contributions” made to a “superannuation fund” on or after 1 April 1989. Section 2 of the Act provides that a specified superannuation contribution is a contribution in money (as opposed to a contribution in kind).

Section 336ZA(2) provides that the amount of the specified superannuation contribution is the aggregate of:

- (a) The amount of the specified superannuation contribution received by the superannuation fund; and
- (b) The amount of the SSCWT payable in respect of the contribution.

This means that the SSCWT is calculated on the gross contribution (including the tax).

Example:

An employer makes a contribution to a superannuation fund of \$100.

The superannuation fund receives \$67 specified superannuation contribution.

$$\text{SSCWT} = \frac{a}{1 - a} \times b$$

Where a = the rate of SSCWT
b = the contribution received by the superannuation fund

$$\text{SSCWT} = \frac{0.33}{1 - 0.33} \times \$67 = \$33$$

The gross contribution is therefore:

\$67 (the amount received by the superannuation fund) plus \$33 (the SSCWT) = \$100.

It is proposed that, for the purpose of determining whether an employer has met his superannuation obligations in terms of a trust deed, the gross contribution will be taken into account. Thus, for this purpose, SSCWT will be deemed to be received by the fund.

Section 336ZB requires employers to deduct SSCWT from specified superannuation contributions when they are made.

Section 336ZC requires employers to pay SSCWT to the Inland Revenue Department by the 20th day of the month following the month in which the tax was deducted.

Section 336ZD requires employers to furnish a statement of deductions made by the 20th day of the month following the month in which the deduction is made.

Section 336ZE provides that specified superannuation contributions are not income of the superannuation fund. These contributions would already have been subject to SSCWT.

Section 336ZF deals with the situation where an employer fails to make a deduction of SSCWT. It provides that the amount in default constitutes a debt payable by the employer to the Commissioner and deems it to have become due and payable on the 20th day of the month after the month in which the specified superannuation contribution was made.

Section 336ZG allows the Commissioner to make assessments of SSCWT. The section also allows for objections by employers to such assessments.

Section 336ZH provides for the imposition of additional tax where an employer fails to deduct or pay SSCWT (Unless the Commissioner is satisfied that the employer has not been guilty of wilful neglect or default). The additional tax is applied at the rate of 10 percent of the amount of default. Further additional tax is applied to the amount of default and additional tax accrues every 6 months until payment is made.

Section 336ZI imposes penal tax of up to 300 percent of the amount of the SSCWT where an employer fails to pay the Commissioner.

Section 336ZJ includes offence provisions for failure to deduct or pay SSCWT. This allows for fines of up to \$15,000 for first offences and up to \$25,000 for subsequent offences.

Section 336ZK applies a number of provisions contained in Part XI of the Act (Tax Deductions) to SSCWT. These include provisions relating to the recovery of SSCWT from employers.

2.2.3.2 Miscellaneous Provisions

New section 140AB of the Act (inserted by section 43 of the Amendment Act) provides that SSCWT is deductible in the income year in which the specified superannuation contribution was made. New section 106(1)(fb) provides that additional tax charged under section 336ZH of the Act is non-deductible.

Section 22 of the Amendment Act includes SSCWT in section 394A to ensure that it is not an income tax for company imputation purposes.

Section 23 of the Amendment Act amends section 396 of the Act which provides legislative authority for Public Authorities to pay "Income Tax" by adding the words - "or any other tax or amount under this Act". This makes it clear that SSCWT is covered by section 396.

Section 24 of the Amendment Act amends section 400 of the Act to ensure that SSCWT can be collected under that section in cases of default.

Section 25 of the Amendment Act provides for the publication of the name of employers charged with penal tax in respect of SSCWT.

Section 26 of the Amendment Act which amends section 428 of the Act, provides for the keeping of business records in relation to SSCWT. It provides that employers must keep a record of:

- (i) The amount of every specified superannuation contribution made.
- (ii) Details of the recipient.
- (iii) The date the contribution is made.

2.2.4 Employer Contributions to Non-Approved NZ Schemes

Contributions to these schemes have in the past been non-deductible and subject to fringe benefit tax (being superannuation category 3 schemes).

From 1 April 1989 employer superannuation contributions to non-approved NZ schemes will be deductible where the scheme is deemed a company. This will be where a scheme is one contributed to by employees which meets the definition of "unit trust" contained in section 211 of the Act. Fully employer funded schemes will not be deemed to be companies and employer contributions to such schemes will not be deductible.

2.2.5 Employer Contributions to Non-Approved Overseas Schemes

The treatment of employer superannuation contributions to non-approved overseas schemes is the same as that for non-approved NZ schemes except that companies as well as unit trusts (deemed companies) are covered by the definition of "superannuation scheme".

2.2.6 Employer Contributions to Approved Overseas Schemes

This paragraph covers superannuation schemes which have been approved by the Government

Actuary under regulations 29 or 30 of the Superannuation Schemes Regulations 1983. Employer superannuation contributions to such schemes are to be given the same treatment as non-approved overseas schemes except for a transitional provision. This is contained in the new subsection (2C) of section 150 (inserted by section 10 of the Amendment Act). This transitional provision ensures that employer superannuation contributions to such approved overseas schemes (which were approved at 31 March 1988) continue to be deductible up until 1 April 1990.

2.2.7 63 Day Deductibility Rule

New subsection (2E) of section 150 (inserted by section 10 of the Amendment Act) provides a special timing rule for deductibility of employer superannuation contributions made on or after 1 April 1989.

Where an employer superannuation contribution is made not more than 63 days after the end of the income year in respect of which

- (a) The contribution was required by the scheme; or
- (b) The amount of the contribution was calculated having regard to the amounts of the earnings paid by the employer to any employee who was a member of the scheme during that income year,

The employer can elect (up to the time the return is filed) to deduct the contribution in the earlier year.

2.2.8 12 Month Deduction Clawback Rule

New subsection (2D) of section 150 (inserted by section 10 of the Amendment Act) disallows the deduction of contributions made during the 12 month period immediately preceding the date of the receipt by that employer of a benefit from the scheme. The amount disallowed equals the amount of benefit in money or money's worth received by the employer.

New subsection (2E) of section 150 (inserted by section 10 of the Amendment Act) ensures that a deduction is not denied where the benefit received by the employer is a bona fide pension, annuity or lump sum payment received by the employer in that employer's personal capacity.

2.2.9 Fringe Benefit Tax Exemptions

Section 19 of the Amendment Act provides for 3 exemptions from fringe benefit tax. These are paragraphs (ga), (gb) and (gc) of section 336N(1) of the Act.

- (i) Paragraph (ga) provides an exemption from fringe benefit tax in respect of low interest loans provided by a "superannuation fund".

Such benefits are to be treated as assessable income of the "superannuation fund" instead of requiring the employer to pay fringe benefit tax.

- (ii) Paragraph (gb) provides an exemption from fringe benefit tax on specified superannuation contributions (for which SSCWT is paid).
- (iii) paragraph (gc) provides an exemption from fringe benefit tax where an employer provides services to a superannuation fund to the extent that the expenditure incurred would have been deductible to the superannuation fund if the expenditure had been incurred by that superannuation fund.

2.3 Contributions In Respect of Major Shareholders

Special rules relating to the treatment of employer superannuation contributions in respect of major shareholders and shareholder employees apply for the period from 1 April 1988 to 31 March 1989 (inclusive).

Section 10(4) of the Amendment Act removes the limitation on deductibility contained in section 150(4) of the Act in respect of major shareholders (from 1 April 1988). This means that the normal provisions contained in section 150 will apply to major shareholders. Because fringe benefit tax does not apply to major shareholders from 1 April 1988 a new section 65A (inserted by section 6 of the Amendment Act) was inserted to tax such contributions for the period from 1 April 1988 to 31 March 1989 (inclusive). This section assesses the contribution to the employee. This income need not be taken into account for provisional tax purposes however.

From 1 April 1989 onwards fringe benefit tax will apply in respect of such contributions and section 65A will cease to have effect.

Subsection 3 of section 65A of the Act (inserted by section 6 of the Amendment Act) ensures that employer superannuation contributions in respect of major shareholders are not exempt from fringe benefit tax where the company is in the course of being wound up during the period from 1 April 1989 to 30 September 1989 (inclusive).

3.0 TAXATION OF SUPERANNUATION SCHEME INCOME

Section 4(2) of the Amendment Act repeals the exemption from income tax for category 1 schemes (contained in section 61(21) of the Act) with respect to income derived on or after 1 April 1988.

Section 4(1) of the Amendment Act amends section 61(2) of the Act to ensure that the exemption for "public authorities" does not apply to the extent to which they are superannuation schemes.

Section 17 of the Amendment Act inserts new section 232D and 232E which make it clear that both the National Provident Fund and the Government Superannuation Fund are subject to tax on their income.

3.1 Taxation of Superannuation Funds (Approved or Registered Schemes)

Superannuation funds (category 1 and 2 schemes and registered schemes) are required to be constituted as trusts. The ordinary trust taxation provisions will therefore apply except where there are specific exceptions. These exceptions are as follows:

- (i) Section 15(2) of the Amendment Act which amends section 228(3) of the Act. This amendment ensures that a superannuation fund is taxed on worldwide income irrespective of the residence of the settlor.
- (ii) Section 15(3) of the Amendment Act which amends section 228(5) of the Act. This amendment prevents scheme contributors (who would be settlors) from being liable for the tax liability of that fund.
- (iii) Section 14(1) of the Amendment Act which amends the definition of "beneficiary income" contained in section 226(1) of the Act. This amendment is needed to ensure that distributions from "superannuation funds" are not taxed as "beneficiary income".
- (iv) Section 15(1) of the Amendment Act which inserts new subsections (2A) and (2B) into section 228 of the Act. Subsection (2A) allows a deduction for expenditure incurred by a superannuation fund to the extent to which it is incurred in respect of developing, marketing, selling promoting and advertising for members to the fund even where that expenditure might otherwise have been non-deductible because it was of a capital nature. Expenditure incurred in acquiring fixed assets will not be deductible under this provision however. Subsection (2B) ensures that trustees of superannuation funds are not taxed on income, gains or benefits arising from the investment of funds in another superannuation fund policy of life insurance issued in New Zealand. This avoids the possibility of having income taxed to both the life insurance company and the trustee of the superannuation fund.
- (v) Section 16 of the Amendment Act which inserts new subsections (6) and (7) into section 231 of the Act. Subsection (6) provides that the disclosure requirements in respect of trusts do not apply to superannuation funds. Subsection (7) provides that prior to 1 April 1990 those disclosure requirements do not apply to approved overseas schemes (under regulations 29 or 30 of the Superannuation Schemes Regulations 1983).

- (vi) Section 17 of the Amendment Act inserts a new section 232 into the Act to provide that the income of a superannuation fund which is a combined category 1 and 2 scheme fund be attributed to the two schemes on a basis satisfactory to the Commissioner. In general this will be the basis used currently.
- (vii) Section 17 of the Amendment Act also inserts a new section 232F into the Act. This section deals with the calculation of depreciation allowances for category 1 schemes for assets first used prior to 1 April 1988. Depreciation is calculated as if depreciation had been claimed since an asset was first used.

Example:

Superannuation scheme with a 31 March 1989 balance date.

Furniture and fittings first used 25 August 1986 and cost \$10,000.

Depreciation calculated at 20% per annum on a diminishing value basis.

Year ended 31 March 1987

Notional depreciation of \$1,000 (Asset used for less than 6 months - 10% depreciation only allowed).

Year ended 31 March 1988

Notional written down value of \$9,000 less notional depreciation of \$1,800 (20%).

Year ended 31 March 1989

Notional written down value of \$7,200. Depreciation of \$1,440 to be claimed for the year ended 31 March 1989.

3.1.1 Taxation of category 1 scheme income

Para 3.1 described modification to the ordinary trust tax treatment of superannuation funds. Section 17 of the Amendment Act inserts a new section 232B into the Act which provides for further modifications. This section provides for the treatment of investment gains and losses (where subject to income tax) and financial arrangements acquired before 1 April 1988 and sold or disposed of on or after 1 April 1988.

Section 30 of the Amendment Act is a transitional section which caters for category 1 schemes which have balance dates (approved by the Commissioner) from 1 April 1988 to 30 March 1989 (inclusive). This section provides for assessable income (except for investment gains and losses and financial arrangements) calculated for the scheme's income year to be apportioned on a daily basis to the period from 1 April 1988 to balance date. Investment gains and

losses and financial arrangement are dealt with under section 232B of the Act.

(It should be noted that a superannuation fund which is a category 1 scheme has not previously been a taxpayer and will therefore have a 31 March balance date unless an alternative balance date has been approved by the Commissioner under section 15 of the Act. Where a superannuation fund has an existing balance date approved in respect of its category 2 scheme it will use that date for its category 1 scheme) .

Calculation of assessable income

- Category 1 schemes with balance dates from 31 March 1989 onwards.

Having calculated income under the ordinary trust treatment (as modified by the provision detailed in para 3.1) the remaining step is to deal with investment gains and losses (which are subject to income tax) and financial arrangement income and expenditure, under section 232B of the Act. The amount to be taken into assessable income is calculated as follows:

- Where an investment (excluding a financial arrangement to which sections 64B to 64L of the Act apply) was made or acquired before 1 April 1988, any profit or loss on sale or disposal in the income year is calculated as the difference between:

- (i) the consideration received or receivable on the sale or other disposition of the investment; and
- (ii) the market value of the investment at 1 April 1988.

- Where the investment is a financial arrangement to which sections 64B to 64L of the Act apply any income derived or expenditure incurred in respect of that financial arrangement is calculated under sections 64B to 64L except that the acquisition price of the financial arrangement is either (at the option of the taxpayer):

- (i) the market value at 1 April 1988; or
- (ii) The adjusted base price, being, in the case of the issuer of a financial arrangement, the acquisition price of that financial arrangement together with all accrued expenditure incurred by the issuer, less consideration paid by the issuer in relation to that financial arrangement before the 1st day of April 1988, and in the case of the holder of a financial arrangement, the acquisition price of that financial arrangement

together with all accrued income derived by the holder, less consideration received by the holder in respect of the financial arrangement before 1 April 1988.

- Category 1 schemes with balance dates from 1 April 1988 to 30 March 1989 (inclusive).

Having calculated income under the ordinary trust treatment (as modified by the provisions detailed in para 3.1) the remaining steps are to:

- (i) Apportion the income (except for investment gains and losses and financial arrangements) calculated for the scheme's income year on a daily basis for the period from 1 April 1988 to balance date.
- (ii) deal with investment gains and losses, and financial arrangements.

Section 30(2) of the Amendment Act provides the following formula for the calculation of assessable income:

$$\frac{a \times b + c}{d}$$

where

a - is the assessable income for the income year calculated under the "new law". (The new law means the Income Tax Act as amended by the Amendment Act) excluding the amount of any profit or losses on the sale or disposal investments.

b - is the number of days from 1 April 1988 to balance date.

c - is the amount of profit or loss on the sale or disposal after 1 April 1988 and in the income year (including any financial arrangement) determined in accordance with the "new law". This means the application of the provisions of section 232B.

d - is the number of days in the income year (in most cases 365 days).

3.1.2 Taxation of category 2 scheme income

Para 3.1 described modifications to the ordinary trust treatment of superannuation funds. The position of category 2 schemes is further modified by the following sections of the Amendment Act.

- (a) Section 12 of the Amendment Act.

This section inserts a new subsection (8) into section 225 of the Act This subsection ensures

that section 225 does not apply to income derived by a category 2 scheme in an income year which commences before and ends after 1 April 1988.

(The transitional provisions in section 30 of the Amendment Act apply for such income years).

(b) Section 13 of the Amendment Act

This section inserts a new section 225A into the Act. Section 225A deals with investments sold or disposed of after 1 April 1988 (excluding financial arrangements to which sections 64B to 64L of the Act apply which were acquired before that date). It caters for the situation where gains and losses on sale or disposal of investments were subject to the specific investment gains regime in section 225 prior to 1 April 1988, but which would not be taxed after 1 April 1988 under the normal law.

Section 225A operates by bringing into assessable income amounts calculated as follows:

In the case of an investment acquired before the last day of the income year commencing on 1 April 1982, the difference between the market value of the investment at 1 April 1988 and the greater of:

- (i) The cost price or acquisition value of the investment; or
- (ii) The market value of that investment on the last day of the income year commencing on 1 April 1982.

In the case of an investment acquired after the end of the income year commencing on 1 April 1982, the difference between:

- (i) The market value of the investment on 1 April 1988; and
- (ii) The cost price or acquisition value of the investment.

(c) Section 17 of the Amendment Act

Where the investment gain or loss (not including a financial arrangement to which sections 64B to 64L of the Act apply) was subject to income tax under the specific section 225 investment gains regime before 1 April 1988 and under the normal law after that date, section 232B (1)(b) applies. In this situation the amount included in assessable income is the difference between the consideration received or receivable on sale or disposal of the investment and:

- (i) Where the investment was made or acquired after the end of the income year commencing on 1 April 1982, the cost price or acquisition value of the investment.
- (ii) Where the investment was made or acquired on or before the last day of the income year commencing on 1 April 1982, the greater of the cost price or acquisition value of the investment on the last day of that income year.

(d) Section 30 of the Amendment Act

This section contains transitional provisions which cater for category 2 schemes with balance dates from 1 April 1988 to 30 March 1989 (inclusive).

Section 30(3) provides the following formula for the calculation of assessable income:

$$a + b + c + \frac{d \times e}{f}$$

where

a - is the assessable income for the income year calculated under the "new law" (The new law means the Income Tax Act as amended by the Amendment Act) excluding the amount of any profit or loss on the sale or disposal during the year of any investment (not being a financial arrangement) .

b - is the amount of any profit or loss on sale or disposal during the income year prior to 1 April 1988 determined in accordance with the "previous law". (The previous law means the Income Tax Act before amendment by the Amendment Act). This means gains and losses as calculated under section 225 of the Act.

c - is the amount of profit or loss on sale or disposal during the income year on or after 1 April 1988 calculated in accordance with the new law. This means gains and losses calculated under section 225A and section 232B of the Act.

d - is the amount of deductible expenditure determined under the "new law" applied for the whole of the income year, less the amount of deductible expenditure for the income year determined as if the "previous law" applied for the whole of the income year.

e - is the number of days in the income year prior to 1 April 1988.

f - is the number of days in the income year of the scheme (in most cases 365 days)

The *d x e* part of the formula effectively removes from deductibility the proportion of expenses calculated under section 228(2A) of the Act which relates to the period prior to 1 April 1988. This was previously included in the calculation of item a of the formula. This allows section 228(2A) to apply from 1 April 1988 and not earlier.

3.2 Taxation of Category 3 Schemes

Section 12 of the Amendment Act inserts a new subsection (8) into section 225 of the Act. This section ensures that section 225 does not apply to income derived by a category 3 scheme after the end of the income year which commences on 1 April 1988. This has the following effects:

- (a) Removes the non-deductibility provision contained in section 225(d)(iii) relating to the developing and marketing of schemes. Such expenditure will be treated under the normal provisions of the Act.
- (b) Removes the specific investment gains regime contained in section 225(2) of the Act.

Section 13 of the Amendment Act inserts a new section 225A which deals with investments (excluding financial arrangements to which sections 64B to 64L of the Act apply) sold or disposed of after the end of the income year commencing on 1 April 1988. It caters for the situation where gains and losses on sale or disposal of investments were subject to the specific investment gains regime in section 225 prior to the end of the income year commencing 1 April 1988, but which would not be subject to income tax after that income year under the normal law.

Section 225A operates by bringing into assessable income amounts calculated as follows:

In the case of an investment acquired before the last day of the income year commencing on 1 April 1982.

- the difference between the market value of the investment at the end of the income year commencing on 1 April 1988 and the greater of:
 - (i) The cost price or acquisition value of the investment; or
 - (ii) The market value of that investment on the last day of the income year commencing on 1 April 1982.

In the case of an investment acquired after the end of the income year commencing on 1 April 1982.

- the difference between:

- (i) The market value of the investment at the end of the income year commencing on 1 April 1988; and
- (ii) The cost price or acquisition value of the investment.

Section 17 of the Amendment Act inserts a new section 232B into the Act which deals with investment gains or losses (not including financial arrangements to which sections 64B to 64L of the Act apply) which were subject to income tax under the specific section 225 investment gains regime under the normal law

In this situation the amount included in assessable income is the difference between the consideration received or receivable on sale or disposal and:

- (i) Where the investment was made or acquired after the end of the income year commencing on 1 April 1982, the cost price or acquisition value of the investment;
- (ii) Where the investment was made or acquired on or before the last day of the income year commencing on 1 April 1982, the greater of the cost price or acquisition value of the investment on the last day of that income year.

- (c) Removes the effect of section 225(4)(e) which stopped sections 226 to 230 of the Act from applying to category 3 schemes.

Sections 226 to 230 dealt with income derived in respect of trusts. This means that category 3 schemes which are not caught by the provisions of section 211 of the Act (Unit Trusts) will be affected by the new trust regime from the end of the 1988/89 income year.

Section 211 of the Act was amended by the Income Tax Amendment Act No 5 of 1988. This amendment (to the definition of "Unit trust") includes contributory superannuation schemes (which are not superannuation funds) within the definition of a "Unit trust".

Summary of Category 3 scheme transition

Income year commencing 1 April 1987

Section 225 applicable
Sections 226 to 230 not applicable
Section 211 not applicable

Income year commencing 1 April 1988

Section 225 applicable
Sections 226 to 230 not applicable
Section 211 applicable (contributory schemes)

Income year commencing 1 April 1989

Section 225 not applicable
Section 225A applicable
Section 225 to 230 applicable (non-contributory schemes)
Section 211 applicable (contributory schemes)

3.2.1 Taxation of Overseas Schemes

The international tax regime applying to trusts, companies and deemed unit trusts will apply to New Zealand residents with interests in overseas superannuation schemes.

3.3 Taxation of Life Insurance Companies

Section 11 of the Amendment Act amends section 204 of the Act to allow for the concessional 25 percent income tax rate to apply to the category 1 and annuity business of life insurance companies. It also allows for the tax deferral outlined in para 3.6 to apply in respect of that business.

The current treatment given under section 204(9) of the Act remains largely intact except for the change to the definition of "Superannuation Policy" (amended by section 11(1) of the Amendment Act). This ensures that superannuation category 1 schemes given approval after 17 December 1987 are taxed under section 204(9) at the rate of 33 cents in the dollar.

Section 11(3) of the Amendment Act inserts 2 new subsections into section 204 of the Act. They are (9A) and (9B) which subject the remaining superannuation category 1 and annuity business of the life company to the 25 cents in the dollar tax rate.

Subsection (9B) covers life companies which have income years with approved balance dates other than 31 March which income year contains 1 April 1988. Subsection (9A) covers all other income years.

The subsection (9A) regime calculates assessable income as follows:

$$(a/b \times c) - (d/e \times f)$$

where

a - is the amount of liabilities in respect of life insurance policies at balance date in respect of:

- superannuation category 1 schemes which are deemed to have been approved on or before 17 December 1987
- annuities

b - is the total amount of liabilities in the life insurance fund at balance date.
(It should be noted that liabilities as it is used in the context of this section means in respect of policies of life insurance, contracts of reinsurance and annuities).

c - is the amount of the profits of the company for the income year, ascertained in accordance with section 204(8)

d - is the amount of liabilities in the life insurance fund in respect of:

- superannuation category 1 scheme which are deemed to have been approved on or before 17 December 1987.
- annuities

at the end of the company's last income year that ended before 1 April 1988.

e - is the total amount of liabilities in the life insurance fund at the end of the company's last income year that ended before 1 April 1988.

f - is the amount in respect of investments sold or disposed of in the income year which were acquired before 1 April 1988, calculated as follows:

- In respect of investments made or acquired before the last day of the income year commencing on 1 April 1982:

by subtracting from the market value of this investment on 1 April 1988, the greater of

- (i) the cost price or acquisition value of the investment; and
- (ii) the market value of that investment on the last day of the income year commencing on 1 April 1982.

- In respect of investments made or acquired after the end of the income year commencing on 1 April 1982:

- (i) All investments except for financial arrangements to which section 64B to 64L of the Income Tax Act 1976 apply;

by subtracting the cost price or acquisition value of the investment from the market value on 1 April 1988.

- (ii) financial arrangements to which sections 64B to 64L of the Income Tax Act 1976 apply;

by calculating the difference between the value of the financial arrangement at 1 April 1988 as if it had matured at that date; and the acquisition value and income deemed to have been derived in previous income years.

The subsection (9B) regime calculates assessable income as follows:

$$[a/b \times \frac{(g \times (h-i) + j)}{k}] - (d/e \times f)$$

where

a - is the amount of liabilities in the life insurance fund at balance date in respect of:

- superannuation category 1 schemes which are deemed to be approved on or before 17 December 1987
- Annuities

b - is the total amount of liabilities in the life insurance fund at balance date.

g - is the number of days from 1 April 1988 to balance date.

k - is the number of days in the company's income year (in most cases 365 days).

h - is the amount of the profits of the company for the income year determined in accordance with section 204(8).

i - is the amount of any profit (or loss) on the sale disposal during the income of any investment of the company determined in accordance with section 204(7).

j - is the amount of any profit or loss on the sale or disposal during the income year, on or after 1 April 1988, of any investment of the company determined in accordance with section 204(7).

d - is the amount of liabilities in the life insurance fund in respect of:

- superannuation category 1 schemes which are deemed to be approved on or before 17 December 1987.
- annuities at the end of the company's income year that last ended before 1 April 1988.

e - is the total amount of liabilities in the life insurance fund at the end of the company's income year that last ended before 1 April 1988.

f - is the amount in respect of investments sold or disposed of on or after 1 April 1988 in the income year (having been acquired before 1 April 1989) calculated as follows:

- In respect of investments made or acquired before the last day of the income year commencing on 1 April 1982.

by subtracting from the market value of the investment on 1 April 1988 the greater of:

- (i) the cost price or acquisition value of the investment; and
 - (ii) the market value of that investment on the last day of the income year commencing on 1 April 1982.
- In respect of investments made or acquired after the end of the income year commencing on 1 April 1982.

- (i) All investments except for financial arrangements to which sections 64B to 64L of the Income Tax Act 1976 apply.

by subtracting the cost price or acquisition value of the investment from the market value on 1 April 1988.

- (ii) Financial arrangements to which sections 64B to 64L of the Income Tax Act 1976 apply.

by calculating the difference between the value of the financial arrangement at 1 April 1988 as if it had matured at that date; and

the acquisition value and income deemed to have been derived in previous income years.

3.4 Income Tax Rates

Section 27 of the Amendment Act amends the 1st schedule of the Act which provides the rates of income tax, with effect from the income year commencing 1 April 1988, in respect of:

- (a) Life Insurance Companies
 - (i) For income assessable under section 204(9) of the Act the rate of income tax is 33 cents in the dollar.
 - (ii) For income assessable under subsections (9A) or (9B) of section 204 the rate of income tax is 25 cents in the dollar.

(b) Superannuation Schemes

- (i) For category 1 schemes which were or were deemed to be superannuation category 1 schemes on or before 17 December 1987 the rate of income tax is 25 cents in the dollar. Category 1 schemes which were personal pension schemes and which admitted new members after 17 December 1987 will not benefit from this concessionary rate.
- (ii) For category 1 schemes other than those referred to in (i), and category 2 schemes, will have an income tax rate of 33 cents in the dollar.
- (iii) For category 3 schemes the rate for the income year commencing on 1 April 1988 is 40.5 cents in the dollar.

3.5 Loans to Superannuation Funds to Members

Section 17 of the Amendment Act provides for a new section 232A which will deem the benefit element of a low interest loan made by a superannuation fund to a fund member to be assessable income of the fund. Section 232A will apply to superannuation funds as follows:

- (a) Schemes with 31 March balance dates - from 1 April 1989.
- (b) Schemes with other (approved) balance dates - from the beginning of the accounting year first commencing after 1 April 1989.

Fringe benefit tax will not apply to such loans, however some of the fringe benefit tax provisions are utilised by section 232A (to determine the assessable income derived by the fund).

3.6 Furnishing of Income Tax Returns

Section 32 of the Amendment Act provides transitional measures dealing with the furnishing of 1988 returns for category 1 schemes and life insurance companies with category 1 business. Category 1 schemes and life insurance companies with balance dates from 1 April 1988 to 30 September 1988 are required to furnish 1988 returns in respect of their category 1 business no later than 7 July 1989 (or such later date as the Commissioner may allow).

Normal filing dates will apply for other returns.

3.7 Income Tax Payments

Section 31 of the Amendment Act contains the following transitional provisions in relation to provisional and terminal tax payments for category 1 schemes and the category 1 scheme business of life insurance companies.

- (i) Subsection (1) provides that no 1989 provisional tax is payable
- (ii) Subsection (2) provides that category 1 schemes and life insurance companies with 1989 balance dates from 1 October 1988 to 28 February 1989 (inclusive) will pay their first instalment of 1990 provisional tax on their second instalment date (making 2 instalments on the second date).
- (iii) Subsection (3) provides that 50 percent of the 1988 terminal tax is payable by 7 July 1989 with the remaining 50 percent payable by 7 February 1989.
- (iv) Subsection (4) provides that 50 percent of the 1989 terminal tax is payable by the normal 1989 terminal tax date and 50 percent by the 1990 terminal tax date except where this deferral was available in respect of the 1988 terminal tax.

4.0 Superannuation Scheme Benefits

The tax status of superannuation scheme benefits will depend on whether the scheme is:

- (a) Approved/registered - a superannuation fund
- (b) Non-approved/non-registered Category 3 - a trust or a deemed unit trust.

4.1 Benefits from Superannuation Funds

The following modifications to the trust tax regime have been made in respect of superannuation funds:

- (i) Section 14(2) of the Amendment Act excludes superannuation funds from the definition of "qualifying trust" contained in section 226(1) the Act; and
- (ii) Section 14(3) of the Amendment Act provides that superannuation funds are "qualifying trusts" on or after 1 April 1990.

Section 227(6) of the Act provides that distributions from "qualifying trusts" are not assessable income. The effect of these provisions is to allow for benefits from superannuation funds to be free of income tax when paid on or after 1 April 1990 (but not before).

4.2 Benefits from Category 3 Schemes

- (a) Contributory schemes (where employee contributions are made).

These schemes will be deemed to be unit trusts under section 211 of the Act. Benefits from such schemes are treated as dividends from the beginning of the income year commencing on 1 April 1988.

(b) Non-contributory schemes

These schemes (which are not deemed to be unit trusts) are taxed as trusts. Benefits from such schemes will generally be taxed as trust distributions.

4.3 Benefits from Approved Overseas Schemes

Section 3 of the Amendment Act inserts a new section 4A(1)(n) into the Act.

This ensures that lump sum benefits from approved overseas schemes (under regulations 29 or 30 of the Superannuation Schemes Regulation 1983) will not be taxed as dividends when paid before 1 April 1990.

4.4 Life Insurance Company Annuities

Section 4(3) of the Amendment Act inserts a new subsection (59) into section 61 of the Act which provides for annuities paid from a life insurance fund of a life insurance company to be exempt from income tax on or after 1 April 1990. This mirrors the treatment given to superannuation funds.

4.5 National Superannuitant Surcharge

Section 18 of the Amendment Act ensures that non-assessable pensions from superannuation funds and tax exempt annuities from life insurance companies continue to be included in the surcharge calculation. This is achieved by including these amounts in item a of the formula in section 336B of the Act.

4.6 Family Support Tax Credit Anti-abuse

Section 21 of the Amendment Act amends section 374B(1) of the Act to include in income for family support purposes from 1 April 1990 any distribution from a superannuation scheme where:

- (a) the recipient's employer made contributions to that scheme in that or the two preceding income years; and
- (b) the recipient continues to be employed by that employer one month after the date of receipt.

The section however does not apply where the distribution is made as a result of genuine retirement.

5.0 MISCELLANEOUS AMENDMENTS

Section 5 of the Amendment Act repeals the definition of superannuation scheme contained in section 64B(1) of the Act. This will allow the definition contained in section 2 of the Act to apply.

Section 7 of the Amendment Act inserts a new subsection (6) into section 96 of the Act. This ensures that section 96 will not have application to transfers or settlements to or on a superannuation fund.

Section 9 of the Amendment Act amends section 149 of the Act to make it clear that contributions to superannuation schemes cannot be deducted under this section (instead of section 150 of the Act).

APPENDIX 1

TAXATION OF SUPERANNUATION SCHEME INVESTMENT GAIN AND LOSSES

Under section 225 of the Income Tax Act 1976 superannuation category 2 and 3 schemes have been subject to income tax on investment gains (and losses) irrespective of how they would have been treated under the normal provisions of the law. As Section 225 ceases to apply investment gains will be dealt with under the normal provisions of the Income Tax Act. These provisions will also apply to superannuation category/schemes (which have never been subject to section 225) Provisions of the Income Tax Act which subject investment gains to income tax include the following:

- (a) Section 65(2)(e) - Personal property sales
- (b) Section 65(2)(f) - Land sales
- (c) Section 65(2)(jb) - Accrual income
- (d) Sections 65(2)(k) and (ka) - Commercial bill redemptions

Investment gains may also be subject to income tax where they are made as part of the income earning process of the taxpayer. This principle has been established through a line of cases relating to banks and other financial institutions beginning with "*Californian Copper Syndicate v Harris* (1904) 5TC 159". This principle will also have application to superannuation schemes and will mean that investment gains will be subject to income tax in most cases.

APPENDIX 2

Gains and Losses on the Disposal of Investments (Excluding Financial Arrangements)

	Legislative Provisions	Include the Difference Between A & B as Assessable Income	
		(A)	(B)
<p>Category 1 Schemes</p> <p>1. Investment disposed of before 1 April 1988</p> <p>2. Investment disposed of after 1 April 1988</p>	<p>Not taxed</p> <p>Section 232B</p>	<p>Consideration received or receivable.</p>	<p>Market value on 1 April 1988.</p>
<p>Category 2 Schemes</p> <p>1. Investment acquired before the end of the income year commencing on 1 April 1982: and</p> <p>Disposed of before 1 April 1988.</p> <p>Disposed of on or after 1 April 1988 and not taxable under the normal law.</p> <p>Disposed of on or after 1 April 1988 and not taxable under the normal law.</p>	<p>Section 225</p> <p>Section 232B</p> <p>Section 225A</p>	<p>Consideration received or receivable.</p> <p>Consideration received or receivable.</p> <p>Market value on 1 April 1988.</p>	<p>Greater of -</p> <p>(a) Cost price or acquisition value and</p> <p>(b) Market value on the last day of the income year that commenced on 1 April 1982.</p>
<p>2. Investment acquired after the end of the income year commencing 1 April 1988.</p>	<p>Section 232B</p>	<p>Consideration received or receivable</p>	<p>Cost price or acquisition value</p>