# TAX INFORMATION BULLETIN VOLUME TWO, NO. 6

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# Our New Deputy

The Commissioner, David Henry, has announced the appointment of Maria McKinley as the new Deputy Commissioner, Corporate Services.

Ms McKinley is currently Assistant Director General, Information Systems, at the Social Welfare Department. She will join Inland Revenue in February 1991.

In announcing the decision, Mr Henry said he was delighted to appoint such a well-experienced state sector manager.

"Ms McKinley brings with her considerable operational, policy, and technology experience which will enhance the direction Inland Revenue is taking."

Ms McKinley is the first woman to hold the position of Deputy Commissioner, and will report directly to the Commissioner. She will have responsibility for finance, human resources, and planning and development.

# Using The Cost Price of Motor Vehicles for FBT

### Introduction

In its final report, the Tax Simplification Consultative Committee asked Inland Revenue to publish an explanation for why the cost price is used to calculate the value of motor vehicle benefits.

### Explanation

When Fringe Benefit Tax was introduced it was considered that cost price was the most reasonable basis for valuing the benefit gained by an employee from the use of an employer's car.

The portion of the cost price - 24% per annum or 6% per quarter - reflects a realistic approximation of the standing and running costs of the motor vehicle that the employee would have to bear if the vehicle was owned by the employee.

This portion of the cost price each year reflects the initial capital outlay of providing the benefit to the employee. The continuing use of the cost price basis in following years is a recognition of the increasing cost of maintaining and running a car as the mileage increases.

If an alternative method had been chosen (such as book value or market value of the vehicle) there would be the problem of valuing the benefit to the employee of repairs and maintenance of the car provided by the employer.

The cost price method is simple to apply and easily verifiable.

**Reference:** H.O.10.F.15.1

(NB: The first article on page 12 is also related to this topic.)

# Livestock Taxation Regime - Notices of Election

## Section 85A (3) Income Tax Act 1976

### Introduction

We have recently been asked to clarify Inland Revenue's requirements for making of an election to change schemes under the livestock taxation regime.

### Background

Section 85A (3) is specific in the requirements for making elections and changing schemes. The legislation requires that:

- the election is in writing,
- it states the income year to which the election will first apply,
- it states the section of the Act to which the election relates.

The legislation also sets out the timing in which the notices of election must be forwarded to Inland Revenue. Where the change is from the trading stock scheme or the cost price scheme to the herd scheme the notice of election must be forwarded to the Department within the time the taxpayer is required to furnish a return of income for the year of change. Where the change is from the herd scheme to one of the other schemes the notice of election must be received one income year and one day before the start of the income year in which the change is to take effect.

In the latter case the Commissioner has no discretion to accept a late notice of election.

### Ruling

In all cases where the change is to the herd scheme, a written notice can accompany the return of income in which the change is to take place. If the return of income cannot be furnished by the due date for any reason, the notice of election must be received before the due date.

Where the change is from the herd scheme, the written notice must be received before the required one year, one day date. Late elections will not be accepted.

The request should be in a letter form. A notation on the set of accounts accompanying the return will not be acceptable.

The same rules will apply to elections required under section 85A (2A), elections not to value immature livestock under the herd scheme.

Inland Revenue does not propose to issue a special form for the purpose of these elections.

**Reference:** H.O. 10.F.1.9.

# Fringe Benefit Tax - Prescribed Rate of Interest for Quarter Commencing 1 January 1991

The Minister of Revenue has confirmed that the prescribed rate of interest used to calculate the fringe benefit of low interest employment related loans will continue at 14.8 percent for the quarter commencing 1 January 1991.

# Economic Statement of 19 December 1990

### Introduction

The following items result primarily from the Economic Statement announced by the Government on 19 December 1990. The items are divided into two parts. Part I deals with all the taxation related issues which were announced in the Economic Statement. Part II has information about the Taxation Reform Bill (No 3) 1990, which was introduced to Parliament on 19 December 1990. Items which were announced in the Economic Statement and introduced in the Bill are explained in Part I.

### Part I

This part explains the background to the taxation items in the Government's Economic Statement of 19 December 1990. The legislation that will give effect to these proposals is the Taxation Reform Bill (No. 3) 1990, referred to as the Bill from here on. As this legislation is subject to the normal Parliamentary process, there may be changes in the form the final legislation will take when passed.

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*ITEM ONE*

## Accident Compensation Levy Payment Change

The effect of this amendment is to implement the recommendation of the Consultative Committee on Tax Simplification that the ACC 506 Return of Earnings form be dispensed with. The amendment is operative for income years commencing on or after 1 April 1991. The amendment is to section 43 of the Accident Compensation Act 1982 to insert a new subsection (1A) which operates to require an employer who pays, credits, or allocates to a shareholder-employee any amount as earnings after 31 May in any year, to include those earnings in the Statement of Earnings required to be delivered by 31 May in the next succeeding year and at the same time pay in relation to those earnings a levy calculated in terms of section 43(3) of the Accident Compensation Act 1982.

The amendment is operative from 1 April 1991.

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*ITEM TWO*

## Accrual Amendments

The Accruals rules were drafted to ensure that income and expenditure associated with financial arrangements were spread over the full term of the arrangement. The legislation was also drafted to ensure that what might have been considered a "capital gain" from a financial arrangement was assessable for income tax purposes. The Simplification Committee considered that many problems had arisen because of the complicated calculations many taxpayers were required to make to meet their obligations. As a consequence the Consultative Committee made a number of recommendations on how the accruals rules could be simplified.

The amendments are to give effect to recommendations 72, 74, 75 and 80 of the Final Report of the Consultative Committee.

Recommendation 72 provides that all taxpayers who must calculate income and expenditure from financial arrangements on an accrual basis, should (where applicable) be able to use the straight line basis rather than the yield to maturity basis if their total financial arrangements have a face value below $1 million at all times during the year.

A number of consequential amendments are made to other sections of the Income Tax Act.

Recommendation 74 provides that the thresholds for cash basis holders be increased to: $600,000 total value or $70,000 of income and, in either case, $20,000 deferred income.

Recommendation 75 provides that the deferred income threshold may be calculated on a straight line basis in place of the yield to maturity basis.

Recommendation 80 provides that estates of deceased cash-basis holders should be able to account for income in financial arrangements on a cash-basis provided the estate continues to fall within the cash-basis holder threshold. This concession is limited to five income years.

The legislation also provides that where the estate ceases to be a cash-basis holder it may not become a cash-basis holder again.

*ITEM THREE*

# New PAYE Tables

This amendment is a result of recommendation 126 of the Tax Simplification Consultative Committee. The Committee recommended that the 20 cent income steps in the PAYE tables be removed in order to reduce compliance costs faced by taxpayers. Appendix A of the Second Schedule to the Income Tax Act 1976 is amended to insert new weekly PAYE tables.

The New PAYE tables apply with respect to tax deductions made from payments of salary or wages which are paid on or after 1 April 1991.

*ITEM FOUR*

# RWT: No Declaration Rate

Section 327ZD details the information which payers of interest are to provide to the Commissioner which is used to check that taxpayers are returning income correctly. One of these items of information required to be provided is the tax file number of the recipient. There is, however, no incentive for any person to supply that number. This amendment is to encourage taxpayers to supply that number by imposing a higher rate of deduction of RWT where the tax file number is not supplied.

The amendment provides that the rate of deduction of Resident Withholding Tax on interest be increased from 24 cents to 33 cents where the recipient has not provided a tax file number to the payer of the interest and will apply as from the income year commencing 1 April 1992.

*ITEM FIVE*

# Amendment to clarify the GST Treatment of Government Grants and Subsidies

This item explains the proposed legislative amendment to the GST Act 1985 contained in the Taxation Reform Bill (No. 3) 1990 to clarify the policy and to ensure that government grants and subsidies are subject to GST.

It has always been the Government's intention that a payment made by the Crown in the form of a grant or subsidy would be subject to GST when received in respect of a registered person's taxable activity.

However, a recent Taxation Review Authority (TRA) decision M129 (1990) 12 NZTC determined that in respect of a Job Opportunity Scheme that the subsidy was not consideration for a supply of goods and services by the registered person and therefore not subject to GST.

The proposed amendment will ensure that the original intention is reflected in the legislation and remove any uncertainty as to the GST treatment of grants and subsidies as a result of the above TRA decision.

A payment made by the Crown or a public authority to a person in respect of that person's taxable activity will be deemed to be considera-

tion for a supply of goods and services in the course or furtherance of that taxable activity. The proposed provision also deems such payments made to any other person on behalf of a person in respect of the later person's taxable activity to be consideration for a supply of goods and services. Accordingly, if the recipient of the payment is registered that person will be required to account for GST. In terms of the proposed amendment the payment of a subsidy under (say) the Job Opportunity Scheme will be subject to GST when received by a registered person in the course of a taxable activity.

The provision will not apply in respect of payments made to a public authority by the Crown as such payments are already specifically covered by the GST Act 1985.

The intention of the amendment is to ensure that only payments made in respect of a taxable activity are brought within the scope of the provision. Payments such as domestic purposes benefit which are paid for the personal use and benefit of a person or a relative of that person are not deemed to be consideration for a supply of goods and services. Accordingly, a person who receives such payment will not be able to register for GST purposes.

The amendment will apply from the commencement of the GST Act 1985 viz., 3 December 1985. The amendment will not apply in respect of such payments to the extent an objection has been lodged on or before 19 December 1990 by a registered person in respect of any payment by or on behalf of Crown or a public authority. Any such objection will be considered in terms of the legislation prior to the enactment of this amendment.

*ITEM SIX*

# Provisional Tax Safe Harbour Provisions

The uplift formula for calculating provisional tax will be lowered from 110 percent to 105 percent for persons basing calculations on the previous year's residual income tax, and from 120 percent to 110 percent in cases where the tax from the last year but one is used.

Amendments are proposed to four sections of the Income Tax Act to reflect the new formulae.

Section 377(1) will be amended so that the uplift formula for calculation of provisional tax payable in respect of income derived in the 1992 income year will be 105 percent of last year's residual income tax.

Section 381(2) will provide that the uplift formula for calculation of provisional tax payable in respect of income derived in the 1992 income year, where a return has not been furnished for the previous year, will be 110 percent of residual income tax of the year before last.

Section 384(5) will be amended so that where the Commissioner has amended a taxpayer's provisional tax estimate, that re-estimate shall not exceed 105 percent of the taxpayer's residual income tax for the previous income year.

Section 384(2) will be amended so that where a taxpayer has made a voluntary estimate which is higher than the uplift figure, the calculation of underestimation penalty will be capped to the extent of a figure based on the 105 percent uplift factor.

These amendments will take effect for payments of provisional tax made on or after 1 July 1991. Taxpayers with early balance dates who have made provisional tax payments for the 1992 income year prior to 1 July 1991 will be able to adjust subsequent payments to reflect the lower amount of provisional tax using the reduced uplift formula.

*ITEM SEVEN*

# Limitation of Deduction for Monetary Remuneration and Derivation of Monetary Remuneration

These amendments remove the tax deferral opportunities arising from the timing mismatch between the time a deduction is claimed for monetary remuneration and the time that remuneration is returned as income.

Current case law and practice allows for this timing mismatch to occur. Monetary remuneration includes any salary, wages, or other income in respect of the employment or services of a taxpayer. Expenditure such as remuneration is deductible in the income year in which it is "incurred". This means a taxpayer may claim a deduction when s/he is definitively committed to the expenditure, even though there has been no actual disbursement in that income year (i.e., expenditure is claimed as a deduction on an accruals basis). Income such as remuneration is "derived" in the income year it is received (paid) or otherwise made available to the employee or the shareholder-employee (i.e., income is returned on a payments basis).

This timing mismatch in respect of remuneration has recently been highlighted by:

(a) the recent Court of Appeal decision [*CIR* v *Glen Eden Metal Spinners Ltd* (1990) 12 NZTC] which held that, by committing itself in a resolution, a company can deduct the costs of a payment to directors, even though the amount deducted exceeds the amount actually paid to directors in the following year; and

(b) the growing use of recently publicised deferred bonus payment schemes. These schemes are based on the advantage obtained by a company deducting the cost of a bonus in an income year even though that bonus is not actually paid to an employee (shareholder-employee) until years later. The bonus is not returned as income by the employee (shareholder-employee) until the year in which it is paid.

The proposed amendments will govern the deductibility of remuneration for all taxpayers and the assessability of remuneration paid by companies to their shareholder-employees.

## Remuneration Subject to PAYE

The proposed general rule will allow a taxpayer to claim a deduction for any monetary remuneration incurred in an income year provided that remuneration has been paid to, or otherwise dealt with on behalf of, an employee during that income year or within 63 days of the end of that income year. This general rule will only apply in respect of remuneration which is subject to PAYE. The 63 day period of grace will allow the taxpayer to claim a deduction for remuneration incurred between the last pay day of the income year and the end of the income year. The proposed general rule will reflect the current treatment for the deduction of remuneration paid or payable to an employee except for remuneration that is not paid within the 63 day period.

## Remuneration received by Employee

The current practice will apply to determine the assessability of the receipt of such remuneration (i.e., when the income is received or otherwise made available to the employee). Such remuneration is usually derived (received) by an employee in the same year as it is incurred and paid by the employer.

## Remuneration Paid to Shareholder-Employees

In relation to a shareholder-employee who receives income to which section 6(2) of the Income Tax Act 1976 applies (i.e., salary, wages etc., which are not subject to PAYE) the above general rule is modified. The company will be entitled to claim a deduction for remuneration incurred in an income year which has been paid or otherwise dealt with on behalf of the shareholder-employee in that income year or by 31 March of the year succeeding the income year (i.e., the last day for the furnishing of a return under the extension of time arrangements). This will allow the company to compute the remuneration to be paid to the shareholder-employee upon the completion of the annual accounts and claim a deduction for that remuneration in the income year it was incurred provided it is paid

within the specified period. For example, a company with a 31 December 1990 balance date (1991 return of income) will have until 31 March 1992 to pay the remuneration incurred in that income year to the shareholder-employee.

Monetary remuneration will need to be incurred in an income year in order for a company to take advantage of this rule. Accordingly, the company will need to be definitively committed to the payment of the remuneration, subsequently paid to the shareholder-employee, at the date when the return is furnished.

### Remuneration Received by Shareholder-Employee

Where a company has claimed a deduction for monetary remuneration paid or payable to a shareholder-employee in an income year, that remuneration is deemed to have been derived by the shareholder-employee in the same income year. This will allow for a matching of the expenditure and the income in the same income year.

### Transitional Issues

These amendments will result in a doubling-up of income in the 1991 income year for taxpayers who have previously enjoyed the benefit of the deferral of tax. Taxpayers with a 31 March balance date who are affected by this doubling-up of income will be eligible in terms of the current provisional tax rules for a remission of the underestimation penalty and interest on short-paid provisional in relation to 1991 income year if payment is made by 7 February 1992. Under these existing rules the Commissioner is required to remit any penalties or interest which result from a change in the law enacted later than the beginning of the month prior to payment date for the third instalment of provisional tax. Those taxpayers eligible for such remission will have to make application to the Commissioner.

Individuals with a balance date other than 31 March (depending on the enactment date of these amendments), and who have previously been deferring their tax, will need to prepare to make catch-up payments on the date of their third provisional tax payment.

The Government has also invited the Finance and Expenditure Select Committee to consider other transitional issues that will be faced by provisional taxpayers that are not catered for in the existing provisional tax rules.

The amendment will first apply for the income year commencing 1 April 1990.

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*ITEM EIGHT*

## Transitional Provisions in Respect of Controlled Foreign Company Regime

As part of its economic statement, the Government has announced that the expiry date of the transitional provisions that apply to the controlled foreign regime will change.

Currently the Income Tax Act provides that the transitional provisions that applied to controlled foreign companies expired on 31 March 1990. The legislative change announced in the Economic Statement has extended the operation of the transitional list for controlled foreign companies, contained in the Seventeenth Schedule of the Act, until 31 March 1991. Thus New Zealand residents with an income interest in a controlled foreign company that is not resident in any of the countries listed on the Seventeenth Schedule will not be required to calculate attributed foreign income. However the requirement to disclose the interest in the company has not been waived.

*ITEM NINE*

# Repeal of Excess Retention Tax

The Valabh Committee in its report to the Government on the taxation of distributions from companies (November 1990) recommended the repeal of excess retention tax (ERT) in relation to income derived in income years commencing on or after 1 April 1990.

The reasons which the Committee advanced for the repeal of ERT are set out in Chapter 4.4 of its report, which has been released to the public. Briefly, these are that ERT is ineffective in that it is possible to structure companies so as to escape the impact of the regime. At the same time, ERT is of considerable nuisance value for companies to which it was never intended to apply.

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*ITEM TEN*

# Livestock Valuation Scheme

The definition of herd livestock is amended so that all classes of specified livestock can be included in the herd scheme.

The herd scheme requires that livestock must be valued at 100% of their national average market value. This means that farmers who wish to take advantage of this amendment for tax purposes derive income when writing up livestock to these values.

Paying the tax on this income often causes cash-flow problems for farmers. This amendment addresses the problem by spreading the resultant income over the year of entry and the following two income years.

Where the herd size increases as a result of retaining home-bred stock, that increase is taxable to the farmer. The farmer is required to value those animals at market value, even though the cost of breeding those animals may be significantly less.

Under the amendment 30% of the income which arises as a result of retaining the home-bred stock may be spread.

It is considered that 30% represents the net income the farmer would have realised if the animals had been sold.

The high price livestock scheme is amended to ensure that where livestock values change substantially such livestock is not included in the scheme unnecessarily.

The high price livestock regime provides that where an animal is purchased for significantly more than the previous year's average livestock value the value of the animal is to be capitalised and written down.

This amendment provides that the threshold value will be based on the higher of the preceding year's value or the current year's values.

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*ITEM ELEVEN*

# Farm Development

An amendment will be made to section 127 of the Income Tax Act 1976 to provide immediate deductibility for expenditure incurred on:

(a) The destruction of weeds or plants detrimental to the land;

(b) The clearing, destruction and removal of scrub, stumps and undergrowth;

(c) The repair of flood or erosion damage;

(d) The planting of trees for preventing or combating erosion;

(e) The planting of trees for the purpose of shelter;

(f) The fencing of land for subdivision.

Under the existing legislation, from 1 April 1991, these items of expenditure would have been required to be capitalized and written down by way of depreciation in accordance with the 13th Schedule to the Act.

*ITEM TWELVE*

# Forestry

The main amendment to the forestry taxation provides that the costs incurred by a forestry business in planting and maintaining trees are deductible in the year these costs are incurred.

The amendment will take effect from the income year commencing 1 April 1991.

Under the current regime these expenses are non-deductible and are entered into an account known as a cost of bush or cost of timber account, and carried forward until the forest is sold or harvested. The expenditure accumulated in the cost of bush account will remain non deductible until the forest is harvested.

The legislation also provides that where a forest is sold to an associated person at a loss the amount in the cost of bush account will not be deductible but is to be carried forward in the associated person's cost of bush account.

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*ITEM THIRTEEN*

# Family Support and Family Benefit Changes

Family benefit will be abolished, and the maximum rate of family support will be increased by $6 per child, with effect from 1 April 1991.

The abolition of family benefit has necessitated a number of consequential changes in relation to rebates where eligibility depends upon a payment of family benefit in respect of a child. The rebates concerned are:

- Child rebate (section 50A of the Income Tax Act 1976)
- Transitional Tax Allowance (section 50C of the Income Tax Act 1976)
- Housekeeper Rebate (section 54 of the Income Tax Act 1976)

The amendments remove the references to family benefit from those sections.

### Family Support changes

Previously, eligibility for family support and the guaranteed minimum family income tax credit was dependent upon family benefit being paid in respect of a child.

Under the new rules, a "qualifying person" for the purposes of both the tax credit schemes will be any person who:

(a) Is aged 16 years or over; and

(b) Is a principal care giver of one or more dependent children; and

(c) Is ordinarily resident in New Zealand, and has been present in New Zealand for a continuous period of 12 months, at any time.

As an alternative to paragraph (c) a person can qualify for family support and guaranteed minimum family income if the dependent children were born in New Zealand, or are likely to remain permanently in New Zealand.

A "dependent child" is one:

- Who is being cared for by the person claiming the tax credit; and
- Who is being maintained as a member of the person's family; and
- Who is financially dependent on the person; and
- Who does not receive a social welfare benefit, a student allowance, or any other analogous payment.

Children for whom payments are made in terms of the placement of children or young persons provisions of the Children, Young Persons, and Their Families Act 1989, and married persons are specifically excluded from the definition of a dependent child.

Otherwise the tax credit schemes will operate as previously.

*ITEM FOURTEEN*

# Re-Negotiation of Double Tax Agreement

In line with its commitment to achieve better harmonisation with the Australian tax regime, the Government has announced its intention to re-negotiate the Double Tax Agreement between Australia and New Zealand.

The Minister announced that the Government is intending to negotiate double tax agreements with other countries in the near future.

*ITEM FIFTEEN*

# Quasi Self-Employed Persons' Expense Claims

The Bill introduces a new section 105AA, with amendments to sections 105 and 106B of the Income Tax Act 1976.

These provisions are necessary to accommodate the allowance of deductions for motor vehicle, advertising and telephone expenses to taxpayers in respect of commission-only income. These taxpayers were previously regarded by the Income Tax Act as employees to whom employment-related expenses are denied by section 105.

Such expenditure is deductible to the extent that it does not exceed the commission-only income in respect of which it was incurred.

The new section 105AA defines "commission-only income" as assessable income derived by any taxpayer in respect of any services performed where the sole means used in the calculation of that income is that of a commission directly related to the services performed.

The new section 105AA also specifies the three classes of expenditure as:

i) Expenditure necessarily incurred in the use of "telecommunication services".

ii) Expenditure necessarily incurred in the advertising of services in respect of which commission-only income is derived.

iii) Expenditure (except of a capital nature) or depreciation necessarily incurred in the provision or operation of a motor vehicle to the extent that the vehicle is used to derive commission-only income.

Consequential amendments are made to section 106B by the insertion of a new subsection (4A) which requires taxpayers claiming deductions for motor vehicle expenditure in the derivation of commission-only income pursuant to section 105AA to comply with the requirements of sections 106B, 106C, 106D and 106E (the new logbook regime).

*ITEM SIXTEEN*

# Simplification II

The Government announced the formation of a new Tax Simplification Committee which will, amongst other issues, focus on reducing compliance costs for small businesses and individuals. A Consultative Document on additional tax simplification measures will be released by the end of March.

*ITEM SEVENTEEN*

# Inclusion of GST in Calculation of "Cost Price" for Fringe Benefit Tax Purposes

The Bill makes an amendment to section 140B of the Income Tax Act, to provide that in calculating the value of a motor vehicle for fringe benefit tax purposes, that value shall include GST.

The need to clarify the legislation arises after the recent decision of the High Court in *CIR* v *Atlas Copco (NZ) Ltd.* The Judge concluded that "cost price" for the purposes of the calculation of FBT means the effective cost price and does not include GST where the person providing the benefit is a registered person and is able to claim a deduction for the GST by way of input tax.

One of the basic principles of FBT is that fringe benefit tax is imposed on the value of the benefit to the employee. In relation to motor vehicles the value of the benefit is calculated to be 6% of the cost price of the motor vehicle per quarter abated by reference to the number of days that that vehicle was not available for use by the employee.

On the introduction of GST it was intended that since the benefit was calculated in relation to the employee the cost price of a motor vehicle should include GST so as to give a correct reflection of the employee's benefit, i.e., had the employee purchased the motor vehicle the cost to the employee would have been GST inclusive. Following the Court's decision in *CIR* v *Atlas Copco* the proposed amending legislation clarifies the position.

The amendment proposes a change to section 140A by inserting a new subsection (5A) to provides that in calculating "cost price" and "market value" for FBT purposes, these amounts shall be GST inclusive. In the case of "cost price" the employer shall include any amount of GST paid on the purchase of the motor vehicle not reduced by any amount of input tax credit in relation to the supply of that motor vehicle.

Where the taxpayer is able to use "market value" because a motor vehicle is being rented or leased, the amount of GST to be included in the calculation is the amount of GST that would be payable if that motor vehicle had been acquired on the date the lease or rental commenced.

Where a car is one of a number of cars (i.e. a pool car) the above provisions apply as appropriate.

(NB: The second article on page 2 is also related to this topic.)

*ITEM EIGHTEEN*

# FBT and Charities

The Bill amends section 336N of Income Tax Act to ensure that fringe benefits provided by charitable organisations to their employees are exempt from fringe benefit tax.

The previous Government repealed, with effect from 1 October 1990, the exemption from fringe benefit tax provided by paragraph (h) of the definition of "fringe benefit tax".

This exemption applied to any society, institution, association, organisation, trust, or fund (not being a local authority or public authority) to which, in a quarter, section 56A(2) of this Act applied.

The proviso to paragraph (h) ensured that where a charitable activity also ran a business employees of that business who were provided fringe benefits were subject to fringe benefit tax.

This amendment effectively reinstates the exemption from fringe benefit tax previously provided by the now repealed paragraph (h) of the definition of the term "fringe benefit". This is achieved by inserting a new paragraph (h) with effect from 1 October 1990. Also inserted is a definition of "charitable organisation" which simplifies the wording of paragraph (h).

A restriction is included to the extent that the fringe benefit is only exempt where -

a) The benefit is provided to enable the employee to carry on, or to carry out, the duties associated with the employer's charitable activity; or

b) To directly assist the employee in working as an employee for that employer.

This restriction is aimed at ensuring that fringe benefits simply provided in lieu of salary will not be exempt. For example, where a motor vehicle is provided as that vehicle is needed for charitable work, the benefit will not be subject to FBT; but where it is simply provided for the private convenience of the employee FBT will be chargeable. Paragraph (b) provides that where a fringe benefit is provided to directly assist the employee in the performance of his/her duties that benefit will also be exempt. For example where a low interest loan is provided to an employee to purchase a house to be used as a residence and as a base for charitable works that transaction will be exempt.

## Application Dates for Economic Statement of 19 December 1990

| | |
|---|---|
| AC Levy payment change | 1 April 1991 |
| Accrual amendments | 1 April 1991 |
| New PAYE Deduction Tables | 1 April 1991 |
| Resident Withholding Tax - No Declaration Rate | 1 April 1992 |
| GST - Government grants and subsidies | 1 October 1986 |
| Provisional Tax Safe Harbour | 1 July 1991 |
| Limitation of Deduction for Monetary Remuneration | 1 April 1990 |
| Transitional Controlled Foreign Company provisions | 1 April 1990 |
| Repeal of Excess Retention Tax | 1 April 1990 |
| Livestock Valuation Scheme | 1 April 1991 |
| Farm Development | 1 April 1991 |
| Forestry | 1 April 1991 |
| Family Support and Family Benefit changes | 1 April 1991 |
| Deductions for Commission-only Salespeople | 1 April 1991 |
| Cost Price of cars to be GST-inclusive for FBT | 1 October 1990 |
| FBT and Charities | 1 October 1990 |
| Simplification Consultative Document | 1 April 1991 |

Part II

# Taxation Reform Bill (No. 3) 1990

**(Excluding items which were in the Economic Statement of 19 December 1990.)**

These items give some background on the main items in the Taxation Reform Bill (No. 3) 1990 ("the Bill") which were not included in the Government's Economic Statement of 19 December 1990.

The Bill is subject to normal Parliamentary process, and the commentary given by this Bulletin refers to the items as they were introduced.

*ITEM ONE*

## RWT Deduction Certificates

Section 327H(7), as contained in the original Resident Withholding Tax regime, was intended to relieve payers of interest from the need to provide Resident Withholding Tax Deduction Certificates in any case where the total amount of interest paid to a recipient in a year was less than $20.

However, major banks have advised that their systems will not allow the amalgamation of interest paid through Databank systems with other investment products operated on stand alone systems, so they cannot be certain that any one client does not have combined interest over $20 even through individual deposits may earn less than $20.

Section 327H(7) is therefore being amended to make it clear that payers of interest do not need to issue Resident Withholding Tax Deduction Certificates where less than $20 of interest is paid to a client on any one account.

*ITEM TWO*

## Carrying Forward of Losses

An amendment is made to subsections (7) and (7A) of section 188 of the Income Tax Act by the Bill. An amendment was made by the Income Tax Amendment Act (No. 2) 1990 to enable the subsidiary companies of local authorities to carry forward their losses. This amendment, in short, was found to be too wide in its effects and could facilitate the trafficking of losses.

In broad terms section 188 provides that a company can only carry forward its losses if there has been a 40% continuity of share ownership from the commencement of the income year in which a loss is incurred until the end of the income year in which the loss is offset. Prior to the Income Tax Amendment Act (No. 2) 1990 this shareholding continuity was determined by "seeing through" any corporate shareholder in the loss company, to the natural person shareholders. The Amendment Act had the effect of restricting this "see through" requirement to ordinary limited liability companies only because in the one case, for example, of the subsidiaries of local authorities there are no natural person shareholders. Because there are several readily utilisable types of corporate entity (eg companies limited by guarantee) which effectively have natural person shareholders controlling them but which nevertheless are not caught by the current wording of the "see through" requirement in section 188(7) it was considered that this amendment could facilitate loss trafficking.

The proposed amendment will tighten up section 188(7) to prevent manipulation while specifically providing for the bona fide loss carry forward situations of the subsidiaries of local authorities and statutory producer boards.

The amendment will take effect from the income year commencing 1 April 1989. This is the same application date as the amendment effected by the Income Tax Amendment Act (No. 2) 1990 to the same subsections and will ensure that the original intention of the amendment is achieved.

*ITEM THREE*

# Provisional Taxpayer Definition

The Bill amends section 413A (Interest on Tax Overpaid) of the Income Tax Act to pay interest to taxpayers who paid at least $2,500 provisional tax during an income year but who turned out not to be provisional taxpayers at the end of the income year.

The existing legislation provides that a taxpayer is only eligible for interest on provisional tax overpaid where that taxpayer was, in fact, a provisional taxpayer and had paid provisional tax. This meant that a taxpayer who paid provisional tax with the expectation of being a provisional taxpayer, but who did not have provisional income in that income year exceeding $3,000 (or a provisional tax liability exceeding $2,500 for the income year commencing 1 April 1991) was not eligible for use of money interest payable from the third instalment date.

This treatment was considered inequitable as use of money interest could be charged in the reverse situation. The Bill amends the legislation to provide that a taxpayer is eligible for use of money interest under section 413A where that taxpayer paid provisional tax exceeding $2,500 and expected to be a provisional taxpayer.

The Bill also provides that taxpayers who paid provisional tax in the income years commencing a April 1988, 1 April 1989 and 1 April 1990 and who expected to be a provisional taxpayer for that income year, but who were not provisional taxpayers as their income did not exceed $3,000, are eligible for use of money interest.

The application date of the amendment is the income year commencing 1 April 1991.

*ITEM FOUR*

# Definition of Salary or Wages

This amendment ensures that PAYE tax is deducted from living alone payments paid by the Department of Social Welfare during the income year. The definition of “salary or wages” in section 2 of the Income Tax Act 1976 is amended to include living alone payments.

This amendment applies with respect to tax on income derived in the income year that commenced on the 1st of April 1990 and subsequent income years.

*ITEM FIVE*

# Retirement Tax Abolition

The Retirement tax provisions are being repealed as they increase compliance costs for taxpayers while at the same time adding nothing to the revenue. Part VA and the Twentieth Schedule to the Income Tax Act, which deal with retirement tax, are therefore to be repealed.

Retirement tax will be repealed with effect from the date the Act receives the royal assent.

*ITEM SIX*

# Electronic Filing

This item explains the legislation changes that have been introduced to both the Inland Revenue Department Act 1974 and the Income Tax Act 1976, which will enable the Commissioner to accept and process returns in an electronic format.

The present Acts assume that returns are filed by way of prescribed forms, ie., paper. The Department's new FIRST computer systems will enable some taxpayers to file returns electronically, and so some sections of both Acts needed to be amended to give the Commissioner the authority to accept returns in that way and then process the returns.

## Prescribed Electronic Format

In the same way as the Commissioner prescribes a paper return form, he must have the ability to prescribe an electronic return. This is done by:

i. prescribing the "format" in which the return is to be prepared, ie., the layout of the information on the return, and

ii certifying that the electronic format in which the return will be transmitted is correct. This is necessary to prevent corrupt data being transmitted to the IRD computer and to ensure that the IRD computer will accept the information when it is transmitted.

## Signing a Return

Section 17A of the Inland Revenue Department Act requires a return to be signed. This is obviously not possible with an electronically filed return, so a new section has been inserted into the Act which deems that an electronic return is signed.

## Evidence

The existing provisions in the Act allow the Commissioner in certain circumstances to produce copies of returns and other documents in evidence at Court proceedings. The relevant sections needed to be amended to allow the Commissioner to provide hard copy transcripts of returns and other information which has been filed electronically.

## Sections of Acts

The sections of the Acts amended or inserted are:

Inland Revenue Department Act - Sections 17A(2) and 22A

Income Tax Act - Sections 9 and 28

*ITEM SEVEN*

# Offsetting Refunds against Tax Arrears

This item explains the legislation changes which have been introduced to the Income Tax Act which will enable the Commissioner to offset tax refunds to any other outstanding tax liabilities.

Currently the Income Tax Act provides limited powers of setoff of tax refunds to any other outstanding tax liabilities. FIRST will incorporate an ability to offset tax refunds where a taxpayer has outstanding and overdue tax either in the same or another tax type. Such offsetting provisions are also consistent with the need to simplify the tax system.

Whilst the FIRST system will give the Commissioner the ability to offset refunds to any outstanding liabilities, the legislation will specifically exclude a number of sections from the offsetting provisions. These sections are in respect of export tax credit incentives, family support credit of tax, imputation, dividend withholding payments, branch equivalent tax accounts, and policyholder credit accounts. The exclusions are extended further to include situations where non resident withholding tax has been deducted in error, resident withholding tax deductions are varied to correct errors, and where any refunds arise in accordance with the resident withholding tax regime. Thus the Commissioner will be able to offset any refund which may arise in accordance with any section of the Act unless it is expressly excluded.

*ITEM EIGHT*

# Non-Charging of Minor Penalties

This item explains the legislative changes which have been introduced to prevent the charging of small amounts of additional tax.

The present Act requires the Commissioner to charge additional tax on all taxes which are overdue. Where the overdue amount is small it is no longer cost effective to charge small penalties.

A new section has been inserted into the Income Tax Act [section 411(A)] which will require the Commissioner to refrain from charging additional tax where the amount of additional tax is calculated to be $5 or less. The threshold of $5 will also apply to incremental tax charged on overdue amounts.

Amendments are also being made to the Goods and Services Tax Act and Accident Compensation Corporation Act to introduce the same threshold for additional tax charged under those Acts.

The threshold will in the future be amended by Order in Council.

### Sections of the Act

The sections of the Income Tax Act 1976 affected by the amendment are:

| | | | |
|---|---|---|---|
| 332(1) | 394L(6) | 327U(1) | 394N(4) |
| 336U(1) | 394ZZF(6) | 336ZH(1) | 394ZZG(4) |
| 370(1) | 398(2) | 384(2) | |

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*ITEM NINE*

# Intellectual Property Rights

Previously Section 11 of the Goods and Services Tax Act specified that services in relation to intellectual property rights for use in NZ were subject to GST even when provided to non-residents. This was in contradiction with the Department's rulings which stated that the services should be zero rated when provided to non-residents.

In order to bring the legislation in line with the department's ruling, section 11 of the Goods and Services Tax Act 1985, which contains the zero rating provisions, has been amended. The amendment ensures that services in relation to intellectual property rights provided to non residents who are outside New Zealand when the service is performed are zero rated for GST purposes. This amendment is back dated to apply from 1 October 1986.

The amendment also includes validating legislation to ensure that intellectual property rights previously conferred are not invalidated due to any GST not having been charged on the supply of the intellectual property rights. The validating legislation applies with respect to the Designs Act 1953, the Patents Act 1953, the Trade Marks Act 1953, and the Plant Variety Rights Act 1987.

## Application Dates for Items in Taxation Reform Bill (No 3) 1990, which were not included in Economic Statement

| | |
|---|---|
| Resident Withholding Tax Deduction Certificates | 1 April 1990 |
| Carry forward of losses | 1 April 1989 |
| Provisional Tax definition | 1 April 1991 |
| Definition of salary or wages | 1 April 1990 |
| Retirement Tax Abolition | Assent date |
| Electronic Filing | Assent date |
| Offsetting refunds against tax arrears | 1 April 1991 |
| Intellectual property rights | 1 October 1986 |
| Non-charging of minor penalties | 1 April 1991 |

# Foreign Investment Fund Regime

## Recent Determinations made by the Commissioner - Industrial Equity (Pacific) Limited ("IEP")

### Introduction

The Commissioner made three determinations on 22 January 1991 under the Foreign Investment Fund ("FIF") regime, pursuant to section 245S(3) of the Income Tax Act 1976.

These determinations are outlined below together with a summary of the public information release made recently supporting them.

The determinations are reproduced in full in the New Zealand Gazette publication of 24 January 1991.

There is a brief explanation of the FIF regime in TIB Volume Two, No.4, of November 1990. You can get more detailed information from the IR275 booklet - "International Tax Guide".

### 1. Outline of Determinations made

FIF15: Industrial Equity (Pacific) Limited
(with respect to IEP's accounting year ended 30 June 1988)

FIF16: Industrial Equity (Pacific) Limited
(with respect to IEP's accounting year ended 30 June 1989)

FIF17: Industrial Equity (Pacific) Limited
(with respect to IEP's accounting year ended 30 June 1990)

These determinations specify that the FIF regime applies to shareholdings which constitute a holding of less than 10% of the total shares in IEP. This will be the case for most shareholders. (Holdings of 10% or greater are excluded from the FIF regime but are required to be accounted for under the Controlled Foreign Company regime separately.)

Having been made with respect to IEP's 1988, 1989 and 1990 accounting years these determinations will apply to shareholder's 1989, 1990 and 1991 income years. Therefore anyone who held IEP shares at any time since 1 April 1988 will have to complete an IR4H disclosure schedule and furnish it to the Department. A separate disclosure schedule is required for each relevant income year.

The following table summarises the application of each separate determination to the relevant accounting year of IEP and the respective income year of the shareholder.

| Determination | | Date Published in Gazette | For. Entity Accounting Year Ended | Taxpayer's Income Year ending on or between and | | Taxpayer's Income Year Affected |
|---|---|---|---|---|---|---|
| Number | Status | | | | | |
| FIF 15 | FIF | 24 Jan 1991 | 30 June 1988 | 30 June 1988<br>1 Oct 1988 | 30 Sept 1988<br>29 June 1989 | 1989*<br>1989 |
| FIF 16 | FIF | 24 Jan 1991 | 30 June 1989 | 30 June 1989<br>1 Oct 1989 | 30 Sept 1989<br>29 June 1990 | 1989<br>1990 |
| FIF 17 | FIF | 24 Jan 1991 | 30 June 1990 | 30 June 1990<br>1 Oct 1990 | 30 Sept 1990<br>29 June 1991 | 1990<br>1991 |

* The transitional provision contained at section 245Y(4) of the Act deems any FIF income that would otherwise be required to be included in the 1988 income year to be derived in the 1989 income year.

### Example

Assume a New Zealand resident shareholder in IEP has a balance date of 31 March. In this example the shareholder's balance date falls on or between 1 October and 29 June in each year. Accordingly the determinations collectively apply to that shareholder's 1989, 1990 and 1991 income years.

If the shareholder's balance date fell on or between 30 June and 30 September in each year then the determinations would relate to the 1989 and 1990 income years only. In this case the 1991 income year would remain to be considered by shareholders in terms of the exception criteria under the FIF regime, as is the case for any foreign entity and any accounting year for which no FIF determination has already been made.

### Rights of Affected Taxpayers

Any person holding rights in Industrial Equity (Pacific) Ltd (or the foreign company itself) may formally object to any of these determinations. Any objection must be made in writing stating the grounds of objection and must be delivered to the Commissioner within one month from the date the relevant determination was published in the Gazette.

Any such objection should be directed to;

International Tax Central Unit
Inland Revenue Department
P.O. Box 895
Wellington.

### 2. Public Information Release

To publicise the existence and implications of these FIF determinations to IEP shareholders, the Commissioner recently made a public information release comprising;

- media statement
- newspaper advertisement
- information package available to IEP shareholders on request.

The media statement and advertisement are reproduced in appendix A to this TIB.

The information package available to IEP shareholders contains detailed information on the obligations arising from the determinations and notes for guidance on the completion of the required IR4H Disclosure Schedules.

A copy of this information package may be obtained by completing the coupon contained in the newspaper advertisement and forwarding it to the International Tax Central Unit at the address on the coupon. Alternatively, you can get the package from any Inland Revenue office or by contacting our Freephone on 0800 808 010 until 28 February 1991.

Shareholders should safeguard their position by complying with their obligations by 31 March 1991 irrespective of whatever developments may arise publicly on this matter.

### Waiver of Late Payment Penalty

To encourage prompt compliance with their obligations shareholders are offered a waiver of late payment penalty. To qualify for this shareholders must furnish their completed IR4H Disclosure Schedule(s) to the Department by 31 March 1991.

This late payment penalty concession should not be taken as a precedent and has only been granted due to the circumstances of this particular case.

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# Due Dates Reminder

### February

14 Interest PAYE deducted during January 1991 due - monthly payers.

Dividend PAYE deducted during January 1991 due.

Non-Resident Withholding Tax deducted during January 1991 due.

20 PAYE Deductions for first 15 days of February 1991 due - “Large” employers.

Tax Deductions for January 1990 due - “Small” employers.

28 GST return and payment for period ending 30 January 1991 due.

### March

5 PAYE Deductions for last 13 days of February 1991 due - "Large" employers only.

7 First instalment of 1991 Provisional Tax due for taxpayers with November balance dates.

Second instalment of 1991 Provisional Tax due for taxpayers with July balance dates.

Third instalment of 1991 Provisional Tax due for taxpayers with March balance dates.

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# TAX INFORMATION BULLETIN

THIS IS AN INLAND REVENUE DEPARTMENT SERVICE
TO PEOPLE WITH AN INTEREST IN NEW ZEALAND TAXATION.

VOLUME TWO No. 6 FEBRUARY 1991