TAX INFORMATION BULLETIN

Volume Eight, No.11 December 1996

This TIB outlines the changes resulting from the passage of the Taxation (Remedial Provisions) Bill, the Taxation (Superannuitant Surcharge Reduction) Bill, and the Customs and Excise Bill 1995.

The **Taxation (Remedial Provisions) Bill** was introduced on 21 May 1996. It resulted in the enactment of the Taxation (Remedial Provisions) Act 1996 [No.159] on 2 September 1996. The latter amends the following:

- Income Tax Act 1994
- Income Tax Act 1976
- Tax Administration Act 1994
- Student Loan Scheme Act 1992
- Goods and Services Tax Act 1985
- Goods and Services Tax Amendment Act [No.2] 1995
- Taxation (Core Provisions) Act 1996 (consequential amendments).

The provisions in the bill pertaining to the confirmation of income tax rates for 1996-97 were enacted separately through the Taxation (Annual Rates of Income Tax 1996-97) Act 1996 [No.68] on 26 July 1996.

The **Taxation (Superannuitant Surcharge Reduction) Bill** was introduced on 31 July 1996. It was enacted as the Taxation (Superannuitant Surcharge Reduction) Act [No.161] on 2 September 1996. This Act amends the following:

- Income Tax Act 1994
- Tax Administration Act 1994.

The **Customs and Excise Bill 1995** was introduced on 27 July 1995. It was enacted as the Customs and Excise Act 1996 [No.27] on 4 June 1996, a later Order in Council making it effective from 1 October 1996. It consequentially amends the Goods and Services Tax Act 1985.

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Inland Revenue
Te Tari Taake

Contents

Income tax rates for 1996-97

Section BB 2, Income Tax Act 1994

The income tax rates for the 1996-97 year have been confirmed as follows:

Policyholder income	33 cents for every $1 of policyholder income
Maori authorities	25 cents for every $1 of taxable income undistributed
Undistributed rents, royalties and interest of the Maori trustee	25 cents for every $1 of income assessable
Companies, public authorities and local authorities	33 cents for every $1 of taxable income
Trustee income	33 cents for every $1 of taxable income
Trustees of superannuation funds	33 cents for every $1 of fund's taxable income
Trustees of group investment funds	33 cents for every $1 of fund's taxable income
Taxable distributions from non-qualifying trusts	45 cents for every $1 of the taxable distribution
Other taxpayers (including individuals)	Income not exceeding $30,875: 22.125 cents for every $1 of taxable income Income exceeding $30,875 but not exceeding $34,200: 24.375 cents for every $1 of taxable income Income exceeding $34,200: 33 cents for every $1 of taxable income
Specified superannuation contribution withholding tax	33 cents for every $1 of the contribution

Special banking option

Sections CB 5 and OB 1, Income Tax Act 1994

Introduction

Foreign social security pensions received by New Zealand residents paid under the special banking option (as contained in the Social Security Act 1964) will be treated as a source deduction payment, and the receipt of an overseas social security pension in a pensioner's bank account will not taxable.

Background

From 1 April 1996, United Kingdom social security pensions (UK pensions) were paid directly to UK pensioners in New Zealand. From 1 April 1997 there will be a special banking option which allows New Zealand recipients of overseas pensions to elect to have their overseas pension paid into a special New Zealand bank account. The overseas pension will be drawn down by the New Zealand Income Support Service, which in turn will pay these pensioners an amount equivalent to the full rate of New Zealand superannuation (NZS) or veteran's pension to which they are entitled.

The subsequent tax-related amendments were added to the bill through Supplementary Order Paper no. 199, released on 15 July 1996.

Key features

- A new paragraph has been added to section CB 5 to exempt overseas pensions from tax. This ensures that double taxation does not occur when a pension is derived and when the equivalent amount of NZS is paid. The exemption does not extend to the equivalent NZS paid out under the special banking option.
- The definitions of "New Zealand superannuation" and "veteran's pension" have been amended to add a reference to the equivalent NZS paid under the special banking option. This enables PAYE to be deducted.

Application date

The amendments will apply from a date to be appointed by the Governor General by Order in Council.

Distributions from group investment funds

Sections CF 2 (3) and OB 1, Income Tax Act 1994

Introduction

Distributions from group investment funds (GIFs) are to be taxed in the same way as distributions from companies and unit trusts. An amendment has been made to the anti-avoidance provision in the definition of "available subscribed capital", to reduce its ambit.

The amendments were added to the bill through Supplementary Order Paper no. 199, released on 18 June 1996.

Background

Section CF 2 (3)

Since 1983 it had been government policy that (except for the trust treatment referred to below) distributions by GIFs to investors were treated in the same way as distributions from companies and unit trusts, so that the tax system did not favour investors in GIFs over investors in other types of managed funds.

This company treatment applied except in respect of distributions from certain amounts invested into GIFs by super funds, estates and some trusts (the "protected amount"). An amendment to section CF 2 (3) in 1992 had the unintended effect of narrowing the scope of that section too far.

Available subscribed capital

In general, if shares are issued by a company or unit trust (including a GIF), available subscribed capital (ASC) will be equal to the amount of consideration received for those shares or units. However, the ASC definition included an anti-avoidance provision that meant that if consideration for the issue of shares or units was in the form of shares, the ASC was increased only by an amount equal to the underlying ASC of the shares contributed, not their market value.

Only ASC can be returned tax-free to shareholders on a redemption of units (other than on a winding-up). Therefore if a GIF issues units and receives shares in consideration, the pool of ASC available for redemptions could be significantly less than it would have been if the ASC had increased by the market value of the shares contributed. If units are being redeemed on a regular basis that pool might, therefore, run out more quickly, which means that redemption proceeds would be taxable dividends.

Key features

Section CF 2 (3) has been amended to provide that, to the extent that an investor's interest is not a protected amount (as defined in the Act), any payment to or transaction with an investor is taxable under the dividend rules. The fund is treated as if it were a company and the investor as if it were a shareholder. Other provisions of the Act relating to dividends, such as the imputation provisions, also apply, so that any such dividend could have imputation credits attached.

The anti-avoidance provision has been amended so that its application is limited to transactions where, immediately after the transaction, there is a commonality of shareholding of 10% or more between the issuing company and the company whose shares are contributed.

Application date

These amendments apply from 3.00 pm, 10 June 1996, when the changes were announced by the Acting Minister of Finance and the Minister of Revenue.

Unit trusts and group investment funds

Section CF 3 (1) (b) (i) (D), Income Tax Act 1994

Introduction

An amendment removes from the pro rata brightline tests all redemptions of units in unlisted trusts (unit trusts and group investment funds) made in accordance with the "slice rule". This corrects an anomaly that occurs if slice rule redemptions are treated as pro rata redemptions.

Background

The amendment was required as a result of amendments contained in the Income Tax Act 1994 Amendment (No.4) 1995, which introduced the new tax regime for unlisted trusts (as defined in section CF 3 (14)) .

From 1 April 1996 unit trusts and group investment funds have the option of issuing units subject to either the ordering or the slice rules. Ordering rule units are redeemed first from available subscribed capital, with no tax consequences until available subscribed capital runs out. On the other hand, slice rule units involve a distribution of reserves as well as available subscribed capital. Any amount returned in excess of the capital attributable to the redeemed units is assessable as a dividend.

Because unit trusts and group investment funds (in relation to category A income) are treated as companies, it was appropriate to subject redemptions of units to the pro rata brightline tests. These tests provide that if there is a pro rata redemption of shares that constitute less than 10 percent, or in some cases 15 percent, of the total value of the company, the entire proceeds are deemed to be dividends.

However, units issued subject to the slice rule are likely to be in a class of their own. This means that whenever they are redeemed they will be pro rata redemptions, subject to the brightline tests, and subject to tax even on the amount which would otherwise be available subscribed capital returned.

It is unlikely that investors in unit trusts and group investment funds will systematically redeem units in lieu of dividends. Therefore, to solve this problem, redemptions of slice rule units have been removed from the pro rata brightline tests.

Key features

Section CF 3 (1)(b)(i)(D) of the Income Tax Act 1994 has been replaced with a new section that excludes all amounts distributed upon the redemption of units in an unlisted trust from the brightline tests if the redemption is subject to section CF 3 (1)(b)(iv)(A), known as the slice rule.

Units that are redeemed subject to the "ordering rule", section CF 3 (1)(b)(iv)(b), will still be subject to the brightline tests. A new section CF 3 (1)(b)(i)(E) has been added for those ordering rule redemptions that are not pro-rata redemptions.

Application date

The amendment will apply from 1 April 1996.

FBT - Healthcare and life insurance

Section CI 1, Income Tax Act 1994

Introduction

The Income Tax Act 1994 includes as fringe benefits employer contributions to a sickness, accident or death benefit fund for the benefit of employees, employer-paid specified insurance premiums and employer contributions to an insurance fund of a friendly society for the benefit of employees. An amendment has corrected an anomaly whereby these contributions and payments also came under the definition of "monetary remuneration" in certain circumstances, and so were subject to double taxation.

Background

When the sickness, accident or death benefit fund contribution and life insurance premium payment provisions were added to the definition of "fringe benefit" in 1990 and 1991, by the insertion of sections CI 1 (e) and CI 1 (f), these contributions and payments were inadvertently exposed to double taxation.

Fringe benefits are precluded from being caught in both the definition of "fringe benefit" and of "monetary remuneration" by the provisions of section CI 1 (o). However, at the time sections CI 1 (e) and (f) were added, section CI 1 (o) was not extended to the benefits to which these sections relate. The amendment has corrected this by ensuring that these benefits will not be classed as fringe benefits, to the extent to which they are monetary remuneration.

During passage of the bill the issue was raised as to when a superannuation contribution is subject to FBT and when is it subject to specified superannuation contribution withholding tax (SSCWT). This issue is addressed in TIB Volume Six, No.1 (July 1994), at page 1.

Key features

Section CI 1 of the Act has been amended to ensure that employer contributions to a sickness, accident or death benefit fund for the benefit of employees, employer-paid specified insurance premiums, and employer contributions to an insurance fund of a friendly society for the benefit of employees, are either subject to fringe benefit tax (FBT) or monetary remuneration, depending on the nature of the provision of the benefit.

Application date

As the Inland Revenue Department's policy has been to apply the legislation as though there were no overlap between monetary remuneration and FBT, the amendment applies from the date of enactment, 2 September 1996, without disadvantaging taxpayers.

Exclusions from FBT

Section CI 1 (ia), (la), OB 1, Income Tax Act 1994

Introduction

Two further specific exclusions from fringe benefit tax (FBT) have been included in the Income Tax Act 1994.

The exclusions relate to employee share purchase plan (ESP) loan benefits and tax assistance given to employees. The exclusions allow certain fringe benefits to be provided to employees without incurring FBT because employees would have been able to get a deduction had they actually incurred the expense.

Background

Some situations have been identified where the payment of FBT on the benefits which are the subject of the FBT exclusions provided for in this amendment would result in overtaxation. The problem arises if an employee would have been entitled to a tax deduction for the expenditure incurred on the provision of the fringe benefit. In most cases this can be avoided by structuring the provision of the fringe benefit in a different way. The exclusions remove the need to restructure the provision of these benefits.

Key features

Two specific exclusions have been included in the fringe benefit definition in section CI 1 of the Income Tax Act 1994:

- an exclusion for loan benefits if the sole purpose of the loan is to enable the employee to acquire shares in the employer under an ESP;
- an exclusion for assistance with the tax affairs of the employee to the extent that the assistance relates to the preparation of the tax return.

A new definition is introduced in section OB 1 for the purposes of the loan benefit exclusion. Under that definition an "employee share loan benefit" is a loan which meets the following requirements:

- The sole purpose of the loan for the period the loan is outstanding and the exclusion is used is to enable the employee to acquire shares or rights, or options to shares, in the employer (or an associate of the employer) under an ESP.
- The loan is used for that purpose only.
- The shares, rights or options must be beneficially owned by the employee at all times during the currency of the loan.
- A condition of the loan is that it must be repaid in full if the employee ceases to be the beneficial owner of any of the shares, rights or options.
- The company issuing the shares, rights or options is not a qualifying company.
- The employer and employee are not associated persons.
- The company issuing the shares, rights or options maintains a dividend paying policy during the currency of the loan.
- The ESP is not an employee share scheme under section DF 7.

An exclusion for assistance with the tax affairs of the employee will be available only if the assistance relates to the preparation of the tax return and that expenditure would have been deductible to the employee.

Application date

The exclusion for ESP loan benefits will apply to the FBT return period which includes 2 September 1996, the date of enactment. The exclusion for tax assistance given to employees will apply from 2 September 1996.

Non-cash benefits to shareholder employees and associated persons

Sections CI 2A, GC 15 (3), Income Tax Act 1994

Introduction

Amendments have been made to the fringe benefit regime as it was unclear whether certain non-cash benefits derived by employees who are also shareholders should be taxed as dividends or fringe benefits. The amendments remove this uncertainty.

They also clarify the treatment of non-cash benefits received by a person associated with two or more other persons. They provide that when fringe benefit tax (FBT) would apply for one associated person, and the dividend rules would apply for another associated person, the FBT rules apply.

Background

The intention of the fringe benefit regime is to tax non-cash benefits which are derived through an employee's employment for the employee's private use. When the employer is a company and the employee is a shareholder, non-cash benefits may also be treated as dividends. The interaction between the fringe benefit and dividend regimes is somewhat confusing as each regime is subject to the other. This causes difficulty determining which regime certain benefits should be subject to, or whether they are subject to tax at all.

Section CI 2A clarifies this situation by providing that company employers can elect whether these benefits are subject to the fringe benefit or deemed dividend rules. When a company does not so elect, the benefits will only be subject to FBT.

Also, an intention of both the fringe benefit and dividend regimes is to tax non-cash benefits when received by associated persons. Conflicts arise when a person who receives a non-cash benefit from a company is associated with two or more other persons, one of whom is an employee and another is a shareholder but not an employee of that company. Under current legislation, again, it is not clear to which regime, if any, the non-cash benefit is subject.

Section GC 15 (3) provides that non-cash benefits are deemed to be fringe benefits subject to FBT when received by a person associated with two or more other persons, and the benefits would be subject to FBT in the hands of one of those persons.

Key features

Shareholder employee

Section CI 2A is inserted to provide that:

- When non-cash benefits are granted to shareholders who are also employees, employers have an option to elect whether the benefits will be treated as fringe benefits or dividends.
- When an employer does not make an election then the non-cash benefits are deemed to be fringe benefits.

The election option is also available to the trustee of an investment trust when the employee is a shareholder of that trust.

The election option is only applicable to non-cash benefits which come within the "any other benefit" provision in paragraph (h) of the definition of "fringe benefit" (such as discounted goods).

The flowchart below illustrates the decision process of section CI 2A

Associated persons

Section GC 15 (3) deals with the situation when a person who receives a non-cash benefit is associated with two or more other persons:

- if the benefit in the hands of one of those persons would be subject to FBT; and
- the benefit in the hands of any other one of those persons would be subject to the deemed dividend rules; then

the non-cash benefit is deemed to be derived by the person in the capacity as an employee, and is deemed to be a fringe benefit subject to FBT.

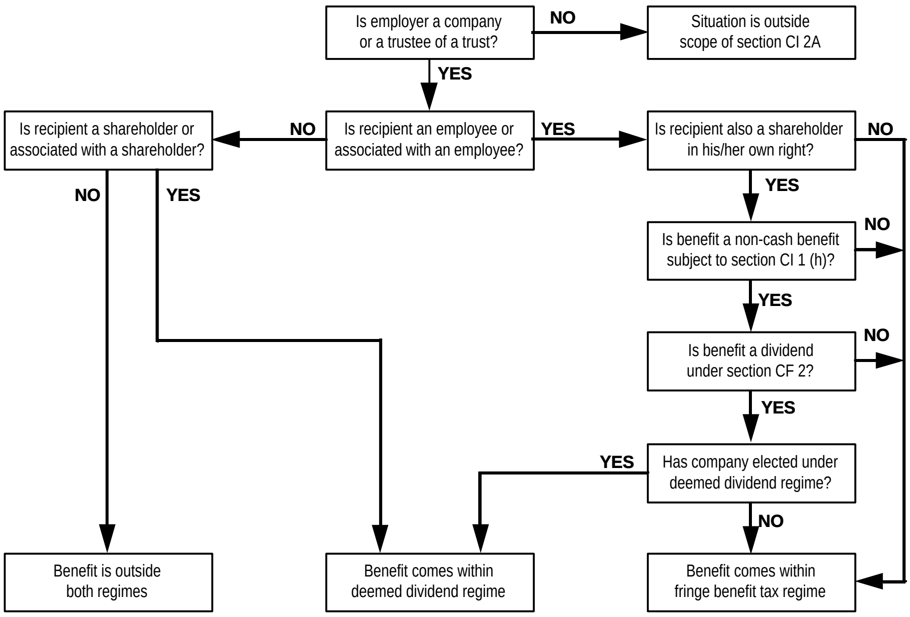
Late election

Section CI 2A (4) requires employers who wish make an election to notify the Commissioner of this election in writing within the time allowed for filing an FBT return following the end of the respective FBT period. Given that these provisions were not assented to until 2 September 1996 section CI 2A (5) was provided to allow quarterly FBT payers to make an election by 23 September 1996 in respect of the quarter ending 30 June 1996.

Application dates

The amendments will apply from 21 May 1996, the date of introduction of the legislation.

Non-cash benefits - determining tax treatment



Expenditure incurred by superannuation funds

Sections DI 3 (3)-(8) and 228 (2D)-(2I), Income Tax Act 1994

Introduction

Amendments expand the rules which allow superannuation funds ("member funds") which invest in another superannuation fund ("master trust") to elect that the master trust deduct the expenditure that the member funds have incurred. Member funds may carry forward expenditure for deduction by the master trust in a later income year if the latter cannot deduct the expenditure in a particular income year because it has insufficient balance of assessable income.

Background

The previous legislation allowed member funds to elect that the master trust deduct certain expenditure incurred by the member funds in the year the expenditure was incurred. However, the master trust had to have sufficient balance of assessable income to absorb that expenditure. Not provided for were situations where the master trust was in a tax loss or simply did not have sufficient balance of assessable income to enable all of the expenditure to be deducted. The amendments are intended to rectify that anomaly.

Key features

Amendments to section DI 3 of the 1994 Act and section 228 of the 1976 Act provide for member funds to carry forward undeducted expenditure to a later income year. They then provide for the member funds to elect for that undeducted expenditure to be deducted by the master fund in that later income year if the balance of the assessable income of the master fund extends to some or all of the expenditure. If not all that undeducted expenditure can be deducted in the later income year, a member fund will be able to carry forward the remaining undeducted expenditure until it is deducted. The member fund wishing to elect to have the master trust deduct the undeducted expenditure in later income years must have invested in the master trust in the year the expenditure was incurred and continue to invest in the master trust when the expenditure is deducted.

Application date

The amendment to the Income Tax Act 1994 is applicable from 1 April 1995. The equivalent amendment to the Income Tax Act 1976 is applicable from 1 April 1990.

Depreciation of leasehold improvements

Section EG 1A, Income Tax Act 1994

Introduction

The depreciation rules have been amended to address a deficiency that prevented a lessee claiming depreciation on land improvements erected by the lessee but owned by the lessor. The amendment provides that when a lessee of land incurs expenditure in erecting fixtures, or making improvements to the land, and they are owned by the lessor under land law principles, the lessee will be entitled to depreciate them.

The amendment applies also to structures erected by holders of a licence to occupy land. The lessor (in the case of a lease) and grantor of the licence (in the case of a licence to occupy) will not be able to depreciate the structures.

Background

The new depreciation regime provides that a taxpayer must own an asset in order to depreciate it. If a lessee of land erects improvements on the land, and these are owned by the lessor, the lessee will be unable to depreciate the improvements.

This amendment deems the lessee to own the improvements, enabling the lessee to depreciate them. At the expiry of the lease, the lessee will either demolish or remove the fixtures or improvements, or will abandon them with or without payment. For depreciation purposes, the lessee will cease to own the property upon expiry of the lease and, therefore, the depreciation recovered/loss on sale provisions will operate.

Key features

Section EG 1A of the Income Tax Act 1994 provides that:

- When a lessee of land incurs expenditure in erecting a structure on the land, and this is owned by the lessor under land law principles, the lessee is deemed to own the structure. For the purposes of this amendment, "lessee" includes the holder of a licence to occupy land.
- When a lessee of land who has depreciated a structure transfers its interest in the lease to a new lessee who "purchases" the structure, the new lessee is deemed to own the structure.
- The lessor will be unable to depreciate the structure during the term of the lease. After the lease has expired, the lessor will be able to depreciate it only if, on the expiry of the lease, the lessor pays the lessee for it. "Lease" includes a licence to occupy and "lessor" includes the grantor of a licence to occupy.

- On expiry of the lease, the lessee is deemed to have disposed of the fixture or improvement.

Sections 108 and 117 of the Income Tax Act 1976 have also been amended to include these provisions.

Application date

The amendments apply from the 1993/94 income year. It is understood that lessees have in practice been claiming depreciation since that time, so the amendment will legitimise these deductions.

In certain circumstances, a lessor may have been eligible to claim a depreciation deduction in relation to a structure erected by a lessee. The amendment will not affect depreciation deductions claimed by lessors for the 1993-94 and 1994-95 income years in tax returns filed by 21 May 1996 - the date of introduction of the bill.

Depreciation of goods purchased subject to a reservation of title clause

Section EG 1B, Income Tax Act 1994

Introduction

The depreciation legislation has been amended to correct a problem that arises if depreciable property is purchased subject to a reservation of title clause. The amendment will enable a purchaser who has possession of the property to depreciate it before title passes to the purchaser.

Background

The amendment applies to the purchase of depreciable goods under a contract which reserves title to the goods to the vendor until the purchase price is paid, but which provides for the purchaser to obtain possession of the goods before payment.

The depreciation legislation provides that only a taxpayer who owns property may depreciate it. Therefore a purchaser cannot claim depreciation on property sold subject to a reservation of title clause until title to the property passes to the purchaser. The purchaser may nevertheless be using the property in its business and should be able to depreciate it.

Key features

- Section EG 1B of the Income Tax Act 1994 provides that a taxpayer who has purchased goods subject to a reservation of title clause is deemed to own the goods until title actually passes to the taxpayer or the goods are repossessed.
- The vendor of the property will not be able to depreciate the property while the purchaser is deemed to own it. (It is, in any event, more likely that the property is trading stock to the vendor.)
- An amendment to section EG 19 provides that if the vendor repossesses the goods, they will be deemed to have been disposed of by the purchaser for cost less the net amount paid to the vendor under the contract. The “net” amount paid to the vendor refers to amounts paid by the purchaser to the vendor less amounts refunded to the purchaser. Assume, for example, the purchase price of an asset is $10,000 and the purchaser has paid $5,000 towards the property. The vendor repossesses the asset and refunds $3,000 to the purchaser. The purchaser is deemed to dispose of the asset for $8,000.

Sections 108 and 117 of the Income Tax Act 1976 have also been amended to incorporate these changes. The new section EG 1B does not apply to hire purchase assets as there are already specific provisions governing the depreciation of such assets.

Application date

The amendments apply from the 1993-94 income year - the date of introduction of the new depreciation legislation. It is understood that, in practice, purchasers have depreciated assets prior to title passing. The amendments legitimise such deductions taken since 1993.

Short-term trade credits and the accrual rules

Sections EH 10, OB 1 and OZ 1, Income Tax Act 1994

Introduction

For purposes of the accrual rules, taxpayers will be allowed to treat certain short-term trade credits as financial arrangements, provided notice in writing is given to the Commissioner of Inland Revenue. Notice must be given within the time required to furnish a tax return for the income year to which the election is to apply. The election, which is revocable in writing, may be made in respect of all short-term trade credits or any class of short-term trade credit which a taxpayer defines, either by reference to the term of the credit or the currency in which it is denominated, or a combination of the two.

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The definition of short-term trade credit has also been amended to include certain short-term trade credits arising from invoices for periodic supplies.

Background

Previously, short-term trade credits were excepted financial arrangements for the purposes of the accrual rules.

Other trade credits are financial arrangements, and any income or expenditure arising in relation to them must, therefore, be brought to tax on an accruals basis. If a taxpayer treats all trade credits in the same way for accounting purposes, there are compliance costs involved in reversing out short-term trade credits for tax purposes. To enable taxpayers to elect to treat short-term trade credits as financial arrangements is a compliance cost initiative which reflects a recommendation of the Valabh Committee on Operational Aspects of the Accruals Regime.

The previous definition of short-term trade credit referred to payment being required within 63 days from the date of supply. However, certain utilities, such as electricity and telephone rental, are supplied on a continuous basis but invoiced periodically, with payment required within a certain number of days from the date of invoice, rather than the date of supply. If payment is required within 63 days from the date of invoice, even if that is more than 63 days from the date of supply, these credits are now included in the definition of short-term trade credits.

Key features

A new section, EH 10, has been added to the Income Tax Act 1994. Taxpayers can elect to treat certain short-term trade credits as financial arrangements for purposes of the accrual rules. This election can be revoked in writing during an income year, but the revocation will have effect only on short-term trade credits created from the start of the subsequent income year.

Taxpayers can elect by class of short-term trade credit, by reference to either the term of credit, or the currency of the arrangement, or a combination of the two.

The definition of short-term trade credit in section OB 1 has been amended to include any continuous supply of goods or services invoiced periodically, for which payment is due less than 63 days after the date of invoice.

Application date

These amendments apply from the date of enactment, 2 September 1996.

Thin capitalisation: rules for determining New Zealand group

Section FG 4 (10)-(14D), FG 10 (3), Income Tax Act 1994

Introduction

A number of amendments have been made to address deficiencies in the originally enacted rules for determining a taxpayer's New Zealand group under the thin capitalisation rules. The amendments do not involve any significant policy change, and apply retrospectively to the beginning of the 1996-97 income year, the original application date for the thin capitalisation rules.

Background

The thin capitalisation regime applies where a non-resident uses excessive debt to fund its New Zealand-based operations. A company is said to be thinly capitalised if its New Zealand group debt percentage exceeds both 75%, and 110% of the group debt percentage of its worldwide group.

The New Zealand group debt percentage is calculated on a consolidated basis for the members of a taxpayer's New Zealand group. Identifying the New Zealand group is a two-step process which requires:

- the identification of a taxpayer's New Zealand parent; and
- an election by that parent to determine whether the members of the group are to be determined using 50% or 66% as the threshold for determining control (and thereby the members of the group) on a tier-by-tier basis.

A number of deficiencies were identified in the original rules for determining a taxpayer's New Zealand group. The amendments address these deficiencies, and improve the precision of the rules for identifying a taxpayer's New Zealand parent, and the members of a taxpayer's New Zealand group.

Key features

- To prevent the thin capitalisation regime being circumvented, the New Zealand group determined in relation to one taxpayer will be the New Zealand group for all members of that group.
- The New Zealand group includes all companies for which control can be traced on a tier-by-tier basis from a given top tier company (the New Zealand parent) using, at the New Zealand parent's option, a greater than 50% or 66% or greater control threshold.
- If a non-resident controls two separate chains of New Zealand companies, the non-resident has the option to include both of those chains in a single New Zealand group.

The definition of a New Zealand group is built around three fundamental concepts:

- The group will contain those companies for which control can be traced on a tier-by-tier basis from the taxpayer's New Zealand parent company.
- At the election of the New Zealand parent company, the threshold for tier-by-tier control will be based on either greater than 50% control or an alternative 66% threshold.
- The New Zealand group will be consistent for all companies in that group (if, in relation to any taxpayer, Co 'A' is in the same New Zealand group as Co 'B', the New Zealand group for Co 'A' will be the same New Zealand group that applies for Co 'B').

It is this last requirement for consistency between members of the New Zealand group that has resulted in the detailed rules in section FG 4 (10) to determine the taxpayer's New Zealand parent. The New Zealand parent is identified in relation to a number of taxpayers, and is required to make consistent grouping elections for all companies for which it is the New Zealand parent (section FG 4 (14B)).

Outline of process for determining a taxpayer's New Zealand group

The rules for determining a taxpayer company's New Zealand group are contained in section FG 4(12) to (14D). The process to be followed in determining the New Zealand group is broadly as follows:

1. Identify the taxpayer's New Zealand parent (section FG 4(10)).
2. The New Zealand parent elects whether to use "greater than 50%" or "66% or greater" as the threshold for determining control on a tier-by-tier basis (section FG 4 (12) - (14)). The election applies consistently for all companies for which the New Zealand parent of the taxpayer is the New Zealand parent (section FG 4 (14B)).
3. The members of the taxpayer's New Zealand parent's New Zealand group (which may or may not include the taxpayer) are then identified (section FG 4 (12)-(14)).
4. If the taxpayer is not included in the New Zealand group of its New Zealand parent, the taxpayer's New Zealand group will include all companies to which control can be traced on a tier-by-tier basis from either the taxpayer or any other company from which control of the taxpayer can be traced on a tier-by-tier basis (section FG 4 (14C)).
5. If the same non-resident person has a 50% or greater ownership interest in two or more New Zealand groups determined under the process outlined above, an election can be made to join some or all of those groups as a single New Zealand group (section FG 4 (14D)).

Identifying the taxpayer's New Zealand parent (section FG 4 (10))

The rules for identifying a taxpayer's New Zealand parent are designed to identify the top-tier company in a chain of companies controlled by a non-resident person. The New Zealand parent can be the taxpayer, or some other New Zealand resident company from which ownership can be traced on a tier-by-tier basis.

The main rules for identifying a taxpayer's New Zealand parent are contained in section FG 4 (10)(b). These rules aim to identify the top-tier New Zealand resident company in the chain of companies containing the taxpayer as the New Zealand parent.

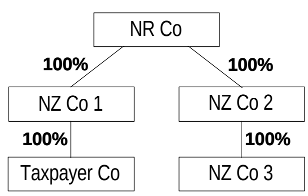
However, the taxpayer will be its own New Zealand parent if:

- it is a non-resident; or
- persons not resident in New Zealand hold aggregate direct ownership interests in the taxpayer of 50% or greater (section FG 4 (10)(a)).

The taxpayer will also be its own New Zealand parent if the rules in section FG 4 (10)(b) fail to identify any New Zealand parent (section FG 4 (10)(c)).

In the unlikely event that section FG 4 (10)(b) identifies more than one New Zealand parent, section FG 4 (10)(d) and (e) contain tie-breaker tests. In the first instance, the New Zealand parent will be the one for which the aggregate direct ownership interests held by non-residents in that company multiplied by the New Zealand parent's ownership interest in the taxpayer (disregarding interests held only by virtue of the associated persons rules in section FG 2(2)) produces the highest value (section FG 4 (10)(d)). As a last resort, the company incorporated first will be the New Zealand parent (section FG 4 (10)(e)).

In the following diagram, Taxpayer Co is not the New Zealand parent under paragraph (a), as it is resident in New Zealand and non-resident persons do not have aggregate direct ownership interests of 50% or greater in the company. Who is Taxpayer Co's New Zealand parent?



Under paragraph (b)(i), the New Zealand parent could be any of NZ Co 1, NZ Co 2, or NZ Co 3, as all three companies are resident in New Zealand.

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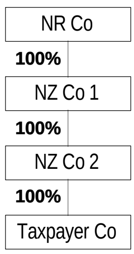
Paragraph (b)(ii) identifies only NZ Co 1 as the New Zealand parent. NZ Co 2 and NZ Co 3 also have ownership interests in Taxpayer Co under section FG 2 (2), because the interests of associated persons (NZ Co 1) are ordinarily aggregated in calculating ownership interests. However, paragraph (b)(ii) states that interests held by associated persons are not aggregated when determining a taxpayer's New Zealand parent.

The conditions of paragraph (b)(iii),(iv) and (v) are also met for NZ Co 1, so NZ Co 1 will be the New Zealand parent of Taxpayer Co.

In the following diagram, Taxpayer Co is not the New Zealand parent under paragraph (a), as it is resident in New Zealand and non-resident persons do not have aggregate direct ownership interests of 50% or greater in the company. Who is Taxpayer Co's New Zealand parent?



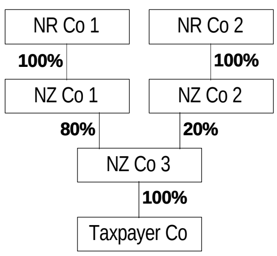
Under paragraph (b)(i), the New Zealand parent could be either NZ Co 1 or NZ Co 2, as both companies are resident in New Zealand.

Paragraph (b)(ii) also does not identify a single New Zealand parent, as both NZ Co 1 and NZ Co 2 hold an ownership interest in Taxpayer Co.

However, paragraph (b)(iii) identifies only NZ Co 1 as the New Zealand parent, as no non-resident person holds a direct ownership interest in NZ Co 2.

The conditions of paragraph (b)(iv) and (v) are also met for NZ Co 1, so NZ Co 1 will be the New Zealand parent of Taxpayer Co.

In the following diagram, Taxpayer Co is not the New Zealand parent under paragraph (a), as it is resident in New Zealand and non-resident persons do not have aggregate direct ownership interests of 50% or greater in the company. Who is Taxpayer Co's New Zealand parent?



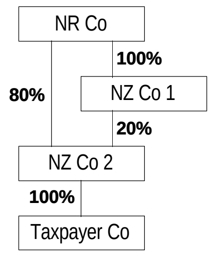
Under paragraph (b)(i), the New Zealand parent could be any of NZ Co 1, NZ Co 2, or NZ Co 3, as all three companies are resident in New Zealand. Paragraph (b)(ii) also does not identify a single New Zealand parent, as all three companies hold an ownership interest in Taxpayer Co.

Paragraph (b)(iii) narrows the choice of companies as New Zealand parent to NZ Co 1 and NZ Co 2, as they are the only companies in which a non-resident person holds a direct ownership interest.

Paragraph (b)(iv) then applies to identify the New Zealand parent of Taxpayer Co as NZ Co 1, as there is no non-resident person who holds a 50% or greater ownership interest in both NZ Co 2 and Taxpayer Co.

The condition of paragraph (b)(v) is also met for NZ Co 1, so NZ Co 1 will be the New Zealand parent of Taxpayer Co.

In the following diagram, Taxpayer Co is not the New Zealand parent under paragraph (a), as it is resident in New Zealand and non-resident persons do not have aggregate direct ownership interests of 50% or greater in the company. Who is Taxpayer Co's New Zealand parent?



Under paragraph (b)(i), the New Zealand parent could be either NZ Co 1 or NZ Co 2, as both companies are resident in New Zealand. Paragraph (b)(ii) also does not identify a single New Zealand parent, as both companies hold an ownership interest in Taxpayer Co. Both companies also meet the criteria in paragraph (b)(iii), as a non-resident person holds a direct ownership interest in each of them. Paragraph (b)(iv) also does not identify a single New Zealand parent, as NR Co holds a 50% or greater ownership interest in all three of NZ Co 1, NZ Co 2 and Taxpayer Co.

Paragraph (b)(v) identifies NZ Co 1 as Taxpayer Co's New Zealand parent, as NZ Co 1 satisfies all the conditions in paragraph (b)(i) to (iv) and holds a direct ownership interest in NZ Co 2.

Election by New Zealand parent

A New Zealand parent can elect to determine members of a New Zealand group using either a "greater than 50%" or a "66% or greater" control threshold. If an election is not made, the New Zealand parent is deemed to have elected to apply the 66% or greater threshold (section FG 4 (14A)).

The "greater than 50%" control threshold replaces the "GAAP group" approach in the originally enacted regime. The original GAAP test required a judgment to be exercised in some instances over whether one company was actually controlled by another company. By applying the explicit "greater than 50%" test instead, the need to apply judgment over whether a company can or should be included in a New Zealand group has been eliminated. This removes the possibility of a dispute arising between taxpayers and Inland Revenue over the appropriate exercise of judgment under GAAP.

The New Zealand parent makes elections under the thin capitalisation rules for all companies for which it is identified to be the New Zealand parent under section FG 4 (10). Elections made by the New Zealand parent for the purposes of determining a taxpayer's New Zealand group must be made consistently for all companies for which it is the New Zealand parent (section FG 4 (14B)). Thus if the New Zealand parent elects to adopt the 66% or greater control test, that 66% threshold must be used for all companies for which the company is the New Zealand parent.

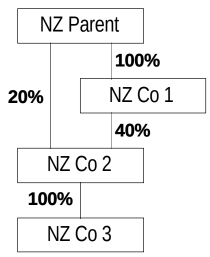
The purpose of requiring consistent elections is to ensure the effect of the thin capitalisation rules cannot be circumvented by making inconsistent elections between companies in a New Zealand group. The effect is that members of a New Zealand group defined in relation to one taxpayer will also be the members of the New Zealand group defined in relation to any other member of that group.

Application of greater than 50% control test in relation to New Zealand parent (section FG 4(13))

Using the greater than 50% threshold, a company will be included in the New Zealand parent's New Zealand group if greater than 50% direct control can be traced on a tier-by-tier basis from the New Zealand parent to the company.

Example 5

In the following diagram, which companies will be included in NZ Parent's New Zealand group?



NZ Co 1 is included in NZ Parent's New Zealand group because NZ Parent holds a "greater than 50%" direct ownership interest in NZ Co 1.

NZ Co 2 is included in NZ Parent's New Zealand group because "greater than 50%" direct ownership interests can be traced on a tier-by-tier basis from NZ Parent and NZ Co 1, both of which are included in NZ Parent's New Zealand group.

NZ Co 3 is also included in NZ Parent's New Zealand group because a direct ownership interest of greater than 50% can be traced from NZ Co 2, which is a member of NZ Parent's New Zealand group.

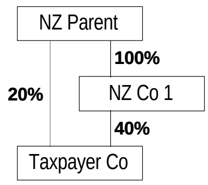
Thus the New Zealand group of NZ Parent will include NZ Parent, NZ Co 1, NZ Co 2 and NZ Co 3.

Application of 66% or greater control test in relation to New Zealand parent (section FG 4 (14))

Using the 66% or greater threshold, a company will be included in the New Zealand parent's New Zealand group if 66% or greater direct control can be traced on a tier-by-tier basis from the New Zealand parent to the company.

Example 6

In the following diagram, which companies will be included in the New Zealand group of NZ parent?



NZ Co 1 will be included in the New Zealand group of NZ Parent, as NZ Parent holds a 66% or greater direct ownership interest in NZ Co 1.

However, NZ Co 2 will not be included in the New Zealand group, as only a 60% direct ownership interest can be traced from companies included in NZ Parent's New Zealand group (ie, NZ Parent and NZ Co 1).

Tracing from non-resident when applying 66% or greater control test (section FG 4 (14)(b))

As well as tracing control from the New Zealand parent when applying the 66% or greater control test, reference may be made to direct interests held by a non-resident person if:

- that non-resident person holds a 50% or greater ownership interest in both the taxpayer and the New Zealand parent; and
- a company that would have been included in the New Zealand group of the New Zealand parent if the greater than 50% threshold was applied is not included when applying the 66% or greater threshold.

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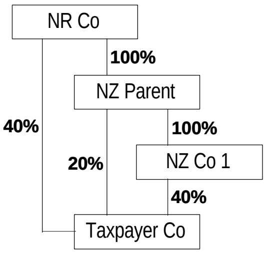
Example 7

The following diagram is the same as example 6, except that NR Co holds a 100% ownership interest in both NZ Parent and Taxpayer Co. Which companies will now be included in the New Zealand group of NZ Parent?



Because Taxpayer Co would be included in the New Zealand group of NZ Parent if the greater than 50% threshold was applied, and NR Co holds a 50% or greater ownership interest in both NZ Parent and Taxpayer Co ("the taxpayer"), direct ownership interests held by NR Co are also considered in determining the New Zealand group under the 66% or greater threshold. Taxpayer Co would therefore be included in the New Zealand group of NZ Parent, as 66% or greater direct ownership interests in Taxpayer Co are held in aggregate by NZ Parent, NZ Co 1 and NR Co.

Taxpayer not included in NZ group of New Zealand parent (section FG 4 (14C))

It is possible that the taxpayer will not be a member of the New Zealand group of its New Zealand parent. In this case, section FG 4 (14C) applies to determine the taxpayer's New Zealand group.

The effect of the rule in section FG 4(14C) is to:

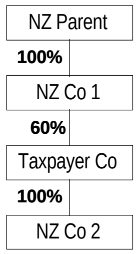
- exclude any member of the New Zealand group of the New Zealand parent from the taxpayer's New Zealand group; and
- trace to higher-tier and lower-tier companies for which the greater than 50% or 66% or greater control test is met on a tier-by-tier basis.

Consider, for example, two arbitrary companies - Company A and Company B. For them to be included in a New Zealand group under section FG 4 (14C), there must be some company (company A, company B, or some third company) from which control can be traced on a tier-by-tier basis (applying the appropriate threshold) to include both company A and company B in the same group. (If such a company exists, that company will also be included in the New Zealand group with company A and company B.)

It is important to note that section FG 4 (14C) does not redefine the New Zealand parent of the taxpayer. This means that the election made by the New Zealand parent for which of the control thresholds applies continues to apply to the determination of a taxpayer's New Zealand group under section FG 4 (14C).

Example 8

In the following diagram, NZ Parent has elected to apply the 66% or greater control threshold. Which companies will be members of Taxpayer Co's New Zealand group?



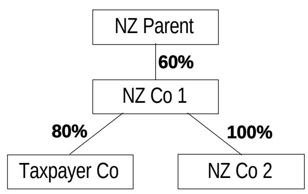
Using the 66% or greater threshold, Taxpayer Co will not be included in the New Zealand group of NZ Parent. Section FG 4 (14C) therefore applies to trace 66% or greater direct interests up and down the chain from Taxpayer Co.

NZ Co 1 is not included in the New Zealand group of Taxpayer Co because there is no company from which 66% or greater control can be traced on a tier by tier basis to include both NZ Co 1 and Taxpayer Co in the same group.

However, NZ Co 2 will be included in the New Zealand group of Taxpayer Co. This is because a company exists (in this case, Taxpayer Co) from which 66% or greater control can be traced on a tier-by-tier basis to include both Taxpayer Co and NZ Co 2 in the same group.

Example 9

In the following diagram, NZ Parent has elected to apply the 66% or greater control threshold. Which companies will be members of Taxpayer Co's New Zealand group?



Using the 66% or greater threshold, Taxpayer Co will not be included in the New Zealand group of NZ Parent. Section FG 4(14C) therefore applies to trace 66% or greater direct interests up and down the chain from Taxpayer Co.

Taxpayer Co, NZ Co 1 and NZ Co 2 will be included in the New Zealand group of Taxpayer Co. This is because a company exists (NZ Co 1) from which control can be traced on a tier-by-tier basis to include all three companies in the same group.

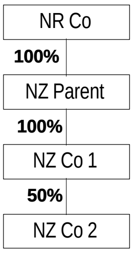
Elections to group multiple chains of companies (section FG 4 (14D))

If the same non-resident person holds a 50% or greater ownership interest in companies of more than one New Zealand group determined under the preceding rules, an election can be made to include any or all of those groups in a single New Zealand group. One effect of this is to allow groups to be traced down a chain through a 50% ownership link.

For such an election to be made, it is necessary for the New Zealand parents of all of the groups looking to become a single New Zealand group to each make the same election to group. This ensures that consistency is maintained, and therefore that all members of the larger group have the same New Zealand group as each other.

Example 10

In the following diagram, can NZ Co 2 be included in the New Zealand group of NZ Parent and NZ Co 1?

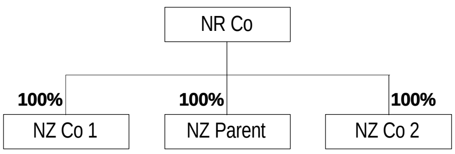


NZ Co 1 and NZ Parent will be included in the same New Zealand group regardless of whether the greater than 50% or the 66% or greater test is applied. Prima facie, NZ Co 2 will not be in the same New Zealand group as NZ Co 1 and NZ Parent since neither the greater than 50% nor the 66% or greater control threshold is met.

However, because the same non-resident person (NR Co) holds a 50% or greater ownership interest in NZ Co 2 and each of the members of NZ Parent's New Zealand group (NZ Parent and NZ Co 1), NZ Parent can elect to include NZ Co 2 in its New Zealand group.

Example 11

In the following diagram, which companies can become members of the same New Zealand group under section FG 4 (14D)?



Each of NZ Co 1, NZ Co 2 and Taxpayer Co will be its own New Zealand parent. Under the rules in section FG 4 (12)-(14C), the New Zealand group for each of the companies will include only itself. Thus before the application of section FG 4 (14D), NZ Co 1, NZ Co 2 and Taxpayer Co will form three separate New Zealand groups.

Section FG 4 (14D) allows a New Zealand parent to elect to include other companies in a taxpayer's New Zealand group if the same non-resident person holds a 50% or greater ownership interest in both those other companies and the taxpayer. Applied in relation to Taxpayer Co, Taxpayer Co (as its New Zealand parent) could elect that either or both of NZ Co 1 and NZ Co 2 also be included in its New Zealand group.

However, such an election would only be effective if reciprocal elections were made by NZ Co 1 and NZ Co 2. Thus if Taxpayer Co elected to include NZ Co 1 in its New Zealand group, NZ Co 1 would have to elect to include Taxpayer Co in its New Zealand group. Similarly, if Taxpayer Co elected to include NZ Co 2 in its New Zealand group, NZ Co 2 would have to elect to include Taxpayer Co in its New Zealand group. If Taxpayer Co elected to include both NZ Co 1 and NZ Co 2 in its New Zealand group, NZ Co 1 and NZ Co 2 would have to elect to include each other in their respective New Zealand groups, as well making the reciprocal elections in relation to Taxpayer Co referred to above.

Special rule where 66% threshold applied (section FG 4 (14D)(d))

Where the New Zealand parent elects to apply the 66% or greater control threshold, a special rule applies to ensure the New Zealand parent cannot 'pick and choose' the members of its New Zealand group. The rule states that the New Zealand parent cannot elect to include a company in a New Zealand group under section FG 4 (14D) if:

- another company has a direct ownership interest in the company to be included in the New Zealand group under section FG 4 (14D); and
- that other company is not included in the New Zealand group after the application of section FG 4 (14D), but would have been included if the greater than 50% threshold had applied instead.

This rule is intended to ensure that two companies in a chain of companies cannot be included in the same New Zealand group by virtue of the election available under section FG 4 (14D) if some company interposed in the chain between the two is not also included in that New Zealand group.

Example 12

In the following diagram, New Zealand Parent has elected to apply the 66% threshold for determining members of its New Zealand group. Can it take advantage of section FG 4(14D) to include NZ Co 2 in its New Zealand group?

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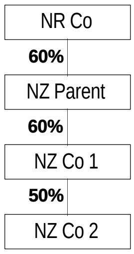


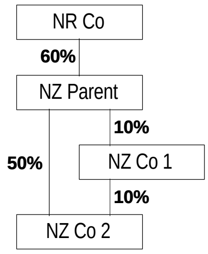
The same non-resident person (NR Co) holds a 50% or greater ownership interest in both NZ Parent and NZ Co 2, thereby meeting the conditions of section FG 4 (14D)(b) for an election to be made. If such an election was made, the New Zealand group of NZ Parent would include NZ Parent and NZ Co 2.

However, there is a company interposed between NZ Parent and NZ Co 2 which has a direct ownership interest in NZ Co 2. If the greater than 50% threshold applied, NZ Co 1 would be included in NZ Parent's New Zealand group. The direct ownership interest held by NZ Co 1 in NZ Co 2 would therefore preclude NZ Parent electing to include NZ Co 2 in its New Zealand group under section FG 4 (14D).

If NZ Parent were to elect to apply the 50% control threshold instead, NZ Co 1 would be included in its New Zealand group under the normal application of section FG 4 (13). Section FG 4 (14D) could then be applied to also include NZ Co 2 in NZ Parent's New Zealand group. The members of NZ Parent's New Zealand group would then be NZ Parent, NZ Co 1 and NZ Co 2.

Example 13

In the following diagram, New Zealand parent has elected to apply the 66% threshold for determining members of its New Zealand group. Can it take advantage of section FG 4 (14D) to include NZ Co 2 in its New Zealand group?



The main difference between this example and the previous one is that NZ Co 1 would still not be included in the New Zealand group of NZ Parent, even if the greater than 50% threshold was applied instead of the 66% or greater threshold. The rule in section FG 4 (14D)(d), therefore, does not apply to preclude NZ Parent electing to include NZ Co 2 in its New Zealand group.

Miscellaneous amendments

A cross-referencing error in section FG 4(17) has been corrected. Section FG 4(18) has been repealed, as it replicated the effect of section FG 4(16)(b).

A minor consequential amendment has also been made to section FG 10(3).

Application date

The amendments apply from the start of the 1996/97 income year.

Transfer pricing

Section GD 13 (4), (12), Income Tax Act 1994

Introduction

The transfer pricing rules have been amended to ensure that, if an arm's length amount is substituted under section GD 13(4):

- the liability of a New Zealand company to deduct non-resident withholding tax (NRWT) from a non-cash dividend paid to its non-resident parent is not affected; and
- the liability of a New Zealand company to make a dividend withholding payment (DWP) deduction in respect of fixed rate shares held in a foreign subsidiary is confirmed.

Background

Previously, if the arm's length amount was substituted for the actual amount of consideration under section GD 13 (4), the obligation of the taxpayer to make a withholding or a deduction was also based on that arm's length amount. This was intended to ensure that DWP would be deducted if an arm's length dividend is substituted in respect of fixed rate shares held by the New Zealand company in a foreign subsidiary.

However, section GD 13 (4), as originally enacted, created an anomalous result if a non-cash dividend arose from a supply made by a New Zealand subsidiary company to its foreign parent for a less than arm's length amount. This was because the substitution of the arm's length amount applied for the purposes of the subsidiary's obligation to deduct NRWT. The obligation of the subsidiary to deduct NRWT from that dividend was, therefore, removed, even though the dividend was still derived by the parent under section CF 2 (1)(c). It was not intended that section GD 13 (4) would have this effect.

A further difficulty was that, while section GD 13 (4) required DWP to be deducted by the taxpayer based on a substituted arm's length amount, section GD 13 (12), as previously drafted, stated that the substitution of an arm's length amount had no effect on the obligation of the taxpayer to make such a deduction. It was not intended that section GD 13 (12) apply to the obligation of the taxpayer to deduct DWP.

Section GD 13 (4) and (12) have, therefore, been amended to reflect that the obligation of the taxpayer to make a withholding or a deduction based on the arm's length amount substituted under section GD 13 (4) applies only for DWP purposes. Any liability of the taxpayer to deduct NRWT will continue to be based on the actual consideration, rather than the amount substituted under section GD 13 (4).

Key features

The liability of a New Zealand company to deduct NRWT from a non-cash dividend paid to its non-resident parent is preserved if an arm's length amount is substituted under section GD 13 (4) of the Income Tax Act 1994.

The liability of a New Zealand company to make a DWP deduction if an arm's length dividend is substituted in respect of fixed rate shares held by the New Zealand company in a foreign subsidiary is confirmed.

Application date

The amendments apply from the start of the 1996-97 income year, to coincide with the application date of the new transfer pricing regime.

New Zealand superannuation surcharge specified exemption

Section JB 4 (1), Income Tax Act 1994

Introduction

An amendment ensures that recipients of the previously frozen rate of New Zealand superannuation who now receive the married person rate because their spouse does not qualify for superannuation may continue to claim the single surcharge exemption level. The single surcharge exemption level will be frozen at $4,160 for the 1996-97 income year.

This change ensures that superannuitants who received the frozen rate of New Zealand superannuation are not disadvantaged as a result of the expiry of the frozen rate and its removal from the First Schedule of the Social Welfare (Transitional Provisions) Act 1990.

Another amendment corrects a legislative oversight which occurred in 1991, whereby recipients of the previously frozen rate of New Zealand superannuation were not entitled to claim the single surcharge exemption level. This was not the intended policy.

These changes will not affect returns already filed by superannuitants.

Background

In 1988 the policy changed in relation to the eligibility criteria for New Zealand superannuation, whereby married superannuitants could claim only the married person rate. Married superannuitants who had previously claimed the single rate because their spouse did not qualify for New Zealand superannuation had their entitlement frozen at the single rate of $183.93 a week.

The idea was that recipients of the frozen rate would move to the married person rate when the latter exceeded the former. By April 1996 the married person rate ($184.33 a week) exceeded the frozen rate ($183.93 a week)

The Tax Reduction and Social Policy Bill (recently enacted in five separate Acts) removed the frozen rate from the First Schedule of the Social Welfare (Transitional Provisions) Act 1990 because the rate became redundant from 1 April 1996. Superannuitants who previously received the frozen rate now receive the higher married person rate of New Zealand superannuation.

Moving recipients of the frozen rate to the married person rate of new Zealand superannuation implies that they will also move from the single person surcharge exemption level to the married person surcharge exemption level. This can, in some circumstances, restrict an individual recipient to a lower surcharge exemption than he or she was able to claim while in receipt of the frozen rate.

The standard married couple joint surcharge exemption level ($6,240 as at 1 April 1996) is higher than the single person exemption ($4,160 as at 1 April 1996) and advantages a superannuitant who has a spouse with little or no income. However, if the younger spouse has significant income, that income is offset against the couple's joint exemption until the older superannuitant's exemption is reduced to a minimum. The minimum married person exemption ($3,120 as at 1 April 1996) was lower than the minimum exemption of $4,160 that was granted to recipients of the frozen rate.

This amendment ensures that superannuitants previously receiving the frozen rate may continue to claim the single surcharge exemption level as a minimum. However, that amount will be frozen at $4,160 for the 1996-97 income year. With the enactment of the Taxation (Superannuitant Surcharge Reduction) Act 1996 the surcharge specified exemption levels have been substantially increased with effect from 1 April 1997. This results in the minimum married person surcharge exemption level exceeding the frozen surcharge exemption level.

From 1 April 1997, all married superannuitants will receive the minimum married surcharge exemption level.

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Key features

Section JB 4 (1) of the Income Tax Act 1994 is amended to ensure that recipients of the previously frozen rate who have now transferred to the married person rate can still claim the single surcharge exemption level. This ensures that recipients of the frozen rate are not subject to an increased surcharge liability as a result of their moving to the married person rate.

The surcharge exemption level for these recipients will be frozen at $4,160 ($80 per week) for the 1996-97 income year. The surcharge exemption level for the 1997-98 income year and subsequent income years will transfer from the frozen exemption level to the minimum married person exemption level as this exemption level will exceed the frozen exemption level.

Section 336E (1)(d) of the Income Tax Act 1976 and section JB 4 (1) of the Income Tax Act 1994 are amended to correct a legislative oversight dating back to 1991, when the surcharge legislation was re-introduced, whereby the previous provisions relating to the single surcharge exemption level for recipients of the frozen rate were omitted.

The Inland Revenue Department has previously allowed recipients of the frozen rate to claim the single surcharge exemption level in accordance with the policy intent of the legislation, although it lacked the necessary legislative authority. Therefore recipients of the frozen rate have not been disadvantaged.

- **Frozen rate of New Zealand superannuation -** Applies to superannuitants whose spouse did not qualify for New Zealand superannuation before 10 October 1988, and still does not qualify. The rate of superannuation was frozen at $183.93 a week until such time as the married person rate exceeded this rate.
- **Married person rate of New Zealand superannuation -** This is the rate which applies to individual married superannuitants when they both qualify in their own right. The rate was $184.33 a week (before tax) as at 1 April 1996.
- **Minimum married person surcharge exemption level -** As at 1 April 1996 the married couple joint exemption level was $6,240 a year. Each spouse receives a minimum exemption level of $3,120 a year. However, if one spouse does not use up her or his exemption level the excess can be transferred to the other spouse.

  This means that a spouse can have a minimum exemption level of $3,120 or a higher amount up to a maximum of $6,240 depending on whether the other spouse earns additional income (other than New Zealand superannuation).
- **Single person surcharge exemption level -** The exemption level which applies to recipients of the single rate of New Zealand superannuation. This is the level below which no surcharge is payable by these recipients. As at 1 April 1996 the exemption level was $4,160 a year.

Application date

The amendment to freeze the surcharge exemption level applies from the beginning of the 1996/97 income year. However, in effect the frozen surcharge exemption level will apply only to the 1996/97 income year.

The amendment to correct the legislative oversight will apply retrospectively from 1 April 1991.

Low income rebate and the veteran’s pension

Section KC 1, Income Tax Act 1994

Introduction

The low income rebate has been amended to enable recipients of a veteran’s pension to claim the low income rebate on income from interest, dividends, royalties, rents and a trust. This will put them on a par with recipients of New Zealand superannuation with respect to the low income rebate.

Background

Veterans who qualify for a veteran’s pension can choose between receiving the veteran’s pension or New Zealand superannuation. The rates paid for both benefits are the same.

Recipients of a veteran’s pension are exempt from the New Zealand superannuitant surcharge.

Previously, recipients of a veteran’s pension were unable to claim the low income rebate on their passive income. This disadvantaged them relative to recipients of New Zealand superannuation, who are able to claim the rebate on their passive income.

The low income rebate for the 1996-97, 1997-98 and 1998-99 income years has been amended. The amendments were necessary to reflect the changes to the rebate resulting from the Government’s tax reduction package contained in the Income Tax Act 1994 Amendment Act 1996.

Key Features

This amendment to section KC 1 of the Income Tax Act 1994 will enable recipients of a veteran’s pension to claim the low income rebate on their income from interest, dividends, royalties, rents and a trust, as well as their pension income.

Application date

The amendment will apply from the income year beginning 1 April 1996.

Section LE 3 holding companies

Section LE 3 (6), (10), Income Tax Act 1994

Introduction

An amendment corrects an error in the credit ordering rules for calculating the minimum income tax liability of a section LE 3 holding company.

Background

Section LE 3 (10) establishes that a section LE 3 holding company will have a minimum income tax liability for an income year at least equal to the amount of supplementary dividends it receives. The minimum income tax liability for section LE 3 holding companies was established as a revenue-protection measure to eliminate the potential for income tax deferral if a supplementary dividend is derived by a section LE 3 holding company with tax losses.

It was intended that the minimum income tax liability be determined before allowing for any refundable credits (such as resident withholding tax and foreign investor tax credits), but after allowing for non-refundable credits (such as foreign tax credits and imputation). However, the original drafting of section LE 3 (10) incorrectly reversed the ordering of the credits. The amendment has now rectified this problem.

Following the amendment, section LE 3(10) works in practice as follows:

Step 1: A section LE 3 holding company will calculate its actual tax liability after claiming imputation and foreign tax credits to which it is entitled.

Step 2: If this liability is less than the amount of supplementary dividends received by the company for the year, section LE 3 (10) operates to establish the company's tax liability to be the amount of those supplementary dividends.

Step 3: The liability determined in step 2 is reduced by the amount of any refundable credits (eg, resident withholding tax, dividend withholding payment credits, foreign investor tax credits arising from dividends paid by the company).

A typographical error in section LE 3 (6) has also been corrected.

Key features

A section LE 3 holding company's minimum income tax liability is established after allowing for non-refundable credits, but before allowing for refundable credits.

Application date

The amendment applies to dividends paid on or after 12 December 1995.

Non-refundable tax

Sections MD 2 (5), MD 3 (4), NH 4 (2), and NH 5 (5), Income Tax Act 1994

Introduction

The imputation and dividend withholding payment (DWP) rules have been amended to remove an anomaly that prevents the Commissioner of Inland Revenue from applying non-refundable overpaid tax towards tax liabilities for previous income years. An identical amendment has also been made to the policyholder credit account regime (PCA) for persons who are life insurers.

Background

Under the imputation and DWP rules, the Commissioner may refund overpaid tax only to the extent of the credit balance in a company's memorandum account. The PCA regime contains similar rules for persons who are life insurers that operate memorandum accounts. At present, the Commissioner is required to credit any non-refundable overpayment towards tax liabilities that arise in the year of the refund entitlement, or subsequent income years.

This creates potential difficulties when the Commissioner reassesses a taxpayer for an earlier income year and is not able to set off any non-refundable overpaid tax against any reassessed liability. The taxpayer is required to make an additional payment to satisfy the reassessed liability.

Key features

The imputation, PCA, and DWP rules have been amended to allow non-refundable overpaid income tax or dividend withholding payments to be credited towards liabilities that arise for both earlier income years and future income years.

Each of the regimes that have been amended has different commencement dates. For this reason, the liabilities against which non-refundable overpaid tax may be applied are as follows:

- in the case of the imputation and the DWP rules, against reassessments for income years after 1 April 1988;

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- in the case of consolidated group companies which operate under the DWP rules, against reassessments for income years beginning from the 1993-94 income year; and
- in the case of the PCA rules, against reassessments for income years after 1 April 1990.

Application date

The amendments come into force on 1 April 1997 and apply from that date to any non-refundable overpayments of income tax or dividend withholding payments made before that date, and not already credited by the Commissioner against other tax liabilities. They will also apply to overpayments made after that date.

Example

Assume a company with a nil imputation credit account (ICA) balance paid a fully imputed dividend on 28 February 1996. This placed the company's ICA in debit balance. Before 31 March 1996, the company made a voluntary tax payment to clear the debit balance.

Shortly after 31 March 1996, the company entered into a tax loss situation and was not eligible for a refund of that voluntary payment because it did not have a credit balance in its ICA.

In June 1997, the company is reassessed for the 1995 income year and has to pay additional income tax for that year. The Commissioner will apply the voluntary tax payment made in 1996 towards the tax liability for the 1995 income year.

Imputation effect of FITC-related refunds

Section ME 5 (1)(e), Income Tax Act 1994

Introduction

An amendment ensures that a double debit will not arise to a company's imputation credit account (ICA) if a breach of shareholder continuity occurs between the payment of a dividend and the receipt of the related refund of the foreign investor tax credit (FITC).

Background

When the new FITC regime was enacted in December 1995, section ME 5 (1)(e) was amended to ensure that a refund of tax resulting from a foreign investor tax credit (FITC) will always give rise to a debit in the company's imputation credit account, notwithstanding that a debit may already have arisen by virtue of a breach in shareholder continuity. This amendment was necessary to ensure that if a company used the FITC mechanism to obtain a refund of tax paid before the continuity breach, it would not place the company in a better position than it would have been in had it attached normal imputation credits to the dividend, instead of paying a supplementary dividend.

However, the amendment did not give the correct result if the shareholder continuity breach occurred between the payment of the dividend and the receipt of the FITC-related refund. This is because the FITC-related refund is correctly attributable to tax paid before the continuity breach. The amendment ensures that in such circumstances, a further debit to the ICA will not arise.

Key feature

A double debit to a company's imputation credit account will not occur if a breach of shareholder continuity occurs between the payment of a dividend and the receipt of the FITC-related refund.

Application date

The amendment applies from 12 December 1995 (the same application date as the previous amendment to section ME 5 (1)(e)).

Correction of cross-reference error

Section MG 15 (1)(d), Income Tax Act 1994

An amendment updates a cross-reference in section MG 15 (1)(d).

Section MG 15 (1)(d) of the Income Tax Act contained a cross-reference to paragraph (h) of that subsection. The reference to paragraph (h) was a technical error, and should have been a reference to paragraph (i), which contains a link to the shareholder continuity rules for consolidated groups.

The amendment applies from the date of enactment, 2 September 1996.

NRWT rate on DWP-credited dividends

Section NG 2 (1)(a), (4), Income Tax Act 1994

Introduction

The rate of non-resident withholding tax (NRWT) on dividend withholding payment (DWP) credited dividends has been reduced from 30% to 15%. The amendment has been made to reduce compliance and administration costs.

Background

The international tax reforms enacted in December 1995 removed the boundary between investors resident in treaty and non-treaty countries on fully imputed dividends for NRWT purposes. This amendment now also removes the boundary for DWP-credited dividends, to reduce compliance and administration costs.

The lower 15% rate of NRWT applies to a dividend to the extent it is fully DWP-credited. The amount of the dividend fully DWP-credited is equal to the amount of DWP credit attached to the dividend divided by the company tax rate (section NG 2(4)). The amendment contemplates that the lower 15% rate of NRWT can apply to partially DWP-credited dividends to the extent they are fully credited.

Example

A company pays a cash dividend of $67.00, and attaches DWP credits of $20.00. How is the amount of NRWT on the dividend calculated?

Cash dividend		$67.00
DWP credit		$20.00
Amount of dividend liable for NRWT		$87.00
Fully DWP-credited portion ($20.00 + 0.33)	$60.61	
NRWT @ 15% (section NG 2(1)(c))		$ 9.09
Uncredited portion of dividend ($87.00 - $60.61)	$26.39	
NRWT @ 30% (section NG 2(1)(a))		$ 7.92
NRWT liability		$17.01

(Note: If New Zealand has a double taxation agreement with the country of residence of the recipient of the dividend, the NRWT rate on the uncredited portion of the dividend will generally be reduced to 15% (section BB 11).)

Key feature

The NRWT rate on dividends has been reduced from 30% to 15% to the extent full DWP credits are attached.

Application date

The amendment applies to dividends paid on or after 2 September 1996.

NRWT on non-cash dividends

Section NG 2 (2), NG 9 (1), Income Tax Act 1994

Introduction

The amendments ensure that:

- no deduction of NRWT is required under section NG 9 from non-cash dividends to the extent they are fully imputed; and
- to the extent the non-cash dividends carry sufficient dividend withholding payment credits, NRWT need not be accounted for.

Background

The international tax reforms enacted in December 1995 introduced a new section NG 2 (1)(b)(ii), which provided that fully imputed non-cash dividends derived by non-resident investors on or after 12 December 1995 are subject to a zero percent NRWT rate. However, there was a conflict between this provision and section NG 9(1), which required NRWT on those same dividends to be deducted at a 30% rate (reduced to 15% in most cases if the investor is resident in a treaty country).

The Commissioner of Inland Revenue made a determination under section NG 10 that all persons were relieved from the obligation to comply with section NG 9 (1) in respect of non-cash dividends which were fully imputed and accordingly subject to a zero percent NRWT rate under section NG 2(1)(b)(ii). This amendment achieves this effect legislatively in section NG 9.

When the imputation and dividend withholding payment regimes were enacted in 1988, it was not possible to attach imputation or dividend withholding payment credits to a non-cash dividend. This ceased to be the case from 1 April 1992 following an amendment to the definition of "dividend" in former section 394A of the Income Tax Act 1976. However, when the amendment was made to section 394A, a consequential amendment was not made to the then section 313 (now section NG 9) to reflect the ability of companies to pay credited non-cash dividends.

Section NG 9 (1) has now been redrafted to ensure the correct treatment of credited non-cash dividends.

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Section NG 9 (1) contains two formulae for determining the NRWT on a non-cash dividend. Which of the formulae apply depends on whether the non-cash dividend is a taxable bonus issue or not. The section expressly does not apply to the extent the non-cash dividend is fully imputed (meaning a zero percent rate of NRWT will apply to that portion of the dividend).

If the non-cash dividend is not a taxable bonus issue, the NRWT liability is calculated using the formula in section NG 9 (1)(a):

$$[a/(1 - a) \times b] + (c \times d)$$

where-

- a is the NRWT rate in section NG 2(1)(a), being 30% (reducible under an applicable double taxation agreement);
- b is the amount of the dividend to the extent it is neither fully imputed nor fully DWP credited;
- c is the NRWT rate in section NG 2(1)(c), being 15%;
- d is the extent to which the dividend is fully DWP credited.

If the dividend is a taxable bonus issue, the NRWT liability is calculated using the formula in section NG 9(1)(b):

$$(a \times e) + (c \times f)$$

where-

- a is the NRWT rate in section NG 2(1)(a), being 30% (reducible under an applicable double taxation agreement);
- e is the amount of the dividend to the extent it is neither fully imputed nor fully DWP credited;
- c is the NRWT rate in section NG 2(1)(c), being 15%;
- f is the extent to which the dividend is fully DWP credited.

Essentially, the two formulae achieve the following effect:

- A 15% rate applies to the extent full DWP credits are attached.
- To the extent that neither DWP nor imputation credits are attached, a 30% rate of NRWT applies (which may be reduced to generally 15% under an applicable double taxation agreement). This portion of the dividend is also required to be grossed up by the amount of NRWT imposed on that portion of the dividend if the dividend is not a taxable bonus issue.

A further modification has been made to ensure that where DWP credits are attached to a non-cash dividend, those credits can be taken into account by the payer of the dividend in determining the amount of NRWT to be deducted. Before the amendment, section NG 9 (2) required the payer to deduct an amount of NRWT from a non-cash dividend calculated under section NG 9 (1). However, the liability calculated under section NG 9 (1) was determined without reference to the amount of DWP credits attached to the dividend, and which would have reduced the liability to deduct under section NG 2 (2) if the dividend were a cash dividend instead.

An amendment has been made to section NG 2 (2) so that the amount of DWP credits attached to a dividend are taken into consideration in determining both the liability of the recipient of the dividend to pay NRWT and the obligation of the payer to deduct NRWT from the dividend. By making section NG 2 (2) apply for all of the NRWT rules, rather than merely for section NG 2 (1) as previously, the offsetting of DWP credits now flows through to the obligation to deduct NRWT from a DWP-credited non-cash dividend under section NG 9.

Example

A company pays a non-cash dividend (not a taxable bonus issue) of $134.00 to an investor resident in a country with which New Zealand has a double taxation agreement which prescribes a maximum NRWT rate on dividends of 15%. The dividend has imputation credits of $16.50 and DWP credits of $33.00 attached. What is the NRWT liability on the dividend?

The extent to which the dividend is fully imputed is calculated using the formula in section NG 2(3):

$$\$16.50 \times (1 - 0.33)/0.33 = \$\ 33.50$$

The extent to which the dividend is fully DWP-credited is calculated using the formula in section NG 2(4):

$$\$33.00/0.33 = \$100.00$$

The extent to which the dividend is neither fully imputed nor fully DWP-credited is therefore:

$$\$134.00 + \$33.00 - \$33.50 - \$100.00 = \$33.50$$

(The DWP credit is included in the amount of dividend liable for NRWT but not the imputation credit (definition of “dividend” for NRWT rules in section OB 1).)

The NRWT liability is determined under the formula in section NG 9(1)(a) as follows:

$$\begin{aligned} & [a/(1-a) \times b] + (c \times d) \\ = \ & [0.15/0.85 \times \$33.50] + 0.15 \times 100.00 \\ = \ & \$20.91 \end{aligned}$$

Section NG 2 (2) then reduces the liability to pay and the obligation to deduct NRWT from the dividend by the amount of the DWP credits attached. As the DWP credits of $33.00 exceed the NRWT liability on the dividend, there is no obligation on the payer to deduct NRWT from the dividend. The recipient of the dividend can seek a refund of the excess DWP credits of $12.09 from Inland Revenue under section LD 9.

Key features

Section NG 9 (1) does not apply to non-cash dividends to the extent they are fully imputed.

Section NG 2 (2) provides that to the extent the non-cash dividends carry sufficient dividend withholding payment credits, NRWT need not be accounted for.

Section NG 9 (1) has been specifically amended to provide that items in the formulae only deal with the portion of the dividend which is not fully imputed.

Application date

The amendment applies retrospectively to dividends paid on or after 12 December 1995, the date from which the zero percent NRWT rate for fully imputed non-cash dividends applies.

FDWP and formerly non-resident companies

Section NH 1 (2)(b), Income Tax Act 1994

Introduction

The amendment clarifies that if a non-resident company becomes resident in New Zealand, the foreign dividend withholding payment (FDWP) rules will apply to subsequent dividends paid by that company to the extent that it has retained earnings on becoming New Zealand resident.

Background

Section NH 1 (2)(b) (formerly section 394ZL(2)(b)) was enacted to ensure that the FDWP regime could not be avoided if a foreign company became a New Zealand resident before paying a dividend to its New Zealand resident shareholders.

A literal interpretation of the previous provision suggested that the FDWP regime would not apply if a formerly foreign company pays a dividend that exceeded the amount of its retained earnings at the time of becoming resident. This was not the policy intention, which is that dividends should be subject to FDWP to the extent of a company's pre-resident retained earnings. The section has, therefore, been amended to reflect correctly its policy intention.

Key features

If a non-resident company becomes resident in New Zealand, the FDWP regime will apply to subsequent dividends paid by that company to the extent of its retained earnings at the time of becoming resident in New Zealand.

Application date

The amendment applies from 21 May 1996.

Removal of redundant administrative positions

Section OB 1, Income Tax Act 1994
Sections 2(1) and 30, Goods and Services Tax Act 1985
Sections 6, 81 (1)(b), 110, 118, 228 and 229 (4) - (6), Tax Administration Act 1994

Introduction

A series of amendments has been made to the provisions of the Income Tax Act 1994, the Tax Administration Act 1994, and the Goods and Services Tax Act 1985 to remove redundant references to the positions of "District Commissioner", Deputy Commissioner" and "Regional Controller" , and to update a section reference to take account of the April 1995 legislative changes.

Background

The Inland Revenue Acts previously contained references to the positions of "District Commissioner", Deputy Commissioner" and "Regional Controller". These references were generally repealed with effect from 1 April 1995. Since then, however, further references have been located and have now been removed.

Following the April 1995 legislative changes, section 6 of the Tax Administration Act 1994, which established the office of the Commissioner of Inland Revenue, was repealed and in its place three new provisions were enacted. A new section 6A now establishes the office of the Commissioner. As a consequence, section 228(1) of the Tax Administration Act 1994, which deems the Commissioner to be appointed under the old section 6, has been updated to refer to section 6A.

Key features

- All redundant references have been removed and, where appropriate, replaced with a reference to an " ... officer of the Department".
- A further minor amendment ensures a correct reference to the Commissioner's appointment.
- A new definition of "Officer of the Department" has been inserted into the Goods and Services Tax Act 1985.

Application date

The amendments will apply from 1 April 1995, the date of the changes to the affected administrative positions.

Portable New Zealand superannuation and the veteran's pension

Section OB 1, Income Tax Act 1994
Section 2, Income Tax Act 1976

Introduction

The tax exemption for portable New Zealand superannuation and the veteran's pension has been extended to those paid under bilateral social security agreements made under section 19 of the Social Welfare (Transitional Provisions) Act 1990. Previously, the tax exemption applied only to portable benefits paid to pensioners in countries with whom no bilateral social security agreement exists.

Background

Portable New Zealand superannuation and veteran's pensions paid to pensioners living in countries with whom New Zealand has no bilateral social security agreement are tax-exempt. However, such benefits paid under bilateral social security agreements were not. This difference in legal status was an oversight, and the Department of Social Welfare (DSW) have not been withholding tax. Legislative amendments have now aligned the law with DSW's practice by extending the exemption to all portable New Zealand superannuation and veteran's pensions.

The amendments treat all portable pensions equally and are consistent with New Zealand's double tax agreement negotiation policy of securing sole taxation rights of pension income for the recipients' country of residence.

Key features

The definitions of "portable New Zealand superannuation" and "portable veteran's pension" in section OB 1 of the Income Tax Act 1994 are amended to add a reference to section 19 of the Social Welfare (Transitional Provisions) Act 1990.

The definitions of "portable guaranteed retirement income", "portable national superannuation", "portable New Zealand superannuation" and "portable veteran's pension" in section 2 of the Income Tax Act 1976 have been amended to add a reference to section 19 of the Social Welfare (Transitional Provisions) Act 1990 to complete the retrospective effect to 1 April 1990.

Application date

The amendment applies retrospectively to 1 April 1990, the date that section 19 of the Social Welfare (Transitional Provisions) Act came into force.

Non-deduction salaries

Section OB 2(4), Income Tax Act 1994

Introduction

Section OB 2 (4) of the Income Tax Act 1994 has been amended so that a close company for the purposes of section OB 2 continues to include all companies with 25 or fewer shareholders, until 1 April 1998.

Background

Section OB 2 allows a close company, under certain circumstances, to pay remuneration to shareholder employees without deduction of PAYE. Such remuneration is generally known as non-deduction salary.

Subsection (4) of section OB 2 defines the term "close company", for the purposes of the section, as including a company with 25 or fewer shareholders. Before the amendment, this extended definition had application until 1 April 1997.

The extended definition was a result of consultation on the Taxation Reform (Binding Rulings and Other Matters) Bill in 1995. During the consultation several issues were raised concerning the differences between the practical application of section OB 2 compared to the legislation. Therefore it was agreed that Inland Revenue would carry out a review of the section, to be completed by 1 April 1997. Consideration of the definition of "close company" for the purposes of the section is part of the review.

However, the review may not be completed, nor the legislation enacted, by this date. Therefore the current extended definition of "close company" for the purposes of section OB 2 will continue to include all companies with 25 or fewer shareholders, until 1 April 1998. By this time the review should have been completed and any necessary legislation enacted.

References to non-standard income years

Section OF 2, Income Tax Act 1994

Introduction

A reference to non-standard income years in section OF 2 of the Income Tax Act 1994 has been updated to include reference to the definition of "supplementary dividend" in section OB 1.

Background

References to income years in Part LE (which contains the foreign investor tax credit (FITC) regime) already include non-standard accounting years. This was achieved by inserting a reference to Part LE in section OF 2, which lists those provisions for which income year references include non-standard accounting years, at the time Part LE was enacted on 12 December 1995.

The definition of "supplementary dividend" in section OB 1, which is used only for FITC purposes, also contains an income year reference. Section OF 2 has now been amended to also include a reference to the supplementary dividend definition.

Key features

The income year reference in the definition of "supplementary dividend" in section OB 1 includes non-standard accounting years.

Application date

The amendment applies to dividends paid on or after 12 December 1995, the application date of new Part LE.

Record-keeping provisions of gift-exempt bodies

Section 32 , Tax Administration Act 1994

Introduction

A discretionary provision to allow records of gift-exempt bodies to be kept in a language other than English has been inserted in section 32 of the Tax Administration Act 1994 (TAA). This will ensure consistency within the provisions of the TAA and with those in the Goods and Services Tax Act 1985 (GST Act) which govern the keeping of business and tax records.

Key feature

The amendment will give the Commissioner of Inland Revenue the discretion to authorise gift-exempt bodies to keep records in a language other than English.

Background

The TAA and the GST Act contain various record-keeping provisions which require that records be kept in the English language. Three of these provisions include a discretion which allows the Commissioner, on application in writing, to permit records to be kept in a language other than English.

However, section 32 of the TAA, which deals with the records of gift-exempt bodies, requires that their records be kept in English and has no discretionary provision. (The term "gift-exempt bodies" is defined in section 3(1) of the TAA, but in general terms is a collective definition encompassing certain specifically named donee organisations and funds, and other income tax exempt charitable and non-profit bodies and community groups.)

There is no sound policy reason why any gift-exempt body should not be able to apply for an exception to the requirement to keep records in English. It is also inconsistent that an organisation can apply to keep records in a language other than English for the purposes of section 75 of the GST Act, but if that organisation is a gift-exempt body it must keep income tax records in English.

Application date

The amendment will apply from the income year beginning 1 April 1996.

Student Loan Scheme - special repayment deduction rate certificates

Section 21, Student Loan Scheme Act 1992

Introduction

An amendment allows the Commissioner of Inland Revenue to issue a special repayment deduction rate certificate for an amount in excess of the borrower's estimated repayment obligation for the income year.

Background

Before the amendment the Commissioner could only issue a special repayment deduction rate certificate for the estimated amount of the borrower's repayment obligation for the income year. The change is designed to encourage borrowers to make voluntary repayments of their Student Loan debts by making it easier for them to do so.

Key features

At the request of a borrower, the Commissioner will issue a special repayment deduction rate certificate for any amount in excess of the borrower's estimated repayment obligation for that income year. An application may be made before or during the income year.

Application date

The amendment applies from the date of enactment, 2 September 1996.

GST - double dipping, input tax deductions for dwellings

Introduction

Amendments correct drafting errors to the application dates of two changes made to the Goods and Services Tax Act 1985 (GST Act) by the Goods and Services Tax Amendment Act (No. 2) 1995 (GST Amendment Act).

The changes were to close a loophole that enabled "double dipping" and to stop input tax deductions being claimed for dwellings that are used principally as private residences. When these changes were made, it was intended that late claims would not be allowed but that registered persons who had committed themselves to a contract but had been unable to claim because the return for the period in which the claim arose had not been furnished, would not be disadvantaged by the retrospective nature of the original amendments.

Explanations of the original amendments are on pages 31 and 32 of TIB Volume Seven, No. 9.

Background

Two changes made to the GST Act by the GST Amendment Act were effective from the date of the announcement of the change by the previous Minister of Revenue. On 21 June 1995 Hon Wyatt Creech announced that an amendment would be enacted to close a loophole that allowed double dipping. On 11 August 1995 he announced a change to ensure that an input tax deduction could not be claimed for a dwelling unless the dwelling itself was used for the principal purpose of making taxable supplies.

When the bill effecting these changes was introduced, the amendments applied not only to supplies made on or after the date of the announcements, but also to supplies made before the announcements, if a return in which the claim was made had not been furnished at the date of the relevant announcement.

The application date for each amendment was modified by the Finance and Expenditure Committee. It was intended that registered persons who had acquired goods under a contract that was unconditional, but who had been unable to make a claim because the return for the period in which the claim arose had not been furnished at the time of the announcement, would not be disadvantaged by the retrospective nature of the amendment. The wording of the original amendment did not achieve this.

Key features

The amendments correct two drafting errors contained in the GST Amendment Act. The errors relate to the application dates for the amendments that were made in that Act to close a loophole that enabled "double dipping" [section 2(5)] and to stop input tax deductions being claimed for dwellings that are used principally as private residences [section 3(3)].

The amendments give effect to the intention that the previous changes would apply from the date on which each amendment was announced by the previous Minister of Revenue, other than for registered persons who would be making future claims (not late claims) for goods acquired under a contract that became unconditional before the relevant announcement date.

Application date

The amendments apply from the application dates of the original changes: 21 June 1995 for double dipping and 11 August 1995 for input tax credits for dwellings.

GST treatment of insurance subrogation payments

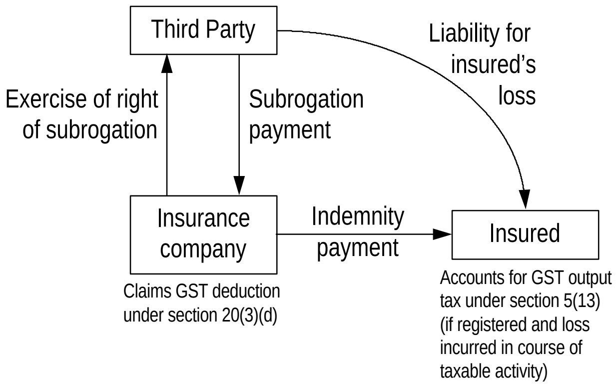
Section 5(13B), Goods and Services Tax Act 1985

Introduction

An amendment has been made to the Goods and Services Tax Act 1985 (the GST Act) to ensure that insurance subrogation payments are subject to GST. (These are payments made by a third party to an insurer in respect of a liability owed by the third party to an insured party who has been indemnified by the insurer.)

Background

The following diagram illustrates the relationships involved when a third party makes a subrogation payment to an insurance company.



The insured has incurred a loss, in relation to which it has then received an indemnity payment from the insurance company. Assuming the insured is GST registered and the loss has been incurred in the course of carrying on a taxable activity, the insured will have accounted for GST, under section 5(13) of the GST Act, on receipt of the indemnity payment. The insurance company will have claimed a GST deduction under section 20(3)(d) on making the indemnity payment.

Subsequently, the insurance company has exercised its right of subrogation and claimed against the third party because of the third party's liability for the insured's loss. (The right of subrogation is the right that an insurer has to receive the benefit of any rights and remedies which an insured party may have against a third party, in respect of any loss for which the insurer has indemnified the insured party.) In response, the third party has made a subrogation payment to the insurance company.

The underlying rationale for levying GST on the insurance subrogation receipt is that:

(a) the insurer has claimed a GST deduction under section 20(3)(d) for the indemnity payment made to the insured; and

(b) the subrogation receipt has decreased the net cost of the claim to the insurer; therefore

(c) the amendment prevents the insurer from making a double recovery of the GST element from both the section 20(3)(d) deduction and the third party who has made the subrogation payment.

Key features

The amendment provides that if:

- an insurer receives an insurance subrogation payment; and
- the insurer has previously claimed a deduction when making an associated indemnity payment;

the amount received (excluding any aggravated and exemplary damages) is subject to GST output tax.

As stated, the underlying policy rationale for levying GST on a subrogation receipt is to prevent an insurer from making a double recovery of the GST element of amounts paid to indemnify an insured. The amendment is, therefore, restricted in its application to insurers who have previously been allowed a deduction under section 20(3)(d) of the GST Act.

Any amount attached to an insurance subrogation payment as a consequence of delayed payment is subject to GST output tax. Such an amount may be commonly referred to as interest (this includes court awarded interest).

A third party making an insurance subrogation payment is able, where they meet the necessary conditions set out in the GST Act, to claim an input tax credit.

Application date

The amendment applies from the introduction of GST, 1 October 1986, except if:

- a registered person has not accounted for output tax on receipt of an insurance subrogation payment, if the last day for furnishing the return for the taxable period to which the output tax was attributable was before the date of introduction of the legislation, 21 May 1996; or
- a registered person had a live objection before the date of introduction of the legislation, 21 May 1996, in respect of the payment of output tax on the receipt of an insurance subrogation payment.

Insurance subrogation payments that fall within these two categories are not subject to GST.

Correction of cross-references to the Customs and Excise Act 1996

Section 12, GST Act 1985

Introduction

Legislative amendments to the Goods and Services Tax Act 1986 (GST Act) have been made to correct cross-references made in the fifth schedule of the Customs and Excise Act 1996 (CE Act).

(Also see the item *Customs and Excise Act 1996*in this TIB for consequential amendments to the GST Act as a result of the enactment of the CE Act.)

Background

Section 12 of the GST Act provides that GST is payable on imports made under or in breach of the Customs Act 1966. The Customs Act 1966 has since been reformed by the CE Act.

The fifth schedule of the CE Act consequentially redrafted section 12 of the GST Act to reflect the new provisions of the CE Act. However, the redraft contained incorrect cross-references to the GST Act. In particular, the fifth schedule provided that sections 112, 113, 114, 116 and 117 of the CE Act were to apply to section 12(4)(c) of the GST Act. However, it was sections 111, 112, 113, 115 and 118 of the CE Act that should have applied.

Further, in the redrafted section 12(4)(d) of the GST Act, section 119 instead of section 117 was specified.

Key features

Sections 111, 112, 113, 115 and 118 of the CE Act apply to section 12(4)(c) of the GST Act. This corrects the previous list of sections 112, 113, 114, 116 and 117.

In redrafted section 12(4)(d) of the GST Act, section 119 instead of section 117 will apply.

Application date

The amendments will apply from the date the CE Act came into force, 1 October 1996.

Taxation (Superannuitant Surcharge Reduction) Act 1996

Sections JB 4 and NI 5, Income Tax Act 1994
Section 33A, Tax Administration Act 1994

The New Zealand superannuitant surcharge thresholds have been raised significantly. The increases allow a couple’s gross income (New Zealand superannuation [NZS] plus other income) to be about 10 percent above the gross average ordinary-time wage before the surcharge applies.

Background

The New Zealand superannuitant surcharge, a form of targeting, imposes a surcharge of 25 cents in the dollar on a superannuitant’s “other income” above a certain threshold. This has the effect of clawing back part or all of the NZS received. The amount clawed back cannot exceed the net NZS (gross NZS less tax payable as if NZS was the last income taxed) received by the superannuitant.

The targeting of NZS has been adjusted so that the cut-in point for the surcharge occurs when a couple’s total income (NZS plus other income) is about 10 percent above average ordinary-time earnings. The threshold for a single superannuitant retains the same relationship to the threshold for a couple as at present.

These amendments supersede the second stage of the increase in the New Zealand superannuitant surcharge exemption thresholds that was to come into effect from 1 July 1997 as part of the Tax Reduction and Social Policy programme.

Key features

The increased New Zealand superannuitant surcharge thresholds are shown in the table below.

Increased Surcharge Thresholds

	Surcharge thresholds of other income	**Estimated threshold of total income (incl NZS)**
Couple	$15,444 p.a. ($297/week)	$34,934 p.a. ($671.80/week)
Single (living alone)	$10,296 p.a. ($198/week)	$23,307 p.a. ($448.21/week)

The amendments:

- Reduce the estimated percentage of New Zealand superannuitants who are subject to the surcharge from about 25% to about 14%.
- Reduce or eliminate the surcharge paid by well over 100,000 superannuitants.
- Amend the circumstances under which a superannuitant is not required to file an annual tax return (by the increase in the thresholds) accordingly.
- Amend the surcharge codes used by superannuitants to have the surcharge deducted from source deduction payments (other than NZS).

Application date

The amendments take effect from 1 April 1997 for the 1997-98 and subsequent income years.

Customs and Excise Act 1996

Introduction

The Customs and Excise Act 1996 came into effect on 1 October 1996. The Act replaced the Customs Act 1966 and consequentially amended the Customs Act references in the Goods and Services Tax Act 1985 (GST Act).

Background

Under the previous legislation, sections 12, 13 and, where applicable, 42 of the GST Act were deemed to be one of the Customs Acts. These sections relate to the imposition of GST on imports, the imposition of GST on goods liable to excise duty and supplied at "in bond" prices, and the recovery of tax respectively.

Other sections of the GST Act refer to the Customs Act, in particular the zero-rating provisions in section 11.

The Customs Act 1996 has been replaced with the Customs and Excise Act 1996. Therefore the references in the GST Act to the Customs Act have been amended accordingly.

Key features

The Customs and Excise Act 1996 has amended the following provisions of the GST Act to substitute references to the Customs and Excise Act 1996 for references to the Customs Act 1996, and to reflect changes in terminology in the Customs and Excise Act 1996:

- section 1(3);
- section 2, definition of "input tax";
- paragraphs (a), (aa), (ac), (ad), (ae) and (b) of subsection 11(1);
- section 11(1A);
- section 11(1D);
- section 11(2)(ca);
- section 12; (see also page XX)
- section 79(1)(b).

Section 13 of the GST Act has been repealed and sections 1(3), 20(3) and 22 amended to reflect this.

Section HK 18 (2) and the definition of the "input tax" in section OB 1 in the Income Tax Act 1994 have also been amended accordingly.

Application date

The amendments to the GST Act apply from 1 October 1996, the application date of the Customs and Excise Act 1996.