Tax Information Bulletin

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1991 Budget Legislation

The articles on pages 3 - 21 of this TIB arise from the Budget presented in Parliament on 30 July 1991. They are broken into three sections:

Budget Night Legislation - Page 3

The topics covered in these articles were included in the Income Tax Amendment Act (No.4) 1991, Income Tax Amendment Act (No.5) 1991, Stamp and Cheque Duties Amendment Act (No.2) 1991, Inland Revenue Department Amendment Act (No.2) 1991, Accident Compensation Amendment Act (No.2) 1991 and the Gaming Duties Amendment Bill 1991.

New Tax Bill Introduced - Page 12

These items are contained in the Income Tax Amendment Bill (No.6) 1991. This Bill is subject to the normal Parliamentary process, including consideration by the Finance and Expenditure Select Committee. The commentary in this TIB refers to the items covered as they were introduced. They will appear again in a later TIB once they have passed into law.

Announcements

These proposals were announced in Parliament on Budget night, but there is presently no specific Bill covering them.

Tax Simplification Consultative Committee Deferral

The Minister of Revenue, Hon Wyatt Creech, made this press release on Budget night:

The Government has decided to defer the decision to set up a further Tax Simplification Consultative Committee for twelve months, the Minister of Revenue Wyatt Creech announced on Budget Night.

The move will allow the Government time to fully implement the recommendations of the previous Simplification Committee before deciding whether another committee is established.

The first Tax Simplification Consultative Committee recommended a very large number of changes in its quest to simplify the tax system, Mr Creech said.

It made 176 recommendations, of which a number have yet to be implemented.

The Government feels that the recommendations of the first Simplification Committee should be fully implemented before a second committee is established.

As well, any new simplification initiative would be premature, given the changes in compliance requirements that could be placed on individuals, business and the IRD as a result of the work of the Change Team on Targeting Social Assistance and other Government initiatives like the Child Support Agency.

A further simplification exercise should not be undertaken until the implementation of these measures is completed.

Mr Creech added that the Institute of Policy Studies was currently conducting a compliance cost study, the results of which should be known by the end of the year.

This should provide better information on where the most significant compliance costs are, Mr Creech said.

Removal of Inter-Corporate Dividend Exemption

Amendment to Income Tax Act

Introduction

There have been a number of changes to the taxation of inter-corporate dividends. The main changes are the:

- Removal of the general inter-corporate dividend exemption on dividends paid on or after 1 April 1992;
- Removal of the inter-corporate dividend exemption on dividends paid under section 192 and 195 debentures or under certain fixed return shares acquired after 30 July 1991 - effective from Budget night;
- Exemption from income tax for dividends derived from foreign companies. This exemption is subject to certain exceptions.

Background

Section 63 provided an income tax exemption for inter-corporate dividends to prevent the multiple taxation of dividends passing between companies. However, under the imputation regime multiple taxation can be avoided by allowing companies receiving dividends to utilise any attached imputation credits. The inter-corporate dividend exemption was unnecessary after the imputation regime was introduced. The exemption also created tax avoidance opportunities and was utilised in a number of tax planning strategies, including the transfer of losses through redeemable preference share deals.

Key Issues

Removal Of General Inter-Corporate Dividend Exemption

Inter-corporate dividends will generally be subject to income tax from 1 April 1992. Non cash dividends which are subject to fringe benefit tax under section 336N(8) of the principal Act will still be exempt from income tax, but only to the extent that fringe benefit tax is payable.

From 30 July 1991, dividends derived by a New Zealand resident company or dividends derived as category A income by a trustee of a group investment fund from a foreign company are exempt from income tax, but subject to foreign dividend withholding payment. However, this exemption does not apply to dividends or similar income for which a deduction has been obtained where the dividends are derived from a company that is incorporated overseas but resident in New Zealand under a Double Taxation Agreement. These dividends or similar income will be subject to income tax under the Act.

The terms “foreign company” and “group investment fund” are defined in this Amendment Act.

Transitional Measure to Stop Redeemable Preference Type Share Deals

Dividends paid on certain redeemable preference type (RPS) share transfers entered into after Budget night are taxable from Budget night.

Dividends are taxable if they are paid on RPS shares or section 192 and 195 debentures acquired after Budget night, except where they are subject to a binding pre-Budget contract. RPS shares issued before Budget night which are subject to a post-Budget alteration, or a post-Budget financial arrangement will also be subject to this provision. For RPS shares in this category, dividends are taxable only if they are payable at a fixed rate or at a rate determined by reference to commercial interest rates, or if they are otherwise equivalent to interest having regard to redeemability, security and variability.

Inland Revenue will closely monitor any loss transfer transactions entered into after Budget night.

For administrative reasons, dividends taxable under this transitional provision will not be subject to resident withholding tax during the period from 30 July 1991 to 1 April 1992.

Application Dates

1 April 1992.
Transitional provisions - 8pm on 30 July 1991

1st Key Dates
1993 income year.
Transitional provisions - 1992 income year

Loss Carry Forward and Loss Grouping

Amendments to Income Tax Act

Loss Carry Forward

Introduction

As part of the general reform of the loss carry forward rules, new legislation requires each shareholder's lowest percentage of rights in a company over a continuous period to be taken into account in determining the continuity of shareholding rules.

Background

Section 188(7) of the principal Act required a minimum 40 percent continuity of shareholding for losses to be carried forward. This enabled share swapping or significant variations in shareholdings to occur without breaching the continuity rules.

Key Issues

Lowest Percentage of Rights Test

From Budget night to the end of the 1992 income year (the "specified period"), the 40 percent continuity threshold will be satisfied by taking into account the lowest percentage of rights attached to shares held by each shareholder of a company.

Example

Lossco has a 31 March balance date. From 1 April 1991 to 31 August 1991, 100 fully paid up shares are held by individuals A and B, who hold 10 percent and 90 percent respectively of the rights attached to the shares.

On 1 September 1991 A and B alter their shareholdings in Lossco to 90 percent and 10 percent respectively (effecting a swap of shares) and retain these proportions to 31 March 1992.

From Budget night, A and B are deemed to hold the lowest percentage of rights attached to the shares held by A and B throughout the specified period, which in this example is 10 percent each. Whether Lossco has met the minimum 40 percent continuity of shareholding is determined as shown below.

		1/9/91	**Lowest**
A	10%	90%	10%
B	90%	10%	10%
Minimum Continuity			20%

Lossco has not met the requirements of section 188(7) and may not carry forward any accumulated losses for offset against any 1992/93 profits.

A relief provision has been introduced which applies where a change in shareholding after 30 July 1991 occurs pursuant to a binding contract entered into before 8 pm on 30 July 1991. In that event, the shares acquired after 30 July 1991 are deemed acquired on Budget night and held through to the date of acquisition. However, the variation in the shareholdings cannot otherwise have breached the continuity rules. Taking the example above, if shareholders A and B had entered into a binding contract before Budget night, they would be deemed to hold 100 percent continuously.

Continuity Percentage

The minimum continuity threshold applicable in the 1992 income year remains at 40 percent, but it increases to 66 percent in subsequent years. The expression "continuity percentage" is defined to replace the expressions 40 percent in the 1992 income year and 66 percent in subsequent years wherever mentioned in section 188.

Application Date

8 pm 30 July 1991

1st Key Date
1992 income year

Grouping Of Losses

Introduction

As part of the general reform to group losses, a loss company and one or more profit companies must be members of the same group at all times from Budget night to the end of the loss company's accounting year. This is the year that corresponds to the 1992 income year.

Background

Section 191 provides a set of rules governing loss offsets between commonly owned companies. Companies that are 66.66 percent commonly owned may form an ordinary group and companies 100 percent commonly owned may form a specified group. Commonality of the minimum applicable thresholds was determined at the end of the income year (31 March). These rules enabled a profit company to

acquire a loss company with losses at any time before 31 March each year, causing further erosion to the tax base.

Key Issues

Commonality Of Shareholding

The thresholds of 66.66 percent and 100 percent commonality must now be met at all times from 30 July 1991 (the specified time) to the end of the loss company's accounting year corresponding to the income year ending 31 March 1992.

Example (illustrating the requirement of commonality at all times from the specified time):

Assume Lossco has a standard balance date of 31 March. Lossco has $100 in losses carried forward as at 29 July 1991 and as at that date is only 60 percent commonly owned together with Profitco. Typically, on 30 March 1992 the shareholders of Profitco would have topped up their shareholding in Lossco to 66.66 percent, ensuring minimum commonality of 66.66 percent as at 31 March for purposes of obtaining the benefit of Lossco's losses in Profitco. In the absence of a Budget night amendment, the losses could have been so offset to Profitco.

Shareholders	Commonality percentages as at:	
	29/7/91	31/3/92
A	30%	33.33%
B	30%	33.33%
	60%	66.66%

Because the amendment applies from 30 July 1991, the commonality percentages held at all times from 30 July 1991 to 30 March 1992 will be below 66.66 percent (the minimum threshold required at all times from 30 July 1991 to the end of its accounting year - in this case 31 March 1992). Lossco may not offset its losses to Profitco.

Groups of companies with non-standard balance dates must maintain commonality of shareholding to the end of the loss company's accounting year corresponding to the income year ending 31 March 1992.

Special relief provisions have been introduced where the acquisition of shares after Budget night is pursuant to a binding contract entered into before Budget night. The relief provision operates to deem the further acquisitions to have taken place from 30 July 1991 and to have been held to the date the shares were actually acquired.

Application Date

8 pm 30 July 1991

1st Key Date
1992 income year

Changes to Imputation Regime

Amendments to Income Tax Act

Introduction

Budget night legislation amended the imputation regime in two ways.

First, the regime was changed as a result of the removal of the inter-corporate dividend exemption.

Second, several defects which had become apparent in the anti-avoidance sections were corrected.

Background

Removal of Inter-corporate Dividend Exemption

The general inter-corporate dividend exemption was removed for dividends paid after 1 April 1992. In addition, dividends paid on shares issued in lieu of debt instruments after Budget night are taxable to corporate recipients from that time. Consequential amendments were made to:

- Section 394D of the Act (credits arising to the imputation credit account ("ICA") of a company);
- Section 394E (debits arising to the ICA); and
- Section 394ZE (conversion of unutilised credits to loss carry forward); and
- Section 394ZG (the general imputation anti-avoidance provision).

Defects in the Anti-Avoidance Rules

Several defects in these rules became apparent over recent months. These are specifically identified below.

Key Issues

Changes Consequent Upon Removal of Inter-corporate Dividend Exemption.

- **Section 394D(1)**

Subparagraph (va) was inserted into section 394D(1)(a). This subparagraph provides that a credit

will not arise to an ICA where income tax is paid by way of the crediting of an imputation credit. This ensures that companies do not obtain a double credit in the ICA for imputation credits attached to dividends they receive.

Section 394D(1)(d) was also amended. Until Budget night a company either obtained a credit in its ICA for imputation credits attached to dividends it received *or* it included the dividend in its assessable income (in the case of life insurance companies). Paragraph (d) prevented a company receiving a double benefit. However, in limited circumstances from Budget night and generally from 1 April 1992 dividends will be assessable to a company. The company will include the dividend and credit in its assessable income *and*, in order to prevent double taxation of the dividend, a credit will arise in the company's ICA for the amount of the imputation credit attached to the dividend. This requires the amendment of paragraph (d). Both of these amendments came into force on Budget night.

- **Section 394E(1)(ab)**

Paragraph (ab) was repealed, with effect from 1 April 1992.

- **Section 394ZE(3)**

Paragraph (b) of this section, which provides for the conversion of unutilised imputation credits into a loss to carry forward, was amended. Excess credits are divided by the extra emolument rate (28 percent). That rate is an approximate mid-point between individual rates. For companies including dividends in assessable income, the appropriate rate is the company tax rate (33 percent). For dividends received by trustees of Group Investment Funds, the appropriate rate is the rate of tax paid in relation to Category A income - also 33 percent at present.

The amendment applies to unutilised credits which have been included in assessable income for the 1991-92 and subsequent years.

- **Section 394ZG**

This is the general anti-avoidance provision in the imputation and dividend withholding payment regimes. The terminology in the section reflected the fact that when it was included in the Act dividends were not assessable to companies. Companies could not obtain the benefit of a credit of tax for imputation credits attached to dividends received. They therefore could not obtain a "shareholder tax advantage", only a "company tax advantage". This terminology became redundant after Budget night. Now, where companies obtain a "credit advantage" they will also obtain an "account advantage". The section has been amended to reflect this.

Correction of Defects in the Imputation Anti-Avoidance Provisions

- **Section 2**

For the purposes of the Act section 192 and 195 debentures will now be treated as shares.

For the imputation anti-avoidance provisions in section 394ZG, this amendment applies to arrangements entered into after Budget night. For pre-Budget arrangements, it will apply from 1 April 1992. For the purpose of the anti-stapled stock provision (section 394ZF), it will apply to dividends paid from Budget night until 1 April 1992 for arrangements entered into after Budget night, and to dividends paid after 1 April 1992 in all cases. It also applies from Budget night to the anti-dividend stripping provisions in section 99(5) and 198. In other cases the amendment takes effect from 1 April 1992.

These debentures are treated as equity in some respects in the Act but they have been used to avoid the imputation anti-streaming provisions. The opportunity has also existed for them to be used to avoid the provisions referred to above.

- **Section 394ZF**

This section counters stapled stock arrangements. Defects in the section were identified: dividends which are beneficiary income and dividends paid to persons associated with the shareholder might not have fallen within its scope. These deficiencies were remedied with effect from Budget night. However, where a dividend is paid before 1 April 1992 under an unaltered pre-Budget night arrangement, the amendment will not apply.

- **Section 394ZG**

As noted earlier, this section is the general anti-avoidance provision for the imputation and dividend withholding payment regimes. Several defects in the section became apparent recently. They were:

- Section 394ZG(2)(a) did not include arrangements involving the issue of shares - only their disposition;
- It was not clear that the anti-streaming provision in subsection (2)(b) applied to dividends which were beneficiary income and streaming arrangements involving the use of bonus issues; and
- The Commissioner had no power to deny credits to a shareholder who had been a party to a streaming arrangement in terms of subsection (2)(b).

These defects were remedied from Budget night for arrangements entered into after that time and from 1 April 1992 for unaltered pre-Budget arrangements.

Non-Resident Withholding Tax on Interest Relaxed, Approved Issuer Levy Introduced

Amendments to Income Tax Act and Stamp and Cheque Duties Act

Introduction

Amendments to the Non-Resident Withholding Tax regime and the introduction of the "approved issuer levy" were announced in the Budget.

From 1 August 1991 "approved issuers" will be able to pay interest to non-residents without deducting Non-Resident Withholding Tax (NRWT). Approved issuers will be required to pay a levy for the right to issue securities that are subject to a zero rate of NRWT. The levy, to be known as the "approved issuer levy", is calculated at a rate of 2 cents for every $1 of interest paid on the security.

Background

The amendment to the NRWT regime is intended to reduce some of the costs incurred by New Zealand residents when they borrow from non-resident investors who are either unwilling or unable to bear the costs of having withholding tax deducted from their interest income. Such non-resident investors typically require the resident borrower to "gross up" the amount of interest paid by the amount of any withholding tax applied to that income. This tends to increase domestic interest rates.

Zero Rating of Interest NRWT

These conditions must be satisfied before any interest payments can be subject to a zero rate of NRWT:

- The persons paying and receiving the interest cannot be associated;
- The interest must be paid by an "approved issuer" on a "registered security";
- Approved issuer levy of 2 cents for every $1 of interest must be paid by the due date.

The important requirements relating to:

- approved issuer status,
- registration of securities, and
- payment of approved issuer levy

are explained in detail below.

This measure only relieves a liability to NRWT. New Zealand residents and non-residents who have a fixed establishment in New Zealand will still be liable for income tax on that interest income as they are not subject to the NRWT regime.

Interest payments to non-residents that do not satisfy the conditions for zero rating will be subject to NRWT in the normal manner.

Approved Issuer Status

Borrowers who wish to pay tax free interest to non-residents must apply in writing to the Commissioner of Inland Revenue (stating their name and IRD number) to obtain approved issuer status. This will be granted unless the applicant has been in serious default or neglect in complying with tax obligations during the period specified in Section 311B of the Income Tax Act. Approved issuer status will apply from the date on which the application was received.

The Commissioner may also revoke approved issuer status for serious default or neglect in complying with tax obligations. However, revocation will affect only the person's ability to issue new tax free securities, not the status of existing securities.

All applications should be sent to:

The District Commissioner
Inland Revenue Department
Non-Resident Centre
P O Box 1247
DUNEDIN

Telephone Number (03) 4771-340
Fax Number (03) 4790-659

Registration of Securities

Only securities that have been registered with the Commissioner of Inland Revenue will qualify for a zero rate of NRWT.

Approved issuers may register by completing a registration form (IR 291B), which they should send to the Non-Resident Centre as noted above. Registration will be accepted providing the registration form has been duly completed and the security that is being registered relates to money lent to an approved

issuer after 1 August 1991. All registered securities will be assigned a registration number, and registration will take effect from the date on which the application was received.

Payment of Approved Issuer Levy

Approved issuers are required to pay a levy for the right to pay interest that is subject to a zero rate of NRWT. Approved issuer levy is calculated at a rate of 2 cents for every $1 of interest paid ("leviable value"), and must be paid to Inland Revenue by the 14th of the month following the interest payment. Failure to pay the approved issuer levy by the due date will make that interest payment liable for NRWT, to the extent that the approved issuer levy is deficient.

For example, if $10,000 interest is paid by an approved issuer on a registered security on 1 September, an approved issuer levy of $200 must be paid to Inland Revenue by 14 October. If no levy is received by Inland Revenue by the due date (14 October) the entire interest payment ($10,000) will be liable to NRWT.

Payments of approved issuer levy should be sent to Inland Revenue's Southern Processing Centre, P O Box 3754, Christchurch, together with a completed approved issuer pay-in slip, IR 67B.

As failure to pay the approved issuer levy by the due date renders that interest payment liable for NRWT, the Commissioner has been given discretion under section 86M of the Stamp and Cheque Duties Act to accept a late payment of levy as being on time. However, that discretion can be exercised only where the delay was due to circumstances beyond the payer's control.

Inland Revenue has prepared a pamphlet on the new Approved Issuer Levy (IR 291A), which is available from any of our offices.

Guaranteed Retirement Income Earner Surcharge

Amendment to Income Tax Act

Introduction

The Guaranteed Retirement Income Earner Surcharge has been repealed from the 1992/93 tax year. From 1 April 1992 it will be replaced by a revised National Superannuation scheme, which the Department of Social Welfare will administer.

Key Issues

From 1 April 1992 Social Welfare will pay the new National Superannuation, which will abate according to the National Superannuitant's income (and, if married, the income of the National Superannuitant's spouse), where that income exceeds $80 per week or $4,160 per annum. The spouse's income will be taken into account whether he/she also receives National Superannuation or not.

The income that will be taken into account for abatement purposes will be the same as that currently used for "other income" for surcharge purposes, i.e., the taxable income of the taxpayer, plus one-half of any pension or annuity, less the National Superannuation and any specified foreign social security pension. The amount of this income will abate the gross National Superannuation at 90 cents in the dollar for every dollar of income that exceeds the threshold of $4,160.

National Superannuitants aged 70 and over will be paid a minimum rate of National Superannuation equal to 50 percent of the standard rate for a married person. Currently this is $4,405.70 a year before tax.

Simple examples of the abatement are provided below.

Inland Revenue's involvement in the new National Superannuation scheme will be to supply Social Welfare with details of the National Superannuitant's income (and if married, the spouse's income), from the tax returns furnished. From this information Social Welfare will do a square-up and make a further payment if National Superannuation was underpaid, or require a repayment of any overpayment. These under or overpayments will adjust the National Superannuitant's income in a future income year or years. The tax treatment of these under or overpayments is still to be determined.

The definition of a pay period taxpayer has been amended to exclude any person (and, if married, that person's spouse) where the "other income" of the person, or the combined income for a married couple, exceeds $4,160. "Other income" is now defined in section 356 as an amount calculated in accordance with the formula:

a - b - c

where-

(a) Is the amount of the taxpayer's taxable income, plus one-half of any pension or annuity that is not taxable income.

(b) Is the amount of any gross national superannuation and gross living alone payment received.

(c) Is the amount of any specified foreign social security pension received.

Various consequential amendments have been made as a result of guaranteed retirement income being replaced with National Superannuation.

Application Date

1 April 1992.

Examples

Under 70

Single National Superannuitant (living alone)

Unabated National Superannuation			$11,807
Other income	15,000		
Exemption	4,160		
	10,840	@ 90c	9,756
National Superannuation payable			$ 2,051

Married National Superannuitants (both under 70)

Unabated National Superannuation (joint)			$17,622
Joint other income	21,000		
Exemption	4,160		
	16,840	@ 90c	15,156
National Superannuation payable			$ 2,466 *

* $1,233 paid to each spouse

Over 70

Single National Superannuitant (living alone)

Unabated National Superannuation		$11,807
Other income	13,000	
Exemption	4,160	
	8,840 @ 90c = $7,956	
Maximum abatement		7,401.30
National Superannuation payable		$ 4,405.70

Married National Superannuitants (both over 70)

Unabated National Superannuation		$17,622
Joint other income	35,000	
Exemption	4,160	
	30,840 @ 90c = $27,756	
Maximum abatement		8,810.60
National Superannuation payable		$ 8,811.40 *

* $4,405.70 paid to each spouse

National Superannuation will be fully abated once the other income exceeds the following amounts:

Single person (sharing)	$16,124
Single person (living alone)	$17,280
Married couple	$23,741 (joint income)

Gaming Machine Duty Introduced

Amendment to Gaming Duties Act

Introduction

A duty on gaming machine turnover will apply from 1 October 1991, at the rate of 5.5 percent. The duty will apply to all gaming machines owned by about 2,050 gaming machine operators currently licensed under the Gaming and Lotteries Act 1977. The legislation to impose and collect this duty will be incorporated into the Gaming Duties Act 1971.

The legislation to impose Gaming Machine Duty has been referred for consideration to the Internal Affairs and Local Government Select Committee. The Government intends that the Gaming Duties Amendment Bill will be referred back to Parliament for its third reading by 22 August 1991.

Background

At present, the Lotteries Commission, racing clubs and the Totalisator Agency Board pay duty on their gaming turnover. However, gaming machine turnover has not been subject to duty. The new gaming machine duty will remove this inconsistency.

The Department of Internal Affairs is responsible for regulatory functions such as the licensing of gaming machine operators. It will also be responsible for conducting random audits of gaming machine operators. The Inland Revenue Department will be responsible for collecting gaming machine duty. Similar arrangements exist for both lottery and totalisator duty.

Key Issues

Imposition of duty

Duty will be imposed, at the rate of 5.5 percent, on the turnover of dutiable games played by means of a gaming machine on or after 1 October 1991. A gaming machine is a machine used to play any game of chance, instant game lottery, or prize competition. Explicitly excluded are machines used as a means of drawing a lottery such as Lotto or selecting numbers in a game of Housie. Turnover is the amount of money or money's worth, in the form of cash, tokens, or credits won, paid to play a gaming machine.

Returns and payment of duty

A gaming machine operator must deliver a monthly return of the gross turnover of all gaming machines and the duty payable on that gross turnover. A gaming machine operator is:

- A society licensed under the Gaming and Lotteries Act 1977 to operate gaming machines; or

- Any other person who operates gaming machines, otherwise than pursuant to a licence issued under the Gaming and Lotteries Act. This is to ensure that unlicensed operators are subject to duty on their turnover.

The return and payment of the duty is due on the 20th of the month following the month to which the return relates. For example, the return and payment of duty for the month of October is due on 20 November.

Where a gaming machine operator has had its licence cancelled or its renewal refused, the return and duty payable are due seven days after the cancellation of the licence or the refusal to renew. In these circumstances, the return period begins on the first day of the month in which the cancellation or refusal to renew occurred and ends on the day after the cancellation or refusal. The Department of Internal Affairs will advise Inland Revenue of the cancellation of the licence or the refusal to renew.

Interest on unpaid gaming machine duty

Interest at the rate of 5 percent a month or part of a month is payable on unpaid duty from the due date and is recoverable as if that interest were duty payable. Any interest charged is not subject to any remission. Interest will not be charged on any amount of duty unpaid (deferrable duty) which is subject to an objection.

Assessments and objection procedures

Generally, the filing of returns and the payment of duty will be on a self-assessment basis. However, the Commissioner will have the ability to issue assessments in certain circumstances. These circumstances are:

- A person defaults in delivering a return;

- The Commissioner is not satisfied with a return;

- The Commissioner is not satisfied that the amount of duty calculated as payable by a person is the correct amount; or

- The Commissioner believes that a person, although that person has not delivered a return, is liable to pay duty.

Where a return has been delivered, the Commissioner may not issue an assessment or an amended assessment after the expiration of four years from the end of the month in which the return was delivered or the assessment was made. This time limit is waived where the Commissioner believes that a person has knowingly or fraudulently failed to make full and true disclosures of the facts necessary to determine the amount of the duty payable.

If an assessment is issued by the Commissioner, it may be objected to in the same manner as is available for GST assessments, and may be referred to the Taxation Review Authority or the High Court. Interest will be payable on duty in dispute (refundable) and deferrable duty (payable) in the same way as for GST.

Recovery of duty

Gaming machine duty is recoverable as a debt to the Crown. Unpaid duty and interest thereon also constitute a debt due and payable, jointly and severally, by:

- In the case of an incorporated gaming machine operator, all persons who, at any time during the return period, were officers, trustees, or other persons acting in the management of the gaming machine operator such as the secretary and treasurer.

- In the case of an unincorporated gaming machine operator, all persons who, at any time during the return period, were members, officers, or trustees of the gaming machine operator.

Unpaid duty will rank in bankruptcy, liquidation, or receivership, without limitation of amount, as a preferential claim. It will have the same priority as PAYE and GST.

The Commissioner can serve a written notice on a third party to deduct a specified sum from any amount payable or to become payable to a defaulting gaming machine operator or any person who has

defaulted in the payment of duty. Every amount deducted must be paid to the Commissioner within the time specified in the notice. Where an amount has been deducted but not paid to the Commissioner, the amount deducted is recoverable from the person making the deduction as if the deduction were gaming machine duty payable by that person.

Offences

Penalties for offences will be as follows:

- A fine not exceeding $200 for the offence of failing to deliver a return by the due date;
- A fine not exceeding $1000 for the offence of wilfully or negligently giving false information;
- A fine not exceeding $500 for the offence of not making a deduction from a payment owing to a gaming machine operator and paying that deduction to the Commissioner.

Refund of duty and interest paid in error or in excess

A gaming machine operator will be entitled to a refund of any gaming machine duty and interest paid in excess or in error. Before a refund is made, the Commissioner must be satisfied that the duty was paid in error or in excess. The time limit for such refunds is eight years from the date of payment unless an application has been made within the eight year period.

Exchange of information

The Department of Internal Affairs and the Inland Revenue Department will have the ability to exchange information for the purposes of administering gaming machine duty legislation. The type of information that will be exchanged is:

- The names and addresses of the societies licensed under the Gaming and Lotteries Act to operate gaming machines;
- Details of licences cancelled or not renewed; and
- Details of under-declared turnover identified during random audit activities.

Application Date

The general application date of the gaming duty legislation will be 1 October 1991. However, the provision that allows for the exchange of information comes into force on the date of assent to allow the Inland Revenue Department to obtain the information necessary to establish the names and addresses of gaming machine operators.

Change to ACC Levies System

Amendment to Accident Compensation Act

Introduction

The way that Inland Revenue accounts to the Accident Compensation Corporation for self-employed ACC levies was amended in Budget night legislation.

Background

Previously, the Commissioner paid an amount equivalent to a self-employed levy to the Corporation on the date on which that levy was assessed. Often this would occur before Inland Revenue received the levies.

In this case, Inland Revenue made payment from the Crown Account, which represented an indirect income subsidy to the Corporation.

The Amendment

Inland Revenue is now required to pay self-employed levies to the Corporation when they are paid to the Department.

Application Date

1 August 1991.

Health Reform - “KiwiCard”

Amendment to Inland Revenue Department Act

Introduction

As a result of the introduction of “KiwiCards”, an amendment was required to the Inland Revenue Department Act to enable the Social Welfare Department to obtain certain information to establish Family Support Tax Credit (FSTC) recipients’ entitlements to the card.

Background

Section 13A has been inserted into the Inland Revenue Department Act 1974, so specific information can be transferred to the Department of Social Welfare. This information will be used solely to establish an initial entitlement to “KiwiCards” for FSTC recipients.

The amendment allows only for the release of the following information for the year ended 31 March 1991:

- Name and address
- Number of children
- Amount of the tax credit

Application Date

The amendment took effect from Budget night and will expire on 31 March 1992.

New Tax Bill Introduced

References to Standard and Non-Standard Income Years

Introduction

A proposed amendment will shorten references in the Income Tax Act to standard and non-standard income years. The provision is of a general interpretative nature only and has no substantive effect.

Key Issues

For example, the Income Tax Act will be able to refer to "the 1992-93 income year" rather than as "the income year commencing on the 1st day of April 1992" or "the income year ending on the 31st day of March 1993". This will simplify drafting.

References in the Act to persons with standard income years will mean people whose balance date is 31 March.

References in the Act to persons with non-standard income years will mean people whose income year ends on a date other than 31 March, being a non-standard income year which corresponds to the relevant standard income year.

People with non-standard income years will be referred to as having:

(i) an early income year, if their non-standard income year ends between 1 October and 30 March inclusive; or

(ii) a late income year if their non-standard income year ends between 1 April and 30 September inclusive.

Application Date

These amendments apply from the date on which the amendment Act receives the Royal assent.

Loss Carry-Forward and Grouping Rules

Introduction

New rules are implemented relating to the carrying-forward and grouping of tax losses. Existing sections 188 and 191 will be repealed and replaced with nine new sections. The new rules are designed to tighten the criteria under which companies can carry forward losses and offset losses against the profits of other companies.

The policy intention of the new loss carry-forward and grouping provisions is to ensure that, as far as practicable, only those individuals who have borne the initial economic burden of a company's losses are able to ultimately gain the benefit of those losses for tax purposes. The intention of the new rules includes that of preventing the commercial trafficking of company tax losses to the detriment of the Revenue.

Background

The current restrictions on the ability of companies to carry forward and group losses are contained in existing sections 188 and 191, which will be repealed by this Bill with effect from the 1992/93 income year. The restrictions in the current sections 188 and 191 have proved to be inadequate and losses have been carried-forward and offset in circumstances where those individuals that have gained the benefit of tax losses are not the same persons as those that have borne the economic burden of those losses.

Key Issues

Purpose of Continuity Provisions - New Section 187A

The statutory purpose of the new loss and credit carry forward rules is stated as ensuring that in

general, at least to the extent of the new minimum continuity of shareholding threshold (66%), only those natural person shareholders who have borne the initial economic burden of a company's losses are able to ultimately gain the benefit of those losses for tax purposes.

This preamble-type provision provides a guide as to the broad scheme and purpose of the continuity provisions. It sets out the principle underlying the detailed rules.

Measuring Shareholders' Economic Interests - New Sections 187B, 187C, 187D

The Bill introduces the concept of a shareholder's economic interest in a company. This concept is central to the continuity and grouping provisions. A common measure of a shareholder's economic interest in a company will apply for the purposes of the loss and credit carry-forward provisions (referred to in the Bill as the continuity provisions) and the grouping rules.

Since a number of provisions require a shareholder to determine its interest in a company, clarity and consistency is enhanced by having a common set of provisions to determine a shareholder's economic interest in a company.

A shareholding individual's economic interest in a company will generally be measured by reference to the percentage of voting power held by that person in a loss company. In certain circumstances where a shareholder's economic interest in a loss company may not be accurately reflected by the voting power held by that person, an additional market value test must also be used to measure that shareholder's economic interest.

Voting Interest Determination - New Section 187C

A shareholder's interest in a company's tax losses or credits will be measured primarily by reference to the percentage of voting power held by that person in relation to decision-making by the company.

Apart from measuring an interest by reference to market value, voting power is seen as the best proxy for a measure of a shareholder's beneficial interest in the losses or credits of a company, and it will often be relatively simple to apply. By exercising voting power, a shareholder can protect its position relative to other shareholders and can ensure appropriate access to the earnings of the company when they are distributed.

Under the new rules, voting power will be defined as the percentage of power to vote in relation to decision-making concerning the:

(i) Distributions to be made by the company;

(ii) Constitution of the company;

(iii) Variation in the capital of the company; and

(iv) Appointment or election of directors of the company.

Where voting percentages vary for these different types of decision-making, the average of these rights will be used for the purpose of applying the voting power test. It should be noted that this approach is different from and supersedes that taken in the 1991 Budget report supplement on business tax policy (page 88).

Application of Market Value Test - New Section 187D

In certain circumstances a shareholder's economic interest in a company at any time will be determined by reference to *both* the percentage of voting power (in respect of that interest) and the percentage that the market value of the interest held by that shareholder is of the total market value of all interests in the company at that time. Shareholders' economic interests, computed using both the market value and voting power tests, will be used in determining whether the minimum shareholder continuity or commonality thresholds have been satisfied.

In general, a shareholder's economic interest will be determined using both the market value and voting power tests where that shareholder's economic interest in a loss company may not be accurately reflected by the voting power held by that person.

The market value of an interest will be defined as what the interest could be sold for in an arms-length transaction. In the case of any share or option listed on an approved New Zealand or foreign stock exchange, its market value would be determined as its middle-market quotation at that time, unless such a quotation does not reflect its true market value. Shares will also be valued by excluding the value attributable to any options issued over those shares that are themselves taken into account in applying the market value test to prevent double counting.

For the purpose of the continuity provisions, the circumstances where a shareholder's economic interest is measured by reference to both the market value and voting power tests include where:

(i) A shareholder has an entitlement to a certain proportion of company profits which, if it can be ascertained, is different from its voting power and can veto any alteration to that entitlement;

(ii) The company or its shareholders have issued options (other than certain options over listed company shares) to acquire shares at their market value, or options are issued over interests in the company not yet held by the issuer.

(iii) The company has issued debentures covered by section 192 of the Income Tax Act after Budget night. Section 192 debentures are taken into account because they share similar characteristics to equity instruments in that their yields depend on the profits of the company. In addition, in relation to the credit carry-forward rules only, the market value test would be triggered if the company issues night fixed rate dividend shares or section 195 debentures after Budget night.

(iv) The company has issued shares (other than fixed rate dividend shares) the returns on which are guaranteed by a third party; or

(v) The shares have been subject to an arrangement with the purpose or effect of defeating the intent and application of the credit and loss carry-forward and grouping rules.

The transitional rules (primarily contained in the Budget night legislation) are designed so that on Budget night almost all companies will be able to provisionally measure their shareholders' interests for the purposes of the new loss and credit carry-forward and grouping rules, by referring solely to the voting power test. This is because section 192 and 195 debentures and fixed rate dividend shares issued before Budget night will not trigger a requirement to apply the market value test until 1 April 1994, if they are still on issue at that time. It will only be as companies issue such instruments after Budget night that there might be a requirement to compute shareholders' interests by reference to the market value of those interests.

Tracing Through Companies - New Section 187C

Subject to certain exceptions (e.g., the special rules concerning listed companies) it is only the economic interest of the ultimate natural person shareholder that will be taken into account in determining whether the shareholder continuity and commonality thresholds have been met. It is therefore necessary to trace through the interests of interposed corporate shareholders in a company to that company's ultimate natural person shareholders.

Nominees and Bare Trustees - New Sections 187B and 187C

The nominee (nominee includes a bare trustee) provisions will continue to require one to look to the beneficial owner of shares in determining whether continuity or commonality of shareholding requirements have been satisfied.

Under the new nominee provisions a person is no longer deemed to be the nominee of his/her spouse or child, as is the case under existing section 191(1)(d). The significance of this change is that transfers within a family group will potentially breach continuity except where such transfers are pursuant to a matrimonial property agreement or a disposition under a will or intestacy.

There will be a common and clearly defined set of provisions that define nominees for the purposes of the new loss and credit carry-forward and grouping rules, and that deem the interests they hold to be held by the beneficial owners of such interests (on whose behalf the nominees act).

Other Trustees

People who are trustees of a trust (apart from bare trustees) will be treated as the same single person for the purposes of the continuity provisions, provided that any change in trustees does not have the purpose or effect of defeating the intent and application of the continuity provisions. An example of this intention or effect would be where there is a change in the beneficial ownership of a trust's assets.

A corporate trustee (other than the Public Trustee, Maori Trustee or a trustee company in terms of the Trustee Companies Act 1967) will generally be deemed to have disposed of its assets to a third party and reacquired them if there is any change in the shareholding of the corporate trustee. This deemed sale and reacquisition would result in a breach of continuity for any loss company owned by the corporate trustee. However, a deemed sale and reacquisition of a corporate trustee's assets will be deemed *not* to occur if it can be shown that the corporate trustee's shareholding change did not have the purpose or effect of defeating the intent and application of the continuity provisions; e.g., where the change in shareholding does *not* result in a change in the beneficial ownership of the trust's assets.

Application of General Rules for Determining Shareholder's Economic Interests to Certain Non-Standard Companies

The general rules for determining shareholders' economic interests should apply to the following non-standard companies:

Unlimited Liability Companies;
Companies Limited by Guarantee;
No Liability Companies;
Co-operative Companies;
Building Societies; and
Unit Trusts.

These entities typically have shares or units that carry voting power for which a market value can be determined. For example, co-operative companies and building societies are similar to other companies in that both have share capital and identifiable shareholders, and voting rights typically attach to the relevant shares.

Unit holders should normally be able to determine their economic interests in a unit trust either by reference to the percentage of voting power they hold in the unit trust and its management, or the market value of their interests.

Widely-held unit trusts, co-operative companies and building societies will be treated in a similar manner to listed companies for the purposes of the shareholder continuity rules.

Listed Companies - New Sections 187B and 187C

For the purposes of the new loss and credit carry-forward rules, it will not be necessary to separately identify direct interests held by any persons that together with their associates hold economic interests of less than 10% in the listed company. The interests of those shareholders who each hold interests of less than 10% in a listed company will collectively be treated as being held by one shareholder.

It will also be unnecessary to look through interests held by a listed company in a loss company unless the listed company and its associates hold an interest of 50% or more in the loss company.

Special rules for listed companies are necessary to reduce compliance costs a listed company would otherwise face in having to identify and separately take into account for the purposes of the loss and credit carry forward rules all the minor interests held in it by natural persons.

Special Corporate Entities - New Sections 187B and 187C

The current definition of a special corporate entity will be expanded to include (in addition to a local authority, statutory producer board or a statutory body established by a specific Act of Parliament) a public authority, life insurance fund and a group investment fund.

For the time being, the members or directors of special corporate entities on Budget night will be deemed to hold, in their collective capacity, all the voting power and all the market value of the entity for the purposes of the loss and credit carry forward and grouping rules.

Corporate groups which include a special corporate entity will be placed on an equal footing with other corporate groups for the purposes of the grouping provisions in new section 191.

It is necessary to make special provision for entities covered by the special corporate entity definition because as a rule these entities do not have share capital or natural person shareholders, features which the general loss and credit carry forward and grouping rules are predicated on.

As stated in a TIB Vol Three No.1 (July 1991), an entity seeking special corporate entity status under the category of a statutory body established by a specific Act of Parliament must submit a copy of its parent statute to Inland Revenue to allow a decision to be made as to whether it is appropriate to treat that body as a special corporate entity.

Carrying-Forward of Losses: General Rules - New Section 188

The minimum continuity of shareholding which must be maintained at all times during a continuity period for a company to carry forward its losses will be increased from 40% to 66%. This minimum continuity threshold is referred to in the new legislation as the “continuity percentage”.

The relevant continuity period will be from the beginning of the loss company’s accounting year in which the loss was incurred through to the end of the loss company’s accounting year in which the carried forward loss is offset against the company’s current year assessable income.

The lowest percentage economic interest held by each shareholder during the continuity period will be used to determine whether the shareholder continuity requirements have been satisfied. If both market value and voting power tests are required to be applied then the lowest economic interest of a shareholder under either of these tests will be taken into account.

If the aggregate of the lowest percentage economic interest held by each shareholder in a company is equal to or greater than the continuity percentage the shareholder continuity requirements will be satisfied and the loss will be eligible for carry-forward.

A breach of continuity can therefore potentially take place where the number and identity of a company’s shareholders does not change over a continuity period but the proportion of shares held by each shareholder does. For example, at the beginning of a continuity period shareholders ‘A’ and ‘B’ hold respectively 80% and 20% of the shares in the company “Lossco”. During the continuity period ‘A’ sells a

60% interest in Lossco to 'B'. The lowest percentage interest held by the shareholders over the continuity period would be 20% in the case of both 'A' and 'B'. Continuity would be breached as the aggregate of lowest percentage economic interests is 40% which is less than the required continuity percentage. Lossco would therefore not be entitled to carry forward its losses to the next income year.

Relief Provisions - New Section 187C

Shares in a company which are transferred pursuant to a matrimonial property agreement will be deemed for the purposes of the continuity provisions to have been acquired by the transferee on the same date those shares were acquired by the transferrer.

Similarly, if shares in a company are transferred under the will or intestacy of a deceased person, the shares will be deemed to have been acquired by the beneficiary or trustee on the same date those shares were acquired by the deceased person.

Loss Carry Forward Transitional Rules

Losses incurred in the 1991/92 and prior income years that would have been eligible for offset in the 1991/92 income year, will continue to be eligible for offset in 1991/92 or carry-forward into the 1992/93 income year and beyond provided that:

(i) A 40% continuity of shareholding is maintained at all times from Budget night to the end of the loss company's 1991/92 income year under the carry forward rules in existing section 188 as modified from Budget night. The 40% continuity threshold needs to be satisfied by taking account of the lowest percentage of shares held by each shareholder in a company during this period (provided that where a change of shareholding occurs after 30 July 1991 pursuant to a binding contract entered into before 8pm on 30 July 1991 the relevant shares shall be deemed to be acquired at that time); and

(ii) A 66% continuity of shareholding, computed using the new rules, is maintained from the beginning of a loss company's 1992/93 income year.

Mining Losses - New Section 188C

The provisions of existing section 188 relating to the losses of mining companies and petroleum miners are separated out from new section 188 and restated in a separate section. There are no substantive changes to the existing provisions.

Special Partnerships

Section 211B of the Act, which relates to special partnerships is amended. A claim for a loss carry-forward will not be allowed unless the Commissioner is satisfied that, if the partnership had been a company, and the interests of the partners in the partnership's certified capital had been shares in that company, the loss could have been carried forward under section 188. The criteria for the carry-forward of losses will therefore be the same for both special partnerships and companies.

Part-Year Losses - New Sections 188 and 191

A company will be permitted to carry-forward or group part-year losses by preparing a set of accounts that relate to the part-year of loss and show the losses attributable to that part-year.

Grouping of Losses: General Rules - New Section 191

Under the new grouping rules loss and profit companies must be members of the same group at all times from the beginning of the loss company's income year (i.e., its accounting year) in which the loss is incurred to the end of the loss company's income year in which the loss is offset. Whereas before shareholder commonality under the grouping rules was only taken at two points in time (i.e., 31 March in the year of loss and 31 March in the year of loss offset) there will now be a requirement of continuity of commonality of shareholding. The new rules are designed to restrict the ability of companies which are not members of the loss source group from benefiting from those tax losses.

The income of one of more profit companies will be able to be offset against the carried-forward or current year losses of a loss company if the profit and loss companies are at least 66% commonly owned at all times from the commencement of the loss company's income year in which the loss is incurred to the end of the loss company's income year in which the loss is offset.

A loss company and one or more profit companies will qualify to be part of a group for loss offsetting purposes if at all times during the requisite period the aggregate of the lowest percentage economic interest of each shareholder in each of the companies in a group is at least 66%. This is similar to the prescribed proportion test in existing section 191 with the main exception that the 66% commonality of shareholding has to be maintained at all times from the commencement of the loss company's income year in which the loss is incurred to the end of the loss company's income year in which the loss is offset.

The losses eligible for offset under section 191 will be:

(i) losses of the loss company able to be carried forward into the income year of offset pursuant to section 188 (which means the continuity test must be satisfied in relation to the loss company); and

(ii) losses incurred in the income year of offset.

If shareholders' economic interests are required to be determined using both market value and voting power tests, the lowest percentage interest held by a shareholder in each company would be the lowest percentage computed using either the market value test or the voting power test.

Where the balance date of the profit company is later than the balance date of the loss company, the loss company will have to maintain shareholder continuity until the end of the profit company's accounting year before its loss can be offset against the assessable income of the profit company.

The restrictions in the current legislation which permit only New Zealand sourced losses to be offset against New Zealand sourced income will be retained. Loss grouping will only be available for the losses of:

(i) Companies that are incorporated in New Zealand and that are not dual resident companies; or

(ii) Companies that are carrying on business in New Zealand through a fixed establishment to the extent to which, if a profit had been made from the transaction in which the loss was incurred, the amount of the profit would have been assessable income derived by the company from that business carried on through a fixed establishment in New Zealand.

Means of Effecting Group Offsets - New Section 191

The means by which corporate groups actually offset losses will be simplified under the new grouping rules. Any corporate group will be able to offset the carried-forward or current year losses of member companies against the profits of other member companies by a combination of subvention payments and elections. Under the current rules, ordinary groups (i.e., corporate groups which are at least two-thirds but less than 100% commonly owned) are restricted to using subvention payments to effect the offset of losses.

With a common means of effecting group offsets the current ordinary group/specified group distinction will no longer exist.

Transitional Grouping Rules

Where the losses to be utilised relate to the 1990/91 and prior income years, the loss and profit companies will have to be members of the same group in the income year that the loss was incurred (i.e., 31 March in the relevant year) and at all times from Budget night to the end of the loss company's income year in which the loss is offset.

Where the losses to be utilised are incurred in the loss company's 1991/92 income year, the loss and profit companies will have to be members of the same group at all times from Budget night to the end of the loss company's 1991/92 income year for those losses to be offset in that year.

Application Date

The new loss and credit carry-forward and grouping rules come into force from the beginning of the 1992/93 income year (i.e., in respect of income years commencing on or after 1 April 1992). For the purposes of both the new carry-forward and grouping rules, references to income years for companies with non-standard balance dates include accounting years corresponding to the relevant income year. As outlined above, transitional measures already enacted with effect from Budget night protect the corporate tax base in the transitional period from Budget night to the beginning of the 1992/93 income year.

Tax Recovery

Introduction

A new tax recovery section will replace section 276. The new provision will enable the Commissioner to recover tax from directors and shareholders of companies that have entered into arrangements or transactions to deplete the assets of the company, leaving the company unable to meet its tax liability.

Background

The original section 276 had a number of deficiencies in its scope and ease of avoidance. The new recovery section is designed to ensure that those persons who are a party to the arrangement are responsible for the payment of any shortfall in tax. In this respect, it is better targeted than the original section. The new recovery section will also have wider recovery provisions, as the Commissioner can recover from both the shareholder as well as a director of the company.

Key Issues

Application or Recovery Provision

The new recovery provision will be triggered by arrangements or transactions that have been entered into to deplete the company of its assets so that it has insufficient funds to fully meet its tax liabilities. However, it will not be triggered by formal (under insolvency proceedings) or informal (under section 414A of the Income Tax Act) arrangements between

the Commissioner of Inland Revenue, the company and its other creditors, which would result in the Commissioner accepting less than the full amount of tax outstanding.

The determinants for the amount of tax liabilities will be based on both current and foreseeable future liabilities such as tax in dispute and unpaid annual Provisional Tax payments.

Who would be liable?

The new recovery provisions would apply only to:
- Directors of the company at the time the arrangement/transaction was entered into;
- Shareholders of the company who had a controlling interest in that company at the time the arrangement/transaction was entered into;
- Associated shareholders in the company whose combined interest gave them a controlling interest in the company; and

- Shareholders who did not have a controlling interest in the company at the time the arrangement/transaction was entered into, but who had benefited from the arrangement/transaction to an extent greater than their proportional interest in the company would warrant.

Controlling interest will be defined in a similar manner to that employed for the purposes of the Controlled Foreign Company (CFC) legislation (see section 245C).

Amount to be Recovered

Directors of the company will be jointly and severally liable for the full amount of the shortfall in tax that has resulted from the arrangement/transaction.

Shareholders with a controlling interest in the company at the time the arrangement/transaction was entered into, or a non-controlling shareholder who received a benefit which exceeded their interest in the company would be liable for:
- tax to be recovered up to the extent of the greater value of their shareholding in the company and the value of the benefit they derived from the arrangement; and
- any additional late payment penalty.

Application Date

31 July 1991

1st Key Date
1991/92 Income Year.

Qualifying Company Provisions for Closely-Held Companies

Introduction

The Bill introduces an elective regime for the taxation of closely-held companies or "qualifying companies". This will take effect from the 1992-93 income year.

Background

The Valabh Consultative Committee in its interim and final reports on the Taxation of Distributions from Companies (released in November 1990 and on Budget night 1991) made recommendations for the taxation of small, family owned companies. The Government has accepted their recommendations and included in the Bill legislation to give effect to them.

Key Issues

Criteria for entry into the regime

Companies with the following characteristics will be eligible to enter the qualifying company regime:

- The company is not a foreign company;
- The company has five or fewer shareholders. Shareholders related by blood or marriage within the first degree (e.g., parent/child, husband/wife) are deemed to be one shareholder;

  Example: Company A has the following shareholders :

Jack	- Father
Jane	- Mother
Paul	- Son
Pauline	- Son's wife
Susan	- Daughter
Mary	- Jack's brother's wife

  For the qualifying company regime there are only three shareholders
  1. Jack - Jane, Paul - Susan (All 1 degree from Jack)
  2. Pauline
  3. Mary

- Each Shareholder in the company is a natural person, or a trustee of a trust where all the income is distributed to beneficiaries, or a qualifying company;
- The company receives during the year no more than $10,000 of foreign income which is not dividend income - i.e., it can receive any amount of foreign dividend income;
- The shareholders have elected to assume responsibility for the tax payable by the company. In general, of course, the company will pay tax. However, the shareholders must assume joint and several liability for that tax.

Election into the Regime

All shareholders and directors of the company must elect by notice to the Commissioner that the company should become a qualifying company. In general, any election takes effect on the first day of the income year following the election. However, companies may nominate a future income year.

Companies have until 1 October 1992 to elect whether they will be qualifying companies for the first year of the regime, the 1992-93 income year.

Taxation of Qualifying Companies

Qualifying companies will be taxed on all dividends which they receive. For the 1992-93 income year, this means that qualifying companies with early balance dates will be taxed on dividends prior to 1 April when the general inter-corporate dividend exemption is abolished. It also means that the exemption until 1 April 1994 for dividends paid on redeemable preference shares issued prior to the Budget will not apply to qualifying companies receiving such dividends.

Imputation credits attached to dividends received by the company will be credited to that company's imputation credit account and will be available to offset company tax on the dividend.

No resident withholding tax will be deducted on dividends paid prior to 1 April 1992 to early balance date qualifying companies.

Qualifying companies may group for loss offset purposes only with qualifying companies.

Qualifying company election tax

Dividends paid by a qualifying company to its shareholders will either have maximum imputation credits attached or be exempt from tax. For this reason, and because it is not intended that the regime be retrospective, revenue reserves in existence before a company enters the regime will be taxed to the company at the corporate tax rate on entry into the regime. This tax is known as "qualifying company election tax".

The company will pay this tax on the amount calculated in accordance with the formula set out in the legislation. In effect, this is the amount which would be taxable to shareholders if the company were to wind up.

As a concessional transitional measure, where a company elects before 31 March 1993 to become a qualifying company a rate of qualifying company election tax of 7.5 percent will apply. That tax will be payable on the lesser of taxable reserves held at the date of election or on 30 November. However, tax at the full company rate is payable on the excess of dividends received over dividends paid during the period from November 1990 until the date of election. This is to prevent companies paying dividend income into a company which will make the election to become a qualifying company, thereby taking advantage of the concessional rate.

On entry into the regime, a company must also cancel its losses. Again, as a transitional measure, companies electing to enter the regime by 31 March 1993 will lose only 25 percent of losses.

Taxation of Shareholders

As noted earlier, shareholders will receive either fully imputed dividends or exempt dividends. This means that where the company pays no tax on a profit (e.g. capital profits) those profits will flow through to the shareholder tax free. Non-cash dividends will be exempt.

Shareholders of some qualifying companies will be able to elect to access the company's losses. In order for qualifying companies to pass through losses, they must have only one class of share. All losses will be attributed each year to shareholders in proportion to their shareholding.

More information is contained on the proposed regime in the Valabh Committee reports referred to above.

Local Authority Taxation

Introduction

Two anti-avoidance amendments relating to the taxation of local authorities will be implemented. The first amendment will insert a look-through provision in the local authority trading enterprise (LATE) definition contained in the Local Government Act 1974 (LGA). This will ensure that any the entity under the control of a local authority is in fact covered by the LATE definition. The second amendment will align the Income Tax Act definition of "local authority" with that contained in the Local Government Act.

Background

From 1 November 1989 local authorities which were previously exempt from all income tax (other than on income received in trust) have had to pay tax on all income derived from LATEs. LATEs themselves are taxed depending on their nature, i.e., on the same basis as companies, trusts, etc.

The definition of a LATE is contained in section 594B of the LGA. One of the statutory purposes of local government is the "operation of trading undertakings on a competitively neutral basis".

Key Issues

The amendments will help to carry out the intention of the current legislation. This intention is to make local authorities liable for tax on income from the trading activities of entities under their control, thus ensuring that these activities operate on a competitively neutral basis.

The current LATE definition in the Local Government Act contains a major loophole; subsidiaries of LATEs do not come within the LATE definition, even though they are still under the effective control of a local authority. The absence of a look-through provision in the LATE definition means that any second tier or further tier company or organisation does not come within the LATE definition.

As local authorities are not liable for tax on income derived from non-LATE entities, a local authority can gain a tax advantage by structuring its affairs (e.g., by using a holding company structure) to circumvent the LATE definition. While a non-LATE entity is still taxed in its own right according to its nature, a local authority can effectively extract tax free income from a non-LATE entity by charging the non-LATE for high rentals, management fee charges and the like.

Although the cost of the high rentals and management fees is deductible to a non-LATE entity which is under the control of a local authority, the corresponding receipt derived by the local authority is not assessable because of the continued application of the local authority tax exemption for income from non-LATE sources. Local authorities can therefore readily maximise the tax free income they derive from non-LATE entities while at the same time minimising the taxable income of these entities.

The above tax avoidance avenue is not available for LATEs as section 61(2A) of the Income Tax Act makes local authorities liable for tax on all income (not just dividends) derived from LATEs.

A look through provision will be inserted in the LATE definition to ensure that second tier and further tier subsidiaries of current LATEs also come within the LATE definition. A local authority would therefore be liable for tax on all income it derives from such second tier and further tier subsidiaries.

The current definition of "local authority" in the Income Tax Act is very wide and could give rise to several tax avoidance opportunities. The LGA local authority definition, in contrast, is more specific and finite and would be unlikely in itself to give rise to any tax avoidance opportunities. An amendment will align the local authority definition in the Income Tax Act with that contained in the LGA.

Application Date

These amendments will apply from the date on which the amendment Act receives the Royal assent.

Announcements

Consolidation

It is proposed that a group of companies will be able to elect to consolidate where these companies have 100 percent common ownership. Ownership will be measured by a shareholder's economic interest in a company (as used in the loss provisions).

The features of consolidating include the ability to:

- Transfer inter-corporate dividends tax free;
- Transfer inter-group assets tax free; and
- Introduce a consistent and simplified joint assessment process.

All member companies must be New Zealand resident taxpayers and there will be no requirement that a parent company must be included in the consolidated group.

The consolidated entity will have special rules governing returns, payment of tax, record keeping requirements, and pre-consolidation losses and credits.

Special rules will also be developed for exit and entry from the group. It is proposed that only when a company exits or the assets exit the group, that a taxable event occurs. In order to meet avoidance concerns, certain tracing rules will be required.

Depreciation

The Government announced its general support of the depreciation recommendations made in the Valabh Committee's discussion document on "Tax Accounting Issues". This support will now enable the commencement of the comprehensive review of rates planned by the Commissioner of Inland Revenue.

Officials were also directed to investigate the feasibility of extending depreciable allowances to intangible assets with a limited economic life.

The Earner's Premium

Introduction

In the Budget it was announced that the Accident Compensation Corporation was introducing an Earner's Premium to cover non-work and non-motor vehicle accidents. This premium is designed to lessen the burden on employers, who are currently funding payments for these accidents. The premium will be assessed at a yet to be determined flat rate. It will be paid by the earner on salary and wages or self-employed income. Inland Revenue will act as collection agent for the premium on behalf of the Accident Compensation Corporation.

Background

Currently, all payments for accidents are funded from the Employer Levy, Self-Employed Levy, and the Motor Vehicle Registration Levy. This generally places employers in the position of having to pay for the cover on their employees for accidents that happen outside the workplace and over which they have no control.

To continue to fund the current level of pay out for these accidents, the levies would have had to be substantially increased. The Corporation has instead announced that employers will not be charged for non-work related accidents and that the individual earners will provide their own cover.

Key Issues

There will be a flat rate, yet to be determined, set for all earners. The term "earner" covers both employees and self-employed persons. The same definitions and maximum earnings rules applying to the employer levy will apply to the Earner's Premium, except in relation to deemed employees on withholding payments.

There are four basic categories of earners, each with their own collection procedures.

Employees

Employers will be required to deduct the premium along with the PAYE deductions from their employees' wages and pay the total to Inland Revenue with their IR 66N. The booklet "PAYE Tax Tables" will be amended to include the premium so that only one amount will need to be deducted from the employee's earnings per pay period. When an employee terminates employment, or at the end of the year for employees who are still working for the employer, the employer will calculate the amount of the cumulative Earner's Premium and show it separately on each employee's IR 12. Calculating the cumulative Earner's Premium will be relatively simple as the amount of the premium will be a flat rate for all earners. This calculation will be necessary so employees can determine the amount of PAYE paid, to complete their annual income tax return. The employer will reconcile both the PAYE and Earner's Premium on the IR 68 reconciliation form.

Self-Employed

The self-employed will pay the Earner's Premium along with their payment of the Self-Employed ACC Levy. It will be assessed on the same leviable earnings with the same maximum leviable earnings.

Withholding Payments

The Earner's Premium on all withholding payments income will be calculated at the end of the year when the person furnishes an income tax return. Payment would be made at the same time as terminal tax.

Shareholder/Employees

Where tax is deducted at source, shareholder/employees will be regarded as normal employees and pay the premium when the PAYE is deducted. Where tax is not deducted at source (by virtue of section 6 of the Income Tax Act 1976), the Earner's Premium will be accounted for at the time the ACC Employer Levy is paid on that income, i.e., with the annual reconciliation due 31 May following the determination of the shareholder/employee income.

Application Date

The Earner's Premium will apply from 1 April 1992.

Valuation of Local Authority Asset Transfers

Background

Part XXXIVA of the Local Government Act 1974 (LGA) provides for the establishment of Local Authority Trading Enterprises (LATEs). A number of local authorities have established LATEs to undertake trading activities.

Generally the LATEs are established to replace undertakings previously conducted by the local authorities themselves. A transfer of assets is frequently associated with the transfer of operations.

Issue

Inland Revenue has received enquiries about the tax treatment of these asset transfers. Section 594ZM of the LGA states that:

> "Nothing in section 111 of the Income Tax Act 1976 shall apply in respect of any property acquired by a local authority trading enterprise from a local authority pursuant to an establishment plan."

Section 111 of the Income Tax Act 1976 deals with depreciation allowances where a taxpayer acquires a depreciated asset. Depreciation is generally based on the price paid for an asset.

Section 594ZM of the LGA does not comment on how the transferred assets are to be valued.

Policy

Inland Revenue considers that the assets should be transferred at either:

a) their "notional tax written down book value", notwithstanding section 594ZM(3) of the Local Government Act 1974; or

b) their true market value.

- **Notional Book Value**

"Notional tax written down values" are to be calculated in accordance with depreciation rates prescribed by Inland Revenue. That is, the original historic cost of the asset less "notional" depreciation at the schedule rates over the number of years the asset was used by the Local Authority.

- **Market Value**

Market value should be an accurate representation as well as agreed to between the parties.

There will be no "depreciation recovered", unless the transferring local authority has (i) been a taxpayer and (ii) claimed depreciation on the asset(s) in question.

Where either method of valuation is used Inland Revenue requires:

(i) an actual sale of assets by a local authority to a LATE at either accurate "notional tax written down values" or true market values; and

(ii) full consideration for the sale passing between the parties; and

(iii) complete and detailed documentation evidencing the transaction (including the listing of individual asset values).

This policy applies from 1 November 1989.

Reference 10 L 6.2

Public Service Mileage Rates

Use For Income Tax Purposes

Introduction

We have been asked to clear up the confusion about Inland Revenue's policy on using Public Service Mileage Rates (PSMR) for the purposes of reimbursing employees for using their own motor vehicles for work related purposes.

Background

For many years Inland Revenue, for administrative ease, has allowed taxpayers to use the PSMR for claiming deductions against assessable income and for calculating reimbursing allowances paid to employees. Some years ago the Commissioner of Inland Revenue restricted the use of the PSMR for tax deduction purposes to 2,000 kms per annum. Where the travel exceeded 2,000 km the actual expenditure incurred for the full year had to be claimed. At the same time this ruling was also intended to apply to allowances and reimbursing payments.

While there was adequate publicity about the restriction of taxpayers' claims in their returns of income, it

is now clear that it was not widely known that the restriction also applied to the other areas mentioned. Hence, there has been very little employer compliance with the restriction.

Ruling

Because of the circumstances mentioned above, the Commissioner will allow the use of the PSMRs on an unrestricted basis to continue. We will not attempt to rectify any cases where the 2000km limit has been exceeded in the past, provided the correct c.c. rating and annual kilometre bandings have been used.

Shareholder/employees

The above ruling will not apply to shareholder/employees. Where the company reimburses a shareholder/employee for motor vehicle expenditure, the public service mileage rates may only be used where the business running does not exceed 2,000 kilometres in any one income year. Where the annual business travel is more than 2,000 km reimbursement must be made on the basis of the actual expenditure incurred. No deduction or reimbursement for depreciation will be permitted. The ruling in TIB 3 - Appendix E, page 9 still applies.

The Future

The reimbursement of motor vehicle expenses to employees is a matter that was considered by the Tax Simplification Consultative Committee (TSCC). The Government accepted most of the recommendations made. Inland Revenue is currently attending to the details for implementation of the recommendations.

One recommendation was that the use of PSMRs be acceptable where the distance travelled did not exceed 5,000km in any one year. After 5,000 km an approved rate should determine the rate of acceptable reimbursement. There was also concern that the PSMRs, with the various "mileage bands" and c.c. ratings, were complicated for employers to use and keep track of the annual progressive mileage. There would also be difficulties where a worker changed employers during an income year.

To overcome some of these difficulties Inland Revenue has decided that employers can:

- continue to use the PSMR on an unrestricted basis, or
- as an alternative, use the following rates;

<table>
<tr><td>Column</td><td>(i)</td><td>(ii)</td><td>(iii)</td></tr>
<tr><td>Kilometres</td><td>PSMR rate</td><td>Rate for 5,000 kms</td><td>Rate Overall</td></tr>
<tr><td>1 to 1600</td><td>65c</td><td rowspan="4">55c</td><td rowspan="5">41c</td></tr>
<tr><td>1601 to 3200</td><td>54c</td></tr>
<tr><td>3201 to 4800</td><td>49c</td></tr>
<tr><td>4801 to 5000</td><td>46c</td></tr>
<tr><td>over 5000</td><td colspan="2">34c</td></tr>
</table>

Examples of use of above chart.

(1) Employee travels 4,850 in an income year.

The employee can be reimbursed by either;

(a) the average PSMRs - column (i), or

(b) the average column (ii) rate of 55c per km, or

(c) the actual expenditure incurred.

(2) The employee travels 10,800 kms in the year.

Reimbursement can be either;

(a) the average PSMRs - column (i) for the first 5,000kms and then 34c per km there after, or

(b) the average column (ii) rate of 55c for the first 5,000kms and then 34c per km thereafter, or

(c) the rate as per column (iii) for the full 10,800 kms, or

(d) the actual expenditure incurred.

NOTE 1: Where the actual expenditure incurred is used to reimburse the employee no reimbursement will be permitted for depreciation or capital payments on the vehicle.

NOTE 2: The alternative rate can be used as from 1 August 1991. Employers who wish to change to this system from the PSMRs, used for the first part of the tax year, should ensure that the annual reimbursement does not exceed the maximum that would be available using the alternative rates.

NOTE 3: Where the employee changes employers during an income year the new employer should obtain from the employee details of the year to date motor vehicle reimbursement paid to ensure maximum limits are not exceeded.

Reference: 10.A.8.4.

Accrual Determinations - Fee Setting

Background

Regulations 3(1) and 11(1) of the Income Tax (Determinations) Regulations 1987 require that fees be charged for accrual regime determinations made in terms of section 64E(1) of the Income Tax Act 1976. Under section 64E(1) the Commissioner is empowered to determine certain matters relating to financial arrangements. A taxpayer may wish to apply for a determination to ascertain the tax treatment for a particular financial arrangement.

The criteria for setting these fees are set out in Regulations 11(2) and 11(3). The Commissioner was not obliged to set fees for the first two years that the Regulations were in force. That time has now lapsed.

For the year beginning 1 July 1991 the fees are:

Application Fee (non-refundable)	$100
Processing Fee (per hour) (that is per hour spent directly processing the application)	$90

These fees include GST.

Regulation 13 does allow the Commissioner to waive fees in exceptional circumstances, either in full or in part.

Applications for determinations should be made to:

The Manager
Technical Policy Development
Inland Revenue Department
PO Box 2198
Wellington

The information required for applications is set out in Regulation 3(1).

Accrual Determination G24: Straight Line Method

The Consultative Committee on Tax Simplification recommended taxpayers be able to use the straight line method (rather than yield to maturity) to account for financial arrangements. The straight line method can be applied if the face value of financial arrangements held or issued by the person is below $1 million.

Legislation implementing this recommendation received royal assent on 28 June 1991. The new section 64E(1)(aa) of the Income Tax Act 1976 gives the Deputy Commissioner of Inland Revenue the power to determine how the straight line method applies to any financial arrangement or class of financial arrangement.

Determination G24: Straight Line Method sets out two ways of applying the straight line method.

Method A applies to arrangements where the principal is fixed and interest, if any, is payable at regular intervals. All finance charges, as defined in the determination, are spread equally to each income year over the term of the arrangement.

Method B applies to all other financial arrangements, for example, loans with reducing principals. The finance charges under method B are spread over the term of the arrangement in proportion to the principal outstanding.

The determination was signed by the Commissioner on 10 July 1991. It is printed in full in the appendix to this TIB.

Reference: Accruals T:181

Interest PAYE - Approval of Alternative Resident Withholding Tax Deduction Certificates

Summary

Any applications for approval of alternative forms of resident withholding tax deduction certificate should now be sent to Inland Revenue District Offices.

Background

Until now, only Inland Revenue's Regional Offices or Head Office could approve these certificates.

New Policy

District Offices are now handling all approval applications for these certificates.

Applications should be sent to the district office in which the taxpayer's resident withholding tax deduction certificate reconciliation is filed.

Reference: H.O. 10.I.6.9
Technical Rulings: Chapter 58

Due Dates Reminder

August

7 First Instalment of 1992 Provisional Tax due for taxpayers with April balance dates.

Second Instalment of 1992 Provisional Tax due for taxpayers with December balance dates.

Third Instalment of 1991 Provisional Tax due for taxpayers with August balance dates.

14 Interest PAYE deducted during July 1991 due for monthly payers.

Dividend PAYE deducted during July 1991 due.

Non-Resident Withholding Tax deducted during July 1991 due.

20 PAYE deductions for first 15 days of August 1991 due - "Large" employers.

PAYE deductions for July 1991 due - "Small" employers.

31 GST return and payment for period ended 31 July 1991 due.

September

5 PAYE deductions for last 16 days of August 1991 due - "Large" employers.

7 First Instalment of 1992 Provisional Tax due for taxpayers with May balance dates.

Second Instalment of 1992 Provisional Tax due for taxpayers with January balance dates.

Third Instalment of 1991 Provisional Tax due for taxpayers with September balance dates.

1991 Terminal Tax due for taxpayers with October balance dates.

14 Interest PAYE deducted during August 1991 due for monthly payers.

Dividend PAYE deducted during August 1991 due.

Non-Resident Withholding Tax deducted during August 1991 due.

20 PAYE deductions for first 15 days of September 1991 due - "Large" employers.

PAYE deductions for August 1991 due - "Small" employers.

31 GST return and payment for period ended 31 August 1991 due.