Tax Information Bulletin

TAX INFORMATION BULLETIN

Volume Nine, No.12 November 1997

This TIB covers changes arising from the Taxation (Remedial Provisions) Bill, which was introduced into Parliament in June 1997 and passed in September 1997. The bill amended several principal Acts and was split into the following Acts:

- Taxation (Remedial Provisions) Act 1997 No 74
- Accident Rehabilitation and Compensation Insurance Amendment Act (No 2) 1997 No 76.
- Child Support Amendment Act (No 3) 1997 No 76
- Diplomatic Privileges and Immunities Amendment Act 1997 No 77
- Local Government Amendment Act (No 2) 1997 No 78
- Student Loan Scheme Amendment Act 1997 No 79

The Taxation (Remedial Provisions) Act 1997 amended the following Acts

- Income Tax Act 1994
- Tax Administration Act 1994
- Goods and Services Tax Act 1985
- Income Tax Act 1976
- Estate and Gift Duties Act 1968
- Gaming Duties Act 1971
- Tax Administration Amendment Act (No 2) 1996
- Taxation Review Authorities Act 1994
- Taxation (Income Tax Rates) Act 1997

The amendments cover a variety of legislative changes ranging from tax simplification to protection of the revenue base.

See the inside front cover for a full list of this TIB's contents.

This TIB has no appendix

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This is an Inland Revenue service to people with an interest in New Zealand taxation.

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Amendments to the Income Tax Acts 1994 and 1976

Double tax agreement provisions

Section BH 1, LC 1 (5), LC 7 (1)(b), LF 1 (2)(a)(v), NC 18 (1)(a), OB 1, OD 5 (10), OE 6, Income Tax Act 1994
Section 88, 119(2)(b), 184, Tax Administration Act 1994

Introduction

An amendment allows an Order in Council to be made to give effect under New Zealand income tax law to the double tax agreement (DTA) relating to Taiwan. A number of consequential amendments have also been made to ensure that the provisions of the Income Tax Act can apply to this DTA.

Several other amendments seek to rationalise the various references to DTAs in the Income Tax Act to make them more concise, direct, and user-friendly.

Background

In the joint communiqué on the establishment of diplomatic relations between New Zealand and the People's Republic of China of 21 December 1972, the New Zealand Government recognised the Government of the People's Republic of China as the sole legal government of China. This position is often referred to as New Zealand's "one-China policy".

In 1996 a DTA relating to Taiwan was signed between the New Zealand Commerce and Industry Office in Taiwan and the Taipei Economic and Cultural Office. This DTA is a private, non-governmental agreement that has no legal effect in New Zealand on its own. Because the New Zealand Government wished to give effect to the terms of this agreement under New Zealand income tax law, amendments to the Income Tax Act and the Tax Administration Act were necessary. Giving effect to this DTA under New Zealand income tax law should not be interpreted as implying New Zealand recognition of Taiwan.

Key features

The main amendment is to section BH 1 of the Income Tax Act 1994, which empowers Orders in Council to be made to give effect to DTAs under New Zealand income tax law. This provision previously allowed Orders in Council to be made to give effect only to DTAs negotiated between the New Zealand Government and the governments of other countries. The DTA relating to Taiwan is a private, non-governmental agreement made between the New Zealand Commerce and Industry Office in Taiwan and the Taipei Economic and Cultural Office. As this DTA has not been made between two governments, an amendment to section BH 1 was required to enable an Order in Council to be made to give effect to it under New Zealand income tax law.

Consequential amendments have also been made to the Income Tax Act 1994 to ensure that the provisions of the Act can apply to both DTAs negotiated with other governments and the DTA relating to Taiwan. The Income Tax Act provisions which have been amended are sections LC 1 (5), LC 7 (1)(b), and OE 6. A consequential amendment has also been made to section 88 of the Tax Administration Act.

Several other amendments have been made to rationalise the various references to DTAs in the Income Tax Act and the Tax Administration Act. These amendments mainly involve replacing expressions such as "provisions of arrangements to which effect is given by an Order in Council made under section BH 1" with the term "double tax agreement". The amendments make the provisions relating to DTAs in the Income Tax Act and the Tax Administration Act more concise, direct, and user-friendly. The provisions amended in the Income Tax Act are sections LF 1 (2)(a)(v), NC 18 (1)(a), OD 5 (10) and the definitions of "eligible company", "foreign company", and "qualifying amalgamation" in section OB 1. The provisions amended in the Tax Administration Act are sections 119(2)(b) and 184.

Application date

The amendments apply from the date of enactment, 23 September 1997.

Exempt income – Reference to Social Welfare (Transitional Provisions) Act

Section CB 5 (1)(f)

Introduction

Section CB 5 (1)(f) has been amended to refer to the Social Welfare (Transitional Provisions) Act 1990. This ensures that overseas pensions that reduce the amount of transitional retirement benefit receivable are treated as exempt income, and all income-tested benefits are treated consistently. Veterans' pensions, also paid under that Act, have been excluded from paragraph (f), as they are paid on a gross basis.

Background

Section CB 5 (1)(f) exempts from tax any overseas social security pension that is subject to the direct deduction policy. Under this policy, the benefit to which the beneficiary is entitled is reduced by the overseas pension dollar for dollar. To the extent that the pension reduces the benefit payable, it is not taxable.

Key features

- Section CB 5 (1)(f) refers to the Social Welfare (Transitional Provisions) Act 1990.
- Veterans' pensions, paid under the Social Welfare (Transitional Provisions) Act 1990, are not subject to section CB 5 (1)(f).

Application date

These amendments apply retrospectively from 1 April 1996, the date from which recipients of transitional retirement benefits received their United Kingdom pension directly from the UK Department of Social Security.

Exempt income – special banking option

Section CB 5 (1)(fa)

Introduction

Section CB 5 (1)(fa) has been amended to ensure that the equivalent amount of income-tested benefit (transitional retirement benefit, 55+, widows' or invalids' benefit) paid out under the special banking option is subject to tax. This amendment extends the special banking option to income-tested beneficiaries.

Background

A special banking option for United Kingdom pensioners came into operation on 1 April 1997. The option provides for overseas pensions to be paid into a special bank account, with this money being drawn down by the Department of Social Welfare. In return, UK pensioners receive an equivalent amount of New Zealand superannuation or veteran's pension.

Section CB 5 (1)(fa) exempts from tax any overseas social security pension which is subject to the special banking option. Under section 70 of the Social Security Act 1964, the benefit to which the beneficiary is entitled is reduced by the overseas pension dollar for dollar. To the extent that the pension is so reduced, it is not taxable. The equivalent amount of benefit paid, NZS or veteran's pension, is taxed in full.

The amendment extends this policy to income-tested benefits.

Key features

Income-tested benefits (transitional retirement benefit, 55+, widow's or invalid's benefit) paid out under the special banking option are subject to section CB 5 (1)(fa). The equivalent amount of benefit paid is taxable in full.

Application date

The amendment applies retrospectively from 1 April 1997, the date from which the special banking option came into operation.

Controlled foreign company currency translations
(Section CG 11)

Introduction

An amendment requires financial arrangements of controlled foreign companies (CFCs) above a certain minimum amount to be translated into New Zealand currency in all cases. This removes the opportunity for taxpayers to choose a reporting currency for their CFCs that creates a foreign exchange loss, even though there may be no economic loss.

An amendment has also been made to require the branch equivalent income or loss of a CFC to be calculated in the same currency each accounting period, unless the Commissioner of Inland Revenue agrees that there is a genuine, non-tax related business reason for a change in the reporting currency.

Background

The CFC regime is a vital component of New Zealand's international tax rules. It ensures that income earned by foreign companies controlled by New Zealand residents is subject to New Zealand tax as it is earned.

The branch equivalent income or loss of a CFC is generally calculated using New Zealand tax rules as if the CFC were a New Zealand resident company, which would involve translating the income and expenses of the CFC into New Zealand currency on an item-by-item or a transactional basis. This would be done using the exchange rate prevailing between the New Zealand currency and the foreign currency in which the income or expenses are denominated when the income is derived or the expenses are incurred.

When the CFC tax regime was designed, it was considered that requiring the income and expenses of a CFC to be translated into New Zealand currency on an item-by-item basis would impose unnecessary compliance costs. Therefore a low compliance cost option (former section CG 11 (3)) giving taxpayers the choice of calculating the branch equivalent income or loss of a CFC in the currency in which it prepares its financial accounts was included in the legislation. If the CFC does not prepare financial accounts, its income or loss is calculated in the currency of its country of residence. The amount of income or loss calculated in the particular foreign currency is then translated into New Zealand currency at the average of the close of trading spot exchange rates for the fifteenth day of each complete month falling within the CFC's accounting period.

However, the currency translation rules in former section CG 11 (3) effectively allowed taxpayers to calculate the branch equivalent income or loss of a CFC in any foreign currency (in contrast to rules applying generally that require income to be calculated in New Zealand currency). Taxpayers were able to use the former legislation to generate foreign exchange losses for their CFCs, even though there may have been no economic loss. Typically, this involved a financial arrangement between related offshore entities. For example, one entity calculated its income using a currency producing a foreign exchange loss against the currency in which the loan is denominated, while the other entity used a different currency, thus avoiding an offsetting foreign exchange gain. This usually occurred after the end of a CFC's accounting period, using historical information on how exchange rates varied during the period.

The amendments remove the opportunity for taxpayers to make ex post facto currency choices by requiring the financial arrangements of CFCs above a certain minimum amount to be translated into New Zealand currency in all cases. The solution safeguards the CFC tax base.

Key features

Section CG 11 has been amended to prevent the creation of artificial foreign exchange losses under section CG 11 (3). This provision used to allow a taxpayer to choose the currency in which it calculated its branch equivalent income or loss. The amendments will exclude the application of this provision in determining foreign exchange gains and losses for all financial arrangements of a CFC if:

- the total value of the CFC's financial arrangements on any day in its accounting period exceeds one million dollars, or
- the net foreign exchange loss of a CFC in relation to financial arrangements in an accounting period (calculated under section CG 11 (3)) exceeds $100,000.

In such cases, foreign exchange gains or losses will be determined in relation to New Zealand currency, instead of the currency chosen by the taxpayer under section CG 11 (3).

However, this amendment does not apply to financial arrangements which are variable principal debt instruments denominated in the same currency as the reporting currency of the CFC and where the other party to the arrangement is not an associated party. The foreign exchange gains or losses of such arrangements will continue to be determined in relation to the currency chosen under section CG 11 (3). The main effect of this exception is exclude the local bank accounts of CFCs from the amendment.

An amendment has also been made to require the branch equivalent income or loss of a CFC to be calculated in the same currency each accounting period. A change to the reporting currency will be allowed only if the Commissioner agrees that there is a genuine, non-tax related business reason for the change. Such consistency of accounting treatment will result in a more accurate determination of income over time.

Application date

The amendments apply to any accounting period of a CFC that ends on or after 17 June 1997.

Non-executive directors' non-cash benefits

Sections CF 2 (1A), CI 1 (na), 2 (3), and OB 1

Introduction

The fringe benefit tax legislation has been amended to treat non-cash benefits received by shareholders solely in their capacity as non-executive directors as exempt from fringe benefit tax and subject to the dividend rules. The amendments clarify the legislation to reflect the original policy intention.

Background

In 1992 amendments were made to the fringe benefit tax rules to clarify the tax treatment of non-cash benefits received by shareholder employees. Generally, non-cash benefits received by shareholder employees were to be fringe benefits subject to fringe benefit tax if derived in an employment capacity.

The legislation was deficient because it required that before a benefit could be exempt from fringe benefit tax it was first to be a non-cash dividend. This was not possible when the benefit was conferred in an employment capacity because the benefit did not satisfy the shareholder capacity test as required by the dividend rules. The benefit would, therefore, be a fringe benefit subject to fringe benefit tax, contrary to its policy intent.

The amendments clarify the legislation to reflect the intention of the original policy.

Although the provision applies to non-executive directors and company secretaries, under the Companies Act 1993 the statutory role of company secretary no longer exists. Therefore the amendments apply to non-executive directors only.

Key features

- Non-cash benefits received by a non-executive director shareholder will be treated as exempt from fringe benefit tax and subject to the dividend rules under section CI 2 (3) when that person has no other employment relationship with the company beyond the formal occupation and statutory obligations of a non-executive director.
- The provision no longer applies to company secretaries because that statutory role does not exist under the Companies Act 1993.

Application date

The amendments will apply from the date of enactment, 23 September 1997.

Depreciation

Sections DJ 6, DJ 9, EG 2, EG 8, EG 12, EG 16A, EG 17, EG 19, EN 2, EZ 11, OB 1, OD 8 and Schedule 17, Income Tax Act 1994
Section 117 Income Tax Act 1976
Section 594ZM Local Government Act 1974

Introduction

Various amendments have arisen from the post-implementation review of the depreciation legislation. Many are minor technical changes, while other amendments reflect more significant policy changes.

Background

Post implementation review of legislation is a key stage of the Government's Generic Tax Policy Process, designed to ensure the effectiveness of tax legislation. The depreciation rules enacted in 1993 are the first legislation to be reviewed under this process. The continuing review has resulted in previous remedial legislation.

The measures enacted in the latest legislation are largely as introduced into Parliament. However, one key change was made at the Select Committee stage of the bill. New section EG 17, relating to the purchase of depreciable property from an associate, applies only to property acquired after 23 September 1997, the date of enactment. The previous section EG 17 is now section EZ 11. This applies to depreciable property acquired on or before 23 September.

Key features

- Section EG 2 has been amended to make it clear that, in order to claim a depreciation deduction, an asset must be used or available for use in producing income or in a business.
- Sections EG 2 and EG 8 have been amended to provide that costs incurred in respect of fixed life intangible property, subsequent to the acquisition of the property, are added to the adjusted tax value of the property at the beginning of the year in which the additional costs are incurred and the total is amortised over the remaining legal life of the property.

- Section EG 12, which provides for the write-off of unused depreciable property, has been amended to clarify the circumstances in which the Commissioner can authorise the write-off.
- A new section EG 16A has been inserted to permit taxpayers to elect that an asset will not be depreciable.
- Copyright in a sound recording is depreciable if copies of the recording are released to the public and the copyright is acquired on or after 1 July 1997.
- There is a refinement to the definition of "estimated useful life" which will apply when the Commissioner sets the depreciation rate for copyright in a recording.
- Section EG 17 has been redrafted to more accurately reflect its intent to restrict the base value of an asset purchased from an associate to the lower of:
  - the cost of the asset to the vendor; and
  - the cost of the asset to the purchaser.

  The restrictions on the base value of an asset do not apply if the proceeds of sale are gross income to the vendor.
- Section EG 17 has also been expanded to include restrictions on:
  - the ability to depreciate intangible assets acquired from an associate; and
  - the depreciation rate to be applied to an asset acquired from an associate.
- Several amendments have been made to section EG 19, which relates to the disposition of depreciable property, to provide for property that is irreparably damaged, lost or stolen. Such property is deemed to have been disposed of for the amount of any insurance payment made in respect of the property.
- Three amendments have been made to the legislation which provides for the tax treatment of patents:
  - Section EN 2 has been amended so that, in calculating the profit or loss on sale of a patent, the cost of the patent is reduced by depreciation deductions allowed. This provides a mechanism within section EN 2 to prevent a double deduction where a patent is sold for less than its cost.
  - The ability to spread income derived on the sale of a patent right has been removed.
  - Section DJ 6 (1) has been amended to limit the ability to obtain an immediate deduction for costs incurred in obtaining the grant, renewal or maintenance of a patent to patents acquired before the date of enactment of the amendment. The general rules for determining whether expenditure is on revenue or capital account will apply.

Application dates

The amendments are generally effective from the date of enactment: 23 September 1997. There are four exceptions, however:

- Copyright in certain sound recordings is depreciable if acquired on or after 1 July 1997.
- Subsection EG 17 (7), relating to the transfer to an associate of intangible property that is non-depreciable to the vendor, will apply to transfers on or after 1 July 1997. The related amendments to the definition of "associated person" in section OD 8 (3) also apply from this date.
- The balance of section EG 17 applies to property **acquired** after 23 September 1997.
- Irreparably damaged assets are deemed to be disposed of for the amount of any insurance proceeds received in relation to the damage, with effect from the 1993-94 income year. For those who have applied existing law, there is a savings provision which deems a disposal to occur at market value.

Detailed analysis

Link between depreciation and derivation of income

Section EG 2 (1)(e) has been amended to clarify that, for a taxpayer to obtain a depreciation deduction, depreciable property must be used or available for use in deriving income or in a business. Previously, apportionment under paragraph (e) occurred only if property was *used* for non-business purposes. It did not apply if the property was not used at all.

Example 1

In April 1998 a taxpayer purchases equipment in anticipation of setting up a home tutoring business in the near future. The equipment cost $5,000. She in fact commences business on 1 March 1999. The depreciation deduction for the 1998-99 year is $42.46, calculated as follows in accordance with the formula in section EG 2 (1)(e). (The calculation is based on a straight-line depreciation rate, including the loading, of 10%.)

Formula: d x f/g = $500 x 31/365 = $42.46

d = 10% x $5,000 x 12/12 = $500
f = 31 days
g = 365 days

Additional costs of fixed life intangible property

Two amendments relate to the tax treatment of fixed life intangible property (FLIP). Under new section EG 2 (3), and an amendment to section EG 8:

- additional costs incurred in relation to a FLIP during its legal life are added to the tax book value of the FLIP at the beginning of the income year in which the costs are incurred; and
- the aggregate costs are depreciated over the remaining legal life of the FLIP (calculated from the beginning of that year).

The depreciation rate in relation to the FLIP therefore changes. In effect, the FLIP is treated as newly acquired from the beginning of that year for the aggregate of the tax book value and additional costs.

Example 2

A taxpayer acquires a right to use a copyright for five years for $10,000 and has an option to renew for a further five years on payment of an additional $5,000. The legal life is therefore ten years, the depreciation rate is 10%, and the annual depreciation deduction is $1,000.

In the first five years, he claims annual deductions amounting to $5,000. In year 6, the $5,000 is paid.

The aggregate of the tax book value and additional costs are $10,000 ($5,000 + $5,000). Under section EG 8, the depreciation rate in years 6 to 10 will be 20% (1/remaining legal life of the right = 1/5).

The annual depreciation deduction in years 6 to 10 is therefore $2,000.

Write-off of unused depreciable property

Section EG 12 (1) has been amended to clarify the circumstances in which the Commissioner may sanction the write-off of an unused asset. The Commissioner must be satisfied that:

- the taxpayer no longer uses the asset;
- neither the taxpayer nor an associate intends to use the asset in the future; and
- it is uneconomic to dispose of the asset.

There is no longer a requirement that the property *can* no longer be used.

Election not to depreciate

Section EG 16A has been introduced to permit taxpayers to elect prospectively, or retrospectively, that an asset will not be depreciable property. The election is effective from the time of the acquisition of the asset, or its entry into the tax base, until the asset is disposed of or exits the tax base.

Therefore the provision does not permit taxpayers to "pick and choose" the years in which they depreciate the asset. It does, however, envisage that if an asset (such as a residential property that is let temporarily) periodically enters and exits the tax base, taxpayers may choose whether or not to depreciate the property for each period.

If a taxpayer makes such an election, the asset is not "depreciable property" (see new paragraph (b)(ix) of that definition). Therefore the depreciation recovery/loss on sale provisions in section EG 19 do not apply to the asset.

Example 3

On 1 November 1997 a taxpayer who owns his own home goes overseas for six months and lets the property. On his return he resumes living in the house. He thinks that any depreciation claimed in relation to his home will be clawed back and therefore does not claim depreciation in his 1997-98 or 1998-99 returns. He elects under section EG 16A (2) in his 1997-8 return that the property is non-depreciable.

Under subsection (5) the election has effect until the property is deemed to be disposed of under section EG 19 (9) – 1 April 1999.

Copyright in sound recordings is depreciable property

Copyright in sound recordings has been added to the list of depreciable intangible property contained in Schedule 17. "Sound recording" is defined in section OB 1 and has the same meaning as in the Copyright Act 1994.

In order to be depreciable:

- the copyright must be produced or purchased on or after 1 July 1997; and
- copies of the sound recording must be on sale to the public.

Copyright in a recording that is produced on or after 1 July will therefore not be depreciable until copies of the recording are released. If the copyright is purchased by a taxpayer from an unrelated party on or after 1 July, the copyright will be depreciable from that time if copies of the recording have been released.

A recording of a work is frequently edited before the final master is produced. Since copyright may exist in every edited version of the recording, there may be some uncertainty about the stage at which the copyright is "produced". Section OB 1 therefore defines "copyright in a recording" to mean the copyright in the version of the recording of which copies have been sold or offered for sale to the public. This means that copyright in a recording is produced when the final edited version of the recording is made.

The Commissioner will set the depreciation rate for copyright in a recording and, in doing so, will use the amended definition of "estimated useful life" which applies for that purpose.

Transfer of depreciable property between associates

A new section EG 17 applies to property acquired after 23 September 1997. The former section EG 17 (now section EZ 11) applies to property acquired before that date.

Restriction on base value of asset – section EG 17 (1), (2) and (3)

Broadly, subsection (1) restricts the base value of an asset purchased from an associate to the lower of:

- the price the seller originally paid for the asset; and
- the price paid by the buyer.

Paragraph (a) applies to transferred property that was depreciable to the vendor. It also applies to the transfer of a lessee's interest in a lease granted before 1 April 1993 if the transferor was amortising a premium paid on the lease under section EZ 6.

Paragraph (b) applies if the property would have been depreciable to the vendor had the vendor incurred a capital cost in relation to the property. It therefore prevents the write-up of an asset from 0 cost to market value by transfer to an associate. It also specifically applies to the transfer of a lessee's interest in a lease granted before 1 April 1993 if the transferor paid no premium on the grant of the lease.

Subsection (1) therefore does not apply to property that is:

- trading stock of the vendor;
- used for private purposes by the vendor; or
- owned by a non-resident vendor who is not entitled to claim a depreciation deduction in relation to the property.

Paragraph (c) ensures that it is not possible to avoid the application of section EG 17 (1) by the vendor electing that the property is non-depreciable.

Example 4

In October 1996 a self-employed person buys a car for $20,000 to use in her business. She depreciates the car for 12 months and then sells it for $25,000 to a company which she has incorporated to own the business.

Subsection EG 17 (1)(a) applies. The company may depreciate the car only from a base value of $20,000. The depreciation recovery provisions apply to the seller in the usual way – all she claimed is recovered on the sale of the car to the company.

If the seller depreciated the asset from its market value, rather than its cost, as a result of applying paragraph (a)(iii) of the definition of "adjusted tax value", the cost to the purchaser is the lower of that value and the purchaser's actual cost.

The restrictions on the base value of an asset do not apply in the circumstances set out in section EG 17 (3). The two most important are:

- if the proceeds of sale are income to the vendor (there is generally no incentive to transfer the property to an associate in this situation);
- if the Commissioner exercises the discretion in subsection (2). The Commissioner continues to have a discretion, in relation to tangible property, to allow the purchaser to base its depreciation deductions on the price paid by the purchaser. This discretion will be considered along with other discretions in the Act as part of the codification of self-assessment.

Restriction on the depreciation rate applicable to the asset – section EG 17 (4)

Subsection EG 17 (4) restricts the depreciation rate that may be applied to an asset acquired from an associate. The purchaser cannot depreciate the transferred property at a higher rate than that applied to the property by the vendor. The restriction applies only if the asset was depreciable to the vendor.

The restriction does not apply to fixed life intangible property (FLIP). The depreciation rate for a FLIP is calculated using the formula in section EG 8, which spreads the cost of a FLIP evenly across its remaining life.

Example 5

A company purchased a building in 1990 and depreciated it at 1% straight line (the depreciation rate applicable to such a building acquired before the 1993-94 year). In November 1997 the building is sold to an associated company.

The associate must continue to depreciate the building at 1% straight line or its diminishing value equivalent (1%) determined by reference to Schedule 10.

The provision has an "avoidance" character in that it targets only transfers which would result in an increase in the depreciation rate applied to the asset. The normal provisions apply if a transfer between associates results in a lower rate being applied to the asset.

Restrictions apply to direct or indirect transfers of property – section EG 17 (5)

The restrictions on the base value of an asset, and the depreciation rate that may be applied to it, apply if the asset is transferred directly or indirectly to an associate.

Transfer of depreciable intangible assets that are not depreciable to the vendor – section EG 17 (7)

Subsection (7) targets the transfer of intangible property that was not depreciable to the vendor because it was not generally amortisable or depreciable at the time it was acquired by the vendor.

If the property is transferred to an associate, it remains non-depreciable to the associate, even though property of that type has become depreciable since the vendor acquired it.

The provision therefore prevents intangible property being transferred to an associate in order to bring it within the depreciation rules. The restriction applies to intangible property transferred on or after 1 July 1997 (the date a new item of intangible property – copyright in recordings - was added to Schedule 17).

Paragraph (b) was inserted on the recommendation of the select committee that considered the bill and submissions. It is intended to exclude from the restriction property that, while not technically depreciable before 1 April 1993, was in substance depreciable by virtue of an amortisation provision. This includes patents and a lessee's interest in a lease.

Therefore subsection (7) does not apply if a lessee's interest in a lease granted before 1 April 1993 is transferred to an associate. Subsection (1) applies to such a transfer to restrict a write-up of the base value. The outcome would be the same if subsection (1)(b) applied - no deduction would be available to the purchaser - but would differ if subsection (1)(a) applies.

Because of changes to the definition of "associated person" in OD 8 (3), the restriction applies if the vendor is resident or non-resident.

Example 6

A company acquired plant variety rights in a new breed of rose in August 1992. Plant variety rights are added to Schedule 17 and become depreciable if acquired after 1 November 1998. The company transfers the rights to an associated company in December 1998. The rights are not depreciable to the associate because:

- plant variety rights were not included in Schedule 17 when the rights were acquired by the company; and
- the company was not able to amortise the cost of the rights under the Tax Act.

Cross references

Various cross-references to the former section EG 17 in the Income Tax Act, and in section 594ZM(3) of the Local Government Act (which relates to local authority trading enterprises), have been changed.

Irreparably damaged property

The pre-1993 rule that irreparably damaged property is deemed to be disposed of for the amount of any insurance proceeds received in relation to the damage has been reinstated in section EG 19 (6A). The amendment applies from the 1993-94 income year unless taxpayers have relied on the post-1993 law and treated the disposal as having occurred at market value.

Example 7

A courier company buys a car on 1 April 1995 for $20,000. The straight-line depreciation rate applied to the car is 10%. The annual depreciation deduction is therefore $2,000.

On 1 April 1998 the car is involved in a crash and is written off. The company receives an insurance payout of $18,000.

In the three years before the crash the company had claimed depreciation deductions amounting to $6,000. The tax book value of the car is therefore $14,000.

The car is deemed to have been disposed of for $18,000 under section EG 19 (6A). Consequently $4,000 will be treated as depreciation recovered on disposal.

Lost or stolen property

Section EG 19 (6A) and (9)(viii) deem property that is lost or stolen in an income year, and not recovered before the end of the income year, to have been disposed of for the amount of any insurance proceeds received (or for no consideration if there is no insurance).

Section EG 19 (5) has been consequentially amended. It provided for the amount of insurance proceeds received in relation to the loss, theft or damage of an asset to be deducted from the adjusted tax value of the asset. It no longer applies to lost and stolen property, only to damaged property that continues to be used.

These amendments ensure that taxpayers can now write off a lost or stolen asset if it is uninsured, or the insurance proceeds received are less than the adjusted tax value of the asset.

Recovery of lost or stolen property

New section EG 19 (6B) applies in the unlikely event that lost or stolen property is recovered, still owned by the taxpayer (because it is uninsured), and used again in its business.

Any write-off in the year of loss or theft is reversed in that year or in the year of recovery of the asset, and the taxpayer is deemed to have acquired the asset on the date of recovery for its adjusted tax value at the beginning of the year of loss or theft.

Patent expenses

Immediate deduction for certain patent costs

Section DJ 6 (1) has been amended to remove the right to an immediate deduction for certain costs associated with the grant, maintenance and extension of patent rights. (The section targets application fees rather than the costs of devising an invention.) Such costs will be deductible only in relation to patents acquired before 23 September 1997.

For patents acquired after that date, the general deductibility rules will apply to determine whether such costs are immediately deductible or must be capitalised and amortised over the life of the patent.

Removal of income spreading on sale of patent

The Commissioner's discretion to permit the spreading of income from the sale of patent rights has been removed, with effect from 23 September 1997. The amendment will not affect existing spreading arrangements.

Deduction for adjusted tax value of patent on sale

Section EN 2 (3)(c) has been amended to provide that, on the sale of a patent acquired on or after 1 April 1993, a deduction is allowed for the cost of the patent *less any depreciation deductions taken.* There is no depreciation recovery/loss on sale adjustment on the sale of the patent (see new subsection EN 2 (3A)). If a patent leaves the tax base without being sold, the depreciation recovery provisions still apply.

These amendments ensure that no double deduction is available if a patent that has been depreciated is sold for less than its cost. Although the double deduction would be disallowed under section BD 4 (4), it should not be necessary to rely on this.

Example 8

A taxpayer acquired a patent on 1 April 1994 at a cost of $20,000. The patent has a life of 20 years and is depreciated as fixed life intangible property. On 1 April 1999 he sells the patent rights for $15,000. Over the five years he has deducted $5,000 by way of depreciation.

Under section EN 2 the taxpayer is allowed a deduction for the remaining $15,000 of the cost of the patent. The $15,000 sale proceeds are gross income and must be included in the taxpayer's tax return for the 1999-2000 income year.

Assignments and settlements of income

Sections FC 11 and OB 1

Introduction

The provision relating to short-term assignments and settlements of income has been repealed. This means that when property or income is transferred for a period of less than seven years the income will not automatically be deemed to be derived by the transferor.

Background

Section FC 11 was originally introduced in 1950 by the Land and Income Tax Amendment Act (No 2) because taxpayers were assigning a proportion of their incomes for short periods to children or other relatives on a lower tax rate. It was an anti-avoidance provision designed to counter income splitting within the family. It was originally intended to be a well-targeted provision, but proved to be unworkable. Various amendments over the years broadened its scope, and led to problems.

Although it was an anti-avoidance provision, section FC 11 was not discretionary, nor did it apply only where an arrangement had a tax avoidance purpose or effect. If a taxpayer came within its terms the provision automatically applied to determine who derived the income. This, coupled with the broad scope of the provision, enabled taxpayers to misuse it.

Key features

Section FC 11 has been repealed because it no longer fulfils its original function. Over time the provision had been amended so that it applied beyond family and related party transactions. The broad scope meant the provision could be used to achieve tax outcomes that were not intended.

Repeal does not signal that diversion of income to a taxpayer on a lower tax rate is an acceptable tax practice. The general anti-avoidance provisions will be used if such arrangements have a purpose or effect of tax avoidance.

Interpretative guidelines have been developed by the courts in relation to when alienation of income and short-term transfers of income earning property constitute tax avoidance. Features of an arrangement that indicate that tax avoidance is occurring include:

- Transfers of income or property are short-term.
- The arrangement has little real effect on business or income earning activity.
- The transaction cannot be described as an ordinary family or commercial transaction.
- A high degree of control over the earning of the income or the disposition of the property is a part of the arrangement.
- There is a close family or business relationship between the parties to the transactions.

Application date

The amendment applies from 1 April 1998 to all assignments and settlements in existence at that date and entered into after that date.

Transfer pricing

Section GD 13

Introduction

The transfer pricing rules previously discouraged non-residents from providing low cost capital to their New Zealand subsidiaries in the form of nil or low rate fixed rate share capital by requiring a market rate of return. Such capital has been excluded from the transfer pricing rules as it is in New Zealand's interests to receive this type of low cost capital.

Background

The inclusion of fixed rate shares in the transfer pricing rules was mainly designed to cover the provision of low or nil rate fixed rate share capital by a New Zealand company to its offshore subsidiary. It is appropriate to apply the transfer pricing rules in this case because no, or inadequate, income is being earned on the relevant capital, which is detrimental to the New Zealand tax base. However, it is in New Zealand's interests for non-residents to provide low cost fixed rate share capital to their New Zealand subsidiaries. It is appropriate, therefore, for the transfer pricing rules not to apply to this type of supply.

The previous application of the transfer pricing rules to inbound fixed rate share capital forced New Zealand subsidiaries using such financing to pay arm's length rate dividends to their non-resident parents which they may otherwise not have paid. This resulted in investment capital being taken out of New Zealand, which is not in New Zealand's interests.

Section GD 13 (5) provides that the transfer pricing rules (in particular, section GD 13 (4)) do not apply to certain supplies made by non-residents. This exception was designed to ensure that the transfer pricing rules apply only if the transfer pricing arrangement results in a net depletion of the New Zealand tax base.

Key features

Section GD 13 (5) has been amended to ensure that the transfer pricing rules do not discourage non-residents from providing low cost capital to their New Zealand subsidiaries in the form of nil or low rate fixed rate share capital (inbound fixed rate share capital). This is achieved by excluding such capital from the transfer pricing rules.

Application date

The amendment applies from the start of the 1996/97 income year, the application date of the new transfer pricing rules.

Qualifying companies – exempt dividends distributed to beneficiaries

Section HG 13 (1)(a), Income Tax Act 1994
Section 393M (1A), Income Tax Act 1976

Introduction

The qualifying company legislation has been clarified to ensure that exempt dividends received by a trustee shareholder from a qualifying company are not subject to tax in the hands of beneficiaries.

Background

Previously, dividends paid by a qualifying company were either fully imputed or exempt from income tax. Uncertainty arose over whether exempt dividends distributed by a qualifying company to a trustee shareholder retained their exempt status when passed through to beneficiaries as beneficiary income. The amendments clarify that they do.

Key feature

A new section HG 13 (1) has been introduced to the Income Tax Act 1994 to cover dividends distributed to beneficiaries. Exempt dividends paid to trustees will retain their exempt status when distributed to beneficiaries.

A new section 393M (1A) in the Income Tax Act 1976 mirrors the amendment.

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 1992, the date the qualifying company regime came into force.

Loss attributing qualifying company – shareholder majority elections

Sections HG 14A, 15

Introduction

For the purpose of electing to become a loss attributing qualifying company, shareholders will be allowed to make a majority election. Also, the revocation of election provisions for loss attributing qualifying companies will be simplified by adopting the same revocation rules applying to qualifying companies. This will reduce compliance costs for taxpayers and simplify the administration of the loss attributing qualifying company rules.

Background

When the qualifying company rules were introduced into Parliament, to become a qualifying company or a loss attributing qualifying company required a unanimous election by shareholders. During the select committee process this requirement was relaxed for qualifying companies but not for loss attributing qualifying companies. The difference in election requirements created additional compliance and administrative costs. In certain circumstances a unanimous election might be impossible to obtain (for example, when a minority shareholder cannot be contacted), so shareholders were unable to take advantage of the benefits which the loss attributing qualifying company rules provide.

Key features

The bill introduces two specific amendments to the loss attributing qualifying company rules:

- A new section HG 14A has been inserted to allow shareholders to make a majority election to become a loss attributing qualifying company.
- Section HG 15 has been amended by removing provisions from the loss attributing qualifying company revocation rules and applying the revocation rules of the qualifying company regime to loss attributing qualifying companies. This allows sections HG 3 (4), 3(5), 5, 6 and 7 to apply to loss attributing qualifying companies.

Application date

The amendments will apply from the date of enactment, 23 September 1997.

Charitable organisations – addition

Section KC 5(1)

The African Enterprise (New Zealand) Aid and Development Fund has been granted charitable donee status.

From the 1998-99 income year, donations made to the Fund will entitle individual taxpayers to a rebate of 33 1/3 percent of the amount donated. The maximum rebate for all donations is $500 per annum. A company (other than a closely held company) will be entitled to a deduction from net income up to the amount prescribed by section DJ 4.

Independent family tax credit

Section KD 7

Introduction

An amendment allows Inland Revenue to backdate payment of the independent family tax credit (IFTC) to when a beneficiary's main Income Support benefit stopped, rather than pay arrears at the end of the income year.

The amendment is designed to assist beneficiaries leave the benefit system.

Background

When beneficiaries move into the workforce there can be a gap of several weeks before they receive their first IFTC payment. This gap may have meant that some beneficiaries could not afford to move off the benefit.

The change follows similar changes made in 1995 to the payment of family support and the guaranteed minimum family income and is designed to assist beneficiaries to move off income-tested benefits. The changes made to family support and the guaranteed minimum family income arose from an Employment Task Force recommendation and are detailed in TIB Volume Six, No. 12, page 20 and TIB Volume Seven, No. 9, page 17.

Key features

Inland Revenue will be able to pay arrears of IFTC back to the date that Income Support ceases payment of a beneficiary's main benefit.

Section KD 7 has been amended to allow this and to correct a cross-reference.

Application date

The change applies from the date of enactment, 23 September 1997.

Excess imputation credit conversion rate for trustees

Section LB 2 (3)(b)(iii)

Introduction

The tax rate at which trustees can convert excess imputation credits has been aligned with the 33% tax rate applying to all trustees (except the Maori Trustee).

Background

Trustees can convert excess imputation credits to tax losses at the extra emolument rate of 24% (during the 1997/98 income year). This inappropriately allows a greater tax loss than if the credits were converted at the tax rate applying to trustee income, 33%.

For example, $100 of excess imputation credits should give rise to a tax loss of $303, instead of a tax loss of $417 if the extra emolument rate has been used (the greater tax loss being $114). (These figures have been rounded.)

The tax rate at which trustees can convert excess imputation credits has been aligned with the 33% tax rate applying to all trustees (except the Maori Trustee). The extra emolument conversion rate that formerly applied was intended to cater for individuals.

Although this amendment may be seen as having retrospective effect, taxpayers have generally not been negatively affected because excess imputation credits can be ascertained only at the end of an income year.

Key features

The tax rate at which trustees can convert excess imputation credits is 33%. This does not apply to the Maori Trustee, for whom there are special rules.

Application date

The amendment applies from the 1997/98 income year.

Annual conversion rate for excess imputation credits

New section LB 2 (3)(b)(iv)

Introduction

Taxpayers converting excess imputation credits to tax losses under section LB 2 (3)(b)(iii) are required to use the rate of tax deduction on payment of extra emoluments applying for that income year. That rate, specified in clause 8 of Schedule 19, applies to every payment of an extra emolument. Amendments specify annual conversion rates of 25%, 24%, and 21.75%. These first and last rates deal with the problem when two or more extra emolument rates apply during an income year.

Background

Section LB 2 (3)(b)(iii) provides a method to convert excess imputation credits to tax losses. It states that item "b" (of the conversion formula a/b) is "the rate of tax deduction on payment of extra emoluments, expressed as a percentage, stated in clause 8 of Schedule 19 and applying for that income year."

The rate specified in clause 8 of Schedule 19 applies to payments of "extra emoluments", as that term is defined in section OB 1. Extra emoluments are lump sum payments made in relation to employment which are not for overtime, nor regularly included in a pay period. However, the extra emolument rate in clause 8 of Schedule 19 is a rate for every payment, not a rate for an income year as required by section LB 2 (3)(b)(iii).

The new legislation specifies an annual conversion rate for the purposes of converting excess imputation credits.

The annual conversion rate will be set with reference to the extra emolument rate applying for that income year. When two or more extra emolument rates apply for an income year, the annual conversion rate will be calculated as the weighted average of the rates applying during that income year.

Key features

- The annual conversion rate for the 1996/97 income year is 25%. This is the weighted average of the extra emolument rate of 28% applying for the period 1 April 1996 to 30 June 1996 and the extra emolument rate of 24% applying for the period 1 July 1996 to 31 March 1997.
- For the current income year (1997/98), the extra emolument rate remains at 24%. Thus, the annual conversion rate will be 24%.
- The annual conversion rate for the 1998/99 income year is 21.75%. This is the weighted average of the extra emolument rate of 24% applying for the period 1 April 1998 to 30 June 1998 and the extra emolument rate of 21% applying for the period 1 July 1998 to 31 March 1999.

Application date

These amendments apply for the 1996/97, 1997/98, and 1998/99 and subsequent income years respectively.

Tax simplification: provisional tax

Sections MB 2, MB 2A, MB 3, MB 4, , MB 5A, MC 2 NC 15, NE 4 and OB 1 and Schedule 13, Income Tax Act 1994
Sections 92(4), 119, 120K, 140A, 141(14), 142E(3) and 178, Tax Administration Act 1994

Introduction

The provisional tax rules will be simplified and streamlined with effect from the 1998/99 income year.

The underlying principles of the reforms include retention of the "safe harbour" where use of money interest does not apply for people whose residual income tax is less than $30,000. The reforms also simplify the rules for larger taxpayers, and streamline them by removing inconsistencies.

The amendments will reduce compliance costs and remove many of the confusing features of the current provisional tax rules. The main ways this has been achieved is by removing the underestimation penalty, providing clear rules on interest starting dates and including rules for determining payments when a balance date changes.

Background

The current rules are a complex amalgamation of two regimes, one setting specified payment amounts to ensure payment during the year and the other providing incentives to pay through the application of use of money interest. The success of the latter method in ensuring payment has provided scope to simplify the rules, especially for those who pay use of money interest, through removal of the under estimation penalty.

The amendments follow consideration of the submissions received on the provisional tax proposals contained in the Government discussion paper *Tax Simplification Issues,* released August 1996.

Key features

- The definition of provisional taxpayer has been be expanded to cover those who had a reasonable expectation of being a provisional taxpayer and who paid provisional tax exceeding $2,500 during the year.
- The underestimation penalty and associated provisions have been repealed. Taxpayers will be required to take reasonable care when estimating.
- Use of money interest regime will begin from the first instalment date for all non-natural provisional taxpayers, natural provisional taxpayers who elect out of the safe harbour, those who hold a certificate of exemption for resident withholding tax (RWT) purposes, and trustees in respect of trustee income only.
- Provisional tax and terminal tax payments that fall due on 7 January will be treated as falling due on 15 January. Also due on 15 January will be the 5 January PAYE and SSCWT payments from larger employers.
- Provisional tax rules for those who change their balance date have been established. The pattern and number of provisional tax instalments and due dates have been prescribed, as has the amount payable on those instalment dates. Rules are also provided for determining the amount of provisional tax payable if a prior year is a transitional year (the year in which the taxpayer adopts a new balance date).
- Natural persons may be new provisional taxpayers. The new requirements are that their residual income tax (RIT) for the past four years was less than $2,500, their RIT for the current year exceeds $30,000, they cease to derive income from employment and begin to derive gross income from a business.
- If the Commissioner assesses or reassesses a taxpayer's prior year RIT on which current provisional tax instalments are based, the amended assessment affects only instalments falling more than 30 days after the amended assessment.

At the end of this item there is a summary chart of the old and new provisions.

Application date

The amendments apply from the 1998/99 income year.

Detailed analysis

Definition of provisional taxpayer

(sections MB 2A and, OB 1 of the Income Tax Act)

The definition of provisional taxpayer in section OB 1 has been amended to include a taxpayer who elects to be a provisional taxpayer. Because persons may now elect to be provisional taxpayers, provisions deeming them to be so in certain circumstances are no longer required. Therefore the term "person incorrectly assumed to be a provisional taxpayer", and associated provisions, have been repealed.

A new section MB 2A has been inserted into the Income Tax Act to allow taxpayers to elect to be provisional taxpayers. Taxpayers will be eligible to make the election if they pay provisional tax exceeding $2,500 in an income year and had a reasonable expectation of being a provisional taxpayer for that year. The section provides that:

- the election must be made in the tax return for that income year; and

- the taxpayer must have had reasonable expectation of being a provisional taxpayer at the point the first payment of provisional tax occurs.

This amendment comprehensively addresses the problem of taxpayers paying provisional tax in the expectation that they would be provisional taxpayers, but turning out not to be and not receiving interest on the overpaid tax (although interest would have been charged had they been provisional taxpayers and underpaid their tax).

Removal of the underestimation penalty and amendment to related provisions

(sections MB 2 and MB 3, Income Tax Act 1994 and section 3(1), 119, 142E(3), 178, Tax Administration Act)

Several amendments have been made to the provisional tax rules to give effect to the removal of the underestimation penalty.

Section MB 2 (1)(c) of the ITA has been amended to remove the reference to taxpayers being required to furnish an estimate of their residual income tax liability. Section MB 2 (2) has been amended to remove the requirement that those with RIT over $300,000 in the current year and who had less than $2,500 RIT in the previous year are required to pay provisional tax. Although they are not required to make payments, they will still be affected by the use of money interest rules from the first instalment date under section 120K(1) of the Tax Administration Act unless they are also new provisional taxpayers.

Section MB 3 (2) of the ITA has been amended to remove the requirement on those with RIT over $300,000 to estimate their provisional tax payable. Subsection (3), which addresses the issue of compulsory estimators who do not actually estimate, has also been removed.

Section 140A of the TAA, which currently provides for the underestimation penalty, has been repealed, with consequential repeal of the associated remission provision (section 178) and the provision providing for the due date for the underestimation penalty (section 142E(3)).

Requirement for estimating taxpayers to take reasonable care

(Section MB 3, Income tax Act and sections 119 and 141(14), Tax Administration Act)

With the removal of the underestimation penalty and associated provisions, taxpayers will not be required to estimate their liability, but if they do they will have to take reasonable care in estimating the amount payable at each instalment date. If they pay more than last year's RIT they will be deemed to have taken reasonable care.

A new section MB 3 (4) of the ITA provides that taxpayers making an estimate or re-estimate must take reasonable care in doing so. Taxpayers must also ensure that their estimates are fair and reasonable at the time made and for any instalment to which they apply.

Section 119 of the TAA, which provides that the Commissioner may determine the amount of provisional tax payable, has been amended to provide that the Commissioner may determine the amount of provisional tax payable should an estimate applying at an instalment date not be fair and reasonable. This section has also been amended to specify that the amount the Commissioner may determine is capped at the amount of provisional tax that would have been payable had the taxpayer not estimated their liability.

Treatment of non-natural taxpayers with RIT less than $30,000

(Section 120K, Tax Administration Act)

Owing to the risk of deferred tax payments, interest on non-natural provisional taxpayers with RIT between $2,500 and $30,000 will now begin on the first instalment date. This provides a consistent treatment of all non-natural provisional taxpayers in that interest applies from the first instalment date regardless of their RIT. The new section 120K(1) of the TAA gives effect to this measure.

Natural persons who hold a certificate of exemption for RWT purposes and trustees, on trustee income, also currently face use of money interest from the third instalment date. They also now come under the interest rules from the first instalment date. The amended section 120K(1) of the TAA provides that use of money interest begins from the first instalment date, while the safe-harbour provided by 120K(4) does not apply to these taxpayers.

Moving early January PAYE, SSCWT and provisional tax instalments to 15 January

(Sections MC 1 (2), MC 2 (2), NC 15 (1)(b) and NE 4 (b))

Currently, three provisional tax instalments and one terminal tax date fall due on 7 January each year. Given the proximity to the Christmas/New Year holiday period, the due date for payment has been deferred until 15 January. This coincides with the due date for GST for those whose returns would otherwise be due on the last working day in December. Similarly, the 5 January PAYE payment due from large employers (those with $100,000 or more gross tax deductions and specified superannuation contribution withholding tax payable) has also been moved to 15 January. These changes are intended to reduce compliance costs.

A significant number of minor amendments were required to give effect to the changes to the provisional and terminal tax due dates.

- The definition of "first instalment date", "second instalment date" and "third instalment date" have been amended.
- The definition of "terminal tax date" and sections MC 1 (2) and MC 2 (2) of the ITA have been amended to provide for 15 January as a payment date.

- Section NC 15 (1)(b) has been amended to move the due date from 5 January to 15 January.
- Section NE 4 has been amended to provide a 15 January payment date for the SSCWT payment.

The amendments to SSCWT and PAYE come into force on 1 April 1998, so first apply to payments in January 1999. The provisional tax amendments apply to the 1998/99 income year, so also first apply to January 1999.

New balance date rules

(Sections MB 2 MB 3, MB 4, MB 5A, OB 1, and Schedule 13, Income Tax Act. Sections 119 and 120K, Tax Administration Act)

The standard provisional tax instalment rules are geared to a standard income year of 12 months, with instalments due on a recurrent basis, every four months. Rules outlining the treatment of a provisional taxpayer when a balance date change occurs have been introduced:

- The pattern and number of provisional tax instalments and due dates will be based on the old balance date, with payments required every four months. However, the final instalment date will continue to be the final month in the transitional year (the year the taxpayer changes balance date).
- Instalment amounts in the post-approval portion of the transitional year will be increased or decreased to take into account the length of the transitional year.
- If the transitional year's RIT becomes the base year's RIT for subsequent payments of provisional tax it will be increased or decreased to take into account the length of the transitional year.

The changes ensure that an appropriate amount of provisional tax is paid during the transitional year and, where applicable, interest on underpayments and overpayments is charged.

The amendments relating to a change in balance date have not been incorporated into existing provisions but run in parallel to the current rules. Although this increases the length of the legislation, it does ensure that the complexity of the rules surrounding payments in a transitional year do not affect all taxpayers.

Section MB 2 of the ITA provides for the determination of the total amount of provisional tax payable in an income year. It has been amended to ensure that the correct amount of provisional tax is payable if a prior year is a year in which a taxpayer changed balance date (a transitional year). The new subsections (6) and (7) gross up or scale down the RIT for the prior transitional year till it represents the RIT that would have applied had that transitional year been an income year of normal length. Subsection (6) also applies for the purpose of section 119(3) of the TAA, which provides that the Commissioner may determine the amount of provisional tax payable by a taxpayer in an income year in a number of circumstances.

The new section MB 3 (5) of the ITA provides that a taxpayer estimating the provisional tax payable in a transitional year must estimate on the basis of a 12-month year before receiving approval for a change in balance date. However, after receiving approval, the taxpayer must re-estimate the tax payable based on the length of the transitional year. This is on the basis that, before approval, the "normal" provisional tax payment rules apply, so a "normal" estimate must support these rules. After approval, the transitional year rules apply, so an estimate of the liability for the actual length of the year is required.

The new section MB 4 of the ITA provides for the determination of the number of payments due in an income year. The new subsection (4) provides that in a transitional year the due dates are determined in accordance with Schedule 13 and the amounts payable in accordance with section MB 5A.

The new section MB 5A of the ITA sets out the provisional tax payable. It applies only in a transitional year, and then only after a change in balance dates has been approved by the Commissioner. Before notification of a change in balance date the "normal" provisional tax rules apply (MB 5A (1) provides for this treatment).

Subsection (2) provides that the due date for instalments, other than the final instalment, must be determined in accordance with Schedule 13.

Subsection (3) provides that the final instalment is due on the seventh day of the last month in the transitional year unless the final month is January, in which case the due date is 15 January. (A provision in the Bill providing that payment would have been due on the taxpayer's balance date if the final instalment date would otherwise have occurred after the end of the taxpayer's income year has been removed. The proposed provision was removed on the basis that no similar restriction applies to provisional taxpayers not changing their balance date.)

There will always be a final instalment of provisional tax payable regardless of length of the transitional year because this subsection simply determines the day in the final month of the transitional year on which provisional tax will be payable.

Subsection (4) provides for new provisional taxpayers who change their balance date. In effect, it removes the obligation to pay either the first, second or third instalment depending on when the taxpayer started business. Note that this provision does not affect the final instalment due date, which is always in the final month. Therefore a new provisional taxpayer will always have at least one instalment of provisional tax.

Subsection (5) provides for the amount payable in relation to a non-transitional year when a taxpayer is not estimating. Because each non-final instalment in the transitional year is four months apart, each payment is effectively based on one-third of a prior year's liability.

Subsection (6) provides that if taxpayers have estimated their liability, the amount payable is their provisional tax

payable modified to reflect the length of the transitional year, less any amount previously due and payable on earlier instalment dates.

Subsection (7) determines the final instalment for non-estimating taxpayers. The calculation is based on the number of days in the transitional year compared with the previous year, multiplied by the amount of provisional tax determined to be payable, less any amount previously due. The important difference between this calculation and those applied to determine the amount payable on non-final instalments is that this calculation is based on days rather than months in the transitional year and the preceding year. This gives an increased level of accuracy and acts to "square up" the overall provisional tax liability.

Subsection (8) provides that, if taxpayers have estimated their provisional tax payable, the amount payable on the final instalment date is their estimate, less any amount previously due and payable on an earlier instalment date. The amended section MB 4 places an obligation on taxpayers in a transitional year who have estimated their liability, to estimate based on the full length of the transitional year. This occurs only once they have been notified that their request for a change in balance date has been accepted. Again the final instalment calculation is based on the number of days in the year, rather than the number of months.

Subsection (9) determines the number of months in the taxpayer's transitional year so both the number of instalments of provisional tax payable can be determined and the amount payable on non-final instalment dates can be determined. Months are used as a measure, over a day counting rule, to minimise compliance costs associated with these provisions.

Section 119(2)(a) of the TAA, which provides the Commissioner with a discretion to determine the amount of provisional tax payable if taxpayers change their balance date, has been repealed because the new specific rules will apply instead of a Commissioner's discretion.

Section 120K (4A) of the TAA deems the amounts to be due on each of the provisional tax instalment dates for the transitional year. As non-final instalments are four months apart, the amount of each instalment is the proportion that four months represents to the length of the transitional year. The final instalment, which may not represent a four-month period, is the income tax liability for the transitional year, less any amounts due on earlier instalment dates. The difference between these deemed amounts and the amounts actually paid by the taxpayer is subject to use of money interest unless the taxpayer is a safe harbour taxpayer.

New provisional taxpayers

(Section OB 1, Income Tax Act)

If a provisional taxpayer is classed as a new provisional taxpayer the current provisional tax rules apply only to those instalment dates falling due after the taxpayer started business. For example, if a company began operating shortly after the second provisional tax instalment date, use of money interest and provisional tax apply from the third instalment date.

Currently, only non-natural provisional taxpayers can be classified as new provisional taxpayers. This exclusion has, however, caused some inequities. The existing definition of the term "new provisional taxpayer" in section OB 1 of the ITA has been expanded to include natural persons if:

- Their RIT for the prior four years was less than $2,500. This acts to ensure they really are new provisional taxpayers, and not ones with varying types of income.
- Their RIT for the current year exceeds $30,000. This ensures they are subject to the use of money interest rules.
- They cease to derive income from employment and begin to derive gross income from a business. This also ensures that taxpayers really are "new" provisional taxpayer and not ones with fluctuating income.

The definition of the term "first business day" has also been amended to provide that a natural person's first business day is the day after he or she ceases deriving income from employment.

Grace period for taxpayers to adjust to changes in their provisional tax liability

(Section MB 2, Income Tax Act)

Under the current rules, if the Commissioner determines a taxpayer's provisional tax liability, that amended liability is used to calculate only those provisional tax instalments, if any, which fall due 30 days or more after the notification of that amendment. Under the new rules this approach has been expanded to apply to situations where the Commissioner assesses or reassesses a taxpayer's prior year RIT, which then affects provisional tax instalments.

Section MB 2 (3)(a) has been amended to provide that an assessment or reassessment of income tax for the preceding income year is not used to determine provisional tax payable on an instalment date if issued less than 30 days before that instalment date.

Treatment of taxpayers under proposed provisional taxpayer rules

Safe harbour taxpayers

The provisional tax payment rules have not been amended for those natural persons in the safe harbour (except for adjustments related to balance date and new provisional taxpayers). These taxpayers will continue to base provisional tax on their last year's RIT plus 5%, or RIT for the year before last plus 10%. If the amount of provisional tax due is not paid on the due date, late payment penalty is incurred.

Taxpayers who wish to pay less than required under these rules without incurring the late payment penalty may estimate their provisional tax payable. This also removes them from the safe harbour from the first instalment date. Taxpayers who pay more than is required or make additional payments remain in the safe harbour.

Taxpayers in the safe harbour are neither charged nor receive use of money interest if they underpay or overpay their residual income tax liability for the income year. Interest will only begin from the terminal tax date if provisional tax is underpaid. Interest on overpaid tax will start from the terminal tax date or the date the annual tax return for that year is filed, whichever is the later.

However, as taxpayers may estimate their liability until the third instalment date, and this action removes them from the safe harbour from the first instalment date, it is possible for taxpayers who consider they have overpaid by the third instalment date to receive interest on that overpayment.

Non-safe harbour taxpayers

Taxpayers who fall naturally outside the safe harbour will have the option of being able to determine their provisional tax liability based on a prior year's liability, as taxpayers in the safe harbour do. This option will be available for all three provisional tax instalments. However, given the application of use of money interest to these taxpayers, it is likely that many will estimate their provisional tax payable.

When taxpayers estimate the provisional tax payable for an income year they will be required to take reasonable care in that estimate. The estimate must also be a fair and reasonable one, as under current rules. If they estimate more than they would have been required to pay had they not estimated they will be deemed to have taken reasonable care.

If they do not take reasonable care, the penalty will be 20% of the difference between a reasonable estimate and the amount actually calculated by the taxpayer.

Summary chart – amended provisional tax rules

	Safe harbour Current rules	Safe harbour New rules	Non-safe harbour taxpayers
Classification:	All natural person provisional taxpayers except: • those with RIT greater than $30,000 • those who opt out • trustees • those with certificates of exemption	Same as current rules	All provisional taxpayers other than those safe harboured
Interest starting date:	Terminal tax date for those safe-harboured	Terminal tax date for those safe-harboured	The interest applies from first instalment date in all cases
Estimation:	Not required	Not required. A taxpayer who estimates leaves the safe harbour	Estimates not required. Current required if RIT greater than $300,000
Instalment amount:	Formula (based on 105% of last year's RIT)	Formula (based on 105% of last year's RIT)	Formula or estimate. A require -ment that taxpayers take reasonable care if they estimate. Currently an under-estimation penalty enforces estimates.
Late payment penalty:	Yes	Yes	Yes, if taxpayer pays less than estimated or required by formula.
Interest on overpayments:	No (but taxpayers may opt out of the safe harbour, in which case interest starts at third instalment date	No (but taxpayers may opt out of the safe harbour by estimating, in which case interest starts at first instalment date	Yes (if more than $100)
Interest on underpayments:	No	No, unless taxpayer opts out of safe harbour	Yes (if more than $100)

Calculation of NRWT on non-cash dividends

Section NG 9 (1)(b)

Introduction

An amendment corrects a drafting error by requiring the amount of a dividend withholding payment (DWP) credit, attached to a non-cash dividend consisting of a taxable bonus issue to be taken into account in calculating the amount of non-resident withholding tax (NRWT) to be deducted from that non-cash dividend.

Background

The drafting error meant that the amount of DWP credit attached to a non-cash dividend consisting of a taxable bonus issue did not have to be taken into account in calculating the amount of NRWT to be deducted from that non-cash dividend.

Key feature

The amendment corrects item "f" of the formula in section NG 9 (1)(b). This ensures that the amount of DWP credit attached to any non-cash dividend consisting of a taxable bonus issue is taken into account in calculating the amount of NRWT to be deducted from that non-cash dividend.

Application date

The amendment applies to dividends paid on or after 23 September 1997, the date of enactment.

Income tax treatment of shareholder-employees

Sections OB 1 and OB 2

Introduction

Several amendments have been made to section OB 2 of the Income Tax Act 1994. The key change provides that the section's existing application, to shareholder/employees of companies with 25 or fewer shareholders, will continue on a permanent basis.

Background

In certain circumstances, income derived by an employee from a company in which they are also a shareholder is deemed to be derived other than by way of source deduction payments. This means that the income is subject to provisional tax, rather than PAYE. The circumstances in which this occurs are listed in section OB 2 (2), and are generally limited to where the income is derived other than by way of regular payments throughout the income year.

Up until 1994, section OB 2 (2) only applied to shareholder/employees of private companies. However, to accommodate company law reform, changes were made to the Act. This included shifting the application of section OB 2 (2) to close companies, which have a narrower definition.

However, concerns were raised that the change would lead to taxpayer uncertainty with regard to the practical application of the legislation, and result in taxpayer exposure to penalties, therefore increasing compliance costs. In recognition of this, the Government passed legislation carrying over application to private companies until 1 April 1998. It also undertook to review the legislation and its practical application. The amendments arise out of this review.

Key features

The present application of section OB 2, to companies with 25 or fewer shareholders, is to continue on a permanent basis.

The section provides that income derived by employees from a close company in which they are also shareholders is subject to provisional tax, rather than PAYE, if, in the preceding income year, they:

- did not derive salary or wages from the company of a regular amount for regular pay periods of one month or less; or
- derived total salary or wages from the company, by way of regular amounts for regular periods, that was less than two thirds of their total income from the company; or
- received any amount in anticipation of any income that might subsequently have been allocated to them by the company.

The amendment removes the requirement that shareholder/employees must make an application to the Commissioner if they wish the section to apply from the initial year that their income falls within the section's criteria. The section now expressly provides that a company and a shareholder/employee can anticipate compliance with the section and apply it in their first year of operation, if they so choose.

The amendment also removes the Commissioner's discretion to deem income falling within the section's criteria for non-source deduction income to be source deduction income. This ensures that income falling within the section's criteria retains its non-source

deduction status, as long as the criteria continue to be satisfied.

The placement of the definition of "close company", for the purposes of section OB 2, has also been amended. The term is now defined exclusively within section OB 1, with inclusion of a reference to the definition to be used for the purposes of section OB 2.

Application date

The amendments apply from when the legislation's present application to private companies lapses, which is the income year commencing 1 April 1998.

Qualifying Companies - Loss of qualifying company status

Section OB 3 (1)(c)(ii)

Introduction

An anomaly in the qualifying company legislation has been corrected by preventing a qualifying company from losing its qualifying company status when a trustee shareholder of the company fails to treat dividends from any other qualifying company as beneficiary income.

Background

The intention of the qualifying company rules is to treat small, closely held companies in a similar way to partnerships. To ensure that the regime is open only to closely held companies, entry is limited to companies with five or fewer shareholders. Family members are counted as one shareholder.

Trustees may be shareholders in qualifying companies provided that all dividend income (not being non-cash dividends other than taxable bonus issues) received by the trustee from any qualifying company during the income year is distributed as beneficiary income. Beneficiary income is income not held by the trust but passed through to beneficiaries within a certain period of time. The requirement is intended to prevent distributions from qualifying companies being trapped in discretionary trusts for onward distribution to beneficiaries who do not qualify as qualifying company shareholders under the shareholder test. (Beneficiaries are at no time actual shareholders but are required to be counted as such for the purpose of determining whether the company exceeds the maximum number of shareholders allowed in a qualifying company.)

An anomaly arose when a trustee held shares in several qualifying companies. If the trustee failed to distribute dividends from one qualifying company to beneficiaries, all qualifying companies with the same trustee lost their qualifying company status. Only the qualifying company from which the trustee did not distribute dividends should be affected. The amendment corrects this anomaly.

Key features

Section OB 3 (1)(ii) has been amended to ensure that only those qualifying companies whose dividends are not distributed by the trustee shareholder as beneficiary income will lose their qualifying company status. Qualifying companies that have the same trustee as a shareholder will not lose their qualifying company status provided their dividends are distributed as beneficiary income.

Application date

The amendment will apply from the date of enactment, 23 September 1997.

State-owned enterprises

Schedule 18

Introduction

The list of state-owned enterprises in Schedule 18 has been updated by the removal of references to companies that are either no longer owned by the state or no longer exist. Two companies, Coal Corporation of New Zealand Ltd and Government Property Services Ltd, have been added to the Schedule.

Background

State-owned enterprises listed in Schedule 18 are included in the special corporate entity definition in section OB 1. Special rules, contained in sections OD 3 (3)(a) and OD 4 (3)(a), apply to special corporate entities when calculating the voting and market value interests of shareholders.

These rules deem all the shares in a special corporate entity to be held by the same single person, that is, by all of its members or directors in a collective capacity. No breach of shareholder continuity is therefore possible with a special corporate entity. This means that any losses or credits in the imputation credit account of a special corporate entity cannot be lost as a result of any actual change of shareholding. The policy reason for this

treatment is that special corporate entities do not ultimately have natural person shareholders (as normal shareholder continuity rules assume).

Several companies that were listed in Schedule 18 were no longer state owned. It was appropriate to subject these companies to the normal shareholder continuity requirements in respect of their losses and imputation tax credits, and this was achieved by their removal from Schedule 18.

As a result of the reordering of the Income Tax Act 1976, Coal Corporation of New Zealand Ltd and Government Property Services Ltd were inadvertently omitted from Schedule 18. The Schedule has been amended to include these companies.

Key features

The following companies, no longer owned by the state, have been removed from Schedule 18:

- Air New Zealand Ltd
- Bank of New Zealand Ltd
- National Provident Management Company Ltd
- New Zealand Steel Ltd.

The following companies no longer exist and have been removed from Schedule 18:

- Broadcasting Corporation of New Zealand
- Geothermal Development and Investment Ltd
- Government Life Insurance Corporations Ltd
- New Zealand Export-Import Corporation Ltd.

The following companies have been added to Schedule 18:

- Coal Corporation of New Zealand Ltd
- Government Property Services Ltd.

Application date

Air New Zealand and New Zealand Steel Ltd were removed from the beginning of the 1992/93 income year, the date from which the special corporate entity definition applied. Bank of New Zealand Ltd and National Provident Management Company Ltd were removed from their settlement dates, 5 November 1992 and 17 April 1992 respectively.

Companies that no longer exist were removed from the date of assent.

Coal Corporation of New Zealand Ltd and Government Property Services Ltd were added from the beginning of the 1995/96 income year, the application date of the Income Tax Act 1994.

Minor remedial amendments to the Income Tax Act 1994

Exempt income – removal of redundant reference

(Section CB 5 (1)(e))

Section CB 5 (1)(e) has been amended to remove a redundant reference to New Zealand superannuation (NZS). NZS is paid under the Social Welfare (Transitional Provisions) Act 1990, and not under Part I of the Social Security Act 1964, as the section implied.

The amendment applies from the date of enactment, 23 September 1997.

Ex gratia payments

(Section CC 1 (2))

- The words “or a parent or child of the taxpayer” have been inserted into section CC 1(2) because their previous omission was incorrect.
- The penultimate line of section CC 1(2) incorrectly referred to “spouse” and has been amended to correctly refer to “parent”.

The amendments take effect from the start of the 1995/96 income year, since the 1995 amendment which created these problems was intended to change only the location of the provision, rather than the policy itself.

Consolidated group loss offsets

(Section IG 6 (1))

- When the Income Tax Act 1994 was enacted, references to sections IG 1 and IG 2 were inadvertently omitted from section IG 6 (1). They have now been included.
- Section IG 6 (1) was repealed and an amended section inserted by the Taxation (Core Provisions Act) 1996 with effect from the 1997/98 year. Therefore references to sections IG 1 and IG 2 have been inserted into the amended section, with the same application date as Taxation (Core Provisions) Act 1996 amendment.

The first amendment applies to the 1995/96 and 1996/97 income years. The second amendment applies from the 1997/98 income year.

Low income rebate for the 1997/98 income year

(Section KC 1)

Section 21 of the Taxation (Income Tax Rates) Act 1997, which inserted a new section KC 1(1) to provide for the low income rebate for the 1997/98 income year, has been amended to allow a rebate for veteran’s pensions.

The amendment applies from the date the Taxation (Income Tax Rates) Act 1997 came into force, 14 May 1997.

Alignment of due dates for RWT

(Section NF 3 (1))

Section NF 3 (1) has been amended by replacing "14th" with "20th". The amendment ensures that the due date for all payments of resident withholding tax (RWT) deductions is the twentieth day of a month following a month the payment is received.

In July 1992 the due date for payment of RWT deductions was generally changed from the fourteenth day of a month to the twentieth day of a month following the recommendations of the Tax Simplification Consultative Committee. However, the due date for payment of RWT for agents and trustees who are required to make deductions of RWT on payments received from which no deductions of RWT are made, remained the fourteenth of the month. To ensure consistency, the due date for agents and trustees has been changed to the twentieth of a month.

The amendment applies from 1 April 1997, the date of the introduction of the new compliance and penalties rules.

Non resident withholding tax amendment

(Section NG 2 (1)(a))

The amendment corrects a drafting error made in section 59 of the Taxation (Remedial Provisions) Act 1996. Section NG 2 (1)(a) is now consistent with the new core provisions.

Section 59 of the Taxation (Remedial Provisions) Act 1996 has been repealed

The amendment applies to dividends paid on or after 2 September 1996, the date of enactment of the Taxation (Remedial Provisions) Act 1996.

Changes to section OB 1 definitions

(Section OB 1)

The following amendments are all of a minor nature, correcting either incorrect, redundant or omitted section references.

- **"Completed":** The section OB 1 definition of "completed" refers to sections EO 3 and EO 4. Both sections employ the word "completed". It is also used in section OB 1, in the definition of "film production expenditure". The definition of completed should also refer to the definition of film production expenditure. Accordingly, the definition of completed has been amended by inserting the words "in the definition of film production expenditure and" before "in section EO 3…".

  The amendment applies from the date of enactment, 23 September 1997.

- **"Continuity provisions"** and **"credit account continuity provisions":** The section OB 1 definitions of "continuity provisions" and "credit account continuity provisions" have been amended by the insertion of a reference to section MF 4 (1)(e), which relates to the shareholder continuity requirement in order to avoid the forfeiture of BETA credits.

  The reference was overlooked during the re-organisation of the Income Tax Act.

  Although this inaccuracy has been present since 1 April 1995, the application date of the Income Tax Act 1994, the savings provisions of the Act would have protected affected taxpayers. Therefore the amendment applies from the date of enactment, 23 September 1997.

- **"Insurance":** The section OB 1 definition of "insurance" has been amended by replacing "OE 2" with "OE 4". The amendment applies from the date of enactment, 23 September 1997.

- **"Market value":** Paragraph (b) of the section OB 1 definition of "market value" has been expanded to include reference to section OD 4, which prescribes market value interests relating to shares and options.

  Paragraph (c) of the section OB 1 definition of " market value" has been amended by replacing the reference to section GC 25 (9) with a reference to section GC 23 (9), which defines market value for the purposes of entry to or exit from the foreign investment fund regime.

  The amendments apply from the date of enactment, 23 September 1997.

- **"Tax credit advantage":** "Section GC 22(8)" has been replaced with "section GC 22(9)" in the section OB 1 definition of "tax credit advantage". The reference to section GC 22(8) was a typographical error.

  The amendment applies from the date of enactment, 23 September 1997.

- **Tax rate for trustees of superannuation funds** (Clause 6, Part A, Schedule 1, Income Tax Act 1994): Clause 6 of Part A of Schedule 1 provides that the tax rate for trustees of superannuation funds is 33%. As this is the same as the tax rate for trustees generally, this clause has been repealed and clause 4 has been amended by removing the reference to clause 6.

  The amendment applies from the 1997/98 income year.

Amendments to the Tax Administration Act 1994

Compliance, penalty and interest provisions

Sections 4A, 37(3), 81, 120K, 120O, 120S, 120V ,139, 140A, 142A, 157, 170, 174, 183A, 183B, 183C, 183D, 183F 183H, Tax Administration Act
Sections IG 10, NC 15, Income Tax Act
Section 43, GST Act
Section 12L, Gaming Duties Act
Sections 118, 118A, 119, Accident Rehabilitation and Compensation Insurance Act 1992

Introduction

Several amendments have been made to the compliance and penalty provisions to reduce compliance costs, correct drafting errors, and make minor policy changes.

Background

In the 1992 Budget the Government announced its intention to review and reform the legislation enforcing compliance with tax obligations. It then carried on a detailed revision of the tax penalties rules and identified a series of weaknesses:

- **Gaps in coverage:** There were no direct sanctions to address many forms of non-compliance which result in some taxpayers paying less than they owe.
- **Flaws in design:** Some penalties tried to address more than one aim in a confusing way.
- **Inconsistencies in application:** There were inconsistencies in the size of penalties applied for similar defaults.

Once it had identified these deficiencies, the Government issued two discussion documents. The first, *Taxpayer Compliance, Standards and Penalties,* outlined principles and high level proposals. After considering submissions the Government then issued a second discussion document. *Taxpayer Compliance, Standards and Penalties 2,* which contained detailed proposals and draft legislation. The document generated a further round of consultation which prompted several other changes to the rules before legislation was introduced and enacted, in late 1996. It generally came into effect from the 1997/98 income year.

The recent amendments fine tune the legislation by introducing a number of compliance cost reduction measures, a number of minor policy amendments, mostly of a taxpayer-positive nature, and correct a number of minor drafting errors.

Key features

- The requirement that taxpayers must request extension of time to file a tax return in writing has been removed.
- The requirement that taxpayers must request cancellation of interest in writing has been removed.
- There will be a 15-day grace period following the issue of a statement of account.
- The small balance write-off has been increased from $5 to $20.
- Before imposing a late filing penalty, the Commissioner must warn a taxpayer either specifically (through a notice) or generally (through advertising) that tax returns relating to a particular period are overdue.
- The application date of remission/cancellation provisions has been made 1 April 1997.

Application date

The compliance cost reduction measures apply from the date of enactment, 23 September 1997. The corrections generally apply from the date of effect of the new compliance and penalties provisions, as follows:

- income tax, from the 1997-98 income year
- GST, supplies made in taxable periods beginning on or after 1 April 1997
- estate and gift duty, gifts made on or after 1 April 1997
- gaming duties, to all races run, all lotteries drawn, all dutiable games played by means of a gaming machine, and all casino wins arising on or after 1 April 1997
- stamp and cheque duties in relation to every instrument of conveyance executed, every bill of exchange made, drawn, or prepaid and every liable transaction entered into on or after 1 April 1997.

The exceptions to these application dates are the changes to the application date of the remission provisions and the amendment to section 157(1). These amendments are deemed to come into force on 1 April 1997 unless, in the case of the remission provisions, a taxpayer has received remission under the previous provisions.

Detailed analysis

Compliance cost reduction measures: sections 37(3), 120O, 120S, 139, 174, 183C(4) and (5), 183H

Removal of requirement to request extension of time to file a tax return in writing

Section 37(3) specifies that a taxpayer requiring an extension of time arrangement must request it in writing to the Commissioner. This provision has been removed to allow taxpayers to request an extension of time verbally. This approach has lower associated compliance and administrative costs, and taxpayers will still be able to request an extension in writing if they so wish. Inland Revenue will confirm or decline the issuing of an extension of time arrangement to a taxpayer by letter to ensure that a record exists.

This amendment applies from date of enactment.

Late filing penalty

Section 139C has been amended to provide that the Commissioner must warn a taxpayer either specifically (through a notice) or generally (through advertising) that tax returns relating to a particular period are overdue, before imposing a late filing penalty.

Payment of interest before a tax return is filed

The new use of money interest scheme provides that interest is paid from the due date of the tax until the tax is refunded. However, interest will generally not be paid on overpaid tax if the taxpayer has not filed the relevant tax return. Payment of interest will begin once the tax return is filed, with effect from the date of filing. An exception to the return filing rule is made in the case of:

- Reconciliation statements. The due date for payment in relation to a PAYE reconciliation return is the same as the due date for the final PAYE payment for the year. However, the reconciliation return has a filing date of 30 May, while the return relating to the last PAYE period is due on 5 or 20 April. Without complex ordering rules it would not be possible to determine to what extent an overpayment relates to a reconciliation statement and to what extent it relates to the final PAYE period. Section 120O has been amended to provide that the return filing requirement does not also apply to payments of PAYE also due on that date. The amendment also applies to non-resident withholding tax and resident withholding tax reconciliations (section 120O).
- Annual payers of fringe benefit tax. A number of these taxpayers may choose to pay part or all of their fringe benefit tax liability during the year and should be eligible for interest if they overpay (section 120S(4)).

Increase in the small balance write-off

Section 174 allowed the Commissioner to refrain from collecting or refunding tax of less than $5. To minimise compliance and administrative costs the threshold for writing off small debts was raised to $20

This amendment applies from date of enactment.

Application of grace period to statements

Section 183C has been amended to provide a 15-day grace period following the issue of a statement of account, during which interest imposed under the new rules will not accumulate. If full payment is not made within the 15 days, interest will be calculated from the start of the grace period. This measure gives taxpayers certainty as to the amount to pay following the issuing of a statement and acts to prevent small residual debts arising.

This amendment applies from date of enactment.

Removal of requirement to request cancellation of interest in writing

Section 183H required a taxpayer requesting a remission or cancellation of a late payment penalty, late filing penalty or interest to do so in writing. Although it is appropriate for remissions to be requested in writing, in the case of cancellations, which are undertaken by the Commissioner, the action is automatic and a written request should not be required. The section has been amended to remove this requirement.

This amendment applies from date of enactment.

Shortfall penalties (Sections 3(1), 138L, 141(3), 141(5), 141A, 141A, 141B, 141C)

Several corrections have been made to the shortfall penalty provisions:

- A definition of acceptable interpretation has been inserted in section 3(1) because the term is used, for example, in section 141A(3). The definition of acceptable interpretation is simply those interpretations which are not unacceptable.
- Section 138L has been amended to ensure that taxpayers have the right to challenge how a shortfall penalty is calculated. This provision is required because of the complexity of the calculations involved, and various decisions are required in determining the amount which is subject to the shortfall penalty.
- The definitions of “tax position”, “tax shortfall” and “taxpayer’s tax position” in the Tax Administration Act are intended to clearly provide that taxpayers take a tax position in relation to every issue or matter embodied in the calculation of their taxable income. In other words, the tax return is a sum of all the tax positions taken by the taxpayer. If a tax position taken by a taxpayer is not correct a shortfall penalty may apply to that position. The definition of “taxpayer’s tax position” and sections 140A(2)(a), section 141A and section 141C of the Act have been amended to confirm this situation.
- Section 141(3) was intended to provide that a separate tax shortfall calculation must be undertaken for each return period, each tax type and each tax position a

taxpayer takes, although this was not stated. The section has been amended to make this explicit.

- Section 141(5) provides for offsetting an overpayment of a tax liability against an underpayment if a taxpayer is liable to pay more than one shortfall penalty. However:
  - There was no provision allowing offsetting when only one shortfall penalty is imposed. This subsection has been amended to allow for the offsetting of an overpayment of tax against one underpayment.
  - The legislation provided that the overpayment was apportioned amongst the *relevant* shortfalls, when the intention is that it be apportioned between all shortfalls. The word "relevant" has therefore been removed.
- Section 141(9) has been amended to clearly show that it applies only for the purpose of subsection (6).
- Section 141B(1) defines an unacceptable interpretation. The previous wording of the definition was cumbersome and has been simplified. In effect, the amendment simply involves removing a redundant reference to an interpretation.
- Section 141B(2) and (3) provide for a threshold below which the unacceptable interpretation penalty will not apply. In the case of taxpayers in loss, the threshold was to be based on the larger of $10,000 and the taxpayer's net loss multiplied by the base rates of tax (up to a maximum of $200,000). However, because the net loss figure was negative, the result was that the $10,000 minimum threshold applied to all taxpayers in loss, regardless of the size of that loss. Section 141B(3) has ben amended to provide that a tax loss is treated as a positive value in determining the threshold for the unacceptable interpretation penalty.
- Section 141B(3) also provides that the threshold for the unacceptable interpretation penalty must be calculated before any group offset election or subvention payment. These adjustments applied only to income tax, although the legislation did not explicitly state this. This provision has been amended to make it clear that the issue of these offsets arises only in relation to income tax.
- Section 141B provides that the unacceptable interpretation penalty can be imposed only on a tax shortfall arising from the taxpayer's tax position if the shortfall exceeds $10,000 and the taxpayer's "total tax figure" (defined as the lesser of $200,000 and 1% of the tax for the return period). The definition of total tax figure provides specific rules for determining the total tax figure if the taxpayer has no tax to pay. The total tax figure was based on the taxpayer filing a tax return on time. This section has been amended to remove the reference to the return having to be filed on time. The total tax figure will be based on the return, regardless of when it is filed.
- Section 141C has been amended to add a new subsection providing that an acceptable interpretation of a tax position also means that the taxpayer was not grossly careless.
- Section 141F provides that an officer of a company can be liable to a shortfall penalty if the officer fails to make a deduction of tax or permits a deduction to be mis-applied. If an officer is liable to a shortfall penalty, the amount to pay is equal to the shortfall penalty which applies to the company. Therefore if the company is charged a penalty for evasion, which is 150% of the tax shortfall, the officer would also be charged the same amount. (The total amount of penalty is not divided between the two.) Further, as the provision is worded, the Commissioner has no discretion as to whether the penalty was applied to the officer or officers involved. This was an unintended change in the policy, so the section has been amended to provide that one shortfall penalty is imposed for the failure, and the tax shortfall on which the penalty is being imposed may be apportioned by the Commissioner amongst the taxpayer and the officer/s involved, as appropriate. The title has also amended to clarify the purpose of the section.

The amendments apply from the date of effect of the new compliance, penalty and interest rules, 1 April 1997.

Use of money interest (sections 120K, 120V and 183C)

The provisional tax rules create a liability for use of money interest by deeming that a provisional taxpayer's residual income tax for the year is due evenly on the three provisional tax instalment date. This general rule has been modified to take into account new provisional taxpayers and changes in balance date. However, no rule deemed a commencement date for interest for those who are in the "safe harbour". While the income liability for these taxpayers was due on the terminal tax date, they also had provisional tax payments due on each instalment date. If taxpayers underpaid, use of money interest applied. Because the intention is that these taxpayers not face use of money interest, a new section 120K(4B) has been inserted with application for the 1997/98 income year. This amendment applies only to that income year because the amendments made to the 1998/99 income year and subsequent years by the new provisional tax rules deal with this issue (section 120K(4)).

A number of minor amendments have also been made to the use of money interest rules:

- The Commissioner is no longer required to pay use of money interest to persons who have had RWT over-deducted from their interest, since the Government will not have had the use of the money over the period it has been over-deducted. This amendment has been made by way of inserting a new section 120V.
- Section 183C(3) provides a 30-day grace period following the issue of an assessment. During this

period the taxpayer can effectively pay the amount stated on the assessment (and any interest accumulated up to the date of the issue of the assessment) and not be charged interest. The section has been amended to terminate the 30-day grace period at the end of the 30 days or the due date for the tax, whichever is earlier.

- Section 120J has been amended to accommodate the enactment of new section 120V: the expression "sections 120K to 120U" has been replaced by "sections 120K to 120V".

The application date of these amendments is the date of effect of the new compliance, penalty and interest rules, which for income tax is the income year beginning 1 April 1997.

Remission provisions (section 157, 183A, 183B, 183C, 183D, 183F, Tax Administration Act and sections 118, 118A, 119, Accident Rehabilitation and Compensation Insurance Act 1992)

Reinsertion of remission provisions

Sections 183A to 183D contain the new remission and cancellation provisions. The two discussion documents proposed that the new provisions apply from a fixed date, 1 April 1997, to all the taxes covered by the regime. A fixed date would prevent two taxpayers in identical circumstances, except that one faced a penalty under the old rules and one under the new, receiving different treatments. However, as enacted, these remission/cancellation provisions applied only to the new rules, while the old provisions continue in force. To prevent two sets of rules applying, sections 183A to 183D have been re-inserted and deemed to come into force on 1 April 1997.

A savings provision (section 103 of the Amendment Act) has been inserted to provide that those who applied for remission under section 182, subsequent to 1 April 1997, may have that remission request addressed under that section. The Commissioner must have received the request for remission before 23 September 1997.

The exception to the 1 April 1997 application date for the compliance and penalty remission provision is ACC premiums, since ACC has been conducting audits on an industry basis. It would be unfair that industries that the ACC has not yet audited face tighter remission provisions simply because they were placed further down the investigation list. Therefore the Accident Rehabilitation and Compensation Insurance Act's remission provision, section 118A, which was replaced by the compliance and penalty regime's generic provisions, has been re-inserted with effect from 1 April 1997. This remission provision will apply to penalties arising in relation to the 1996/97 and earlier income years. However, the generic compliance and penalty regime's remission provisions will apply to remissions from the 1997/98 income year.

Sections 118 and 119 of the Accident Rehabilitation and Compensation Insurance Act have been reinserted for the period 26 July 1996 until the beginning of the 1997/98 income year. This confirms that penalties on unpaid premiums may be imposed for this period.

Minor amendments to the remission provisions

Several minor amendments have been made to the remission provisions:

- Section 183A provides for remission of a late filing penalty and late payment penalty if a taxpayer has reasonable cause. One of the intended criteria for qualifying under this provision is that taxpayers correct their defaults as soon as practicable. However, the requirement did not apply to the late filing penalty. An amendment has been made to correct this deficiency.
- Section 183B allowed the Commissioner a discretion to remit a late payment penalty if a taxpayer complied with an instalment arrangement. However, if a taxpayer did comply with an arrangement there would have been no reason for the Commissioner not to remit the late payment penalties. Therefore section 183B has been amended to remove the Commissioner's discretion.
- Section 183D provides for remission consistent with the collection of highest net revenue over time. It has been amended to:
  - Provide that remission is not available on the basis of the taxpayer's financial position. Unlike the other penalty remission provisions, the section did not include a restriction that remission is not available on the basis of the taxpayer's financial position.
  - Clarify the relationship between this section and the Commissioner's duty under section 6A. The section now provides that the Commissioner when considering remission have regard to the importance of the late payment penalty, late filing penalty and use of money interest in promoting compliance, especially voluntary compliance, by all taxpayers with the Inland Revenue Acts.
- Section 183F provides that small amounts of penalty and interest are not to be charged. The provision has been amended to provide that late payment penalty or interest will not be imposed on any amount of tax outstanding of less than $100 after the due date. The previous wording allowed penalties to be imposed if a taxpayer made partial payment.

The amendments apply from the date of effect of the new compliance, penalty and interest provisions, 1 April 1997.

Other minor amendments (sections 4A, 81, 140A, 142A, 170, Tax Administration Act and sections IG 10, NC 15, Income Tax Act)

- Section 4A(2) of the Tax Administration Act (TAA) defines when a deduction of dividend withholding tax or a source deduction payment is made. The section then defines when they have been mis-applied, but

referred only to dividend withholding payments. The provision has been amended to correct this oversight.

- Section 4A(4) of the TAA is intended to provide that shortfall penalties may be imposed on a default in accounting for tax if the tax return shows a higher tax liability than actually paid by the taxpayer. This is achieved by the provision deeming the tax paid to be the taxpayer's tax position, allowing a shortfall penalty to be imposed, should the Commissioner wish, on the difference between the tax payment and the position returned. However, as previously worded, the provision applied to all taxes. It has been amended to be limited to withholding taxes.
- Section 81 of the TAA provides that the Commissioner may disclose information for the purposes of administering the various taxes and duties for which the Commissioner is responsible. However the new rules did not apply to the Child Support Act and the Student Loan Scheme Act, which had the unintended consequence of removing them from the scope of section 81. This section has been amended to include these Acts.
- Section 140A of the TAA provides for the underestimation penalty. With the introduction of the shortfall penalty provisions it was appropriate that the underestimation penalty apply only to an underestimation that occurs in relation to the tax position the taxpayer initially takes in a tax return. Any subsequent change in tax liability should not result in further underestimation penalty because shortfall penalties are available to deal with this problem. As the provision was worded, it was possible for an underestimation penalty to increase on a second reassessment. Section 140A has been amended to prevent this.
- Section 142A provides that a new due date must be set if a taxpayer's liability to pay tax is increased beyond the amount calculated by the taxpayer. However, the provision did not make it clear that the calculation is the one provided by the taxpayer in a tax return. This section has been amended to include a reference to the calculation being that contained in a tax return.
- Section 157(1) gives the Commissioner the power to recover tax and penalties in default via a bank as a lump sum. An amendment to this section requires a bank to recover any interest which has accumulated on the overdue tax and penalties after the Commissioner issued the recovery notice. To reduce compliance costs, the bank will be informed of the amount of interest which is accumulating daily on the overdue tax and penalties. This approach removes the need for the Commissioner to issue a second recovery notice for the additional interest. A similar amendment has been made to the GST recovery provisions, The Gaming Duties Act and the Accident Rehabilitation and Compensation Insurance Act.
- Section 176 of the TAA provides relief from an income tax liability in cases of serious hardship. The definition of the term "tax" in the Tax Administration Act was previously widened, as a result of the broad scope of the new compliance and penalties legislation, to include all taxes and duties, rather than just income tax. A consequence of the earlier amendment was that taxpayers could request remission under the provision in relation to, for example, GST, when it is the policy intention that this remission provision be limited to income tax. Therefore section 176 has been amended to provide that it applies only to income tax.
- Section IG 10 of the Income Tax Act 1994 provides for the use of losses to pay penalties. A provision has been inserted that allows a loss incurred by a company in a wholly-owned group of companies to be used to pay a shortfall penalty imposed on any company in that group.
- Section NC 15 of the Income Tax Act 1994 sets a due date for the payment of tax discrepancies identified as a result of the completion of a PAYE reconciliation. As previously worded, the due date was 20 April when, in relation to larger employers, it should have been 5 April. This provision has been amended to confirm a 5 April due date for larger employers.

These amendments apply from the date of effect of the new compliance, penalty and interest provisions, 1 April 1997.

Objection rights for thin capitalisation determinations

Section 90A(4) and (5) of the Tax Administration Act 1994

Introduction

The redundant objection rights open to taxpayers in respect of determinations on the apportionment of interest costs under the new thin capitalisation rules have been removed. Taxpayers continue to have rights under the new dispute resolution procedures to challenge any determination issued.

Background

Subsections (4) and (5) of section 90A referred to the objection rights open to taxpayers in respect of determinations made under this section. Similar objection rights in the other determination provisions, namely sections 90 and 91, had been repealed in line with the new dispute resolution procedures. These subsections were redundant since any determination made under section 90A would be subject to the right to challenge by taxpayers under Part VIIIA.

Key features

Subsections (4) and (5) of section 90A are repealed to remove the anomaly that would have retained objection rights for taxpayers who have had determinations issued under this section. The new disputes resolution procedures replaced objection with a single challenge process. Repeal of the redundant provisions ensures consistency of treatment with all of the determination provisions in the Act.

Application date

The repeals apply from 1 October 1996, the date the new dispute resolution procedures came into force.

Binding rulings on livestock

Section 91 C(1)(e) Tax Administration Act 1994

In order to clarify the legislation relating to binding rulings on specified livestock and non-specified livestock, two amendments have been made to paragraph 91C(1)(e).

Subparagraph 91C(1)(e)(v) has been amended to relate solely to binding rulings on specified livestock. A new subparagraph, (vi), which relates solely to binding rulings on non-specified livestock, has been inserted.

The amendments apply from 23 September 1997.

Binding rulings on matters subject to determinations

Section 91C(1)(e)(iA), Tax Administration Act 1994

Introduction

An amendment prevents the Commissioner of Inland Revenue from making a binding ruling if the matter in question is or could be the subject of a determination issued under the thin capitalisation rules. This ensures that there is a clear demarcation between binding rulings and determinations.

Background

A reference to section 90A was inadvertently omitted from section 91C(1)(e) when the thin capitalisation rules were enacted. The effect of this omission was that a taxpayer could seek either a binding ruling or a determination on any matter that is the subject of Part FG of the Income Tax Act 1994. This was inconsistent with the general demarcation between the binding rulings legislation and various determinations rules.

Key features

New subparagraph 91C(1)(e)(iA) prevents the Commissioner from issuing a binding ruling on matters that are, or could be, the subject of a determination issued under the thin capitalisation rules in section 90A.

Application date

The amendment applies from the start of the 1996/97 income year, to coincide with the application date of the new thin capitalisation rules.

Binding rulings on matters under challenge

Sections 91E(3)(b) and 91F(3)(b) of the Tax Administration Act 1994

Introduction

The Commissioner of Inland Revenue now has a discretion to decline issuing a private or product ruling if the matter on which the ruling is sought is subject to a challenge. This ensures that the Commissioner retains the right to decline a ruling in cases where a court decision on a question of law is pending.

Background

When the disputes resolution procedures were enacted, references to "objection" were replaced with references to "challenge" in relevant provisions except for sections 91E(3)(b) and 91F(3)(b).

Key features

Sections 91E(3)(b) and 91F(3)(b) of the Tax Administration Act 1994 (TAA) have been amended by inserting the words ", challenge,". This results in the Commissioner having the right to decline a ruling if the matter on which the ruling is sought is subject to a challenge.

Application date

The amendment applies from 1 October 1996, the date the new dispute resolution procedures came into force.

Binding rulings and double tax agreement procedures

Section 91E(4)(d)(ii), 91F(4)(d), Tax Administration Act 1994

Introduction

Amendments ensure that binding rulings cannot be issued on all double tax agreement (DTA) procedures, including tax sparing protocols involving competent authorities.

Background

The previous legislation stated that the Commissioner could not issue a binding ruling if the matter on which the ruling was sought was being dealt with (or in the Commissioner's opinion should be dealt with) under a DTA procedure that allows the competent authorities to agree on the application of any provision of that DTA.

It was the policy intention of the binding rulings legislation for all DTA procedures involving competent authorities to be taken outside of that regime. However, the relevant wording in the legislation was not clear about preventing rulings being issued on the tax sparing protocols. This is because it referred to both competent authorities agreeing on the matter, whereas the procedure under the tax sparing protocols requires both competent authorities to be actively involved but leaves the final decision with the New Zealand competent authority.

Key issue

Section 91E(4)(d)(ii) (relating to private rulings) and section 91F(4)(d) (relating to product rulings) have been amended to ensure that binding rulings cannot be issued on all DTA procedures (including tax sparing protocols) in New Zealand's DTAs involving the competent authorities.

Application date

The amendments apply to private rulings and product rulings made on or after 23 September 1997.

Assessments of further income tax

Section 101(3) Tax Administration Act

Section 101(3) has been amended by replacing references to "Part VIII" and "an objection" with "Part VIIIA" and "a challenge".

The amendment applies from 1 October 1996, when the new dispute resolution procedures came into effect.

Time bar for amendment of assessments

Sections 107A and 108 Tax Administration Act 1994

Introduction

A new section 107A restores the former four-year statute bar against reassessments of returns filed between 1 October 1996 and 31 March 1997.

Background

An unintended consequence of the introduction of the new tax disputes resolution procedures enacted in 1996 was the creation of a period between 1 October 1996 and 31 March 1997 in which the Commissioner was not subject to the four year statute bar against reassessments.

The amendment

New section 107A re-enacts the former section 108 in the same terms as that section existed before its repeal. Section 107A applies to returns filed between 1 October 1996 and 31 March 1997.

Application

The new section is effective from 1 October 1996.

Assessments and notices to deduct tax arrears

Sections 109A and 157(10) of the Tax Administration Act 1994

Introduction

Amendments clarify that:

- notices of assessment; and
- notices of deductions to be made from monies due to tax defaulters,

issued after 1 April 1995, are issued under the Tax Administration Act (TAA), not the Income Tax Act 1976.

Background

When the Income Tax Act 1976 (the 1976 Act) and the Inland Revenue Department Act 1974 (the IRD Act) were reorganised, provisions from both Acts were amalgamated into the TAA. The TAA came into force on 1 April 1995, and applies, where appropriate, to tax on income derived in the 1995/96 income year and subsequent years. Practical difficulties arose because the IRD Act had applied from a particular day (1 January 1974), whereas the sections transferred from the 1976 Act applied to a particular income year.

Key features

New section 109A has clarified the policy intention of the application of the TAA to notices of assessment. Those issued since 1 April 1995 will have been issued under the TAA, irrespective of the income year to which they relate. The income tax liability for years before the 1995/96 year will, however, still be assessed under the 1976 Act.

The amendment to section 157(10) ensures that all notices of deductions to be made from monies due to tax defaulters issued since 1 April 1995 have been issued under the TAA. The deductions may be in respect of outstanding tax from income years both before and after the 1995/96 income year.

Application date

The amendments apply from 1 April 1995, the date the TAA came into force.

Certain rights of challenge not conferred

Section 138E(1)(e)(iii) Tax Administration Act 1994

To correct an omission from the drafting of the original provision, section 138E(1)(e)(iii) is replaced. The replacement paragraph (iii) re-enacts the omitted exclusions.

The amendment applies from 1 April 1995, the date the Tax Administration Act 1994 came into effect.

Goods and Services Tax Act 1985 – minor remedial amendments

Tax file number

Sections 2(1) and 24(2B)

These amendments define "tax file number" in line with the Income Tax Act definition and insert that term to replace the term "Inland Revenue Department's identification number" in section 24(2B).

Section 24(2B) requires a debtor's "tax file number" to be used on a tax invoice when there is a sale in satisfaction of a debt and the debtor – the supplier – does not have a GST registration number. (Goods sold in satisfaction of a debt are deemed to be supplied in the course of a taxable activity carried on by the debtor.)

The amendments align the terminology used in the GST and Income Tax Acts.

The amendments apply from the date of enactment, 23 September 1997.

Amendments to other Acts

Correction of cross-reference to the Social Security Act 1964

Section 30, Child Support Act 1991

The child support formula in section 30 contains a living allowance component that is based on Social Welfare benefit allowances. The Social Security Amendment Act 1996 resulted in the relevant schedule in the Social Security Act 1964 being re-lettered. This amendment makes the consequential amendment that should have been made to section 30 at that time.

The amendment applies from 10 May 1996, the date that the Social Security Amendment Act 1996 was assented to.

Removal of redundant references to District Commissioner

Sections 83(1), 83(2), Child Support Act 1991
Sections 3, 12H(2), 12L(1), Gaming Duties Act 1971

References to the redundant position "District Commissioner" in the Child Support Act 1991 and the Gaming Duties Act 1971 have been removed and, where appropriate, replaced with a reference to "… an officer of the Department".

A new definition of "Officer of the Department" has been inserted into both the Child Support Act and the Gaming Duties Act.

The amendments apply from the date of enactment, 23 September 1997.

Conferring effective tax exemptions on international organisations

Section 9AA, Diplomatic Privileges and Immunities Act 1968

An amendment has been made to the Diplomatic Privileges and Immunities Act 1968 to ensure that the tax exemptions intended to have been conferred by Orders in Council made under section (9)(2)(a) of that Act and under the corresponding provision of the Diplomatic Immunities and Privileges Act 1957 are conferred as originally intended.

The amendment has retrospective effect so as to cater for the twenty international organisations for which Orders in Council conferring ineffective tax exemptions have previously been made under the Diplomatic Privileges and Immunities Act 1968 or its predecessor, the Diplomatic Immunities and Privileges Act 1957. The amendment applies in respect of these Orders in Council only.

Correction to Student Loan Scheme Act

Section 28, Student Loan Scheme Act 1992

Section 28 of the Student Loan Scheme Act 1992 has been amended to correct a number of cross-referencing errors arising from amendments made to the provisional tax rules in 1993. These errors were carried forward to the reordered Income Tax Act 1994. In addition, the omission of a cross-reference to the Tax Administration Act 1994 has been corrected. The amendments do not make any policy changes.

The section has also been amended by the insertion of the underestimation penalty previously located in the Tax Administration Act. The penalty has been moved because it now applies only to student loan repayments.

The changes apply from the date of enactment, 23 September 1997.

Correction to Taxation Review Authorities Act 1994

Sections 17 and 30 Taxation Review Authorities Act 1994

Amendments correct the cross-reference in section 17(2C) and amend the regulation-making authority in section 30(2) to enable the filing fees to be challenged on proceedings brought under this Act.

The amendments apply from the date of enactment, 23 September 1997.

Corrections to Taxation (Income Tax Rates) Act 1997

Section 16(1), Taxation (Income Tax Rates) Act 1997

Section 16(1) of the Taxation (Income Tax Rates) Act 1997 contained an incorrect reference to "section 51(1) and (2)". Section 16(1) has been amended to omit the reference to "section 51(2)".

These amendments apply from 14 May 1997, the date of assent of the Taxation (Income Tax Rates) Act 1997.

Remedial provisions arising from the Taxation (Core Provisions) Act 1996

A number of remedial amendments have been made to correct drafting errors in the Taxation (Core Provisions) Act 1996. All the amendments apply from the 1997/98 income year.

Income Tax Act 1994

Section CB 10 (2)(b)

A possible ambiguity in section CB (10) (2)(b) has been clarified. The amendment ensures that the provision's application does not depend on whether a company has gross income in an income year.

New section DJ 13A

A new section DJ 13A makes it clear that a deduction is allowed for the cost of minerals, flax and timber that have been extracted, removed, sold or disposed of. It also allocates the allowable deduction to an income year. Which income year it is allocated to depends on whether the property is trading stock or not. If the property is not trading stock, the provisions of section EF 2 (*Matching Regime for Cost of Revenue Account Property*) will apply.

If the property is not trading stock, the provisions of section EF 2 (matching regime for cost of revenue account property) will apply.

New section EQ 1

A new section EQ 1 clarifies that excess allowable deductions may be treated as a net loss for grouping purposes. Otherwise they are carried forward as a net loss.

As a result, section LE 3 holding companies that receive supplementary dividends in that income year will have an income tax liability for that year at least equal to those dividends.

The amendment also clarifies that the calculation of non-refundable credits and convertible credits are not affected by this provision.

Section EQ 1 and IF 7 operate together to ensure that losses offset against supplementary dividends are reinstated. The replacement of the pre-core provisions legislation (section LE 3 (10) and LE 3 (11)) by sections EQ 1 and IF 7 clarify that the reinstated losses are subject to the shareholder continuity rules.

New subpart ID 1

A new subpart ID 1 clarifies the law relating to the calculation of some schedular income tax liabilities. It identifies classes of schedular gross income for which a calculation of schedular income tax liability may not take into account losses that are carried forward.

Section IF 7

An amendment has corrected a cross-referencing error, and clarified that the calculation of non-refundable credits and convertible credits are not to be affected by this provision.

Insertion of new subsection (3) and (4) into section II 1

New subsections II 1 (3) and II 1 (4) clarify section II 1 to limit the amount of a policyholder net loss that a life insurer may offset against policyholder income. They also provide that a life insurer may offset the policy-holder net losses only against policyholder income.

Section BC 6 (4)(a)

The reference in section BC 6 (4)(a) to "future year" has been amended to read "future income year".

Section CB 9 (e)

The reference in section CB 9 (e) to "income" has been amended to read "an amount".

Section CI 1 (o)(i)(A), section HH 1 (6), section IE 2 (8)

The cross-references to section CH 1A have been removed and replaced with references to section CH 3.

Section EZ 9 (2)(c)

The cross-reference to section BB 5 in section EZ 9 (2)(c) has been replaced to refer to section CE 4, since section BB 5 has been repealed.

Section HI 4 (2)

The reference in subsection (2) to "subclause (1)" has been replaced with "subsection (1)".

Section LB 2 (3)

An amendment clarifies that a loss calculated under section LB 2 (3) can either be made available to other group companies under the loss grouping rules, or be carried forward to offset against future net income.

Section LC 1 (5)

Section LC 1 provides for tax credits paid outside New Zealand. The Taxation (Core Provisions) Act replaced section LC 1 (1), (2), (3) and (4) with section LC 1 (1), (2), (3), (4) and (5), but omitted to renumber the existing section LC 1 (5), resulting in two LC 1 (5) sections. The second section LC 1 (5) is now numbered LC 1(6).

Section LC 14 (4)

The formula in section LC 14 (4) for calculating a taxpayer's "notional income tax liability" has been amended. The effect is that the family support tax credit, the guaranteed minimum family income tax credit and the independent family tax credit are not taken into account in calculating the notional income tax liability.

Section LE 3 (10)

Section LE 3 (10) has been amended to include a cross-reference to the new section EQ 1.

Section ME 4 (1)(a)

An amendment ensures that an imputation credit arises for payments made to satisfy provisional tax and terminal tax obligations in respect of the 1997/98 and subsequent income years. Provisional tax and income tax paid in respect of income years before the 1997/98 income year will continue to be subject to the pre-core provisions legislation.

Section NE 2 (1) and NE 5 (a)

Sections NE 2 (1) and NE 5 (a) contained cross-references to clause 9 of the first schedule of the Income Tax Act. This has been amended to refer to clause 10.

Section NF 9 (1)(j)

Section NF 9 (1)(j) has been amended to remove the cross-reference to section DJ 16, replacing it with section DJ 17.

Section OB 1

Various amendments have been made to definitions in section OB 1:

- "Applicable basic tax rate" – the formula has been corrected
- "Assessable income" – replaced for reasons of clarity
- "Cost" – inserts a cross-reference to the new section DJ 13A
- "Income from employment" – inserts a cross reference to section BD 2 (2)(c)
- "Residual income tax" – includes refundable rebates under subpart KD in the calculation of residual income tax
- "Sale or other disposition" – inserts a cross reference to the new section DJ 13A
- "Schedular gross income" – corrects the application to general insurers
- "Supplementary dividend" – extends the meaning of the term to the Income Tax Act 1994
- "Trading stock" – inserts a cross-reference to section EF 1

New definitions have been inserted:

- "Section LE 3 holding company"
- "This Act"

Part B

Various defined terms contained in Part B were not included in the list of defined terms at the end of the section. The defined terms have now been inserted.

Section BC 9 – diagram

The diagram entitled BC 9 sets out the steps for satisfaction of income tax liability in respect of credits. Credits for supplementary dividends have been inserted into the section BC 9 diagram, to be considered after non-refundable credits and before convertible credits.

Tax Administration Act 1994

Section 120P

Section 120P has been renumbered 120P(1) and a new subsection (2) has been inserted.

Section 120R(a)

An amendment has been made to section 120R(a), replacing the reference to "loss" with the words "net loss".

Section 138J and 138K

Section 138J was replaced by a reformulated section 138K resulting in two different versions of section 138K, and the removal of section 138J from the Act altogether. Section 138J has been reinstated, and the core provisions section 138J shifted to replace section 138K.

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