Contents

Summary of Amendment Acts

Several Revenue Acts were enacted on 28 September 1993

The Income Tax Amendment Act (No 3) 1993 amends the Income Tax Act 1976. The principal features are:

- relief from double taxation for foreign portfolio investors by refunding company tax
- the underlying foreign tax credit regime
- a new regime for the taxation of general insurance
- taxation of transfers of forests and forestry rights
- a new system for resolving tax disputes, including a test case procedure
- clarification of the treatment of employer-provided clothing for fringe benefit tax purposes
- a number of other remedial issues

The Inland Revenue Department Amendment Act (No 2) 1993 amends the Inland Revenue Department Act 1974 by providing for the exchange of information between the Inland Revenue Department and the Department of Social Welfare.

The Goods and Services Tax Amendment Act (No 2) 1993 amends the Goods and Services Tax Act 1985.

The Estate and Gift Duties Amendment Act 1993 amends the Estate and Gift Duties Act 1968.

The Stamp and Cheque Duties Amendment Act 1993 amends the Stamp and Cheque Duties Act 1971.

The Accident Rehabilitation and Compensation Insurance Amendment Act (No 3) 1993 amends the Accident Rehabilitation and Compensation Insurance Act 1992

The Student Loan Scheme Amendment Act (No 2) 1993 amends the Student Loan Scheme Act 1992.

Underlying Foreign Tax Credits

Sections 394ZM(1) and 394ZMA-394ZMH, Income Tax Act 1976

Introduction

An Underlying Foreign Tax Credit (UFTC) regime has been introduced which will allow underlying taxes paid by foreign companies to be credited against any Foreign Dividend Withholding Payment (FDWP) payable. The regime applies to all dividends paid on or after 28 September 1993.

Background

Currently New Zealand companies must deduct FDWP at the rate of 33% from any dividends they receive from foreign companies. Non-Resident Withholding Tax (NRWT) deducted by the foreign country is the only credit allowed against the FDWP payable in New Zealand. No credits are allowed for any underlying taxes that the foreign company has paid.

The UFTC regime will allow taxpayers to claim a credit against any FDWP payable for underlying taxes that the foreign company has paid, as well as for the NRWT paid to the foreign country.

Amount of FDWP payable - section 394ZM(1)

The amount of FDWP payable is the greater of nil and the amount calculated using this formula:

$$([a + b + c] \times d) - b - c$$

where -

a is the amount of the dividend paid after deducting NRWT

b is the amount of any NRWT paid on the dividend

c is the amount of UFTC calculated on the dividend

d is the income tax rate for resident companies for the income year that covers the imputation year in which the dividend was paid.

Eligibility for UFTC - Sufficient Interest - section 394ZMA(2)

A company can only claim a UFTC if it is liable for FDWP. To qualify for a UFTC, the New Zealand company receiving the dividend must have a "sufficient interest" in the foreign company. A company has a "sufficient interest" if it has a voting interest or market value interest of 10% or greater in a foreign company and the foreign company is either:

- resident in a grey list country; or
- a Controlled Foreign Company (CFC); or
- a Foreign Investment Fund (FIF) for which the taxpayer is using the branch equivalent method to calculate the FIF income or loss.

"Voting interest" is determined by the taxpayer's right to appoint or elect the directors of the company.

Eligible Accounting Year - section 394ZMA(1)

A company can only claim a UFTC in an "eligible accounting year". This is defined to mean any of the company's accounting years in which it meets these four conditions:

1. The company has a sufficient interest (see above) at all times in the accounting year.
2. The year is either
   (i) the year the dividend is paid; or
   (ii) the year immediately before the accounting year in which the dividend is paid; or
   (iii) an accounting year immediately before any eligible accounting year.
3. If the company is a low tax jurisdiction company,
   (i) the accounting year must end on or after 28 September 1993; or
   (ii) the accounting year must end after 1 April 1988, if the company is a CFC.
4. If the accounting year starts before the commencement date, the accounting year must be one for which the taxpayer has given details to Inland Revenue (see page 6).

A "low tax jurisdiction company" is any company resident in a country specified in Part A of the Seventeenth Schedule to this Act.

There must be no break in continuity of ownership between years before a year's earnings and taxes can be taken into account. For example, a taxpayer may have a sufficient interest in a foreign company for three years. It then sells its shares in the company, and at a future date acquires a sufficient interest in the company. If it does this, it cannot use the earnings and taxes from the three year period to calculate a UFTC on dividends received.

Situations where no UFTC is available - section 394ZMB(2)

A company cannot claim a UFTC if:

- It is a qualifying company (defined in section 393A of the Act), or
- It doesn't have a sufficient interest in the company at the time it derives the dividend, or
- The dividend is paid on a fixed rate share, or
- The company paying the dividend can claim a deduction for it outside New Zealand, or
- The dividend is paid out of an amount that one company (Co.1) derives from another company (Co.2), and Co.1 was not liable for tax outside New Zealand on the dividend, yet Co.2 could claim a deduction for the dividend outside New Zealand.

Dividends paid from lower tier companies - section 394ZMD

A New Zealand company can claim a UFTC for tax paid by lower tier companies, as long as the NZ company has a sufficient interest in the lower tier company.

The amount of the UFTC which can be claimed is limited to the tax paid by the lower tier company and the amount calculated using this formula:

$$([a + b + c] \times d) - c$$

where -

a is the amount of the dividend after the deducting any NRWT

b is the amount of UFTC calculated

c is the NRWT paid on the dividend

d is the income tax rate for resident companies for the income year in which the dividend is paid.

This formula effectively limits the foreign tax credit to the lesser of the foreign tax paid and the New Zealand tax on that income.

Calculating the amount of UFTC - sections 394ZMC and 394ZME

The UFTC regime distinguishes between dividends paid from companies resident in grey list countries and dividends paid from companies resident in non-grey list countries. Dividends paid from grey list countries are deemed to have tax paid equal to the New Zealand tax on the dividend income, but dividends paid from non-grey list countries are only allowed credits for actual tax paid.

Dividends paid from companies resident in non-grey list countries

A credit will only be allowed for actual tax paid on dividends paid from companies resident in non-grey list countries. The UFTC is calculated by allocating the proportion of foreign taxes paid on the foreign company's earnings to the dividend paid, on a pro-rata basis. This is achieved by the following formula:

$$a \times \frac{(b + c - d - e)}{(f - g - h)}$$

where -

a is the amount of the dividend (before deducting any withholding tax) on which a foreign dividend withholding payment must be made

b is the aggregate amount of income tax paid or payable by the company for all eligible accounting years (excluding income tax deemed paid on dividends from lower tier companies)

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c is the amount of income tax deemed paid by the company on dividends derived from lower tier companies in all eligible accounting years

d is the amount of UFTCs the company claimed during an eligible accounting year (excluding the current year), calculated as if

(i) for dividends the company didn't derive, assume the company did derive the dividends at a time when it had a sufficient interest in the foreign company; and

(ii) for any dividend derived before 28 September 1993, assume this section applied at the time the dividend was derived

e is the aggregate amount of dividends from grey list countries which are deemed to have tax paid credits attached to them paid in the current year calculated as if, for dividends the company didn't derive, the company derived them at a time when it had a sufficient interest in the foreign company

f is equal to the greater of

(i) the aggregate amount of the company's after-income tax earnings (less after-income tax losses) for all eligible accounting years; or

(ii) the aggregate of

(a) all dividends the company paid during the year (except dividends included in item h of the formula); and

(b) the amounts of items g and h of this formula

g is the aggregate amount of dividends the company paid during an eligible accounting year (excluding the current year)

h is the aggregate amount of dividends paid during the current year on which the company:

(a) is entitled to no credit; or

(b) received dividends paid from grey list countries which have deemed paid tax credits; and

where dividends not derived by the taxpayer were treated as if they were.

Where the foreign company's financial statements are not prepared in New Zealand currency, the UFTC should be calculated in the foreign currency and converted to New Zealand currency on the day the dividend is paid.

Earnings of a foreign company - section 394ZMA(1)

A foreign company's after-income tax earnings amount is its after-tax net accounting profit. (This includes extraordinary items and the accounting provision for tax, but not statutory liabilities for tax). To qualify, the accounts must:

- comply with Generally Accepted Accounting Principles (GAAP) of New Zealand and be audited, or (if these accounts do not exist) they must:
- comply with the GAAP of the country in which the foreign company is resident, or (if these accounts do not exist) they must:
- be used by the company for reporting to any central or state government or creditors unassociated with the company.

Dividends paid from companies resident in a grey list country - section 394ZME(1)

Where a company resident in a grey list country pays a dividend, deemed paid tax credits arise if all of the following conditions are satisfied:

- The company paying the dividend is resident in a grey list country.
- The company has been liable for tax in a grey list country in all eligible accounting years, because of where it is domiciled, resident, incorporated, or has its place of management.
- The company has been calculating its income without applying any of the preferences listed in Part A of the Sixteenth Schedule (apart from the preference listed in paragraph 1 of Part A of that Schedule, where the exemption is for a grey list country).

  The preference in paragraph 1 of Part A of the Sixteenth Schedule applies where a grey list company is carrying on business in another country and the income derived from that business is exempt from tax in the grey list country. As long as the business activity which is exempt from tax is being carried on in another grey list country, the use of this preference will not deny the New Zealand company from claiming deemed paid tax credits.

- ***Either*** the company has been a foreign company (as defined in section 63(1) of this Act) at all times during the period starting on

  (i) the first day of the third accounting year before the first accounting year in which the taxpayer had a sufficient interest in the company; or

  (ii) the company's incorporation date, where the taxpayer had a sufficient interest in the company when it was first incorporated or first acquired a sufficient interest in the company less than three years after the incorporation date,

  and ending with the time the dividend is paid;

  Or the company is a member of the same wholly-owned group of companies as the taxpayer at the time the dividend is paid.

- The company has maintained a tracking account (explained on page 5) for transactions occurring on or after the latest of these dates: (this will be the "effective date")

(i) 20 October 1992

(ii) The first day of the first eligible accounting year

(iii) The first day of the accounting year in which the company elects to maintain a tracking account.

If the company meets all of these conditions, it can use this formula to calculate UFTC:

$$a \times \frac{b}{(1 - b)}$$

where -

a is the amount of dividend (before the deduction of any withholding tax); and

b is the rate of resident companies tax, expressed as a percentage, applying in respect of the income year in which the dividend is paid.

This will mean that dividends paid from grey list countries will be effectively exempt from FDWP.

Note that if any of the conditions listed above do not apply, although the company will not be able to claim deemed paid tax credits, it may be able to calculate a UFTC for tax actually paid using the formula in section 394ZMC.

The tracking account - section 394ZME(2)

As stated above, one of the criteria for receiving deemed paid tax credits from a grey list company is that a company must maintain a tracking account for that company.

A tracking account is needed so only credits for actual tax paid can be claimed where income earned outside the grey list is routed through a grey list company.

The tracking account keeps a record of dividends that grey list companies receive for which a deemed paid tax credit would not arise if those dividends were received directly by the New Zealand company. Therefore, the tracking account keeps a track of the following dividends received by grey list companies:

- All dividends received by the grey list company (except those that are taxable in the grey list country) from companies resident in non-grey list countries (excluding New Zealand)
- All dividends received by grey list companies from other grey list companies in which the New Zealand company has an interest of less than 10%; and
- All dividends received by a grey list company from another grey list company to the extent to which the dividend would include tracked income if it were paid directly to the New Zealand company.

Credits to the tracking account

These items are referred to as applicable payments. They are credited to the tracking account:

- any standard dividends on which the grey list company is not liable for tax. A standard dividend is defined to mean cash dividends, any loans that have been forgiven, any property that has been distributed to all shareholders to the extent the property's market value exceeds the consideration provided by the shareholder, any taxable bonus issue, any amount distributed as a reduction or return of share capital, and any income that a unit trust distributes to a unit holder
- Any other dividend on which the grey list company is not liable for tax, which is not:
  (i) a standard dividend; or
  (ii) an attributed repatriation; or
  (iii) a dividend arising from the difference between the rate of interest specified for FBT purposes and the interest rate in fact payable on a loan, to the extent the loan is treated as an applicable payment paid by a “relevant associate”
- Any amount that a relevant associate subscribes for shares issued by the company, to the extent the relevant associate has retained earnings
- Any loan that a relevant associate advances to the company, to the extent the relevant associate has retained earnings (except to the extent the company anticipates that the loan will be repaid within five years)
- Any amount a relevant associate pays which is not a dividend, but would be assessable income of the company if the company were resident in New Zealand
- If the company elects to have a later effective date, the company's retained earnings at the end of the accounting year immediately before the year for which the taxpayer makes the election

A relevant associate is a company that is associated with both the grey list company that receives the dividend and the New Zealand company that would receive dividends from the grey list company, and is a CFC or resident in New Zealand.

Retained earnings

Retained earnings is defined to mean the aggregate of shareholders' funds calculated under GAAP, less the aggregate of these amounts:

- The company’s paid-up share capital
- The company’s share premium account
- Any amount of shares subscribed by the company where that amount has been credited to another company’s tracking account
- Any principal balance of a loan outstanding which has been credited to another company’s tracking account
- Any other income which has been credited to another company’s tracking account.

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These items should not be deducted:

bonus issues or reinvested distributions made by the company, except to the extent to which such bonus issues or reinvested distributions:

(a) are derived by another company as applicable payments; or

(b) give rise to a FDWP liability; or

(c) are derived by a shareholder of the company and are subject to income tax.

Debits to the tracking account

The following items are debits to the tracking account:

- Applicable payments paid by one grey list company to another grey list company if the New Zealand company maintains a tracking account for both companies;
- Dividends paid from the grey list company to the New Zealand company.

Deemed paid tax credits are only available to the extent the dividend paid exceeds the amount calculated by multiplying the dividend by the lesser of 1 and the amount determined by the formula:

$$a/b$$

where -

a is the credit balance of the tracking account on the last day of the accounting year; and

b is aggregate amount of all dividends paid by the company during the accounting year.

Where the accounts are not kept in New Zealand currency, they should be kept in the currency of the grey list company, and all dividends paid to the grey list company from non-grey list companies should be converted to the currency of the grey list company's accounts.

An amount derived will be treated as being liable for income tax if the income is taxed but the taxpayer is able to offset the income with a benefit which reduces the tax liability (For example, a loss or a foreign tax credit which results in no income tax being payable in the grey list country).

Where the tracking account only applies to part of a dividend, the part for which deemed paid tax credits cannot be claimed will be treated as a separate dividend and the UFTC on this dividend may be calculated on the basis of the amount of tax paid.

Procedures for UFTCs - section 394ZMF

Taxes paid before the commencement date

The commencement date for all companies is the first day of the accounting year in which the enactment date falls. This means that if a company has a 31 March 1993 balance date, the regime has a commencement date of 1 April 1993 for this company.

However, the UFTC regime does allow companies to claim credits for taxes paid before the commencement date. To claim these credits, the company must furnish these details to Inland Revenue within two years from 28 September 1993 (or by such later date as Inland Revenue may allow if we are satisfied that the failure to meet the deadline is beyond the company's control):

- the company's earnings for any one or more consecutive accounting years immediately before the commencement date
- the income tax paid or payable on the earnings of those years
- dividends paid by the company during those years
- amounts of UFTCs on those dividends.

Low tax jurisdictions

The UFTC regime does not allow income tax paid by low tax jurisdiction companies to be claimed for pre-commencement years. An exception to this is where the low tax company is a CFC or where it has received dividends from a company not resident in a low tax jurisdiction. In the latter situation, the low tax jurisdiction company is deemed to derive and pay underlying taxes on only those dividends received from another company which is not resident in a low tax jurisdiction. Any New Zealand company that wants to claim a credit for taxes paid during those years must file appropriate details with Inland Revenue.

Evidence of tax paid

A company will be treated as having no amount of income tax payable on its earnings for an accounting year unless the company can furnish one of these to Inland Revenue:

- a copy of a receipt from the relevant revenue authority to confirm that the tax was paid
- a copy of the foreign company's tax return
- a copy of a statement of account from the relevant authority requesting payment
- Any other evidence which satisfies Inland Revenue that the amount is payable, such as an auditor’s certificate.

Inland Revenue may ask the New Zealand company for details of the calculation of the UFTCs claimed, details of any tracking account and information about taxes paid by lower tier companies.

Interest paid in conduit financing arrangements - section 394ZMH

Section 394ZMH is an anti-avoidance rule to protect the New Zealand tax base. This section denies a company interest deductions in circumstances where that company can be seen as acting as a conduit for the financing of investments into grey list countries. The avoidance opportunity arises because dividends from grey list countries will be free of FDWP because they are deemed to be fully covered by overseas tax credits.

The provision only applies where all of these conditions are met:

- A company derives dividends that are deemed to be fully credited.
- The same company pays interest to that company or to a person associated with that company.
- Non-residents own 50% or more of the company receiving the interest, and this company is not a CFC.

Where the provision applies, interest is non-deductible up to the extent of the grey list country dividends.

Interest on some dividend withholding payments - section 394ZMG

FDWP is payable quarterly. However, taxpayers will not have all the information to work out the UFTC until the end of the foreign company's accounting year. For example, they will not know the foreign company's earnings for the current year or its tax payable on those earnings at the time when the FDWP is payable.

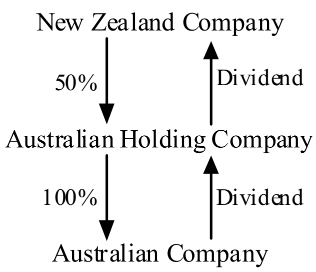
Therefore, section 394ZMG requires taxpayers to estimate their FDWP liabilities and pay the correct amount of FDWP within one year of the 20th of April immediately following the end of the dividend-paying company's accounting year in which it paid the dividend.

Interest will be payable to Inland Revenue if any FDWP is owing, and Inland Revenue will pay interest if FDWP has been overpaid. The interest rates will be the same as those for the provisional tax regime.

Examples

These examples show how the UFTC regime operates.

Example 1



New Zealand Company (NZCo) owns 50% of Australian Holding Company (OZHCo), which owns 100% of Australian Company (OZCo). OZCo pays $100 dividend to OZHCo, which pays a $100 dividend to NZCo. No NRWT has been deducted in Australia as the dividend is fully franked.

To claim a UFTC, NZCo must have a 10% or greater interest in OZHCo and OZCo, which it does. As OZHCo and OZCo are resident in a grey list country, NZCo will be entitled to deemed paid tax credits. The tracking account of OZHCo and OZCo will have a nil balance as neither has received any dividends from companies resident in non-grey list countries or from companies in which NZCo has an interest of less than 10%. Therefore, NZCO's UFTC will be calculated using the formula in section 394ZME as follows:

$$a \times \frac{b}{(1 - b)}$$

where -

a is the amount of dividend (before deducting any withholding tax); and

b is the rate of resident companies tax, expressed as a percentage, applying for the income year in which the dividend is paid.

Therefore a equals 100 and b equals 33%.

UFTC = $100 x .33/.67

= $49

If this was the only foreign dividend that NZCo received, its FDWP position will be as follows:

Dividend ($100 + $49)	$149
FDWP @ 33%	$ 49
Less UFTC	$ 49
FDWP payable	NIL

This example illustrates that the deemed paid tax credit will apply where a New Zealand company receives a dividend from a company resident in a grey list country and the grey list company has not received any dividends from companies not resident in grey list countries or grey list companies in which the New Zealand taxpayer has an interest of less than 10%.

Example 2

Assume NZCo also has an interest of 60% in a Korean Company (KCo) which is a CFC. KCo has been trading for two years and has accumulated accounting earnings of $500 on which it has paid taxes in Korea of $100. It has paid no dividends in the past to NZCo. KCo now pays a $200 dividend to NZCo which includes NRWT of $20.

NZCO's underlying foreign tax credit will be calculated using the following formula:

$$a \times \frac{(b + c - d - e)}{(f - g - h)}$$

Where -		
	a = $200	e = 0
	b = $100	f = 500
	c = 0	g = 0
	d = 0	h = 0

(These letters are all explained on pages 3-4.)

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Therefore NZCO's underlying foreign tax credit will be $40, calculated as follows:

$$\$200 \times \frac{\$100}{\$500} = \$40$$

The amount of FDWP that NZCo must pay on this dividend is calculated as follows:

Foreign dividend ($200 + $40)		$240
FDWP @ 33%		$79
Less		
- Underlying foreign tax credit	$40	
- NRWT paid in Korea	<u>$20</u>	
		<u>$60</u>
FDWP payable		$19

This $19 FDWP liability may be offset by any credits in NZCo's branch equivalent tax account.

Example 3

In this example, NZCo owns 100% of OZCo (resident in Australia) which owns 100% of HKCo (resident in Hong Kong). No income of HKCo is taxed in Australia. OZCo and HKCo derive the following income and pay the following taxes in their first two years of trading:

	Profit	Taxes Paid
Year 1		
OZCo	$200	$70
HKCo	$100	$20
Year 2		
OZCo	$300*	$100
HKCo	$200	$30

* Includes $100 dividend from HKCo.

Year 1

In year 1, HKCo pays no dividends to OZCo. OZCo pays a $100 dividend to NZCo.

OZCo is resident in a grey list country so deemed paid tax credits will apply. The balance in the tracking account of OZCo is nil as it has received no income from companies resident in non-grey list countries or from grey list companies in which NZCo has an interest of less than 10%.

Therefore NZCO's UFTC will be calculated using the formula:

$$a \times \frac{b}{(1 - b)}$$

where -

a is the amount of dividend (before deducting any withholding tax); and

b is the rate of resident companies tax, expressed as a percentage, applying for the income year in which the dividend is paid.

Therefore a is equal to 100 and b is equal to 33%

$$\begin{aligned} UFTC &= \$100 \times .33/.67 \\ &= \$49 \end{aligned}$$

If this was the only foreign dividend received by NZCo, its FDWP position will be as follows:

Dividend ($100 + $49)	$149
FDWP @ 33%	$ 49
Less	
- UFTC	<u>$ 49</u>
FDWP payable	NIL

Year 2

In year 2, HKCo pays $100 dividend to OZCo. No NRWT is deducted in Hong Kong. This dividend is not taxable in Australia. OZCo pays a $200 dividend to NZCo. No NRWT is deducted from this dividend in Australia.

The $100 dividend received by OZCo from HKCo will be credited to the tracking account of OZCo maintained by NZCo. Deemed paid tax credits will only be available where the dividend paid by OZCo exceeds the balance in its tracking account maintained by NZCo. The portion of the dividend paid to NZCo which is to come out of the tracking account is calculated by multiplying the dividend received by NZCo ($200) by the fraction:

$$a/b$$

where -

a is the credit balance of the tracking account of OZCo at year end.

b is the total amount of dividends paid by OZCo

Therefore a = 100 and b = 200

$$\begin{aligned} \text{Dividend paid from tracking account} &= 200 \times 100/200 \\ &= \$100 \end{aligned}$$

This means NZCo is treated as receiving two dividends from OZCo, a $100 dividend which will be entitled to deemed paid tax credits, and a $100 dividend which must have the UFTC calculated based on the amount of tax paid by OZCo.

OZCO's UFTC

It must be first worked out what share of taxes OZCo can attribute from HKCo. This is calculated using the formula:

$$a \times \frac{(b + c - d - e)}{(f - g - h)}$$

Where -		
	a = $100	e = 0
	b = $50	f = 300
	c = 0	g = 0
	d = 0	h = 0

(These letters are all explained on pages 3-4.)

$$\text{which} = \$100 \times \frac{\$50}{\$300} = \$17$$

Therefore OZCo will be deemed to have paid a further $17 of taxes.

NZCO's UFTC

The deemed paid tax credit for the first $100 dividend will be calculated as follows:

$$a \times \frac{b}{(1 - b)}$$

where -

a is the amount of dividend (before the deduction of any withholding tax); and

b is the rate of resident companies tax, expressed as a percentage, applying in respect of the income year in which the dividend is paid.

Therefore a equals 100 and b equals 33%.

UFTC = $100 x .33/.67
= $49

The UFTC on the second $100 dividend paid from the tracking account will be calculated using the following formula:

$$a \times \frac{(b + c - d - e)}{(f - g - h)}$$

Where -		
	a = $100	e = $49
	b = $170	f = $500
	c = $17	g = $100
	d = $49	h = $100

(These letters are all explained on pages 3-4.)

which = $100 x 89/300 = $30

If this was the only foreign dividend received by NZCo, its FDWP position will be as follows:

Dividend ($200+ $49 + 30)	$279
FDWP @ 33%	$92
Less	
- UFTC ($49 + $30)	$79
FDWP payable	$13

This $13 FDWP liability may be offset by any credits in NZCo's branch equivalent tax account.

Application Date

The regime will apply to all dividends paid on or after 28 September 1993.

International Tax Amendments

Branch Equivalent Tax Accounts

Sections 394D, 394E, 394ZM, 394ZZP, 394ZZQ and 394ZZX, Income Tax Act 1976

Introduction

The Branch Equivalent Tax Account (BETA) system has been made more flexible so foreign dividend withholding payments (FDWP) can be offset against an attributed foreign income tax liability, as well as allowing tax paid on attributed foreign income to offset a FDWP liability. This will ensure that an early dividend from a controlled foreign company (CFC) will not cause double taxation.

In summary, the new BETA account system allows:

- a BETA debit balance (arising from FDWP payments) to satisfy an attributed foreign income tax liability;
- attributed foreign income tax liabilities to credit a BETA account;
- a BETA credit balance to satisfy a FDWP liability; and
- FDWP liabilities to debit a BETA account.

Background

Previously, an early dividend from a CFC could result in double taxation. The BETA account system resulted in a timing problem in the first year if a CFC paid a dividend before tax on the attributed foreign income from that CFC was paid. FDWP, which is payable quarterly, would be due, as would tax under the CFC regime. The previous regime was not flexible enough to deal with such timing problems. It was not possible to offset FDWP payments against an attributed foreign income tax liability. Under the previous law a BETA credit balance could only be offset against FDWP liabilities or transferred to an imputation credit account.

Key issues

The major feature of the new BETA regime is that FDWP can now be offset against an attributed foreign income tax liability, as well as allowing tax paid (or losses offset) in respect of attributed foreign income to be offset against an FDWP liability. An early dividend received by a New Zealand company from a CFC will therefore no longer cause double taxation.

Allowing FDWP paid to offset an attributed foreign income tax liability is achieved by providing that debits arise to a BETA account when FDWP payments are made (whether directly or by reducing a loss under section 394ZN) in respect of dividends received from CFCs (section 394ZZP(3)(a)).

Section 394ZZQ(5) allows a company to use the BETA debit balance arising from FDWP paid to satisfy an attributed foreign income tax liability. A BETA debit balance is accordingly credited in payment of an attributed foreign income tax liability (section 394ZZP(1)(c)).

Section 394ZZX, which limited refunds of tax paid on attributed foreign income to the amount of the BETA credit balance, has been repealed. The repeal is necessary because debits can now arise to a company's BETA account for FDWP paid.

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Grouping of BETA debit balances

The grouping of BETA debit balances is provided for under the new BETA regime (sections 394ZZQ(5) and 394ZZP(1)(c)). A debit balance in a company's BETA account can be used to satisfy an attributed foreign income tax liability of another company in the same group.

Grouping of BETA credit balances

The previous BETA regime did not allow BETA credits to be transferred within a group of companies. The new regime will allow a BETA credit balance of one company to be offset against the FDWP liability of another company in the same group (sections 394ZM(2), 394ZZP(3)(b) and 394ZZQ(3)).

As BETA credits can arise in a company's BETA account from offsetting the losses of other group companies against the company's attributed foreign income, it is consistent that the BETA credits of one company should be allowed to be offset against the FDWP liability of another group member.

Reversal of BETA debit balances

A reversal, by way of a credit arising in the BETA account, of BETA debit balances arising from FDWP paid will occur in the following circumstances:

- on a refund of FDWP paid to the company under section 394ZO (section 394ZZP(1)(d));
- where the company has not satisfied the 66 percent shareholder continuity requirements from the time at which the debit balance arose (section 394ZZP(1)(e)); and
- where the company ceases to be resident in New Zealand (section 394ZZP(1)(f)).

Credits and debits arising in ICA

It is not possible under the new BETA regime to transfer non-loss related BETA credits to a company's imputation credit account, either by way of direct election (former section 394ZZQ(1)) or when the company offsets the credit balance in its BETA account against a FDWP liability. Accordingly, paragraphs (h) and (i) of section 394D(1) which provided for such transfers to be recorded as credits in an imputation credit account have been repealed. Such transfers are no longer necessary as tax paid on attributed foreign income will now credit both the imputation credit account and the BETA account.

A credit will arise in a company's imputation credit account equal to any credit balance existing in the company's BETA account at the time of the transition to the new rules (28 September 1993). This ensures that such credit balances are not effectively lost.

Because of the changes to the operation of the BETA account system, a further amendment provides that a credit arising to a company's BETA account from tax paid on attributed foreign income will no longer result in a debit to the company's imputation credit account (achieved by the repeal of paragraph (f) of section 394E(1)). Tax paid on attributed foreign income will therefore give rise to a credit both in a company's BETA account and its imputation credit account.

An attributed foreign income tax liability satisfied by way of crediting a BETA debit balance under section 394ZZQ(5) does not give rise to a credit in the company's imputation credit account (section 394D(1)(a)(vii)).

Application date

The amendments to the BETA account regime apply from 28 September 1993.

International Tax Amendments

Dividend Withholding Payments

Sections 394D, 394ZN, 394ZO and 394ZV, Income Tax Act 1976

Introduction

The procedures for paying and refunding FDWP have been made more flexible. Inland Revenue may now allow late elections to offset losses against FDWP liabilities, and the ability to use losses to claim a refund of FDWP has been increased. Minor amendments have also been made as a consequence of an earlier amendment to section 394ZN allowing group losses to be offset against a FDWP liability.

Election date to use losses to offset FDWP liability - section 394ZN

A company must pay the amount of FDWP due to Inland Revenue within 20 days after the end of the quarter in which it was paid foreign dividends.

A company can elect to use its own or any group losses to satisfy a FDWP liability. Previously, this election had to be made within the same period for payment of FDWP, i.e., within 20 days after the end of the quarter.

Inland Revenue may now extend the period for electing to meet a FDWP liability by offsetting a loss in any particular case.

It is envisaged that Inland Revenue will use this discretion in cases where losses were available for offset against a FDWP liability within the 20 day period after the end of a quarter, although the election to use those losses was not made within this period.

Any additional tax payable under section 394ZN(4) because FDWP has not been paid by the standard due date will be recalculated based on the later date allowed by Inland Revenue to elect to use losses to offset a FDWP liability.

This amendment applies to dividends paid on or after 28 September 1993.

Using losses of obtain FDWP refund - section 394ZO

A company can now use its own carried forward and current year losses or those of other group members to obtain a refund of FDWP it has paid. Previously, a company could only use its own current year losses to obtain a FDWP refund.

The treatment of losses in relation to obtaining FDWP refunds under section 394ZO is now consistent with that for elections to satisfy a FDWP liability by reducing a loss under section 394ZN.

This amendment applies from 28 September 1993.

Restriction on credit arising where losses used to satisfy FDWP liability - sections 394D and 394ZV

Under section 394ZV(1)(a), a credit equal to the amount of FDWP a company pays is recorded in its dividend withholding payment account. A qualification to this provision is that a credit shall not arise to the extent that payment of FDWP has been satisfied by electing to reduce losses (section 394ZV(3)). The reason for this limitation is to prevent company losses being passed on to individual shareholders.

With effect from the 1992-93 imputation year, a company has been able to offset its FDWP liability against the losses of other companies in the same group (section 394ZN(2A)). A reference to this subsection has now been included in section 394ZV(3) to ensure that a credit will not arise in a dividend withholding payment account where the payment of FDWP has been by way of reducing the losses of another company in the same group as well as the company's own losses.

A similar amendment (i.e., insertion of a reference to section 394ZN(2A)) has also been made to section 394D(3) which prevents credits arising in the imputation credit account of a company which does not maintain a dividend withholding payment account where the payment of FDWP has been satisfied by utilising losses.

These amendments apply from the 1992-93 imputation year.

International Tax Amendments

CFC Life Insurers

Section 245J(20A) and (25), Income Tax Act 1976

Where a CFC carries on a business of providing life insurance, or is owned by a CFC carrying on the business of providing life insurance, its assessable income or loss will be the amount that is actuarially determined to be its profit or loss with which the shareholders (and not the policyholders) are attributed.

This provision does not apply where Inland Revenue:

- considers that the amount so determined is not a reasonable and fair reflection of the relevant profit or loss; or
- has requested and not received sufficient information to enable us to review the actuarial calculation.

Foreign investment fund income or loss relating to a CFC life insurer which is determined to be an entitlement of the policyholders is not attributed to the New Zealand shareholders in the CFC life insurer.

These provisions are necessary because a CFC foreign life insurer's income is mostly attributable to its foreign policyholders rather than its New Zealand shareholders. It is therefore not appropriate to attribute the policyholder-related income of a CFC life insurer or its lower tier CFC or FIF interests to its New Zealand shareholders.

The previous section 245J(20A) only dealt directly with a CFC life insurer; it did not cater for the lower tier CFC or FIF interests of the CFC life insurer.

International Tax Amendments

Foreign Investment Funds

Definition of entitlement to benefit - section 245R(1)

A definition of the term "entitlement to benefit" has been inserted into the legislation. It clarifies that for the purposes of determining what is a foreign investment fund (FIF) interest, an entitlement to benefit from a foreign superannuation scheme or a foreign life insurance policy includes a contingent or discretionary entitlement.

It is not considered that beneficiaries under the will of a person whose life is insured will be subject to the FIF regime because of this definition. However, it is clear that a policyholder's entitlement to benefit will include benefits of a discretionary or contingent nature.

New market value definition - section 245R(1)

The aggregate contributions method of measuring the market value of a foreign superannuation interest when using the comparative method of calculation may be used only on first entry to the FIF regime. This method of measuring market value deems the market value of a foreign superannuation interest to be an amount equal to the total contributions made. The definition may not therefore be used for the comparative value method of calculation on an on-going basis.

Non-standard accounting years - section 245R(7)

The non-standard accounting years provision in the FIF regime has been repealed. This provision was superfluous in light of an equivalent provision in section 245A(2)(f) which applies for all Part IVA purposes.

De minimus exemption - section 245RA(2)

The de minimus exemption from the FIF regime (applying when an individual's foreign investments do not cost more than $20,000) has been amended to ensure that expenditure incurred on a person's behalf - as well as expenditure directly incurred by the person - will be taken into account in determining whether the $20,000 threshold has been reached.

This amendment will ensure that employer contributions to foreign superannuation schemes are taken into account for the purposes of the de minimus exemption.

If expenditure incurred on behalf of a person was not taken into account for the purposes of the de minimus exemption, significant foreign investments directly owned by individuals would not be covered by the FIF regime and therefore would not be taxed on a current basis.

Life insurance policy death benefits - section 245RB(7)

The exemption from the FIF regime of death benefits from foreign life insurance policies has been amended to apply when a person entered into the policy:

- before first becoming resident in New Zealand; or
- if the person was previously resident in New Zealand, during a period of at least ten years when the person was non-resident before becoming a New Zealand resident again.

Using alternative methods to calculate FIF income or loss - section 245RC(8)

An amendment has been made to clarify that where persons voluntarily elect to change their method of calculating FIF income or loss, the election must be in accordance with the various restrictions applying to voluntary elections.

Comparative value method of calculation - section 245RD

The comparative value method for calculating a person's FIF income or loss has been amended to allow a deduction for expenditure incurred on the person's behalf in acquiring a FIF interest as well as for expenditure directly incurred by the person.

In particular, the amendment will benefit members of foreign superannuation schemes, and will ensure that only the proportion of the underlying income of a scheme, not employer contributions, will be taxed as it accrues.

Deemed rate of return calculation method - section 245RE

For FIF interests held in the previous income year, the deemed rate of return method formula has been amended so that any expenditure a person incurs to acquire any more of the FIF interest during the current income year is taken into account.

Under the deemed rate of return method, where a FIF interest is acquired or disposed of during an income year, the income year is divided into separate notional income years. The prescribed rate of return applying to each notional year is adjusted according to the number of days in each.

The start and end of these notional income years has been clarified to ensure that there is no double counting of the date on which the acquisition or disposition occurs. A notional income year will end either on the day the FIF interest is disposed of or on the day before the day on which the interest is acquired. A new notional income year will start either on the day after the day the FIF interest is disposed of or on the day the interest is acquired.

Accounting profits calculation method - section 245RF

The wording of the accounting profits method of calculation formula has been amended to refer to net after-tax accounting losses as well as profits. Similar amendments have been made to section 245RC(6), which sets out the restrictions on the use of the accounting profits calculation method.

Extension of BETA regime - section 245RH

A taxpayer holding an interest in a second tier FIF interest will be allowed a BETA credit for tax paid under the FIF regime where a CFC or a FIF using the branch equivalent method is interposed between the taxpayer and the second tier FIF interest.

The BETA regime will also continue to apply to FIF income calculated under the accounting profits or branch equivalent methods.

The BETA regime applies as if:

- the FIF income were attributed foreign income of the person;
- the FIF were a CFC; and
- the FIF interest were an income interest (within the meaning of the CFC regime).

The extension of the BETA regime to certain FIF interests and calculation methods is intended to avoid double taxation of dividend flows by allowing BETA credit balances to be used to offset FDWP liabilities.

Taxation on distributions from foreign investment funds - section 245RI

Under section 245RI, any distribution from a FIF interest already held on 2 July 1992 is assessable as a dividend, if that distribution would have been assessable had the FIF regime not been enacted, and to the extent that it exceeds the net FIF income derived.

Section 245RI ensures that pre-effective date (generally 1 April 1993) accumulated earnings don't receive more generous tax treatment under the FIF regime than they would have before the FIF regime was introduced. The provision qualifies section 245RB(6), which provides that any person using the comparative value or deemed rate of return methods is deemed to derive no assessable income (other than FIF income) from a FIF interest.

The previous exemption from section 245RI which applied to gains derived from a partial or total disposition of an interest has been removed. It was unnecessary since the section only applies to gains which would have been assessable if the FIF regime hadn't been enacted (in particular, the section does not apply to non-taxable capital gains). The previous exemption was also undesirable as it may have exempted gains from certain types of disposition that were previously taxable.

Income arising under section 245RI is now treated as FIF income rather than dividends. This amendment has the following results:

- income arising under section 245RI can now obtain the benefit of the transitional provision in section 245Y(10), which allows FIF income derived in the 1992-93 income year to be returned in the 1993-94 income year
- section 245RI income can now be offset against FIF losses and also be taken into account for determining the amount of FIF loss which may be offset against New Zealand sourced income under section 245RJ
- timing problems in calculating a FDWP liability on an amount that will not be known until after the end of an income year are removed.

Minor drafting changes - sections 245N, 245RF, 245RJ, 245RK and 245RI

A number of minor drafting changes which arose out of the Income Tax Amendment Act (No.2) 1993 have also been made, such as corrections to several wrong cross-references.

Application date

All of the above FIF-related amendments have the same application date as the new FIF regime which was enacted by the Income Tax Amendment Act (No.2) 1993 (generally 1 April 1993).

Foreign Investor Tax Credit Regime

Sections 308A, 4B, 327K, 375 and 394D, Income Tax Act 1976

Introduction

Double taxation of non-resident portfolio investors has been reduced. The total New Zealand tax on most distributed company income which is paid to non-resident portfolio investors will be limited to 33%, the same level of tax as on New Zealand shareholders.

The relief from double taxation (a combination of company income tax and non-resident withholding tax) for non-resident portfolio investors is achieved by reducing the company tax (by way of a credit) which is charged on a company's income to the extent it is owned by non-resident portfolio investors. The company in turn will pass on this credit for company tax to its non-resident portfolio shareholders in the form of a supplementary dividend.

Non-resident portfolio investors remain liable for non-resident withholding tax (NRWT) on dividends (including supplementary dividends) they derive from New Zealand resident companies.

Where a company's dividends are fully imputed the tax credit has been set so that the total New Zealand tax is 33% on distributed company income received by investors which are resident in countries with which New Zealand has a double tax agreement.

The measures providing relief for non-resident portfolio investors from double taxation are mainly contained in new section 308A. Minor consequential amendments have also been made to the dividend definition, resident withholding tax, provisional tax and imputation credit provisions (sections 4B, 327K, 375 and 394D, respectively).

Key features

- The regime applies to non-resident investors with less than 10% interests in New Zealand resident companies.
- Only direct interests in New Zealand companies are taken into account in determining which investors are non-resident portfolio investors. The regime does not take into account indirect interests held through other companies (i.e., the corporate look-through rules do not apply).
- Associated person interests are aggregated when determining whether the interest of a non-resident investor constitutes a less than 10% interest.
- Underlying company tax is effectively refunded to non-resident portfolio investors, resulting in the total New Zealand tax on most company income distributed to non-resident portfolio investors being limited to 33%.
- The refund of company tax is achieved by allowing New Zealand companies a tax credit, which they will use to pay non-resident portfolio investors a supplementary dividend.
- The tax credit that a company receives is available only to the extent of imputation credits attached to the dividends that it pays to non-resident portfolio investors. The company can only use this credit to reduce company tax liabilities. If it has no such liability the credit is not refundable.
- Special rules apply where dividends have dividend withholding payment credits attached.
- If a company has paid no tax in the current year it can use the credit to refund tax paid in any of the four immediately preceding income years.
- The tax credit is offset against income tax payable after allowing for foreign tax credits but before allowing for imputation and resident withholding tax deductions.
- A tax credit received by a company can be claimed against the tax liability of another company in the same wholly owned group.
- A "safe harbour" rule applies to protect companies in certain circumstances where a supplementary dividend is paid to a non-resident investor which does not in fact qualify as a non-resident portfolio investor.
- Special rules apply to the application of the benchmark dividend and anti-credit streaming rules.
- Specific statutory authority has been given to companies to pay supplementary dividends to ensure that there is no conflict with company law rules.

Background

Previously, non-resident portfolio investors were double taxed on income distributed from New Zealand companies. A New Zealand company pays tax at a 33% rate. A further 15% is levied on dividends, in the form of NRWT, resulting in a total New Zealand tax impost of 43% on pre-tax income. For countries with which New Zealand has no double tax agreement, the NRWT rate is 30% and the total New Zealand tax impost was therefore 53%.

In contrast, the total tax levied on New Zealand company income which is distributed to New Zealand shareholders does not exceed 33% (provided the shareholder's effective tax rate does not exceed this level) because of the effect of the imputation system which prevents double taxation of New Zealand shareholders.

The reason for this different treatment is that resident shareholders can use imputation credits to reduce tax on dividend income, but non-residents cannot.

Eligibility to receive supplementary dividend - section 308A(1)

The tax credit is only available for dividends paid to non-resident portfolio investors. A "non-resident portfolio investor" is defined as any person (corporate or individual) not resident in New Zealand whose voting or market value interests in a New Zealand company are less than 10%.

Only direct interests are taken into account in determining whether a non-resident shareholder has a less than 10% interest in a New Zealand company. The corporate look-through rules in sections 8C(3)(d) and 8D(3)(d), under which interests held by companies in other companies are traced through and attributed to the ultimate individual shareholders, do not apply. The non-inclusion of indirect interests is intended to simplify the operation of the non-resident portfolio investor regime.

Example

If Foreign Co.A owns 20% of NZ Co. and Foreign Co.B owns 5% of Foreign Co.A and 9% of NZ Co., only Foreign Co.B's direct interest in NZ Co. is taken into account in determining whether it qualifies as a non-resident portfolio investor. Foreign Co.B's 1% indirect interest (i.e., 5% x 20%) in NZ Co. is not aggregated with its 9% direct interest in NZ Co., so it doesn't breach the 10% threshold.

In determining whether a non-resident investor's interest constitutes a less than 10% interest, the interests held by any persons associated with the investor are aggregated with the investor's interests. The associated person definition used for section 308A purposes is that contained in section 245B, which generally applies to the controlled foreign company and foreign investment fund regimes. This definition includes as associated persons companies that have a 50% or higher common ownership; it also includes a company and an individual who owns 50% or more of that company.

Example:

If Foreign Co.A and Foreign Co.B are owned by the same persons, and Foreign Co.A owns 5% of NZ Co. and Foreign Co.B owns 6% of NZ Co., neither company would qualify as a non-resident portfolio investor.

Example:

If Foreign Co. owns 7% of NZ Co. and a non-resident individual owns 50% of Foreign Co. and 8% of NZ Co., neither Foreign Co. nor the non-resident individual would qualify as a non-resident portfolio investor.

Availability of the tax credit

The tax credit is available only:

- to the extent of imputation credits attached to dividends received by non-resident portfolio investors; and
- where the company has paid the non-resident portfolio investor a supplementary dividend equal to the amount of the tax credit.

Only one supplementary dividend may be paid with each dividend. This is to prevent the foreign investor tax credit regime being used to reduce the total New Zealand tax imposed on income distributed to non-residents to less than 33%. While the supplementary dividend does not need to be paid by the company at the same time as the normal dividend, it does need to be paid in the same income year as the dividend to which it relates.

Calculating the tax credit - section 308A(2)

The foreign investor tax credit regime reduces the tax which is charged on income earned by a company to the extent it is distributed to (and therefore attributable to) non-resident portfolio investors. The regime uses the imputation credits already allocated (which were previously unusable) to dividends paid to non-resident portfolio investors to calculate the value of the tax credit received by the company. The company in turn passes these credits on to non-resident portfolio investors in the form of a supplementary dividend.

The amount of the tax credit is limited to the level of imputation credits attached to the dividend that the non-resident portfolio investor receives. This is to ensure that a credit is available only to the extent that full company tax at a 33% rate has been paid.

The tax credit received by a company is calculated by multiplying the amount of post-credit imputation credits attached to the dividend by 0.5583. This means the credit is set at 0.5583 cents for every dollar of post-credit imputation credits attached to dividends paid to non-resident portfolio investors. This formula reduces the company's tax so that the total New Zealand impost on company income distributed to non-resident portfolio investors is no more than 33%, provided the dividends are fully credited at a rate of 33 cents of imputation credits per 67 cents of cash dividend and the NRWT rate is 15%.

The amount of tax credit a New Zealand company will receive can be calculated directly by multiplying the imputation credits it would normally distribute on dividends paid to non-resident portfolio shareholders by 0.358275 (i.e., 0.5583/1.5583). Thus, if a company distributed $33 of imputation credit to its non-resident portfolio investors in the absence of this tax relief, then the credit would be $11.82.

Table 1 (on page 16) illustrates the calculations for a company that pays tax at 33% on $100 of profit which is fully distributed net of tax to shareholders. The table sets out the different treatments for a New Zealand investor, a non-resident investor before the foreign investor tax credit regime, and a non-resident portfolio investor under the new regime. In the last situation it is

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seen that the total New Zealand tax take is reduced to the level applying to New Zealand shareholders (i.e., 33%). This table assumes that the foreign investor is resident in a country with which New Zealand has a double tax agreement (i.e., the NRWT rate is 15%). It can be seen that under the foreign investor tax credit regime the credit reduces the company's tax bill by approximately $12. The dividend received by the non-resident investor is increased by the same amount (in the form of a supplementary dividend) from $67 to $79. The $12 tax credit is approximately equal to:

- 35.82% of the pre-credit $33 of imputation credits
- 55.83% of the post-credit $21 of imputation credits
- 15% of the post-credit $79 dividend.

Table 1: Credit approach where dividends fully imputed and investor resident in a treaty country

	NZ Investor ($)		Foreign Investor (previous) ($)		Foreign Investor (current) ($)	
Gross profit		100		100		100
normal company tax	-33		-33		-33	
add back credit	0		0		12	
Net company tax		-33		-33		-21
Profit after tax		67		67		79
Dividends		67		67		79
less personal tax (@33% of $100)	-33		0		0	
add back imputation credits	33		0		0	
less NRWT (@ 15% of dividend)	0		-10		-12	
Net dividend to shareholder		67		57		67
Tax paid to NZ		33		43		33

Table 2 illustrates the situation where the non-resident portfolio investor is resident in a non-treaty country so that the NRWT rate is 30%. The credit has been set so that the total New Zealand tax impost is 33% on distributed company income paid to non-resident portfolio investors where company tax and NRWT are 33% and 15% respectively. Thus, the total New Zealand tax charged on income earned by non-resident portfolio investors resident in non-treaty countries will exceed 33%. However, such investors will still receive a similar amount of benefit under the regime as investors from treaty countries. This table also assumes that the dividends paid by the company are fully imputed.

Table 2: Credit approach for non-treaty country

	NZ Investor ($)		Foreign Investor (previous) ($)		Foreign Investor (current) ($)	
Gross profit		100		100		100
normal company tax	-33		-33		-33	
add back credit	0		0		12	
Net company tax		-33		-33		-21
Profit after tax		67		67		79
Dividends		67		67		79
less personal tax (@33% of $100)	-33		0		0	
add back imputation credits	33		0		0	
less NRWT (@ 30% of dividend)	0		-20		-23	
Net dividend to shareholder		67		47		56
Tax paid to NZ		33		53		44

Table 3 illustrates the application of the regime where a dividend is not fully imputed. It also illustrates the effect of the new regime on the home tax treatment of non-resident portfolio investors. In particular, it shows that the non-resident portfolio investor regime results in an increased tax take for the home country of the investor. It is assumed that the home country and New Zealand have a double tax agreement.

Table 3: Credit approach - different imputation levels and home tax treatment

	Fully Imputed (previous)		Fully Imputed (current)		Partially Imputed (25% tax) (current)		Unimputed (current)	
Profit		100		100		100		100
less normal company tax	-33		-33		-25		0	
add back credit	0		12		9		0	
Net Company Tax		-33		21		16		0
Profit after tax		67		79		84		100
gross dividends	67		79		84		100	
less NRWT (@15% of dividend)	-10		-12		-13		-15	
Net dividends repatriated home		57		67		71		85
Tax paid to NZ		43		33		29		15
Net dividends		57		67		71		85
gross dividends	67		79		84		100	
home taxes (@33% of gross dividends)	-22		-26		-28		-33	
add back foreign tax credits for NRWT	10		12		13		15	
Net home tax liability		12		14		15		18
Net dividends		45		53		56		67

Dividends with Dividend Withholding Payment Credits attached

Special rules apply where dividends paid to non-resident portfolio shareholders have dividend withholding payment (DWP) credits attached as well as, or instead of, normal imputation credits. Dividend withholding payment credits represent payments of FDWP, whereas normal imputation credits represent company income tax payments. A difference between imputation and DWP credits from a non-resident investor perspective is that non-residents cannot use normal imputation credits, but they can use DWP credits to meet their NRWT liabilities, with any excess credits being refunded.

The objective of the foreign investor tax credit regime is to reduce company tax attributable to non-resident portfolio investors so that, in most cases, the total New Zealand tax impost (including NRWT) on those investors is not higher than the 33% tax rate imposed on most New Zealand resident shareholders. Effectively, the objective is to remove, in most cases, New Zealand double tax (a combination of company tax and NRWT) on income attributable to non-resident portfolio investors. Where these investors receive a dividend with DWP credits attached, they can use the DWP credits to meet their NRWT liabilities, with any excess credits being refunded. Because of this there is no New Zealand double tax requiring relief. It would therefore be inappropriate to give foreign investor tax credit tax relief and continue to allow DWP credits to meet NRWT liabilities or be refunded for the same dividend.

The legislation deals with this issue by effectively splitting a dividend into two components:

- the component that is not subject to double tax because any NRWT liability is absorbed by DWP credits (the DWP portion); and
- the remaining component representing income subject to both company tax and NRWT (the remaining portion).

The effect of the legislation is to exclude the DWP portion of the dividend (including normal imputation credits attributable to that portion) from non-resident portfolio investor tax relief and allow tax relief only for the remaining portion. This is achieved as follows:

The DWP portion is calculated according to the definition of that term in section 308A(1). This defines the DWP portion as a/b where a is the amount of DWP credits attached to the dividend and b is the applicable NRWT rate. This is the amount of the dividend for which DWP credits fully cover any NRWT liability. Thus, with a 15% NRWT rate, every $1 of DWP credits translates into $6.67 of DWP portion. With a 30% NRWT rate, every $1 of DWP credits translates into $3.33 of DWP portion.

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Non-resident portfolio investor tax relief is calculated on the basis of normal imputation credits attached to a dividend. This by itself excludes DWP credits from giving rise to relief under the new regime. However, this is not sufficient. The entire DWP portion, including normal imputation credits attributable to that part of the dividend, should be excluded from relief calculations. Normal imputation credits are apportioned between the DWP portion and the remainder of the dividend on the basis of the percentage of cash dividend each represents. Normal imputation credits thereby attributed to the DWP portion are subtracted from the total imputation credits giving rise to the tax relief. Legislatively, this is achieved by section 308A(2)(d).

Note that where DWP credits fully meet any NRWT liability on a dividend, no non-resident portfolio investor tax relief is available.

Credit against company tax payable - section 308A(2)

The tax credit is available against payment of the company's income tax payable. The company's terminal tax payment is therefore reduced by the amount of the credit to which it is entitled. Under the provisional tax system, a company paying provisional tax on the estimation basis will reduce provisional tax by the amount of credit it estimates it will have by the end of its income year. There is no requirement for a company to have paid any provisional tax before it pays a supplementary dividend. The supplementary dividend will give rise to a tax credit reducing terminal tax payable which will flow through to lower provisional tax payments.

Credit carry back - section 308A(3)

When the tax credit is calculated, it produces a reduction in the current year tax liability. However, there could be cases where a company pays dividends with imputation credits but has no current year tax liability. This is because the imputation credits attached to the dividend paid in the current year relate to the taxable profits of prior years.

This situation is addressed by allowing the credit to be used to refund tax paid in any of the four immediately preceding income years. Only tax relating to the 1993-94 or later income years is refundable in this way. Otherwise, there would in effect be a retrospective refund of income tax paid before the foreign investor tax credit regime started.

Credit ordering rules - section 308A(2),(3)

The credit for company tax available under the non-resident portfolio investor regime is offset against income tax payable by a company *after* allowing for foreign tax credits available under section 293. If that were not the case, it is conceivable that a company might extinguish its New Zealand tax liability under the foreign investor tax credit regime, leaving no New Zealand tax liability against which it could offset any available foreign tax credits. Such credits are lost if they are not offset against New Zealand income tax payable on foreign income in the same income year that the foreign income is derived.

The credit for company tax available under this regime is offset against income tax payable by a company *before* allowing for imputation credits available under section 394ZE which are attached to dividends received by the company. This ordering rule allows a company deriving fully imputed dividend income to still utilise the tax credit available under the foreign investor tax credit regime. Such a company can convert resulting excess imputation credits into a loss which can in turn be offset against the income of other companies in the same group or carried forward by the company (subject to normal shareholder continuity requirements).

The company tax credit available under section 308A is also offset against income tax payable by a company *before* allowing for resident withholding tax credits available under section 327K. This ordering rule is of benefit to companies receiving income from which resident withholding tax has been deducted, as excess resident withholding tax credits are refundable. Resident withholding tax credits are offset against income tax payable by a company after allowing for imputation credits (section 327K(3)).

Application of credit mechanism to wholly-owned groups - section 308A(3)

Under the regime the company paying the supplementary dividend to a non-resident portfolio investor is entitled to the tax credit. However, in a group of companies, the parent company paying a supplementary dividend to a non-resident portfolio investor may have no tax liability of its own that it can offset the tax credit against, as the subsidiaries themselves pay the tax within the group.

This situation is addressed by allowing a tax credit received by a company to be claimed against the tax liability of another company in the same wholly-owned group. For this to happen, the company that receives the tax credit must elect to do so by filing a written notice with its tax return for the relevant year.

The four year credit carry back rule also applies to a wholly-owned group; a company may use a tax credit it receives to reduce tax paid by another company in the same wholly-owned group in the four years preceding the income year in which the dividend is paid.

Anti-avoidance rule - section 308A(4)

There is a general anti-avoidance rule which provides that a person will not qualify as a non-resident portfolio investor if an arrangement has been entered into concerning the shares of the relevant New Zealand company, which has the purpose or effect of defeating the intent and application of the non-resident portfolio investor regime.

Safe harbour rule - section 308A(5)

A company could pay a shareholder a supplementary dividend on the basis that it considered the shareholder to be a non-resident portfolio investor but, in the absence of any other rule, be denied a tax credit because it is later discovered that the shareholder did not in fact qualify as a non-resident portfolio investor (by virtue of not being a non-resident or not having a less than 10% interest in the company). Accordingly, there is a "safe harbour" rule which is designed to provide more security for companies paying supplementary dividends.

This safe harbour rule deems a person to be a non-resident portfolio investor relative to the company if all of these conditions are met:

- The person has a less than 10% interest in the company *or* the person (including that person's nominee or agent) has given written notice to the company that it qualifies as a non-resident portfolio investor.
- The person is not associated with the company.
- The person is not deemed under the anti-avoidance rule not to be a non-resident portfolio investor by virtue of any arrangement to which the company or an associate of the company is a party.
- The company does not have reasonable grounds for believing that the shareholder is not a non-resident portfolio investor.

If the above requirements are satisfied the company can treat the shareholder as qualifying for tax relief under the foreign investor tax credit regime. It will not face any penalty if the person turns out not to be a non-resident portfolio investor.

Where the safe harbour rule has resulted in a shareholder being deemed to be a non-resident portfolio investor but the shareholder does not in fact have that status, the shareholder becomes liable for an amount of income tax equal to the tax credit received by the company, plus any penalties (section 308A(6)).

A nominee company can give notice to an issuing company that an investor qualifies as a non-resident portfolio investor. This gives the issuing company protection under the safe harbour rule. Such a nominee company does not become liable under the deemed agency provisions of section 283 if it transpires that the investor did not in fact qualify as a non-resident portfolio investor, provided the nominee company did not have reasonable grounds for believing that the investor was not so qualified.

The issuing company itself is also not liable under the deemed agency provisions of section 283 in a situation where the safe harbour rule applies.

Application of benchmark dividend and anti-credit streaming rules - section 308A(7)

Where a company receives a tax credit under the regime, the company's tax payments are reduced; this in turn reduces the amount of imputation credits available for distribution with dividends. It would defeat the purpose of the regime if this reduction in tax (and corresponding reduction in available imputation credits) combined with the benchmark dividend and anti-credit streaming rules to prevent companies:

- distributing the normal amount of dividend with the normal amount of credits attached; or
- paying supplementary dividends.

To deal with this, companies are relieved from the benchmark dividend and anti-credit streaming provisions in the imputation and FDWP regimes in relation to the payment of supplementary dividends. Consequently, supplementary dividends can have no imputation credits attached even though the normal dividend will have credits attached.

For the purposes of the imputation regime benchmark dividend and anti-credit streaming rules, a company is also deemed to have attached an imputation credit to the normal dividend it pays out equal to the amount of the tax credit. This deeming provision is necessary to enable a company to pay the same level of imputation credits to its domestic and foreign shareholders and thereby not contravene the anti-credit streaming rules.

Just as importantly, the deeming provision also ensures that the benefit of the tax credit that a company receives under the regime is passed on to its non-resident portfolio investors because otherwise there would be a breach of the imputation credit rules. A company that paid normal fully credited dividends to non-resident portfolio investors and a supplementary dividend would be deemed to have attached to the normal dividend additional imputation credits equal to the supplementary dividend. This would result in a breach of both section 394G(1) (the maximum imputation credit rule) and section 394(G)(2) (the benchmark dividend rule). To avoid such a breach the company would need to reduce the supplementary dividend to zero. Only by reducing the level of normal imputation credits by the level of tax relief available can imputation credit streaming rules be complied with. This is the right policy result because the tax relief itself reduces corporate tax and should therefore reduce the normal level of imputation credits.

Section 394D(1)(a)(iva) provides that income tax paid by way of crediting under section 308A does not give rise to a credit in a company's imputation credit account.

Ability to pay supplementary dividends and company law requirements - section 308A(8)

The payment of a supplementary dividend by a company to a non-resident portfolio investor is specifically deemed not to contravene:

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- any provision of the Companies Act 1955 or section 45 of the Companies Act 1993; or
- the company's articles of association or constitution; or
- any other rule of law.

The reasons for this provision are as follows:

- to relieve companies of the need and cost of changing their articles of association or constitutions to authorise the payment of a supplementary dividend to their non-resident portfolio shareholders
- to override section 45 of the Companies Act 1993, which prohibits companies from having constitutions which permit differential dividends to be paid to shareholders of the same class
- to remove any doubt that any provision of the Companies Act 1955 or any other rule of law could prevent companies from paying supplementary dividends even if their articles of association or constitutions specifically permit such payments.

A company may still insert a provision in its articles of association or constitution which prohibits the payment of a supplementary dividend provided such provision expressly refers to section 308A(8) of the Income Tax Act 1976.

Application date

The company tax credit is available for dividends paid on or after 28 September 1993.

General Insurance Companies (Non-Life Insurance)

Sections 208-210, Income Tax Act 1976

Significant changes have been made to the taxation of general insurers:

- reinsurance premiums paid to foreign reinsurers will become deductible;
- claims received on those policies will become assessable;
- reinsurance premiums paid to foreign reinsurers will be subject to tax in New Zealand at 3.8% of the gross premium;
- the off-shore insurance income of New Zealand insurance companies will become assessable in New Zealand.

The changes take effect from 1 July 1993.

Sections 208 to 210 have been repealed and replaced.

The changes bring the tax rules governing non-life insurance business into line with those for other businesses. The present tax of 10% on direct placement insurance premiums, levied under section 209, is a proxy for taxing the New Zealand sourced income of foreign insurers. Foreign insurers can often claim a credit for this tax against the tax levied on the New Zealand sourced premium income in their home country. Section 209 has now been extended to cover reinsurance premiums.

Background - the previous regime

The previous regime for the taxation of insurance (other than life insurance) companies was contained in sections 208 to 210A inclusive. Section 210A relates to resident Lloyd's names and has not been affected by any of the changes in this Act.

Resident non-life insurers

Resident general insurance companies were previously the one exception to the rule contained in section 242 that income derived by any person resident in New Zealand is assessable for income tax in New Zealand, whether the income is derived from New Zealand or elsewhere.

Section 208(1)(a) excluded from the income of a resident insurance company, income derived from insurance business carried on outside New Zealand. This exclusion also applied to any item of income that was connected with the insurance business carried on outside New Zealand.

The exclusion did not, however, extend to income of the classes referred to in paragraphs (e), (f), (g), (h), (k), (l) and (m) of section 242(2). Income of these classes (which was deemed to be derived from New Zealand) continued to be taxable in New Zealand, regardless of whether the income was derived in connection with the company's insurance business carried on outside New Zealand.

Section 208(1)(b) did not allow general insurance companies a deduction, in calculating their assessable income, for reinsurance premiums paid out of New Zealand. Claims and recoveries received for losses on risks reinsured outside New Zealand were also excluded from the assessable income of the New Zealand insurer.

Apart from the exceptions contained in section 208, which are discussed above, general insurers were generally subject to tax in New Zealand in the same manner as any other company.

Non-resident non-life insurers

Non-resident insurers were liable for tax in New Zealand on premium income derived from insuring New Zealand risk.

Section 209 applied to non-life insurance business placed directly with an overseas insurer where the insurer did not carry on business in New Zealand, or the premium was not included in the foreign insurer's income derived from New Zealand.

It deemed the foreign insurer to derive a profit equal to 10% of the premiums paid. By applying the 38% tax rate applicable to companies not resident in New Zealand to the deemed profit of 10% of the gross premium, a New Zealand tax liability of 3.8% on the gross premium income arose.

The person paying the premium was deemed to be the agent of the foreign insurer and liable to file tax returns and pay the tax assessed on behalf of the foreign insurer.

There was no dichotomy in taxing premiums derived by corporate and non-corporate insurers under this section, as was the case with section 210, which applied only to non-corporate underwriters.

Section 209(1B) specifically excluded application of the section to reinsurance.

Non-resident non-corporate underwriters

Insurance premiums paid by an insured person through an agent to any non-corporate underwriter who was not resident in New Zealand were assessed under section 210. It applied to both direct insurance and reinsurance premiums.

The section deemed the underwriter to derive taxable profits equal to 10% of the premium payable under the contract to which the section applied. It was designed primarily with Lloyd's syndicate underwriters in mind and as a support to section 209.

Where a non-resident, non-corporate underwriter had an agent (as defined in section 210) in New Zealand and entered into a contract of insurance with an insured person resident in New Zealand, the non-resident underwriter was deemed to be carrying on business in New Zealand and subject to tax on that premium income accordingly.

Although the section applied to placements of both direct insurance and reinsurance, section 210(6) provided that the section applied only to contracts of reinsurance that exhibited the following characteristics:

The contract had to be between a non-resident, non-corporate underwriter and a person in New Zealand who carried on the business of insurance, and was reinsuring a risk of any kind (other than life insurance). It was also necessary that there was an agent of the underwriter in New Zealand.

The New Zealand agent of the underwriter was liable to make returns and pay the tax assessed on behalf of the foreign underwriter.

Key issues of new regime

Sections 208, 209 and 210 have been repealed and replaced by new sections 208 and 209.

From 1 July 1993 New Zealand general insurance companies will become liable for tax in New Zealand on all income derived from insurance business carried on both inside and out of New Zealand.

Likewise reinsurance premiums paid to foreign reinsurers will be deductible and any recoveries received on those reinsurance contracts will be assessable.

Transitional rules

The new section 208 applies only for the transition to the new rules. Once the transitional period has elapsed section 208 will have little, if any, application.

The transitional rules deal with bringing into the tax base the assets and liabilities that New Zealand insurance companies use for the purposes of insurance business carried on out of New Zealand.

The rules also determine the treatment of premium income, reinsurance premiums, and claims.

For the purpose of the transition from the old rules to the new, the change is regarded as occurring as at 1 July 1993. This date is referred to as the *Transition Time* in the legislation.

Assets - section 208(2)(a)

All assets of a company held for the purposes of an insurance business carried on out of New Zealand are deemed to have been disposed of to an unrelated third party and to have been reacquired immediately afterwards for a consideration equal to their market value at 1 July 1993.

This provision allows values to be attributed to company assets that were used in an insurance business carried on out of New Zealand. The values will be used to determine the tax consequences attributable to these assets from 1 July 1993 onward; they will determine the acquisition value of investments and the depreciable value of depreciable assets and so forth.

It also ensures that any income received from any asset connected with a company's insurance business carried on out of New Zealand is attributed to the appropriate period to which it relates.

The deemed sale and reacquisition excludes from the tax base any income that accrues from an asset in the period to 1 July 1993.

For example, if a company held equity investments that would give rise to assessable income on sale under the new rules, the deemed sale as at 1 July 1993 ensures

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that any income accrued to that date is excluded from the company's assessable income for that income year. The same scenario applies to interest bearing securities and other forms of financial arrangements.

Excluded from this provision is income deemed to be derived from New Zealand from:

- the ownership of any land;
- any mortgage of land;
- shares or debentures in any company, or local or public authority;
- debentures or other securities issued by the New Zealand Government;
- the sale of property in New Zealand;
- interest or a redemption payment derived from money lent in New Zealand;
- interest or a redemption payment derived from money lent outside New Zealand to:
  - any person resident in New Zealand except where the money lent is used by the resident for the purposes of a business carried on outside New Zealand through a permanent establishment;
  - any person not resident in New Zealand who uses the money lent in a business carried on in New Zealand through a permanent establishment.

The classes of income referred to above were assessable in New Zealand under the previous rules. As their tax status has not changed it was not necessary to have the transitional rules apply to the assets underlying that income.

Liabilities - section 208(2)(b)

New Zealand general insurance companies with liabilities arising out of insurance business carried on out of New Zealand and outstanding as at the transition time are deemed to have been relieved by an unrelated third party and immediately thereafter paid to reassume the liability for a consideration equal to the market value for assuming such a liability at the time.

The purpose of this provision is to separate out any expenditure incurred by an insurance company on a liability outstanding at the transition time.

The expenditure will be allocated to the respective periods to which it relates, thus ensuring the appropriate deductibility rules are applied to that expense.

Premium income - section 208(2)(c)

Rules are set out for determining what portion of premium income is brought to account where the period of risk under the contract to which the premium relates commenced at or before the transition time.

The rule applies where:

- the company as insurer has entered into an insurance contract for insurance business conducted out of New Zealand; and
- the period of risk under the contract commences on or before 1 July 1993 and ends after that date.

Where these conditions are satisfied the amount of the premium deemed to be derived by the insurance company after 1 July 1993 is obtained by a simple formula which assumes that the premium income is derived evenly over the period of risk to which the contract relates.

The formula used is:

$$\frac{a}{b} \times p$$

where -

a is that part of the period of risk under the contract that falls after 1 July 1993

b is the total period of risk under the contract

p is the amount of the premium.

The amount determined by the formula will be the premium income that relates to the period of risk falling after the transition time. This amount is to be brought into account as assessable income.

Example

General Insurance Co operates a branch in Australia that is in the fire and general business. All General Insurance Co's contracts expire on the anniversary of the contract. Separate calculations will therefore need to be made for all contracts that extend beyond 1 July 1993.

Assume for the purposes of this example that General Insurance Co has only one customer, Manufacturing Co. The insurance contract commenced on 1 January 1993. Manufacturing Co. pays AUD 17,000 per annum for all its fire and general business.

General Insurance Co's balance date for New Zealand tax purposes is 31 March.

The assessable income arising from the insurance contract with Manufacturing Co for General Insurance Co's year ending 31 March 1994 will be:

$$\frac{183}{365} \times \text{AUD } 17{,}000$$

$$= \text{AUD } 8{,}523$$

This amount must to be brought to account as at 1 July 1993.

Claims - section 208(2)(c)

There are also rules to determine the deductibility of an amount payable by the New Zealand company on a claim where the period of risk under the contract to which the claim relates commenced on or before the transition time.

Where the company pays an amount under such a claim, the company can only deduct the payment from its assessable income if the event that gave rise to the claim occurred after 1 July 1993.

This makes it clear that only those claims payable after 1 July 1993 (for contracts where the period of risk includes 1 July 1993) will be deductible from the insurer's assessable income, where the actual event covered by the policy occurred after 1 July 1993, and that event is the dominant, effective or operative cause of the loss giving rise to the claim.

Claims payable under an insurance policy that covers the transition time will not be deductible if the event giving rise to the claim occurred before the transition time, even though the loss may not have been incurred until after the transition time. Such situations could arise under contracts of professional indemnity, for example.

Reinsurance premiums - section 208(2)(d)

Deductions are now permitted for reinsurance premiums paid out of New Zealand.

The new section 208(2)(d) provides rules for determining the timing of the deduction of reinsurance premiums paid out of New Zealand, where the risk under the reinsurance contract covers the transition time.

The premiums payable out of New Zealand under the reinsurance contracts are treated as having been paid evenly over the period of the contract.

The formula used is:

$$\frac{a}{b} \times p$$

where -

a is that part of the period of risk under the contract that falls after 1 July 1993;

b is the total period of risk under the contract; and

p is the amount of the premium.

The amount determined by the formula will be the reinsurance premium that relates to the period of risk falling after the transition time. This amount will be deductible from the insurance company's assessable income for its income year that first ends after 1 July 1993.

Example

General Insurance Co. reinsures all its fire and general business with Reinsurance Co. of Woolongong Ltd.

General Insurance Co. carries 40% of the risk under its insurance contracts with the balance reinsured. For its year ended 31 March 1994 General Insurance Co. paid AUD 6,000 in reinsurance premiums for its contract of insurance with Manufacturing Co.

The period covered by the reinsurance contract is the same as the head contract, i.e., 1 January 1993 to 31 December 1993.

The amount deductible from the assessable income derived during the income year ending 31 March 1994 will be:

$$\frac{183}{365} \times \text{AUD } 6{,}000$$

$$= \text{AUD } 3{,}008$$

Reinsurance recoveries - section 208(2)(d)

Claims and recoveries received for losses under reinsurance contracts with non-resident insurers are now assessable.

Where a New Zealand company receives an amount for a claim for a loss under a reinsurance contract (where the period of risk under that contract started before the transition time and ends after that time) section 208(2)(d) contains rules to determine how that amount is to be treated.

Any amount derived by a New Zealand insurance company from any claim for a loss under a reinsurance contract is deemed to be assessable income of the company where the “event giving rise to the claim” occurs after the transition time. This amount is deemed to be assessable income derived by the company on 1 July 1993 or the date upon which the event giving rise to the claim occurs, which ever is the later.

Again, as with an amount payable by the New Zealand insurer on a claim, the use of the words “event giving rise to the claim” make it clear that amounts received after 1 July 1993 (under the reinsurance contract where the period of risk covers 1 July 1993) will only be assessable if the actual event giving rise to the claim occurred after that date.

The event occurring after 1 July 1993 must also be the dominant, effective or operative cause of the loss giving rise to the claim. It will be a question of fact as to what the dominant, effective of operative cause of the claim is and when it occurred. However, if it occurred before 1 July 1993, any amount received for that loss will not be assessable. This will be the case regardless of when the recovery is received.

Application date of new section 208

The previous section 208 has been repealed with effect to income derived and any expenditure or loss incurred on or after 1 July 1993

The transitional provisions contained in the new section 208 apply to the tax on income derived in the 1993 and subsequent income years.

Non-resident non-life insurers - new section 209

The new section 209 is intended to ensure that any insurer not carrying on business in New Zealand

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through a fixed establishment in New Zealand, who derives premium income in respect of the business of insurance of New Zealand risk shall be assessable for income tax in New Zealand on the deemed taxable income.

The new section applies both to direct placement insurance and reinsurance. It makes no distinction between corporate and non-corporate insurers.

For the purposes of this section "Insurance" is defined as "insurance or guarantee against any loss, damage, event, happening, contingency, or risk of any kind, not being life insurance".

This definition is intended to carry over the application of the previous section 209, i.e. the intention is neither to narrow nor broaden the concept of insurance to which the previous section applied.

Section 209(2) is the primary taxing provision. It applies where:

- any insurer derives a premium which is deemed to be derived from New Zealand (a new source rule has been inserted in section 243(2)(ma) for this purpose); and
- at the time of derivation the insurer is not resident in New Zealand; and
- the premium is not attributable to any fixed establishment of the insurer in New Zealand.

Where these conditions are satisfied the insurer is deemed to derive taxable income equal to 10% of the gross amount of the premium received.

The applicable tax rate is that for companies not resident in New Zealand, which is presently 38%. This gives an effective tax rate of 3.8% of the gross premium income derived by the non-resident insurer to which the section applies.

Where an insurer is subject to the 3.8% tax on the gross premiums under the new section 209(2):

- the amount of income tax for which the insurer is liable on the premium is determined solely by reference to the provisions of that section; and
- that premium income is excluded from any other assessable income the insurer may derive from New Zealand.
- no deduction of any amount is permitted from the premium income, i.e., the premiums are assessed on a gross basis.

These provisions ensure that New Zealand receives the correct amount of tax on the premium income, as levied by the section, and that the income is not offset against any losses the non-resident insurer may have in New Zealand from any other activities carried on in New Zealand.

In cases where the 3.8% tax is deducted from the insurance premium or the insurance premium has been grossed up for the purposes of calculating the tax, the full amount will be deductible.

Agency provisions - section 209

The new section contains more specific rules for treating certain New Zealand persons as agents of non-resident insurers.

The section also contains rules to ensure that banks and other financial institutions are not deemed to be agents in certain circumstances.

An objective of the agency rules is to treat the New Zealand resident person who actually pays the premium to the insurer, or to a non-resident agent of the insurer, as having the primary responsibility as agent of the insurer for New Zealand tax purposes.

Although the primary responsibility of agency is assigned to the person who actually pays the premium to the insurer or non-resident agent, this does not preclude other people resident in New Zealand from also being regarded as agent. In fact, the agency rules are structured in such a manner so as to ensure agency is concurrently applied, not only to the person paying the premium but, to any other person or the insured person.

In practice this will mean that where the person with primary responsibility as agent of the insured fails to meet their obligations, Inland Revenue may still seek either the tax return or payment of income tax of the non-resident insurer from either of the two other persons identified in the section.

Ultimately, however, it is the insured person that has liability to furnish returns and pay any tax assessed on behalf of the non-resident insurer.

The general agency provisions of Part VII of the Act will continue to apply to section 209 agency. Section 269 allows a person who is an agent to recover any tax from the principal, by deducting it from any amount owing by the agent to the principal.

Where a person has filed tax returns and paid tax as agent of the non-resident insurer, no other person will be liable as agent.

Banks and other financial institutions who from time to time are required to make payments on behalf of their customers as part of their business, but who are not otherwise a party to the transaction, are excluded from the agency rules.

Where a bank or other financial institution pays a premium to a non-resident insurer on behalf of another person, it is not regarded as the agent of the non-resident insurer. Instead, the person on whose account the funds are drawn to pay the premium will be regarded as the agent, and become liable accordingly.

The banks and financial institutions to which this exclusion applies are:

(a) Any registered bank as defined in section 2 of the Reserve Bank of New Zealand Act 1964 and any person who is either referred to or within any of the categories of persons referred to in Part A of the First Schedule to that Act:

(b) Any building society as defined in section 2 of the Building Societies Act 1965:

(c) Any company formed under section 4 of the Trustee Banks Restructuring Act 1988.

Application date of new section 209

Except for reinsurance premiums paid before 1 July 1993, the section applies to any premium paid on or after 1 July 1993.

For reinsurance premiums paid before 1 July 1993, the section will apply to the extent that they are deductible to the New Zealand insurer under section 208(2)(d).

New source rule - section 243(2)(ma)

The new section 209 applies to insurance premiums that are "deemed to be derived from New Zealand".

The new section 243(2)(ma) deems a premium to be derived from New Zealand where a contract of insurance:

- is offered or entered into in New Zealand; or
- is entered into by a person resident in New Zealand; or
- is entered into by a person not resident in New Zealand, for the purposes of a business carried on by the person in New Zealand through a fixed establishment in New Zealand.

It contains a proviso to exclude premiums with a source in New Zealand where the premium relates exclusively to risks located outside New Zealand. The proviso does not apply where the insured person and the insurer are associated.

The proviso is designed to treat foreign branches of New Zealand residents in the same manner as a foreign subsidiary.

Application Date

The application date is the same as that applying to the new section 209.

Employer-Provided Clothing and FBT

Section 336N(1), Income Tax Act 1976

Introduction

Employer-provided clothing will now be specifically exempt from FBT if it meets certain criteria. This amendment applies from 1 April 1985.

Background

Although it isn't specifically mentioned, employer-provided clothing is a fringe benefit under section 336N(1)(e). Previously, the legislation contained two general exemptions from FBT that could be applied to employer-provided clothing.

The first is the allowance exemption (336N(1)(j)(iv)). This exemption applies where the supply of clothing removes the need for the employer to pay an allowance under section 73 of the Act to the employee. For example, uniforms worn by nurses and protective clothing will not incur FBT because of this exemption. The allowances exemption has been retained. This will remove any burden for those who already qualify for this exemption to fulfil any new requirement.

The second exemption is the premises exemption (336N(1)(n)). This section exempts from FBT all benefits enjoyed on the employer's premises, and benefits enjoyed while carrying out employment duties elsewhere (except at the employee's place of residence). Therefore, clothing worn only on the employer's premises will not be subject to FBT. However, if the clothing is worn in travelling to and from work or off the employer's premises during work hours for any reason except to perform work duties the exemption may not apply.

The amendment resolves this problem by removing clothing from the premises exemption from 1 October 1993, and introducing a new exemption specific to clothing.

Key issues

An exemption from the definition of "fringe benefit" which is specific to clothing has been introduced and is contained in paragraph (p). This exemption is in addition to the allowances exemption discussed above.

Any benefit consisting of the provision (whether by way of sale or otherwise) of distinctive work clothing to an employee by an employer is excluded from the definition of a fringe benefit. This new exemption will allow employers to provide "distinctive work clothing" to employees without incurring FBT.

The legislation contains this definition of the term "distinctive work clothing":

"Distinctive work clothing", in relation to an employer, means any clothing (which may be a single item of clothing) that forms part of or constitutes a uniform in relation to the employer's activity or undertaking, where the Commissioner is satisfied that:

(a) The uniform is identifiable with the employer by virtue of:

(i) A name, logo, or other similar identification regularly used by the employer in the carrying

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on of the employer's activity or undertaking being permanently and prominently displayed at all times; or

(ii) The uniform's pattern, colour scheme, or style having ready association with the employer; and

(b) The clothing is worn by employees in the course of or as an incidence of their employment by the employer and would not normally be worn by employees for private purposes.

Application date

The distinctive work clothing exemption will apply from 1 April 1985, the date the FBT regime began. Clothing will be specifically removed from the application of the premises exemption contained in paragraph 336N(1)(n) from 1 October 1993, which is the start of an FBT quarter.

A taxpayer who has paid FBT on clothing provided to staff may be entitled to a refund if that clothing meets the definition of "distinctive work clothing". Employers who think that they may be entitled to a refund should contact their local Inland Revenue office and ask for Taxpayer Services.

Common questions about the new exemption

Can a single item of clothing constitute a uniform?

For the purposes of the definition a single item of clothing will constitute a uniform. Therefore, if a single jersey is provided which meets the criteria of the definition it will be exempt.

Whose name, logo or similar identification needs to be displayed?

The definition does not require the uniform to display the name, logo or similar identification of the employer; it only needs to display an identification regularly used by the employer. Therefore, a trade name, name of a franchise or a product will suffice if it is regularly used by the employer and the Commissioner is satisfied that it is identifiable with the employer.

What will be considered to be permanent?

To be permanent the identification must be woven into, stitched or ironed onto the clothing or be permanent by some other similar means.

What will be considered to be prominent?

The Commissioner will consider identification to be prominent if it is of a reasonable size. For example, 3cm by 7cm or 4cm by 5cm would be large enough. Also, the colour of the identification should be distinguishable from the colour of the clothing.

What does "at all times" mean?

The definition does not require the identification to be displayed on every individual item of clothing. The uniform as a whole need only display the identification. However, the identification must be displayed "at all times". For example, a jacket, shirt and trousers are supplied to an employee. The jacket has the identification on it but it is often removed during a working day. Therefore, the shirt would also need to have identification on it to satisfy the "at all times" criteria.

However, if only a single item of clothing is provided by an employer, such as a jersey, only that item needs to display identification to be exempt.

Do all uniforms need identification to be exempt?

To be "distinctive work clothing" a uniform does not need an identification if the uniform's pattern, colour scheme or style is readily associated with the employer outside the workplace.

When can distinctive work clothing be worn?

Part (b) of the definition limits the use of distinctive work clothing to work use and use incidental to work. The definition does anticipate an element of private use. For example, attending a non work related meeting on the way home from work would not fall outside the bounds of the definition.

Note that part (b) relates to "clothing" rather than "uniform", so each item of clothing provided by an employer must meet the criteria established in part (b).

Cases Stated - Modified Procedure

Sections 33 and 34, Income Tax Act 1976
Sections 36 and 37, Goods and Services Tax Act 1985
Sections 90, 91 and 92, Estate and Gift Duties Act 1968
Sections 72, 73 and 74, Stamp and Cheque Duties Act 1971

Introduction

There have been similar amendments to the case stated procedures in each of the Inland Revenue Acts. Objections can now be referred directly to the High Court as cases stated. Regulations will be gazetted shortly to provide similar provisions for objections referred to the Taxation Review Authority for determination.

Background

Under the current provisions, a taxpayer who has objected to an assessment made under any of the principal Acts is only required to request that a case be stated. On many occasions the existing process does not cause the taxpayer and Inland Revenue to explain to each other their respective views of the facts and analyses of the applicable law. Both the taxpayer and Inland Revenue often don't gain a full understanding of the opposing view until shortly before the hearing of the case, or sometimes even during the hearing.

When Inland Revenue and the taxpayer fully understand each other's views, some issues or cases can be agreed. The new procedure ensures that this process of sharing information and analyses occurs during the stating of the case. Inland Revenue will actively seek to exchange this information earlier, preferably before the formal objection process begins.

Key issues

Under the amended provisions there are new obligations for both the taxpayer and Inland Revenue. This is to make sure both parties understand the substance of an objection before it reaches the Court for hearing, and to make sure disputes are referred to the Court promptly for hearing.

Taxpayer's obligations

Within three months of requesting a case stated, the objector must give Inland Revenue a notice in the prescribed form which shows the objector's points of objection. The prescribed form is printed by Inland Revenue (form IR 265). Objectors can use either the printed form, or a typed document in the same format.

This notice must contain enough detail to give Inland Revenue and the Courts this information:

- the facts on which the objector relies in support of the objection
- the propositions of law (if any) on which the objector relies in support of the objection
- the issues which the objector wants the Court to determine.

The objector must deliver this information to the Commissioner at Inland Revenue's Head Office in Wellington, or to some other address if Inland Revenue requests this in writing. The document can be delivered personally, posted, or sent by courier.

The objector must send in with this document copies of any documents which will be used to support the objection. If there are a lot of documents, the objector can attach a list of them instead of sending individual copies.

Note that if an objector doesn't send in this documentation within the prescribed period, the objection is deemed to be withdrawn and Inland Revenue does not have to take any further action on the objection.

The Court may grant further time to serve the points of objection and documents.

Inland Revenue's Obligations

Within three months of when we receive the objector's points of objection, (or longer if the Court has allowed it), Inland Revenue must state and sign a case stated to the court. That case must include these items:

- particulars of the assessment to which the taxpayer is objecting
- the objector's stated grounds of objection
- the question for determination of the court
- the points of objection served by the objector
- a notice in the prescribed form stating any further facts which Inland Revenue thinks are relevant to the issues to be determined
- the issues which Inland Revenue claims need to be determined by the court.

Inland Revenue must file these documents in the registry of the High Court specified in the objector's request for stating of a case. If the objector didn't specify a registry, Inland Revenue can choose one, taking into account the objector's convenience.

Inland Revenue must serve a copy of this case stated on the objector, either personally or by sending it by registered post to the objector at the address for service specified in the objector's points of objection.

Inland Revenue may apply to the High Court to extend the time limits for service of points of objection or filing the case stated. If Inland Revenue applies more than two months after the due date, the High Court will only grant an extension in exceptional circumstances.

If Inland Revenue doesn't file a case stated within the time limit (or any further time allowed by the Court), the objector may apply to the Court for an order directing Inland Revenue to allow the objection. The High Court must make such an order unless it is satisfied that there are reasonable grounds for the failure to file the case within the time limit. It may also refuse to make such an order and make such other orders as it thinks fit in the circumstances.

At any time before the case stated is set down for hearing, Inland Revenue may file an amended case stated and the objector may serve amended points of objection on Inland Revenue.

Application dates

For each of the principal Acts referred to above, these changes apply to objections lodged on or after 1 April 1994.

Test Case Procedure

Section 33A, Income Tax Act 1976
Section 36A, Goods and Services Tax Act 1985
Section 92A, Estate and Gift Duties Act 1968
Section 74A, Stamp and Cheque Duties Act 1971

Introduction

There are now test case procedures in each of the Inland Revenue Acts. Each provision is expressed in similar terms.

Background

Before these amendments, it was not possible to resolve on a "test case" basis groups of objections which involved substantially the same issue under one of the above Inland Revenue Acts. Inland Revenue had to prepare cases stated for hearing all objections by affected taxpayers on the point, even where the High Court's finding on an objection which was typical of that group of taxpayers might have effectively resolved the point in dispute for all objectors.

Key issues

Test cases may be commenced only in the High Court.

An objection may be designated as a test case if Inland Revenue considers that determination of that objection (whether on a question of law or of law and fact) is likely to settle one or more issues involved in other objections.

At any time after a taxpayer has lodged an objection but before the Taxation Review Authority or the High Court has determined it, Inland Revenue may notify the objector in writing that the objection will be stayed because there is a test case on a similar objection before the High Court. Such notifications effectively stay the objections of taxpayers so notified until the test case is determined.

Where a test case is stated to the High Court, a stayed objector may notify Inland Revenue that the objector requires the objection to be heard and determined. If an objector does this, Inland Revenue has 14 days from receiving the notice to apply to the High Court for an order to stay the objection until the test case is determined. Inland Revenue must also notify the stayed objector if we apply to the High Court. If we don't make this application within the 14 days the stay will lapse.

The High Court may dismiss Inland Revenue's application to have the stay continued, cease the staying of an objection, or continue the stay.

At any time where an objection has been stayed, Inland Revenue, an objector, or both may apply for an order lapsing the stay.

A stay lapses when the test case is determined and all appeal rights on it have expired.

All notices that must be served on Inland Revenue are to be delivered to Inland Revenue's Head Office in Wellington. For any notices that Inland Revenue must serve on the objector, we can serve them to the objector personally, or send them by registered post to the objector's usual or last known place of abode or business in New Zealand, or to an agent the objector has appointed.

Application date

For the Income Tax Act 1976 and the Goods and Services Tax Act 1985, objections made after 28 September 1993 may be designated as test cases or stayed while a test case is determined. For the Estate and Gift Duties Act 1968 and the Stamp and Cheque Duties Act 1971, objections made on or after 1 April 1994 may be similarly designated or stayed.

Forestry Changes

Sections 74, 81A, 90, 91, and 197, Income Tax Act 1976

Introduction

A potential tax avoidance loophole which may have previously enabled forestry companies to avoid paying any tax on the transfer of forests has been closed.

The general effect of the amendments is twofold:

- All dispositions of timber and timber rights are made taxable.
- Where the timber or timber rights are transferred for less than market value, the transfer is deemed to be a sale at market value.

Anyone who disposes of timber or timber rights will be taxed on the market value ascribed to the transaction. However, the person who acquires the timber or timber rights will be able to deduct the cost of the acquisition (i.e., that market value) when the timber is harvested or the timber right is sold.

Background

Where land is sold with standing timber, the value of the timber is taken into account in calculating assessable income under section 74(5) and 74(2)(b) of the Income Tax Act. However, it may have been possible to structure dispositions of forestry blocks so that any gains derived from these dispositions were not taxable income.

The loss to the revenue base would have been substantial if these practices had become widespread. A press statement announcing the Government's intention to amend the forestry provisions and provisions dealing with disposal of trading stock was made on 24 June 1993, with immediate application from that date.

It was subsequently noted that the disposition of existing forestry timber rights was not specifically included in section 74. The Government decided that dispositions of rights to take timber should be subject to the new rules from 5 August 1993, the date of introduction of the Taxation Reform Bill No 7.

Generally these changes are designed to ensure that the tax treatment of timber and timber rights is consistent with the general tax treatment of dispositions of revenue assets. This corrects anomalies that existed between section 74 and the rest of the Act.

Income from selling timber and timber rights

Section 74 relates to assessable income from selling timber. It has been amended to:

- extend the section to cover all dispositions of timber; and
- specifically include within the ambit of the section rights to take timber.

A right to take timber is defined to include any licence or easement or right of taking any profits or produce from the land to the extent that the licence, easement, or right relates to timber.

In conjunction with the new treatment of timber as trading stock under sections 90, 91, and 197 of the Act, assessable income under section 74 also includes deemed profits or gains as well as actual profits or gains from sales or other dispositions of timber or rights to take timber.

Spreading of income

Assessable income from selling timber can be spread over three years preceding the sale. Section 81A has been amended to extend the spreading provision to include:

- income from dispositions other than sales of timber; and
- sales and other dispositions of timber rights.

This reflects the amendments made to section 74.

Income from disposal of trading stock

The definition of trading stock in section 90 now includes timber and timber rights. The effect of this amendment is that:

- Inland Revenue can attribute a value to any timber or timber rights sold together with other assets of a business.
- For the purposes of this section, dispositions of timber and timber rights, (or any share or interest in this trading stock) will be treated as a sale at market value or other value as determined by the Commissioner.

A further amendment has been made to ensure that the granting of a timber right such as a licence, easement, or forestry right is a disposition to which a deemed value can be applied.

Selling trading stock for inadequate consideration

The definition of trading stock in section 91 is amended to include timber and timber rights. This amendment will allow Inland Revenue to treat any disposal of timber, or a right to take timber for inadequate consideration, as a sale at market value or other value as determined by the Commissioner. The same result applies if any share or interest in this trading stock has been disposed of for inadequate consideration.

A further amendment has been made to ensure that the granting of a timber right such as a licence, easement, or forestry right is a disposition to which a deemed value can be applied.

The value attributed to the timber or timber rights will be taken into account in calculating the assessable income of the person disposing of the trading stock, and the cost of the timber to the person acquiring it.

Distributing trading stock to shareholders

Section 197 treats distributions of trading stock to shareholders as sales at market value. It has had these amendments:

- It now applies to distributions of timber or rights to take timber within the meaning of section 74.
- It includes distributions to persons associated with the shareholders.

The value attributed to the timber or timber rights will be taken into account in calculating the assessable income of the person distributing the trading stock, and the cost of the timber to the person acquiring it.

Although the application dates for amendments to this section will be the same as for the other forestry amendments, there is a special exception for liquidations.

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Where a liquidator was formally appointed, in accordance with the Companies Act 1955, before 24 June 1993 (for timber), or 5 August 1993 (for timber rights), the sale will be deemed to take place at cost value of the trading stock .

Application dates

The new tax treatment of rights to take timber generally applies from 5 August 1993.

The treatment for all dispositions of timber applies from 24 June 1993; the date the Government announced its intention to amend the tax treatment of forestry.

Double Deductions of Investment Losses

Sections 64G, 106(1)(b), 106(1)(ba)204C and 191A, Income Tax Act 1976

Introduction

New provisions amend the rules governing accrued income from financial arrangements written off, and the deductibility of bad debts and share losses.

Background

Before these amendments, deductions for bad debts and share losses were not subject to any prohibition on double deduction of losses. As a result, there was potential for tax avoidance by some corporate groups. In addition, the policy intention of section 64G, which is the prohibition of bad debt deductions arising from loans between associated persons, has not been achieved in practice.

Key issues

The amendments remove any potential for double deduction of losses arising from bad debts and share losses and also ensure that the original policy intention of section 64G is achieved.

Section 64G is replaced with a new section 64G which makes these changes for financial arrangements:

- It clarifies that a deduction for certain bad debts (trade credits) is permitted.
- It prohibits double deductions of bad debt losses.

A consequential amendment is made to section 65(2) of the Act (which lists items included in assessable income) as a result of the drafting changes to section 64G.

Section 106(1)(b) (relating to bad debts) is rewritten and a new section 106(1)(ba) (relating to share losses) is inserted. These amendments make these changes:

- They clarify the inter-relationship between section 106(1)(b) and section 64G on bad debts from financial arrangements which are subject to the accrual rules.
- They prohibit double deductions for bad debts and share losses.

The deductibility of bad debts from financial arrangements subject to the accrual rules is governed by section 64G. This means deductions for bad debts between associated persons are prohibited and will not be permitted under sections 104 and 106(1)(b) (using the argument that the debts are revenue in nature). ***This replaces Inland Revenue's policy statement on the treatment of bad debts under the accrual rules, which was set out in TIB Volume One, No.3 (September 1989). Inland Revenue's policy will cease to apply from the 1993-94 income year, being the application date of the amendments to section 64G and 106(1)(b).***

Example - Deduction for bad debts arising from loans between associated persons

Lender Co is a banking corporate which owns 67 percent of the shares in Borrower Co (a property development company). Lender Co lent Borrower Co $1 million, which is written off as a bad debt when Borrower Co is put into liquidation. Lender Co is not permitted a deduction for the bad debt written off under the Act as Lender Co and Borrower Co are associated persons. A deduction is now not available under Sections 104 and 106(1)(b) for bad debts of a revenue nature.

Double deductions of losses arising from bad debts are now prohibited under section 106(1)(b)(iv). The provision applies in the context of corporate losses grouped under section 191A of the Act only. It will apply where money is lent by the lender and the borrowed funds are used as expenditure taken into account in calculating a loss incurred by the borrower or any other company in the group. If that loss is grouped against group income under section 191A of the Act, the prohibition in section 106(1)(b)(iv) applies to prevent the lender from later claiming a deduction for the bad debt (Ignoring for the moment that if the debt is a financial arrangement, the prohibition of deductions for bad debts between associated persons in section 64G will apply).

Example - Prohibition on double deductions

In November 1993, Lender Co lends Borrower Co (in which Lender Co owns 67 percent of the shares) $2 million. Borrower Co uses the money in a high risk business venture. The venture fails. Borrower Co makes a business loss of $1 million from the investment for the 1993-94 income year. This loss is grouped against Lender Co’s income for the 1994 income year. In May 1994, Lender Co decides to write off the $2 million debt owing as bad (Borrower Co being put into receivership). Lender Co is not allowed a deduction for $1 million of the bad debt written off as that sum has been deducted once earlier as a group loss against Lender Co’s income in the prior income year (Ignoring for the moment that if the debt is a financial arrangement, the prohibition of deductions for bad debts between associated persons in section 64G will apply).

Double deductions of losses from share investments is also prohibited under section 106(1)(ba), which is the equivalent of section 106(1)(b)(iv). It will apply where losses on shares held by the investor company are incurred (assuming the loss-producing activity or investment was funded by money from the equity holdings) because of losses incurred in a group company. If the group loss is offset against group income under section 191A of the Act, the prohibition in section 106(1)(ba) applies to prevent the investor company from later claiming a deduction for any share loss incurred.

Section 204C of the Act relates to profits and losses on the disposal of property by life insurers. It has been amended to prohibit deduction of a share loss that has already been deducted under the grouping provisions.

For group loss offsets, a new provision in section 191(7A) prohibits double deductions of amounts which have earlier been claimed as a bad debt or share loss deduction.

Thus, using the above example, if Borrower Co's loss had not been grouped for the 1994 income year, Lender Co could have deducted the $2 million lent as a bad debt in May 1994. Given the facts in that example, Borrower Co will not be able to group its loss in future income years; it may only carry that loss forward.

Application date

All the amendments apply from the 1993-94 income year.

Part Year Loss Grouping

Section 191A(5) of the Income Tax Act

Introduction

Part year losses which have been carried forward to a subsequent year can now be grouped.

Background

Section 191A(5) allowed a loss company's part year loss to be grouped against a profit company's income where these conditions were met in the loss company's year of offset:

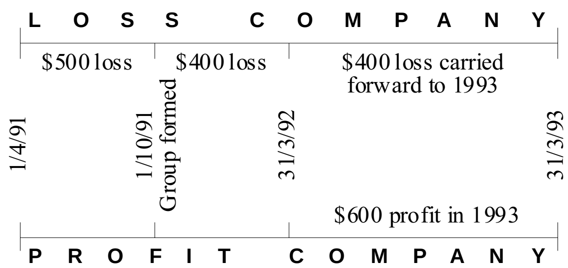
- The profit company and the loss company are in the same group of companies.
- If the profit company has a later balance date than the loss company, the companies must also be in the same group for the profit company's year of offset.
- Continuity of ownership must be maintained.

This section did not allow a part year loss offset where the companies were in the same group for part only of the loss company's preceding loss year.

Key issues

Section 191A(5) is rewritten to enable a part year loss offset where a group situation exists for part only of a preceding loss year. This is limited to losses incurred in the 1991-92 and subsequent income years. The old requirements for part year loss offset are largely repeated.

Example - Part year loss offset where group exists for part only of preceding loss year



A part year group loss offset of $400 is permitted in 1993 income year, provided continuity and commonality requirements satisfied from 1/10/91 and adequate part year accounts furnished to Inland Revenue.

Application date

The amendment applies from the 1992-93 income year.

"Special Corporate Entity" - Meaning Extended

Section 8B, Income Tax Act 1976

Introduction

The term "special corporate entity" has been extended to include life insurance companies that do not issue shares.

Background

For life insurance companies, the old definition of the term meant:

- a life insurance fund within the meaning of section 204(1) of the Act; and
- a life insurance company which is a statutory body established by an Act of Parliament and that does not issue shares.

The term did not include certain insurance companies that do not issue shares and which are not established by an Act of Parliament.

Key issues

The term "special corporate entity" is extended in section 8B(f) to include life insurance companies (being entities engaged principally in the business of providing life insurance to the public) that do not issue shares.

This means that for carrying forward or offsetting losses and for imputation credit account provisions, interests held in such life insurance companies do not have to be physically computed. Under sections 8C(3) and 8D(3) ownership interests held in a special corporate entity are deemed to be held by the same single person.

Application date

The amendment applies from the 1992-93 income year.

No Deductions for Leased Personal Property

Section 222E, Income Tax Act 1976

Introduction

Deductions can no longer be claimed for leases of private or domestic assets.

Background

Section 222E entitled lessees to claim deductions for certain lease payments in absolute terms. It had no limitations if the payments did not meet the normal criteria under section 104 (business criteria) or section 106(1)(j) (not private or domestic expenditure). This enabled deductions of private or domestic expenditure (such as rental of television sets) to be claimed on leased assets.

Key features

The amendment restricts deductions for lease payments under personal property leases to payments that meet the normal production of assessable income criteria under section 104, and which are not private or domestic expenditure.

Application date

The amendment is backdated to 1982 (the year the provision was enacted), but it will not apply to lease payments already claimed in a return furnished to Inland Revenue before 5 August 1993 (the introduction date of the amending legislation).

Consolidation of Mineral Mining Companies

Sections 191E and 191O, Income Tax Act 1976

Introduction

These amendments modify the way the consolidation regime applies to consolidated mineral mining groups.

Key issues

To maintain the integrity of the mineral mining provisions in the Act, section 191E is amended so that a mineral mining company to which section 216 of the Act applies may form a consolidated group only with other mineral mining companies. In addition, to preserve the ring-fencing of loss provisions that apply to mineral mining companies, section 191O is amended so it does not apply to mineral mining companies.

Application date

This amendment applies from the application date of the consolidation regime. This means that the change takes effect from the 1993-94 income year for companies with standard or late balance dates, and from the 1994-95 income year for companies with early balance dates.

Debt Forgiveness - Double Taxation under Section 188(6)

Income Tax Act 1976

Section 188(6) operates to reduce the amount of losses that may be carried forward if a debt is forgiven. A potential double taxation situation arises where a shareholder's debt is forgiven. This is because the forgiveness may:

- constitute a deemed dividend taxed to the shareholder under section 4 of the Act; and
- reduce the amount of losses that the shareholder can carry forward because of section 188(6).

The amendment to section 188 removes this potential for double taxation by ensuring that the losses that the shareholder can carry forward will not be reduced by any amount forgiven that is also taxed as a dividend.

The amendment applies from the 1992-93 income year.

More than One Accrual Method

Sections 64C and 64E, Income Tax Act 1976

Introduction

Amendments to the accrual rules will allow taxpayers to use any of the tax calculation methods in section 64C for the same class of financial arrangement, if they meet certain conditions.

Background

Before this amendment, taxpayers who used more than one method to calculate income or expenditure from a particular class of financial arrangement for financial reporting purposes could not take advantage of some of the tax calculation methods available in section 64C. For instance, a taxpayer who used mark to market for some swap contracts for financial reporting purposes, but yield to maturity for others, could not use mark to market at all for tax purposes. This change will enable taxpayers in this situation to use the tax calculation methods in section 64C.

Tax law generally requires people who are not cash basis holders to calculate their income from financial arrangements using the yield to maturity method (if possible) or a method approved by a determination. Taxpayers may use an alternative method if (amongst other conditions) they use the same method for financial reporting purposes for all such financial arrangements. They may also use a mark to market method if (amongst other conditions) they use that method for financial reporting purposes for all such financial arrangements. However, financial reporting standards will often require that the same type of financial arrangement be treated differently, depending on the purpose for which it was entered into. As long as taxpayers meet the requirements of the new provision, using different accrual methods for accounting purposes will not prevent them from adopting the tax methods in section 64C.

Key issues

To meet the existing requirements in section 64C each method must continue to meet these conditions:

- It must have regard to the principles of accrual accounting.
- It must conform with commercially acceptable practice.
- If it is an alternative to yield to maturity or to a method in a determination, it must result in an allocation that is not materially different from yield to maturity or the method in the determination.
- It must be consistently applied for financial reporting purposes for all such financial arrangements.

The method will be deemed to have complied with the last requirement for a particular financial arrangement if it meets these conditions:

- It reflects the dominant purposes for which the financial arrangement was acquired.
- It will be consistently applied to the financial arrangement for tax purposes.
- It is not adopted to avoid tax.
- Inland Revenue has approved it in the taxpayer's particular circumstances, either in writing or in a determination issued.

The taxpayer would be expected to demonstrate that it has well developed internal controls that require the dominant purpose to be determined at the time the financial arrangement is entered into. This is likely to limit approval to a relatively small number of financial institutions.

Example

A bank invests in Government Stock securities as both a long term investor and as a trader. The investment portfolio would usually be accrued using the yield to maturity method, but the trading portfolio would usually be accrued using mark to market. Each deal ticket would identify the dominant purpose for entering into the financial arrangement. From this deal ticket the bank's financial records would be updated at the time the transaction is entered into.

Provided the requirements of the new section 64C(4A) were complied with, Inland Revenue

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would allow the taxpayer to use the mark to market method for tax purposes, even though the taxpayer did not use it for financial reporting purposes for all Government Stock securities.

Application date

The provisions will apply in the 1993-94 income year and subsequent years.

Depreciation

Sections 107A, 108D, 108G, 108I, 108O and 117, Income Tax Act 1976

Introduction

A number of minor changes have been made to the depreciation provisions. Some of these changes correct drafting errors in the original legislation, while others address concerns raised about the operation of the regime.

Key issues

- The start dates of the various provisions of the original regime are rewritten to make it clear how they apply to early, standard, and late balance date taxpayers.
- The rule which sets the starting point for depreciation as the value at the end of the 1992-93 year is amended to make it clear that it does not apply to assets sold then reacquired.
- A "look-through" rule is introduced for internationally mobile petroleum exploration assets. This is to remove an avoidance opportunity under which asset values could be manipulated to avoid New Zealand tax liability.
- The provision for calculating an asset's adjusted tax value is amended to make it clear when current year depreciation is to be deducted.
- An incorrect reference in the definition of "depreciable property" is corrected.
- The section which provides the two and three shift allowance is amended to make it clear when the allowance terminates.
- The provision which allows either straight line or diminishing value methods to be used is amended to make it clear that it applies to assets acquired from 1 April 1993 onwards.
- An incorrect reference to a Schedule is amended.
- The rule requiring general rates to be banded is extended to provisional rates.
- The facility for taxpayers to write off assets costing less than $200 is extended to self-created assets.
- The low-value asset write-off is also amended to allow taxpayers to write off goods taken into capital account which were originally purchased as trading stock.
- The apportionment provision for assets that are used partly for business and partly privately has been amended so it operates correctly.
- Inland Revenue's discretion to allow some assets to be disposed of other than for market value is removed.
- A Schedule which the amendment Act failed to include in the principal Act is inserted.

Application dates

All these amendments have the same application date as the provision being amended; either 1 April 1993 or the start of the 1994-95 income year.

First Year Depreciation

Previous Section 112, Income Tax Act 1976

An amendment clarifies the now repealed section 112 of the Income Tax Act which dealt with the First Year Depreciation allowance. This amendment ensures that Energy Trading Operators, Harbour Boards and all other entities contained in sections 197A to 197J, which were exempt from tax at the time they acquired assets, do not claim first year depreciation on these assets. This amendment applies from 31 July 1986.

Disposal of Intangible Assets

Section 117, Income Tax Act 1976

There are several minor amendments to section 117, to clarify how it applies to intangible assets and land improvements.

- Section 117 is now limited in its application to intangible assets which are not excluded depreciable property (as defined in section 107A). This means section 117 applies only to depreciable intangible assets purchased or first used after 31 March 1993.
- The exception to the above rule is software, which (if it is not trading stock) is caught by section 117 on its sale if any deduction for its purchase or creation has been claimed.
- The adjusted tax value of such software is its cost less all deductions claimed for its purchase, creation and depreciation.
- Section 117 also applies to the sale of depreciable land improvements that are excluded depreciable property, provided the property was depreciable under the previous depreciation regime.

Application date

The amendments apply from 1 April 1993.

Livestock Valuation for Tax Purposes

Sections 86, 86A-F, 86J, 175-177, 185A, Income Tax Act 1976

There is a detailed description of the amendments made to the livestock valuation regime in TIB, Volume Five, No.2 (August 1993).

The main points are:

- There are amended transitional provisions for bailments and leases in existence on or before 2 September 1992.
- Livestock placed "at use of" a partnership by a partner may be valued at national standard cost by the partner where the partnership also uses national standard cost.
- The date on which livestock must be valued at for the purposes of calculating a differential herd ratio has been amended with effect from the 1993-94 income year.
- Some minor drafting errors have been corrected.

Further clarification of legislation

Where any herd livestock on hand at the beginning of an income year was valued under the herd scheme in the previous income year, it will be valued under the herd scheme at the beginning of the current income year as well. This was the original intention of the legislation. (A new subsection 86D(3) confirms this).

Ruling on election to use transitional provisions for bailed livestock

Section (26) of the Amendment Act provides for elections furnished before this Amendment Act was enacted. Inland Revenue may extend the time for making elections to use the bailed livestock transitional provisions.

Where an election is furnished to Inland Revenue before the day thirty days after this Amendment Act was enacted (i.e., furnished on or before 28 October), it may be revised at any time up until and including 31 March 1994. The thirty day period is so taxpayers and their tax advisers have time to become aware of the change.

Where an election to use the transitional provisions is sent to Inland Revenue after 28 October 1993, it must be furnished with the taxpayer's tax return for the 1992/93 income year.

Hire Purchase Agreements

Sections 76A, 85, 222F, 222G, Income Tax Act 1976

Introduction

There have been some enhancements to the new hire purchase regime that was enacted earlier this year. These changes -

- clarify the treatment of transfers of hire purchase agreements where legal title in the asset changes hands;
- set out the tax treatment for repossessions or early terminations of hire purchase agreements; and
- provide for spreading excess income arising in one income year as a result of changes to the hire purchase legislation.

Background

A new tax treatment for hire purchase agreements entered into on or after 1 April 1993 was introduced earlier this year. Broadly, the new hire purchase regime made these changes:

- It brought hire purchase agreements within the accruals rules. This was achieved by amending section 64B of the Income Tax Act 1976 to remove hire purchase agreements from "excepted financial arrangements". (The accrual rules deal with the loan element of hire purchase arrangements.)
- It dealt with the deemed sale of hire purchase assets to the borrower under the agreement (referred to as the lessee), and deemed purchase by the lender (referred to as the lessor) at the termination of the agreement. These provisions are set out in sections 222F and 222G of the Act.

The underlying objective of the hire purchase regime is to treat hire purchase arrangements as closely as possible to equivalent transactions involving the sale of an asset financed by a loan. To achieve that result, a hire purchase agreement is treated separately as:

- the sale of the asset at market value by the vendor; and
- the provision of a loan - equivalent to the proceeds of the sale - by the vendor to the purchaser.

The loan component of the hire purchase agreement is subject to the accrual rules. Under those rules, taxpayers must generally account for interest income and expenditure as it accrues, not on a cash basis.

Where a hire purchase agreement is terminated the vendor is deemed to reacquire ownership of the asset. Sections 222F and 222G determine the deemed price at which the asset is deemed to have been purchased and disposed of.

Key changes

These are the principal changes to the existing hire purchase regime:

- Where a hire purchase agreement is terminated and the lessee does not acquire ownership of the asset, the vendor (lessor) is deemed to acquire the asset at the "lessor's outstanding balance" at that time.
- If an asset reverts to the vendor, and it is a business asset of that vendor, s/he must treat it as trading stock under section 85.
- The definition of a hire purchase agreement is amended so that, where the agreement is assigned, a deemed sale of the asset is triggered only if the asset reverts to the assignee at the termination of the agreement.
- The definition of the "core acquisition price" and the "acquisition price" of hire purchase arrangements in section 64BA(1) is only applied to the initial holder of the arrangement. If a hire purchase agreement is assigned, the core acquisition price would be determined under general rules (generally the amount of consideration paid to acquire the agreement).
- There are technical changes to the definition of "year of adjustment" in section 76A of the Act. This section governs the transition to the new tax treatment of hire purchase agreements.
- Section 76A has been modified to allow spreading of additional income that arises as a result of the legislative changes in the income year in which 1 April 1993 falls.

Deemed sales and purchases under hire purchase agreements

Section 222G deems a lessor to have sold an asset for the *lessor's disposition value* (generally the cash price of the asset) at the start of a hire purchase agreement. Likewise, the lessee is deemed to have purchased the asset for the *lessee's acquisition value* (again, usually its cash price).

There have been amendments to the provisions in section 222G that deal with situations where ownership of an asset is deemed to revert to the lessor at the expiry or termination of a hire purchase agreement. A hire purchase agreement might be terminated early because the lessee either defaults on or buys out of the contract.

Where beneficial ownership reverts to the lessor at the termination of an agreement, sections 222F and 222G ensure that a lessee (borrower) always pays full consideration to a lessor (lender) for the amounts owed at that time, including accrued but unpaid interest. Accordingly, the borrower can never be taxed on any debt forgiveness income from a hire purchase agreement.

The effect of these sections is that where there is a shortfall in the amount owed to a lessor under a hire purchase agreement after an asset has been repossessed and sold, the lessor can claim a deduction for the shortfall as a loss on the sale of trading stock, or as a write-down of trading stock on hand at balance date to its market value. This result is equivalent to the treatment of a repossessed asset financed by a non-hire purchase loan. In the latter instance, the lender would also account for accrued but unpaid interest when determining income or expenditure in the year the asset is repossessed. The difference between the (higher) total amount paid and payable to the lender and the asset's market value would be deducted as a bad debt.

Deemed acquisition and sale price of reacquired assets

Under s.222G, a lessor is deemed to purchase a reacquired asset for an amount equal to the "lessor's outstanding balance". The lessee is deemed to sell the asset for the "lessee's outstanding balance".

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Broadly, the intent of subsection 222G(2) to (3B) is to deem a lessor to purchase (and the lessee to sell) the asset for an amount equal to the outstanding balance of the loan at the time the agreement is terminated. The outstanding balance is the amount owed by the lessee at the time of termination. This amount is then decreased by any additional payments the lessee makes, or increased by any payments the lessor makes to the lessee at the termination of the hire purchase agreement.

The central element of the lessor's and lessee's "outstanding balance" (defined in s.222F) is the amount of the net balance due (defined in section 22(3) of the Hire Purchase Act) at the termination or expiry of the agreement. However, storage, repossession and other costs and expenses associated with a breach of a hire purchase agreement by the lessee are excluded.

The amount due under the Hire Purchase Act (excluding any repossession and associated costs) is:

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The scheme at a glance

The Income Tax Amendment Act (No.2) 1993 introduced a new tax treatment for hire purchase agreements (HPs), and the recently enacted No.3 Act refined that treatment. The regime applies to HPs entered into on or after 1 April 1993

Entering an HP agreement is deemed to be a sale of an asset at its market price. The profit element of the sale is recognised in the year of sale and the purchaser is entitled to claim depreciation where appropriate.

Such HPs are also financial arrangements which are subject to the accrual rules. This was achieved by removing HPs from excepted financial arrangements.

The effect (depending upon the application of the accrual rules) is:

- the interest element is recognised as income/expenditure over the term of the agreement on an actuarial basis; and
- on termination and expiry there is a "wrap up" operation (the base price adjustment - BPA) to ensure that all income and expenditure is recognised.

Where the lessee does not complete the transaction it is necessary to deal with:

- the repossession and sale of the asset;
- any "wash up" payments between the parties.

Most of the amendments in the No 3 Act deal with the special provisions which cater for agreements that terminate before their full term.

The rules ensure that there will be no adverse implications under the accruals rules for non-business lessees.

Central to the scheme of things is the determination of an "outstanding balance" for the lessor and lessee. The "outstanding balance" is an amount equal to

- the net amount owing under the agreement (excluding repossession and associated charges):

\- less the amount the lessee (purchaser) pays to the lessor (vendor) where the sale proceeds are less than the amount owing;

\+ plus the amount the lessor pays to the lessee where the sale proceeds exceed the amount owing.

The outstanding balance is added to item "a" of the BPA for both the lessor and lessee. In the operation of the BPA:

- "wash up" payments cancel out and repossession and associated charges are excluded, so the BPA continues to be concerned only with principal and interest; and
- the full amount owing is deemed to have been paid. Without this the BPA would result in deemed assessable income to the lessee where the payments made are less than the acquisition price.

The asset is deemed to be acquired by the lessor and disposed of by the lessee for the amount of the outstanding balance at the time the agreement is terminated.

Assets which revert to the lessor on termination or expiry are deemed to be trading stock. The deemed acquisition of trading stock results in a deduction for the amount of the outstanding balance. This offsets the income of that amount which is deemed to be derived under the BPA. Depending on the amount of any sale proceeds or year-end stock valuation, the lessor may get a further deduction or have assessable income.

Repossession and associated expenses and recoveries thereof are deductible and assessable according to ordinary principles.

Where a deduction for deemed acquisition of trading stock has been taken there can be no bad debt deduction for amounts owing or to become owing under the agreement.

Any payments that the lessee makes after the year of termination are income to the lessor.

Any payments the lessor makes after the year of termination are expenditure incurred (if not previously included in the lessor's outstanding balance) and income to the lessee (if not previously included in the lessee's outstanding balance).

The No. 3 Act also provides a spreading provision for excess income arising from the application of the new HP regime in the year of adjustment (the 1993/94 year for taxpayers with standard balance dates).

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- *reduced* by payments the lessee makes to the lessor consequent upon the termination of the agreement, because these payments are consideration paid by the lessee (or derived by the lessor) under the base price adjustment in s 64F(2) of the accrual rules (or s.64F(3) if the lessor is a cash basis holder).

  Payments by the lessee reduce the amount owed by the lessee at the termination of the agreement, so they are excluded. These amounts are referred to in item 'b' of the formula for computing the outstanding balance in s.222F.

+ *increased* by payments the lessor makes to the lessee on the termination of the agreement, since the lessor and lessee must account for these payments in the base price adjustment under the accrual rules. (These amounts are referred to as item 'c' in the outstanding balance formula in s.222F.)

  Payments by the lessor to the lessee are likely to include amounts recovered on the sale of a hire purchase asset, if these exceed the amount the lessee owes. Such payments increase the lessor's deemed cost of reacquisition of the reacquired asset (and increase the lessee's deemed sale price).

In s.222F, the "lessee's outstanding balance" and the "lessor's outstanding balance" are defined separately. However, the two definitions are identical except for different references to the relevant base price adjustment provisions in items 'b' and 'c' of the formula. For lessors, items 'b' and 'c' refer to both sections 64F(2) and 64F(3) of the accrual rules to encompass cash basis holders of hire purchase agreements. By contrast, for lessees, items 'b' and 'c' refer only to s.64F(2) of the accrual rules.

Section 85 has been amended to ensure that where the vendor holds repossessed assets (which are business assets) at the end of an income year, the vendor can claim a deduction for any difference between the "outstanding balance" and the market value (if the market value is less than the outstanding balance). This will prevent any asset which might otherwise be treated as a fixed asset from having an unrealistic value because the outstanding balance at which it is reacquired includes an element of accrued but unpaid interest.

Implications of the accrual rules

The implications of s.222F and s.222G are that where a hire purchase asset is repossessed due to early termination:

- interest, including accrued but unpaid interest up to the date of termination, that accrues in the year in which the agreement is terminated is returned in that year. The deemed reacquisition price produces this effect. This amount is computed under the accrual rules base price adjustment;
- if a shortfall arises because the value of the reacquired asset is less than the outstanding balance owing (including accrued and unpaid interest), and the lessee does not make a payment to satisfy the shortfall, that shortfall is effectively deductible as a loss on sale of the asset (if sold during the year it is reacquired) or as a write-down of trading stock to market value (if the asset is still on hand at the end of the holder's income year).
- if an amount in excess of the outstanding balance is likely to be recovered (because the market value of the asset is higher than the outstanding balance) the lessor must return any amount received in excess of the outstanding balance in the income year in which the repossessed asset is sold.

Examples

These examples show how the hire purchase rules in sections 222F and 222G and the accrual rules apply to hire purchase agreements. They assume the sale and repossession of a hire purchase asset within a single income year. For an example of the accrual of income and expenditure between income years, see pages 41 and 42 of TIB Volume Four, No.9 (May 1993)

Example 1: Shortfall between recoveries and the amount due on termination

Assume the following facts for a hire purchase transaction:

Vendor's balance date:	31 March
Date hire purchase entered into:	5 June 1993
Cash price of property:	$1,000
Deposit paid by purchaser:	$100
Amount loaned by way of HP agreement:	$900
Term of agreement:	24 months
Interest rate on the loan: compound rate of 20% p.a. payable monthly in arrears	
Monthly instalments:	$45.81
Total of seven instalments actually paid	($320.67)
Last instalment paid on 5 January 1994	
Termination of agreement completed on 5 March 1994	
Repossession and associated costs:	$100
Market value of recovered asset:	$650

The amount due under s.22(3) of the Hire Purchase Act on the termination of the agreement is $795.87. (Under the Hire Purchase Act, a vendor must notify a defaulting purchaser of the balance owing and the date from which an agreement which has been breached is to be terminated.)

Excluding repossession costs of $100 (which are deductible as current expenditure under ordinary rules) the amount due is $695.87. This amount includes accrued but unpaid interest of $22.63. Of the total amount, the lessor recovers $650 on the sale of the asset.

The lessor's outstanding balance is calculated using the approach outlined above. Item 'a' of the formula in s.222F is $695.87 (the amount due less repossession and associated costs). Items 'b' and 'c' of the formula are zero. The outstanding balance at which the lessor is deemed to acquire (and the lessee to sell) the hire purchase asset is $695.87.

The lessor must calculate income or expenditure that arises:

- from the sale of the hire purchase asset (or on the write-down of reacquired assets held on balance date to market value, where applicable); and
- under the accrual rules.

Income/loss on sale or under trading stock provisions

The asset is deemed to be acquired by the lessor for the outstanding balance of $695.87. It is sold for $650, so the lessor has a loss on sale of $45.87 (the loss may also arise if the asset is held on balance date and its value is written down to market value).

Income/expenditure under the accrual rules

The lessor's income or expenditure is calculated under the base price adjustment in section 64F(2) of the accrual rules using the formula:

a - b - c

where:

a is the amount of consideration paid or payable to the holder under the agreement. In the example this amount is $1,116.54 - the sum of the deposit initially paid ($100), instalments made until January ($320.67) and the outstanding balance calculated under sections 222F and 222G ($695.87);

b is the acquisition price of the agreement ($1,000); and

c is the net amount to which the holder has previously been subject to tax (in this example, item 'c' is zero).

On this basis, a - b - c is $116.54 for both the lessor (being income) and the lessee (being expenditure).

The overall income from the arrangement for the lessor is $116.54 less the loss on sale of $45.87 - giving net income of $70.67.

Example 2: Lessee pays part of shortfall

The facts in this example are the same as in Example 1 except that the lessee makes a payment of $20 on the termination of the agreement in partial satisfaction of the amount outstanding.

Item 'a' of the formula in s.222F to calculate outstanding balance is $695.87, as in Example 1. From this amount, deduct the payment of $20 received by the lessor (represented by item 'b' of the formula). Item 'c' of the formula is zero (the lessor made no payments). Accordingly, the outstanding balance at which the asset is deemed to be purchased is $675.87.

Income/loss on sale or under trading stock provisions

The asset is deemed to be acquired by the lessor for the outstanding balance of $675.87. It is sold for $650, giving rise to a loss on sale of $25.87 to the lessor (as before, the loss may also arise if the asset is held on balance date and its value is written down to market value).

Income/expenditure under the accrual rules

Again, the lessor's income or expenditure is calculated under the base price adjustment in section 64F(2) of the accrual rules, using the following formula:

a - b - c

where:

a is the amount of consideration paid or payable to the holder under the agreement. In the example that amount is $1,116.54 - the sum of the deposit initially paid ($100), instalments made until January ($320.67), *the payment received by the lessor upon termination ($20) and the outstanding balance calculated under sections 222F and 222G ($675.87)*. (The total amount of consideration received by the lessor is unchanged from Example 1; changes to the composition of that amount from Example 1 are italicised for emphasis);

b is the acquisition price of the agreement ($1,000); and

c is the net amount to which the holder has previously been subject to tax (in this example, item 'c' is zero).

On this basis, a - b - c is $116.54 for both the lessor (being income) and the lessee (being expenditure). This is unchanged from Example 1.

The lessor's overall income from the arrangement is $116.54 less the loss on sale of $25.87 - giving net income of $90.67.

Example 3: Asset sold for more than the outstanding balance

Assume the same facts as in Example 1 except that the asset is sold for $850. The proceeds of that disposition are used as follows:

$100 is retained by the lessor to offset repossession and associated costs incurred;

$695.87 is used to satisfy the remaining balance of outstanding principal and interest owed at the termination of the agreement; and

$54.13, being the remainder, is paid to the lessee.

As in Examples 1 and 2, item 'a' of the outstanding balance formula in s.222F is $695.87. Item 'b' is zero (no payment is made by the lessee). Item 'c' is $54.13; the amount the lessor paid to the lessee - this is added to the amount determined in item 'a' to calculate the outstanding balance. Accordingly, the outstanding balance at which the lessor is deemed to acquire the asset is $750.

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Income/loss on sale or under trading stock provisions

The lessor is deemed to have acquired the asset for the outstanding balance of $750. It is sold for $850, giving rise to a profit on sale of $100 to the lessor.

Income/expenditure under the accrual rules

As in Examples 1 and 2, the lessor's income or expenditure is calculated under the base price adjustment in section 64F(2) of the accrual rules using the following formula:

a - b - c

where:

a is the amount of consideration paid or payable to the holder under the agreement. In the example that amount is $1,170.67, which is the sum of the deposit initially paid ($100), instalments made until January ($320.67), and the outstanding balance calculated under sections 222F and 222G *($750)*;

b is the acquisition price of the agreement (in this case $1,054.13 - the initial cash price of the asset plus the payment of $54.13 paid by the lessor upon the termination of the agreement); and

c is the net amount to which the holder has previously been subject to tax (in this example, item ‘c’ is zero).

On this basis, a - b - c is $116.54 for both the lessor (being income) and the lessee (being expenditure). This is unchanged from Examples 1 and 2. (The additional amount of $54.13 recovered and returned to the lessor affects items ‘a’ and ‘b’ of the base price adjustment formula equally. It is specifically added in ‘b’ and is included in the calculation of the outstanding balance in ‘a’, so it does not change the net result.).

The lessor's overall income from the arrangement is $216.54, made up of accrual income of $116.54 and profit on sale of $100. The profit on sale effectively represents the recovery of deductible repossession and associated costs.

Note that in all three examples, the lessor's accrual income is the same. Adjustments to reflect shortfalls in the amounts recovered compared to amounts owing, or amounts recovered in excess of amounts owing, are reflected in the loss or profit on the sale of reacquired assets.

Cash Basis Holders

Cash basis holders and lessees who aren't required to comply with section 64C of the accrual rules do not have to account for accrued but unpaid interest. Accordingly, for these taxpayers subsections 3 and 3A of s.222G exclude accrued but unpaid interest from the definition of outstanding balance. This ensures that income or expenditure that arises under the base price adjustment should normally be interest paid or received in the year of termination.

Example 4

Assume the same facts as in Example 1 above. However, the holder is a cash basis holder under s.64D of the Act. Accordingly, accrued but unpaid interest of $22.63 is deducted from the outstanding balance of $695.87 computed in example 1, as provided for in section 222F(3). The outstanding balance at which the lessor is deemed to acquire (and the lessee to sell) the asset is reduced to $673.24.

Income/loss on sale or under trading stock provisions

The lessor is deemed to have acquired the asset for the outstanding balance of $673.24. It is sold for $650, giving rise to a loss on sale of $23.24 to the lessor (as before, the loss may also arise if the asset is held on balance date and its value is written down to market value).

Income/expenditure under the accrual rules

The lessor's income or expenditure is calculated under the base price adjustment in section 64F(3) of the accrual rules using the following formula:

a - b - c

where:

a is the amount of consideration the holder derives under the agreement. In the example that amount is $1,093.91, being the sum of the deposit initially paid ($100), instalments made until January ($320.67) and the outstanding balance calculated under sections 222F and 222G ($673.24);

b is the acquisition price of the agreement ($1,000); and

c is the net amount to which the holder has previously been subject to tax (in this example, item ‘c’ is zero).

On this basis, a - b - c is $93.91, being income for the lessor.

The lessor's overall income from the arrangement is $93.91 calculated under the base price adjustment, less the loss on sale of $23.24. This gives net income of $70.67 (the same as in Example 1 above).

Subsequent recoveries or payments

Paragraphs (c) and (d) of section 222G(3B) deal with recoveries of any amount that the lessee owes to the lessor, or the return to the lessee of any amount recovered in excess of amounts owed by the lessee, if these payments are made after the income year in which a hire purchase agreement is terminated or expires. Generally, amounts subsequently paid are taken into account as assessable income and expenditure incurred in the year they are paid, as follows:

- they are deemed to be expenditure of the lessor; and
- they are deemed to be income of the lessee if the lessee has claimed a deduction on the hire purchase asset (such as depreciation), or if the asset was a revenue asset.

Example 5

Assume the facts in Example 2 above except that the lessee pays the $20 after the income year in which the hire purchase agreement is terminated, the asset sold, and the base price adjustment is calculated (with the lessor computing income in that year as described in Example 1). Under s.222G(3A)(c), the lessor returns the $20 in the year it is received.

Example 6

Assume the facts in Example 3 above, except that the repossessed asset is sold and the $54.13 additional payment to the lessee is made in the income year following the year in which the agreement terminates. Since no amount had been paid to the lessor at the time the outstanding balance was computed, the outstanding balance in the year of termination would have been $695.87 (being the amount owed at termination by the lessee, excluding repossession costs). The repossessed asset would have been held on the balance date of the lessor and, it is assumed, would have been valued at cost ($695.87). Accordingly, the only income that arose in the year in which the agreement is terminated would have been calculated under the accrual rules. The base price adjustment would have resulted in the recognition of $116.54 of income to the lessor, with the same calculation as in Example 1 above.

In the following year when the asset is sold for $850, the lessor would recognise $154.13 as profit on sale (being the difference between the sale proceeds and the deemed acquisition cost under s.222G of $695.87). Under s.222G(3A) the lessor would also be able to deduct in that year the payment of $54.13 to the lessee. The net result is assessable income to the lessor in that year of $100.

Assignments and transfers of HP agreements

The assignment of income from a hire purchase agreement is treated as an ordinary assignment if the original lessor retains legal ownership of the underlying asset but assigns the income stream. The lessor will remain the original holder for the purposes of s.222F and s.222G. Assignments of hire purchase agreements have been excluded from the definition of a hire purchase agreement in s.222F(2).

The definition of a lessor in section 222F has been extended to include any assignee of a holder of an agreement. This means that where a hire purchase agreement and the legal title in the underlying asset are both transferred:

- The original hire purchase agreement is deemed to be terminated for the purposes of calculating the initial holder's income under the accrual rules. The initial holder would calculate a base price adjustment
- The new holder would calculate accrual income from the agreement by referring to the price actually paid for the agreement, not the initial acquisition price of the hire purchase agreement (which is generally the cash price of the hire purchase asset). This is achieved by an amendment to paragraph (ca) of s.64BA(1). The definition of the acquisition price of a hire purchase agreement in that paragraph applies only to the "first holder" of the agreement.
- The new holder would be deemed to be the lessor for the purposes of applying s.222G on the termination of the agreement.

The issuer of the agreement should be unaffected by the transfer.

Example 7

"Retailer Co" enters into a hire purchase agreement with an issuer on 5 June 1993. The cash price of the hire purchase asset (and hence, its core acquisition price under s.64BA((1)(ca) of the Act) is $1,000. The term of the agreement is 24 months with monthly instalments of $45.81 plus an initial deposit paid of $100. The total consideration payable over the term of the agreement is $1,199.44. Retailer Co decides to sell the agreement on 5 January 1994 to Finance Co for $670. Under the terms of the sale, Finance Co assumes legal ownership of the hire purchase asset. As the assignee of Retailer Co, Finance Co would be treated as the lessor under sections 222F and 222G if the beneficial ownership reverts to the lessor on the termination of expiry of the agreement.

Retailer Co would calculate a base price adjustment to work out its income from the agreement for its 1993-94 income year. Income would be calculated by referring to the amount realised for the agreement ($670), instalments made to the time of sale ($320.67) and the acquisition price of the hire purchase agreement ($1,000). In the year the hire purchase agreement acquired by Finance Co matures or is terminated, a base price adjustment would be computed to determine income from the agreement for that year. In calculating the base price adjustment, the core acquisition price of the agreement would be the amount actually paid for the agreement, i.e., $670.

Transitional relief for pre-April 1993 hire purchase assets

Transitional rules in s.76A of the Act allow taxpayers to recognise the retail profit element of pre-April 1993 hire purchase agreements as hire purchase payments become due and receivable (provided the retail profit element which would otherwise be assessable from 1 April 1993 is more than $1,000). Those transitional rules are described on pages 38-39 of TIB Volume Four, No.9 (May 1993). In the absence of any other transitional relief, this means that for the income year in which 1 April 1993 falls (referred to as the "year of adjustment") the following amounts of income would have been returned:

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- the appropriate share of the retail profit element of pre-April 1993 hire purchase agreements on a due and receivable basis; and
- the retail profit on assets sold since 1 April 1993.

If there was no transitional relief, the result of returning a portion of "previous years' retail profit" as well as "this year's retail profit" in the year of adjustment results in a "bubble" of doubled up assessable income. To alleviate the cash flow pressure that this would cause for taxpayers, s.76A has been amended to permit taxpayers to evenly spread the additional income that arises in the year of adjustment from pre-April 1993 hire purchase agreements between the year of adjustment and up to the following three income years.

The year of adjustment is the taxpayer's income year in which 1 April 1993 falls. For taxpayers with standard balance dates the year of adjustment is the 1993-94 income year.

This relief is provided under section 76A(4A) and is available where the additional income that arises from pre-April 1993 hire purchases on a due and receivable basis in the year of adjustment exceeds $1,000.

Taxpayers must notify Inland Revenue in their income tax return for the year of adjustment:

- the total amount of unreturned profit element of pre-April 1993 hire purchase agreements; and
- the amounts of that profit which are to be returned in each of the three income years following the year of adjustment.

Example 8

As at 31 March 1993, the unreturned profit element of all hire purchase agreements held by Retailer Co was $400,000. Retailer Co has a 31 March balance date. Allocated on a due and receivable basis, the allocation of that amount between Retailer Co's 1993-94 income year and the subsequent two income years is as follows:

1993-94	$250,000
1994-95	$150,000
1995-96	0

In the 1993-94 income year, Retailer Co also derives $300,000 as profit on the sale of assets subject to hire purchase agreements. Under s.222G, this income is assessable in that year.

Under s.76A(4) Retailer Co is permitted to spread the unreturned profit element of pre-April 1993 hire purchase agreements on a due and receivable basis as outlined above. In addition, the profit element of pre-April 1993 hire purchase agreements that becomes assessable during Retailer Co's 1993-94 income year (the year in which 1 April 1993 falls) on a due and receivable basis can be spread evenly between that year and up to the three immediately succeeding income years. This is provided for in s.76A(4A). On that basis, Retailer Co is able to spread the $250,000 that arises in the 1993-94 income year as follows:

1993-94	$62,500
1994-95	$62,500
1995-96	$62,500
1996-97	$62,500

Under s.76A(5), Retailer Co must notify Inland Revenue in its 1993-94 income tax return of:

- the aggregate amount of unreturned retail profit required to be added to assessable income in the 1993-94 and following income years (in this case, $400,000); and
- the amounts to be returned in the three immediately succeeding income years following the 1993-94 income year (which is the year of adjustment for Retailer Co).

On this basis, Retailer Co would return $62,500 of previously unreturned retail profit in its 1993-94 income year in addition to the $300,000 profit on sale of assets sold subject to hire purchase agreements in that year. Retailer Co would notify in its 1993-94 return of income the allocation of the remaining unreturned profit element as follows:

1994-95	$150,000 + $62,500 = $212,500
1995-96	$62,500
1996-97	$62,500

Application date

The amendments in general apply to hire purchase agreements entered into on or after 1 April 1993.

The amendment in section 85 (to include reacquired assets in trading stock) applies to assets reacquired after 1 April 1993.

The spreading provisions apply to tax on income derived in the taxpayer's income year in which 1 April 1993 occurs. For standard balance date taxpayers this will be the 1993-94 income year.

Retirement Income Policies

The Retirement Income Bill was passed through its final stages on 29 September 1993, and became:

- The Retirement Income Act 1993;
- The Social Welfare (Transitional Provisions) Amendment Act (No.2) 1993;
- The Income Tax Amendment Act (No.4) 1993

and will apply from 1 April 1994.

Background

The Bill was an outcome of the Todd Task Force on Private Provision for Retirement. The leaders of the Alliance, Labour and National Parliamentary parties entered into an historic "Accord on Retirement Income Policies" on 25 August 1993. This accord is now incorporated as a schedule to the Retirement Income Act.

Key issues

The three Acts together provide for -

- the appointment of an independent Retirement Commissioner:
- periodic reports on retirement income policies being implemented by current Governments:
- a change of name of National Superannuation to New Zealand Superannuation:
- periodic adjustments to the level of New Zealand superannuation within a range of levels:
- a transitional retirement benefit for anyone adversely affected by the raising of the age of eligibility for New Zealand Superannuation.

The Retirement Income Act sets out the role, functions and powers of a Retirement Commissioner and provides for periodic reports on the retirement income policies being implemented by the Government of New Zealand.

The Social Welfare (Transitional Provisions) Amendment Act provides for a transitional retirement benefit which will be available (subject to an income test) to persons born between 1 July 1934 and 31 March 1939 (inclusive) for certain defined periods before they become eligible for New Zealand superannuation.

That Act provides for adjustments to the amount of New Zealand superannuation and veterans' pensions in line with movements of the Consumer Price Index. It also sets limits for New Zealand superannuation and veterans' pensions; these will not be (for a married couple) less than 65 percent or more than 72.5 percent of the average ordinary time weekly earnings. (There are minor differences in line with other existing differences in criteria for payments.)

Tax legislation issues

The Income Tax Amendment Act (No 4) 1993 deals only with a series of minor technical amendments which provide that wherever the expressions "national superannuation", "national superannuitant" and "national superannuitant surcharge" appear they are replaced with new terms reflecting the agreement in the Accord.

The new expressions are "New Zealand superannuation", "New Zealand superannuitant" and "New Zealand superannuitant surcharge"

Application date

All of the provisions in these Acts apply from 1 April 1993.

National Superannuitant Surcharge - Specified Exemption

Section 336, Income Tax Act 1976

From 1 July 1993 the Department of Social Welfare may means test people who receive residential care disability services (subsidised care). In these cases the spouse may be paid the unmarried rate of national superannuation.

This change ensures that a spouse who receives the unmarried rate of national superannuation is allowed the unmarried specified exemption rate when calculating any surcharge liability.

The change applies from the 1993-94 income year.

Superannuation Tax Reform

Sections 204Q and 228, Income Tax Act 1976

Introduction

There are two minor amendments to the superannuation provisions to correct existing technical problems. They do not make any policy changes.

The double taxation of investment income earned by two of National Provident's superannuation schemes has been corrected. Also, it is clarified that tax cannot be avoided on interest where a superannuation fund either lends to, or invests in, another superannuation fund.

Background

These amendments were required because:

- double taxation would unfairly lower the post-tax returns of the two National Provident superannuation funds; and
- existing legislation might allow the avoidance of tax on interest payments and investment income distributions between certain superannuation funds.

Key issues

The key legislative amendments make these things clear:

- Certain National Provident superannuation schemes are not subject to the life office tax regime (which, combined with the NPF's organisational structure, causes double taxation), even though there are a small number of employers who do not contribute to the schemes.
- Interest earned by a superannuation fund on a loan to another superannuation fund is taxable. The distribution of investment income from a parent superannuation fund to a member fund is not deductible.

Application dates

The first amendment applies from the beginning of the 1991/92 income year, in order to remove any past double taxation. The second amendment applies from the beginning of the 1993/94 income year.

"Income-Tested Benefit" and "New Zealand Superannuation" Definitions

Section 2, Income Tax Act 1976

There have been minor amendments to the definitions of "income-tested benefits" and "New Zealand Superannuation", to reflect the recently-enacted accommodation supplement (which replaced the accommodation benefit) and tenure protection allowance (Social Security Act (No.3) 1993). These payments are excluded from the definition of income-tested benefits and national superannuation, so they are not assessable.

Funeral grants paid to a surviving spouse are also included in the exceptions in both definitions.

The reference to telephone allowances, has been removed, since these have been discontinued.

The amendment applies to amounts paid on or after 1 July 1993.

Increased Family Support Rates

Section 374D, Income Tax Act 1976

Introduction

An amendment enacts the increased Family Support rates and new age structure which were announced in this year's Budget.

Background

The Government considered that the current Family Support age structure did not adequately deal with the costs of teenage children, so it decided to increase the rate for additional children 13 and over from $22 per week to $35 per week. Further, the rate for additional children under 13 was increased from $22 per week to $24 per week.

Key issues

The following table shows the old and new rates and age structures:

	Old maximum weekly rates (Before 1/10/93)	New maximum weekly rates (After 1/10/93)
Eldest Child	$42.00	$42.00
Each additional child 13 or over	$22.00	$35.00
Each additional child under 13 years	$22.00	$24.00
Those additional children who are 16 to 18 years of age before 1 October 1993 and who are entitled to receive the higher rate of $42.00 will continue to receive this rate until they cease being dependent or until the end of the calendar year in which they turn 18.		

Inland Revenue will automatically re-issue certificates of entitlement to ensure that families who have already applied for Family Support receive their increased entitlement from 1 October 1993. The new rates of Family Support for non-beneficiaries will be direct credited to their bank accounts on Tuesday 12 October 1993.

Beneficiaries will receive their increases on the following dates:

- Domestic Purposes, Widows and Invalid Beneficiaries: 5 October 1993
- Sickness, Unemployment and Training Beneficiaries: 14 October 1993

Application date

The increased rates and new age structure apply from 1 October 1993.

Disclosure of Information for Family Support - Double Payment Identification

Section 13C, Inland Revenue Department Act 1974
Section 375(G)(13), the Income Tax Act 1976

Introduction

An amendment will allow Inland Revenue to match information on Family Support recipients against information that the Department of Social Welfare (DSW) holds, to identify families who may be receiving Family Support from both departments. Social Welfare will also use the information to help identify whether benefit fraud is occurring.

Background

The purpose of this amendment is to maintain the integrity of the Government's social assistance programmes (Family Support and benefits). At present Inland Revenue pays Family Support to non-beneficiaries and Social Welfare pays it to beneficiaries.

Key issues

The amendment allows information held by Inland Revenue about Family Support recipients to be transferred to DSW. DSW will match that information with information they hold on beneficiaries who are receiving Family Support. Where a match occurs and a family is identified as receiving Family Support from both Departments, the results of the match will be transferred back to Inland Revenue.

Inland Revenue will write to those families who are identified as receiving a double payment, and ask them to provide reasons why the Inland Revenue payment should not be ceased. The amendment to the Family Support legislation enables Inland Revenue to stop paying Family Support if the recipient does not reply, or doesn't give sufficient reason why it should not be cancelled.

The provisions of the Privacy Act 1993 will apply to the notification process.

DSW will retain a copy of the results of the information match to help identify whether benefit fraud has occurred.

Application date

This amendment applies from the 1993/94 income year onwards.

Birth Certificate Required if Family Support Paid During Year

Section 374G, Income Tax Act 1976

Introduction

Family Support applicants must now supply birth certificates or other information to verify the existence of children when applying for Family Support. The reason for this requirement is to reduce the likelihood of fraud. It prevents Family Support claims for non-existent children.

Key issues

When a family applies for Family Support for 1994-95 and following years, they must provide children's birth certificates or other information acceptable to Inland Revenue which verifies the children's existence. Other acceptable information includes the child's IRD number, passport or driver's licence. Once a child's existence has been accepted, the family will not have to supply the same information again in following years.

However, if a different applicant applies for Family Support in a later year for the same child, s/he will have to produce a birth certificate or other information with that application.

If an applicant cannot provide the birth certificate or other information at the time of filing an application, Inland Revenue will still accept the application and pay the Family Support entitlement for a period of eight weeks. If the birth certificate or other information is not provided within the eight week period, the Family Support payment for the non-verified children will cease. The applicant can make a subsequent application for Family Support once the birth certificate or other information is available.

Application date

This amendment will apply to Family Support applications from the 1994/95 income year onwards.

Disclosure of Debtors' Address Information

Section 13D, Inland Revenue Department Act 1974
Section 240, Child Support Act 1991

Introduction

An amendment allows Inland Revenue to give the Department of Social Welfare (DSW) addresses of liable parents and past beneficiaries who owe money to DSW.

Background

Currently, the Child Support Act 1991 allows Inland Revenue to transfer address information to DSW to help recover unpaid liable parent contributions.

The amendment extends the transfer of address information to cover debts owed by past beneficiaries (those who received benefit overpayments but are no longer receiving a benefit).

Key issues

Where liable parents and past beneficiaries (debtors) owe money to DSW, DSW will be able to access IRD address information on that debtor and the address of his or her last known employer. This information will help DSW to track the debtor and recover debts owed to the Crown.

The provision in the Child Support Act is repealed, and included in the new section 13D of the Inland Revenue Department Act. The information match complies with the requirements of the Privacy Act 1993.

Application date

The amendments come into force on 1 June 1994.

GST on Motor Vehicle Registration Fees

Section 5(6A), Goods and Services Tax Act 1985

An amendment provides that the Ministry of Transport will return the GST on motor vehicle registration fees from 1 April 1994. At present NZ Post is the sole collection agency for motor vehicle registration fees, and returns the GST.

Tax Invoices- Keeping Records for Second-Hand Goods

Section 24(7), Goods and Services Tax Act 1985

Under section 24(7) of the GST Act, any registered person who acquires second-hand goods which are not a taxable supply must keep certain records. These records do not have to be kept if the consideration for the supply was under $20.00. The amendment raises this threshold to $50.00 for supplies made on or after 28 September 1993.

Unit Trusts - Tax Exemption for Dividends

Section 63(2H), Income Tax Act 1976

When the inter-corporate dividend exemption was removed from 1 April 1992, corporate managers of unit trusts who act as intermediaries in buying and selling units in the unit trust would have been liable for tax on any dividend component of any redemption of trust units. The Government is considering how to deal with this situation.

Section 63(2H) was put in place to ensure that the tax exemption for dividends arising when a unit trust's corporate manager redeems units remained intact.

The original extension of the inter-corporate dividend exemption was to 1 April 1993. This was later extended to 1 April 1994.

Consultation with unit trust operators is continuing. The Government has not yet made any decision on this issue.

It is therefore necessary to extend the inter-corporate dividend exemption to dividends derived from redemption of units in a unit trust by that trust's corporate manager until 1 April 1995.

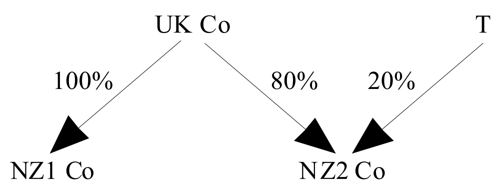
Dividends and Associated Persons Transactions - Definitions

Section 4(13), Income Tax Act 1976

Section 4(13)(d) excludes from the dividend definition associated party transactions which satisfy certain criteria. It has been amended to correct a drafting oversight. There is a detailed explanation of the effect of section 4(13) in TIB Volume 4 No. 9 (May 1993); this item should be read in conjunction with that explanation.

The amendment inserts a reference to "non-resident withholding income" in subparagraph (d)(i). This makes it clear that a dividend arises in the following circumstances:

Example



UK Co owns 80% of NZ2 Co and 100% of NZ1 Co. Both NZ1 Co and NZ2 Co are resident in New Zealand. T has a minority interest in NZ2 Co.

NZ1 transfers property to NZ2 for no consideration.

The transfer of property from NZ1 Co to NZ2 Co is a dividend (derived by NZ2 Co) because the criteria in section 4(13) are not satisfied. The transaction breaches paragraph 4(13)(d) because if NZ1 Co had transferred the property to UK Co, the transfer would have given rise to a dividend which was non-resident withholding income of UK Co.

(Had NZ2 been a wholly owned subsidiary of UK Co. an *exempt* dividend would have arisen to NZ2 Co under section 63(2K)).

The amendment applies from 26 April 1993, which was when the Minister of Revenue announced the amendment.

FBT Paid in Foreign Jurisdictions

Section 106(2)(b), Income Tax Act 1976.

An amendment will allow a deduction against assessable income in New Zealand for FBT paid overseas.

Previously, the definition of "income tax" in section 106(2)(b) included FBT paid overseas, so it couldn't be deducted from assessable income in this country. The amendment removes FBT paid in foreign jurisdictions from the definition of income tax.

This amendment applies from 1 April 1994, to coincide with changes in the Australian FBT regime. One of these changes will allow Australian taxpayers a deduction for FBT paid in Australia.

Collection of PAYE and Earner Premium

Sections 2, 353, 355, 365 to 373, Income Tax Act 1976
Sections 77, 115, 117 and 130, Accident Rehabilitation and Compensation Insurance Act 1992

Introduction

Amendments enable PAYE and ACC earner premium to be collected and recovered as one sum.

Background

The amendments ensure the efficient collection and recovery of ACC earner premium. Employers deduct earner premium as part of PAYE. The amendments ensure that any collection and recovery action by Inland Revenue on unpaid PAYE includes the earner premium component. Penalties can also be imposed on the combined amount. This means the PAYE and earner premium do not need to be separated out before compliance action can be taken.

Key issues

In essence, the amendments make these changes:

- They insert a definition of "combined tax and earner premium deduction" into the Income Tax Act.
- They enable recovery action to be taken for the combined deduction.
- They make it an offence under the Income Tax Act to fail to account for the combined deduction.
- They impose penalties (penal and additional tax) on the amount of the combined deduction.
- They amend the Accident Rehabilitation and Compensation Insurance Act 1992 to ensure that action relating to the non-payment of earner premium cannot be taken under both the Income Tax and Accident Rehabilitation and Compensation Insurance Acts.

Application date

The amendment applies from 28 September 1993, the date of assent of the Act. However, there is a provision so that Inland Revenue does not have to separate out PAYE and earner premium deductions for the purpose of collecting, recovering or imposing penalties on any such deductions made on or after 5 August 1993.

Twice-Monthly Tax Deductions - Groups of Companies

Section 353(5A), Income Tax Act 1976

Section 353(5A) prevents employers from splitting into smaller units to avoid paying PAYE twice monthly (which is necessary where total deductions of PAYE, Specified Superannuation Contribution Withholding Tax and Earner Premium are more than $100,000 per annum).

Paragraph (a) defines when two or more companies are deemed to be one employer. It has been replaced by a reference to the grouping provisions in section 191(3)(a) of the Income Tax Act. The percentage for determining whether two or more companies are a group is reduced from 66 2/3 percent to 66 percent, in line with section 191.

The amendment applies to deductions made on or after 28 September 1993.

Crown Health Enterprises Not Allowed to Maintain Imputation Credit Accounts

Section 394B(2), Income Tax Act 1976

Crown Health Enterprises have been added to the list of companies in section 394B(2) which are prohibited from maintaining imputation credit accounts.

The amendment recognises that the Crown (the sole shareholder in the Crown Health Enterprises) cannot benefit from any imputation credit that may be attached to dividends it receives, because it is exempt from income tax. The amendment is also consistent with the recent amendment preventing Crown Research Institutes from maintaining imputation credit accounts.

The amendment applies from 11 May 1993, the general commencement date of the Health and Disability Services Act 1993 (under which Crown Health Enterprises are established).

Local Authority Trading Enterprise Definition

Section 63(2K), Income Tax Act 1976.

Introduction

Airport companies, port companies and energy companies have been included in the local authority trading enterprise (LATE) definition for the purposes of the wholly owned group intercorporate dividend exemption in section 63. Dividends derived by local authorities from these companies will therefore not qualify for this exemption.

Background

Local authorities are liable for tax on all income derived from LATEs. Following an amendment by the Income Tax Amendment Act (No.2) 1993, airport companies, port companies and energy companies are no longer excluded from the LATE definition for the purposes of the local authority income tax exemption in section 61(2A) of the Income Tax Act.

The Income Tax Act uses the LATE definition contained in the Local Government Act 1974. A LATE is defined in section 594B of that Act to mean, in short, any entity which the local authority controls. This definition specifically excludes airport companies, port companies and energy companies. The reason for these exclusions is that the relevant companies would otherwise be subject to the LATE regulatory regime in addition to their own sector-specific regulatory regimes.

Key issues

Section 63(2K) of the Income Tax Act has been amended to include airport companies, port companies and energy companies in the LATE definition for the purposes of the wholly-owned group intercorporate dividend exemption. Consequently, dividends derived by local authorities from these companies will no longer qualify for this exemption.

The amendment ensures that airport companies, port companies and energy companies are now included in the LATE definition for all income tax purposes.

The policy reason for the non-application of the wholly owned group intercorporate dividend exemption to a local authority is that because a local authority has no shareholders itself it should be treated as an ultimate (i.e., natural person) shareholder. It should therefore not get the benefit of any intercorporate dividend exemption.

The amendment is consistent with the policy intention of the local authority income tax provisions, which is that local authorities should be liable for tax on income derived from all entities under their control, thereby ensuring that these entities operate on a competitively neutral basis.

Application date

The amendment applies to dividends derived by local authorities from airport companies and port companies on or after 28 September 1993. In the case of dividends derived by local authorities from energy companies, the amendment applies to dividends derived on or after 23 July 1993.

No Student Loan Deductions from Income-Tested Benefits

Section 98A, Student Loan Scheme Act 1992

The Department of Social Welfare has been granted an exemption from the requirement to make student loan repayment deductions from income tested benefits until 31 March 1994.

Charitable Organisations - Change of Name

Section 56A(2), Income Tax Act 1976

Amendments reflect the name changes of two organisations having charitable donee status:

- The former Lepers Trust Board Incorporated is now known as the Pacific Leprosy Foundation.
- New Zealand Catholic Overseas Aid has changed its name to Caritas Aotearoa - New Zealand.

This amendment applies to gifts made during the 1992-93 income year and any subsequent year.

Other Minor Corrections

There have been minor drafting corrections to section 191N(6) and (7) of the consolidation regime, section 327M of the resident withholding tax regime and section 6(2) of the Finance Act 1987.

Annual Tax Rates

The income tax rates for the 1992-93 income year will continue to apply for the 1993-94 income year.

Gift Duty Exemption Restricted

Section 75A(5), Estate and Gift Duties Act 1968

Introduction

There is a gift duty exemption for property transferred by Court order under section 25 of the Matrimonial Property Act 1976. This exemption is now limited to transfers of property between spouses or settlements solely for the benefit of minor or dependent children of the marriage. The exemption will therefore not apply to transfers of property made to discretionary family trusts.

Background

The gift duty exemption in section 75A(5) of the Estate and Gift Duties Act 1968 applying to Court-ordered property transfers under section 25 of the Matrimonial Property Act 1976 was previously open-ended. The exemption had been applied by the Courts to transfers of property made to third parties such as discretionary family trusts. The application of the section 75A(5) gift duty exemption to property transfers made to family trusts had undesirable implications for creditor protection, income splitting and avoidance of social assistance targeting purposes.

Gift duty currently acts as one of the few barriers to people immediately transferring their assets by outright gift to associated parties such as family trusts in order to defeat creditors, allow income splitting and avoid social assistance targeting measures. Divestments of assets are often structured as sales (at market value) rather than outright gifts so as to not incur gift duty. The debts which are taken back from such sales are assets of the transferor which can be claimed by creditors and taken into account for social assistance targeting purposes until they have been extinguished by gifting programmes. Such gifting programmes can take a considerable time to complete.

Key issues

Section 75A(5) of the Estate and Gift Duties Act 1968 has been amended so that the gift duty exemption applying to Court-ordered property transfers under section 25 of the Matrimonial Property Act is limited to transfers of property between spouses, and settlements *solely* for the benefit of minor or dependent children of the marriage.

The gift duty exemption applying to Court-ordered transfers of property under section 25 of the Matrimonial Property Act 1976 does not now apply to any other persons. In particular, the exemption will not apply to transfers of property made to discretionary family trusts (including trusts whose potential beneficiaries include minor or dependent children of the marriage). The exemption will only apply to trusts which are settled solely for the benefit of minor or dependent children of the marriage.

Application date

The amendment applies to Court orders which are made under section 25 of the Matrimonial Property Act 1976 on or after 28 September 1993.

Petroleum Mining - Minor Amendments

Sections 214D, 214F and 214L, Income Tax Act 1976

There have been a number of minor drafting amendments to sections 214D, 214F and 214L of the Act. With one exception all of these amendments are of a technical nature.

The only substantive change has been to s214F(9). The previous wording did not achieve the intention of the legislation under all circumstances. It has now been adjusted to reflect the original intention.

This section is a clawback provision which operates when a exploration well which has been abandoned and had its expenditure deducted is subsequently used for petroleum production. In this situation this clawback provision is activated. The tax burden of the clawback was always intended to be apportioned on the basis of the ownership of the well at the time the section is applied, not when the deduction was claimed. These modifications to the clawback provision apply from 16 December 1991.

Restructured Income Tax Act Proposed

Plans are under way to enact a restructured Income Tax Act early next year. On 21 September the Minister of Revenue tabled in Parliament the Second Report of the Working Party on the Reorganisation of the Income Tax Act 1976. A proposed new Income Tax Act was attached to this report.

The tax policy in the new Act is identical to that contained in the Income Tax Act 1976. The differences are in these areas:

- the provisions have been arranged in a new and more logical order;
- minor drafting changes have been made to modernise the wording of the legislation.

The re-organised legislation is not intended to make any change to existing law. A provision stating this is contained in the proposed Bill.

Background

The Income Tax Act is the largest and most extensively amended piece of legislation on the statute books.

In its final report released in October 1992, the Consultative Committee on the Taxation of Income from Capital recommended reorganising the Income Tax Act 1976 and the Inland Revenue Act 1974. In November 1992 the Government established a working party to do this. This working party's brief was to report to the Ministers of Finance and Revenue with detailed drafting instructions for reordering and reorganising the income tax legislation. The working party was to consult the Parliamentary Counsel Office, the Treasury, and the Inland Revenue Department during this process.

Main changes

A new structure has been adopted, dividing the new Act into the following 15 parts:

A Application
B Core Provisions
C Income further Defined
D Deductions further Defined
E Timing of Income and Deductions
F Apportionment and Recharacterised Transactions
G Avoidance and Non-Market Transactions
H Treatment of Net Income of Certain Entities
I Assessment of Income and Treatment of Losses
J Surcharges
K Rebates
L Credits
M Tax Payments
N Withholding Taxes and Taxes on Income of Others
O Definitions

A new numbering system is also proposed. Sections will now be identified by reference to the Part and Subpart in which they appear. For example, section 394ZZZJ becomes section MD 4. This reference indicates that the section appears in Part M - Tax Payments, Subpart D - Refunds.

The language of the legislation has been modernised, although the changes have been restricted to those that do not change the meaning of the law. For example, a subsection which read

> *"A taxpayer shall pay tax pursuant to this section on all income deemed to be derived by him under section XX of this Act for the income year ending on the 31st day of March 1994."*

continued on page 52

would become

> *"A taxpayer shall pay tax under this section on all income deemed to be derived by that taxpayer under section XX for the 1993-94 income year."*

The proposed Act omits provisions of the 1976 Act which no longer have any practical effect, even though they are technically still in force. In almost all cases these are provisions with restricted application dates which have now passed.

Two other proposed Acts are also included in this package. A new Tax Administration Act will combine the administrative provisions of the Income Tax Act 1976 and the Inland Revenue Department Act 1974. A new Taxation Review Authorities Act will contain the provisions which relate to those Authorities.

Legislative process

The proposed legislation has been referred to the Finance and Expenditure Select Committee, which has called for public submissions in much the same way as would normally be done for a Bill. The Minister of Revenue has said that the draft Bill will be able to be reported back to Parliament soon after the election.

Copies of the Working Party's report and the proposed legislation are available from usual legislation stockists.

Volume Five, No.4 October 1993

This Tax Information Bulletin deals with recent tax legislation. It covers these Acts:

- Income Tax Amendment Act (No 3) 1993
- Goods and Services Tax Amendment Act (No 2) 1993
- Estate and Gift Duties Amendment Act 1993
- Stamp and Cheque Duties Amendment Act 1993
- Inland Revenue Department Amendment Act (No 2) 1993
- Accident Rehabilitation and Compensation Insurance Amendment Act (No 3) 1993
- Student Loan Scheme Amendment Act (No 2) 1993

There is a full list on Page 1 of the topics covered in this bulletin.

We haven't included “Questions we've been asked” or “Case notes” in this TIB because there wasn't enough room. They will reappear in the next issue.

This TIB has no appendix